



**Australian Government**  
**Productivity Commission**

**PRODUCTIVITY COMMISSION**

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

**MR P HARRIS, Commissioner**  
**DR S KING, Commissioner**

**TRANSCRIPT OF PROCEEDINGS**

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**MR HARRIS:** Good morning, everybody, and I'm going to open the public hearings for the Productivity Commission's Inquiry into Competition in the Australian Financial System. There are three commissioners on this inquiry, two of us are here today. Our third commissioner is delayed by health issues in Melbourne. So Stephen King is on my right, and I'm Peter Harris, Chairman of the Productivity Commission. I would like to offer a welcome to country. I would like to acknowledge that we meet on the land of traditional owners of the Gadigal People of the Eora Nation in a place called Sydney.

The purpose of this round of hearings is to facilitate some public scrutiny of our draft report and we're going to assume that people who are submitters have read the draft report. I would also note I did a speech on Monday to CEDA which tried to explain some of the thinking behind some of the parts of recommendations that appeared to have been the subject of public comment and perhaps may not have been as clearly understood as we would have liked. So for those of you interested in it there is this speech on our website which I did to CEDA on Monday if it's also potentially relevant.

Following this hearing today and tomorrow in Sydney we will hold hearings in Melbourne and then we'll be looking to do a final report that should get to the government by 1 July. What that means in practice for people doing submissions to us is we're looking for submissions on the draft report by 20 March, we'll then go into a phase through April and May which is about recutting and recalibrating findings and recommendations and analyses that we've done.

Then the final report, as I said, will be available to the government by 1 July. The government decides when that report is published, not us, we publish the draft but the government publishes the final. They have 25 sitting days in which to decide to publish. That is a longish period. Based around parliamentary sitting programs, it could be some months.

We like to conduct our hearings in a reasonably informal manner but there are quite clear structures in our legislation for how these hearings are legally backed. A full transcript is being taken, we're also live streaming. We say that we're out of the experimental phase for the live streaming, and today is the first time I think we've done it, as if it is going to be a permanent product of our communications area in the Productivity Commission. So for those who are participants today you are on live streaming as well as being recorded.

We don't ask participants to take an oath but according to the legislation participants should be truthful in their remarks. Participants are also welcome to comment on issues raised not just in their own submissions but by others in the course of the inquiry. There will be a transcript made available, we plan, within a week from each of these hearing dates so you can follow this more permanently in a written form as well.

Now I should ask people in their remarks potentially to ensure that they are not defamatory of other parties. As hard as it is to believe we have actually had one or two examples where people have come along here and sought to - well, we worry that they might be putting themselves in a position of defaming an individual so it's important to be careful about not

targeting persons with your remarks.

In the unlikely event of an emergency there is an assembly point here, I'm going to rely upon the lead technician where we meet to be able to guide you but you can see the green exit signs and if you hear the alarms and we're all clear I'm sure with that, follow the green exit sign to where the staff will advise you about the assembly point. I think it's Hyde Park somewhere but I guess most people won't necessarily want to go all the way to Hyde Park they may just want to make sure they've exited the building safely.

Our first participants today are going to be representatives from Choice and I invite them to identify themselves for the purpose of the record.

**MR KIRKLAND:** Thank you, Chair. Alan Kirkland, CEO Choice.

**MR O'HALLORAN:** Xavier O'Halloran, Policy and Campaigns Team Lead.

**MR HARRIS:** Do you want to make any opening comments?

**MR KIRKLAND:** I will just make a few brief opening comments, thank you. In I guess opening the conversation this morning I would observe that it's a perverse thing that at a time when there is plummeting confidence in major financial institutions, particularly banks, which you see recognised by the fact that the banks themselves through the Australian Bankers Association have launched a major series of initiatives to try to rebuild community trust, or to stop that erosion of trust, and also at the political level by the establishment of a Royal Commission, so at a time of this plummeting consumer trust you at the same time have got major banks with a persistently high market share and very low rates of switching.

So those factors indicate that there is a lack of effective competition in the banking market, and that that is indeed something the Commission has obviously observed. To go back to some of the observations in our original submission we would say that in looking at competition there is no shortage of supply side competition. While there has been some consolidation in the ADI market due to mergers and demutualisations in recent years there are still plenty of institutions and there are also plenty of offers in the market for all of the major financial products.

So while there are certainly some things we can do to improve competition and create a more level playing field on the supply side, as the draft report identifies, we would argue that the bigger challenges and problems are actually on the demand side. Just a few thoughts on what that might involve. Firstly, we need to make it easier for consumers to understand and compare products. That's a particularly basic feature of any marketing which shares competitive pressure. That includes making the actual costs of products more transparent and giving consumers control over decisions that have costs embedded in them, and there are a number of examples where that's not the case now.

We also need to make it easier for consumers to obtain advice that helps them to make decisions that reflect their best interests, given they're often required to make decisions about very complex products and many consumers seek advice to assist with those decisions. Related to that, we need to reform commission structures that discourage consumers from choosing the best offer and from switching to a better offer down the track. So they're a few of the key things we hope to focus on today as we discuss some of the specific recommendations and findings.

**MR HARRIS:** Thank you for that. Stephen, do you want to open up with anything specific?

**DR KING:** Yes. Let's just start off with the last one, which is the consumer power bit. We've got some recommendations on improved information, we know open banking is under way, obviously very happy with it building on our earlier data inquiry recommendations. At the same time we get told that consumers don't read terms and conditions, they simply take it as given.

There is no scope for negotiation. In what sense, and we've seen past examples such as tick and flick in Australia, we've seen bank account number portability in the UK, to what extent do you think those demand side reforms are actually realistic? Are they going to have an effect? If they're going to have an effect where will they have an effect? Are we missing anything in what we've looked at at the moment?

**MR KIRKLAND:** I think that all of those reforms have potential to have effect but if we do open banking alone without looking at some of the other features of the market then we potentially just make it more efficient for current models that produce bad outcomes to operate. So to give you an example, if we introduce open data but without dealing with the way in which commissions are paid then what we're going to effectively have is much more efficient mortgage broker models that still produce significant conflicts in a way that is anticompetitive and favours major players.

So open data has significant potential to make it easier for third parties' advisers comparison services to help consumers to choose financial products but only if some of those conflicts are removed that influence the sorts of recommendations that are made now.

**DR KING:** A follow-up then on that you raised mortgage brokers and third parties a couple of things I'd like to touch on there. The first one - in fact I will do them in reverse order. The first one is that you mentioned commissions and the way that mortgage brokers are paid. Do you want to expand on that, and obviously we've got a request for further information to look at those commissions, and particularly trailing commissions, and try and understand their rationale better?

**MR KIRKLAND:** Certainly, it is very hard to understand the rationale for trail commissions, I mean the only rationale you can really see for a trail commission is to ensure that once the consumer has taken out a mortgage that they stay in that mortgage and are

never encouraged to review their circumstances and consider switching. We acknowledge some of the changes that have been agreed by industry to commissions.

So removing volume based commissions largely, and doing some of the soft dollar payments will result in some improvements but obviously leave trail commissions in place. Trail commissions, particularly if they're accompanied by commission clawbacks, simply encourage brokers to never approach a client again and encourage them to review their circumstances. It's hard to see how that in any way helps either consumers or encourages competition in the market.

**DR KING:** Can I push you a bit on that, because your response is the exact opposite of the public response about the mortgage brokering industry who have said publicly that they view trailing commissions, or trail commissions, as being essential to ensure that they continue to service the client over the term of the loan. What's your response to that claim, that they create an incentive for the brokers to provide ongoing service?

**MR KIRKLAND:** Well, the trail commissions are not being paid by the client. The trail commissions are being paid by the lender. So I don't understand the argument that says that it encourages an ongoing relationship with the client. Indeed, it's hard to see how that would create an incentive for a broker if there was a better offer available in the market to encourage the consumer to switch, which is something that you want to encourage. We don't want ridiculously high rates of churn, particularly if commissions are being paid because that will ultimately add costs to end users, but we do want a situation where consumers are encouraged to review their circumstances from time to time and where it's in their best interests to switch products or switch lenders.

Trail commissions discourage that. Another sign of the problems that we see is the fact that trail books are for sale on the open market. So we saw one example of a trail book for sale for around \$40,000 on the basis that you would expect a trail income of \$1600 a month plus GST. So when the trail books are actually being sold to a different mortgage broker it's hard to see how in that situation this claimed ongoing relationship of trust and advice would continue to exist.

**DR KING:** We also raise the possibility, because it has been raised with us, about moving to a completely consumer pays model for mortgage brokering services, any thoughts on that?

**MR KIRKLAND:** I think it's important to acknowledge, as indeed the Commission does in the draft report, that consumers are in fact paying now, that commission is added to the cost of mortgages, and the Commission has estimated it could be as much 16 basis points. So the question is if consumers are paying how do we make sure the way in which they're paying actually facilitates greater competition? We would say if there's more transparency about what people are paying then that is likely to encourage greater competition.

That if that replaces the commission model it removes the risk to competition that we've described as arising from trail commissions, and indeed from commission clawbacks. So

it will be vastly preferable for consumers to pay. That would also encourage more competition on the basis of either price or on differentiation of service offered to consumers. Because there is nothing in the current arrangements that really encourages brokers to try to offer the best value service or the highest quality service to a consumer and who is approaching them for advice.

**DR KING:** Even though the mortgage brokering industry say that moving to an explicit consumer pays, so ending commissions, would destroy the mortgage broker industry, you don't agree with that or you think that - what's your view on that?

**MR KIRKLAND:** My view on that is I guess I'm able to draw on advice in other sectors. It's only a few years ago that we faced a similar debate about financial advice and there were very strong arguments from the financial advice industry that said that if we removed commissions from the financial advice model and moved to a primarily consumer pays model that it would destroy the industry. Several years into those reforms being in effect there is no sign of the financial advice industry reducing in size or disappearing. So all I can do is point to that as a parallel that where we had this argument, that if consumers have to pay they're not going to do so, that has not been the case in financial advice.

**DR KING:** Do you think that - because financial advisers has been brought up, again one of the things that we've asked for more feedback on is the potential for financial advisers who can't currently offer advice on credit products such as a home loan to be able to offer that sort of advice, what is your view on that? Yes, start with that and I might push a bit further?

**MR KIRKLAND:** We think that idea has merit as long as the current duties that apply to financial advisers continue to apply whether they're providing advice on a mortgage. So that's in summary of best interest duty, a duty to consider all of the clients' circumstances and provide the clients what's in their best interests. So if that duty continued to apply and they were able to provide mortgage advice without requiring a separate licence then we think there's merit in considering that.

It would be interesting I think to look for evidence around the impact of the current models. We understand there are some businesses that are dual licensed with a credit licence and a financial advice licence. It will be interesting I think to speak to ASIC and potentially some of the consumer casework organisations to see if they see any particular problems emerging from those integrated models. But in the absence of any evidence we think the idea is worth considering.

**DR KING:** Again, the mortgage broker industry response has been, well, it shows a lack of understanding by the Productivity Commission. That it will just mean that there's one class advisers. Do you think, you know, in other words there won't be mortgage brokers and financial advisers any more they just think there will be a broader class of financial advisers, do you see that would be a consequence, and if so can you see any problems with that?

**MR KIRKLAND:** I don't believe that would be the consequence. I mean, just to explain what we'd like to see in its entirety, we would like to see the application of a best interest duty to all mortgage brokers and not just those who are part of vertically integrated models. Perhaps we can come back to that issue. But if that were the case and you also allowed financial advisers to provide mortgage advice without being separately licensed then there would still be a lower barrier to entry to be a mortgage broker because there are a number of other qualification requirements which are increasing over the next few years that apply to financial advisers. So it would be, even if the one duty applied, it would still be easier to become a mortgage broker with less obligations than it would be to become a financial adviser. So I think you would still see both models operating within the industry.

**DR KING:** The last one - - -

**MR HARRIS:** Don't go too far away from trailing commissions because I want to ask about that.

**DR KING:** All right, my last one then I'll put back to you on trailing commissions. The last one that I had because it was just raised there, the duty of care obligation that we've raised as a possibility for lender-owned aggregators. You've just said that you'd prefer to see that extended to all mortgage brokers, how would you see - do you see that as being enough, would you prefer to see stronger obligations along the sort of broker lines, do they make sense in mortgage broker and how would you like to see them implemented and enforced?

**MR KIRKLAND:** We would like to see a duty that is much closer to the paper test of best interests. I mean there would need to be some consideration to the detailed drafting around the degree of investigation of a client's circumstances to form a view on best interests and whether that needs to be exactly the same as in a financial advice area or whether it might be framed slightly differently, but ultimately the test should be about best interests. Because we think it's actually placing a lot on consumers to understand that when they go to different types of service providers who appear to be doing roughly the same thing they actually know - the experience fundamentally different standards of care.

I guess we would also have a concern if any higher duty, whether it's a duty of care or some sort of general duty of care, or other best interest duty, if it was only applied in vertically integrated models. Because we don't see vertical integration as the sole cause of poor mortgage advice to consumers, consumers often get poor advice from independent brokers as well. Often that's poor advice that's about the choice of lender. So unless you actually apply a best interest across the industry you won't be dealing with that.

We'd also be concerned that if the best interest duty only applied to brokers in vertically integrated models then there's still an incentive for lenders with significant market power to establish preferential relationships with independent brokers, it's just it will no longer be as attractive to do that through ownership. They will still be able to do it through commissions and other business arrangements. So I don't think that the - I can understand why from a competition angle it seems attractive to apply a higher level of duty to those in



vertically integrated models but I don't think it will actually resolve that issue of lender choice conflict as ASIC describes it because I think that other business models will evolve and develop very quickly that maintain that conflict.

**DR KING:** How would you actually see it working in practice? I mean a criticism of quite frankly broker type regulations is that they all sound very good, how do you make them implementable, how do you make sure that the broker or the broader adviser is actually acting in the customer's best interests, is actually only providing them with opportunities or products that are in the client's best interest? I mean, you know, it's a criticism that exists with the current laws so extending the current laws to brokers is going to raise the same sort of criticism?

**MR KIRKLAND:** I would argue that while the broker laws are in a way still something the industry is getting to know that they are working relatively well. Because they provide a clear standard the regulatory environment then applies when looking at the work of financial advisers so it applies a different standard, it provides a different standard that is implied by an external dispute resolution body such as the Financial Ombudsman Service when it's dealing with complaints.

It then provides also a benchmark that ASIC can use when it's investigating the processes of financial advisers, whether that's through shadow shopping or file reviews, or indeed talking to a financial advice business about problems they themselves have identified. So there have been a series of cases in recent times where major businesses have announced remediation schemes based on not having complied with the laws. So I think we're starting to see that have effect and it provides a clear standard that external bodies can apply when looking at the work of a financial adviser and I think the same would apply with mortgage brokers.

**MR HARRIS:** So not having really departed too far because it's still on the topic of progress on this trailing commissions thing. So the insurance industry once was very much dominated by trailing commissions. I don't know the degree in which it has been eradicated but it appears to be fair less common as a sort of driver today. If I recall it correctly, the rationale was pretty much the same, we like to have these arms' length sales parties that will, "look after the customer", but rarely was there any evidence of those parties becoming, if you like, a constant source of information to people about their income protection insurance or whatever and other insurance they had been sold.

So is that experience also indicative of the fact that we wouldn't necessarily see, you know, a complete collapse of the third party sales model if trailing commissions weren't in place? Is the insurance industry a good sort of indicative example of the same thing?

**MR KIRKLAND:** I think it is. I mean it's similar to financial advice so where we've moved away or at least reduced the role of commissions in the system, and particularly though it's more in favour of user pays, we can see those third party models disappear.

**MR HARRIS:** So our focus here is really on these incentives for brokers in relation to information provision because that's the thing that consumers most self-evidently need in a complicated market, they need forms of information that are useful and easily utilised. You would think if a broker was acting on behalf of a consumer via this pay for service that there would be a flow of information, is there much evidence of a flow of information from brokers to individual consumers about the better deals being offered this year versus the deal they got last year?

**MR KIRKLAND:** We're not aware of any. I mean, our sense of the market is that the broker relationship is very much a point in time relationship and once the mortgage deal is closed it pretty much ends there.

**MR HARRIS:** What about the banks themselves, I mean, they're quite powerful players in this, they're the ones paying the money as we point out, whether it's asserted or not that it's actually a relationship between the borrower and the broker it's actually a relationship paid for by the provider of the loan. Why don't we see banks dealing with this directly? I mean, you would think they would be interested in this apparent disincentive. We've seen in comment churn is a problem. We'd like to use this to discourage churn. I haven't actually seen it said by the banks but I've seen it said by the brokers, on behalf of the banks I guess. But why don't we see the banks managing this sort of relationship in the consumers' interests, why is that not evident?

**MR KIRKLAND:** I think, I mean our sense is that the banks have a love/hate relationship with brokers. Because on the one hand, on the hate side I guess, they resent the high commissions that they have to pay to get mortgages that are originated by brokers. On the other hand it's a very effective channel, and we know from the ASIC data that it also tends to bring in higher value loans. So I think in the current arrangements it's very hard for banks to let go of the broker channel because it will have a huge impact on the amount of mortgages that they're writing.

**MR HARRIS:** We also commented in the draft report and to date I haven't seen anybody come back with any advice so I'm going to ask a few people the same question, but if you go directly to a bank and you obtain a loan you're not getting any reward for avoiding the imposition on the bank of that commission chunk of money up front and trailing commission, why is that the case?

**MR KIRKLAND:** I really hope some other witnesses can help to answer that question for you but it's a very apt observation and it just I think goes to that point, it sort of helps to demonstrate the point that consumers are actually paying for some things that happen in the system, absorbing some costs, but it's in a way that gives them absolutely no control over many of the services that are provided. So that's where you get these funny distortions where you don't see flow of value to consumers where you would expect to see it.

**MR HARRIS:** Yes. The introduction of, I will call them financial advisers, has potentially if that recommendation firms up as an alternative source of advice to consumers on, as it were, how to obtain a loan. I mean, in the financial services industry, as I understand it,

there are actual rebates paid that can benefit investors. There's no such thing as a rebate here, apparently, for a person who says, look, I'm only after simple advice, I don't expect to see a \$3000 upfront payment made. Perhaps do you think we might see some alternative forms of remuneration develop if we allowed financial advisers into the brokering channel?

**MR KIRKLAND:** I don't know but I would hope that it would create opportunities for rebates where they're paid to be passed on to consumers because consumers have really got no way of expecting that at the moment.

**MR HARRIS:** Yes.

**MR O'HALLORAN:** Although that said, it becomes a kind of funny business model. We've seen some mortgage brokers offer to rebate commissions to consumers. I think it almost creates an extra complexity for a consumer trying to figure out what the best deal is for them if they're having to factor in a rate as well as a rebate to compare different offers and find the best one for them.

**MR HARRIS:** But I want to stick with that, I'm glad you raised it because we did get submissions, a couple, from the individual brokers who told us that their business model was in fact going to be based around rebating some part of the upfront payment that on the average loan, the two and a half, three and a half, thousand dollar kind of amount, back to the consumer and that they were deeply discouraged from doing so by other industry parties.

Now, I don't know whether that's common practice or just bad luck for the parties who are proposing such a business model but it does suggest alternative thinking, which is why I asked the question prior to this one, it does suggest alternative thinking about potentially rebating some of that commission up front. So are there business relationships here of an informal kind that can prevent new style brokers, if you like, offering to rebate commissions, and if so isn't that an issue for the banks themselves as well? I mean, they're the ones paying this, wouldn't they be interested in new style broker arrangements which offered back to consumers a bit of a rebate?

**MR KIRKLAND:** I don't think we're in any position to comment. That's an interesting observation.

**MR HARRIS:** Just people say we don't understand this particular commission sector, and you can clearly see I don't understand something like that. I sort of don't understand who is the powerful party inducing this kind of behaviour and structure. If there is no powerful party inducing this kind of behaviour and structure, that's a really unusual circumstance. Generally speaking somebody here is instituting this arrangement. Anyway, that's enough on trailing commissions. People are probably bored silly by the whole concept on how far it might go. We should probably turn onto other topics. Again, I - - -

**DR KING:** Yes, but just before we leave, because Julie is communicating with me via distance.

**MR HARRIS:** Sorry, yes, our commissioner remotely in Melbourne.

**DR KING:** Our commissioner remotely who unfortunately was unable to travel today was interested in just a few more details on financial planners moving into the credit space, if I can call it that, and the sort of risks that you see in there and how you actually would see that operating in practice, you know, is it actually going to be viable. What are the things, you know, if we say, yes, this looks good, we're coming up with a discussion leading up to a final recommendation, what are the caveats that we need to put in there, what are the things that we need to show, hey, don't forget this when you're designing the system?

**MR KIRKLAND:** I think that we need to be reminded, and if one of the assumptions is that it's safe to move to that system because much higher standards apply to financial advisers, and that's only partially true at the moment because of the nature of the transition period of a number of the changes around financial advisers. So the best interest duty does already apply.

But some of the new requirements around education and qualifications are being phased in very, very slowly so in the financial advice industry there are a number of people who would have levels of qualification that are very similar to some of the lowest level of qualification of mortgage brokers, so at least for the next sort of five or so years. But there's not necessarily a significant gap in the level of qualifications between brokers and advisers so that's just something to be mindful of in the transition period if this needs to be measured.

**DR KING:** Okay.

**MR HARRIS:** So here is what might for many who will be considered to be a sort of sub issue in all of this but it's intriguing again for us, so this is this idea of the intensity of policy effort that's gone into from time to time trying to address the ability of a consumer to change banks and this flick and tick kind of process. Now in analysing this, as you probably could see from the draft report, we sort of started out thinking that could be quite important but increasingly it became evident that, to our thinking at the moment, which is why I'm asking you to comment on it, that, look, this may be last century's issue.

