



Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

**INQUIRY INTO COMPETITION IN THE
AUSTRALIAN FINANCIAL SYSTEM**

MR P HARRIS, Presiding Commissioner
DR S KING, Commissioner
MS J ABRAMSON, Commissioner

TRANSCRIPT OF PROCEEDINGS

**AT 530 COLLINS STREET, MELBOURNE
ON TUESDAY, 6 MARCH 2018 AT 9.38 AM**

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MR HARRIS: Okay. I think we're going to start roughly on time. Can I check sound is okay? Checking sound. TV's okay? Excellent, TV's okay.

So we're going to resume the hearings in the competition and financial system inquiry. I'm Peter Harris, chairman of the Productivity Commission. I have with me Mr Stephen King and Julie Abramson, who are the other commissioners on this inquiry.

I'll just run through the basics from yesterday for people's benefit, who weren't here. So in the nature of this inquiry, we run it pretty informally. Social media is allowed, but taking photographs or broadcasting needs prior permission from us. Witnesses who turn up and offer evidence are encouraged strongly to be truthful, that includes by our Act and not just us. We also encourage people to attempt not to be defamatory because this is being broadcast.

There are exit signs in the corridors, should the alarms sound, which for the first time ever in history it did sound yesterday which was quite a shock to all of us, and there'll be floor wardens to direct you for the evacuation procedures and the assembly point is Enterprise Park down by the Yarra. But I'm sure, most people will probably find something better to do with your time than to assemble. Nevertheless, that's what the OH&S procedures...(inaudible)...

I think our first witness this morning is present. Can you identify yourself please for the record?

MR RUSSELL: Yes, I'm Michael Russell, managing director of MoneyQuest Australia. We're a franchise mortgage broking group that is an ACL holder.

MR HARRIS: Michael, do you have some opening comments you'd like to make?

MR RUSSELL: Yes. Look, firstly, I do want to thank the Commission for allowing me to appear today at short notice. We have submitted a formal submission and, I guess, why I wanted to appear today is I thought it was important to, first of all, put a face behind the submission; and secondly, I really would like to flesh out a little bit and put some context around six items in the submission, particularly. And, if you don't mind, I'd like to, perhaps, go through those six items very quickly.

By way of background, I have been involved in retail financial services most of my life, over a decade employed in banks writing home loans, and for almost two decades working within the mortgage broking industry. I have been at the coal face throughout lots of reforms, starting with the exciting deregulation that took place in the '80s and had the opportunity to move from a main stream four pillar bank to a new foreign bank and saw how exciting that was to really innovate in customer service and product innovation. I've seen a lot of great things occur and a lot of not great things occur. I thought it was important I appear today to give you a real sense of what's going on in the coal face.

So there's six items I want to talk about today. I want to put into perspective the \$2.4 billion that has been raised a number of times in terms of the total lender commissions paid annually to brokers. There has been a little bit of commentary about the fact that it appears large and warrants some sort of public analysis. I want to put this into perspective. I think it's important.

I then want to talk about who is paying for it right now, because I think the Commission is grappling with that and I want to remove any clouds or uncertainty around who is paying for that and why.

Number 3, I want to talk about your draft finding 8.1, pertaining to the fact that mortgage brokers have only originated their loans at slightly lower interest rates than bank first party channels, and just explain what that means.

I want to talk about, number 4, fee for service. This has come up over the years and I really want to knock this on the head and demonstrate, in practical terms, why it is very anticompetitive and very unfair in terms of blocking people that are presently able to access very affordable mortgage credit advice. And I want to bring into context, what happened with FOFA and how we all know FOFA's primary purpose was to make financial advice accessible and affordable for all Australians and bringing your fee for service in for mortgage brokers doesn't seem consistent with what we're doing with financial services reforms.

I want to talk about switching, because much of the Commission's report focused on "switching" and I would really ask the Commission to stop using that word and I'll explain why. "Switching" denotes to people not familiar with the industry that it is easy to switch home loans as it is easy to switch utilities or health insurance. But you can't switch a home loan easily, given that individuals need to go through a full credit assessment over again. It is a refinance. It necessitates a full credit application. And I think "switching" is actually a really misleading term when it comes to home loans and I'll explain why in a minute.

I want to demystify trail commissions a little bit, because in my close to two decades trail commissions were initially put into the economic equation for a very definitive reason. And we, who have worked in the industry, worked hard for our trail commission. and I'll explain why. Unfortunately, those within the lender community that put trail commissions in are no longer with us. But they were put in with a set of obligations that we have to fulfil throughout the life of the loan and I'd like to actually address that and demystify a little bit of the argument going around about trail commission.

And finally, I would just like to close with a couple of closing comments. I've been fortunate to, over the journey, have worked with ASIC and Reserve Bank in particular. And, from time to time, there's a real misunderstanding around the relationship brokers have with our lenders and our involvement in credit policy and credit decisioning in these sorts of things and I just want to make absolutely certain that everybody is fully aware of what a mortgage broker can control and what we can't control and the job that we do. So

if you're okay with that, I'd like to start. But I'm assuming you're going to interrupt me and ask questions as we go, which is fine.

MR HARRIS: No, no.

MS ABRAMSON: No, no.

MR HARRIS: We're going to ask you though to make sure that you keep your answers as succinct as you can.

MR RUSSELL: Yes.

MR HARRIS: Because we have another speaker coming on at 10.

MR RUSSELL: Yes.

MR HARRIS: And one or two people have appeared here imagining that they have unlimited time.

MR RUSSELL: Yes.

MR HARRIS: There isn't, unfortunately, unlimited time for all people to occupy as much space as they want to. So try and keep it succinct, if we could.

MR RUSSELL: Certainly. Look the first point I want to make with respect to the \$2.4 billion, which is apparently the number paid in terms of lender commissions annually to mortgage brokers. And I just want to say a couple of things, because since the report came out, there have been a couple of headlines suggesting that "Hey, this in isolation wants public analysis". And over the years I've learned that, you know, numbers and statistics are always very persuasive and generally contain a bit of bias by the people by the people using them. But the facts are that they can be misleading in isolation.

Our industry's been, unfortunately, plagued, you know — the villains of misleading information at the moment appear to be UBS. If you draw numbers in isolation are very dangerous. I just want to make a point that if you look at home loan arrears at the moment, - they're running at about 1.2 per cent, very low in terms of historical averages. And if you think about that you'd think, that would seem to suggest a healthy mortgage market and good credit control.

But if I were to give you that number, 1.2 per cent in actual dollars as it represents of a \$1.7 trillion home loan market, you'd probably look at that number and think, gee, that's an extraordinarily high number. So I'm always concerned when I do see headline numbers and then inferences made that this is a dangerous thing. And I want to put it in perspective that your number is very consistent with the MFAA's Intelligence Survey recently last year that there's around about 16,000 mortgage brokers operating in the market. And if you just

do a very quick calculation, you'll see that the average revenue per mortgage broker is about \$150,000.

That is a revenue number, not a net number. When you remove from that the fee that the mortgage broker pays to their franchise aggregator, the MFAA have recently reported that the net revenue number per broker is \$133,000. I'd like the Commission to again, not be focused on that number and think, that's a high salary number. That is a net earnings number. Anecdotally, about 50 per cent of a broker's net earnings is their net take home pay. Brokers incur normal sorts of business costs, such as occupancy costs, administration staff, compliance costs, IT costs, marketing costs.

So when you break that down and you look at a net number of about \$67,000, it's certainly not an offensive number by any means, and I just wanted to just spend a couple of minutes, and I thank you for allowing me to just make that point.

The second point, moving on as quickly as I can, the draft report raised in the question well, who's paying for this, and there was an inference, "Well, the consumer's paying for it all. The shareholders are paying for it," and I'd, just again, like to be very clear. We are an outsourcer. That \$2.4 billion a year is a variable cost spread across all of our bank and non-bank lenders. It's a variable cost and yes, the banks and non-bank lenders are paying for it and then that flows through to the shareholders, who are absorbing it. But I need to again, just to be - - -

MR HARRIS: Sorry, sorry, let me stop you there.

MR RUSSELL: Yes.

MR HARRIS: Because you have just merged two thoughts into one and without any evidence.

MR RUSSELL: Yes.

MR HARRIS: So you've said, and I said it my speech last week, so you can certainly go to that speech if you want to, and you will see, common sense tells you it is either a shareholder or a customer who is paying for it unless the cost is covered entirely by some cost saving, and that's the analysis that we've been trying to perform, not, I might point out to you.

MR RUSSELL: Sure.

MR HARRIS: Not simply a question of whether \$2.4 billion is big or small, it is big enough to warrant analysis, that is a self-evident point, it is a rather large amount of money regardless of how many trillions you want to throw around, \$2.4 billion isn't just nothing. But you've just made the leap from "it could be shareholders or customers", to "its shareholders". So since you are on this point, unpack that a little bit for me.

MR RUSSELL: Yes.

MR HARRIS: Prove to me that customers aren't paying.

MR RUSSELL: Yes. Well, we all know that as a cost of origination and servicing, and I will get to the servicing because brokers are paid an up-front commission to originate the loan and a trail commission to provide the ongoing service, and I will touch on that in a minute. Rolled up, those costs are absorbed by our bank and non-bank lenders. Now, whether some of that costs are passed on to consumers in terms of premiums on home loan rates or anything for that matter, ultimately the net result flows through to shareholders.

What the point needs to be made is that there's always been a debate about, you know, which channel is more efficient. The point I want to make is, it presently costs the bank and non-bank lenders \$2.4 billion a year to deliver around about \$200 billion a year in processing in new originations a year. The point is not which channel is more cost efficient, the point is could the banks and non-bank lenders actually originate and service those loans at a cheaper amount than \$2.4 billion and I can categorically let the Commission know that no, they could not because where a variable cost working on success only if the lenders, who are not ...(indistinct)...

So if the banks or non-banks were to move that \$200 billion of origination and servicing into their environment, just have a think about it logically, could they do that for better than \$2.4 billion, given that we are only paid on success. So the notion that they wouldn't have to bring up a significant buffering because if they have to bring footprints in and FTE in, they would have to build in a buffer.

MR HARRIS: So in the alternative, we know that online sales of mortgages are developing. They are small but they're developing quite significantly. So it isn't just a binary calculation. It might once have been a binary calculation, floor space versus a broker to do the services, as you say, a variable cost.

MR RUSSELL: Yes.

MR HARRIS: There's actually a third party in there. And we did ask the banks, who ought to know this, for data, and we didn't get a good response. I think one institution gave us some information but not sufficient to make a calculation across all of the institutions. So do you have any data to support or is there any study that you have seen that would enable us to move beyond the "he said/she said" version of this to, you know, something that would justify the calculation of whether there is a benefit to match this cost?

In other words, we can see the cost. We can see the prospective benefit. As you pointed out in one of your other comments, that benefit is shrinking, I mean in terms of the size and differentiation between the interest rates that a broker can get versus the interest rate you can get by going into the branch, it is still there but it is shrinking. And so we wanted to unpack that, which is the standard approach a Commission would take to a question like this.

MR RUSSELL: So the answer is no, I haven't got any definitive evidence, other than anecdotally and logically to suggest that mortgage brokers have been operating 25 years now and have become extremely professional, sophisticated and embraced technology in the way we process our mortgage loans and the way we run our businesses. We have become extremely efficient.

To suggest that banks could originate and service what we do more efficiently is an argument for debate because there's no - yes, there's no definitive study that has been done on that. I can just draw anecdotally and I can - over the years having worked in banks, with banks, the mortgage broking businesses are extremely efficient.

In terms of, Peter, what you mentioned about digital online services, I've been in this industry almost two decades and I've seen them come and go. The fact of the matter - and I thought Anthony Kale was very succinct yesterday that mortgages in Australia and mortgages throughout the world are still being consumed largely face to face, and you know, to draw on something that UBS said recently which was very inflammatory and untrue, that mortgages are nothing more than a commodity that be consumed with robo advice, it just shows a complete ignorance and lack of understanding.

Mortgages are a commodity, but human beings are not, and we see it all the time that no single borrower or joint borrowers are ever the same. Their circumstances are inherently different when it comes to their employment, their change in employment, their change in residency, their family situation. They've recently had children. They're about to have children. Matching individual needs with commodities needs to be done at this point in time face to face. And it doesn't matter what I think. Consumers have had plenty of options over the last two decades to try to fulfil some of their mortgages on line. They don't want to. They just don't want to. They want to do it face to face. They want a professional to validate a lot of the questions and concerns that they have.

I think the notion - I'm not saying it won't happen - but the notion that home buyers can be seen as commodities wrapped up in robo advice, we're a long way away from that, and it's not only us. Throughout the world, mortgages are still consumed face to face. So I understand yes, it its available, but given that mortgages are now consumed the old fashion way, still using technology to lodge our applications and these sorts of things, I think that the analysis of whether lenders can originate \$200 billion a year themselves and continue to communicate to clients as we do throughout the life of a loan, yes, it is an interesting one, that there is no definitive study but having worked on both sides of the ledger, I would cast some doubt that 25 years of building the efficiency in our businesses could be readily picked up and absorbed within our banks and non-bank lenders at this point in time, but I accept there's no definitive - - -

MR HARRIS: Just before we get off this question of who's paying for it. So these costs cover roughly 50 per cent of loans originated each year because that's the broker channel.

MR RUSSELL: Yes.

MR HARRIS: So roughly 50 per cent of parties are going directly to branch. They're not creating any costs associated with mortgage brokerages but they're not getting any advantage. Do you see that as an inherently unfair position for a consumer to be placed in? If you go to the branch apparently you save the banks money. Now, this is apparently because, of course, as we know, branches are being paid for by somebody.

MR RUSSELL: Yes.

MR HARRIS: This whole proposition are they being paid for by shareholders, you know, generously or are they being paid for partially by customers. Well, clearly, at some point, the customer is going to be paying for the cost of branches. But this is also very unclear from any data. So before you leave the topic of who's paying for it, do you know, at least, of any data from your experience previously in the financial system that says banks have made calculations on the cost of branches and the business that goes through a branch in a decision-making process as to whether or not to keep a branch as a place where you can originate a home loan.

I mean it is asserted that this analysis has happened. But again the data is not readily available.

MR RUSSELL: I would be certain the banks would have that sort of data. The banks would absolutely know their costs of originating and servicing mortgages. Because the thing about mortgages that's often misunderstood. Mortgages are not a set and forget product and a lot of people that don't work in the industry just can't grasp that. This might be interesting for you to know that we've recently - and again, anecdotally I've known for a long time, but we've recently surveyed - our mortgage brokers have been in existence longer than five years keeping it in context that the average mortgage loan's about five years, and we asked them that over the life of a mortgage loan, what percentage of your mortgage customers would you do an annual review, a regular annual review for, and would you do a variation for?

Mortgage brokers do a lot of variations for no remuneration. That's why we get paid trail, but I'll touch on that later. We do a lot of variations. Whether it's a variation of fixed to variable. Whether it's a variation of variable to fixed. Whether it's an interest only rollover. We do a lot of variations to loans and a lot of annual reviews.

Now, the number came back at 71 per cent. So 71 per cent of all mortgage clients throughout the duration of their loan would utilise our services for a review or variation during the loan, and that's a really key statistic. They are not set and forget. So when - again to your question, when banks make the calculation it's not only the origination cost that needs to come into the calculation. It's the ongoing management of that mortgage client.

It is very important we conduct annual reviews of our mortgage customers because they are new innovations continuing to go on, but there's also a sense of apprehensiveness

amongst mortgage customers when they see certain products and interest rates advertised. So we do conduct annual reviews and loan variations are a very big part of our business, and we do not get paid for that.

MR HARRIS: That 71 per cent. What size group was that?

MR RUSSELL: So we surveyed our mortgage brokers that have had more than five years' experience in the industry because that's important. If you survey a group under five years and they wouldn't have had the complete exposure to an average loan life, and around 71 per cent - - -

MR HARRIS: But how many brokers?

MR RUSSELL: Oh, in our network, I think there was about 25. We're a relatively small - - -

MR HARRIS: Out of about 18 brokers.

MR RUSSELL: I beg your pardon.

MR HARRIS: About 18 brokers - - -

MR RUSSELL: Yes, yes, we're about - you know, we're a network - we're a relatively new franchise, but we have around 25 brokers that have been operating five years or longer.

MR HARRIS: Okay. That's all - - -

MR RUSSELL: I've also - and in addition to that, I went outside to - just to stress test that. I went outside to about a dozen Mortgage Choice brokers where I used to work and the numbers lined up exact, and anecdotally, that's about what I know anyway.

MR HARRIS: We should keep going in time so.

DR KING: Just get onto trail commissions.

MR HARRIS: I'm going through this list. I'm taking the notes. Your next one in order was 8.1 and this question about why brokerages are developing less of a benefit than they were in 2012.

MR RUSSELL: Okay. So I'd ask the Commission not to see that finding in a negative light, but rather take comfort that in a very low interest rate environment, mortgage brokers are still able to negotiate rates better than what the lenders are offering through their first party. So yes, the rates, the differential, has come down a little as rates have come down, but the fact of the matter is that mortgage brokers can't impact fixed interest rates, basic variable interest rates. The only rates we can possibly negotiate for our clients better than maybe what they will be to access through first party is variable interest rates.

So to me I look at this and I can say, that's great because our proposition is not all about pricing, but the fact that we are still delivering a lower price than our first party competitors it shows that we're still doing our job, but our job is more so one of providing peace of mind to customers that - you know, we're providing them choice and convenience that no single bank can offer. We're also providing people peace of mind that, you know, should a consumer go to a bank and get a home loan, you know, the question is always "Could a third party have negotiated a slightly better rate" and that's why one of the reasons you join, you know, you access a mortgage broker. I don't want the Commission to see that one in a negative light at all.

MR HARRIS: But hang on before we depart your wish to not see it in a negative light, it does suggest that either - and I think you've just answered this but I want you to answer it a little more clearly if you could.

MR RUSSELL: Sure.

MR HARRIS: It says either the banks are offering less in terms of the breadth of a potential discount against - yes, you know we have a criticism of concepts like the standard variable rate.

MR RUSSELL: Yes.

MR HARRIS: And the greyness of the apparent discounts that are available.

MR RUSSELL: Yes.

