AUSTRALIAN BANKERS' ASSOCIATION INC.

Submission

FINANCIAL SYSTEM INQUIRY

RESPONSE TO FINAL REPORT

March 2015

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Glossary

ABA	Australian Bankers' Association
ADI	Authorised Deposit-taking Institution
AFSL	Australian Financial Services Licence
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
FCS	Financial Claims Scheme
FOFA	Future of Financial Advice
IRB	Internal ratings-based
PwC	PricewaterhouseCoopers
RBA	Reserve Bank of Australia
SMSFs	Self-managed superannuation funds
TLAC	Total Loss Absorbency Capacity
VA	Voluntary administration

Overview

The banking industry welcomed the Financial System Inquiry (**Inquiry**) to ensure the Australian financial system is as fit for purpose in supporting economic growth and prosperity in 10-20 years' time, as it is now.

The banking industry supports the objectives of ensuring the financial system is efficient, competitive and flexible within a framework in which consumers can trust their money is safe and the industry acts in the best interests of their customers.

The Inquiry's conclusion that the essential structure and operation of the financial system is sound and that what is needed is a refinement of the details rather than wholesale reform, is supported by the industry.

The banking industry has assessed the recommendations against whether they support economic growth and national prosperity, enhance protections for consumers, and are consistent with the Federal Government and the industry's desire to promote innovation and productivity and reduce the regulatory burden on industry.

Some broad observations on the recommendations are as follows.

Resilience

The banking industry agrees there are benefits for the industry in being viewed as unquestionably strong on a global basis.

In this respect, we note the industry is already highly regarded in a global context. Australia's four major banks are among the highest rated banks in the world, in the small group of only 12 banks globally which have earned the Standard & Poor's rating of AA- or better and have a stable outlook.

The industry agrees with the Inquiry that capital is only one measure of the strength and resilience of a banking system. Other critical aspects include liquidity levels, asset mix and quality, governance frameworks and risk management controls, the quality of prudential regulation and sovereign rating.

Even on the basis of capital alone, Australia is well placed. Empirical work provided to the Inquiry by the Australian Bankers' Association **(ABA)**[1] showed Australia's four major banks are well capitalised relative to both the global standards and by comparison with banks regulated in many other jurisdictions.

The Final Report focusses on capital but does not quantify the additional net benefits to system stability of higher capital charges or the introduction of leverage ratios.

1 PwC, (August 2014), *Australian Bankers' Association: International comparability of capital ratios of Australia's major banks*, Appendix 4, Financial System Inquiry – Response to Interim Report

Given there is a range of views on the current standing of Australian banks relative to global peers, the banking industry supports the need to develop an effective disclosure for international comparisons of capital levels.

Discussions on the capitalisation of banks and related issues would be facilitated by the application of a set of guiding principles that make clear the policy objectives that are trying to be achieved.

At this time there is considerable work on capital, leverage, and loss absorbing and recapitalisation capacity being progressed by the Financial Stability Board and the Basel Committee on Banking Supervision **(BCBS).** This important international work is central to the domestic implementation of the recommendations on measures to strengthen the resilience and resolution capability of the financial system as a whole and it would be appropriate to review the recommendations after this work is further progressed and the outcomes have become clearer.

There may be unintended consequences in Australia moving too far ahead of global benchmarks on these issues. Consideration must be given to the implications for international competition of current and potential future requirements while balancing the need for matters of domestic competitive neutrality to be addressed.

On the recommendation to narrow mortgage risk-weight differences for capital between the internal ratings-based (**IRB**) and standardised approaches, there is a range of views among member banks as to the appropriate timing of the policy response. Notwithstanding these differences, there is a common industry view that certainty is needed on the future levels of mortgage capital requirements and the timing of any changes to those requirements.

On other recommendations, the banking industry supports the proposals to strengthen funding for the economy, including improvements to the retail corporate bond market and an increased range of funding options for small business.

Consumer outcomes

The banking industry welcomes the two recommendations to overturn policy which disadvantages consumers.

The first is the recommendation to scrap the proposed tax on savers announced by the previous government for deposits protected under the Financial Claims Scheme (**FCS**). The banking industry agrees there is no need to tax savers now to build a pool of funds that might be needed some time in the future. It supports the proposal for the arrangements to be reinstated under which, in the event of a failure of an Authorised Deposit-taking Institution (**ADI**), the Government provides the necessary funds to protect deposits of that institution and then reclaims them from liquidating the institution and if necessary from contributions from the rest of the industry.