It may not be so important now for consumers to be able to readily change banks by shutting one account and opening another, if indeed accounts are, like, cheap. You usually seem to be offered one if you change just a product to another bank and get a credit card to another bank and go to a home loan with another bank even though your primary bank is somewhere else. You can have payment arrangements rapidly forward back. So I'm just wondering whether this whole flick and tick thing is likely to be, as I said, an important issue last century but perhaps less of an issue now and perhaps even without wanting to say that technology solves all problems with a new payment system perhaps even less so today. What's your view on flick and tick in that context?

**MR KIRKLAND:** I think that the combination of open data, open banking, and changes to payments technology will mean that it's much easier for people to switch banks.

Probably our focus on some of those more rudimentary forms of switching will be less important in the next little while. So I think that, you know, models that require consumers to sort of go to a new lender and have them change all of their direct debits over are probably less important. So it will be increasingly easy for people to cancel an existing direct debit or automatic payment arrangements and set up new ones.

**MR HARRIS:** In that comments on the new payment system we did point out that it appears to be currently set up primarily about single individual payments whereas if you could enable your persistent payments, your once a month payments, your health insurance or your, you know, fill in the blank, the sorts of things that are regular deductions, to equally be switched by simply offering a new identifier that linked to your current account that would solve also a substantial part of this problem that has been alluded to in terms of people finding it complicating to shift their regular payments across. Would that be right, are we on the right track there? We're introducing a new payment system, as you might be able to tell, for whether it can actually solve problems in the future rather than simply be an efficiency device.

**MR KIRKLAND:** We haven't looked at it detail but I think it is, whatever the arrangements, it is important that we think about how we make it easier for people to change to those regular payments. I think probably the solutions are probably different to what we thought they were about 10 years ago. It's not an area we've done a lot of attention for.

**DR KING:** You mentioned earlier on just on that the importance of third party providers, we sort of side-tracked into brokering from the first discussion, now any thoughts, have you got any particular recommendations of where we should look for examples of these sort of innovations overseas or in other product areas where technology has essentially reduced switching costs by enabling third party providers to use data to better help consumers?

**MR KIRKLAND:** I'm not aware of any really well developed models. I think in a way the commission looked at this quite well in its work on a consumer's right to their data. I think the examples we're most aware of are in the UK where, you know, the early attempts involved opening up data in a way that will allow consumers to download their transaction data into Excel Spreadsheets and then upload them into something else, and clearly those types of systems don't work, it needs to be as seamless as possible.

We need to make sure that the sort of data that can be extracted is the sort of data that consumers need in order to make decisions and switch. So for example, it's relatively hard at the moment to identify all of your regular payments, it's a very manual process, and if we ensure that open data is implemented in a way that allows you to quickly do that then potentially you've reduced the switching costs quite a lot. Because that's a product that the third party can build, they can identify all of your monthly or quarterly payments and it's then easy to sort of facilitate you moving them to a new credit card or a new bank account.

**DR KING:** A side point on this, in your earlier submission you had some switching data from 2014 that you were able to provide us so thank you very much for that, do you have any more up to date data that you're able to - - -

**MR O'HALLORAN:** I don't think we do, no.

**MR KIRKLAND:** Unfortunately, no.

**DR KING:** We're always interested in data, any - - -

**MR HARRIS:** We'll ask, we've got the begging bowl out for data for everybody, you know. It was a theme in Monday's speech too, like it's really interesting, there's huge amounts of - numbers and numbers collected in this industry and not as much data as you might imagine for analysable purposes.

**DR KING:** Just a final one, because the issue of different products and the different ways customers interact with different products was raised and the terrible economic term is, "multi homing", for where customers hold, for example, multiple current accounts with different banks. Now obviously not likely to be a strategy many customers do with their home loan, for example, or the banks would certainly get very upset as to order of the rights of everybody's home loans. Do you see differential problems for people, we concentrate a lot on the lending side of the market or of the platform, which is bank, and we haven't concentrated as much on that deposit side because it doesn't seem that they're the same sort of problems. One of the potential reasons for that is customers, well, I'm sick of this bank I'll just go next door and open a bank account there and I actually don't close the one at Bank A even though I've opened one at Bank B, or I'm sick of that credit card at Bank A, there's a Bank C is offering a good transfer deal so I will just open one up but I don't close the other one. Do you see customers engaging in that sort of behaviour, is that why we're not seeing the same sort of angst on that deposit side that we're seeing on the lending side?

**MR KIRKLAND:** We would say it's interesting. If you compare Australia to the UK there's a much bigger focus in terms of competition on current accounts or transaction accounts in the UK. But that's because the whole market works in a different in that to some extent current accounts there play the role of personal loans and to some extent credit cards play here because there's a much - overdrafts are a very common feature of the UK system whereas they're not here.

So that means that transaction accounts are a pretty low stakes decision in Australia, they don't involve on the whole - well, there are examples of people having to pay unfair fees, on the whole they don't involve significant costs to consumers. So we think you're right in not having so much focus on the area of transaction accounts and having greater focus, relatively greater focus on mortgages and credit cards. That's where the greater costs to consumers occurred.

**DR KING:** Following up on that, are there concerns about the bundling activities of banks? So I mean it is now the case that you go in and you're after a home loan and you get a credit card with it and you get an account with it, and you get a mortgage offset account with it, and there's incentives in some of the banks and in some of the brokers to make sure you take out the biggest loan possible and when you say you don't need it they say, well, don't worry about that, mate, because you've got the mortgage offset so you're not actually going to pay the interest anyway but it pushes up my bonus, that sort of bundling behaviour, has that been something that's been on your radar and is that a concern? Because again it's not something that has come up a lot to us, we've mentioned it in our report, in our draft report, but that's about it.

**MR KIRKLAND:** We are concerned about it, and it's one of the reasons that we think there needs to be a lot of focus on mortgages because the mortgages are from the anchor product for a range of other bundled products, transaction accounts, and particularly credit cards because a package might often involve a waiver of an annual fee for a credit card, perhaps a credit card that's got a high value rewards program or what's described as a high value rewards program.

So the typical pattern would be you take out a mortgage, you get an offset account, you're offered a credit card with this what appears to be an attractive waiver of a high annual fee but that credit card will be a credit card with a relatively high interest rate, significantly higher than the best rates on the market. But the nature of the bundling means that it's a very complex set of decisions for a consumer to understand and compare to what it would look like if they unbundled those products and compared them to others in the market, the mortgage against other mortgages, the credit card against other credit cards.

That sort of the nature of the discounting and the mixing up of fees and charges versus interest means that it obscures what for some consumers might in fact be the most important decision in relation to the credit card which is what's the interest rate, because if they're not repaying their entire balance every month then the interest rate is a very important driver of costs. We see a huge spread in credit card interest rates from the best on the market to those that are typically offered, especially by the major banks.

**DR KING:** What about the mortgage offset accounts which - I mean, we have heard stories that the way commissions are paid both internally and externally from banks encourages those, I've always wondered a bit about the Australian Tax Office's view of mortgage offset accounts, but from a consumer perspective are these a dangerous product, are they a product that you have concerns with, or are they wonderful and provide extra convenience, what's your view?

**MR O'HALLORAN:** It's not something that we've looked at deeply, so we haven't really considered what the consumer harm is there, I know the anecdotal evidence is that people do at times like having that facility available to them and can use it as an opportunity to save part of what they might otherwise put into a savings account because the interest rates are much better than they would probably achieve in any savings account. So, yes, but we haven't looked deeply at all the issues surrounding it.

**MR KIRKLAND:** We would be concerned if the incentives around mortgage offset accounts mean that people are having a higher mortgage accrued from what they're actually seeking, if that then exposes them to greater risk, but we haven't got a lot of evidence if that is happening now.

**MR HARRIS:** You've been pretty active in this area for a fair time, and we obviously only since the middle of last year, so there are quite a few things that you will know more about than we will, and one of them surely is this opacity, this uncertainty about what actually is the price when you go for a loan. There are these things that exist in the finance sector, these standard variable rate concepts, and then the incredibly interesting thing called the comparison rate which extends obviously well out beyond home loans to many, many loans.

As you probably can tell from the draft report because the way we do our work is we start from the absolute zero and try and understand why something is the way it is, and this one has been particularly difficult to understand. We're yet to find the industry expert again who can say to us, you know, a comparison rate is absolutely vital and is built this way and that proves its vitality, its crucial nature. So I'm going to give you the chance to tell us, particularly in the context that we've otherwise recommended that we can see from digital data today that it is readily possible to publish what last month's, you know, Sydney Western Suburbs income of \$90,000, \$350,000 mortgage was in each institution.

It is really possible now to publish the actual real time number. No one has done it but it's not beyond the bounds any more of technology to do it and so we've recommended that kind of reality pricing as against this unusually opaque kind of pricing structure. So can you tell us a bit more about why it is so and whether consumers are in any sense, you know, at risk as a result of this opaque stuff?

**MR KIRKLAND:** I think the idea of a comparison rate is a good thing because it's very hard for consumers to understand whether the rate that they're being offered is a good value rate or not. To some extent that opacity I think then feeds the market for mortgage brokers because people have no way to be confident that what they're being offered is a good rate so they seek assurance from a third party, although they're not guaranteed that that's what they will get. So the idea of a comparison rate is a good thing but only if it reflects what's actually happening in the market.

So we think that it will be much better to move to a system where you've got data readily available that reflects what rates that consumers are actually getting in the market. I think that probably it would be best if that the data that was published was not just the average rate for consumers in a particular class, whether or not that's in the way that you've described or defined in some other way, but not just the average rate but also the spread. So for people like me what's the lowest rate that people are paying today and what's the highest rate and what's the average or medium?



Because I think people need to be able to sort of understand what's the scope for negotiation, because that's one of the complexities in this market, is that whatever the published rate is, whatever the average is, there's always a degree of movement in what's the rate you may actually pay. People have no way of knowing how much they may be able to negotiate at the moment.

**MR HARRIS:** Yes, you can tell from the report we're a bit wary about averages, there's a lot you can do to average within a range.

**MR KIRKLAND:** Yes.

**MR HARRIS:** It may not make it indicative if deliberately chose medium simply because it is a reality as well, there is a medium and can be found in each range. So ranges, yes, but certainly medium seems to be a better - well, in the statistical sense anyway a better way to try and offer information in our current judgement. Do you think if we had this that comparison rates would disappear? I mean one of the rationales put to us is well a comparison rate can also absorb the average cost of fees over the average life of the average loan. We think well that's probably useful information if everybody believes they're average, but if they don't it may or may not tell them anything useful. So do you have a view on that?

**MR O'HALLORAN:** Yes, I guess a lot of people aren't average without feeding in their specific mortgage details then the comparison rate isn't going to give them an accurate reflection of what the rate is that they will actually be paying. So, yes, I think that's correct.

**MR HARRIS:** As certain fees get phased out but the comparison rate doesn't alter it might suggest that either those fees were irrelevant in the first place or if they're reasonably significant numbers, as some of the fees that have been phased out seem to be, that you may not necessarily have again a market relevant benchmark. Or so we've been advised. Is that - - -

**MR O'HALLORAN:** If that happens with fees I guess I would be wary of the way banks might try and gain the system by moving fees around to make comparison rates look cheaper, if we move to a different model that didn't include fees as a component of that that would add to more confusion, I think.

**MR HARRIS:** To the best of your knowledge, does comparison rates include the upfront payment to a broker?

**MR KIRKLAND:** We have no idea. No, I don't think - - -

**MR HARRIS:** Yet you've been in the game a long time and you don't know that. People say to us we carry a burden of ignorance, and we say yes we do, can someone tell us why this is the case. Again it's hard to work out but it's 3000 bucks that's been added in the last 20 years, probably less than that, really, and it's an interesting question about whether

it features in the comparison rate or not. But maybe as a result of me asking you this question some other person listening will tell us the answer to this.

**MR KIRKLAND:** Absolutely.

**MR HARRIS:** We'll be very interested. But it doesn't seem to take away the point that it's quite an opaque set of pricing structures that are available to consumers and a very unusual thing for particularly for a really big product of a long term nature. So you would think that at least we can add some value by getting real time pricing out there into the market place. Thank you. What else have we got here that I need to ask?

**MR KIRKLAND:** We were keen to make some brief comments on LMI.

**MR HARRIS:** That was actually the next one. I knew there was a link in LMI because it's interesting, isn't it, we were struck by the number of borrowers who are subject to LMI. It's quite remarkable, a quarter or something, a bit less than a quarter of first time borrowers are subject to this. It too is a quite opaque market.

**MR KIRKLAND:** It's an extremely opaque market. So on the one hand you've got lots of borrowers subject to it, on the other hand you've got very, very few suppliers. Two of them are owned by major banks. So that's says to us there's something wrong. If you look at LMI, I mean, I think it's very hard to justify the existence of LMI in its current form - -  
-

**MR HARRIS:** Sorry, for everybody, anyone listening that is up on the stream, lender's mortgage insurance, an insurance which insures the bank but is paid for by the consumer somewhere.

**MR KIRKLAND:** So that's an important point. Let's start there. So this is not insurance that covers - provides any value to the consumer, it provides value to the lender by ensuring them for risk of default by the consumer. So if we think about it this applies to borrowers who are deemed to be at higher risk of default. It's our understanding that in many cases those consumers are already paying some sort of interest rate premium. Again, I think it would be hard to demonstrate that and it would be interesting to ask other parties to the inquiry about that.

But our understanding is because consumers have got the ability to get a range of rates that people who have a lower - sorry, a higher LVR are more likely to be paying a higher interest rate to start with. Then those with that high LVR are required to take out this or to pay for this product yet they have no ability to exercise choice. It returns no value to them. It further adds to the complexity of decision between providers because alongside having to consider the interest rate, however you might benchmark that against the market, any fees and charges, the impacts of bundling other products in, you've then got to compare the cost of the LMI if you're required to pay it.

So it actually adds to the complexity of the comparison task. A further complication is consumers don't understand what it is. There's a reasonable amount of research that suggests that most people think that consumers are getting value from it because it's something that they've been told they're paying for, I think, and because they way it's described. So we would argue that LMI should end and far from simply allowing it to be refunded, which would provide some value, some improvement on the current arrangements, we would instead argue for an abolition of LMI.

We think that the extent that some borrowers represent extra risk than that risk should be priced into the loan so the price is more transparent, it's much easier for borrowers to compare products. If lenders feel or for prudential reasons they need to insure for some of that risk there's nothing that would stop them continuing to do that. We just shouldn't dress it up as a product that's being sold to consumers, because it's simply not.

**MR HARRIS:** Yes. You've commented on this idea of refunds if you replace your loan within a reasonably short period of time so that the insurance is still potentially insuring you but you've effectively just cancelled it and you get no refund. I know that's been tried before so we learned that in the course of this inquiry, and people found it very difficult to calculate a fair arrangement after the event at the time of calculation so we proposed that it be done at the time of the loan.

In other words that you might have a three year period of coverage effectively for your loan and as mortgage insurance and if you change your loan in that period you should get X dollars back from that payment up front. Again, that to us didn't actually sound like we created anything terribly novel, it must have been thought of before by somebody in the industry. To your knowledge, is that the case, is there anywhere we can find someone who has already worked out why this is a dopey idea?

**MR O'HALLORAN:** Well I guess our one concern with that would be how that product ends up being structured. So if in your example it lasted for three years and you've kind of got a reasonable payback on it if you switch within that period then, yes, that would be probably be fine for the consumers. At least it's been put to me by one of the representatives of the bank that the level of risk drops off very dramatically after a loan is taken out.

Say if in a different example they were only offering products that offered refunds within say the first six months or the first year then we might be back at square one in terms of what realistically refund the consumer might get on their LMI products. That's why we kind of looked at the proposal and thought that maybe pricing the risk begins with the value of the loan, it might be a cleaner and simpler solution. It also is easier for a consumer to compare products without having to compare the cost of this component product as part of their mortgage.

**MR HARRIS:** This is just because I'm reacting to the outline of your proposition, and we're all feeling our way here so this is not me trying to be dogmatic or anything, but in a circumstance where there was no LMI and instead the loan price itself reflected the relative

judgement about the capacity of a person to service the loan, and people with different loan to valuation ratios had different rates, all that sounds quite logical, but then what you're really saying is rather than the insurance being paid by the person creating the risk we would shift it into a generic form.

It would be up to a bank as to whether or not they then took those slightly higher priced because they were higher risk loans, bundle them up and brought an insurance product against them. Then that cost would be spread across all borrowers, I would assume, by the bank and therefore aren't you somewhat switching the liability from the party who is the risky party, the borrower, to all borrowers, wouldn't you be doing that?

**MR KIRKLAND:** We would expect that the banks wouldn't spread the cost across all borrowers, that those that represent a higher cost of lending to the bank would pay a higher cost, a very marginally higher rate. So, no, we wouldn't expect those costs to be spread across all borrowers.

**MR HARRIS:** Okay, it just seemed the path of least resistance to as it were bundle them up every three months and as it were sell them off to the insurance industry in a risk management sense. But, okay, no, I take your point.

**MR KIRKLAND:** But I think banks are accustomed to looking at their loan books and identifying the different risk profiles of different groups of customers. I mean, that's something they're required to do as part of the prudential regulation system anyway. So this would fit very neatly with that approach that they're already applying to be identifying those that present a risk for which the bank also needs to ensure. So we would expect it wouldn't be particularly difficult for banks to build that into the rate. To be clear, we're not suggesting that consumers would pay more under this system, consumers who are identified as being at higher risk at the moment are paying now because they're being required to pay LMI.

Then they're paying interest on top of that because in many cases they then add it to the value of the loan. So if you look at the sort of what happens through that process you've got some banks who are, well right through the process, some of them are making money from running mortgage brokering businesses, they're then making money from the mortgage itself, they're then making money from the LMI business that they own, and then they're making money from the interest on the LMI. That's an incredibly opaque sort of arrangements for a consumer to understand and build into their decisions about which product or which lender they go with. I think it's one of the factors that works against competition in this market.

**MR HARRIS:** Yes, it's not so much a problem that they make money off any of these individual processes, someone in order to offer the product is going to make money, it's more a question of whether the parties paying are either aware they're paying, isn't it, or if they are aware, that they have got a choice, that's what it comes down to in the end, isn't it?

**MR KIRKLAND:** Absolutely, from a competition perspective. I mean, obviously we're concerned that when people don't understand how the payments they're making are being distributed across the system. But from a competition perspective it's the fact that the person who is paying for this relatively expensive product actually has no control over the decision so there is no incentive to reduce price.

**MR HARRIS:** Did you want to do any on LMI?

**DR KING:** Just a very minor question, more a curiosity from my own background, and you may not be able to answer this, when first getting into this inquiry and finding out about LMI and that being an upfront lump sum fee where the customer seems to have no choice of who's providing the insurance, any reason why it evolved this way that you're aware of, why isn't it for an example an annual fee whilst you maintain an LVR a low rate or something like that which would - it just struck me as an outsider as being sort of the obvious way that you would sell an insurance product. But any thoughts on that?

**MR KIRKLAND:** Look, it's incredibly difficult to explain why LMI operates in the way it does now because it just doesn't make sense. The only reason I could give is because it's the simplest and most convenient arrangement for banks and that they profit fairly handsomely from it.

**MR HARRIS:** Right, that's all I have on - - -

**DR KING:** Sorry, a couple more things, actually, I will pick up on that last one. You've noted the degree of integration with the banks and the lack of often transparency as to who owns what and who you're dealing with, most obviously the brokers, but also for the LMI products and so on. One of our suggestions is just more transparency there making sure the customers know the data so if I go to Aussie for example and just pick one that's owned by the Commonwealth Bank, if I'm going to Westpac and getting LMI through them and that's actually a Westpac internally provided LMI, or provided by Westpac's LMI company, do you think that sort of transparency will have a significant effect? Is it important or is this sort of just, you know, customers aren't going to care, what's your view on that?

**MR KIRKLAND:** We're always cautious about expressing a strong view about the likely impact of changes to disclosure requirements because we know that disclosure often has reverse effects, so I think that we welcome a focus on the need for better disclosure in a range of areas in the draft report from ownership structures through to commissions if they remain the system. But we think that the form of disclosure needs to be very carefully tested with consumers to test what impact it has on behaviour. Because there is always a risk that a form of disclosure actually has the opposite effect or a quite different effect to what's intended and it could impact and increase the market power of major players when it's intended to provide a more level playing field.

**DR KING:** Really a different topic but one we haven't touched on, we do talk about the renaming and changing of general advice, your feedback on that and are consumers at risk

of misunderstanding current general advice or what falls under general advice, what are the benefits if you see any of change in that and how should we deal with it, is it just coming up with another name that doesn't sound like advice or is more detailed reform in that area needed?

**MR KIRKLAND:** We think more detailed consideration is needed. We have been long concerned about the term general advice because in reality no advice as a normal person would understand is provided in those situations. That's an additional concern when there are early signs that one of the impacts of the changes to the regulation of financial advice more generally and particularly personal advice means that some businesses are starting to shift to models where they purport to only provide general advice because lower requirements apply. So we think there's probably additional risk around general advice at the moment and in the near future. But again I would say any shift in terminology would need to be tested so we'd need to test whether whatever the new term is or proposed new terms are, how consumers understand them and whether they're actually understood in the way in which we intended them to be understood.

**DR KING:** Any potential risks of moving in that direction or you see generally this just being a good thing as long as it's tested properly?

**MR KIRKLAND:** In general we see it as a good thing as long as it's tested properly because we think the current term is misleading about what is actually provided.