MR HARRIS: It does suggest, your comment and the data itself does suggest, either the bank are offering less by way of potentially negotiable discounts for brokers to get access to, or it suggests you're less effective. One or the other.

MR RUSSELL: Yes. So I think it's necessarily either. I think that what mortgage brokers have done over the last 20 odd years is keep banks and non-bank lenders very accountable to delivering competitive products and that's - this is one of the things that started in the revolution in the '80s was, you know, when the foreign banks and mortgage brokers arrived, it delivered a level of competition that hopefully we can all say in 20 years' time in 2018, banks and non-bank lenders through first and third parties, the pricing differential has narrowed significantly, and that's actually what we've achieved.

And you are right, you've identified it and that was the objective 20 years ago, and it's only through competition, really good healthy competition that that has arrived, so I don't see that as a negative. I see that as a terrific outcome in promoting a really healthy mortgage market where consumers have choice. Consumers have the choice whether they want to go and approach the bank direct, or whether they want a mortgage broker to scan the market and see if there is a slightly more suitable product from other competitors. So I don't see that as a negative.

MR HARRIS: All right. I think your next comment was on fee for service and the FOFA.

MR RUSSELL: Yes. So fee for service online, I'm particularly bullish on. I haven't liked the notion for a long, long time. I was really pleased in my previous role when FOFA reforms were rolled out at the same time as we launched the a financial planning business, and you know, the concepts of FOFA have been very familiar with a lot of us in mortgage broking for a long, long time. You know it's the obligation upon all of us to make the availability of financial advice accessible and affordable for everybody.

At the moment mortgage consumers have this magnificent pricing parity across first and third parties. They're able to access mortgage brokers or go to banks direct without fear, favour or pricing discrepancy. The mere notion of providing a fee impost or a tax if you use a broker, I find offensive. I find it is discriminatory for a lot of people that really need mortgage brokers to assist them.

I think it is anti-competitive and I just don't see any reason why anybody could suggest we'd impose this impost upon individuals. So there's two points. One I think it's grossly unfair. The second point is, is the outcome of directing more consumers that can't afford the fee for service back to first party. Is that outcome in any way in the consumer's best interest? Is that outcome in any way a positive thing to be promoting competition in the lender market? I just don't see it.

Mortgage brokers for better or worse, have been the whipping boy since day one, and I can tell you that the mortgage brokers comprise wonderful small business people that invest heavily into their business and are very passionate about delivering home loans for consumers and I still remember myself, the very first home loan I wrote in 1984 and the joy I got in communicating that to my customer. It hasn't changed my love of that business and I - you know, I'm digressing but I'm very passionate about why somebody would be promoting to create a disparity in pricing between first and third parties.

MR HARRIS: So fee for service, at least says there's a fixed amount of money that a broker would get, whereas a commission is a percentage. So there is a natural incentive to have the largest loan possible because a broker will earn the most and yet the costs to the broker do not appear to vary very much as a result of the size of the loan.

The effort from a broker to put together a \$350,000 loan is probably pretty much the same as a \$700,000 loan.

MR RUSSELL: Correct.

MR HARRIS: The commission is different.

MR RUSSELL: Correct.

MR HARRIS: So that seems to be against somebody's interest if you were going to price according to cost.

MR RUSSELL: Yes.

MR HARRIS: Now, not every price in the economy is determined by the cost obviously. Many of them logically are and should be determined by demand. But it does argue somewhat counter to your proposition, I think, and presumably explains why consumer advocates appear to be in favour of fee for service. In other words, when you say this is anti-competitive, I'm not sure how it becomes anti-competitive. We can discuss that a little.

MR RUSSELL: Yes.

MR HARRIS: But it certainly doesn't seem to be in the consumers' interest which is a different thing slightly to competition, so the consumer itself is being charged or the shareholder is being charged or somebody is being charged, a percentage when the amount of effort doesn't vary but the percentage may result in quite a variable increase in payment. So can you explain that a bit?

MR RUSSELL: Largely what you've said is factual and correct, and ASIC in their report last year correctly drew out, very forensically, drew out that - there are a number of conflicts pertaining to upfront commission when paid on loan size, and we don't dispute that. If we look at - what you're saying is again correct, the amount of work that goes into originating a mortgage loan irrespective of loan size, is roughly the same.

But that's a separate argument. If we look at that and say, you know, well possibly we need to remove the conflict and maybe, you know, narrow the gap in terms of what that upfront payment the lender makes is. That's one issue, and I'm happy to talk about that issue, but that's very different to what we're talking about in terms of levying a charge on the consumer because the conflicts around upfront commission and loan size, can't be disputed, and the industry through the combined industry forum has already, I think, arrived at a very sensible juncture there to - - -

MR HARRIS: We understand that those changes have yet to be implemented. That's evidence that we've received both from brokers and from other parties.

MR RUSSELL: Largely they are being implemented right now.

MR HARRIS: Are being implemented?

MR RUSSELL: Yes. So a lot of the soft dollar - the soft dollar issues in particular have been completely eradicated from the industry. In terms of the upfront commissions, most, if not all of the lenders, have rolled out changes to the way they remunerate for lines of credit to make sure that they again, recognise the conflict and only pay a mortgage broker

based on what is actually drawn down at settlement, and not the, you know, the unused line of credit.

There's clearly a conflict that was correctly addressed and been dealt with but, you know, my point is that you can't charge a consumer, you can't create an imbalance between first and third party. You can certainly address the upfront commission paid by lenders because that's not being paid directly by a consumer, and exactly what you have just raised then, I don't disagree with in terms of conflicts around upfront commission, but I just think the industry has been such a windfall for consumers over the last 20 years. It's not broken. The remuneration correctly weights the broker to get rewarded reasonably for a originating the loan, and one point I'd like to make is, you know, again, there's a lot of commentary around the level of upfront commissions, and I'd like the Commission to know that on average it takes around 20 man hours to originate a home loan. That will vary but it's around 20 man hours and increasing.

DR KING: So doesn't come down though to a very simple question of who are you working for?

MR RUSSELL: Yes.

DR KING: If you're paid by the banks, you're working for the banks. If you're paid by the customer, you're working for the customer. You won't expect a real estate agent to act for the buyers. They act for the sellers and they're paid by the sellers. That's why you have buyers' advocates. Aren't brokers who only receive funds from the banks for remuneration they're working for the banks?

MR RUSSELL: Yes. So again, I understand the rationale behind that. I completely disagree. We work for our customers first and foremost. We are not incentivised by the banks to sell more - we're not incentivised more or less to sell certain products. We're paid the same rate of commission irrespective of the product we sell. We work first and foremost for our customers.

DR KING: Why do you work first and foremost for the party that's not paying you, rather than the party that is paying you?

MR RUSSELL: Because - - -

DR KING: I mean, you say there's no incentive to not - - -

MR RUSSELL: Yes. We work along the notion of trying to aspire for clients for life because ultimately a happy client, a satisfied client, the consequences of that is we get remunerated. We don't lend for - we're not an employee of the bank, we don't - yes, the banks do pay us.

MR HARRIS: So you're not an employee, but 70 per cent of broking is employed by banks.

MR RUSSELL: Yes. We're not employed by the banks.

MR HARRIS: So you're saying independent brokers, that's - - -

DR KING: Rather than bank becoming - - -

MR RUSSELL: I think to draw the analogy that because we are remunerated by the bank, we work for the bank is just not accurate. Our customers, our customers are our customers and our customers are everything to our business. Without our customers we do not have a business. We built our businesses putting the customer at everything that we do to create customers for life. We place our customers to the lenders that present the most suitable options for our clients. We're not, in any way, influenced in any way by lender. ASIC, you know, hundreds and thousands of line items of commission data, trying to draw or looking to draw some sort of correlation between are brokers influenced by lenders paying higher rates of commission, and there is no correlation at all.

Brokers, there is a correlation between the lender offering the most competitive pricing, credit policy and service, yes. So I understand what you're saying but that is not how it works at the coal face.

MR HARRIS: So you - sorry, I know Julie wants to ask a question, but I just need to finish off that statement that you just made. So then that would logically indicate to me that you would not have a problem with our recommendation that brokers, not just bank owned brokers, but actually independent brokers, which you've assured us work primarily for the customer, then you shouldn't have a problem at all with our recommendation which says a duty of care should be imposed upon, you know, more than just bank owned brokers, it should be imposed on all brokers.

MR RUSSELL: Yes.

MR HARRIS: Good.

MR RUSSELL: Yes. And one of the - again, whilst I understand the perceived conflict that people might look at when looking at the bank owned mortgage brokers and thinking that they may be working under a position of conflict, I can assure the Commission that these independently owned mortgage brokers that just so happened to be sitting within aggregation businesses owned by banks, they are not swayed, influenced at all, by the lenders that just so happen to own their aggregation businesses.

MS ABRAMSON: Can I just ask, Michael, about claw back?

MR RUSSELL: Yes.

MS ABRAMSON: We've had some submissions and one of the associations(indistinct)..... Commission yesterday so interested in your view.

MR RUSSELL: Yes. So claw backs and I've read the report and I would like - maybe I'll move into switching because that's relevant to claw back. So, you know, our claw backs generally run 18 to 24 months. Some banks are at 18, some banks are at 24 months, and as the report correctly pointed out, they do present mortgage brokers with a zero sum gain financially if we do refinance a client during the claw back period, the initial claw back period of the loan. We will claw back our up front commission from lender one and be paid that identical commission from lender two. So there is a lot of work for a zero sum gain.

That said, there are a couple of points to make - there's two points to make. Nowadays, there is a lot more work done in packaging up and putting a home loan to lenders than ever before, and that workload is exacerbating as we move into a much more regulatory risk diverse environment. But the work is not only work that we undertake, its work that the consumers have to undertake as well in terms of providing all of the documentation to verify their living expenses and certainly verify their income. There is a lot more forensic analysis undertaken now, particularly around living expenses, and that creates an impost on the client when they go and apply for the mortgage loan. And it's not an impost that can be under-estimated.

So what we find at the coal face is that certainly the first year or two of a home loan consumers are quite reluctant to even entertain the notion of going through that process all over again. They really will only go through that process in the first two years if there are significantly monthly savings and they need to be significant. If they're only marginal savings, a lot of consumers - and we can point out that there can be, you know a marginal saving in their monthly repayments and a reduction in the overall repayment on their home loan. If that saving is only marginal, which tends to happen more often than not in a low interest rate environment, inertia kicks in and the desire not to go through that process again.

So we don't - we actually don't refinance a lot of loans during the claw back period anyway, so it's kind of moot.

MS ABRAMSON: Can I just pick you up on one point, Michael?

MR RUSSELL: Yes.

MS ABRAMSON: You said before that 71 per cent of customers would have loan revisions during the five years, but what you're just amplifying now is that that is not within the - usually within the claw back period.

MR RUSSELL: Yes. So that's a good point. The first review we undertake is around the five week mark, and we contact our clients, either over the phone or we ask them to come in, and that is very important because we make sure that they're direct debits and they're off-set accounts have been correctly linked. So professional mortgage brokers do that

because mortgage loans can - the relationship can go very sour in that first five weeks if the first mortgage payment is not made or offset. So we do that first review.

We then do the next review at 12 months. And at 12 months it's really just checking in, seeing how mortgage clients are coping with their loan repayments. Just assessing whether or not or trying to understand whether or not anything might have changed in their own personal circumstances, and generally there's not a high demand to consider a refinance, you know, at that 12 month mark.

So there is work done but we don't do a lot of refinancing during that claw back period. When we move on - so if we look at the average loan life of five years and we move beyond the claw back to the balance of the three years, that's when we do, as I said, 71 per cent of clients we have high touch points. That's when possibly clients are more open to looking at refinance options. They're personal circumstances have changed. They might want to make - put in a request to rollover their interest only period. They may look at interest rates and the movement and might want to fix all or part of their mortgage, so we are quite active in that period.

But claw backs were initially bought in as part of the economic calculation of the Lending Commission. They were bought in initially to combat churn and that's what happened, and the industry did a couple of decades ago, you know, have some problems with churn. We've routed all these people out, but the system has actually helped stop churn because, you know, putting a mortgage loan application in requires a lot of work from both broker and client. You know, if there are any brokers left that think that they could go out and churn a client, they're certainly underestimating the desire of any clients to participate in that.

MR HARRIS: It's a funny thing through because we did get the same testimony yesterday and yet if not the same people were saying only two weeks ago in response to our report that the payment was actually about ceasing churn. So you can see how easy it is for us to be confused when we read public statements.

MR RUSSELL: Yes.

MR HARRIS: Quite aggressively made in some cases that the purpose of these follow on arrangements, both trailing conditions and claw backs, was (a) to manage the customer which is an interesting relationship issue, but we can accept at face value perhaps that's a positive one, but (b) to cease churn, and we think, as we know publicly, that might well be in the banks' interest, perhaps it's in the brokers' interests since they're getting paid for it, but it's not always in the customers' interest. Indicative rates have varied quite recently.

MR RUSSELL: Again, I initially started working when home loan interest rates were 15.5, 16 per cent. What I can assure you now is that in this low interest rate environment with mortgage applications having a lot of work, the notion of churn, it just does not exist now, and it would be a very foolhardy broker that would think for a minute that there's an opportunity to engage in churn because - - -

MR HARRIS: We're just at the end of time, but our next person isn't here yet and I think we've got trail commissions to go.

MS ABRAMSON: I think they are here.

MR HARRIS: They are outside, okay. Did you want to ask something about trail commissions?

DR KING: Look, really just - you mentioned claw back. It's really - you say that trail commissions are a payment for the ongoing management of the client. In the contracts that you have with the lenders, is there any explicit obligation, so is there anything in the contracts that says trail commissions are so that you will be able to do X, Y and Z? And let me supplement that with a similar sort of thing. Is there any performance obligation upon you? In other words, does the trail commission cease getting paid if you haven't reported back to the bank that you've made contact with the customer and done a review every 12 months, and you'll see the parallel with what I'm asking with the review arrangements that have been put in place with wealth management.

MR RUSSELL: Yes.

DR KING: What we appear to have here is a payment that has been asserted as being in the customer's interest and about managing them where there appears to be some plausibility of the thought that the customer could benefit from a review. But is there any obligation in the contractual arrangements between you and the banks to ensure that that customer does get a review?

MR RUSSELL: So there's not. Initially, as I said, when trail commissions were part of the outset of mortgage broking, we had very strong leaders within the lender third party businesses that made it very clear for those of us from the outset that we are paid trail commission to be the first port of call for any client enquiries during the life of their mortgage. There was an expectation that we would do the variations and just so you know, quite often most of the variations require a full credit review, a full application sorry. We then - - -

DR KING: Sorry, that's even if you're refinancing within the same bank?

MR RUSSELL: Within the same lender and it can be even for an interest-only rollover, for an application that moves from variable to fixed rate. We can often be asked to do full applications now to make sure circumstances have not changed with clients - - -

MS ABRAMSON: That would be the legal obligations.

MR RUSSELL: That's exactly right, and what then happens is, we then print the loan documents. These can run quite thick and then arrange to meet the clients. There's a lot of work undertaken then, and we were expected to have to do that and we've taken that on,

and we've run with that to the point now that professional mortgage brokers that have got successful businesses see that management of the client throughout that trail commission duration as why they get paid their trail commission, and if you look at the that the bank and non-bank lenders have now - you know, if you look at their infrastructures, they don't have the infrastructures to manage mortgage holder expectations throughout the life of the loan.

So to your question. No, there is nothing particularly stipulated. The industry took the guidance or the obligations very seriously when we were paid trail commission. We've invested sizeable amounts into our customer relationship management programs. We invested a lot in the training of our mortgage brokers. What they need to do when they do an annual review.

And I was really heartened when I picked up a little bit of what Anthony Cahill said yesterday when he said that NAB were actually looking to hard code some KPI expectations around what brokers need to do to be entitled to receive trail commissions because we wouldn't have a problem in the world stepping up to those obligations.

DR KING: So just on that, do you think it would be a good idea, so that, you know, the better brokers who are providing the service anyway, there's a direct link back to the contractual obligations and the trail commissions and those brokers who aren't providing those services who are still getting the trail commissions miss out? Do you think that would be good?

MR RUSSELL: I think it is high time that happened because, as I said, mortgage brokers have been the whipping boys for a long time with respect to trail commissions and misinformation about what we do for the trail commission and the fact of the matter is, we work very hard with our clients through the life of their loan for that trail commission.

MR HARRIS: And so the logic would be that if there was a duty of care imposed, this would become the evidence on an ongoing basis that says a duty of care has been discharged.

MR RUSSELL: Yes.

MR HARRIS: Pretty much as it is in wealth management, as we understand it.

MR RUSSELL: Yes, well, look, FOFA - - -

MR HARRIS: I'm not aiming for all the positives and negatives of FOFA, but just sticking with this - the logic flow of saying duty of care and evidence that duty of care is being discharged, would be, you know, supported presumably by such an arrangement.

MR RUSSELL: That would be supported by the vast majority of professional mortgage brokers who would not have a problem with that because they're discharging those obligations now. As FOFA requires a two year opting, you know, really trying to

encourage professional financial planners to do these reviews and justify their service fees that they earn, mortgage brokers would not have a problem, you know, working the KPIs and justifying the commissions.

One final point re switching that I didn't make. I'd like the Commission to understand why I don't like the term "switching". As you probably know, there has been a real tightening in credit standards in recent times, and one of the consequences across all banks is that the serviceability, the maximum borrowing amounts have come down considerably, and to give you an example, someone that may have qualified, based on their living, their income and living expenses 12 months ago for circa \$800,000 today would probably qualify for around \$600,000.

So one of the things I'd really like the Commission to understand is that the notion of suggesting to consumers that they can switch, has a misleading element there because it is a full refinance application and I was only talking to some of our brokers last week and they are saying that they have a backlog of refinance requests, but these clients that have perfect repayment records - repayment records now amount for nothing. Zero. You know, when I first started in lending it was all about repayment records and character and capacity.

Now, it has changed such that we unfortunately have a lot of clients that have the perfect repayment records that would like to switch to a product that provides them with a financial benefit each month but they no longer qualify for that same amount.

MR HARRIS: Thanks for your time today, Michael, and for the testimony you have given. Some of it is actually quite useful and we may be back in touch with you to quantify a few other points before we do finals. So we appreciate that.

MR RUSSELL: Thank you.