The second is the recommendation to unwind the 2012 change which imposed a three year inactivity threshold for bank accounts and life insurance policies to be deemed to be unclaimed monies and transferred to Government. The banking industry supports the objective behind the legislation, to assist consumers reconnect with lost bank accounts, but the reduced threshold period has been shown to be inappropriate and to have caused considerable issues for consumers. The industry therefore supports a reversion to the prior longstanding arrangement of a seven year inactivity threshold.

On financial advice, the banking industry strongly supports new powers to ban individuals from management, the introduction of a new financial adviser register, and initiatives to raise the competency of financial advisers. The industry also supports, in principle, the strengthening of product issuer and distributor accountability and product intervention powers for the Australian Securities and Investments Commission (**ASIC**). The development of any new obligations will need to be handled carefully to avoid stifling innovation and competition in financial products and creating unacceptable regulatory risks across the industry.

Innovation

The banking industry supports initiatives to enhance innovation. However, the regulatory framework applying to emerging products and business models must be carefully assessed to protect the interests of consumers and investors; the stability of the system; and to ensure that differences in regulation, and protections between products and sectors, are clearly communicated and understood.

Superannuation and retirement income system

The banking industry fully supports the seeking of political consensus on the objectives of the superannuation and retirement income system. The promotion of transparency and competition across the superannuation and retirement income system and choice of funds, as well as improved governance standards for all superannuation entities, is particularly important to ensure enhanced and sustained outcomes for members.

Regulatory system

The banking industry fully supports improving regulatory and taxation settings to remove distortions in the flow of funding to the real economy and to promote competition, innovation and economic growth. The promotion of best practice regulation-making, including an increase in the time available for industry to implement complex regulatory changes, improved accountability of regulators and better transparency of decision-making, is particularly important.

The banking industry believes that any extension of the "user pays" principle for regulators must be accompanied by an appropriate governance framework to ensure industry contributions as cost recovery are utilised efficiently and that fees are reasonable, consistent with the services provided and paid for by the beneficiaries.

Next steps

The banking industry is an integral part of the lives of almost all Australians, whether they are depositors, borrowers, investors or users of the payments system. The industry is proud of the contribution it makes to helping grow the Australian economy, providing jobs and promoting prosperity and looks forward to continuing to play its part in facilitating a strong future for all Australians.

The banking industry and the ABA look forward to working with the Government to develop its responses on the Inquiry's recommendations and to determine issues of implementation and timing. Our ultimate goal is to ensure the banking system continues to serve Australia as well into the future as it has in the past.

Detailed response on recommendations

Recommendation 1 (p41): Capital levels

Set capital standards such that Australian authorised deposit-taking institution capital ratios are unquestionably strong.

The banking industry agrees there are benefits for the industry to be viewed as unquestionably strong on a global basis. These include continued access to international funding markets in times of economic or financial volatility and enhanced confidence of domestic investors and depositors in the safety and stability of the system.

It is important to recognise that bank capital is only one component or measure of the strength and resilience of a banking system. As the Inquiry correctly notes, there are a number of other aspects which are also critical in determining the overall strength of a financial system.[2] In addition to capital levels, these aspects include, but are not limited to: liquidity levels and backstops; asset mix and quality; governance frameworks and risk management controls; the strength of prudential regulation and oversight; and sovereign rating.

These attributes are interlinked. They combine to provide investors with a view of the overall strength of a country's financial system. It is not appropriate to focus on just one attribute (in the Inquiry's case, capital ratios) to the exclusion of all other attributes in seeking to compare financial system strength across jurisdictions.

On capital, the industry notes that a number of important BCBS reviews are currently underway and are expected to have significant implications for banks' capital levels around the world, including for Australian banks. These will change the environment in which the relative strength of Australian banks' capital holdings should be assessed. The banking industry believes that the outcomes of these reviews need to be considered before final decisions are made on the Inquiry recommendations on system wide capital requirements.

[2] Financial System Inquiry, Final report, p34

A premature domestic adjustment runs the risk of subsequent further action in response to changes in the international regulatory environment. Changes to capital rules are costly, and, if it is judged that reform is required, should only be done once.

The Australian banking industry is already highly regarded in a global context. Australia's major banks are among the highest rated banks in the world, in the small group of only 12 banks globally which have earned the Standard & Poor's rating of AA- or better and have a stable outlook. The quality of bank lending in Australia is high with non-performing loans at 1.1%, much lower than for the Euro area (7.8 %), UK (4.8 %), and USA (2.9 %)[3].

Further on this point, the PricewaterhouseCoopers (**PwC**) analysis provided to the Inquiry by the ABA[4] concluded that the four Australian major banks are well capitalised. That analysis found that, on average, the Australian banks are at or above the 75th percentile of bank capital relative to the most appropriate comparator set of global banks.

The Inquiry has not provided evidence of any investor or market participant who questions the strength of Australia's banks or who assesses the existing capital holdings as inadequate.