**DR KING:** I just have one other one on another topic again so I'm just flicking topics a little bit. One of our information requests, which I've got up here, 10.1, is looking at - sorry, I'm trying to find it, the ePayments Code. Now I'm not sure if you're familiar with that. Really a question, let me start at a very general level, obviously we're looking at recommended as our draft recommendation expanding the coverage of the ePayments Code.

Our information request is, you know, looking at various ways the ePayments Code might be able to be improved, particularly for dealing with unauthorised transactions and who's liable for those transactions. Any thought on either the ePayments Code generally and our view that it could apply to any party involved in an electronic transaction and then if you're happy we'll go down into some of the details. But again, I don't know your background knowledge on the ePayments Code?

**MR KIRKLAND:** We've done less work on this issue than some of the other issues before the inquiry. In general we think the ePayments Code provides an important level of protection for consumers so we'd like to see it apply as broadly as possible. We haven't really thought in detail around what the boundaries of that application should be.

**DR KING:** Okay.

**MR KIRKLAND:** So we think it's a worthwhile area of inquiry but we can't add much more to that thinking at this stage.

**DR KING:** Similarly, presumably if we start getting down to the nuts and bolts of who should be liable for what part of an unauthorised - yes, okay, no, I wouldn't want to push that.

**MR HARRIS:** The only other thing left is the sort of bigger question of the competition champion, a term we devised to try and convey a party that didn't necessarily have any greater regulatory responsibilities but were in the circumstances where the decisions that impacted upon competition were likely to be taken should be invited into the tent, if you like, before those decisions are finally taken.

Now, not necessarily a sort of consumer level kind of concern but I thought you might have a view on this, particularly the question, and we'll ask most of the participants this if it looks relevant to them, our concept had been the government should designate somebody for this purpose, some entity, we didn't see a reason to create a brand new entity for this purpose because there are a number of parties that could take up that role. The ACCC is reasonably self-evident to most people. But ASIC itself has a role in competition at the product level and therefore has expertise in this area too.

So this question of should the Treasurer designate some entity to take responsibility for competition within the activities of regulators in particular, which is the focus we had more generically across the economy. Clearly it's the ACCC or it's ASIC where statute says so. This is really in the interaction between regulators. Do you have a view on that at all or - and again, I'm not necessarily trying to set you up, if you have none feel free to say so.

**MR KIRKLAND:** No, we've got some observations on that set of issues. One we'd absolutely think would be valuable to have competition clearly considered in major decisions at the Council of Financial Regulators and for there to be some transparency around the way in which competition is considered before decisions are made. We think there's a need for caution around how the role of - sorry, just to step through it, we do agree that whatever happens competition should be added to ASIC's mandate. We've backed that since it was recommended by the Murray Inquiry and we think that would be important regardless of where the primary responsibility for competition lies in the system.

We think the way in which a competition role is framed is quite important so we would, I guess, have some hesitation about framing it as a consumer - sorry, as a competition champion role because we think it's important that competition is always grounded in the ultimate object of competition, which is to promote the best interests of consumers or end users, as it's framed in several Commonwealth Acts. competition is best pursued by a regulator where it's effectively balanced with consumer protection, which is something that we'd see the ACCC as doing fairly well.

So we think wherever it sits they're important considerations. The other one is that it has to be resourced. So we would say that ASIC at the moment probably isn't effectively resourced to take on a competition role. At this point in time the government has decided to give some resources to the ACCC. Which we think is a good thing. We think there are

pros and cons between ASIC and the ACCC so we don't have a strong view about where that should sit but we think that those other sort of considerations should apply about the objects of competition, balancing it with consumer protection, and ensuring that whichever regulator gets the role has adequate resources.

**MR HARRIS:** Thank you very much for that. Others?

**DR KING:** No.

**MR HARRIS:** You're done? Is Julie done?

**DR KING:** Julie is done.

**MR HARRIS:** Thanks very much to Choice for appearing here this morning and for the breadth of your comments, and for putting up with us asking you things where perhaps, you know, sometimes we put you on the spot but you've nevertheless been very helpful. So we appreciate your time.

**MR KIRKLAND:** It's always a pleasure, thank you.

**MR HARRIS:** So I think 10.45 we'll restart so I'll be pretty keen to do that on time, with Bendigo and Adelaide Bank. Thank you very much.

**ADJOURNED**

**[10.23 am]**

**RESUMED**

**[10.44 am]**

**MR HARRIS:** I think we're going to restart but I need to just look across and make sure that we're recording okay. If we are recording okay? So, I think we have Bendigo and Adelaide Bank now to present. Would you gentlemen like to identify yourselves for the purpose of the record?

**MR FENNELL:** Thank you. My name is Richard Fennell. I'm the Chief Financial Officer of Bendigo and Adelaide Bank.

**MR CROUCH:** And my name is Travis Crouch. I'm the Divisional CFO for Bendigo and Adelaide Bank.

**MR HARRIS:** Okay. Do you want to make any opening comments?

**MR FENNELL:** Yes, if we may.

**MR HARRIS:** Sure.



**MR FENNELL:** We would like to start by expressing our appreciation of the work completed to date by the Productivity Commission in helping to highlight a number of relevant and significant issues which impact the state of competition in the Australian financial system, and the need for the relevant regulatory bodies to take a more proactive approach to the consideration of competition in the banking industry.

Specifically, we appreciate the Commission identifying the issues relating to the implementation of Basel guidelines on risk weightings for non-IRB banks across residential mortgage and SME lending, which have had a major impact on the ability for banks, such as ours, to compete since the accreditation of IRB banks over ten years ago.

The following finding and two recommendations specifically relate to the ability for smaller ADIs to compete with the major banks here in Australia, and we would like to make a comment upon those. Finding 5.1, cost of funds for different size banks, the materially lower risk weights able to be used by the IRB accredited banks for residential and SME lending have been the overwhelming impediment to our ability to compete in our preferred lending target segments of the market. Since the accreditation of IRB banks in Australia this has resulted in our bank, along with other non-IRB banks, having to accept either lower growth or lower returns, except for relatively short periods of time when competition eases.

In addition, the three notch credit rating uplift under the Standard & Poor's methodology afforded to the major banks on the basis S&P expect these banks will receive government support on the basis of being too big to fail, adds to the challenge we confront. This rating differential does impact on both the availability and cost of wholesale funding for our bank.

Recommendation 9.1. As highlighted in the draft report, the differential in risk weightings for SME lending is profound and results in a vastly skewed playing field between the IRB accredited banks and others. APRA has made an initial concession in its Basel III discussion paper to lower secured SME lending risk weight to 85 per cent from 100 per cent for standardised banks. However, this is unlikely to be sufficient to materially close the gap between IRB and other banks in ability to compete for SME lending unless APRA requires IRB banks to recognise a materially higher risk weighting on their SME lending.

Recommendation 16.1. In relation to the recommendation to review standardised risk weights for residential mortgages, we appreciate the proposed more granular risk weights proposed in the recent APRA Basel III discussion paper. However, as for SME lending, to deliver a more competitive environment APRA will need to align IRB risk weighting floors using a similar granular distribution and at levels which will allow true competition to exist between IRB and non-IRB banks. Of course, this needs to be done in the context of their being an incentive for banks to improve their risk management practices to a level that warrants IRB status, but that will require some careful thought.

In addition, we'd like to comment upon a number of other specific findings and recommendations of the Productivity Commission's report. Recommendations 8.3 and 4 relating to collection and transparency of home loan interest rate data. We believe

competition within the financial services industry is not limited to price competition. True competition encompasses a much broader consideration of value for the consumer, which includes aspects such as trust in the provider, product features, service levels, accessibility and, in our bank's case, returns provided to the community the consumer resides in.

Accordingly, to further focus the provision of the information upon interest rates and fees risks further entrenching the dominance of those banks who have the inherent advantages of those favourable regulatory and ratings outcomes described previously because they will be able to compete harder on price at the same return on equity than the other smaller banks.

Considering all these factors, we do not support these recommendations 8.3 and 8.4.

In relation to information request 8.2, should brokers pay fee for service, we do support a move to fee for service brokerage to remove the inherent conflicts involved in the commission based structure and ensure fees earned are aligned with the value of the service provided. However, we also recognise such a change will have significant and varied implications which will need to be carefully considered before such a change is implemented.

Finding 13.2, tick and flick, has not been effective. In our experience one of the factors limiting the effectiveness of tick and flick has been the variability in some banks meeting the requirements of making all information available within the prescribed period. We also believe not all customers who seek to change banks are made aware of this service, limiting its use.

Information request 16.1, where can IRB accreditation processes be improved. We believe from an accreditation process perspective it would assist ADIs seeking to apply for accreditation if APRA was to outline its key requirements from a process and timeline perspective, including key milestones that need to be met along the way. In this context an iterative and consultative approach akin to the guidelines and approach adopted for ADI licensing would be beneficial.

Finally, on recommendation 17.1, new competition function for a regulator, we support the Council of Financial Regulators to take a more active role in considering the competition impacts of proposed regulatory actions. I would be happy to open it up for questions and discussion.

**MR HARRIS:** Just on that last one, could you clarify when you said you supported, any particular regulator you had in mind?

**MR FENNEL:** We don't have a strong view although I'm looking forward to seeing what the ACCC has to say a little later. They seem the most logical party to take responsibility, given their current remit and the ability to broaden that remit to include financial services, particularly given the work they've been doing recently on the mortgage industry, or the mortgage element of the industry.

**MR HARRIS:** So do you want to go back up to the top of the list or do you want me to keep going?

**DR KING:** I was going to go back up to the top of the list.

**MR HARRIS:** Go back up to the top of the list.

**DR KING:** Yes. So really the top of the list, other than you supporting our work, is the risk weights and the APRA discussion paper. Do you mind - are you happy to go into a bit more detail? I realise the discussion papers have only been out for about a week, but can I take it from your opening comments that you sort of felt fine as far as it goes but not enough nuance in the SME area? So does that - are you able to expand on that? Have I got that right and are you able to expand on it?

**MR FENNEL:** Yes, so Stephen the discussion paper release went into quite a bit of detail and was quite specific around non-IRB banks and the expectations around risk weightings by LVR bands, by type of mortgages. For example, between owner occupied P&I and other mortgages and also SME lending. In relation to IRB banks, it did provide some information around correlation factors and other elements that would feed into the risk weighting, but APRA alluded to the fact that before they finalise where they want to go with risk weights for IRB banks they expect to apply additional scalars and potential floors. They didn't, in the discussion paper, go to the same level of breaking down by LVR how things will work for IRB banks, for example with mortgages, and we don't know what floor the scalars will use when it comes to SME lending.

So APRA is now going to go through a quantitative impact study and a number of banks have been asked to participate in that. I'm assuming that at the end of that when they come out with their next paper we'll get more information in relation to what those scalars and floors will mean for both mortgages and SME lending. If they were to remain largely where they are today then we're going to still have significant issues from a competition perspective in SME lending, as you point out in your draft report, where IRB banks, risk weighting is around 50 per cent. For secured SME lending we will move from 100 to 85. But that's a huge gap still between roughly 50 per cent and 85 per cent risk weighting, which would lead to a situation where non-IRB banks remain in a situation where they have to either accept a significantly lower ROE to price at the same level, or are non-price competitive.

We in our organisation have had plenty of examples where we compete hard for business lending and SME lending and we just cannot get to the same price point as some IRB bank competitors are prepared to go because the ROE on that is well below what is acceptable to us. We assume, given the lower capital requirements, given the different risk weightings, it is still at an acceptable ROE for those IRB banks.

**DR KING:** Just to follow up on that, and again please correct me if I've got that wrong, but I took from your opening comments that you saw a potential solution for this as being

to raise the IRB risk weights on SME secured loans rather than to lower the standardised rates?

**MR FENNELL:** At the end of the day what we're looking for is an even playing field. APRA seems to have made a determination of what they think is an appropriate risk weighting for SME lending for non-IRB banks in the discussion paper, and left open the ability to moderate the IRB bank risk weighting. So the reason I focussed on that is that appears to be the area that is still open for consideration by the regulator.

**MR HARRIS:** But doesn't that - I mean, this is the whole conceptual problem we've had with shifting of risk weights that occurred after Murray as well, which you can also read in our draft report - this idea that lifting a risk weight for a party that might have done quite a lot of work - I mean, this is not a criticism of either the IRB banks or those that haven't chosen to but have done quite a lot of work in terms of managing our risk structure - but to lift the cost of a risk weighting, a) raises the price of the market which doesn't look terribly smart any way, but b) intuitively looks like it must be driven solely by a focus on safety, on security.

In other words, there isn't a balance here. It's just that the default position is if we have to shift the risk weights because we've perhaps worked out we could be more sophisticated with them, our sophistication leans only in one direction and that's up. Otherwise it doesn't make -it says the more that we find out about how we can manage risk in a more sophisticated fashion the more that we're going to have to raise prices. That intuitively is leaning only in one direction, isn't it, towards safety?

**MR FENNELL:** It is, and - - -

**MR HARRIS:** Not towards competition.

**MR FENNELL:** - - - it reflects the primary remit of the Australian Prudential Regulatory Authority.

**MR HARRIS:** Which is why you might want at least a contrary view run by another entity.

**MR FENNELL:** I wouldn't disagree.

**MR HARRIS:** It's very, very interesting. Can I ask about the 85 per cent too? I mean, the precision of the numbers here, we're in no position at the Productivity Commission to go, "Oh, a better number should be X" and quite possibly you may well feel the same. The number itself is a precise measure of something that is astonishingly hard to be precise about. But 85, if I recall rightly, is still higher than some other countries would require for what appear to be similar lending products. Now, I can't be sure of that either but that's why I'm asking you. Is that right? Is the opening round discussion here on SME weightings pitched also at a level which says well, we might be able to relent a little but not very much by comparison even with other countries?

**MR FENNELL:** It certainly appears conservative, and the other element that is interesting to consider is it assumes that all non-IRB banks are taking the same level of risk in writing SME lines. Now, we're all competing in the same market for SME lending, and at that smaller end there's a lot of lending done. What that is intuitively saying is that all of the non-IRB banks are taking a very similar amount of risk in that secured SME lending, however that is recognised as being higher risk than an IRB bank that has done more internal analysis and historical analysis of the performance of risk for that aspect of their business, and therefore they can write that at a lower risk weight which, having - we've invested a lot in our bank to move towards IRB and we would argue that we are well down the path of understanding the risks we take and certainly 85 per cent risk weighting would appear conservative from the analysis we've done, particularly when it comes to secured SME lending.

**MR HARRIS:** Just to get the position out on the table, in our draft report we suggested that if there were some gradations, some variations to what is otherwise a single line risk weighting for SME lending, that as a consequence of that it might be arguable that a price to a small enterprise for a loan would vary, but certainly against a specific level of allocated capital, which is the way your business operates, you would be able to offer more loans. Is it more likely more loans, more likely price, more likely - I mean, we didn't want to presume the price would actually shift very much but we did want to suggest thought that, taking an existing amount of capital with variation risk weightings you'd be able to take on more loans.

**MR FENNELL:** Certainly conceptually we can take on more loans, but the amount of capital we are holding is not the thing that is holding us back in writing SME lending. It is actually the inability to price competitively with those that are able to hold a lot less capital against those. We would like to write more business in this space, and in fact we lose business that we've already written in this space to competitors who are able to come and offer existing customers of ours a more competitive offer because of the amount of capital they have to hold.

**MR HARRIS:** So in fact do you think it's more likely that you will be able to offer better prices to SMEs? We didn't want to presume that, but if that's the case it's quite an important consideration here from the point of view of a person seeking a loan anyway. It would be an important consideration.

**MR FENNELL:** Yes.

**MR HARRIS:** So price you think could actually benefit from this shift in risk weightings?

**MR FENNELL:** Certainly on a case by case basis there have been loans that we have had to forego to a competitor because we have been unable to price at a level that is competitive because of the ROE on that loan because of the capital required, given the risk weighting we have.

**DR KING:** Can I just clarify that, because in your opening remarks it came across to me at least that you are suggesting that the IRB risk rate would be raised?

**MR FENNELL:** Yes.

**DR KING:** Rather than the standardised risk weight be lowered. Now, presumably to get more price competition it would need to be the standardised risk weight coming down towards the IRB weight if you go the other way?

**MR FENNELL:** Yes, that's true. Again, our view is we want a more even playing field and I don't think you should necessarily assume if a higher price is being charged because more equity is required to be held against loans by the IRB banks that that will necessarily be a detrimental impact for the industry. It depends on your view, whether you have the view that more stability is required or more competition is required. However, the assumption that IRB banks should go higher was on the basis that the discussion paper was very prescriptive around standardised banks. Now, that doesn't mean APRA cannot change it. I think, however, the way it was written with an indication they expect to apply scales and floors to IRB banks from what they put in the discussion paper, their inclination is to go the other way as far as increasing those risk weights rather than further reducing the risk weights for standardised banks.

**DR KING:** Yes. I guess I just want to make it clear, or make sure I'm clear on your views, if that occurred that would not - that would level the playing field from your perspective but would not lead to lower prices to small businesses?

**MR FENNELL:** I think that is a fair assumption.

**MR HARRIS:** You also comment - I don't want to leave risk weightings but I want to sort of go around it a bit. You also commented on the role of rating agencies and their assessment of too big to fail. There's a logical link here, isn't there, between variations in risk weightings which are skewed towards safer. Even as we learn more and can be more sophisticated in our judgment we're even going to be more safe. Doesn't that whole contribute to this whole idea of too big to fail? In other words, there's a lot of rhetoric now being devoted to the idea that policy is not oriented towards supporting too big to fail, but in fact actions regularly seem to be oriented towards too big to fail. You know, there may be more activity in the SME space but it's going to be safer. Are we not seeing that here as well? Am I being too harsh?

**MR FENNELL:** I think when we look at what's driving too big to fail and its interpretation by the rating agencies, they take a very narrow view focussed around the size of the entity and its importance to the Australian economy as a whole. We think it's also important to consider the importance of different banking entities to not just the whole economy, but the economies in which they operate. So as an organisation that has over 500 branches, including 90 in locations where we are the only branch in that location, the idea that the Australian government would be happy for an organisation like ours to fail - I shouldn't say happy, but accepting of that and the implications of banking services being

removed from those 90 locations other than the provision of electronic banking, is an interesting concept and I think an over-simplistic view taken by the rating agencies.

**MR HARRIS:** Yes. I just - - -

**MR FENNEL:** I'm not sure I answered the question specifically.

**MR HARRIS:** No, I think you came tangentially at it but I came tangentially at the whole risk weighting question too because this too big to fail, it's not something that's easy to address directly without making possibly an intemperate remark and I try not to make intemperate remarks, I've learned. An unwise thing to do. Comprehensive credit reporting, what - this is again tangential to risk weighting but it's the same thing to me, anyway. I look at why you might have gradations and variations in what has been - let's stick with SMEs - this single line risk weighting. We're now saying maybe we can break it up. As comprehensive credit reporting becomes mandated and you obtain better information about customers and so do your competitors, and so there's the better sharing of information, I haven't seen too much mental linkage placed by any party in the finance sector about the possible benefits of this to things like variations and risk weighting. Is that just because it's, as it were, behind the scenes kind of thinking and no one really wants to talk about it very much, or what's the story here? Because there's an intense logic surely to this whole idea of once we have this information we'll be able to better price risk. That's why we want it. In which case, it should affect risk weightings but it doesn't seem to be there. It doesn't seem to be mentioned at all.

**MR FENNEL:** For an advance bank, or IRB bank, I think there is the opportunity with better access to that information with comprehensive credit reporting to better align risk with price, and the ability then to be able to show that that lower risk is based on logic and data should allow a lower risk weighting through their models that they - - -

**MR HARRIS:** But why the big model?

**MR FENNEL:** However, for standardised - - -

**MR HARRIS:** You see, why the big model? This is the question. Why not a selective use of it? We were told in the course of developing the draft report that there is a thing called doctors' home loans, and they're much safer apparently to lend a home loan to a doctor than - I would argue doctors really aren't that well remunerated. You can probably think of a different class of person who is exceptionally well remunerated. Perhaps they're greater risk takers than doctors, I don't know. So there is this informal view about certain classes of home loans are much safer. But that stuff doesn't creep near the formalised risk weightings, and yet I can't work out why it wouldn't at least be perhaps not happening today, but being envisaged as being a mechanism by which we can vary risk weightings in a more sophisticated fashion selectively.

In other words, you don't have to run the giant model. You could just say I'd like a slightly better risk weighting for this class of loans which I can demonstrate to you by the objective

fact is the equivalent of doctors' home loans. In the case of the SME space, we had one party suggesting to us that tradesmen's utes were similar to doctors' home loans. A tradesman would not want to ever see their ute lost. It was - and so that was an indicator. It was almost they had, as it were, headroom against the value of the ute. That there was a lending opportunity there. And a safe one.

This level of sophistication is rarely alluded to, it seems to me, and I can't sort of work out why, given we are going towards comprehensive credit reporting and therefore it's an obvious use.

**MR FENNELL:** It is certainly something that within banks is given great consideration. There are a number of factors that we need to consider in writing a mortgage, whether that be an SME mortgage or a residential mortgage. They're factors like LVR which now is being focussed on by the regulator, the type of loan, interest only versus principal and interest, and investor versus owner occupied. But factors like serviceability - I think what you're talking about with your example is the character of the person and that - and also the purpose of the lending.

Now, we do lots of modelling around - and I'm sure a lot of other banks do lots of modelling around different personas, and to try and inform the character piece around credit. You might be interested that one of the personas that performs very strongly is public service. I won't comment on income versus doctors. However, that is an important factor in assessing the risk, which goes then to the pricing. Although, as you say, for a non-IRB bank it does not impact the amount of capital we have to hold. So it informs the risk that we're prepared to take and the price we'll pay for that, but it will not impact the ROE because it's not impacting the E.

