



Insight

Everything you need to know about the Banking Royal Commission



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Introduction

While it is no surprise that the Big 4 banks in Australia (CBA, Westpac, ANZ, NAB) always appear in the headlines for some reason or another, recently you may have realised this has increased in frequency. The reason for this is the **Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry**, which was established on 14 December 2017. Each of the major banks received requests for documents that are to be delivered to and reviewed by the commission before each hearing. The commission will have 12 months to complete inquiries, with a final report expected to be delivered on 14 February 2019.

A royal commission is a formal independent public inquiry initiated by the government. They generally occur when something imprudent or illegal occurs a continual basis for a period, and can be applied to many areas of life, such as for the financial services industry, trade unions, or child sexual abuse.

What prompted the banking royal commission?

In the past decade or so, our banks have been hit with one scandal after another, which has left consumers and businesses questioning the integrity of the financial services industry. A royal commission has been called because both the banks and government want to address the uncertainty surrounding this sector and give Australian's more assurance about the institutions that should supposedly protect their assets.

As expected, the main driver for the big four banks is profit, which results in little regard for other stakeholders, in particular the consumer. Bank employees and executives have engaged in conduct that isn't in the best interests of customers, such as by offering them credit limit increases or loans when they don't have a stable income, issuing new credit cards when they are self-proclaimed gambling addicts, and miscalculating fees and interest, consequently overcharging customers. These are examples of the types of misconduct that have been uncovered by the commission so far, which threatens to taint the reputation of the banks further.

The banks have also exhibited negligence in ensuring that their systems and technologies in place are operating correctly and free from error. In the case of CBA, their intelligent deposit machine (IDM) ATMs had no limit on the maximum number of transactions allowable per day and could accept up to 200 notes (\$20,000) at a time. They also experienced a coding error, which meant that they failed to automatically submit reports when deposits above the threshold for an individual were reached. This error went undetected for three years, and as a result, it is suspected that customers took advantage of this to launder money domestically and internationally.

A similar issue at ANZ was discovered in relation to their administrative system. It failed to apply the correct discount rate, causing customers to be charged the wrong interest and fees on home

loans amounting to around \$90 million. Customers have been refunded about \$75 million so far, with more compensation expected to be paid.

The commission is trying to uncover what caused these instances of misconduct to occur, how the banks responded, and what systems or procedures need to be implemented to ensure it doesn't happen again. In order to evaluate this, they will be reviewing past disputes involving the banks, as settlements with customers can provide a strong indication of whether there was any misconduct. For example, they will look at determining whether the banks' responses were adequate, and whether the cases were isolated incidences, or hint at the existence of wider issues, such as governance (failure to hold anyone in senior positions accountable for their actions) or wider culture problems (promotion of an aggressive profit driven culture/ 'shareholder' view).

The Federal Opposition has been pressuring the Government to hold a royal commission since April 2016, arguing that it would increase the strength of the banking sector. Initially, the banks and the Prime Minister, Malcom Turnbull, were reluctant claiming that it would create too much unnecessary disruption, and be a waste of taxpayers' money. Although more recently, the PM has received sustained pressure from his own Government AND by the big four banks in favour of the royal commission, as it is believed to be imperative to restore public confidence.

However, following the first round of inquiries, Treasurer, Scott Morrison, said the royal commission hadn't uncovered anything the government didn't already know about, which really raises questions about the necessity of the inquiry. There are also further concerns it could damage the reputation of Australian banks amongst foreign funders who provide capital to make loans in Australia -there is the perception the conclusion of the commission could lead to tighter regulation, thus lowering the banks' profits.

What has been discovered so far?

The first round of the commission targeted consumer credit, which uncovered several deficiencies relating to financial planning and insurance which have tainted the public's trust of the big four banks. It has been found that banks have failed to check if customers can afford to repay loans and overdrafts, and have sold insurance products to people ineligible to make a claim.

The second round will look at instances where fees were charged but no services were exchanged, with CBA and AMP being used as the primary case studies. ASIC will also be scrutinised for its industry's disciplinary regime. ANZ, Westpac, AMP and their subsidiaries will be the key studies in analysing inappropriate financial advice and while ANZ and NAB will be analysed for improper conduct by financial advisers.



Potential Implications

Stricter rules for lending

- Banks are likely to respond by tightening their lending standards, particularly in the home loan market – which would put a downward pressure on house prices. This would ensure a more thorough inspection of supporting income and expense documentation, and ensuring that the customer is able to pay back

Withholding of executive bonuses

- Boards may defer or withhold bonuses from executives of divisions that engage in risky behaviour or misconduct. In the past, there have been limited financial consequences for executives who behave in a way not normally not be accepted by other employees. Instead, they receive lucrative bonuses and are dismissed with a pat on the back, simply because they were able to bring in some profits for the bank. We should not be encouraging and rewarding executives to engage in conduct that poses a risk to customers and clients.

Implementation of BEAR

- Enforcement of the Banking Executive Accountability Regime (BEAR) which improve the overall banking culture. This includes more specific measures for pay packages, so that senior bankers are held accountable for their actions. Banks will be able to alter their compensation structure to be more aligned with long term performance and risk management. Regulators globally have already reconsidered and altered the composition and system of rewards, to ensure there is sufficient capital and stable funding first

Open Banking regime

An Open Banking regime would be one viable solution to address some of the issues discovered in the royal commission. This aims to give customers control over their own financial data. The primary aim is to promote greater competition in the banking industry and encourage customers to consider switching banks and increase the prominence of FinTechs, who may be able to provide new and more tailored financial solutions. It would ensure more transparency, as banks will have access to real time and historical data about income and expenses, thus allowing banks to meet stricter requirements for responsible lending. Banks would also be able to identify when customers are not meeting saving and spending targets, and help them avoid difficult situations, such as defaulting on loans.



ABA code of conduct

A new compulsory code of practice would aim to rebuild trust with the community and demonstrate the commitment to eliminating misconduct. As members of the Australian Banking Association (ABA), the big banks will need to sign a code which forces banks to write contracts in plain English, stop unsolicited credit card limit increase offers, give customers the ability to cancel cards online and provide greater transparency around fees.



Thanks for reading

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