The banking industry notes there may be diminishing returns in achieving the additional net benefits to system stability through raising capital requirements relative to global peers. Indeed, this point is recognised in the Final Report.

> *"The benefits of increasing capital are not linear; however, the incremental benefit will decrease as the starting level of capital rises."*[5]

The economic costs of higher capital charges are explicitly quantified, vis, the Final Report estimates that a one percentage point increase in capital requirements would increase the average interest rate on a loan by less than 10 basis points and would reduce real GDP by less than 0.1 percentage points or less.[6]

However, the additional benefits to system stability of higher capital charges are not stated as precisely, with the Final Report alleging the benefits are "significant" through quoting various studies of the cost of a financial crisis to individuals, the economy, the Government and taxpayers.[7] The conclusion is a judgement call:

> *"The Inquiry's judgement is that….further strengthening the banking sector would deliver significant benefits to the economy at a small cost."*[8]

That this is an assertion suggests caution needs to be exercised against moving too far in advance of global benchmarks in lifting capital levels for the industry as a whole.

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[3] Reserve Bank of Australia, (September 2014), *Financial Stability Review*

[4] Australian Bankers' Association: *International comparability of capital ratios of Australia's major banks*, submission to Financial System Inquiry, Response to Interim Report

[5] Ibid, p51

[6] Ibid, pp53-58

[7] Ibid, pp50-53

[8] Ibid, p41

Notwithstanding the evidence presented to the Inquiry by the ABA, the banking industry acknowledges that there is a range of views as to the current positioning of the Australian banks relative to global peers.

It is therefore imperative that the work already underway with the Australian Prudential Regulation Authority (**APRA**) to develop an effective means of comparing Australian bank capital levels with levels overseas be expedited and concluded in a timely manner. On this point, the industry notes there are considerable difficulties in determining what adjustments to capital measures are required to achieve a consistent approach across jurisdictions. The industry will continue to work with APRA to agree a suitable methodology.

This work is currently focussed on IRB banks. Once the template is sufficiently advanced, the banking industry believes it could form the basis for discussions with standardised banks, if necessary.

Even with a workable comparison tool, the industry believes that a fixed top quartile requirement presents a number of practical limitations as a measure of relative global strength. These issues include:

- The reality that a multitude of regulatory and market factors determine individual bank capital ratios globally. This means that a top quartile requirement would be an inherently moving measure, creating ongoing uncertainty for banks and market participants alike.
- Movements of the top quartile measure will be largely determined by regulators in overseas countries solving their own specific issues, which may not be a reflection of the capital strength of individual institutions. For example, Finansinspektionen (the Swedish financial supervisory authority) imposed stricter capital requirements for Swedish banks in 2014, which were macro-prudential measures aimed at reducing systemic risks in the Swedish economy[9]. This is an example of how capital requirements of Australian banks would be impacted by the macro-prudential policy goals of an overseas regulator.
- Increased mortgage risk-weights which may result from the current BCBS consultations would lead to (all other things being equal) higher capital holdings, or lower common equity Tier 1 ratios – which does not reflect the true change in capital strength. This is another limitation of a purely relative capital ratio measure.
- The challenge of a truly harmonised base from which to compare capital ratios, and the even greater difficulty of directly comparing one institution's capital ratio with that of another institution in a different jurisdiction, especially given the national discretions that are used differently and widely by regulators in each jurisdiction. This is further complicated by factors such as the tax and accounting regimes of that country.

[9] The Riksbank, (2014), *Monetary Policy Report*, p. 45

- Determining an appropriate "sample set" of banks. The Inquiry recommends the sample set should be "internationally active banks", presumably banks with which Australian banks are actively competing for funding. This comparison set of global peer banks must be broadly similar in terms of size, business models and the complexity of operations and the reliance on issues of debt in offshore markets. This sample set of internationally active banks would need to be continually monitored and updated.

Should APRA determine implementation of a top quartile requirement is appropriate, the industry and the regulator should consult extensively to ensure these practical issues are comprehensively considered.

As an alternative to a hard relative target for capital ratios, the banking industry believes a principles-based approach focussing on the key objectives of capital, would be appropriate. Such principles could include:

- ***Strength*** - All banks benefit from the Australian banking system being seen as among the strongest in the world;
- ***Competition*** - Prudential regulation should be competitively neutral and should not result in competitive advantages or disadvantages for any banks within the system;
- ***Clarity*** - Measurement of the capital holdings of Australian banks relative to international benchmarks must be based on a simple, transparent and stable methodology;
- ***Certainty*** - International comparisons must provide the maximum amount of certainty about capital holdings and relative global rankings; and
- ***Proportionality*** - Capital holdings must reflect the relative risk to system stability and the relative simplicity or complexity of the bank's operations.