**MR HARRIS:** I should stop doing this because we have a limited amount of time.

**DR KING:** Yes. I want to touch on a couple of things. I was just going to point out it's MDs rather than PhDs. You mentioned mortgage brokers at the beginning and the payments. I guess a double barrel one for you, you support a change in the way that they're paid but we'd be interested if you could flesh that out a bit more. But I think the more important one from us is understanding mortgage brokers and how they interact with a bank like yours. In particular, how much does your lending business depend on mortgage brokers and how do you make the decision internally as to well, we could open another branch there or we could rely on mortgage brokers. Does it allow you to go into new markets? Have there been situations where you've said well actually, that branch probably isn't viable and we can leave it to mortgage brokers? How do you make those decisions? How do you run the numbers, that sort of thing? Really understanding that interaction with brokers.

**MR FENNELL:** We are probably less reliant on mortgage brokers than many banks and we have been very focussed on the development of a strong branch network, primarily since the advent of our community banking model some nearly 20 years ago where communities can open a branch of a Bendigo Bank as a franchisee. So we - and that remains a reverse



inquiry model where we're not out there selling to a community that you should open a community bank. Rather, the community comes to us and says we would like to open a branch. There's a significant process, including feasibility studies, they need to go through to show that that would be successful. But we continue to increase our branch footprint, primarily through that community bank model.

We do, however, recognise the importance of the broker business with roughly half of Australians choosing to select a mortgage by going to a broker. It would be a brave decision not to participate in that market. So we do have an offering there, however that really is quite separate to our strategy around our retail business through our branch network, which we look to continue to grow and enhance. Our broker business, we also want it to be successful but they are run quite separately and I can't think of a time when we make a decision around our branch network based on should we, or should we actually use third party in that particular space? The reality is they both are generally competing in the same market, whether that be a geographic market or anything else, and quite often you'll find one of our branches in the same shopping strip as an outlet of a major broker. So it is not an either/or in our organisation.

**DR KING:** Can I push that a bit further because the community banking model, when you're looking at a franchisee setting up you have to, both sides have to do due diligence. The last thing you want is an unsuccessful franchisee.

**MR FENNELL:** Yes, correct.

**DR KING:** A significant part of their business will come about through writing loans.

**MR FENNELL:** Yes.

**DR KING:** If there is a significant mortgage broker presence in that same market surely that comes in to when you're considering whether the branch is viable. So I can understand that there would be situations where they can co-exist, but are there also situations where you say look, the market isn't big enough in this particular community because of the broker presence? I'm thinking if they're in the same market surely the - - -

**MR FENNELL:** Sure. They're in the same market with different brands from our organisation and different offerings. So our brand that we use in the broker market is the Adelaide Bank brand. The Bendigo Bank brand is our retail offering through our retail and community bank network. The Adelaide Bank brand is effectively an online brand once you take out the mortgage through a mortgage broker. The Bendigo Bank brand is a full service offering with access to the branch network obviously and the 500 plus points of presence, plus a range of other - a broader range of products and services on offer through that brand. Whereas there is a more limited range of products and services through the Adelaide Bank brand. So they can co-exist, and they actually compete arguably for people who are looking for different things. People who walk into a mortgage broker, they are going there without a view, I want to go and bank necessarily with CBA, Adelaide Bank or anyone else. They're going in there to buy a mortgage and to be advised on that.

People who come to our bank generally come to our bank and walk into that branch because they're looking for the service offering that we provide. It is differentiated, including around things such as what we do in the local community. It is also - they're probably looking for a bank that does things a little differently and arguably old school. We do strange things like publish the phone numbers of our branches. Because we have a branch centric model. So there are examples of things that we do differently that we find, customers find attractive, that they're not going to get if they go into a broker.

**MR HARRIS:** Just one specific thing on that though. If the Adelaide brand is therefore essentially an online and almost broker channel kind of brand, that must make the paying of trailing commissions quite a - I don't know, an absurd option really. It says it's all online from the time you get it. For the average loan, \$665 per year in perpetuity for an online based product seems a very expensive thing. Now, you presumably have very little choice about that because, as you say, you have to play in the market.

**MR FENNELL:** Yes.

**MR HARRIS:** But it does rather raise the question about pricing the service, let alone whether there is a conflict. It just simply says the pricing of the service seems pretty high, doesn't it?

**MR FENNELL:** Probably goes back to the point I made in my early or introductory comments around our view that a fee for service model is more appropriate.

**MR HARRIS:** Yes, and clarity around that for the person raising the loan. Stephen, I am conscious of the time so if you've got any more?

**DR KING:** One more. One more. Just on the same area, and it is sort of - in a sense you must face a bit of the Jetstar/Qantas problem. You don't want to make Jetstar look too good because it takes passengers off Qantas. I'm sure Qantas knows internally exactly how much money it makes out of a Jetstar customer versus a Qantas economy customer, and I suspect it makes more out of Qantas economy but that's up to them. Similarly, presumably internally you have a pretty good understanding of right, if it's under the Bendigo brand this is the amount of profitability or value to the bank as a whole.

**MR HARRIS:** Yes.

**DR KING:** If it's Adelaide online, this is the value. If it's through a mortgage broker, this is the value. Are you able to give us some insight into those different values?

**MR HARRIS:** We do that assessment. As you say, it would be unusual not to do that sort of assessment. We do that assessment. The challenge really is around the retail business and how do you allocate the cost of a network such as ours to those products? So a branch, should the majority of its costs be allocated to the job it does in actually raising deposits?

Or should it be to the job it does in actually generating mortgages? What assumptions you make around that will impact that significantly.

The other option is to say well, do we assume that's just a sunk cost because we've made the decision to have a branch there and then we'll just do it on a marginal cost basis? So all of those factors are ones that we need to take into account. If you allocate the costs in a way that is - let's take a simple approach and say 50/50 between deposits and loans through a branch - then the return that we would get through our branch network is probably lower than that through the broker channel. However, there are so many benefits that come to our organisation in our ability to generate funding for the whole bank because, being roughly 80 per cent deposit funded, the funding we generate through our retail network goes a long way to funding our Adelaide Bank business as well. So we get huge benefit there. Not to mention the reputational benefit we have in having over 500 points of presence for a bank our size and the things that those branches do in their local community which is beyond just selling products and services.

**MR HARRIS:** Just one thing if I could do the closing off question then, if you were buying a broking business though you would do that analysis, wouldn't you, beforehand? What can we save in terms of our operating expenses by moving more of our business relatively speaking into the broking channel? You would have to do that cost based analysis. It would vary, depending on the business model that you just described which is complicated and potentially unique. But you would nevertheless have to do that cost analysis, wouldn't you?

**MR FENNEL:** We would, but we've never done it because we've never felt strategically it made sense for us to vertically integrate by owning a broker.

**MR HARRIS:** Quite, but I'm just trying to make sure because we have been accused of misunderstanding the reasons why banks go and buy broking businesses and it just almost seems screamingly obvious to me so I have to ask the question when banks turn up here. Anyway, I want to thank you for your time presenting today.

**MR FENNEL:** Thank you.

**MR HARRIS:** We will probably be further in touch with you because it has been quite truncated, but we're already over time and it's been very useful to get those contributions. Thanks a lot.

**MR FENNEL:** It's a pleasure.

**MR CROUCH:** Thank you.

**DR KING:** Thank you.

**MR HARRIS:** I think since we're over time we'll race into Westpac. They have been waiting patiently. Peter King is here and he's been waiting patiently to come on up. So

the gentlemen from Westpac will set themselves at the table and when they're ready perhaps you can introduce yourself for the purposes of identification on the record.

**MR P KING:** Thank you, Chairman. Peter King, Group CFO, and with me today is Curt Zerber, our Group Treasurer.

**MR HARRIS:** Opening statement, Peter?

**MR P KING:** Yes, thank you. So firstly, we welcome the opportunity to discuss the Commission's draft report on Competition in the Australian Financial System. In addition to our remarks today, Westpac is preparing a written response which we will lodge in March.

**MR HARRIS:** Thank you.

**MR P KING:** Today really my comments will focus on three areas that we believe require further consideration. The first is that competition and stability settings must work together and cannot be separated. The second is consumers have plenty of choice, but we agree that they need easier ways to compare products. Thirdly, while banks are profitable our returns on equity have come down over the past decade and when compared to the ASX200 they're not out of line with the average of ROEs there.

If I just elaborate on the first point, that competition and stability must work together, we see it as important that the financial system supports the economy through economic cycles, not just in the good times. The impact of the GFC was a stark reminder that when stability and competition settings are misaligned that economies and consumers can see large impacts.

We believe for the most part that Australia's financial system, combined with its robust regulators, has proven to be both competitive and well calibrated to deliver those services over the economic cycle. Prior to the GFC many countries focussed too much on competition and growth, and when the reset occurred economies contracted and unemployment increased. Australian banking policy has held firm on both competition and stability, and since the GFC we have boosted our capital levels and we strengthened also liquidity levels and our funding bases.

For example, just to bring that to life, the new funding regulations, NSFR and LCR, aimed at improving our funding base, saw intense competition for customer deposits over the last decade. In the case of term deposit spreads, they've moved from being priced around 45 basis points below the swap rate, the equivalent swap rate, in November 2007 to approximately 80 basis points above the swap rate in 2017. And deposits are the foundation that gives banks the ability to lend, and we believe that the intense competition for deposits hasn't been picked up in the draft report.

Just in completing this point, I note that the government also has a keen focus on competition as implementing significant reforms. As you know, these include making it

easy for new entrants into the system and improving data sharing, and these reforms should be given sufficient time to embed after which their effectiveness can be reviewed.

The second area is that, while there is plenty of choice in the system, we agree that it can be difficult for customers to make sense of it all. As outlined in our original submission and noted in the draft report, customers have more choice in banking than ever before. Just as an example, there's over 4,000 mortgage products and 100 providers in mortgages, and for anyone to compare those would be a pretty big effort. So we agree that so much choice makes it difficult to compare, and that's the reason that we support the move towards an open data regime in banking which will facilitate informed decision making and promote innovation and efficiency in the system.

Just while on the topic of choice, I should say we see ourselves as a service company, not a product company. Our strategy is to differentiate ourselves on the service. So to bring that to life, in the last 12 months we've introduced more than 100 features in mobile banking to improve customer service.

The final point is that Australia's major banks are not highly profitable as the draft report indicates. Now, it's true that as a sector we make large dollar profits but that doesn't necessarily equate to being highly profitable. The large profit numbers reflect the sector's significant size and productivity, and in fact as we outlined in a couple of the charts which we provided to the Committee, the returns do not stand out in relation to Australia's large listed entities and are in line with other banking systems, or comparable banking systems, offshore.

Just to bring that to life, Westpac makes less than 1 per cent return on assets and its return on equity has fallen about 40 per cent over the last decade. The decline in the ROE can be traced back to competitive impacts on margin, de-leveraging to meet higher capital requirements, our merger with St George and increased compliance costs.

Just when considering returns, it's also important that the banking system is seen as strong and profitable, given its role in importing offshore wholesale funding into the country. Westpac, for example, has around \$150 billion of offshore wholesale funding outstanding, which is the equivalent of 300,000 new home loans. Offshore investors see profitability as a big requirement when deciding to invest in Australian banks.

So just in closing, we believe the inquiry is an opportunity for Australia to reinforce the strength of the system and the competitive environment in which we operate. Westpac is proud of the financial system and it has consistently stood behind the nation in times of stress and has positively contributed to the economy in good times as well. We think it's vital that we recognise the value that strong banks play in underpinning the economy over the cycle, whilst also recognising that reform to improve competition will be good in the long run. Curt and I would be happy to take any questions.

**MR HARRIS:** Thanks very much. So just on profitability, since you mentioned it and everybody does, are we really debating, if we're debating anything on profitability, the use

or misuse of not the term “highly profitable” but the word “highly”? Because you have subsequently acknowledged it’s important to be profitable and we in our own most evident summary page, the key points did, from our 600-odd pages, get summarised down to the key points right at the front and we did notice that it is - note that it is no bad thing necessarily to be profitable.

**MR P KING:** Thank you.

**MR HARRIS:** One would hope that that would contribute to stability. So it’s quite important. So we are really debating this question of “highly”. Your preferred measure now in this proposition here today, and you did have it in your earlier submission as well, is return on equity. But equity is a funny thing in the banking industry, isn’t it, because there are numerous sub-equity products that also provide you with a similar basis as equity but are classified somewhat differently, and so that’s not something that is made available to other sectors. So hybrid equity, for example. So we, when we did our draft report, went and started out with banking industry analysts who tended to be more expert than we were, and it was suggested that that interest margin was in fact the industry sort of preferred rough measure of profitability. Which is why, as you can see from our draft report, we cited that as being one of the greater evidence of stability than, as you say, the return on equity has diminished over a decade.

So maybe you could clarify why you think it’s more important to concentrate now on return on equity here because we sort of thought we were going in the right direction.

**MR P KING:** Well, I think - let me give you an analogy for the country. So if you think about pre-GFC we had low government debt, much higher interest rates from today and the dollar was relatively high. So going into the GFC we had the fire power to defend a downturn. So the government had the fiscal capacity to boost spending, interest rates could be lowered to boost demand, and the dollar would come down. So if we roll forward through the FSI today, what the FSI basically said was banks, particularly major banks, you need to be seen as unquestionably strong in a global sense, given your role in importing wholesale funding into the country. It is a big number.

We look at today and we see interest rates very low. Now, there’s not a great deal of ability to lower them much more. They could be lower, the impact - - -

**MR HARRIS:** Official rate you are talking about here?

**MR P KING:** Yes, official rates. The fiscal position is not as strong as it was. Now, the dollar is still relatively high so it could come down. So what we have spent the decade doing is boosting our liquidity funding and capital resources so that we reduce the probability of the impact of event. So that’s the context. In terms of how we think about the bank, the bank is - it earns revenue both in interest income and fees. It’s got costs and it’s got credit costs. So the thing that the interest margin doesn’t pick up is credit costs in particular. So the one - and if you think about the role of a bank, it lends and it’s got maturity transformation. Not all those risks are picked up in an interest margin.

So effectively we hold some provisioning for expected loss and then we hold capital for unexpected loss. The only measure that brings those all together is ROE. So if you were to look at our investor presentations to our investors who give us the capital, that is the one metric that I think they focus on the most.

**MR HARRIS:** Yes, I can understand why an investor might focus on that if only for ultimately sheer pragmatic reasons. But we were doing a competition based analysis which is less than, or different to, an investor's analysis and so from our perspective we were trying to find whether or not there were reasonably clear indicators of how competitive behaviour is reflected across institutions. Anyway, I'm not trying to defend this. I'm more trying to understand the fact is there is different advice at different points in time about what's a better profitability measure. We weren't questioning ultimately profitability. In fact, we were sort of trying to hint that you wouldn't want too many institutions - - -

**MR P KING:** The challenge we had over the last period is there's been so many moving pieces that have impacted every ratio on the bank. So if I think about funding, we have materially moved the proportion of our funding base that is domestic deposits because it's a safer organisation. This is through the cycle point, that we don't want to just have a system that works well and is very competitive. We need one that actually works well in stress as well. The learning from the GFC was if you over - if you don't get that balance right the impact on the economy can be big.

**MR HARRIS:** Just one more, if I could for you, just on this GFC point because it does - and I did say earlier to the Bendigo and Adelaide representatives I'm wary of making intemperate remarks, or apparently intemperate remarks on some questionably strong issue, but it is true, isn't it, we were pretty strong as a banking system going into the GFC and survived reasonably well, but we came out of it with exactly the same philosophy that other countries who did not go into it as well positioned as we did and came out of it much worse, we still emerged with the same desire to make a strong system unquestionably strong. We do rather persist in emphasising something where we - - -

**MR P KING:** It's this trade-off though between the other parts of the economy are not as strong. Interest rates can - it's difficult to lower interest rates to boost the economy so the banks had to increase their individual strength.

**MR HARRIS:** Yes. No, I'm more referring to the use of the GFC as a point at which - you know, it's almost implying that we too were in a bad state and, as you have noted in your own presentation, we were more competitive by some measures pre the GFC compared to those measures post the GFC, but the rationale for why we should abandon being, as it were, more competitive in favour of being unquestionably strong - is it really about our performance during the GFC then? Because our performance was pretty good because we entered the GFC in an okay state.

**MR P KING:** If you look at who was pretty good versus who wasn't, if you look at those businesses that used wholesale funding, mortgage warehouses solely to fund their mortgage

book, a lot of them don't exist anymore. So this is the point about it's not just in the good times that we need to set up business models, it's also to survive a cycle.

**MR HARRIS:** Yes, yes. But we have emphasised the unquestionably strong proposition, despite the fact that the evidence would suggest we went in unquestionably strong in terms of that regulated end of the spectrum. There was a freezing up of wholesale markets which was reflected in much poorer financial performance for entities, but we didn't appear to have gone in on a basis, given we were more competitive before the GFC, that said somehow stability was under threat through that level of competition pre the GFC. We didn't seem to have anyway, based on the - - -

**MR P KING:** Well, those - - -

**MR HARRIS:** What we can find in the data.

**MR P KING:** Some of those firms didn't survive. They didn't make it.

**MR HARRIS:** Outside the regulated space.

**MR P KING:** Well, we can debate that but Bankwest was bought by - - -

**MR HARRIS:** Offshore firms did actually have - because they were regulated offshore did actually take more risks. So this is my point about we seem to have imported the philosophy of - because other countries had different systems to ours, nevertheless we must now be under - - -

**MR P KING:** Just one final point. Australia is one of the largest importers of wholesale funding in terms of banking systems, and so that is a big consideration in the calibration of the system. One that we agree with. We agree that we don't want to turn up to offshore investors and have a question about the strength of the system. It wouldn't be good for the Australian economy because if we get capital flows going out it means the banks shrink.

**MR HARRIS:** Yes. Stephen?

**DR KING:** Yes, I want to follow up on two things there. Firstly, when you're talking about those smaller institutions, banks range from the big four through to very small institutions. Am I to infer from what you're saying that unquestionably strong means we should never have any bank fail? So I guess that's the first question. I just want to clarify what you're getting at there?

**MR P KING:** Well, the reference point for unquestionably strong is international investors see the Australian system as unquestionably strong. Nothing to do with failure. They see it and they want to invest in the country through the banks.

**DR KING:** Okay. So the second point then comes back to your reliance on return on equity and international funding, and isn't there a problem for a too big to fail bank that



return on equity isn't really adjusting for the risk that you may be taking because the shareholders - so downsize risk, limited liability means that the worst they can get is to walk away with nothing in their pocket. So wouldn't you expect to see return on equity to have dropped, not because of any competition effect but simply because as the regulatory requirements imposed by APRA reduce the risk for the banks you will necessarily see return on equity drop for those banks?

**MR P KING:** You haven't - but I think the question there becomes - well, it has is sort of the first point, and if you look at both the ten year trend and the most recent trend is it has dropped, is the first point. The second point is investors decide on the price that they'll invest in the company, so offshore investors. They make the decision on how much they invest and the price they invest, and the rating agency rating is an input into the process. Now, I haven't had - Curt hasn't told me he's had an investor come up and say I'll give you cheaper money because of this government guarantee thing. They make their decision based on what they see. They have alternative choices and that goes into the cost of funding for the group.

So I think that there is the argument that because we are safer organisations investors should lower their returns, whether they be debt or equity. A lot have not. In some cases they've said actually the risks might be a bit bigger than what we were pricing pre the experience of the last ten years.

**DR KING:** I am going to move on to another topic.

**MR HARRIS:** Yes. I will probably - well, it depends. No, let me stay in this area before you go to the specifics because I want to ask you about our generic recommendation about a competition champion. Now, you may have no view on this question at all because it's really a perspective around whether there is sufficient advocacy for competition within the regulatory system. Now, I'm sure you're familiar with the nature of the recommendation but you may or may not have noted in the speech on Monday we pointed out that the Bank of England which - and the UK did suffer more from the global financial crisis than potentially we did, and people can argue whether that was the nature of the competition in the system or other effects, but nevertheless the UK has revised its willingness post the GFC to focus a little more on competition by creating a secondary objective for the Bank of England's prudential regulation of entity. Consciously did so in support of this idea that it's quite difficult for the prudential regulator to have regard to competition because in the analysis for the papers that supported that particular position, taking a - came to the conclusion that the prudential regulator will favour stability and that's just a logical conclusion.

So the UK, having suffered more in the GFC and therefore needing obviously to take a position about guaranteeing its system was seen as unquestionably strong, has nevertheless added more to its support for competition as well post the GFC. We haven't in a direct sense via this advice to the regulatory authority. So do you think there is a need to address it as we have suggested in our report, or do you have no view?

**MR P KING:** I think I'm not going to comment on who, because I think that - - -

**MR HARRIS:** I won't ask you to do that.

**MR P KING:** I think the idea of having someone with a lens on competition is worthy, but the point I made in my opening remarks was how does it come together. So how do - this is a pendulum and you can swing it too far one way or the other. I think you're being clear in your report that it's swung too far one way versus the other. My encouragement would be to try to work out how the two ideas will meet because in running a bank it's going to be no use to me if I've got two polar opposed regulators that want competition, want stability, and they don't meet. So to me it's how do the two ideas come together.