MR HARRIS: But I am going to move on.

MR RUSSELL: Thank you for the opportunity.

MR HARRIS: Thanks a lot.

Could you identify yourselves, please, for the record?

MR ELLIOTT: Sure. So I'm Shayne Elliott, the Chief Executive of ANZ.

MR OHLSSON: I'm Fred Ohlsson. I'm the group executive of ANZ here in Australia.

MR YETSENGA: I am Richard Yetsenga. Chief economist at ANZ.

MR HARRIS: Do you have opening comments you would like to make?

MR ELLIOTT: Yes, a few comments. So thank you for the opportunity to speak with you this morning. As a bank with roughly 15 per cent market share, we have welcomed inquiries into the competitiveness of the Australian banking system. Evidence based policies that support contestability offer us, and others, the best chance to win customers through price and service.

We agree with the Commission that lower barriers to entry and open data promise more competition. Open data will allow us to innovate and win customers with better services. It also opens the doors for our competitors, large and small, new and existing. Each day we work hard to serve the 15 per cent of customers who bank with us, and to convince the 85 per cent who don't, that we can offer them a better price and service.

We understand that policy makers must balance stability with competition, and as we've seen overseas, if you get that balance wrong, consumer wellbeing and economic stability can suffer through poor practices, bank collapses and financial crises.

Australians benefit from financial systems stability through economic growth and the confidence that deposits will be repaid. It is true that deposits are backed by the taxpayer up to a point, but bank stability means that this backing is easier for taxpayers to provide.

Over a 22 year period from 1995, key return matrix for ANZ have all trended down despite Australia's long run of economic growth. Our return on equity is down 36 per cent over that period and from its high point in 2002, the decline is 51 per cent.

If you look at revenue per dollar of average interest earning assets, which effectively looks at what we earn and fees and interest on our lending to customers, that's down 49 per cent, and similarly, net interest margin, which measures the difference between what we pay in interests costs and what we receive in interest revenue, is down 41 per cent. While bank returns have trended down, consumers have benefitted from innovations such as internet banking and new ways of paying.

With the pressure on returns, our strategy in the Australian retail market is to be the best bank for people who want to buy and own a home or start to run a small business, and as a result, we are focusing on the owner occupied home loan market, and through a mixture of pricing, service and underwriting policies, we've grown our market share in this market significantly from 15.8 per cent to nearly 16.3 in the two years to December, and those figures include loans which have been securitised.

Now, to achieve this increase, we've had to consistently win business from others who are trying to do the same thing and in some periods, we've managed to expand one and a half times faster than the system as a whole, while at other times we've only expanded at half system growth and that means the market is fluid and competitive.

In the market, consumers have won, with increased discounts delivering lower rates. Consumers are refinancing both within and between banks to capture lower rates driven by that competition. And as you know, part of the story with home loans are of course brokers.

Consumers use brokers to understand the market, to help with the loan paperwork and to negotiate a better deal. We're happy to help customers whether they choose to use a broker, our branch network or our mobile lenders. About half of our mortgages originate from brokers and as such, while we don't own a broker network, we believe the integrity of the channel is critical. In addition to helping our customers, brokers also help those banks without branch networks compete.

The Productivity Commission has made some recommendations concerning brokers and we see merit in enhancing the consumer protections in this space. A best interest duty could support the existing law to promote consumer interests when receiving help from a broker. Finalisation of the Commission's recommendations on this topic, in our view, should take into account the need for trust in brokers as advisors, whether consumers are willing to pay for loan help and brokers' role in levelling the playing field for banks without branches.

And lastly, in relation to the new payments platform, we believe it is too early to reach a conclusion on whether a mandated access regime is required. NPP is open by design and it will succeed for its 80-odd shareholders if innovative overlay services have access to the platform and these services will make it more attractive to consumers and this will drive volume that will benefit the shareholders. So thank you for your time and I and my colleagues welcome your questions.

MR HARRIS: I appreciate your opening statement and succinct comments because it gives us time for quite a few questions if that is okay. Can I just take one point of your presentation there? You did suggest that there are increased discounts on offer. We've just had a discussion with a broker and we have data in the report which suggests that the broker channel, in any event, has delivered in relatively recent times, less of an advantage. Still an advantage over branches, but less.

We were comparing 2012, I think to 2015 and the apparent comments, although I'm not going to quote anybody in this kind of forum, you know, as giving us answers that are anything more than a sort of general perception.

MR ELLIOTT: Yes.

MR HARRIS: Does that appear to be right. There has been a shrinking of discount capacity in relatively recent times. Your comment says an increase in discount capacity, so do you know any reason why a confusion might persist?

MR ELLIOTT: So I will ask Fred to give a bit more detail, but I mean, I think it's probably - I'm guessing because I don't know what it was - - -

MR HARRIS: No, no.

MR ELLIOTT: I'm guessing it is to do with the timeframe. So if you look over the long timeframe and I've said, you know, since I've been in Australia since '09 and looking at

discounts, they've absolutely trended up. However, in the very short term, so looking over perhaps the last year, they got to an extreme high, probably 18 months ago.

MR OHLSSON: Mid-2016.

MR ELLIOTT: Yes. They got to a very extreme high and they hadn't moderated since then, but even today, they're still elevated compared to where they were three, four, five years ago. That would be our view.

MR OHLSSON: Yes, absolutely, I would support that and I think when we look at the flow though and discounting, ebb and flow a bit, so at a given point, you know, it might feel or there might be an impression that discounting is lower at the time and you know, any given quarter, in any given month, but over the last three, four years the feeling is certainly to overall, over time, an increase in the amount of discounts.

MR HARRIS: Well, isn't that curious because the data clearly shows that, just comparing 12 to 15, the success of the broker in negotiating discounts has been to negotiate a lesser discount, in other words, whilst they have negotiated some discount, it's been shrinking. So can you explain why the broker generally otherwise is growing and you know, everybody's into it and consumers, I think, are being encouraged by a complexity to go there. Not encouraged in the sense of being forced at gun point, but certainly encouraged to go there and yet there's a lesser level of success now than there was even three years ago.

MR OHLSSON: What I would say is that in absolute terms, the discount levels today are higher than three years ago. That's what our data definitely points to. It might have been a reference to, I guess the broker channels success of providing discounts compared to other channels, and the way we think about this as Shayne said, you know being - as Shayne pointed out in the opening statement, being a bank and 15 per cent market share, it is very important for us when we serve our customers, both to maintain them and acquire new ones, is that we compete well through every channel, not just through brokers. There might be a perception of, at this point, maybe that it's more competitive through the other channels so maybe the advantage of going through a broker has decreased over the last two or three years.

For us it is very important the way we think about it, you know, it is important for us to, I guess, keep our share and win share and it's very important for us that we compete well and very, very similarly and across all channels. If that's through our proprietary branch channel, if that's through online acquisition servicing, if it's through mobile lenders or through brokers.

MR HARRIS: Yes. No, it's easier - it's possibly explained by precisely that. If you are being more generous at the branch in 2015 than you were in 2012, it could have been - - -

MR ELLIOTT: What I would say though, the way we do this at ANZ, is that we - that is important for us as we are, you know, equally competitive because for us, you know, we

want to make sure we show up well in any channel. It's important that we show up well and give customers choice regardless of what channel they have their preference for.

DR KING: A number of potential explanations, one fairly obvious one, I just want to make sure we're not doing, how do you measure discounts internally? So when you say discounts, discounts compared to what? Is that standard variable rate?

MR ELLIOTT: Yes.

MR OHLSSON: Yes.

DR KING: Just wanted to make sure - - -

MR OHLSSON: The way we think about discounts, that's the starting point is the SVR.

DR KING: Yes.

MR YETSENGA: Sorry, I was just going to round that off. I mean, the others used the expression more generous at the branch. I mean, the other alternative may be that the other information channels that consumers have to get information about the products available are becoming more effective, whether it is comparison websites or other sources, or even gleaning information through informal avenues like social media and other things probably has become more important over that period. So brokers are competing in that segment, I suppose, rather than being the only way that consumers distil the information.

MR HARRIS: There's multiple factors involved and that's accepted. We can't be absolute about these things, but what we can say is the data suggests that that channel is less successful now than it was and our interest in that is primarily, I guess, driven by the fact that it's quite an expensive channel or so it appears. Now, we've had disputes over how expensive the broker channel actually is, and moreover we've had a dispute about who's paying. So we find assertions that a customer isn't paying to be, you know, counterintuitive, and the responses that we've got to date are ones which suggest that - at best they're anecdotally based.

Now, you are doing the paying. Tell me what the view of the ANZ is about who's actually paying for this service and therefore who should expect to get something in return for that payment.

MR ELLIOTT: Well, at the end of the day, the customer, the consumers are paying for almost everything that we do, whether - they're also paying for the branch network, and they're paying for internet banking and they're paying for everything. I get, you know, obviously as you know, it's not necessarily always transparent, the customer in that case that what the brokerage or what that fee is and they're not writing a cheque for it, so it's less visible to them, and we know that, you know, the mere fact of writing a cheque or paying something, changes people's behaviour so it's slightly, you know, it's less

transparent, but ultimately yes, the customer pays. We build it into our model when we're thinking about pricing.

MR HARRIS: So we were having this discussion in the context of should a broker be under a duty of care to act in a customer's best interest and that's step 1. If the customer through whatever mechanism is actually paying for and would have a reasonable expectation that the service is being provided to them, in our draft report, as I'm sure you know, we have recommended that a duty of care might be imposed on bank owned brokerages, but this morning we've heard and I think we've heard a little bit of testimony as well last week as well, to the effect that high quality independent brokers apparently wouldn't mind if a duty of care was imposed upon them as well.

So those two notions do fit quite neatly together. If the customer is paying they would have a reasonable expectation then they should have an assurance. The question is how do they get that assurance.

MR ELLIOTT: Yes.

MR HARRIS: It could be done through regulation. It could be done through contract as well. But there seems to be a lot less resistance now to the notion that a duty of care would be a reasonable thing and possibly more a question of its design as to how we go about doing this because we have learned perhaps from financial advice on design issues. Would that be - again, I'm putting words in your mouth, but that's the way we try and do this because we're trying to get you to debate with us - - -

MR ELLIOTT: So I think it's important to go and ask consumers. Let's find out. But my guess, and I've done a bunch of focus groups when I first took on the job and listened to people and issues, I imagine that a lot of people think that the broker does have a duty of care to them. I imagine that when mums and dads walk into a broker, they assume that that is the case. You may even go as far to say they have a best interest duty as well. I don't know, but I think there is an expectation and I think FOFA and others have probably raised that expectation. People would say well, if that's the rule for a financial planner, I assume it is for a broker. But I think it is important to go and ask consumers and their representatives to see what they would expect. Yes, I would agree with your statement, it's certainly not unreasonable.

MR OHLSSON: I think that's the similar aspect in regards to, I guess, the commission and what you were alluding to, I think Peter, in regards to a fee potentially, and paying for the fee of that advice or that conversation that support that guidance from the broker. I think that's - there are examples all over the world of that taking place, as opposed to it being, I guess, not the fee. Not the disclosed fee, and I think that's another thing that would be important to check with consumers what they would prefer.

MR ELLIOTT: And our understanding there are brokers in Australia who do charge customers directly. I'm not sure how prevalent that is or how big a part of the market, but there are certainly brokers who go out and offer and get paid by the borrower directly.

MR HARRIS: Yes. Well, we should probably separate these into the question of a fee versus a commission, which is a percentage-based value where again I have the impression, without actually having it crystallised into decision-making as I understand it within the industry, I get the impression that perhaps a fee is a better proposition. The question might be should it be paid by the customer or should it still be paid by the bank. But they're different things. I don't know whether you have an impression that perhaps there is any movement going on in this area.

MR ELLIOTT: A fee versus commission?

MR HARRIS: A fee versus commission and the incentive effects that can be created by percentages.

MR ELLIOTT: So look, I think, you know, as part of the Sedgwick review there was some referral to and the industry is looking at the whole area of broker commissions and the way that they get paid. As Fred said, I know - our experience looking around the world, there are the markets that have a kind of fixed fee rather than a volume based type thing. There's absolutely merit in looking at it. The reality is today in that kind of openly highly competitive market that it's taking us down a commission-based structure, and there's - I guess it's understandable logic to that because, you know, given there's an alignment between the commission and the revenue and the volume obviously driving revenue for the bank, there's an alignment of interest there, but I think there is merit in looking at a fee based structure.

I can't imagine myself that will evolve naturally. That would require some intervention either as an industry or through regulation, would be my guess.

DR KING: ANZ is in a slightly odd position though in the broker space. So you don't own any aggregators as I understand it. But you do have that franchise network which is mobile lenders.

MR ELLIOTT: Mobile lenders, yes.

DR KING: Mobile lenders, yes. Which I'd assume and I'd be interested if I've got this wrong, but I'd assume you've added being a broker competitor if I can put it that way.

MR ELLIOTT: Sort of, yeah. So I guess, ...(indistinct)... position is odd, but as a good one, it's a decision we've made. I think the mobile lenders do differentiate themselves from a broker. It's got ANZ all over it.

DR KING: Yes, it's - - -

MR ELLIOTT: You know it's ANZ. You're right. I guess the compensation model is different than if they're our own employees and that attracts certain types of people to that

industry who like to work in kind of a small business. If you look that's essentially what they are, small business operators.

MR OHLSSON: We work very closely too with our branches because as Shayne pointed out they are ANZ franchises and they - you work very closely with our branches making sure if we have customers they want to be served out of hours and then, you know, we provide that convenient solution.

DR KING: Yes, it was more for when you were talking, "Well, perhaps it would be better to have fixed rather than a variable payment." I wondered had you tried any of that with your own franchises? Have you tried varying them, taking them away from the broker.

MR OHLSSON: No, we haven't. We haven't. We find, you know, the way we do today with our mobile lenders that works really well.

MR ELLIOTT: You know, they were quite small just to put their numbers in, so what this is about ten per cent of our - - -

MR OHLSSON: Ten per cent - well, ten, fifteen per cent of up flow depending on, you know - - -

MR ELLIOTT: The broker is a path.

DR KING: It was more if you had tried experimenting with them, it would be fantastic.

MR ELLIOTT: No, no, we don't do that, no.

MR HARRIS: It's hard to go one out, isn't it, in a commercial sense?

MR ELLIOTT: It is. It is.

MR HARRIS: In order to work this, you might well lose them with a preference of - - -

MR ELLIOTT: Going to a broker.

MR HARRIS: While still maintaining a percentage arrangement as a proper broker - - -

MS ABRAMSON: Can I ask a question which is related sort of in the wealth management and also the mortgage broking? One of the things that we're looking at was introducing competition by allowing wealth management or financial planners to actually advise on loans. And some of the reaction that we've got is - and I do understand the legal background to this, is but they're such fundamentally different products. But when you think about it your home loan for most people is going to be the biggest financial product that they take out, and I've been thinking about this from a sort of licensing point of view and the range of licences that you hold. So just interested in your views.

MR ELLIOTT: So yes, I read about that. I mean, so if I stand back - there's nothing stopping people doing that today. So if I'm - have a financial planner myself, I can go and get a broking licence and there's nothing prohibiting that, but for some reason that has not evolved.

Our view, from experience and looking at the products, they are different and people, our customers think about them in a very different way. You know, there's that old adage that you know, the wealth products are sold and mortgages are bought. You know, people think about them very differently. They think about who they go to for that advice, so there doesn't - experience would suggest there isn't quite the natural fit that there might otherwise be. But as I said there's nothing stopping in particular a financial planner getting a broker's licence. It's interesting - - -

MR OHLSSON: Well, sometimes what we say is that financial planning, I guess, houses, they work closely with broker firms so there's kind of like an alliance.

MR ELLIOTT: Yes, if you come into an ANZ, you'll find that our home loan managers who are authorised, sit next to the financial planners and they do - share clients and talk together and kind of tag team with their own specialisations.

MR HARRIS: Yes, inside branches, we could probably see it. It was a question really - this is a competition inquiry and we're thinking of competition from four parties in the industry and we were thinking - and it appears the data to support this - that it's interesting the regulatory structure doesn't support the notion that a potential source of competition for brokering, which are financial planners - it doesn't envisage that that might be the case. And so we were thinking perhaps we can clean up a regulatory anomaly and at the same time, perhaps we can introduce some form of competition that might affect this apparently quite large price that's paid for broking, and attached to that was the fact that it appears that financial planning, at least in its basic form, doesn't cost as much as broking alone.

Now, we've had that disputed and we're going to try and find some better data, although given our access to data arrangements haven't worked as well as perhaps it might have - I might put on the record here, if you're able to offer us some information about financial planning charges for the equivalent of the average loan being \$350,000 nationally, placing \$350,000 in an investment arrangement, we'd be very interested in knowing whether there is a significant differential there that might suggest that the competition could drive prices down towards, you know, perhaps a happier mean. Anyway, that's the notion.

Competition in the industry doesn't just involve competition as it were, at the supply and there can also be competition amongst the facilitators and so we were interested in those areas.

Can I turn - if that's okay with my fellow commissioners - can I turn to the big structural issue in this which is macroprudential and the idea of a competition champion particularly in those forums where necessarily behind doors, macroprudential issues are discussed and debated and then intervention occurs. We have concluded in draft form that

macroprudential intervention is likely to persist. Whether we believe it's likely to persist simply because central banks have been somewhat constrained in their ability to use cash rates in the post-GFC environment which eventually will regularise itself, or whether it's simply because once a tool is discovered there's temptation to use it, particularly if it can be finely tuned, it seemed a wise thing to maintain that for either source.

Now, we did note in ANZ comments in an online blog that you're suggesting that on this sort of general area of whether macroprudential interventions are going to persist, that we might be right in the short and mid-term but not in the long term and I thought, "That's a curious comment. I'll be interested in knowing why".

MR ELLIOTT: I don't know who wrote that blog.

MR HARRIS: Okay. Well, anyway, maybe you can just have a look at it and we will see - our group will determine where we saw it - - -

MR ELLIOTT: I think, you know, the reality is macroprudential, you are quite right, is a new trend. It's an emerging trend and in efforts to kind of, you know, tweak and clip the edges around the business, you know, and I think it's a recognition that the traditional tools have had some gaps in them and so, you know - and obviously people are concerned about the inflation in house prices, the rapid growth of investors, et cetera, et cetera, and so these are a blunt tool.