**MR HARRIS:** We were quite conscious of that. So the idea is, as I said, a subtle one. Subtle to the point where, I guess, we were worried at some stages that people might say this is going to have no impact at all because the competition champion would not be a decision maker. The competition champion would be a point of independent advice, thus APRA's decision making would remain APRA's decision making. It would just be that rather than internalising a discussion with itself, effectively on the topic, it might find someone else to interact with prior to implementing the decisions. In any event, you've been - it was good of you to say something on the record on the issue because I know this is an area where it's often hard to take a public position. You go.

**DR KING:** Right. Switching direction slightly, on to mortgage brokers, and obviously Westpac owns some aggregators. The RAMS operation, for example, is slightly different to most broking operations in that it writes loans under the RAMS name rather than simply either selling the white label products or the label products. We obviously have a draft recommendation with regards to obligations on both vertically indicated aggregators and the mortgage brokers working under them, and their duty to the client. Your views on that?

**MR P KING:** I might just clarify on RAMS. RAMS is not an aggregator. So RAMS sells RAMS product. Westpac sells Westpac products.

**DR KING:** That's why I put RAMS as being slightly different, yes.

**MR P KING:** In the broking camp. But to your point, I think there is merit in having brokers aggregators, whether they're owned by the banks or separate, with a responsibility that is in the customer's interests. I would understand the differentiation between a bank owned aggregator and an independent aggregator, for that word. I think there should be the same standard in the market, that if you operate in that market you operate with these requirements. I think it's - we have no issue with the recommendation but we think it should apply to the whole industry, not to a sub-set of the industry.

**DR KING:** By the whole industry - so RAMS' funding for all of their loans would come from Westpac?

**MR P KING:** The banking entity is - the banking licence is Westpac.

**DR KING:** Yes, so you would see that obligation also being on anyone at RAMS writing a mortgage?

**MR P KING:** But RAMS only sell - yes, but if you go to RAMS you get a RAMS product.

**DR KING:** Yes, I know.

**MR P KING:** So that's why I say - - -

**DR KING:** Your earlier answer is the clear position though. You're saying no problem with the duty of care as long as it applies to everybody.

**MR P KING:** Everybody.

**DR KING:** Therefore there's no differentiation. We did give that consideration. The only reason is, or the primary reason - I mentioned this in the speech - we differed between the two is because we can see two different forms of conflict of interest, one ownership, one incentives, but more than that it was the future of financial advice or reforms that seem to have encouraged that form of concentration in the industry which is I'm too small to have absorbed potential liability that might come from this higher duty of care, and so I need to, as it were, see my business absorbed by a larger business, and so we've ended up with some concentration. We don't know whether that's cause and effect, and we wouldn't mind looking at that in this industry as well before we deal with - - -

**MR P KING:** - - - I would comment there that the FOFA law and the credit laws are two very different laws. I think it needs to be well thought through which path you go down because they're very different laws.

**MR HARRIS:** Yes, and I think we're trying to - - -

**MR P KING:** It's not clear cut.

**MR HARRIS:** We're trying to be careful there as well. The way we've characterised the language was meant to recognise that and we did take some advice from ASIC before we cast that recommendation in the way we did. But we will be careful at the final as well.

**DR KING:** RAMS is obviously a hard one to deal with because, as you said, it's not an aggregator and our recommendation was in terms of aggregators so I just wanted to make sure you weren't casting RAMS out as being something different. Westpac though, I assume actually and this is something I haven't got the data on in front of me - you would have independent mortgage brokers writing Westpac loans. Any idea of the per cent of your loan business that would go through them?

**MR P KING:** It ranges, but 45 per cent as a rough estimate.

**DR KING:** Okay. You would have heard our discussion earlier on about well, trying to get a handle on what's the cost of having a loan written through a mortgage broker versus through a bank and then in your case through something like a RAMS or a St George - - -

**MR P KING:** Yes. Let me tell you how I think, because I think the question is how do you think about it, how do you make a decision?

**DR KING:** Yes.

**MR P KING:** There's two aspects to that. How the customer approaches buying the mortgage is very important, and a lot of customers will choose to go through brokers, and that's a feature of the market. So we think about the demand out of each channel, and then we think about how we meet that demand. So in the case of proprietary flow of mortgages, or coming directly into Westpac, the decision you have there is how many home finance managers do you have. So do you employ a new person or not. So I wouldn't frame it around do you open a branch. Often we've got a branch there. The question would become do you put a home finance manager in or not. If you do, how many do you put in? That will depend on the flow, the demand coming into that particular region.

So it's not so much - and the concept that you can choose to direct the flow I don't think works because it's a customer choice about where they go. So that I think I would reframe it to say well, if you had a - how would you compare hiring a home finance manager versus using an external broker, which will answer the question you've raised about the relative cost. You can't really break it down. I think it's hard to break it down into a per sort of mortgage cost because of what you heard from Bendigo.

**DR KING:** Yes, but just picking up on what you have said and what Bendigo and Adelaide said earlier on, so you would see the relevant costs though at a branch level as being that marginal cost. What is it going to - you've got your branch there. What's it going to cost to get another - - -

**MR P KING:** Do you hire them or not is the decision. That is the decision. Then you want to be comfortable that they're going to write, that they're going to be able to generate enough business to pay for themselves in mortgages per week. So there's a different way to think about the question, is what I'm saying.

**DR KING:** Yes. Understanding that, and understanding that the customers who go to brokers aren't necessarily the same as go to a branch, but there's still going to be some sort of overlap there. When you're making that simple hiring decision to what degree do you look at the depth of the market? To what degree do you say well, they're going to be able to - - -

**MR P KING:** You look at it by branch.

**DR KING:** You look at it by branch.

**MR P KING:** Regional.

**DR KING:** Do you take into account drawing more customers that would have gone to brokers into the branch, or do you keep them completely separate? How do you deal with

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**MR P KING:** We would love to do that but it's not always the case that we can do it. Our preference is first path, that is our preference, but this is the point about the customer chooses.

**DR KING:** Okay, so your preference is - can I just get you - I just missed what you said.

**MR P KING:** Our preference would be to write through our branch network, home finance managers.

**DR KING:** Okay. Why?

**MR P KING:** Because of the cost.

**DR KING:** So it would be cheaper in that sense to write it through the branch network than through the mortgage brokers?

**MR P KING:** Yes.

**DR KING:** Okay. Can I get you just to expand on that? Sorry, this is the economist in me. Cheaper purely in dollar numbers or - - -

**MR P KING:** How about we put some data in our submission?

**DR KING:** If you would be able to do that that would be fantastic. Okay, that would be brilliant.

**MR HARRIS:** Can I just ask on this question, it's more about the competitive dynamics in the industry. Your preference then is to go with the branch because there's quite a big cost to obtaining a loan through the broker channel, and that's in part presumably the up-front payment and the trailing commission and stuff like that, presumably. Tell me if that's not right. But that's a cost. Yet you're a very active participant in the market place in broking as well but your prices, yours as in the bank owned broker's price, isn't any lower. It's not as if you're using your ownership in the broking channel to reduce the cost of dealing through a broker. That's a competitive dynamics question, and it's really the logical - are we going to earn our return by owning these businesses, by keeping the price high, or are we going to use it for competing on the cost? Why is that the case?

**MR P KING:** That question is also verging into an area of competition law that I shouldn't be going into.

**MR HARRIS:** Okay. I can see a reason why it wouldn't go into that question, but it was more a question of presumably people advising on the business case to enter the broking channel must have made a decision which says we're going to try and do it for simply the high returns that are now evident in this part of the industry, or we're going to do it for a more strategic reason. Can I ask at least was it a strategic reason or a high return reason?

**MR P KING:** When you say "our broking business" what do you mean?

**MR HARRIS:** You do have some ownership. I'm not going to go down the path of what RAMS is but you have some ownership in the broking channel.

**MR P KING:** No.

**MR HARRIS:** No?

**MR P KING:** Well, RAMS is not a broker. It's a brand. RAMS doesn't offer anyone else's products.

**MR HARRIS:** Okay, well that's why I wasn't trying to deal with RAMS per se, but are you telling me that Westpac owns no businesses that - - -

**MR P KING:** We have a small, very small, investment in a start-up called Uno - - -, a start-up which is - - -

**MR HARRIS:** Is that relatively recent?

**MR P KING:** Which is seeking to be a digital broker. It's high risk, and the flow in that business is tiny. So that's just small.

**MR HARRIS:** I can't really ask you this question because you're not active in the space. Although it's available for me to ask somebody else then.

**DR KING:** Before we leave RAMS, I'm old enough to remember the "good old days" when you had Aussie and RAMS securitising, using warehouse funds from the big four to fund what was at that stage a vibrant securitised mortgage market which seems to have got, with the GFC, a rather poor reputation it appears, based more on practices overseas quite frankly than in Australia. But if you view that as being a wrong view I'm more than happy for you to say so. That market hasn't really re-emerged post GFC. There doesn't seem to be a big amount of securitisation, except when we look at the data that was a big '90s disruptor and you will note from our report that's where we suddenly circle it and say my gosh, have a look at what happened to the home loan market at that stage. Why hasn't that market re-emerged? Whose fault is it for want of a better word, and do you see that as a future direction? Obviously not for RAMS now, but for others?

**MR P KING:** No, but I think - well, there's two points to make. One is the business models for those organisations weren't built for a cycle. They funded 25 year mortgages

way too short and when there was a liquidity disruption it failed. So the business model was high risk and was found out. That's one. Two is there has been a regulatory change that the bank liquidity - so when we buy liquid assets we used to buy a lot of RMBS. We don't now. We buy government and semi-government paper are predominantly what we buy to meet the high quality liquid asset requirements. So there has been a structural change in the market of banks not buying that paper, and there's probably been less investors in that market.

**MR ZERBER:** There has been a re-emergence of the securitisation market in the last two or three years. So I don't know what data you're looking at comparative to - - -

**DR KING:** Well yes, it's come back in a small way but it's nothing like it used to be.

**MR ZERBER:** I'd have to look at the data, but I would say it would be more than just a small one. But I think the challenge is here you've got to remember that through the crisis the government bought \$15 billion of RMBS because no one else would buy it, and investors who are looking to make a return are rational beings, so as an economist - they're not buying it because they see a - - - trade-off in other parts of the investment and opportunity. So the investors, I think, are very rational beings and I think they found out that there was challenges, whether it be liquidity, underlying economic values for those investments, which has curbed their appetite for that asset class, all things being equal.

So it's kind of like saying why isn't our corporate bond market bigger as well. There's a number of reasons for that. We as an issuer would love it to be bigger because we would benefit, as would all parties. So I think there's a dynamic here that is as much of an investor question as it is an issuer question. But I think, you know, my experience is at the moment that the diversification of the funding models has been the key differentiator in good and bad times, but clearly in bad times there was a number of models that were sought out, and so this is the balance that we're trying to help the Commission appreciate is that through the cycle the stability versus competition is a very, very fine point that needs to be considered.

**DR KING:** Can I just follow up on two things there? First, on the fact that you don't now hold the securitised mortgages as part of the tier one capital. That's presumably following - - -

**MR ZERBER:** On a liquid assets - - -

**DR KING:** Okay.

**MR ZERBER:** - - - and to be clear, we hold some.

**MR P KING:** The thing about our balance sheet on the asset side is having a large amount of liquid assets that can be turned into cash very quickly, so basically the two big parts - - -

**DR KING:** Has that changed in your holdings being driven by the change in regulatory requirements?

**MR P KING:** Have a look at - yes, have a look at the attachment we put on the back of the opening statement and you will see where it was in 2008 and where it was now. Globally the global change for liquidity portfolios is that you hold much more government paper basically, which is deemed the most liquid style of paper. Yes, it has changed.

**DR KING:** Yes. To what degree has that been - is that decision driven by the changes in the international approach to bank regulations - - -

**MR P KING:** It's been a big part of it. A big part of it.

**DR KING:** Yes. The second bit is, is Westpac still active in providing warehouse funds to securitisors, and if so how viable is that business compared to pre GFC?

**MR P KING:** Well, I think yes we are. It's around \$10 million to size it for you. So it's not a large part of the business. Given the nature of the lending, really it is - we think about it as a flow business, not a funding business. So you're effectively warehousing selling RMBS into the market on behalf of a client. Given the nature of those they're quite short term facilities and you wouldn't - I wouldn't see that that portfolio would grow significantly from where it is at the moment.

**MR HARRIS:** Have your risk weights increased on warehouse funding since the GFC?

**MR P KING:** Yes, there's changes that are going through but that will be reflected in how we think about that business.

**MR HARRIS:** Since we've got a limited amount of time before we start next, I would like to do lenders' mortgage insurance while we can.

**DR KING:** If you can, and then I will just come back to one thing that Julie has asked for.

**MR HARRIS:** Okay. Just on LMI, we have a recommendation that it would be logical to set up front a refund schedule should a borrower switch loans, but is otherwise required to pay up front for LMI. What is your view on that? I mean, the subject has been attempted to be resolved in the past but with a degree of difficulty because it does not appear that this concept of setting a repayment schedule for - I mean, we are advised that LMI is really only there for the very early years of the loan and therefore presumably has - it's value is reduced to zero inside the first two or three years. What is your view on the idea nevertheless that where someone does switch loans and is less of a risk after two years that they should get some part of that LMI refunded that they've otherwise paid for up front?

**MR P KING:** The view is it's a fair question. So we certainly can think about it. Unfortunately the answer is not straight forward because the re-insurance arrangements in that business assume that there's no repayment after two years. So LMI sort of exists from



a customer perspective to give them earlier access to funding, so effectively they get a loan that they probably wouldn't otherwise get. From the bank's perspective it's tail risk. It's insurance for tail risk in the mortgage portfolio. We re-insure a lot of that risk and the re-insurance arrangements that are currently in place assume that there's no refunds beyond two years. So it can be looked at. It would be - a change in the market would be a change in the re-insurance arrangements and - - -

**MR HARRIS:** What would re-insurers think about the new product?

**MR P KING:** Yes.

**MR HARRIS:** Okay, that's an interesting point because I personally didn't know that re-insurers took that view of two years as the expungement, of the expunging issue. Earlier we heard from Choice. I don't know whether you were here for Choice?

**MR P KING:** No.

**MR HARRIS:** But their proposition was that LMI is sort of unnecessary and they would prefer to see a borrower that has a more adverse loan to valuation ratio, manage that risk via the pricing alone rather than the need for insurance. In part, although I'm not trying to put the case totally, but just in part the logic appeared to be that there probably, as we have suggested too in the draft report, people are probably, but it's hard to get the data to make the conclusion firm, probably paying for this twice in the sense that they may be a higher risk anyway and they're paying for LMI, therefore they're probably paying a higher loan risk and LMI. I think Choice was saying on balance perhaps, but nevertheless their preference would be no LMI and just do it through price. What is your reaction to that?

**MR P KING:** Well, it comes back to customers and that is a model that works in other industries, but I think you'd have to work through the identification of when people can get credit. So it's not like you can move to a price based solution and everything stays the same. So one of the reasons that LMI exists is to - people save a certain amount and then they top up through the insurance which means they can get the loan earlier. If you did it through price there would be a different point of getting a loan.

**MR HARRIS:** For the marginal customer that goes over the price the internal model that you're prepared to - in other words, the cost of the risk is so high they would simply be denied the loan.

**MR P KING:** Yes, so you'd actually have to look at that proposal and the LMI proposal together to work out which is the best model.

**MR HARRIS:** Yes, okay. Sorry, you had one last thing?

**DR KING:** Yes. I think two just because we haven't asked anyone else this this morning.

**MR HARRIS:** The ACCC is - - -

**DR KING:** Yes, I know. Banning interchange fees, views?

**MR P KING:** I think interchange has got a role. So we need to have payment systems that are invested in and interchange helps that. It also shares the cost between acquirers and issuers. So no, I don't think we would be in favour of an outright ban on interchange.

**DR KING:** Okay. Do you mind expanding just on - you've touched briefly on FOFA and those sorts of obligations. You suggested caution in bringing together, I guess, the financial advice and mortgage broking, or expanding financial advice into credit products, and you discussed FOFA briefly. What do you see as driving that? Why do you see that there is - is there a problem you see there or - - -

**MR P KING:** Well, they're different requirements. One is effectively a not unsuitable and one is in the best interests. So they're different requirements. So if you're a planner operating in both wealth and credit markets, how does it come together? Are you - have you got two sets of laws that you need to meet? Practically can it work?

**DR KING:** It's the practical putting in place of - okay.

**MR HARRIS:** I want to do interchange fees since you've raised it, just a simple question really. Probably not a simple answer, but a simple question. So would you be confident, would Westpac be confident that if we asked for data that demonstrated there was an ongoing cost that this fee managed or ameliorated or related to, we could be given such data? Because the number of inquiries that have gone down this path in the past and looked at this and said oh, it doesn't look like there's actually much of a case to keep recovering costs, that would have once been - do you think we could be, in a mature system - - -

**DR KING:** We know the fees for - - -

**MR HARRIS:** Do you think we could get data on cost?

**MR P KING:** The RBA has had good looks at this, so I would suggest they're the first point of call.

**MR HARRIS:** Which we have done, and as I said inquiries support - nevertheless seem to have gone - not RBA per se, but Murray for example. It's hard to find evidence that would actually put the fee in place, that has that - and not every time is there a charge, is there a cost directly related to it. I mean, markets don't work that way. But nevertheless you would think in this case under the sustained reviewing pressure, if the fee remains therefore there should be some evidence that this is what we're doing, this is why we're doing it in a cost recovery sense or some other cost sense. So you think there are no sources other than the RBA that we could tap?

**MR P KING:** I think the RBA is the best source because they've had a good look at it, in a cost place.

**MR HARRIS:** I think we can access that, so I'm trying to find any other data source that you might want to hypothesise might exist out there.

**MR P KING:** I'm not sure what the specific question is but maybe we can talk about it.

**MR HARRIS:** Well, there are other players in the payment system who may actually have information.

**DR KING:** Do you view that the RBA has got the cost based interchange fee right? If you're saying just look at the RBA data, presumably we infer from that that you say yes, they've got it right. They had it wrong up until last July because they suddenly changed it, but yes they've got it right now.

**MR P KING:** They're regularly reviewing it every three months so I think the point about payments is you've got to look at - we've got cash, you've got MMP coming in, you've got EFTPOS, you've got debit, you've got credit cards. Are the incentives sending people the right signals? That's always a good question to ask.

**MR HARRIS:** That's why I alluded - I'm interest in costs. I agree incentives - as I said, price is not always there just on a cost recovery basis. But we'd like to look at foundation  
- - -

**MR P KING:** - - - just go to cost on this stuff then no one will invest. That's the challenge.

**MR HARRIS:** There are other payments that - - -

**MR P KING:** - - - was late to the party on chip and cards and now they're fighting from behind.

**MR HARRIS:** Okay. We should keep going. I'm just primarily interested in identifying alternative data sources because there's a bit of a struggle on data here. Anyway, thank you very much for your time and your contributions and for the submission that you are planning to put in as well, and we will probably be in further touch. Thank you.

**MR P KING:** Thank you.

**DR KING:** Thanks Peter.

**MR HARRIS:** So we will get the ACCC now. All right, would you guys like to identify yourselves for the record please?

**MR BEZZI:** Certainly. Marcus Bezzi, I'm an Executive General Manager with the ACCC. My responsibility is the Specialised Enforcement and Advocacy Division.

**MS CHUCAIR:** Molly Choucair, General Manager of the ACCC's Financial Services Unit.

**MR HARRIS:** Do you guys want to make opening remarks of any kind.

**MR BEZZI:** That would be excellent, yes thank you. The ACCC welcomes the Productivity Commission's draft report into Competition in the Australian Financial System and the opportunity to appear at this hearing. Among the Commission's recommendations was the need for an existing regulator to be given the role of championing competition in the financial sector. The Commission anticipates - that is, the Productivity Commission, I should say - anticipates that the regulator would have a number of functions, including but not limited to conducting transparent analyses of the impact on competition in the financial sector of prudential regulation and other regulatory measures.

The Productivity Commission has made a number of other findings and recommendations in its draft report, and the ACCC will respond to many of them in our written submission. We would like to focus our opening remarks on three issues. Competition advocacy and the ACCC's role in financial services. The ACCC's Financial Services Unit, embedding greater transparency in decision making and the commitment to competition.

On the first of those topics, competition advocacy reminds policy and lawmakers that competition drives innovation, choice and better outcomes for consumers. We agree with the Commission that there is a particular need for greater competition advocacy in the financial system. In the 2017/18 budget the Treasurer announced that a permanent team will be established within the ACCC to investigate competition in our banking and financial system, and Ms Choucair leads that team that has now been established. With our strengthened mandate from government we believe the ACCC is well placed to bring its singular focus on competition to important regulatory decisions in the financial sector. Our approach seeks to be driven by market dynamics and be unfettered by the limitations of regulatory regimes.

We believe there is considerable scope for us to work more closely with APRA, ASIC and the RBA in considering and providing advice on the impact of key measures they take, or in helping to inform their decision making in relation to competition issues. Such an approach would ensure that nothing falls through the cracks. Currently regulatory and macro prudential measures apply only to those entities subject to such measures. For example, ADIs or financial licence holders. Focussing on competition means that all competitors within a market, whether or not they hold ADI, including those who are outside the remit of specific regulators and potential competitors, can be considered. The ACCC will seek to play an important role in achieving an appropriate balance between the objectives of system stability and competition within the financial sector.

Access to consumer data is a critical competition and consumer issue, and there has been an important development in this area since the Commission published its draft report. As part of its response to the Commission's report on data availability and use, the Treasurer announced on 9 February that the government has committed to introducing open banking

using a dual regulator model. With the ACCC as the lead regulator, we will be strongly supported by the Office of the Australian Information Commissioner. At the heart of the proposal is giving consumers access to the data that is held about them by business, including the ability to direct that such data be copied and provided to a third party.