Whether they will always be thus, I would tend to think that they - we're probably through a bit of a cycle. They'll be popular for a period of time. They'll achieve their aims and then probably will recede, but you know - - -

MR HARRIS: That's inconsistent with this sort of statement but I guess from our perspective, if you looked at it in almost the entirely opposite way. I mean if the choice is between using shifting cash rates which are a broad swing across the economy and do, in almost all circumstances, damage entities that were not the target but necessarily that's what a cash rate does, versus a quite selective intervention at a particular point via the macroprudential regulator, it does seem that these macroprudential tools are capable of refinement and increasing precision, and could therefore be desirable, versus shift in the cash rate unless for a very big monetary policy reason, like obviously a shift in the cash rate ...(indistinct)... so it happens.

MR ELLIOTT: Although they do expose, they have their own weaknesses as you know because they always sound simple, but in the execution they raise all sorts of complexity.

MR HARRIS: Correct.

MR ELLIOTT: For example, the obvious one recently being, you know, when we say "Oh, we should put a cap on investors", well, let's define what an investment property is. Is a holiday home an investment property? Is it not? People do actually live in more than one home increasingly. What does that mean? So we start getting into complexity of

definitions, and therefore we end up having potentially regulatory arbitrage. Now, I don't - it's early days and I'm not suggesting that that's happening, but history will suggest - - -

MR HARRIS: Yes, people will take advantage of that. We don't have any malicious presumption here. People will take advantage of it because it's a market.

MR ELLIOTT: Yes.

MR HARRIS: In a market, this is the activity that we expect to happen. You know, you see an advantage, you will price according to the advantage and things will change as a consequence of that. Anyway, we're interested in this question of would it persist? Because clearly if macroprudential interventions disappear as a tool, then we possibly need to worry less about it than we have been.

But it is an important part of our contention that a competition champion in those sorts of forums would be desirable because otherwise the macroprudential regulator in APRA must all balance necessarily towards stability. It must favour that.

MR ELLIOTT: Sure.

MR HARRIS: It may be able to take into account, have regard to competition. Whenever it is a finely balanced judgment, the balance is going to fall towards stability, thus - the question is could an alternative party be making an argument in those forums for considering competition, achieving a slightly different outcome or achieving it via a slightly different methodology.

And that little homily is supported, I think, by the fact that we've noted that in the UK, and I mentioned this last week so you're probably in observing these hearings and therefore you know, the UK itself, even though it had quite a difficult global financial crisis by comparison with us, nevertheless the lid might have gone on too far in favouring stability and changed its remit to its prudential regulator to create this secondary objective of favouring competition, so a more explicit direction than simply have regard to competition.

We haven't done the same thing here. We had a better global financial crisis than they did, but we're apparently less worried about competition.

MR ELLIOTT: Well, I mean, in one - we didn't have a financial crisis essentially. You know, consumers didn't have a crisis. There were no runs on banks. There were no failed institutions. There was no cost to the tax payer in terms of bail outs so I think in Australia, the system here, the regulatory system, the stability framework, worked incredibly well and Australia and Australians are better off for it.

Now, you can argue that it was, you know - the arguments it was too stable perhaps, but I think it became a great benefit to the economy.

MR HARRIS: That's right, but would you simply - do you offer any support for the idea there should be a competition champion at the macroprudential level?

MR ELLIOTT: I don't know. I mean, I take it for granted that - and maybe I am wrong - but I've taken it for granted that the Council of Financial Regulators do consider competition in terms of their setting. That it's not just stability because if it was my view, we'd have a very different system today. If they were solely functioning on stability and they had no regard for competition, we wouldn't be living in the world we are today, and I think the government itself has actually moved pretty pro-competition in terms of making it easier for people to form banks, lowering the capital requirements. Making it easier to put bank in your name. You know, putting together regulatory sandpits for start-ups et cetera.

All of those are pro-competition and they have been actually the thrust of most recent changes in the system.

MR HARRIS: That's right, and as we observe in our report, none of those have induced any significant competitive change and they might prospectively do that, but entry itself into the banking industry - well, we've got the numbers, they're in the report, it hasn't been the competitive threat that a text book might make out.

MR ELLIOTT: Well, that's true although there's still a large number of ADIs in the country and there's certainly a large number of non-banking financial institutions. All one has to do is turn on the radio on the way to work and hear all the adverts for financing opportunities for small businesses et cetera. So there's a wide arrange of options available for people more so than before.

MR HARRIS: Well, there's an analysis in the report and that's why we think this question of the overall level of intervention which clearly has an impact on competition and it necessarily does.

MR ELLIOTT: Yes.

MR HARRIS: It has in those examples we've used, constrained competitive response from those very institutions including to the non-bank sector which you mentioned apparently.

MR ELLIOTT: Although can I make a comment. I mean, I think - I get that and I understand it and yes, by definition there are some various entries in the system and therefore there will be less competition as a result and that's undoubtedly true. However, the barriers are not such that there are a wide range of financial institutions globally who have had every ability and it's not that difficult to come and get a licence and set up a bank in Australia and compete and some have.

But some may have chosen not to, I put it to you, not because of the regulatory barriers, because it's hard. Because it's competitive, because returns are low, because there are

some scaled requirements in terms of being in an effective competitor in the market. Now, that may change with fintech and open data. We'll have to wait and see.

MR YETSENGA: Can I make - sorry, just two final comments. I mean, there's conventional monetary policy that also has competitive impacts. I mean, countries that have had very low interest rates, and one and a half sounds low but countries that have gone closer to zero, banks that can access wholesale funding have a substantial competitive advantage over banks that primarily rely on deposit funding.

So I think to think about macroprudential as being fundamentally different from a conventional monetary policy, I'm not sure that there's a clear dividing line there. I think they both have competitive implications and just, I guess, to pick up your phraseology a bit, fine tuning, and I guess for me, I think if there's a presumption that the market with a large number of players and with reasonable information will generally do a reasonable job of allocating things efficiently and we should let the market do its role, I guess I get nervous about that conjunction of events because, you know, history may well look backwards on this period and say actually at the risk of trying to fix what happened to other countries during the crisis, we became very involved in the financial system in lots of different ways, and the effects of that will only become clear over time.

So if there was as shift back to conventional monetary policy on balance, I suspect that would be a good thing rather than - - -

MR HARRIS: Yes, I don't think I'm saying - I mean, I have a sense of what's desirable; I'm merely saying it appears to be a mechanism that is under increasing use at the moment.

MR ELLIOTT: True.

MR HARRIS: Yes, it has that ongoing attraction of being precise in its targeting versus a cash rate; it has costs by being precise in its targeting because, as you pointed out, arbitrage opportunities were a dividing line. And I guess that's why our solution has been as subtle as it is, which you know, to suggest that an entity is stated as being the competition champion in the closed-door forums that debate these kinds of things, and that a statement of expectations is varied for the other participants to say, "We expect you to pay attention to the competition champion," you know, it's a pretty subtle and nuanced change.

Those in the industry who are steeped in this do accept that such subtle nuanced change can be of significance, but it is still pretty subtle and nuanced, and hardly, I think, an endorsement of the idea that one mechanism is preferential to another. We wouldn't disagree with your broad statement that says it would be far preferential for the market to be open the allocations here, as far as possible.

Stephen, you're last.

DR KING: I wanted to change directions slightly, and get onto risk rates generally and then I think Julie, you wanted to do the SMEs in particular?

There's been a recent history in banking in Australia of - it appears, and I'd be interested in your views of this - of playing down, if I can put it that way, the differences between the IRB banks and the standardised banks. There have been recommendations that this is relevant to competition and you've seen our comments on those recommendations. And you'll be aware obviously, that the APRA discussion papers came out a couple of weeks ago.

From your perspective as one of the five IRB banks, is the value of being an IRB bank being eroded by the prudentials changing and essentially saying, "Well, fine, you can have your internal risk rates but we're starting to floor them; never going to raise the floors on them," so they start looking very much like a standardised rate.

I mean, you know, for want of a better way, did you guys do your dough when you put in all of those systems for the IRB to become an IRB bank, the sort of investment that you made was substantial; you were expecting a return on that, or it was quite reasonable for you to - - -

MR ELLIOTT: So, no, we didn't do our dough. And you know, being an IRB bank is a good thing; forget the regulation. Being more granular and being more thoughtful about how we manage risk is a good thing; it's in our interest to do so. So we haven't done our dough; it's been good for us and we are a better risk-managed institution as a result of what we've learnt and continue to invest in that.

Your question about has the value diminished over time? Mostly certainly, because the return on that investment was, you know, essentially, one way of thinking about it, and it's only one, is well, what was the RWA advantage it gave you after versus standardised? It wasn't that long ago that difference was almost 20 per cent difference, you know, on a home loan for example. And today, it's more like 10. So, yes, the value of it has diminished but it's still worthwhile.

I mean, as I said, it's a good thing to be on an advanced system and to be using better analytics to understand our risk: how can it help me?

DR KING: Do you see the direction that APRA has gone in the discussion papers, which are looking at a more nuanced, standardised risk, for example, residential property, as being a desirable thing?

MR ELLIOTT: At the end of the day, I guess there's two objectives here; one is to make sure that the playing field is as level as it can be, reflecting that it can't be totally level because you know, we are investing in different systems and amounts, and in terms of being better risk managed, there should be a reward and a benefit for being better at risk management, right? So there should be that benefit.

So we've got to get that because if we eliminate it all, then the incentive for us is not to invest in risk management systems, and how that is to the benefit of Australian consumers or shareholders or the economy is not clear to me; so, there's that point.

But on the other hand, the nuances in terms of refinement, of understanding various differences in risk, you know, I think is a good direction. So understanding that there is a difference

between potentially an owner occupier and an investor; there is a difference between small businesses, you know, and the nature of those small businesses, you can't just categorise them as all the same and therefore all be equally risk weighted.

DR KING: The term "level the playing field" gets used all the time here, so "level the playing field" between the standardised and the IRB bank.

MR ELLIOTT: Yes.

DR KING: And I don't understand it. I mean, it strikes me as being a bizarre concept in many ways. If a company invests in a new IT system or new factory, that means that if they were to produce a better product and the others who haven't invested go out of business because they can't compete, we'd normally say that is a good thing for the economy.

MR ELLIOTT: I agree.

DR KING: So in what sense does level - - -

MR ELLIOTT: I agree with you: it is generally the smaller players - those on standardised - who say that they are somehow at a disadvantage, and our answer to that is, "Well, you can become an advanced bank. It requires investment and scale, and system and technology, but you can achieve it. There's no rule that says you can't have it."

And you know, Macquarie is a very good example, you know, one of the non-big four who made the investment to go and be an advanced bank in terms of their models, so I agree with you. And that's what I'm saying, there should be a benefit if you make those investments.

DR KING: So would you view the APRA moves to essentially move away from the IRB rates and push up those IRB rates to standardised rates as anti-competitive?

MR ELLIOTT: I don't think I would use those terms. I mean, I think globally, in the Basel committee there was a view that perhaps the models need some kind of speed limit, overrides, whatever you want to call it, to kind of give them more ballast, right? Maybe we became too reliant on just pure models and they need some ballast in them just to kind of make them a bit more even; that has inevitably led to a shrinkage of that advantage that you're talking about, yes.

MS ABRAMSON: It's kind of a comment really, because I think this is where you're going: we've made some recommendations about APRA being more granular around the risk weighting for SMEs, so I take it, Mr Elliott, from what you're saying, that that would be a move that you would be supporting?

MR ELLIOTT: Sure, yes.

MS ABRAMSON: Yes.

MR HARRIS: You have a new payments system as a point, and I think you may be - anyway,

you've given promise to it, I'm not sure that many people have. If I take your presentation directly, I don't think you're disagreeing with our view that this is going to be fundamental infrastructure for the future, for people to be able to compete - - -

MR ELLIOTT: Agree.

MR HARRIS: - - - in one area of the finance system. Your proposition is, I think, it's too early to impose an access obligation upon the payments board, I guess, that's going to run this. I'd appreciate your view on this: we found when we were enquiring into this that it was quite difficult to determine what the arrangements were likely to be, beyond the initial participants who had, obviously, funded this.

And I think the reason we were attracted to an access obligation is, it tends to be a mechanism which enables you to crystallise how you're going to go about allowing participants, who weren't original investors, to play without having to, I guess, justify almost, to their competitors, that they should be allowed to play.

This is an area that has come up in a number of regulated industries, and I think it'd be fair to say, access agreements aren't that popular. But that's their benefit: their benefit is, it crystallises your thinking about how this might happen; do you have a reaction to that at all?

MR ELLIOTT: So, look, I try to think about this as simply as I can, you know, which is going to your point earlier: there needs to be an incentive for the investment to create such benefits. So we spent, as an industry, a huge amount of money, hundreds and hundreds of millions of dollars, to create this, and there needs to be the incentive that says, "Hey, if you go and spend on new infrastructure, there's a benefit to the investors." And they don't take that - hopefully - for granted.

Hang on, but when I think about their openness - so there's nothing to suggest in the discussions or the documentation today that it is not viewed as going to be open, in terms of open access. What we're saying is, we've only just - actually we hadn't even launched the system yet; it's being tried out at the moment, so it's really hard to - - -

DR KING: Really early days.

MR ELLIOTT: It's really early days, literally weeks in. I mean, we haven't even turned it on at this point, so it's a bit early to say.

Having said that, I think about these new networked worlds we live in, whether it's a Google world or whatever, or whether it's the credit card networks; the value of these networks increases in terms of the more users and more access to them.

So in terms of a shareholder in this, it's in my interest to have more access, more users, more volume going through that platform, you know? Realities in our world, we have a history of closed-loop networks failing miserably, and there are some in the cards business and other payments around the world.

Openness is an asset to the owners of that infrastructure and will continue to be so. So I think it's actually a total alignment of interest to say, "We want more and more people on the new payments platform," because the utility of it will increase. If I say to my own customers, "It only works between certain kinds of banks and you can't do these," that will limit its utility, so it's in my interest.

DR KING: Have you also seen these platforms - and obviously it's a concern for competition regulators around the world – that the first mover advantage is particularly important, but often we may see a slew of overlay services initially; it's likely that one or two will end up dominating the market.

Isn't the problem here that whilst there may be a preference for open access, as you've mentioned, unless it's actually formally stated, unless it is, in a sense, governed by the RBA, we might find in five years' time that well, it wasn't quite so easy to get access to build overlay services, and by that stage it's too late, it's whoever has won the competition, they've got the market share and the competition is gone by that stage.

MR ELLIOTT: Look, my reaction about that is based on a whole bunch of assumptions: if this, maybe that, possibly in the future; I mean, none of those things we know, right? So there is no evidence to suggest any of that is the case, it's all ifs and possibilities.

You know, which overlay services are we talking about?

DR KING: I'm just thinking of...(indistinct)... Google - - - we can run through the platforms that are now dominated by a single player.

MR ELLIOTT: Right.

DR KING: And what's to stop that happening on the NPP?

MR ELLIOTT: Well, you know, again, that's a theoretical discussion I'm sure we can debate; I don't know.

DR KING: Well - - -

MR ELLIOTT: But in saying that, I don't see any incentive at - there's a slight difference here, and again, I'm not an expert in this field, but you know, NPP is not run by ANZ, where world domination is my goal and I want 90 per cent share. It is run by a consortium, and say, Google isn't run by consortia, Facebook isn't run by a consortia of industry players, you know.

Maybe cards is an interesting one to look at: where you've got a Visa and MasterCard you know, both open platforms, you know, thousands and thousands of bank members who fight really hard to have more openness in their networks and compete very, very heavily; maybe that's a better model to look at in comparison?

MR YETSENGA: I think that is the problem about technology dominance, though - allowing open access doesn't do anything to affect that, does it? If it's a market and a system in which

some sort of natural monopoly exists, then it still exists, regardless of how much access you allow. It might take you longer to get to the single dominant entity, but it shouldn't change the - - -

DR KING: Or allow competition on the platform from day one, rather than finding out in five years' time that really, it wasn't open from day one.

MR YETSENGA: There's a dozen institutions I think, on the platform now. I mean, it strikes me as pretty competitive to start something from scratch.

MR HARRIS: I don't think we doubt that the original investors themselves have plans to deal with this, in terms of their own cross-competitive outcomes. I don't think we doubt that; you'd have to be mugs to put the amount of money in that's gone in, without having - - -

MR YETSENGA: Yes.

MR HARRIS: - - - some idea of how you plan to utilise it in a competitive sense.

No, our question is really the one I posed at the outset: there does not appear to have been any crystallisation of our thinking about the other entities. And those other entities - I think you referred to this Shayne in your opening address - are innovators using data to create overlays that would benefit from direct access to the new payment system.

The question is, how do they get access? And in our investigation, going around the multiple parties, that originally we thought were responsible for this and finally getting through the complex labyrinth - this actually involved us going to the wrong meeting in the wrong building at one point.

MR YETSENGA: Right.

MR HARRIS: Well, we thought we'd found the right party and we weren't. But having got there, we asked this question, how do they get access? And I won't say people were uncooperative, I just think they hadn't conceived of necessarily having a structured format in which we could say, "If you want to be - have not been ...(indistinct)... you want to deliver a service that potentially needs to use this, this is how you're going to go about doing it, this is the cost, this is the bona fide issue you'll need to establish, this is the safety of data."

Access arrangement could establish that and we considered that would be a support to innovation; in other words, it becomes convenient to plan how I might put an overlay service through this, that was all. We didn't think it was there.

MR ELLIOTT: Right, so it's more like - - -

MR HARRIS: It's sort of like an - - -

MR ELLIOTT: ...(indistinct)...

MR HARRIS: - - - explanation is, it's early days, that's the explanation.

MR ELLIOTT: Yes, that's more like the open day, that regime, "How do I - yes.

MR HARRIS: Yes, how do we get there? Anyway, we think it's important and since you raised it I thought I would make something of it, and maybe if you've got a submission that comes following this, you - - -

MR ELLIOTT: Sure.

MR HARRIS: - - - might want to give us a little bit further advice on that. I realise, as I've said, that access regimes are not necessarily the most popular mechanisms for dealing with major strategic infrastructure, but the concept behind them seems to be an advisable one when you start out, knowing how you're going to do that.