International experience, especially in banking, has shown that consumers, giving consumers access to their data, known as the right to data, increases competition as it gives consumers more scope to compare competing offers, make more informed choices and more easily move their business. Data portability increases competition, particularly for more complex products and services, and creates scope for businesses to make more tailored offerings, including to innovate new or different products that better meet their needs.

The ACCC welcomes this development and is looking forward to working towards open banking for the benefit of competition and consumers.

I would like to talk a little bit about the ACCC's Financial Services Unit. Following the Treasurer's budget announcement we established the FSU. Many of the responsibilities proposed by the Commission for the competition champion are aligned with the FSU's mandate. The FSU was established in 2017 to undertake regular inquiries into specific financial competition issues. It will generate - this will facilitate greater and more consistent scrutiny of competition matters in the sector. The FSU currently comprises 12 staff but it is supported by in-house expert advisers within the ACCC that provide legal, statistical and economic analysis. Accordingly, the capacity of the FSU is larger than the notional staffing numbers suggest and it has scope to concurrently undertake a mix of market studies and investigations, among other matters, as required.

The residential mortgage price inquiry is the first task of the FSU and our interim report will be issued shortly. From July 2018 onwards the FSU will commence its market studies work and the precise scope of that work is still being determined, but it could include assessing the impact of regulatory measures which affect the ability of the smaller banks to compete against the majors, barriers to entry in financial services markets and consumer switching.

I would like to just talk about embedding greater transparency in decision making and commitment to competition next. The ACCC supports increased transparency in regulatory decision making impacting the financial system. Ideally new or amended regulation would be developed in consultation with, or input from, the competition regulator. That input would be reflected in consultation material or otherwise publicly available information to allow the merits of the proposed regulation to be debated. The ACCC stands ready to work in this way with APRA, the RBA, ASIC and the Council of Financial Regulators.

The ACCC is also keen to work with APRA, the RBA and ASIC should they require specialist competition expertise when seeking to balance their respective statutory completion objectives with their other statutory objectives such as financial system stability.

We note the Commission's view that the competition champion should be a member of the Council of Financial Regulators. Membership of the CFR is appropriately a decision for government. Whatever mechanism or process is ultimately adopted, the ACCC is firmly of the view that it is important for competition to be given greater significance in the regulatory decision making process. A threshold question to resolve is which matters should be considered by the regulator with the role of the champion in competition. In our view, priority should be given to measures likely to have a significant impact on the competitive process in the market and measures which prevent new competitors from entering a market, or otherwise increase barriers to entry.

Thanks again for the opportunity to appear before the Commission today and we are very happy to answer any questions.

**MR HARRIS:** Thanks to the ACCC for that opening comment. Could we go straight to this - the largest structural change in our report which is this nature of having a competition champion and you have alluded to it in your opening remarks in a couple of different ways. As you said, membership of the Council of Financial Regulators is a matter for government, which is of course literally true but will not necessarily help us come to a decision on who might best do this. I am going to try and concentrate on capacities and capabilities of a party, but I'm going to do it with our recommendation in mind and hopefully you will be able to work along with that.

So from our perspective we see membership not just being another seat at the table, kind of thing. We see it as clearly a source of independent advice to the primary regulatory structure when it deals with the nature of regulatory interventions into the marketplace that could have an impact on competition, and thus sort of almost characterising it as membership. Indeed, it's not about membership at all. It's about the ability, appointed by the Treasurer in our position, to be the advocate for competition as an independent source of advice.

Thus we did see two parties, and you're obviously one of them, that might do that and I'm not going to ask you to make comment individually about them other than on this question of resourcing. So the capability of the ACCC to undertake such a role isn't just limited to the number of people. In fact, it's really not reflected at all by the number of people you can throw into the task. It's this ability to assess the sorts of questions that we've been discussing here this morning about the, if you like, the risk appetite that a regulator, primarily focussing on stability of the overall system, has in mind for the industry. So it's a capability question, if I could go beyond it, than just an inquiry kind of question. Would you be willing to comment on that at all, this question of having the capability or obtaining the capability?

**MR BEZZI:** Well, I think there are aspects of our structure, our experience, our history which give us a unique capability to provide advice about - from a competition perspective. We are used to giving advice within government. We give this, for example, to the Minister for Communications when - - is dealing with issues such as spectrum limits. We provide

advice to the Foreign Investment Review Board. We currently provide advice to the Reserve Bank if they're considering designating payment systems. So this is something that we currently do, and we're currently resourced to do. We've done it for a number of years. Not to a great extent in the financial sector, but it is certainly something that we do do.

We also have the capacity to draw on our experiences dealing with a range of oligopolistic markets. We deal with energy. We deal with telecommunications. We deal with a number of markets where there are small, powerful players, and we do find that many of the issues from one market to another are similar and that lessons in one can be drawn in to another.

Now, I think that is a unique capability about a generalist regulator, and one of the strengths of having a generalist regulator provide competition advice to other regulators. Look, I think that we've got the - a depth of understanding and depth of experience in these competition issues that is very substantial and it exists at a whole range of levels within our organisation, from Commissioner level right down to relatively junior levels within our organisation. So that's another important capability, very important capability. It adds credibility. It also enables us to really bring a fresh perspective to issues that - and perhaps look at things slightly differently.

Look, we are also used to working within government and, as I say, giving advice to other regulators when they call on us to do so. We have very good, constructive, respectful relationships with other regulators. We understand and respect their role. I think they understand our role and our expertise and our experience and often that works very well. We very much welcome the government's mandate given to us last year to increase our role in the financial sector. It's a gradual increase, as I outlined in the opening statement, and that we will continue to develop that role.

I'm not sure whether I've answered all those bits of your question? I think I did.

**MR HARRIS:** No, I mean the core sort of consideration we've been given here is this question of capability which probably better exists offshore. For example, as we have noted in the report, foreign regulators in this area - we use the UK as quite a good example - have had experience in this field. It's that kind of capability I'm talking about, not necessarily historical or even recently generated capacity which I have no question about the ACCC's general capacity. It's this question of debating in a field where the systems stability regulator needs to hold some form of common understanding of a competition adviser, if you like, or the competition champion. It's that kind of capability that I think we were questioning. Of course, it's presumably available. It would have to be made available. So I note that - I think we've heard this question of resourcing is perhaps being viewed as a question of do we have the people in terms of numbers, or has the government given us a funding mandate, and it's capability really of a slightly different kind that we were thinking of.

**MR BEZZI:** Look, I understand and there were certainly - in the Financial Services Unit we've got people from a range of bodies, including some of the regulators that we've

spoken about today, and actually also including the Financial Conduct Authority from the UK. So we've got a whole range of people with experience of the sort that you're talking about, and deep knowledge of the sector, which of course is complemented by the broader knowledge that the agency has and the broader experience that the agency has in dealing with a range of sectors.

**DR KING:** Can I just follow up on that, because in some ways the task that we see of the competition champion is quite different from anything else that, in my understanding, the ACCC would do. You will notice in our report we refer to the Hilmer type test that we expect the champion to be looking at. Is this a change where the costs in terms of competition are larger or smaller than the benefits, and the benefits will be in terms of stability existence. So it's being able to make that evaluation.

But the second part is well, the second part of the Hilmer test which is to the degree that there are competitive effects of a proposed intervention, what other ways could the same objective be achieved at less cost to competition? Now, the ACCC as I understand it currently doesn't carry out that sort of analysis annually, and would - I'm not sure who does.

**MR BEZZI:** Look, I think we are heading into that territory in some of the market studies that we're currently doing. We've done market studies into gas and electricity markets, and they're not within my area of responsibility but the sense I have is that we are touching on some of those issues in terms of the recommendations that we're considering and the issues we're touching on. I think in the last couple of years we've really taken on a much more significant market studies role. I think we've got five or six directions to commence large market studies, many of which touch on exactly that issue. We're doing one in relation to North Queensland insurance at the moment, which touches on some of those issues. The gas one certainly does. Perhaps also electricity, although I'm not as familiar with that.

**DR KING:** I guess one of the bits of feedback that we immediately had as soon as the draft report came out, and we put forward the ACCC as a potential candidate for the competition champion, was people have long memories and they go back to the early 2000s when credit cards first came into play and they note that the ACCC seemed very keen at that stage to handball competition analysis in that part of the financial system off to the RBA. So I guess one response we've had is well, the ACCC has shown that they're not - they don't have the appetite to work in these financial markets. How would you respond to that?

**MR BEZZI:** Well, I think we're a much larger organisation than we were in the early 2000s. We're a more sophisticated organisation. We're also differently led, and I suppose my feeling is that in those days we were probably a third the size we are now. We have - it's not about staff numbers. It's about experience and sophistication, and I think we are much more focussed on a broader range of things and that's demonstrated by the responsibility that has been given to us in relation to these market studies in very complex areas.



**MR HARRIS:** Would you think a — we will call it resourcing capability — a resourcing capability that might add value here would be the appointment of a commissioner with specific interests in this area? I know this is - - -

**MR BEZZI:** It's always - - -

**MR HARRIS:** Government views notwithstanding, just that the concept of somebody with that kind of - - -

**MR BEZZI:** We've got commissioners, or certainly one commissioner, with a lot of background in financial services issues. But yes, it's always helpful to have someone with a background in an industry. Yes, I agree.

**MR HARRIS:** Particularly if there's interaction between the stability of the financial system and - anyway, it was just a thought, I guess.

**MR BEZZI:** One of our commissioners was a longstanding senior officer at ASIC, for example, for a long period.

**MR HARRIS:** Yes. Transparency, you mentioned in the course of transparency, which I see as relating to this whole question here - so one of our propositions was in order for the Council of Financial Regulators to lift its influence really and also show the balance between competition and stability, and its proposed actions was to publish its minutes in the way the RBA does when it's proposing to take an intervention. We call that a transparency device, and I assume you would too. But you alluded in your opening remarks to new regulations to support transparency. Now, it's quite possible in terms of our recommendations that the recommendation for what I call reality pricing could be considered to be a transparency device. So when you said new regulations, were you referring specifically to any particular area in relation to our recommendations?

**MR BEZZI:** No, I don't think I said new. We support increased transparency in regulatory decision making. I don't think I said there'd be new regulation to increase transparency. I think we had in mind that when new regulations were being developed that it would be done in a - - -

**MR HARRIS:** Oh, a transparent fashion. So it wasn't a regulation for transparency.

**MR BEZZI:** There would be more open consultation and there'd be a capacity for greater engagement with competition issues.

**MR HARRIS:** Okay, thanks for that.

**DR KING:** I have a slightly different direction.

**MR HARRIS:** No, I'm out of this area.

**DR KING:** Really I'll start off on integration, and what we're now facing in the financial system is mortgage brokers, being the obvious case, although we have talked also about LMI this morning, but focussing on mortgage brokers, 70 per cent of mortgage broker loans are written for institutions that are vertically integrated. I think it's approximately the right figure. Does the ACCC see an issue with the current vertical integration in the financial system? So that's the first part of the question. The second part of the question is obviously a lot of this integration occurred under the existing merger laws and was not stopped by the ACCC, and Aussie and RAMS being the obvious example that had some publicity at the time. Do you see any issues with the current rules that the ACCC faces in being able to prevent integration?

So the first, is it a problem. If not, then the second part becomes partly redundant. The second part though is that the powers in this area that exist under the merger laws, are they enough? Is more needed? Is it different in financial services?

**MR BEZZI:** Well, this was one of the very interesting parts of, particularly interesting parts of the report. Look, we're giving thought to these issues and what we'd like to do is to put in a written submission that addresses these issues. I'm sorry to sort of skirt the question, but rather than commenting on the issue in detail now I'd really like to finish our internal discussions about it and then make a submission about it. I mean, we do see it as an important development in the market. I think you noted before the competitive impact of the mortgage brokers before the GFC. It's much greater than it is now, and there's no doubt that a case can be made that is as a result in part at least because of the vertical integration issues.

You've identified I think in the report some issues about disclosure of information and representations that are made in that, in the broker area. As you note, consumer protection in financial services is the responsibility of ASIC, but it is a very interesting part of the report and we will comment on it.

**DR KING:** I will have to change topic. Have you anything more on integration of that area, or I'm happy to move on to another topic which is the NPP is the next one I have. I'm just noting the allusion to the further advice coming.

**MR HARRIS:** So that's good.

**DR KING:** NPP, so obviously the ACCC isn't one of the Board, unlike the RBA which is on the Board. So you're able to offer perhaps a fairly unique perspective of being a party that deals with access regimes quite broadly over the infrastructure and isn't on the Board of the NPP. So it's difficult for us to obviously ask the RBA about things like a deemed declaration of the NPP. What is your view on - so we've suggested, put a draft recommendation that it be declared for access, an access regime be put in place under the RBA. What is your view of that? Is that a sensible way to go? Do you feel that it's too early for that? Yes, general views on that and then we might get into specifics.

**MR BEZZI:** So the specifics are once again, is one of those topics that we would like to address in our written submission. In general, I would say that that is exactly the sort of issue that we would see ourselves as being in a position to engage with the RBA on, and indeed on other payment system issues. That's been something that has happened. So for example, the issue of cost routing. I might ask Ms Choucair if you are interested in understanding some of our engagement with the RBA in relation to that issue?

**DR KING:** Yes please.

**MR BEZZI:** Molly, if you could explain some of the work that we've done closely with the RBA on that?

**MS CHOUCAIR:** Sure.

**DR KING:** So this is the - - -of debit transactions?

**MR BEZZI:** Yes.

**MS CHOUCAIR:** That's right, in the context of - - - So we've been there as the regulator with the RBA in relation to this issue. We're watching this space quite keenly. Obviously the RBA has a primary responsibility in terms of the declaration it might make in that regard. So we as the ACCC certainly support this cost routing, and we would support merchants having that choice. In merchants having that choice we would also be keen to ensure that consumers were aware how their transaction was being routed. So there's a transparency element in all of that, which could very well be an issue for ASIC in terms of misleading and deceptive conduct in relation to financial services. But more broadly I guess the Commission is keen to watch potential reactions in this space from other participants of the market who might be impacted by this cost routing coming into effect, and specifically how the international card schemes might respond. So very much through a competition lens we're watching that space and obviously will note any development, but there might be scope for us to look at that issue more closely, depending on how it all plays out.

**MR BEZZI:** I think that's a good example of the way in which we can work with the RBA. We've got an MOU with the RBA under which we can agree to provide advice on designated payment systems or systems issues. We've got good relations with the area within the RBA that deals with those issues, and we think that is a great example of how the agencies can work closely on the competition issues.

**DR KING:** As we've got into the routing of debit transactions, there appear to be different choices or different approaches used in different countries. In our draft report we tend to focus on the merchant choice. I think that maybe the US allows a customer choice approach. Does the ACCC have views on which of those is best or would be more desirable for competition?

**MS CHOUCAIR:** Yes. So I think it's fair to say that we don't have a considered position. We're certainly aware that in different jurisdictions there have been different approaches undertaken and you're right, in some jurisdictions it's the consumer choice that ultimately prevails. I think in Australia we're certainly moving more towards a merchant choice. I guess what our position is is with being agnostic on those two options, is just ensuring that consumers are aware of the network over which their transaction will be routed, so they're making an informed choice even if it's ultimately the merchant that decides how the payment will be routed.

**DR KING:** I have nothing further to ask.

**MR HARRIS:** You don't? Okay. So you mentioned access to data and the importance of open banking, and although that regime is - - - stage and have only just been announced. You see the ACCC's role as being a party involved there, as being a significant shift. Is there - the purpose of our final report I think going into - and the assumption might well be there is probably not going to be much by way of developments in the next three or four months that we could assess and cover off on the final report, but you did refer I think to arrangements with the Information Commissioner as well. So are there likely to be developments in this area? We've seen progress as being important and it looks quite positive, but is there anything else that you could offer on the record about what is likely to happen with open banking?

**MR BEZZI:** Probably not, between our role and the office of the Australian Information Commissioner, it - - -

**MR HARRIS:** No, it was more I don't know - we had seen what we've put in the draft report as likely to be what we will come out with in the final report, which is this is important. Open banking is quite an opportunity as a catalyst in this area. The design though of what the data is that is shifted from one institution to another is crucial. We've had some background briefings on banking but I just didn't know the degree to which, for example, you were involved in that ongoing decision making or - - -

**MR BEZZI:** So we're going to be responsible, as I understand it, for writing the rules. We're going to be responsible for setting the accreditation criteria, as well as enforcement and overseeing the data standards. I think you're right, it is early stages. I think probably, although this isn't my area of responsibility, but my understanding is that there is a process going on where the Treasurer has invited comments on the report. I suspect that those comments will be considered and then that process will be taking place before you finalise your report. There probably won't be much to add to that process in the meantime.

**MR HARRIS:** In the intervening period, okay. That's fine. I don't think I had anything else from recollection. I did, but I haven't written it down if I have. No, I haven't written it down. So I think we will be happy to close at that point unless there is anything specific you would like to get on the record before we finish?

**MR BEZZI:** No, that's great. Thank you very much.

**MR HARRIS:** Thank you very much for your participation and for the future submission that you are going to be putting in. So I think for everybody's benefit we could probably take lunch now until 1.30 when we come back with the fabulously named Xinja. So be here at 1.30. Thanks very much.

**ADJOURNED**

**[12.45 pm]**

**RESUMED**

**[1.30 pm]**

**MR HARRIS:** We're going to restart and I think we have representatives from Xinja at the table who I think I'm going to ask to identify themselves for the purpose of the record.

**MR WILSON:** Thanks, Commissioner. My name is Eric Wilson, I'm the Chief Executive Officer for Xinja.

**MS LE:** And I'm Van Le, the Director for Strategy and Innovation at Xinja.

**MR HARRIS:** Do you have some opening comments you'd like to make?

**MR WILSON:** We do, if we may, thank you. Commissioner, ladies and gentlemen, thank you for the opportunity to speak to the Commission. We'd like to commend the inquiry and the work of the Commission generally. We'd also like to thank all of the industry and the non-industry participants who contributed, what we judge to be, an incredibly important discussion. We'll keep our presentation reasonably short, and well we love the sound of our own voices, but hopefully to allow plenty of time for the Commission for questions.

Xinja will be, if all goes according to plan, Australia's first neobank. We began building Xinja at the end of 2015 and applied to be granted ADI status in September 2017. We've raised about \$10,000,000, have a waiting list of thousands and thousands and thousands of people, been granted our ACL and draft AFSL by ASIC recently and hoped to be granted our IDI status by APRA and become a bank between April and June this year.

By happy coincidence, our first product is also shipping today to our early customers and I'd like to thank, if I may formally, our regulators ASIC and APRA and the policy makers for that vision, assistance and guidance on our journey so far.

We aim to be a for profit but also a for purpose business, and revolutionise the Australian banking industry, in favour of everyday Australians. If successful, we'll be the first new retail bank since Macquarie, some 20-odd years ago, and we feel it's time that Australian's got access to the same neobanking technology and experiences that have been available overseas for a number of years now.

If it's helpful, we'd like to share with the Commission, our experience of competing as a start-up and trying to build a neobank in Australia. It's worth mentioning that, in many ways, we're dealing with regulations that never envisaged the possibility of a start up being a new entrant in the banking sector. It's worth remembering that it will take time and experience to expose and rectify all of the regulatory booby traps that are waiting for new banks.

I think what is critically important to talk about here is that this review comes at a very important time for Australians and for the Australian financial services industry. We are on the cusp of a revolution within financial services, one that is already sweeping the world outside of our shores. The old moulds of high margin and high cost operating models are passing, and the time of smaller models, highly flexible, lower costs, super levels of transparency are already starting to sweep into financial services markets around the world.

Neobanks may be a new concept here and people may sort of looking at us curiously, but they are already well established in the UK, well established in Europe and spreading throughout the world. I believe there are 86 at the last count. That Australia still doesn't have any at all, I think is, in of itself, an interesting statistic.

Xinja supports the key findings and recommendations of the draft report, and we'd like to address a number of areas specific to competition in the retail banking sector, if we may, and my colleague, Ms Le, will talk about this in a little more detail in a second.

The report echoes very much what customers have told us about what frustrates them about banking and about money, in that it's not easy to make the right choices. It's difficult for customers to currently compare products effectively. There's a lack of accessible information. Products are complex. What appears to be one rate in a mortgage product, for example, means something completely different.

There's a really strong case to be made for a new regime of transparency across these products. There really are brand or marketing smokescreens, which the report raises and I think it's one of the greatest threats to this new neobank movement is that neobanks are impersonated by the older, more traditional banking organisations, but with a shiny new brand slapped on the front. Indeed, we're starting to see those in the market today and you have to look through five or six pages of disclosure before you can actually spot that this business is a joint venture with X.

One of the things that has struck us much – as somewhat a surprise, and I am an ex-big four banking executive, is that the trust between many Australians and their banking institutions is deeply broken, and I personally have no understanding of the depth of that break, until I started this business some years ago. There are concerns about the lack of effective competition and flow of commissions, creating an environment where advice that appears independent is not independent.

Finally, we hear from our customers all the time that breaking up is really hard to do. Customers tell us they'd like to switch, they're happy to switch, they want to do so, but

from their perspective all of the existing players look the same. Where do they go? Why go through the effort if there really isn't much variation? Of course, secondly, it's a lot of work to switch. The ability to switch bank accounts, to port data simply and easily, is simply too discouraging.

We're enormously encouraged by the PSD2 developments in Europe. We believe open banking is a critical part of the open data movement generally for consumers and is a revolutionary tool for competition within Australia. We applaud the open banking review recently released, and we think this is a key contributor to consumer choice and convenience.