LMI, I have taken you past your time - - -

MR ELLIOTT: That's all right, okay. LMI.

MR HARRIS: Lenders mortgage insurance has become, from being a sort of slow moving element of this inquiry, become quite a significant one in the course of these hearings, and we may come back and ask you for some data on LMI - - -

MR ELLIOTT: Yes.

MR HARRIS: - - - and how we - you - go about engaging with the industry that provides the insurance: could we start there? It's been an interesting revelation that there's not competitive tendering of what is quite a large chunk of money for quite a large group; in fact, it's surprising to me that the degree of home owner utilisation of lenders mortgage insurance, you know, 20-odd per cent has to take out LMI.

It's quite a big chunk of money; it's generally capitalised into the loan; it seems quite an odd arrangement. Now, not to say there's anything wrong with that, but the particular aspect that we asked people about so far and that no-one's been able to offer us any good explanation for why it isn't the case of re-tendering of this from time to time, if there is a preferred provider. But why doesn't re-tendering occur with LMI - - -

MR ELLIOTT: Do you mean from the bank?

MR HARRIS: Yes, the bank - - -

MR ELLIOTT: So you're saying ANZ, being - - -

MR HARRIS: Well, you're ensuring your loan, so you're - - -

MR ELLIOTT: We don't disregard re-tendering, we consider whether we are the best provider of that insurance - because at ANZ it's an in-house arrangement - or are we better to

go to an external provider? The problem you get into with external providers, frankly, in a small - we do - we can reinsure a little bit. In a smaller market like Australia, it's a concentration risk: if everybody insures with the same provider for that insurance, when things go bad, that insurance is worthless.

And so we have to consider those risks, and that's actually much more important than a few basis points or a bit of cost here and there in terms of the tendering. And again, we all know that in our daily life, if you're going to insure your house, insure it with somebody who's going to be around when you need them, and that's really important. And what we know about housing when there's a problem it'll be cyclical, it'll be lots and lots of people having problems, all at the same time.

MR HARRIS: But aside from - and I can debate the in-house nature of it, therefore the fact that you're absorbing that risk - - -

MR ELLIOTT: Yes.

MR HARRIS: - - - so, you know, in a sense if there was a meltdown, you know, you're a slightly riskier proposition as a consequence; that might be a counter-argument.

But my point was really, there are two large external providers, and there's you internally. It's a standard of economics to say, occasionally we test the market and say, "can they do a better job than us?" And particularly in this case where you're not paying for it, your customers are paying for it.

MR ELLIOTT: Yes, but our customers don't have to bank with us, they don't have to borrow the money from us; it's a competitive market. If they want to go to somebody else, they can. We're transparent about it, the cost is transparent; they know what it is. And as I said, it's not about - with all due respect - it's not as simple as that cost issue.

The most fundamental issue for us is that the insurance is good when we're going to make a claim, and you know, the reality is, there are a small number of providers who are massively concentrated in terms of their exposures.

MR HARRIS: Yes.

MR ELLIOTT: You might suggest that - you know, one thing that I - self-insuring, ANZ is a large, massively diversified organisation with a significant amount of capital base, and we capitalise our LMI appropriately. We're still regulated, it's a regulated entity; we capitalise it, but we have diversification which a lot of the independent providers don't have.

MR HARRIS: Right. But we're a competition inquiry, so - - -

MR ELLIOTT: Sure.

MR HARRIS: - - - we're looking at this as a sub-market, which is the way we approach the whole of how do you boil down competition in the finance system to areas where competition

might need some kind of policy response? This one appears to be quite an unusual market in the sense that the actual purchaser is not in charge of the price but has to accept it as a consequence of buying a larger commodity; that is, a home loan.

Has to accept that, or as you say, could go elsewhere, but it's late in the transaction; they've invested quite a lot of time. And the degree of competition in this market isn't the kind of competition you would say might be traditional: that is, someone would be out there testing my in-house product versus my external supplier.

Now, I can understand your point about risk, don't get me wrong.

MR ELLIOTT: Yes.

MR HARRIS: I mean, it's an entirely rational commercial judgement, but from our perspective the question is, this means that the market looks like it isn't functioning.

MR ELLIOTT: And again, maybe this is a completely inappropriate analogy, but it's a little bit like buying a car: I don't go through and say, "I understand who all the possible providers of the airbags are, and I'll pick from you. And I'd like to know who are the possible providers of the steering wheel and the seats, and all those bits and pieces?" It's a package.

And our package of our product, if you want a highly-g geared mortgage, there's a package. You get it, it's ANZ, and we tell you what's in it, and the LMI is part of that package and if you don't want the LMI, you can't have the loan; it goes together.

MR HARRIS: Gives you access to - - -

MR ELLIOTT: So the idea that we should slice and dice all the features and functions and we compete on an individual - I don't think it's reasonable for us to provide that.

Your point about should we tender it out and make sure we're getting the best price; we do, but what I'm saying is, we go through the analysis quite regularly. And you know, I was the CFO, I've been through it, we do go through that analysis to decide should we keep this in-house, or should we go outside? And it's not just a thing we go through as a routine and tick a box; we do give it serious thought; we are engaged with those other providers, we talk to them, we engage quite heavily.

It's not quite as simple as just tendering out, but we do engage with it, formally.

MR HARRIS: I'm trying to use the form of language which - - -

MR ELLIOTT: Yes, no, no, I understand - - -

MR HARRIS: - - - means we can have a discussion, rather than - - -

MR ELLIOTT: But we do consider it.

MR HARRIS: Yes, all right.

DR KING: Just one small matter. So under the IRB weights at the moment - - -

MR ELLIOTT: Yes.

DR KING: - - - there seems to be very little benefit for the IRB banks to actually have LMI insurance in terms of capital savings, and it's paid for by the customer. In your case, it's kept internal because you have your own LMI provider. To an outsider like me, this seems like something where it's a nice way to put a little bit of an extra impost on the customer, you know, perhaps an extra \$10,000 if they're a 90 per cent LVR, with no cost saving from your perspective. I mean, you know - - -

MR ELLIOTT: Well, so the difference is, I think you would agree that if you walk in - and looking at an assumption - if you have a half a million-dollar house and you borrowed \$450,000, that is more risky than if you come in and borrow \$100,000. And therefore, if it's more risky, you would expect to pay more, and the way that people are paying more in this case, is by taking up the insurance. And so, it's a way of price differentiating for risk.

Because the sole driver of LMI is a risk one: high loan-to-value, or not? And as I said, it's not secret, it's completely transparent, and that is a way of reflecting the risk. It's got nothing to do with the risk weightings; forget whatever the risk weightings are. I mean, we don't run the bank just based on what regulators ask us to do; we run it prudently, based on our understanding and our imagining of that risk, and so we have to price for the risk that we take.

So in New Zealand, slightly different, we do it differently. It isn't through an LMI, it's through what we call a low equity premium, so kind of the same outcome: people with low equity or people with high loan to value pay a little bit more because it is riskier. But they pay it in a different way than through a formal insurance arrangement.

MR HARRIS: Does that mean here that they don't pay a premium as well as LMI? Can you guarantee that that is the case?

MR ELLIOTT: Well, when you say guarantee, you know - - -

MR HARRIS: You've got banking policy, so - - -

MR ELLIOTT: Yes.

MR HARRIS: - - - you know, whatever the policy is, is it your policy that if a customer is required to take out LMI, their interest rate does not then need to reflect their loan to valuation ratio circumstances?

MR ELLIOTT: Well, yes, in theory. The problem with that argument is that it assumes that it's a binary decision that is a two-factor problem, you know, that the price is only LMI or not LMI; the price is all the same. And as we know, it's not. The pricing is a many, many factored issue to do with that person's income, their credit history, their household expenses, the loan

to value, where the house is, what it's made of; all those other things go into that pricing decision, so it's not quite as simple as that.

I'm sure we could find people, absolutely, that are paying LMI who, on the face of it, are not getting the discount rate that somebody else might be getting, who is almost similar, because as I said, you know, we have a million mortgages on our books; there are so many factors that go into pricing.

MR HARRIS: Yes. No, we did have a sort of conclusion that rested on the word "probably" but did say, "It's probably a case that you're paying twice if you're paying LMI." Your suggestion is probably the case that you're not, but - - -

MR ELLIOTT: Well, there might be cases where people are - when you say paying twice, again, it's a package, right?

MR HARRIS: Sure.

MR ELLIOTT: And how they're paying for their loan might be in the rate, it might be through LMI, but it is transparent what the customer is buying; they know what they are paying; it's easy to compare with anybody else at any time, and make a decision whether they want to, you know, choose our package or go somewhere else.

MR OHLSSON: I think APRA came out quite recently, saying that they are looking at LMI and the consideration of it and the like, and LMI and the risk weights, you know. So it is something that's - - -

MR ELLIOTT: And it would be a logical - - -

MR OHLSSON: - - - being considered.

MR ELLIOTT: There would be a lot of logic in that.

MR OHLSSON: Mm.

MR HARRIS: Okay. I was thinking of wrapping up now, because we've - - -

MR ELLIOTT: Okay.

MR HARRIS: - - - taken you over time.

MR ELLIOTT: That's all right.

MR HARRIS: But thank you very much for your generosity with the time. Is there anything that we haven't asked you that you'd like to put on the record at all, or anything you'd like to correct a misapprehension that I made, or anything - - -

MR ELLIOTT: I mean, look, thanks for the opportunity to come and have a chat about it.

We have obviously gone through your ...(indistinct)... in some level of detail. What we thought we'd do is just kind of focus on well, we had a point of view that might be a little bit different than - we've been monitoring the things that you've had a look at, but I'm just repeating stuff.

MR HARRIS: Yes, it's good this, isn't it? Yes.

MR ELLIOTT: Yes, so it's fine. And now we've obviously got the opportunity to put through our formal written submission which we'll do, and we'll take some of the leads you gave us today on areas that are of interest, where we can provide a bit of data on it, and a bit more of our insights, perhaps.

MR HARRIS: Thank you very much for your time.

MR ELLIOTT: Thank you.

MR HARRIS: For everybody's benefit, there is the possibility - it's probably now cold - of a cup of coffee outside. And we're back in 10 minutes' time. Thanks.

MR ELLIOTT: Appreciate your time.

MS ABRAMSON: Thank you very much.

ADJOURNED

[11.42 am]

RESUMED

[11.52 am]

MR HARRIS: So let's restart; I think ASIC is coming up to the table. And once you guys have settled and if you want a glass of water, pour it now so that it doesn't go over the sound system and deafen everybody. But once you've done that, could you introduce yourselves please, for the record?

MR KIRK: Yes, my name is Greg Kirk. I'm the Senior Executive Leader of Strategy at ASIC.

MR SADAAT: My name is Michael Sadaat. I'm the Senior Executive Leader for Deposit Takers, Credit and Insurers at ASIC.

MR HARRIS: Okay. I'm just going to check with the sound guys if those microphones are in slightly the wrong places, we'll just wave if the sound isn't as good as we need it to be.

MR SADAAT: No worries.

MR HARRIS: But I think currently it's okay for everybody. Opening statement needed from ASIC?

MR KIRK: We do have a short, I think, statement.

MR HARRIS: Go for it.

MR KIRK: Well, first of all, we thank you for the opportunity to appear today, and we welcome the Commission's draft report and the attention it has drawn to competition in Australia's financial system.

A key priority for ASIC is to identify where the failure of competition to operate effectively results in poor conduct and consumer harm. The draft report includes a number of findings and recommendations that are relevant to ASICs work and mandate, and we'll respond to each of those recommendations in our written submission.

I just wanted to focus some opening remarks on three issues: improving consumer outcomes, data and transparency, and regulatory settings.

Firstly, on improving consumer outcomes: as noted in our first submission, poor consumer outcomes can be a sign of competition not working as effectively as it could be. In our experience, in many cases the practices involved do not breach competition laws and may not breach conduct laws. These types of failures often require a tailored regulatory response.

ASIC has worked to address some of these competition problems in financial markets, with effective results. A good example is our work on add-on insurance and flex-commissions in car yards. There, we've obtained refunds of over \$120 million for consumers in a market which is characterised by excessive supply side or "reverse" competition. That is, vigorous competition by lenders and insurance for access to the car dealership intermediaries, rather than to the consumers themselves.

And in that context, we welcome the Commission's support for ASIC to proceed with our proposal to mandate a deferred sales model for add-on insurance through car dealerships, and for the Government to consider extending this to other parts of add-on insurance products.

Next, I'd like to discuss data and transparency. We welcome the Commission's strong focus on data and harnessing new technologies to facilitate consumer understanding. Like the Productivity Commission, we support the proposed open banking regime. We think, with appropriate regulatory settings, increasing consumers' access to their own data has the potential to empower decision making and stimulate competition and innovation within the financial services sector.

We agree with the Commission that a significant component of consumer choice is providing consumers with the right sort of information, at the right time. While we think there has been too much focus in the past on the provision of individual contractual disclosure on "terms and conditions", there has been too little focus on providing consumers with meaningful information on performance - that is, how the product the consumer is considering and the entity providing it performs in practice, and how what the consumer is being offered compares to what is being offered in the market more generally.

In appropriate cases, we are working to make that "performance" type information available.

For example, to improve public trust and consumer understanding in life insurance, there was a clear need for better quality, more transparent and more consistent data on claims. ASIC has been working with APRA on establishing a new public reporting regime for claims data, and for outcomes in the life insurance industry.

However, we also know that the complexity of financial products and services and consumer decision making means simply providing more information may not necessarily improve competition and consumer outcomes. It's important to ensure that any additional information and data provided to consumers is actually beneficial through, for example, consumer testing.

Finally, I'd like to discuss regulatory settings to promote competition. Competition in financial markets is dynamic and evolving. Ensuring effective competition in the Australian financial system is an ongoing process. Each regulator has a role to play. As a starting point, each regulator needs the right mandate and regulatory toolkit to promote effective competition.

We support the Productivity Commission's recognition of the importance of ASIC having a broad, proactive competition mandate to undertake our role effectively. An appropriately broad mandate would allow us to factor and appropriately balance competition into our regulatory decision making, and address market failure as a driver of misconduct or poor consumer outcomes.

We also support regulators working together to consider competition issues in the financial system, and to learn from each other's expertise and perspectives, whatever mechanism is ultimately chosen to achieve this.

We look forward to continuing our work with the Productivity Commission in this inquiry, and we're happy to take any questions.

MR HARRIS: Thanks very much, Greg. I could start off, I think. In the case of deferred sales models, ASIC has been pretty clear about the car dealership insurance product being separated and having a clear, separated, decision making framework for choosing whether you enter into the insurance product as well as purchase the car.

We went further and suggested that most of these add-on insurance products appeared to involve the same kind of impact on a consumer, that is, the skewed encouragement to purchase a product that you didn't necessarily come there to purchase, but has been conveniently included, and it doesn't give you the opportunity to determine whether you're getting value for money, or indeed, a product that you really need at all.

Now, we'd suggested that in a manner which attempted to encourage the industry itself to review these products as much as the regulator to do so. So we haven't received much feedback to date on that. Have you received any feedback to date on that, or do you have a view on whether that should be the case?

MR SADAAT: Well, we would agree that the concerns around the sale of add-on insurance are not confined to the car dealership channel. We have seen some significant concerns in that channel, which is why that's been an area of focus for us, but we also have done work looking

at the distribution of add-on insurance products through other channels, including through banks themselves.

And to that end, we've recently been working with the banking industry as part of the update to their code of banking practice, and the banking industry is proposing to introduce a deferred sales model for the sale of consumer credit insurance that is sold with credit cards in branches, and over the telephone, where there's a face to face or telephone interaction with the customer. And that will result in a four-day delay between the sale of the credit card and the sale of the add-on insurance, the consumer credit insurance.

We think that's a good step, and it's an example of the industry self-regulating, but that doesn't cover the field in terms of the types of add-on insurance products that banks themselves will sell. We think there is probably quite a strong case for the sale of consumer credit insurance with personal loans to also be brought within a deferred sales framework. So far, the industry hasn't proposed that. And one thing we will look to do is monitor the market to understand how that is evolving, including how the deferred sales model for credit cards works in practice.

But certainly, it is a positive step, but we think there could be more work to do there.

MS ABRAMSON: Can I just ask a follow up question, Michael? You mentioned, I think, the industry standard of four days. Do you have a view at ASIC about what is a reasonable period of time, or what you'd be thinking there?

MR SADAAT: We don't think there's a magic number. Four days is the same amount of time that the UK has gone with - - -

MS ABRAMSON: Yes.

MR SADAAT: - - - as part of their implementation of the deferred sales model for gap insurance sold through car dealerships. I think the key point is that there needs to be a separation in terms of the sale of the underlying product with the sale of the insurance; enough time for the consumer to think about what product they're being offered, particularly when it's a product that they hadn't at all thought about before walking into the bank or walking into the car dealership. So enough time to review any disclosure material, think about their needs, think about whether the product could be purchased elsewhere for a better cost.

So our view is that a couple of days is probably the minimum you would think of, in terms of, you know, introducing a deferred sales model. It's something we're going to be canvassing as part of the second round of consultation for our deferred sales model for car yard add-on insurance. We haven't arrived at a view as to whether it should be four days, but we don't have any concerns with four days, as it were.

MS ABRAMSON: The Insurance Contracts Act - I mean, I can't quite remember - but it does have, like, a cooling off period for some insurance products, doesn't it? You can take it on notice, you don't have to respond now.

MR SADAAT: I think that's right, and it may be for consumer credit insurance, but it's not

a deferred sale, it's a cooling off so that - - -

MS ABRAMSON: Yes.

MR SADAAT: - - - you make the decision on the day - - -

MS ABRAMSON: And then you can change your mind.

MR SADAAT: You can change it, I think, in the next 14 days.

MS ABRAMSON: Yes.

MR SADAAT: But the general history - and I think that's probably true in a number of jurisdictions with those sort of cooling off periods - is that people - the people who are unaware that they've even got the product are certainly unaware that they also have the right to cool off from getting it. And that the uptake of that is relatively low, and people are not very conscious of it. People are not spending their time immediately after this major transaction where they might've bought a car and finance insurance, reviewing it all and working out whether - they're out driving their car.

MR HARRIS: Can I ask it from the alternative perspective - and this is not a question of how ASIC views insurance products per se - so, this is a product that the insurance industry collectively at least has to endorse, in order for it to be offered to consumers: it's not just a question that a car dealer or a financial institution, or indeed, a whitegoods warehouse offers an insurance product along with a major purchase. The insurance industry has to be conscious and willing and supportive of the transaction.

So is it normal for ASIC, rather than to look at the individual product, the bundled insurance with the car or the bundled insurance with a credit card, is it normal or even plausible for ASIC to invert it and say, "You know, we see enough of a pattern here to instead call in the insurance industry and ask the question, 'Why are you so willing and cooperative to offer a product which clearly has such a poor rate of claims history, or certainly, is being offered in a circumstance where consumers are unable to access sufficient information to judge whether it's a good deal or not?'"

In other words, can we consider that this could be inverted to become a debate between the regulator and the insurance industry, or is that outside your either normal operating remit or indeed, outside your legislative remit, to do that?

MR SADAAT: I think in fact, that's the approach we've been taking to these issues. We've been focusing on the conduct of the insurance companies, because they're the firms and entities that we regulate directly - they're licensed by ASIC, and they've got obligations to ensure that, you know, the products that they're selling through these channels are creating good consumer outcomes.

So our engagement has primarily been with the insurance companies in understanding the impact of these products. We've done significant data collection from the insurers to

understand how many products they're selling; the claims ratios and performance of the products; and we have, as I said, done extensive engagement with the insurers to understand how they go about overseeing these distribution channels to ensure that good consumer outcomes are occurring.

If we proceed with a deferred sales model, it will be through modifying the obligations that insurers have in distributing these products, rather than any new obligations on the distributors themselves, because in some cases - actually in many cases - the distributors themselves are authorised by the insurers to distribute these products, they're not separately licensed by ASIC. So our focus is very much on the product manufacturer, as it were, which is the insurance company.

And with the Government's proposals around issuer - - -

MS ABRAMSON: The new distribution - - -

MR SADAAT: The new distribution obligations, design and distribution obligations, that will really strengthen our toolkit when it comes to sheeting home responsibility to the product manufacturer so that the product manufacturer can't turn a blind eye to how their products are being distributed.

MR HARRIS: So it's plausible then that, although your priority currently is in motor vehicles, we could see a solution which is to turn all add-on insurance on its head and say, it must be a separated product?

MR SADAAT: Yes, that's theoretically possible, yes. Certainly, what we're doing at the moment is, you know, we're doing it with reference to the powers that we have, and you know, we don't have unlimited powers for example, to implement deferred sales across the board; we would have to consider that carefully.

And so, your recommendation that Treasury lead that work is, we think, the right one, because it is a question of policy around how these products are sold.

MR HARRIS: Yes, yes. and there's a markets group now in Treasury that could do that, but it doesn't necessarily have to be undertaken by a brand-new entity.

We've also had this proposition, we put forward what we considered to be a structural proposition about the idea of having, at the highest levels within the industry, an entity charged by the Treasurer with becoming competition champion: the advocate for competition in a circumstance where regulation, in whatever form it's in, including macroprudential intervention - the specific example we were using in that report.

But regulation is being applied in support of stability, and perhaps competition is being not as thoroughly analysed for potential adverse impacts that might occur from that intervention. So we put forward the proposition that it could be either ASIC or the ACCC. Do you have a view explicitly as to whether or not in those forums, you'd be a better advocate than the ACCC, or are you happy to leave that to the Government to decide, or...?

MR KIRK: I think we're still working through the implications of it internally, so certainly today, we don't have a settled position. I think we would have to put one in our written submission to you.

We have been advocating for some time, including through the Financial System Inquiry, that we do have a bigger role in competition, whether we have a mandate. But that has been conceived up until now as very much focused on our own work in relation to conduct, not a broader immediate relation to other regulatory measures taken by other regulators.

So it would be an additional step, as conceived in the report, for us to take on that role. And as I said, we're still working through the implications of that.

MR HARRIS: Yes.

MR KIRK: I hope to have a settled position for you in the - - -

MR HARRIS: Yes, you definitely went beyond what Murray was proposing; indeed, I think he's commented to that effect as well, so we're happy to accept that level of responsibility.

Anyway, that's fine, if you don't have a settled view today, I'm not going to pursue it further, but we would appreciate knowing - even if you don't, in the submission, come to a final conclusion - the factors that influence your judgement: it might well be relevant. Anyway, whatever benefit you can offer us in the submission, that would be great.

MS ABRAMSON: Can I ask about mortgage brokers and the best interests duty? I think it's fair to say, at least from the people that we've had before us, that there doesn't seem to be a great degree of concern about a best interests duty, because some of the industry players have said, "Well, we're looking after the client, we'd be acting in their best interests."

But one of the things I'm interested in, firstly, your view on it, but also bearing in mind the report that ASIC released into the financial planning industry in terms of the performance of a number of the people that you looked at; if you support a best interests duty, what type of things also might need to go with it to make it actually be something that's happening in the marketplace.

MR KIRK: I think broadly, our view is that there is scope to increase the standard expected of mortgage brokers, and I think when mortgage brokers were first regulated, when credit regulations became national in 2010, it was a big step forward to bring in standards around responsible lending, and that included standards around meeting the needs and objectives of the customer.

But at that point, the standard that was set was the same for the product issuer. If you went into the bank and asked for a loan, the standard was in exactly the same terms as for a mortgage broker, and it does seem that a mortgage broker is seeking to offer customers something more in terms of work helping navigate people across the marketplace, than is offered by a particular loan issuer.

So there does seem to us to be scope to raise the standard. Whether just adopting the best interests duty from the Corporations Act, as applicable in the financial services, is the best solution to that, we're not sure. It may be better to start with the obligation that's on them now and to work in some more specific requirements.

The two elements now of responsible lending are that the loan has to be repayable by the consumer, given their financial circumstances, without undue hardship, but it also has to meet their needs and objectives. And I think often at the moment, the needs and objectives are only explored in very broad terms. So, you know, the main need is to buy a house, "I need a home loan to buy a house," rather than more detailed needs and objectives about you know, looking for the most competitive loan I can get, the best price right across the market.

And so, something more explicit about what they should be canvassing and addressing in meeting consumers' needs and objectives may be a more direct way to get to the sort of solution that we're talking about.

MS ABRAMSON: And would your thinking - and I'm not trying to put you on the spot because I realise that this is a process and there's a policy decision upfront about what that "duty" might be - would that be something that you would do under the standards, or at least your regulatory powers, or your regulation guides about what type of skills you have to have to do certain things?

MR SADAAT: So I think raising the standard that brokers need to meet - because that standard is currently in the law - - -

MS ABRAMSON: Yes.

MR SADAAT: - - - it would require a change to the law to raise that standard. We currently have regulatory guidance around competence levels that need to be met.

MS ABRAMSON: Yes, yes.

MR SADAAT: So that's something that ASIC could look at, but I don't think we've got a view that raising competence standards would necessarily change the outcomes for consumers, if that was the only thing to get - you know, if there's a concern around whether consumers are being provided with quality advice, there could be a number of drivers of poor quality advice, including what the legal standard is, the remuneration structures, ownership structures, competency standards - it could be, you know, all of those things put together.

But, you know, I think we would need to think that through I think, before we were sort of confident that there was a clear need, for example, to raise competency standards in that sector. In reviewing the remuneration models as part of that work we did, where the report was published at the beginning of last year, we noted that a number of things could be done to improve remuneration models; we didn't go as far as to say that commissions should be abolished, but we did say that the standard commission model could be improved.

The industry has come together and proposed a number of improvements to that standard model, and we think they're positive suggestions. I suppose one thing to consider is whether you wait for the impact of those to flow through to the market and then assess whether further change is required, or whether there's enough evidence now to say that, you know, more fundamental change is required to those commission arrangements.

And you know, for our own purpose, I don't think we've landed on that position.

MS ABRAMSON: Just a follow up question, I guess: we're looking through the competition lens, so one of the things we've been thinking about is whether wealth management advisers should be able to also advise on loans. And one of the things a number of people have said to us is, "Ah, but they're fundamentally different. Credit is entirely different from financial services, or wealth management products," and we've got two regulatory regimes. So I'm just interested in your views on that as well.

MR KIRK: Again, maybe going back to the history for a moment; again, when the credit regime was being established federally for the 2010 regime, the representatives of financial planners had quite a strong voice in the consultations on that, because they wanted to make sure that nothing in the regime was a barrier to financial planners providing mortgage advice.

And it was expected at the time that there would be - certainly they were suggesting - that there would be, maybe, financial planners who would want to do both. I think we agree with your observation that hasn't turned out to be true.

At the moment we're going through some of our databases to try and get you some data that would cross over, but - - -

MS ABRAMSON: That would be really helpful.

MR KIRK: - - - as a broad indicator, it looked to be about 4 per cent of licensees have a dual licence, and maybe a little bit higher when you get into the number of representatives they have - - -

MS ABRAMSON: Yes, yes.

MR KIRK: - - - as a percentage of the market. But still, not significantly higher. We'll try and get you some data on that.

In terms of what the causes of that are, we will also try and address what are the regulatory barriers to it, and some of them, you know, you do have to get separate licences, but if you've already got the one licence and you've been operating well, that would get you a fair way along the path on the assessment. Slightly different training requirements: both have to be in ADR, both have to have PI insurance cover.

So they're relatively similar, so some additional costs, but we'll work that through.

MR HARRIS: We had a concept, you know, 20-odd years ago, pioneered at COAG when

once COAG was taking a great deal of interest in structural reform and red tape, and that was called “mutual recognition” and it seems a bit odd here that we couldn’t have a mutual recognition arrangement within the one regulatory entity, for dealing with this.

What’s the impediment to saying one party currently licensed can offer the products that the other licensed party can, as long as they meet these regulated standards? In other words, why can’t you create - - -

MS ABRAMSON: It’s a hybrid licence.

MR HARRIS: - - - a common regime?

MR KIRK: I think that would definitely - - -

MR HARRIS: And then offer it to people.

MR KIRK: Yes. That would definitely require legislative change.

MR HARRIS: Quite. But leaving aside the mechanics, the concept, you know? We can manage mutual recognition between, you know, entities that were trained in different - I think even New Zealand qualifies for this - so training in different countries for slightly different regulatory standards for, I don’t know, being surveyors and being whatever. It seems weird we can’t do it inside the one organisation.

MR KIRK: Conceptually, you could do that. That said, it may not be the case that the regulatory system is the only barrier there, in the sense that - - -

MR HARRIS: No, it - - -

MR KIRK: - - - even from some of the people who’ve come and answered questions before you, there seems to be a strong sense of almost a cultural divide, you know - - -

MR HARRIS: Quite.

MR KIRK: - - - “We’re this,” or, “We’re that, but we’re not both.” And to some extent, you also - because financial advisers can and do provide advice on credit now, and they’re permitted to, and in fact, our regulatory guidance encourages them to in some circumstances; the difficulty they have is providing advice on particular credit contracts. So ...(indistinct)... - - -

MR HARRIS: Well, if they’re being paid for them - - -

MR KIRK: - - - loan and being - well, I’ll get to the being paid for it. So they’re able to do that now, up to a certain point, but unless they have the credit licence they can’t set up the loan. But other barriers for them being able to do that may include the sorts of industry structures, having to be accredited with an aggregator, having to be part of a particular industry body; that type of thing. And they, in fact, may be more significant than the regulatory hurdles.

Certainly, historically, if you're only doing that sort of work, setting up mortgages on a relatively sporadic basis as part of a practice which is more focused on investment advice, some of the costs of participating through an aggregator and having arrangements with all these lenders may either not be available to you, or may be less economic - - -

MR HARRIS: This is a competition inquiry; we're talking about competition in the advisory space here, so these are potential competitors. If there are barriers that are created by industry practice, that too can be dealt with by the competition regulator itself, if it had to. I mean, I'm not sure this is literally a matter that the ACCC would care to look at, but clearly, if regulation amends and allows a party to offer both the products in an advisory sense and then we find some industry association prevents them from so doing, by some particular standard, well, that's a substantial lessening of competition, in principle.

So, you know, people would have to be a little careful here about how far we took industry practice to prevent competition in the advisory space, wouldn't they?

MR KIRK: Yes. That said, there may be legitimate reasons for some of them.

MR HARRIS: There may well, in which case the investigation would presumably demonstrate that.

MR KIRK: I would accept that. And just on your point about they can't be paid for it, certainly our work on commissions discovered a separate category of people who were paid commissions, who don't arrange the loan but just refer the borrower to the lender. And it seems to be that professionals, lawyers, accountants and financial advisers, are reasonably prominent amongst people who are acting as referrers.

And the strange one in there was that the commission they were paid for just doing the referral was almost as large as the commission the mortgage broker was paid for doing all the extra work in responsible lending, meeting the laws and setting up the loan.

So, yes, again, some industry structures that possibly are worthy of examination.

DR KING: Sorry. I did notice in some of the discussions we've had with mortgage brokers that yes, their contracts include that there may be a payment to another party possible, but the payment you're talking about here is direct referral: a lawyer referring a particular client to a bank directly to write a mortgage?

MR SADAAT: Yes, there's an exemption within the law for referrers.

DR KING: Yes.

MR SADAAT: And if they operate within the exemption, they're not required to be licensed by ASIC, or authorised by another licensee. And there is now a fairly large industry of referrers, comprising professionals, lawyers, accountants, advisers, who do directly refer consumers to a particular lender. And as long as they disclose to the consumer that they're receiving a commission and they don't do anything to help the consumer arrange the loan, then

they can fall within that exemption and they'll be paid by the lender, a commission.

You know, as we reported on in our report, those commissions can be quite significant. In some cases, you know, as close to the commissions that are paid to mortgage brokers, who are doing more work than a referrer is supposed to be doing.

DR KING: So when you say “assist” the consumer in actually getting the loan, does that mean filling out paperwork, providing information about that consumer to the bank so that - - -

MR KIRK: Getting together the documents around their financial position?

DR KING: Yes. But they could be aware or discuss the consumer's financial position and then say, “Well, you should be eligible for a loan.” I mean, I'm just wondering where the boundary there is.

MR SADAAT: Well, what they can do under the law is quite limited. I guess, there's a risk that some might be going beyond what they're allowed to do under the exemption, and that risk is potentially exacerbated by the incentives that are provided by banks. And we have seen cases where misconduct has occurred by so-called referrers, and ASIC has taken action against those.

But yes, it is a feature of the law, and as a result, there is now an industry of referrers that includes financial advisers, and therefore they're paid for that referral activity.

DR KING: Just a final one on this: you said referrers to a particular bank. Do you know referrers who will have, you know, say multiple banks, and they will decide, “Well, actually, you'd be best off with the ANZ.” Or, “No, you'd be best off with St George,” and so they - rather than just having an arrangement with one bank for referrals?

MR SADAAT: I think I'll have to take that on notice. It's possible, but certainly, to the consumer they can't give the impression that they've considered the consumer's circumstances and you know, picked a particular - - -

DR KING: ...(indistinct)... it starts getting very grey.

MR SADAAT: Yes, yes.

MS ABRAMSON: They would be giving advice.

DR KING: Yes, okay.

MR HARRIS: I'd like to ask about your regulatory sandbox, and innovation. You mentioned data and your support for open banking, and obviously ours too, and that seems to be progressing. ASIC operates a regulatory sandbox arrangement where you can allow a new entrant to a market that you regulate to experiment, as it were, with a product and potentially test that in the market without breaching some regulatory standards.

How does this go with participants in the financial markets who have products that are regulated, not just by you, but potentially by, you know, one of your fellow regulators, without being terribly specific. Although I could be, I have a particular case in mind, but it appears that there are - and logically, this would be the case - that boundaries in financial products overlap a little. How do you go about offering the benefits of the regulatory sandbox to a party who is in that position?

I mean, for example, in all the payments arrangements, you know, so the RBA is interested in payment arrangements, at the margin APRA, always interested in payment arrangements. You also are interested in payment arrangements. So, just in that area, how do you go about running a regulatory sandbox?

MR KIRK: Certainly, our regulatory sandbox is limited to what's within our mandate. And we don't authorise products, so the thing that we're exempting people from is from the entity getting a licence, but we're doing that because they've got a new product idea, they want to test it, but all the costs of getting that licence and setting up just to test whether there's a market for this product, are a discouragement to them going ahead.

But we can only give relief through the sandbox from the obligations that they owe under the laws that we administer, so it doesn't help them with other entities. Though we obviously try and cooperate and coordinate and make sure people are aware of other obligations and we can refer them on, but we can't address through that sandbox, obligations that they owe elsewhere.

MR HARRIS: Right. Well, you can't in some legal sense, because you don't own the regulatory barrier. But had you considered entering into agreements with fellow regulators who have said, "We're interested in this party getting to market, but there are regulatory barriers to them experimenting with their product."

Although I hate the term, because it's so regularly misused in the public sector, but "memoranda of understanding" kind of arrangements that effectively provide a pathway to market for possibly new competitive products, which is why we're interested in this area. I mean, the sandbox idea appears to have been, you know, almost ASIC-owned kind of territory, but the industry itself is regulated in multiple fashions, so for a sandbox to properly work you would assume that is one of your interests, or perhaps is it the Treasury's interest, or, shouldn't somebody be looking at this question of products that do enter into other market territory as well as yours, in the finance industry?

MR KIRK: Yes, I might have to take it on notice, partly because of the things that we're authorising in our regulatory sandbox are small in scale, generally. I mean, both the size of the activity and how many transactions they're going enter into as a result, and also the amount of money at stake for any particular consumer, I think in general they won't trigger requirements of regulators that are more focused on either systemic stability or the stability of a particular entity. And they're not deposit taking entities, they're not insurers, so that doesn't come up.

MR HARRIS: Let's take the payments area. So we've got this Payments Board - it's not necessarily a regulator but it certainly controls access to the payment system. Would you consider that to be an area that you'd have any - if there's a product in that area, would you

have any role in allowing, I don't know, this sandbox concept, the possibility of experimenting with utilisation, would it go that far?