I think it's mentioning specifically, the objectives behind the recommended reforms that we would like to call out and pinpoint for their importance. Firstly, clarity, about how products are priced, how the features vary, what the minimum scope for a provider or a group of providers is to provide that for that clarity, and how they can – and an examination of how they can exert significant influence over price.

We're also a huge supporter of sufficient information, for both providers and consumers to be able to make informed decisions. The flow of data allows customers to make really strong decisions and it allows us, as product providers and as bankers, to be able to give a risk price for individuals, to be able to make really intelligent decisions for our customers.

Thirdly, low barriers. Industry participants have to enter this market and we have – if we wish to expand within it, we have to make sure that there are low barriers to entry, and we don't believe that that is inconsistent with making sure that our financial infrastructure is safe and secure. I've been a banker most of my career. The last thing I'd want to see is our financial infrastructure fall pretty to weakness.

Finally, and perhaps most difficult, we need to make sure we install a regulator environment that doesn't impose undue distortions, that doesn't favour incumbents or doesn't overly favour start-ups. The access, or the provision to access a particular financial product or particular providers, need not to be influenced by the regulatory environments in which they're operating.

I think possibly the most important thing for us out of this report is that we strongly agree that the key to new competition or to – sorry, that the key to real competition in the market is to encourage new entrants, and this passes the pub test. I remember recently the conversation in the media about the bank tax, quite disregarding whether you think it's a good thing or a bad thing, the conversation was all around the bank tax will be passed on to the customers of the bank. But that, of course, assumes that the customers of the bank have nowhere else to go. If you make it easy for them to move, they have viable other non-big four alternatives, it's a – it's then a conversation for the banks to how to deal with that tax, and not a customer that's locked in and can't escape it.

ASIC, in January, changed the requirements around crowd funding. Now crowd funding is an important thing for start-ups, but I wouldn't want to overstate its importance. We've

been very fortunate and raised over a million and a-half in equity crowd funding over the last three or four weeks and it is important, and our duty to those shareholders is massively important. However, to build a bank, a million and a-half is not a material amount of money. The types of money we talk about are 15, 20, \$25,000,000. So it's important to make sure that we don't use crowd funding as an excuse to make other reform – not to make other reforms.

We look forward very much to the passage of the legislation currently before Parliament that will make it easier for start-ups, like Xinja, to enter the market and create competition, allowing them to use the term “Bank”, allowing us to hold less regulatory capital in the first instance.

Perhaps two most important points around this, we'd like to highlight the need for regulations relating to ownership to take into account the impact on start-ups. Whilst Australia doesn't need a whole bunch of new banking honour guards, it's not that we wish to hang on to equity, but the current requirement that only one individual can hold 15 per cent of a bank makes it incredibly difficult. I think there's probably only me and two or three other people in this country, dealing with this problem. I say, the issue isn't that I want to walk away with 80 per cent of the bank, the issue is I have to sell that equity at certain times to allow me to raise more money to build the bank. If I'm forced to do that in a fire sale, not only does it cheapen the equity, but it also limits my ability to actually get the bank up and running.

The other thing to consider, of course, is that many ventures of this type are backed by venture capitalists and corporates and the level of risk required to back a company like ours, often necessitates and investment of more than 15 per cent of the equity. So these limits place constraints on us in terms of raising capital and allowing it to grow. I appreciate the easy pathway down there is to go, obviously, the principal shareholder just wants to hang on to it. But actually, it's a little more complex in nuance than that, allowing us to build a bank and to take it forward.

Finally, I think we'd like to also think a little bit about how the interplay of ADI licensing and ACL licensing works. So with a credit licence, Xinja can issue mortgages to the extent that we have funds to lend. Our first challenge, of course, is to access wholesale funding.

But the second challenge is then that where we can access whole funding, a restricted ADI limits our ability to offer offset accounts with those mortgages. This means we have to make difficult choices around how we split our \$2,000,000 cap as a restricted ADI on deposits between offset accounts to provide a better outcome for home loan customers which means a smaller number of mortgage customers, or that we allow ourselves to use that \$2,000,000 to raise deposits which again allows us to – it turns into a vicious circle for us.

Finally, before I hand over to my colleague, I'd just like to talk about the role of technology. The role of technology is massively significant in this change and this revolution that is coming to banking. Just to give you some numbers, a legacy bank is likely to spend



somewhere between 25 to 30 to 40,000,000 to build a new, or to alter their new bank end banking platform. Currently large banks spend about \$600,000,000 a year on these bank end banking platforms. However, we're able to bring a cutting edge back end banking platform, probably two or three generations ahead of this country from Europe for about \$20,000 and then a monthly - - - as a service fee.

So these barriers to entry are falling, and it's incredibly important that our regulatory environment allows people like me, and hopefully lots of other neobanks, to come into this market in a safe, regulated fashion, but not constrained from competing and offering some real, genuine alternatives. So to talk for a little bit about some specific additional recommendations, I'll ask my colleague, Van, to speak.

**MS LE:** I might start with that point on technology and some of the very early conversations that we've had with customers in terms of what they'd like to see next, brought into the Australian banking sector, especially our younger customers, our millennials. One of the most striking quotes that we've come across is a millennial who said, "We do everything differently to our parents, except banking. Banking is the same". I think that, in some ways, captures the opportunity that's available to this sector, not just in terms of technology, but also how we compete on a national stage.

So in addition to the recommendations that have been put forward by the draft report, there are a few additional proposals that we'd like to put forward and they cover four key areas, the first one being recommendations – additional recommendations to empower consumer choice; recommendations around encouraging new entrants into this space; recommendations that specifically address competitiveness in the home loan market; and finally, recommendations around further expanding the benefits of competition.

So I'll start firstly with some recommendations focussed on consumer choice and confidence. We would like to recommend that ASIC's existing work on financial education by MoneySmart as well as its work on the National Financial Literacy and Capability Strategy be incorporated into the broader framework of empowering consumers to make good choices.

One of the first barriers to consumer power in this market is the level to which consumers actually engage with financial products and services. Some of the research we've done has highlighted that 39 per cent of workers spend over two hours a week thinking and worrying about finances while at work, and that's time spent just worrying. Yet, only half an hour a week is actually spent engaging with financial decisions or financial activities. You compare that half an hour a week to the 1.8 hours per day that people spend on Facebook. So we believe there's a real challenge and opportunity around encouraging consumers to actually engage firstly, if they're going to be in a position to have more consumer power in a highly complex market.

We also note that 41 per cent of people actually want to spend less time on money administration. This, I think, speaks strongly to the potential for technology and open

banking, to be able to achieve these stronger consumer outcomes without placing the full burden of the effort of achieving competitive outcomes, on consumers themselves.

We also note that good financial advice is particularly important for consumers to be able to make good choices. Many of our customers have told us that they trust the Barfoot Investor more than they trust their banks when it comes to advice on money. We note that only 14 per cent of the work force actually use a financial planner, and some of the concerns for customers is the perception that financial planning is expensive, is too sales-focussed and lacks independence.

There are a number of initiatives in the National Financial Literacy Strategy and Consultation that starts to address these and I think they need to be considered in conjunction with the broader framework of the level of competitiveness in this sector, so that consumer power is balancing with market structures themselves. We believe a strong national financial capability strategy is absolutely crucial for empowering consumer choice and that needs to start with existing consumers, but also take into account future consumers, especially those going through our education systems.

The second round of additional recommendations we'd like to add, is specifically around encouraging new entrants into the banking sector. Firstly, we'd like to propose that prudential regulations, while critically important for protecting the stability of our financial system, also takes into account the relative risk of new entrants to the overall stability of the financial system at a whole. We think it's disproportionate to expect start-ups to meet the same high prudential standards designed for larger organisations to ensure that they don't fail to a level that impacts the whole market.

Secondly, we propose that any regulation affecting licensing banks the financial services sector, takes into account the differences in business lifecycles of different participants, especially early stage participants. When you introduce regulation that's designed to change the conduct of existing players, you may inadvertently prevent or stifle new players from coming into the market. So it's really important that regulation is viewed, not only in terms of its impact on existing participants, but also those who might want to enter the market.

Along that same vein, we also believe that to the extent that there will be a regulatory body or a competition body or competition functions that come into play in the financial services sector, those functions should specifically include analysis of the competition impacts on start-ups and early stage competitors, particularly because that is where the highest risk and opportunity is for disruption, competition and innovation in this sector.

I'd like to now address how do we improve competitive outcomes, particularly in the home loan market. If you take a step back for a moment, if we look at the benefits of competition in the financial services sector, I think it's worth looking at where those benefits ultimately impact the everyday consumer. For many consumers, the primary financial product or service that impacts their pocket is their home loan or mortgage. So one of the questions

that we should be asking ourselves, with all the recommendations coming out of this review is, how does this play out in competitiveness in the home loan market?

One of the recommendations of the review was to enable the central collation of home loan rate data. What we'd like to propose is that there is a technology aspect to that that enables consumers to not only access that data, but more importantly access it in real time at the point at which customers are trying to make those decisions, being able to compare home loan rate data that is days old, even weeks old, in a market that is moving so fast can, inadvertently, disadvantage consumers.

The second additional recommendation is that consumers have visibility where their brokers or advisors are lender owned. We are not suggesting that brokers and advisors not have a role or that it isn't appropriate for commissions to be a part of the economy. But we do believe that consumers should be empowered with visibility of the relationship between lenders and brokers and advisors where there is one.

We also propose that customers have visibility when they are being recommended a home loan that happens to be one which pays a higher level of commission compared to other alternatives. Again, this is about ensuring that consumers are fully informed.

An additional recommendation specific to home loans is ensuring that regulation includes analysis of barriers to entry, specifically into the home loan market, not just for lenders but specifically home loans that are attached to offset accounts. It doesn't work to consider the loan separately from the deposits because, for the majority of Australian consumers, how those two elements work together is key to their overall financial wellbeing. So we recommend that in assessing the competition in the overall financial services sector, we give particular attention to competition in offset-based home loans.

Finally, we believe that the ACCC's experience in dealing with wholesale markets, may provide some learnings that are relevant when considering the competitiveness of wholesale funding in the Australian banking sector.

Finally, we have one key recommendation around expanding the benefits of competition. We believe that whilst it's important to look at improving the level of competition within the Australian financial services sector, Australia has the capacity to think beyond our current markets and consider how does enabling a competitive financial sector here, position Australian businesses to compete on a global stage.

To that end, we note other sectors, such as software development, where we've had amazing Australian start up stories, such as - - - and also Atlassian where they've been able to take a leadership role, not only in Australia but internationally. So a really great sign that we have a strong competitive financial services sector here is looking at the incidents of Australian businesses that are competing well here, but that are also competing on the international stage. We'd now like to invite questions and comments on our submissions so far.

**MR HARRIS:** Thank you very much for that. Can I start with this 15 per cent ownership element? You may know more about the progress of this because, I presume, you have been consulted as this – as well. What we currently understand to be the case is that there is a draft regulatory reform buzz around to change the ownership level from 15 per cent.

But the way you presented your case, as I understood it, was you have to have a very high ownership level in order to, as it were, sell down equity in tranches over time to bring in additional capital to – as the business needs to grow. So is your proposition that you start out at you know 80 to 100 per cent owned by an individual and have a sort of sell down strategy? Is that the idea? Without necessarily going into things that are terribly commercially sensitive for you, I'm trying to work out whether this proposition on 15 per cent is to lift 15 to 25 or to lift 15 to a very high number and go down?

**MR WILSON:** I think perhaps the easiest way to answer that question is truthfully and openly. So the current founders of the venture own about 70 per cent of our business still. I think at the point where you reach a capability to apply for a restricted ADI and you've been through that process, it's very unlikely that the founders would have 80 to 100 per cent, simply because you have to gather capital around you. I think, even without – banks are capital hungry businesses. So even without any regulation, it is likely that that founder number will fall to 25 to 30 per cent, even without any kind of effort.

I think the key for us isn't around what that final number is and we're comfortable, to be honest, if it's 10, it's 15, it's 20, it's 25, whatever – wherever that ends up. I think the issue for us is the certainty about that pathway, and we've seen it in other sort of financial services industries here. The issue is when it comes in a hurry and it can't be prepared for. So APRA may sell, "You need to sell to get to this point". All of a sudden there's a glut of equity onto the market because it has to be sold in order to keep – to ensure they remain compliant.

So we would like to see a pathway where, perhaps, it starts around 70, 80 per cent but there's a clear considered action approach, through a number of years, where that equity falls. We would have, for example, no problem at all where APRA say to us, "Okay, Xinja, these are your requirements when you go off for a restricted ADI, but within three years we expect you to be compliant with the 15 per cent". So it's not about the numbers for us. It is about being able to take that pathway in a careful, considered fashion and not having to create a fire sale.

**MR HARRIS:** Is that what happens overseas? You've alluded to other neobanks, but you're the sort of – well there's – I don't want to say you're the only, but you are a pioneer here.

**MR WILSON:** - - -

**MR HARRIS:** Is that way – is it the way other countries deal with this?

**MR WILSON:** So I haven't had these types of conversations with any of the founders of the overseas neobanks. They - it is not a consideration that comes up for them at all. So I'm not familiar with the regulation in Europe and the UK.

**MR HARRIS:** But it means their regulators must be finding a way to deal with this because presumably, whilst you might not be asking us specifically about that, in the trade press there'd be a sell down of option known.

**MR WILSON:** Agreed.

**MR HARRIS:** So is it your general impression that people do start at a much higher level?

**MR WILSON:** Yes, I believe so. I believe so. I think the general impression is that the process is less closely monitored. We're not necessarily advocating that, as I said before. You know, we object – our outcome is not that we wish to see a whole bunch of banking - - - created in Australia. Our outcome is that we see a whole bunch of neobanks created in Australia and we're given the opportunity to move to an equity position over time that we can control it and use that equity to funnel our businesses into growth.

**MR HARRIS:** You referred to using the term “bank”, and yet we also hear the term “neobank” or something like that you used. There's a lot of sensitivity around this, or historically there are reasons around using the term “bank”. So is it the case that there's a settled view now on the right terminology or is that not yet here?

**MR WILSON:** Look, certainly we've been getting a very clear feed from our regulator on this. The word “bank” is tightly controlled. It doesn't matter whether you call it a “neobank” or you start it with a “Q”, at the end, or however it is. It's a regulated word and you can't go near it. I think the interest in this legislation is that once it goes through, those of us that are on a restricted ADI will be allowed to call ourselves a bank. Some of the credit unions will be allowed to call themselves banks. Personally, I think that's an outstanding development, because it allows us to compete on a much better playing field.

If your question is, should the term “bank” be freed up further so that you can use it before you get a restricted ADI, I don't believe so. I think that would be quite a dangerous place to be.

**DR KING:** Can I just push a bit on that?

**MR WILSON:** Of Course.

**DR KING:** Is the name “bank” that important? I mean, you seem to be putting a lot of weight on it?

**MR WILSON:** Yes. I think for us, it synonymous with the – that the government guarantee the deposits. So you know, and I get asked the question all the time by investors, they say, “Okay, well that's great. Well, you know what happens if you run off to the

Bahamas with everybody's money", you know. The answer to that is (1) I'm never going to run off to the Bahamas, but also that the government provides a guarantee of \$250,000 per person on those deposits, and the word "bank" signifies that and often links, in consumer's mind that if you have a bank, they're government guaranteed and the money is safe.

**DR KING:** Okay. Even though, the legal situation is significantly more complex than that?

**MR WILSON:** Absolutely.

**DR KING:** Okay. To the degree that it then, as soon as you get the name "bank" you're underwritten by the government, there's a - both an implicit and expectation by depositors and the electorate and explicit role there by the government, you said that new interim - so you know let's say the new interim's got the name of a bank, it should be subject to less prudential regulation.

I mean, is there, from the government perspective, actually more risk from - not a system's stability point of view but simply from you know if you think of the government as a reluctant insurer you know, the 18 year old driver is a lot higher risk than the 65 year old who's now - let's bring it down to someone, 50 year old experience but not going eye sight problems or anything - driver, is it the same in banking really but from the government's perspective, new interim's called "bank" and with all that goes with the name "bank" can be considered a higher risk?

**MR WILSON:** So I think there's a couple of good questions in there. Firstly, we don't in any way advocate that the non-capital restrictions should be waived or varied at all. So, for example, of the enormous plethora of things we have to prove to our regulator, everything from credit policies through to disaster recovery planning, we're very comfortable for those to remain in place. We feel that those types of things are absolutely critical to the security of the financial infrastructure and we support those 100 per cent.

I think the things we've looked to change in the regulation, and they are starting to change, is those blanket statements. So, for example, recently it was, "You can't become a bank unless you have 50,000,000". Well, what does that mean? We're looking for regulation based on risk and risk weighted assets. In terms of you know are neobanks more risky than traditional legacy banks, I think probably we have to look overseas for that. So we've not seen an implosion of any of the neobanks overseas. There's been no horrific stories of people losing money and so forth.

On an individual level, you'd have to say that the likelihood of a neobank struggling financially was obviously greater than CommBank or Westpac, absolutely. The impact of that however, when covered by the government guarantee on consumers, is massively mitigated. The amount of capital required to hold at the moment on 3 to 3,500,000 in capital for 2,000,000, you know just off the top of your head that seems a pretty comfortable

coverage ratio, and indeed far higher than any traditional bank maybe would be required to hold over its deposit base.

So I think the proposed legislation is probably in a position where it imposes a considerable level of capital cover on us. But because the absolute numbers aren't too massive, I think we're pretty comfortable with the way it's going in terms of capital coverage.

**DR KING:** I just wanted to change the direction on that slightly and just see – in terms of barriers, I'd like to get just a little bit more information on the offset accounts and that's rolled in terms of lending. I just also wanted to - get back to that in a second – but before that do, just to understand the lending side of your business. You've got, I think you said, 2,000,000 in deposits at the moment. For lending, would you be requiring – you said “wholesale funding” – would you be looking at sort of warehouse funding and securitisation type of model or would you be holding the mortgages on your book? What sort of model are you looking at pursuing, and then I can ask you questions about - - -

**MR WILSON:** Just to clarify, so we don't hold deposits yet. We're not a – we don't have ADI status yet.

**DR KING:** Yes.

**MR WILSON:** And 2,000,000 is the number that the restricted ADI allows us to hold.

**DR KING:** Sure. Okay.

**MR WILSON:** So in terms of a book, the best way to think of us to start with is as non-bank lender. So we don't have large amounts of deposits to draw on. So in order to be as safe as we can, we seek various, and are seeking various funding lines. Some of them are all the usual suspects that you'd expect in Australia. We also look overseas for overseas pension funds. We also look to private funding lines. So our cost to funds, certainly at the beginning, is substantially higher than the perhaps the big five. So and then obviously, we look to securitise over time as we mature in our market. Then as our deposits start to pick up and we move on from the restricted ADI into an ADI with ADI with conditions, we then perhaps look to a more traditional funding sources from our own deposits.

**DR KING:** Do you see issues at the moment with the regulatory constraints around the wholesaling funds? My small historic knowledge on that is just to note our you know Aussies and Rams were the big innovation of the 90s, big competitive affect and of course dried up as soon as the wholesaling fund dried up and the securitisation market has been – come back but fairly flat.

**MR WILSON:** Absolutely. This is an absolutely core strategic question to organisations trying to build neobanks. One of the conversations we had two to three years ago when we were trying to decide the strategies and would it be – actually, should we go down the non-bank lending route and do exactly as you've described. Our decision not to do so, to go down the bank avenue, was exactly for the reasons you just outlined, what do you do when

the wholesale markets dry up? What do you do when securitisation markets start to become a little difficult? That was a decision to move down a full bank and to seek an ADI because it allows ourselves to gather deposits and to grow a deposit base in order to insulate ourselves from exactly those problems.

**DR KING:** You mentioned offset accounts. Do you mind, a bit more detail on that, because I think this is the first time I've heard it raised. Others may have heard this raised elsewhere. But you said "restrictions on offset accounts related to mortgages".

**MR WILSON:** Yes. So just for clarity, an offset account is effectively where you allow customers to hold a pool of money, and that pool of money counts as if they paid it off their mortgage. The difficulty that we're discussing here is around the restricted ADI which only allows you to hold 2,000,000 in deposits. And as a new bank, I have conflicting priorities, I want to build deposits and I also want to make as great a deal as I can for the people taking home loans from us. So if I need to offer offset accounts for our home loans, obviously, I have to put that into the deposit file.

**DR KING:** Yes.

**MR WILSON:** But hang on, I can't use those deposits because they're required for the home loans. So treating deposits in offset accounts the same as deposits, which might be in a savings accounts which the restricted ADI does, will cause us some complexity in the first early months of this – of the restricted ADI. I think the solution there is potentially either some distinction between those types of funds and that can be done by a - placing restrictions on us as to what we can do and what we can count those funds for, or potentially examining the ability to increase the amount of deposits we can take when they're specifically related to - - -

**DR KING:** To a specific loan.

**MR WILSON:** - - -

**DR KING:** Yes, okay.

**MS LE:** The other competitive impact of that is, is if we need to go down the path where we are limited to \$2,000,000 in deposits initially, then the kind of products and services that we can bring to market to compete when it comes to home loans will more likely be limited to standard vanilla loans that don't have an offset capability. Meanwhile, our purpose intentions are to be able to offer you know greater financial wellbeing for customers. So on the one hand you may have less competition, less new competition in those types of home loans, or we may need to be a situation where we have a little bit more flexibility to grow as an overall bank that is competing both on home loans and deposits, otherwise it may be quite some time before we see genuine competition, especially in features and innovation and pricing for customers on home loans without the ability to do offsets and home loans together.