MR KIRK: I think it may be better for us to explore this in our written submission, in the sense that - - -

MR HARRIS: Yes, I'd be interested - - -

MR KIRK: - - - I would like to check whether there are entities that are small enough to satisfy the requirements of our sandbox and their activities small enough, who would, nevertheless, be subject to regulations administered by the - - -

MR HARRIS: Yes. Because - - -

MR KIRK: - - - parameters of the Board. And I think I would need to check that before I - - -

MR HARRIS: But you can see, going on out there in the marketplace, there are lots of overlay entities we are floating and might be relevant to this, and might not.

MR SADAAT: So on payments specifically - - -

MR HARRIS: No-one seems to own them, and yet the government is clearly interested in this; after all, it asked you to set up the regulatory sandbox, and yet the finance system is a system, it's not just an ASIC-regulated set of products, is it? So the question is, is the sandbox designed to allow entry? And we're a competition inquiry, we're interested in entry.

MR SADAAT: And on payments specifically, the framework for the regulation of payments for both conduct-related and prudential issues is a fairly graduated framework right now. So there are exemptions that ASIC has put in place that mean you can do quite a lot with payments without necessarily needing a licence.

So, for example, if you operate low value payments, you may not need a licence from ASIC, and you can scale up your business to a point before any prudential regulation kicks in as well. So, on payments specifically, I think we would say that the framework is fairly graduated, and the Murray inquiry has recommended that it be made more graduated, and that's something that we've been talking to Treasury and APRA about, so there could be more scope for accommodating innovative business models there.

But the framework is quite flexible at the moment, and we do, when it comes to the bits that we're responsible for, consider whether further relief or exemptions are required on a case by case basis, for the innovative providers.

MR HARRIS: Yes. I guess what I'm feeling for - and this is relating in a sense to a competition champion, in other words, who would you go to if you were looking for someone to, as it were, champion your competitive entry here? And the answer in the system appears to be, well, it all depends on, you know, who owns the black letter law.

And yet, the black letter law doesn't necessarily envisage all of these kind of overlay activities that can be triggered. The ...(indistinct)... payment system is an example of this; there appear to be a lot of opportunities there. Anyway, we're interested in that; if you've got any comments in your submission, I wouldn't mind seeing that, if you can address it.

DR KING: Just one other: we haven't mentioned the mortgage data proposal that we've got, where ASIC would have a role in publishing the relevant data, although it's expected it would be collected by APRA. Do you have any views on that? Is that a useful way forward, or do you see problems with that? Just interested in your views.

MR KIRK: I think broadly, we would agree with you that that pricing and comparative pricing of mortgages is somewhat opaque at the moment, partly because the standard variable rate is not what a lot of people get, and it's hard to know whether the discount you're getting is the same as the discount other people are getting.

So the more data, and the more public data, that enable people to have a real idea of what the price of the loan they're getting is, relative to what's being offered in the marketplace generally at the moment, would be very good. I think we also think if we were going to embark on that, we'd want to sort of consumer test what is our most useful information, and what's the best way to present it.

I've certainly had it suggested to me that if you just gave the median, maybe the median then becomes the anchor and maybe that's not a good thing, so I think some of that would need to be unpacked and explored, and consumer testing would be important. But broadly, we would be in favour of it.

MR HARRIS: Yes. Well, we haven't a clear interest in that; we don't want to go to the point of being totally prescriptive in the design, but we could easily see how the design could ensure that consumers weren't better informed, which is why I think the median was chosen in the first place: it's harder to play games with a median.

But anyway, we're quite interested in the design proposition, so if you have any views on that? I mean, we take your point and I don't think we were going to rule out consumer testing at all; obviously, the implementation of it is deeply desirable, but the question is, I think we need a proposition that doesn't go in the first place, to be easily gamed.

MR SADAAT: And the trouble with the current comparison rate that's required to be disclosed in advertising is that it's built on assumptions around the size of the loan and the term of the loan, and those assumptions are not necessarily reflective of what people are actually borrowing these days.

But moreover, the comparison rate is based on the advertised rate, not on the rate that people get when they either talk to a broker or a lender. So again, it's not a very good guide as to whether the rate you are being offered is a good rate. It also doesn't include other things that, you know, affect the cost of the loan like LMI, because the requirement is that a comparison rate include mandatory fees, but not contingent fees, and LMI, being a contingent fee is not

included within the comparison rate.

So there is certainly scope for better public disclosure of home loan rates because at the moment, consumers only really have anecdotal information about that.

MR HARRIS: Well, you particularly would consider something called a comparison rate. Yes, standard variable rate; it's an interesting nomenclature, but you know, expectations are not raised by that, but something called a comparison rate, you would expect that one of the key inputs to it is something like the median for the last month, so that it is continuously being updated.

Now, last month where, a good question, and that's why we've addressed that in our recommendation. But nevertheless, the comparison rate, the use of that term, does condition the expectation of a potential borrower - whether it was deliberately designed to do that or not, it must, because it says, "Here's the comparator."

And so, having some, as it were, truth in advertising here would seem to be deeply desirable so that consumers aren't conditioned to imagine they aren't entitled to a better rate if they pushed a little harder. Now, that's a debate that can be had in a competitive market: what does push a little bit harder mean, but the bottom line is, I don't think you should start out with a rate that says it's a comparator if it isn't a comparator, based around real time data; it just seems to be very unusual.

And us trying to get to the bottom of this has been quite frustrating, so that contributor to how a comparison number is built up is quite important, almost in any market where you might expect the consumer to be able to look after themselves to some degree. Even if they have a broker, they should still be able to look after themselves to some degree, because separately, it was demonstrated brokers' allegiances are - notwithstanding their intent to be as loyal as they can to their customers, the payment arrangements are a little skewed, to say the least.

Okay, that's prices. Anything else? Nothing else? I haven't got anything else here. Other issues that we've failed to draw out from you that you would like to go on record?

MR KIRK: No, I don't think so. Anything else, we'll make sure it's in our submission.

MR HARRIS: Okay.

MS ABRAMSON: Sorry, Peter, one thing. The insurance; we've made some proposals about the type of disclosure that would go with the insurance - - -

MR KIRK: Yes.

MS ABRAMSON: So that's about disclosing what the increase is in the policy; obtaining any views you have on that would be quite useful. Happy to have it in your written submission.

MR KIRK: Right ...(indistinct)... sorry.

MR HARRIS: No problem. Okay, thanks very much for your time today.

MR KIRK: Thank you.

MR HARRIS: I think we have ME Bank next. Once you guys have settled yourselves, could you please identify yourselves, for the record?

MR MCPHEE: Jamie McPhee; ME Bank.

MR BECK: Tony Beck, a consultant for ME Bank.

MR HARRIS: Jamie, do you have a little opening statement that you'd like to make?

MR MCPHEE: Yes, I do, thank you. And so, what I thought I might do is make a few short comments at the opening, but I think probably the real value is in the discussion, so I'll keep them relatively brief. But before I do, I'd just like to acknowledge the quality of the draft report, and all of the work for the commissioners; it's something that we've obviously read in detail. I think it's a very good piece of work.

So we do appreciate the opportunity to appear before the Productivity Commission to reflect on and contribute to the public discussion regarding the draft report. As I've said, I believe the draft report is an excellent public policy contribution document in relation to improving the competition in financial services, and particularly in retail banking. The regional banks do intend to make a further submission to the Productivity Commission, responding to the report in more detail.

I'd just like to start with a little context, if I may? It's just that ME is a small bank with a unique business model, due to our ownership structure of the industry super funds. ME was set up to help all Australians get ahead and achieve dignity in retirement, and that still remains, absolutely, our core purpose today.

As a small bank, ME is heavily dependent on the policy settings that promote competitive neutrality. We've made regular submissions over recent years to the various inquiries, including the Financial systems Inquiry, the Productivity Commission, and the Senate Economics Committee, and we continue actively engaged in the public debate concerning competition and pressing the need to level the playing field.

It is our view, until the GFC, a relatively level playing field existed for banks, credit unions, building societies and non-ADIs, however, post-GFC, regulation has tilted the playing field materially in the favour of the larger banks by reducing the capital requirements and lowering their relative funding costs due to their "too big to fail" status.

As identified in the Productivity Commission's draft report, the benefits of competition to the individuals and businesses for whom the financial system exists are being reduced in the quest for stability. Regulators have focused almost exclusively on prudential stability since the GFC, promoting the concept of an unquestionably strong financial system.

We view this as a critical finding, as an attempt to rebalance the regulatory setting somewhat towards competition. ME believes it is now the time to identify, acknowledge and discuss the issues of competitive neutrality in a constructive way, with a view to improving the system for the future.

Consequently, ME supports the concept that competition become part of the responsibility of the regulators when setting policy. Competitive neutrality is about ensuring all service providers compete on an equal footing and that the regulatory arrangements do not favour some service providers over others.

On this point, all we're really asking for is a fair go, not a subsidy or a handout, just an opportunity to compete fairly, and we don't believe that to be an unreasonable request.

As the commissioners are aware, ME has been advocating for some time for the following issues to be addressed: one, reducing the gap in mortgage risk weights between advanced model banks and standard model banks. Two, addressing the too big to fail funding advantage of the major banks. Three, reducing overall compliance burden of the smaller ADIs. Four, implementing requirements for mortgage brokers to disclose ownership interests. Five, the removal or redesign of macroprudential restrictions that have the effect of locking in the market share status quo.

On this last issue, it's been pleasing to read Wayne Byres' comments recently that the 10 per cent limit on investor loans may have served its purpose and be ready to be removed because it was never really intended to be permanent policy. These initiatives ensure a more level playing field and put the industry in a stronger position to implement other reforms such as open data, which will ultimately be in the consumers' best interest.

In relation to risk weights, ME notes the Productivity Commission's draft report findings that larger institutions have a cost advantage through lower risk weights, compared to smaller banks. It's pleasing to see that the Productivity Commission's draft report - or since the Productivity Commission's draft report was released - APRA has published a discussion paper which is mostly consistent with the Productivity Commission's findings.

A major focus of the proposals is adjusting the risk weight outcomes in the residential mortgage asset class. ME will engage closely with APRA on this consultation with a clear focus on how the newly proposed risk weights will impact on the competitive position of standardised banks versus IRB banks. It's too early to fully assess the impact of APRA's proposed changes but we note that APRA has made the standardised risk weight system more reflective of the underlying risks including the proposal to set 20 per cent as the minimum risk weight compared to 35 per cent today.

In relation to too big to fail, ME also welcomes the draft finding that larger ADIs benefit from lower costs of funding compared to smaller institutions, in part reflecting the expectation of government support. This is a key issue for the regional banks because the cost of funding is the major competitive distortion between small and large banks.

Having said that, we acknowledge the difficulty in finding a solution, and note the Productivity

Commission has not made any explicit draft recommendations which would directly address this issue. We recognise that the Productivity Commission has formed a view that the major bank levy does not improve competitive outcomes as it does not reduce the cost to smaller banks, however we do believe it is pro-competition because it partly offsets a funding cost subsidy to the major banks.

In relation to disclosure of mortgage broker ownership, which is also key to creating a level playing field, it's noted in the draft report that smaller banks are dependent on the broker industry to overcome scale and geographical disadvantages. We see the growth in the mortgage broker industry as a testament to improving customer service, as broker loans now account for 56 per cent of all new loans originated. The main issue for the regional banks is ensuring that the customers of mortgage brokers know the identity of the broker's owner so the consumer can factor in this information into their decision making.

So, look, I'm going to leave my opening comments there. Just before I do, I'd like to again commend the draft report and acknowledge the consultative approach and we greatly appreciate the opportunity to contribute and we also look forward to making a further submission in which we will continue to prosecute the case for a level playing field in the five key areas that I previously mentioned.

So with that, happy to open up to take any questions.

MR HARRIS: Thanks Jamie. Can I deal with the one where you said we have obviously identified an issue in relation to too big to fail, and the market benefit that that conveys to the larger financial institutions when they go into wholesale markets to raise money.

MR MCPHEE: Yes.

MR HARRIS: Yesterday, I think Suncorp said to us, "Look, there's a three notch rating difference that remains there" and you know - actually very few people didn't notice our comment on the levy and I'm not sure whether I'm happy or unhappy about that because I don't think we did it in order to garner controversy but we certainly thought it was a relevant consideration.

But a crucial point there surely is if these shifts in risk weighting or in application and levies do nothing to shift ratings agencies' perceptions, then that three notches is going to remain.

MR MCPHEE: Yes.

MR HARRIS: And all we end up doing is - unless the risk weighting is needed to be made tighter because they were misjudged, and then I leave that aside, it's entirely a matter for you guys and the regulators between you to work out. But if it is driven by this perception of the big banks have an advantage, yet the ratings agencies just shrug their shoulders, it says we're adding cost to the industry without actually addressing this core problem.

I can't remember in the end - I look at the team here and they're going to shake their heads and think, "How can the Chairman not remember this?" but I can't remember if we actually

concluded anything in relation to the ratings agencies, but the logical position is, they determine this, and - - -

MR MCPHEE: Yes.

MR HARRIS: - - - for a regulator or a government to pursue that differential, possibly is going on a fool's errand, isn't it, if in fact the ratings agencies are going to not vary that three notch differential.

MR MCPHEE: So, I think you talked about two quite separate issues, right? So, one is the risk weights which is the difference, obviously, between standard banks and an IRB - - -

MR HARRIS: Yes.

MR MCPHEE: - - - or an advanced model bank. But bring it back to the cost of funding, to your point, absolutely, it's the rating agencies which provide the rating notch upgrade, because of their belief that the government will bail them out. So, that's then what has to be addressed; it has to address that belief, because if that's not changed - and how we do that I think is quite complex because we want to absolutely ensure the stability of the system, but offshore there's all these bail instruments and the like.

But exactly to your point, as long as there's a subset of the banking sector where the rating agencies believe that too big to fail or government support will be provided, but not to the others, then that differential exists, which will always accrue the advantage to the major banks.

MR HARRIS: The logic of that position suggests that it could only be addressed - and that's a 'could' - only be addressed if it were addressed directly; that is, too big to fail just doesn't apply to the four, it applies to a much larger group. But that, in itself, brings on a substantial, well, if nothing else, a moral hazard for government - - -

MR MCPHEE: Right.

MR HARRIS: - - - but also other implications. But aside from addressing it directly, you know, this is the question; to the extent governments or regulators are interested in addressing this differential, aren't they on a fool's errand?

MR MCPHEE: Well, there's one other way you could address it. So, absolutely that one is that everyone's all in, or all out. So, that does deal with it from exactly the way that you described.

Another one could be that if it's acknowledged that there is a benefit accruing to the major banks - I think it's factual - I think it would be hard to acknowledge anything other than that, is it possible to conduct a calculation by an independent body that determines what that value is that's accruing? Is that value accruing really being accrued by the taxpayer? Because in effect, that's the person that's providing this implicit guarantee via the government.

And then on an annual basis, that then becomes, where should that benefit accrue to? Should

that accrue to the people that, in effect, provide the benefit, which is the general public, and therefore it'll either be applied and adjusted on an annual basis, to simply level the playing field; that's the other way it could be done.

MR HARRIS: Yes, I see. In our report, we did notice the RBA had done calculations of premium that might be applied here, and if I recall rightly - this bit I can remember - the suggestion was that at some point it could actually reduce to zero, this differential.

MR MCPHEE: Right.

MR HARRIS: Which I found a little surprising, because I look at this more commercially and say, well, ratings agencies are paid to find differences between banks because otherwise - - -

MR MCPHEE: Yes.

MR HARRIS: - - - why is every capital raising treated exactly the same? So, it may be, in principle, possible to suggest it should be driven down to a relatively low amount at the time of stability in a financial system, but it seems unlikely there will ever be no differentiation. So, even if you were to calculate some model that does that, is it likely - I guess I'm really saying, aren't the ratings agencies in exactly the same position really, as quasi-regulators? They're crystallising a judgement about risk in the market, and they're going to do it, regardless of what anybody does.

MR MCPHEE: Yes. So, then there's the two mechanisms that we just talked about. The one is all in or all out, so - - -

MR HARRIS: All in, all out, I appreciate.

MR MCPHEE: And the second one, as I said, so it can change over time, because the RBA also had a report that shows the benefit accruing was between 20 to 40 basis points, so the point that you're making is, it actually, obviously, varies with time.

So that's all my point is that if you actually set the levy on an annual basis, whatever you're doing actually then should reflect the current market conditions, and again, create a level playing field. Because it's not actually hard to determine if you issue this amount of wholesale funding at this rating, this is the price that you pay. If you issue the same amount of wholesale funding at a three notch lower rating, this is the price you pay.

And then it just becomes a mathematical equation, and so therefore I think that's quite discoverable, and so therefore, should that benefit - and our belief is that that benefit because it's about government support - therefore that benefit has been ultimately provided by the taxpayer, the community, then shouldn't that benefit accrue back to the people who are providing it?

All I can tell you is that I don't have any insurance policies where I haven't had to pay a premium. No-one is giving me free insurance, so isn't that analogous to what's happening here? That's a proposition that we have put forward previously.

MR HARRIS: Sorry, one last thing, just to - - -

MR MCPHEE: Does that make sense?

MR HARRIS: No, I understand what you're saying; just with this supplementation. The party doing the analysis would have to be a pretty credible party, wouldn't they - - -

MR MCPHEE: Yes.

MR HARRIS: - - - for this to be accepted, as you say, an insurance premium versus some of the other claims that are occasionally made against - without being terribly specific, are you tap dancing around the edges of various things?

MR MCPHEE: That would be absolutely critical, wouldn't it? If you think about - and it's not really sort of for me to suggest who that may be, but the RBA, you know, ultimately sets the cash rate, so again, that's a pretty important decision which a lot of information is taken to make that decision. So, there are many very credible bodies that could do that.

And to be honest with you, the amount of calculations that the financial sector is making all the time, and some of them are relatively complex, I actually don't think this one, in comparison, is actually all that complex, and is quite discoverable, would be our proposition.

DR KING: Just the rating agencies, and pretty much, upgrade, obviously affects the wholesale funding. Should we be asking, do you see the same issues on deposit side? So, do you see the major banks being able to offer lower returns to depositors because they are viewed as safer than say, an ME Bank?

MR MCPHEE: Well, the way that that's been dealt with - I think to some degree banks, and our costs and our cost structure should reflect the businesses that we've built up; I mean, that's our obligation: to make sure that we're running safe, secure and efficient businesses.

Where that issue has been solved up to \$250,000, of course the financial - - -

DR KING: Having ...(indistinct)... the guarantee.

MR MCPHEE: Yes, that's right. And to be honest with you, I'm actually not sure exactly what percentage of the population that covers, but that covers obviously the lion's share, so I think that issue in the retail space has already been dealt with. Does that make sense?

DR KING: No, no, I thought that would be the range, I just wanted to make sure - - -

MR MCPHEE: Yes.

DR KING: - - - it was on the record.

MR MCPHEE: Our cost of retail deposits is higher than the major banks, but I think in that

context, we're just looking for a level playing field; I mean, we can't sit here asking for a subsidy or anything else, so it's our responsibility to make sure that depositors feel comfortable depositing their funds with ME Bank, and I think that sits with us.

MR HARRIS: You commented in your opening remarks too, about the strong predisposition of regulators towards an unquestionably strong system, and you suggested that an increase in regulatory arrangements in favour of competition would be desirable. We put forward this, we think quite subtle proposition, about the appointment of a competition champion - - -

MR MCPHEE: Yes.

MR HARRIS: - - - and a revised statement of expectations, to the parties that are involved in regulating activity here in favour of them recognising the competition champion and in particular ...(indistinct)... of financial regulators taking some account of an analysis put forward by this entity.

And you noted, I'm sure, in our report we had two choices, in ASIC or the ACCC; do you have a preference, or would you be prepared - or a group of banks that you often appeared here with, would they be prepared to have a view on what should be a desirable party here?

MR MCPHEE: So, my view is that I actually think it was a suggestion we completely agree with, and to have stability in the system, you know, and no focus on competition will ultimately drives to the ...(indistinct)... type behaviour too, down the track.

In relation to exactly who that should be, we actually haven't had that discussion yet as a group of banks, but that is absolutely something that we will address in our follow up report.

MR HARRIS: Thank you for that, we'll look forward to seeing it. The point from our perspective, in putting this up is, they're both well-recognised entities in the market place, they're not really entities that would fail to understand the sensitivity of what we're discussing, you know, our - - -

MR MCPHEE: Yes.

MR HARRIS: - - - prudential intervention being the requisite example we used; it's a very sensitive tool. So, don't think we've taken anything other than a subtle approach to this. There have been suggestions I think - not made to this inquiry but to other inquiries - that varying legislation would be a desirable alternative approach; you don't have a view on whether you know, legislation for example, if it was legislation, should be varied?

MR MCPHEE: I think - - -

MR HARRIS: UK has varied its regulators - - -

MR MCPHEE: Yes, yes.

MR HARRIS: - - - legislation, but we didn't go down that path.

MR MCPHEE: I think the critical thing is what we're trying to solve for here and I think that's absolutely spot on. In relation to the mechanism of the organisations you've put forward, they're both credible, you can make it as part of the remit of sort of, other regulators. To be honest with you, I think all of them are workable solutions; I think it's actually the intent, that people actually want to genuinely achieve both stability - and no-one's going to argue against, we need a strong financial system, but also a competitive one.

So the only way that I'd answer is, I think there's a number of credible solutions and I think for the success or otherwise we'd be the intent that actually sits behind that. I think, you know, you callout the example of macroprudential policy that came in, and to some degree we feel stifled competition, sort of almost put status quo as the rhythm or the measurement going forward.

We are completely supportive of what the macroprudential policy is trying to achieve. When you think about, you know, from running a healthy economy, you know, monetary policy and then what you do to influence your economy through monetary policy when you've got a one and a half per cent cash rate. Then fiscal policy, then of course, you've got both sides of government or main sides of government, saying that they're going to get back into budget balance; there's a level of impact that you can have through that.

So macroprudential policy, I believe, makes complete sense. And you know, we've got high levels of household debt and high house prices. All we're saying is, what we want to make sure is that there's the appropriate consultation time and it's just thought through what those consequences might be, not just through the managing the economy lens - which I think we've all got to sign up for, I mean, that's a very sensible thing that we want our government and regulators to do - but also have a look at what may that do to competition, and then should adjustments be made the way it's applied, to ensure that it doesn't stifle competition going forward.

So really what I want on the record is to make the comment that we agreed with the intent of what's trying to be achieved, it's just how it gets executed and make sure that competition lens is just considered prior to implementation.

MR HARRIS: Quite. Any questions?

MS ABRAMSON: I just wanted to ask about mortgage brokers.

MR MCPHEE: Sure.

MS ABRAMSON: And we've made some comments around how mortgage brokers are paid in terms of commission and trailing fees, and we've also had some evidence from the brokers about clawback, so I'm just interested on your perspective on those issues.

MR MCPHEE: Sure. I think that the way mortgage brokers are paid is transparent, it's fair, and at the end of the day, you need an industry, or any services being provided, to be profitable otherwise it won't be provided. So, from my perspective, the upfront fees quite clearly disclose

the trail commissions, you know, quite clearly, disclosed.

And if you actually have a look in comparison across the industry, there's not a huge amount of difference about the payments being made. So, if we manage to put the power back in the hands of the consumer, for us probably the issues with mortgage brokers comes down to really understanding their ownership structure and does that influence or have an influence about the advice that's being given?

So we sit here and say that we're not unhappy with the fee structure that underpins that industry, but it's about just being completely transparent about the ownership structure. You think about it like this: why wouldn't we make publicly available, the flows that brokers are putting towards lender? And should there be no advice? No-one should be uncomfortable providing that information.

Now, what happens if each of the aggregator groups, the broker groups, there was more, if you like, the share was skewed towards the owner of that group, now let's say it was different across each of them, then that would be curious. And so, would that then be worthwhile of further investigation?

Now, if that's not happening, then why would anyone have any concern about providing that information? And so that's where we sit; we just believe the consumer has a right to know the ownership of the person that they're talking to and therefore they can make the judgement whether that may or may not skew that person's bias towards one product over another product. Putting the power back in the hands of the consumer is really where we're coming from.

MS ABRAMSON: If you went down that disclosure route, and we've had a bit to say about this, so you have the disclosure of the aggregator's ownership, but if I've understood you correctly, where would you put the obligation to say how much of the percentage of the owner's product, you know, or the bank's product - - -

MR MCPHEE: Yes.

MS ABRAMSON: - - - was actually the mortgages that are written? Because if I understand your proposal, that's where you were going; how would make that disclosure?

MR MCPHEE: Well, banks are disclosing their information all the time, right across the regulatory body; a lot of information that we provide goes to APRA, in terms of the loans we're writing, the bands, the LVR bands, how much investor, how much owner occupied, how much interest only, how much principal interest; this is, to be honest with you, really just another data point that could be very, very easily provided.

Now, where the information was made available, how public that information was that was made available, that would have to be thought through but it would certainly put this issue really to bed once and for all because once a responsible entity has that information, you'll actually just see if there's any anomalies there.

MS ABRAMSON: Sorry, I know I'm pressing you, but - - -

MR MCPHEE: No, that's fine.

MS ABRAMSON: - - - this is an interesting response. So, what you would be saying is, you're collecting the data that you collect, how many loans are written by a particular aggregator, to that lender?

MR MCPHEE: Yes.

MS ABRAMSON: That's really what you're saying?

MR MCPHEE: Yes, that's right. And let's say we owned an aggregator business and our market share is say, 8 per cent, I don't think anyone has, so I might as well say that our market share is 8 per cent, but we were getting 16 per cent of that business, or we're getting 4 per cent of that business or we're getting 8 per cent of that business.

Now, I'm not saying if we're getting 16 per cent that's necessarily wrong. I mean, it might've been for a period of time that the product that we had in the marketplace, the product, the pricing, the features to service, was superior to what could be got elsewhere and therefore we should get a greater level of market share; we just provide that information so those questions could be asked, that's all.

MR HARRIS: Yes. And we have some numbers, as you know, in our draft report on a couple of examples where there appears to be a disproportionate success rate if you like via owned brokers versus other participation in the broker channel. But you know, we know it's not a perfect conclusion can be drawn from that information; we know that's the case. But it's indicative, potentially - - -

MR MCPHEE: Yes.

MR HARRIS: - - - of some problems. We have had it put to us at some points that a fee for service, that is, a fixed amount of money for the service, might be preferable to a percentage of the loan achieved, as a way of reducing an incentive to take out the largest possible loan. And I'm separating fee for service, because it often conflated; it has been in a number of the comments that we received back. It's often conflated with fee for service and paid by the customer - - -

MR MCPHEE: Yes.

MR HARRIS: Interested in paid by the customer as well, not just missing it, but just on fee for service versus percentage, because I think it's been accepted that there isn't that much variation in the work required to deliver a \$700,000 loan versus a \$350,000 loan, but you get a higher payment for it.

MR MCPHEE: Yes.

MR HARRIS: So, do you have a view on that?

MR MCPHEE: Not a strong view, in terms of probably a fee for service feels cleaner if you like, and for the reason that you are doing but I know there are also benefits of doing it on loan sizes as well. I mean, the one thing I would say really, in answer to that is, it all comes back to discharging your obligation about acting in the customer's best interests and responsible lending.

So I tend to probably focus on that as the key issues that we need to make sure that we as banks and brokers and distribution channels are really discharging our obligation. And that's why when I talk about it, I just like the little context around the bank; I mean, I talk about the whole reason the bank was established was to help all Australians get ahead, and that was to actually get better priced mortgages. So, at the end of the day, if you genuinely are sitting there acting in a customer's best interests and genuinely discharging your duties about responsible lending, to be honest with you, I think the fee structure to some degree, is worth debate.

But do I have a strong view on it? No, but I have a strong view that you should be acting in the customer's best interests, and you should be absolutely discharging your duties around responsible lending.

MR HARRIS: Yes, and for those who closely read our report in this area, and it certainly hasn't been the case for everybody who's commented publicly, but we had a firm recommendation on acting in the customer's best interest and a query as to whether or not we should have a view on commissions, and trailing commissions in particular, just because they exemplify some of the skewed incentives that appeared to be obvious.

But our balance probably went, yes, more clearly in the direction of acting in the customer's best interest was pre-emptively logical because it decreases the possibility that a payment arrangement is then used as a rationale - - -

MR MCPHEE: Yes, that's right.

MR HARRIS: - - - to act against the customer's best interests. But it would need to be backed up, wouldn't it? And this came up, I think, with our discussion with the ANZ as well, but it may have been with the brokers too; when you pay a brokerage a trailing commission, it's been asserted that that is primarily about looking after the customer, whatever that means.

MR MCPHEE: Yes.

MR HARRIS: But it appears that you don't subsequently track that behaviour at all; "you" being the industry itself, per se.

MR MCPHEE: Yes.

MR HARRIS: Trailing commission is paid but the contract with the broker, or the agreement with the broker, doesn't require them, for example, to offer the customer once a year, a review of their loan status. Now, in the course of some of our hearings, today in particular, I think it's come up that that might be a deeply desirable thing to do such that the payment was clearly

... tied to the customer at least getting a service.

MR MCPHEE: Yes.

MR HARRIS: Because there is no current obligation upon the broker to offer that service, as we understand it; could you correct my impression if I'm wrong, or otherwise - - -

MR MCPHEE: No. So, your observations as to the way we operate are actually accurate; we don't track that. I mean, one of the things is, that obviously there is an expectation of course that the broker is there, always acting in the customer's best interests, then you'd think from time to time is checking in with that consumer to make sure that their loan and their mortgage is meeting their current requirements, change, you know, et cetera, et cetera.

So again, I think that's an interesting issue for discussion, and I think we should all welcome further discussion and debate around that.

MR HARRIS: Okay, good.

DR KING: One last one. For your mortgage portfolio, do you securitise any?

MR MCPHEE: Yes, we do.

DR KING: And - - -

MR MCPHEE: Actually, we're one of the larger securitisers - it's between 20 to 25 per cent of our sort of liability, is securities, yes.

DR KING: Oh, okay. So, presumably you would need to fund of that short-term funding through warehouse funding, or - - -

MR MCPHEE: Yes, well - - -

DR KING: - - - your - you know - - -

MR HARRIS: Also, because - - -

MR MCPHEE: Actually, going into the GFC, ME Bank was 100 per cent securitised funded which was not a great position to be in. So, since that period of time, we've built a much more balance liability balance sheet. Because of our rating at BBB, and not getting sort of the benefit of the too big to fail three rating notch upgrade, probably rather than issuing so much into the wholesale markets, our default plan is actually issuing into the securitisation markets.

And so if you actually look at our balance sheet, now how then those loans are funded before they're securitised, it's with normal core deposits: retail deposits, business deposits, you know, institutional deposits. And then when you term-out some loans, it's just then part of the ongoing mechanism of how we fund; we're a \$27 billion balance sheet, so it's just a mechanism. And we probably securitise - for the last three or four years, it's been once a year at around between

a billion and a billion and a half.

DR KING: Okay. so, I guess my key interest was on the warehouse funding side, which you don't rely on, so it's - - -

MR MCPHEE: Well, we do have warehouses, so we do have warehouse funding; it's not what I'd call "we rely" - it helps us as a mechanism. So, we do have warehouse funds, it's not that we don't have warehouse funding but that's just one of another source - - -

DR KING: Sources, yes.

MR MCPHEE: - - - that we'll fund. We think about ourselves as having seven different funding pools, which gives us that diversity. So, really, I was just trying to create - the picture I'm trying to paint is, it's just one of seven different funding sources.

DR KING: Yes, so how have you found - obviously the model has changed a lot since the GFC.

MR MCPHEE: Yes.

DR KING: I presume a lot of the pressure to change that model came out of the GFC, but - - -

MR MCPHEE: Yes.

DR KING: - - - it's also come out of some of the regulation that's popped up around securitisation - - -

MR MCPHEE: Yes.

DR KING: - - - since the GFC. Do you have any comments on that? I mean, how is that affecting your business model?

MR MCPHEE: Yes, I do. So, I found the way the securitisation markets have been handled in this country by a whole range of players has been terrific. You know, I was also at Adelaide Bank, I was the Manager at the Adelaide Bank when the GFC hit, which again, had quite a high level of securitisation. And of course, then there was the AOFM, which started buying parts of the securitisation.

The way that market has been built back up, the support by certain regulators or parts of the community, and also the change to what you can securitise or not securitise, and when you get your relief through the different sort of regulations, I think has been well handled and it's a good market out there. I think it's a genuine - should be - one of the funding sources that's available to the banks; I don't think it's a bad funding source. Everybody's sort of got that sort of image through the GFC - - -

DR KING: Got a reputation?

MR MCPHEE: Yes, it did get that reputation through the GFC. So, I think it works well and I think generally the players, the regulators right through, have done a good job.

DR KING: Okay. Any changes? If you had your wish book open and said, “Well, I could change this,” or - - -

MR MCPHEE: If I had the Treasurer sitting here, I might be able to answer that question on a more informed basis. If I can just take that on notice?

DR KING: All right.

MR MCPHEE: But I’m sure he’d have some ideas. But I just want to say, I think it’s been well handled. You know, it’s fine, we asked for certain things, I mean, we need to acknowledge when things have been well handled, and I’d say that’s been well handled.

MR HARRIS: Okay. I think I’m out of things to ask you about; are there things that we’ve failed to ask you about that you’d like to get on the record? I know that you’ve got - we could do LMI, I wasn’t going to - well, lenders mortgage insurance, it has become quite a topical item in the course of these hearings, versus the process leading up to the draft report.

We’re interested in how financial institutions go about pricing the product. Consumers pay for it, obviously, it’s generally incorporated into their loan; by the time they’re ready to qualify for the loan, they’ve really got limited choice, unless they push back on the size of it, and probably limited knowledge. It appears to be the case that relatively few financial institutions would go to market to test the price.

Amongst the larger institutions, I guess as a smaller institution you probably would go to market quite often, to get a price for this.

MR MCPHEE: So, our case in point is, we believe that we’d get - so our obligation is to act in the best interests of the customer, right? Because it sits with our core purpose, so we will drive everything from that perspective. And it’s not just what I say, it’s actually how we act and what we do.

We were exclusively Genworth, and we tender, you know, periodically; I think it would be two years ago we moved from Genworth to QBE. And the reason we did that is, we went out to tender; it was a good competitive tender, and we felt by moving to QBE at that point in time, it was in our customers’ better interest to do so.

We don’t believe it’s in our customers’ better interest to have the two, because on one hand if you’re big enough you can say, “Well, that creates the competitive tension” and then you can direct the flow as to where you’re getting the better value. For us, the better competitive tension is, we go out to tender on a periodic basis, and it gets to more favourable pricing through that way because it actually gives enough flow to get that cheaper pricing; so that’s how we deal with that issue.

DR KING: You just pass the tender price through to the customer?

MR MCPHEE: Yes, and if you actually had a look at the two proposals, what you'll see is, we went for the proposal that ultimately was in the customers' better interest, so there's nothing in it for us other than to make sure we're acting in the customers' best interest.

The fact is, I take the point that by the time the customers talk about LMI, they're a fair way down the track, however, you will find that customers will challenge - not all, of course - but will challenge the LMI and that does become part of the overall decision as to whether they go with lender A or lender B, simply through the mortgage broking space because that's when they get the comparison, "Well, here's the rate, here's the fees, here's the LMI. This LMI is say, \$4,000, this LMI is \$3,000." Does that thousand dollars difference, when you're taking those other things into consideration, mean that the consumer is better going with lender A rather than lender B? So, also, price tension does happen at some stage during the consumer making the decision.

MR HARRIS: Okay Jamie, thank you very much for your participation.

MR MCPHEE: Thank you.

MR HARRIS: And the round table submission here today; hopefully we'll be back in touch with you again before the completion of this inquiry.

MR MCPHEE: Thank you.

MR HARRIS: Thanks for your time.

MR MCPHEE: We will definitely put in another submission with our regional peers. We appreciate your time, and again, we thank you for the quality of the reports, so thank you. And thank you.

MR HARRIS: Okay. So, we are now going to close the public hearings in Melbourne. And for the purpose of this inquiry, I'd like to thank again, through the electronic distribution mechanism, all the participants who've made time to come along and endured our questions. And we'll indicate, once again, that we have a period open for submissions until 20 March; certainly, hoping to get increased participation as a result of the attractiveness of these hearings, and the comments that have been generated.

And, that we expect to have a final report in the Government's hands by 1 July. Otherwise, I declare the hearings closed.

ADJOURNED AT 1.36 PM