**DR KING:** I've only got one other on technology, so I sort of - - -

**MR HARRIS:** No, no, that's it. I was going to ask the offsets question myself. You've done that.

**DR KING:** Okay.

**MR HARRIS:** So you're on the last question.

**DR KING:** All right. Technology. So was it 20,000 up front plus a monthly fee that you pay for the software? We know that the existing banks had significant troubles with their IT systems and incompatibilities, simply getting products – all their products which were traditionally on different IT systems, onto one IT system. When they have had attempts to integrate, they haven't been so successful. Yet, you're –and we're talking about billions rather “20,000” for traditional banks.

Where do you see this going? I mean, you've just suggested – I mean, in a sense it suggests the economies of scale. Technology is going to rip the economies of scale out of banking. Am I getting that right and, if so, does that mean that really we've got a current system that supports a bunch of dinosaurs and we should be getting – thinking about how they should exit the system rather than support it within the system?

**MR WILSON:** Look, I think the – I think it's worth saying that I think there is a growing train of thought, and I'm certainly a proponent of this, that there is a want, in every couple of generations, change, structural change coming to the finance industry. I'm not saying it will happen tomorrow or next week or next year. But within three to six years we're going to see substantial changes in the cost mould and the cost bases of banks.

Right now, you know we're talking about back end banking platforms, so the ability not to have to build your own, the ability not to run a branch network, the ability not to meet 30,000 people sitting in a branch network. That's just the cost side. So you know our ability to operate banks without these massive barriers to entry around cost and high cost are disintegrating before our eyes, as we see that now.

I think what creates a double whammy there is we're also starting to see a complete revolution in the way services are provided and how much they cost, how much they charge to customers. You know, we have distributed ledger technologies. We have you know supranational and supracurrency arbitrages across different product sets. It won't be that long before individuals who want a – you know who want to get a mortgage, are able to arbitrage lenders from around the world. They're able to arbitrage different currencies around the world and it will all be packed up – packaged up nice and easily in a consumer retail bundle.

The ability that you're – idea you're only going to have four people or four companies to choose from, is done. That market already exists. It's just a case of it maturing a little bit and us being ready to enter into it. It is of major concern to me. I mean, I'm a banker by

background and, Xinja aside, it is a major concern to me that one of the key hearts of our economy is completely unprepared for this tsunami of change that is coming towards it.

That means there are people unemployed. It means there are families that are impacted by it, bankers – I know no one sheds a tear for the banker. But you know these are big economies, big companies that support many families. There is massive change coming and I think you know the wave of some of the redundancies that we’re seeing now, some of the big four, you know the profitability levels are simply not sustainable and it concerns me deeply. But look we’re sticking our head in the sand rather than stepping up, making regulatory changes, which we’ve started to. We’re making technology changes and business model changes to cope with, survive this massive tsunami of change that’s coming.

**MR HARRIS:** Okay. Thanks very much for making your time available today and for your contribution to the inquiry.

**MR WILSON:** Thank you. Thank you very much.

**MR HARRIS:** I appreciate it and we’ll probably be in touch further, before we finalise it.

**MR WILSON:** Thank you.

**MR HARRIS:** Thanks a lot.

**MR WILSON:** Thank you.

**MR HARRIS:** Now I think we have one last submitter this afternoon, which is Peter Mair. Peter, come on down.

**DR KING:** Peter, is it “Mayer” or “Mair”?

**MR MAIR:** Mair.

**DR KING:** “Mair”.

**MR HARRIS:** Just for the record, Peter, could you identify yourself?

**MR MAIR:** My name’s Peter Mair. I’ve had a bit of history in the business of financial system reform. Well, thanks for the opportunity to come here today. Among others, I owe it to Keith Campbell to be here today.

In 1981, Keith certainly did not envisage a financial system like we have today. He had something else in mind and, as you know, things develop differently. I was interested, Mr Harris, in your address to CEDA the other day and I’ll just touch on a couple of key points you made that draw out the correspondence of our views and understanding of things up to a point. You talked about the “degree of competition is a factor created by regulation and

the regulators”. I agree with that. You talked about “the most important underlying theme being a proactive regulator for competition”. You talked about “the link between competition and instability” and you “understand the way regulators had applied controls to protect stability but limit competition”. You and I agree that regulators must be at the heart of the Commission’s report.

We started to drift a little bit apart when you were talking about nuances and subtleties in regulatory arrangements. We had a bit of an overturn of both peace and competition in our time. When you’re dealing with these powerful focus, intangible sort of institutions and power brokers, there’s not a lot of room for nuances and subtleties, I can tell. A little bit of four by two capped between the eyes would be a helpful bit of equipment to take with you.

You then - against that sort of background of general agreement, we part company because you see the way ahead as being through the council of financial regulators augmented with a competition voice or spokesperson. I don’t go along with that prospect at all. I think the critical question that we are agreed on is what regulatory arrangement for Australia is likely the best managed, the practical reconciliation of stability and competition. You’ve got confidence in the council of regulators augmented with the ACCC.

My approach, similarly, in visions a coordinating oversight body but one that is very clearly independent of existing independent regulators. May I say, that between us I think history is against you. I gave the secretariat some reference points that I suggested for today’s discussion.

**MR HARRIS:** Yes.

**MR MAIR:** One of them was to say that regulatory history is relevant. I’m disappointed that so far, the report has not given an assessment of what went wrong nor, having regard to what went wrong, what elements of that can now be corrected. There’s not actually a lot of room to move from – or at least quickly from where we are now. I would suggest that the Commission consider aiming for a financial system that operates as if it were competitive. I’d like to see the Commission outline a framework, an institution framework, a narrative of how the system would ideally work in the best interests of the people, in the sense as if it were competitive, as if it had been competitive and had delivered us something closer to the ideal than the bit of a mess that we seem to have.

When looking at the history, I have made the point that in the early hours, under the guise of deregulation and so on, there was a big mistake made in that the major banks were deregulated in circumstances where that played into their hands. In the Commission’s report, I could find not real sort of allusions to that important bit of history and that elephant, if you like, is still in the room and still dominating anything to do with the prospects for competition and proper operation of the financial system. Over the past – yes?

**MR HARRIS:** It is hard though, to unwind history. In Productivity Commission Reports, we will tend to take quite a lot of analytical consideration about history, but we won’t tend

to write very much up unless it's going to contribute to – and this is why this solution will work better. The unwinding of deregulation through the 80s, it's just simply not a practical possibility today.

**MR MAIR:** No, no, I understand that. But having regard to the history and that history involves all the institutions that are around today, the Reserve Bank and APRA, ACCC, ASIC, so on. That history didn't happen in a regulatory vacuum. It happened with the institutions that we have today and I suggest to you that the way history has unfolded should have a bearing on your assessment of the role of those institutions in correcting whatever way you consider it to have gone wrong and addressing the shortcomings.

**MR HARRIS:** Now you've talked about a - sort of an oversight entity or quite a separate entity to the current set of regulatory bodies.

**MR MAIR:** Yes.

**MR HARRIS:** How would you see such an oversight entity intervening? In other words, on a day to day basis, presumably APRA still exists and does what it does and ASIC exists and does what it does and the RBA, even though it's, in a sense, one step removed even from APRA and ASIC on a day to day basis, nevertheless does something of what it does, I assume, and then there is this separated entity. Is that the idea?

**MR MAIR:** More or less. Ahead of that, I think, the history of the ACCC and ASIC is such that the community would no longer regard them really as credible organisations in the consumer protection area. I know people in both organisations well and there are excellent people there. It's not the people's fault. It's rather that, in the case of ASIC, they've not been empowered to do the things that they actually want to do. In the case of the ACCC, the ACCC was told to get out of the road of the financial business a long time ago. That was when, 20-odd years ago, when they had a very well-respected chairman. But these regulatory games are not played gently, I tell you.

But to go to your more important point, we do need an institution and agency that can bring a credible competition policy role to the table. I see that as being an agency akin to what the Americans have established in the Consumer Financial Protection Bureau. It starting may well bring people directly from ACCC, from ASIC. But I think the idea of consumer protection needs to get a new start. I think, the handicaps that have been placed on the ACCC and ASIC need to be recognised from the history and addressed and removed from the functions of a new institution.

**DR KING:** Can I just press you a bit on that so that I can understand? I mean, ASIC has the financial consumer protection role.

**MR MAIR:** Yes, they do a stop, stop - - -. It took them 10 years to even get their mind around financial planners being required to act in the best interests of the customers. I was on the front row all through that. Just last year or two, I stumbled into another racket called

“funeral insurance”. If those agencies can’t take those products out and demand the customers be given refunds, then there’s gone very seriously wrong.

**DR KING:** Yes. So that sort of gets exactly where I wanted to go. You’re saying, well we need to set up a new body.

**MR MAIR:** Yes.

**DR KING:** Is it that it needs to be a new body because the risk there is that you’re just saying, okay, well let’s go back to – you know let’s turn the clock back 10 or 15 years and we’ll start all the learning process again?

**MR MAIR:** No, no, no, no.

**DR KING:** Or is it that ASIC needs different legislation to give it different power?

**MR MAIR:** It needs a different – it’s – after 20, 30 years with these organisations, there are cultural problems the same as there are cultural problems in the banking industry. I suggest to you, commend to you, the idea of a new organisation that brings from – brings together the competition and consumer protection functions of both the ACCC and ASIC, but let’s put that to the side.

You go with whatever you may choose, including considering that option. But whoever’s going to be promoting competition and protecting consumers, has to have the power to do it and they have to be accountable for doing it. It’s all very well the ACCC coming along and on a road to Damascus saying their mind is nearly focussed. They’ve had 30 years to stand up and be counted and they have not. ASIC, I don’t want to go through the catalogue of the way consumers have not been protected by ASIC when they should’ve been. It’s not because the people in ASIC are necessarily not the best, but rather they are not empowered to do the job that they think they’ve been given to do.

**MR HARRIS:** So, you’re not really proposing are you then, an oversight entity because - -

**MR MAIR:** Well - - -

**MR HARRIS:** Because the Murray Inquiry had such an option. We did look at that. We don’t actually think – just another not necessarily going to go you there. You’re really proposing structural change amongst the existing set of regulators to focus on consumer financial protection?

**MR MAIR:** Well, sorry, I went – I diverted from your question before to cover that issue about competition and consumer protection possibly being put into a new organisation, at which point you would have the Reserve Bank and APRA, which I see as a consolidated group, and you would have the competition consumer protection people.

Now the supervisory oversight that I've got in mind would be made up, obviously, of competent independent people. But they wouldn't have a role to be on the front page of the paper every day and so on. They would just be there to make sure that the other regulators, the regulators that are in place, were actually doing their job and they'd be free to take – I actually call it a “Standing Royal Commission”. That may sound a bit pretentious, but it would give the power to the people doing this oversight to hear from and listen to people who have issues and complaints about why the existing regulators are not doing the job properly.

That's why I come back to this history being relevant. We've had 30 years or more since Campbell to find the right path and we haven't done it.

**MR HARRIS:** Okay. I think I saw that more clearly now.

**MR MAIR:** I talked about the elephant in the room or alluded to one. The Commission - the terms of reference, which I didn't have high regard for, nonetheless did extend an invitation to the Commission to examine personal deposit accounts and arrangements. I don't know where you look for that one. But you know, you missed the importance of the one trillion of free deposits. It beats me. That is the single most important impediment to competition, efficiency and fairness. Not only that, this is where the history again becomes very relevant, we've got a trillion dollars today when interest rates are down around two and a-half per cent. Imagine if we were back in the mid-18s, the cash rate's 15 to 17 per cent and they've still got the trillion. That's what they had. They went on a competitive rampage that basically took over the system.

The pillars have got this advantage, and if you're aiming to have anything approaching a competitive level sort of playing field, the competitive advantage that the pillars are getting from holding the \$1 trillion dollars of free deposits which, incidentally, is tied up, entrenched in tax avoidance scheme where the banks take your money for free and they give you services for free. That stuffs up the efficiency of the retail payment system.

Not only that, they don't spend all the money on cheap payments. A lot of that money was misused to run rampant through the system taking over everything in sight, driving people out of town. Look at all those foreign banks, 15 to 16 of them. They only came in in 1985 and they were gone within a few years because they were ridden out of town. They couldn't stand the heat.

**MR HARRIS:** Yes. But what would you do about – you call them “free deposits”, right. So it implies that you think they shouldn't be free. So are you proposing that in some way there should be what, a fix price for putting deposits into - - -

**MR MAIR:** Let me come at it obliquely. There was a time when pensioners were ducking the means test by putting money on bank deposits where they got paid no interest and the government, social security people, said “Well, we'll put a stop to that”.

**MR HARRIS:** They put a deeming rate on it.

**MR MAIR:** We'll put a deeming rate on. Now why you've get after the aged pensioners and leave everybody else untouched, I've got no idea. That's the first step I'd do.

**MR HARRIS:** But a deeming rate will only make any difference, because it's a notional charge.

**MR MAIR:** No. Well, hang on.

**MR HARRIS:** It won't make any difference to the banks themselves.

**MR MAIR:** It certainly does. It certainly does. If you're an old age pensioner like me, you'll realise that banks start paying you interest at the deeming rate.

**DR KING:** I think one of your proposals is that the ATO, essentially, deem income to those deposits.

**MR MAIR:** Yes, on the daily balance and the banks calculate that and put a – they either give you the interest or they put a credit – in fact in your account on which becomes taxable interest.

**DR KING:** So that would be - - -

**MR HARRIS:** So it's like a price fixing for deposits then?

**MR MAIR:** I beg your pardon?

**MR HARRIS:** It's like a price fixing arrangement for deposits.

**MR MAIR:** Well, not – it's certainly a better - - -

**MR HARRIS:** You're not proposing – you're proposing a deeming rate on it. It becomes - - -

**MR MAIR:** At the minute they've agreed on zero.

**MR HARRIS:** No, no. But I think what you just said is, you're proposing a deeming rate that becomes money deposited in someone's bank account. So that says that whether it's from the ATO or anybody else, you still have to have a regulation to do this. It certainly wouldn't regulate a price for deposits. That's really what you're saying.

**MR MAIR:** As they've done for pensioners.

**MR HARRIS:** Well, in the case of pensioners, they deemed – and it didn't really matter whether the banks paid them the money or not, they were still deemed, weren't they?

**MR MAIR:** You are deemed. If you've got assets, you are deemed to earn.

**MR HARRIS:** Yes. But you're going one step further, you're saying a regulatory arrangement should impose a price on deposits which banks then pay. That's what you're saying.

**MR MAIR:** The regulation would say that whether banks pay interest or not is their business. But in terms of a relationship with their customers, this tax avoiding barter scheme that's in place would be disrupted by requiring banks to deem that they had paid interest to their customers or actually pay it.

**DR KING:** Well, a potential outcome though of what you're proposing is that customers – those customers who currently have these deposits and are receiving services, say, for this in return, they end up worse off and they're in a situation where they've got four banks in an industry where, as I understand, you've agreed is not particularly competitive. I just see there's a substantial risk there if the consumer ends up bearing the cost of the deemed interest rate without you know - - -

**MR MAIR:** Well, I mean, if you follow it through, the first thing that the customers would get would be interest.

**DR KING:** Why?

**MR MAIR:** Sorry?

**DR KING:** Sorry, so the banks aren't paying them interest at the moment.

**MR MAIR:** No.

**DR KING:** Yes. The tax office says, "Well, sorry, you're not getting any interest on that account but you're paying some tax on it".

**MR MAIR:** Yes.

**DR KING:** Okay. Why are the banks suddenly going to come and just say, "Well, yes, gee, we'll lower our profits and give you some interest on it"?

**MR MAIR:** The object here is, apart from equity in the tax system and stopping tax avoidance, barter and so on - - -

**DR KING:** Yes, I understand that.

**MR MAIR:** The object here is to neutralise an unfair advantage. It's not only unfair, it's an unassailable competitive advantage that the major banks have. The history, that's why I keep suggesting you look at the history, why do you think all the State banks, all the



foreign banks, all of your building society banks – where have they gone? They’ve gone home with their tail between their legs or they’re now part of the pillars.

**DR KING:** Yes. But just coming back - - -

**MR MAIR:** Yes?

**DR KING:** I mean, so I’m just imagining a customer’s response to this. The customer’s response is going to be “The ATO has said I’m paying tax on money I’ve never earned and I’m going to somehow the big four banks to give me that money”. I think that’s – I – it’s possible, and if there was competition, I can imagine that interest rate you’re talking about would start being paid. But the problem is there isn’t competition, that’s your starting point.

**MR MAIR:** I think you should let your mind wander a little further than that because the reaction of the consumers will be something to behold. Not only will they be getting deemed interest on which they have to pay tax - - -

**DR KING:** Yes, pay tax in. Yes.

**MR MAIR:** - - - or may be getting actual interest, on which they have to pay tax, but once the banks don’t have that easy money, which they’ve getting off the free deposits, they’re not going to have as much money around to subsidise the provision of free services. So the customers may well be starting to confront the idea that they actually have to pay for the advantage services, instead of this ridiculous culture we have allowed to take root which is free banking. In this country, we have a culture of free banking.

I know there’s a lot of media talk and complaint about so called “exception fees”, if you don’t pay this on time, they kick you to death. But the real racket is back in this one trillion of deposits. When you’re looking at competition, we’re not so much looking always for competition, what we want is the product of competition which is efficiency and fairness and so on, and innovation. By allowing the retail payment system to have been corrupted in the way that it has been, we have not had efficiency. We’ve not had fairness and we’ve not had the innovation that we would have.

Just before leaving the retail payment system, the credit card racket. That’s another element of it and that’s another element, especially, of the way in which this free banking nonsense has been allowed to take hold. When you use your credit card, you don’t pay. It’s free, right. You use your EFTPOS card, you might get charged 50 cents. The banks use free and price to get you to use free. When you use free, that means you’re not paying, but the merchant is copping a merchant service fee of up to 1 per cent.

I certainly like your idea of – you’ve got an idea of removing interchange fees. I would suggest, perhaps, you modify that in – the one I’d like to see globally is that there are no ad valorem fees, no percentage fees. The European community now has an arrangement which allows a 30 - .30 per cent interchange fee for credit cards and a .20 for debit cards. Australia hasn’t even gone down that far.

This is a very interesting point when you're talking about the ACCC. You go back to around 2000, which was when I had a hand in driving those inquiries and the eventual reforms, the initial report was a joint one written by ACCC and Reserve Bank and I don't think the Reserve Bank was all that keen on reducing those fees.

That goes to this other nonsense about the competition and stability. The authorities in always looking for stability, are – have got these arrangements in place, the free deposits, and this credit card business that underwrite. So not only do they want stability, but they're underwriting that by giving these pillars this very soft income from the free deposits and from excessive credit card charges. So I commend you for the no interchange fees, but just suggest, yes, either no percentage fees or at least, very least, go to the European standard.

**MR HARRIS:** We do expect to do a bit more on interchange fees.

**MR MAIR:** Having suggested you might do more, I would discourage you from getting involved in the academic nonsense that parades as sensibly analysis. This is “how long is a piece of string” stuff. There is no need for a percentage fee on transactions. The transaction is a transaction. If they're lending money, they charge interest. This credit card business, and if you go back – I won't waste your time today, but if your secretariat goes back to the very submissions I've made over the last 20 years to all these inquiries, it will set out clearly for you, the way this racket has been run. It's just been round and round in a circle. They're still playing around with – they've put a cap on the fees, but then the issue was, issue some cards with no fees and some cards with – it has been gaming the system and it's been permitted. These are organisations that are setting around the council of financial regulators, they're the ones that have been knowing what goes on and have done nothing about it.

Within the Reserve Bank, incidentally, there is a payment system board which is sort of separate. Yes, I would, frankly, remove responsibility for the retail payments stuff out of there and put it, probably, in this organisation that I was talking about before, this new organisation.

**MR HARRIS:** We probably have time there for about one point, if you have got a series and then maybe – because you've put the submissions in.

**MR MAIR:** I have put the submissions in, that's - - -

**MR HARRIS:** If there is one more point though, I think you've got a couple that are highlighted. Could you just pick one and maybe we can finish on that one?

**MR MAIR:** Well, in relation to the new agency that I propose, the guiding light that I'd put above its door is the golden rule that banks and others should not offer and sell financial products which they would not want offered and sold to their parents, their kids or anyone else. If you're looking for a simple illustration of this defective product that should be proscribed, funeral insurance. If you watch, ever watch the SBS World News - if you're

ever silly enough, you're sick at home one day and watch the morning TV, they are flooded with this nonsense. You ring them up, the first thing they do is instead of them contacting you, they sucker you into you ringing them. That changes the whole dynamic. Then ASIC says, all they have to do from that point is disclose and they disclose in ways that befuddles old people like me that are wondering if they need funeral insurance.

**MR HARRIS:** We've got insurance here. We might look a bit more of funeral insurance as a consequence.

**MR MAIR:** Well, it's not just funeral insurance.

**MR HARRIS:** No, no. But we don't want to get - - -

**MR MAIR:** But it makes the point, the golden rule point, you've got executives selling this stuff over the phone and taking commissions, and they'd be outrages if any of their own parents bought this.

**MR HARRIS:** Okay.

**MR MAIR:** Thank you for your time, gentlemen.

**MR HARRIS:** Thanks very much for coming here today. So the hearing's going to be suspended now, so that I can go to Senate Estimates in Canberra. Then, I think we start again tomorrow morning at 9.00, -10.00?

**DR KING:** 10.00

**MR HARRIS:** We're starting at 10.00 for anyone who's dedicated enough. So hearing is now suspended. Thank you very much.

**MATTER ADJOURNED AT 2.47 PM UNTIL  
THURSDAY, 1 MARCH 2018 AT 10 AM**