Finally, the industry notes that regulatory certainty and continuity will best be served if APRA remains the authority which continues to make the decisions on the size and implementation of bank capital requirements.

Recommendation 2 (p60): Narrow mortgage risk-weight differences

Raise the average internal ratings-based (IRB) mortgage risk weight to narrow the difference between average mortgage risk weights for authorised deposit-taking institutions using IRB risk-weight models and those using standardised risk weights.

The industry believes there should be a level of relativity in regulatory capital requirements between the IRB and standardised approaches to credit risk. In Australia, this is particularly important in the calculation of capital required for mortgage exposures.

On 22 December 2014, the BCBS released several consultation papers which propose fundamental changes to the calculation of regulatory capital for banks. This occurred after the release of the Inquiry's Final Report. Two BCBS papers which are relevant to Recommendation 2 of the Final Report are:

- *Revisions to the Standardised Approach for credit risk* – proposing a revised approach for calculating standardised risk-weighted assets using a limited number of 'risk drivers' and less reliance on external ratings; and
- *Capital floors: the design of a framework based on standardised approaches* – proposing a capital floor for IRB banks, based on the new standardised approaches.

These reforms proposed by the BCBS may result in a narrower difference between credit risk approaches. Work is underway globally to determine this. This BCBS work will consider the appropriate risk factors and sensitivities for standardised weights calculation, and the appropriate relativity of risk-weights under the IRB approach with those under the standardised approach. This relativity will likely be achieved through a capital floor on IRB risk-weights based on the standardised approach. The industry is actively responding to these and other BCBS consultations in 2015.

The ultimate goal of this greater level of relativity should be to enhance resilience and confidence in the financial system and ensure that regulatory capital requirements for banks are a function of the underlying risk of their mortgage portfolios.

On this point the industry supports the observation of the Inquiry that APRA consider options to streamline and decouple the accreditation process so that an ADI may be accredited for regulatory capital models for credit and market risks without having been accredited to model operational risk.

In considering the specific recommendation, some member banks believe that APRA should finalise its response within the timeframe of the Government's response to the FSI Report. Other member banks believe that the outcomes the BCBS consultations bear on capital requirements to a material extent, such that those outcomes should be understood before a response to Recommendation 2 is finalised.

Notwithstanding differences of opinion as to the timing of the response, it is a common industry position that APRA's response to Recommendation 2 should provide certainty of future mortgage regulatory capital requirements for banks operating under both IRB and standardised approaches, and the timing of any changes to those regulatory requirements.

Recommendation 3 (p67): Loss absorbing and recapitalisation capacity

Implement a framework for minimum loss absorbing and recapitalisation capacity in line with emerging international practice, sufficient to facilitate the orderly resolution of Australian authorised deposit-taking institutions and minimise taxpayer support.

The banking industry is not convinced there is a need for loss absorbing and recapitalisation capacity in addition to that provided by capital requirements, particularly given the Final Report recommendations to further strengthen capital holdings. Nevertheless, it acknowledges there is international momentum for the development of such a framework and recognises that it is likely that the domestic regulator will be required to respond to new international standards.

Should additional loss absorbing capital be required (over and above any additional capital arising from other recommendations contained in the Inquiry's Final Report) then the industry would recommend that APRA give consideration to solutions other than equity issuance and bail-in for senior unsecured debt. Possible options include another tranche in the capital structure, the ability to contractually bail-in senior unsecured debt or debt issued out of a holding company structure.

APRA should consult further with the industry in regards to the legal structure and mechanism by which loss absorbency would be triggered, for example, contractual versus statutory bail-in. To some extent this will be informed by the quantum of Total Loss Absorbency Capacity (**TLAC**) required and market developments. The industry notes that the contractual Point of Non-Viability mechanism applied to Tier-2 debt issued by Australian banks results in incremental cost relative to the statutory regime applied in most other offshore jurisdictions. Consideration should be given to not drive further price disadvantages in the structuring of other TLAC instruments. Some of these instruments will be issued offshore and they may be subject to interpretation by foreign courts. For this reason, the trigger mechanism must be as transparent as possible to investors at issuance, which favours a contractual approach.

The banking industry stands ready to work with APRA in developing an appropriate loss absorbing and recapitalisation framework. The industry acknowledges and supports the Final Report's caution that Australia needs to tread carefully as this area is complex and evolving. The industry supports the guiding principles recommended in the Final Report for developing a loss absorbing and recapitalisation framework aligned with international standards.

Recommendation 4 (p76): Transparent reporting

Develop a reporting template for Australian authorised deposit-taking institution capital ratios that is transparent against the minimum Basel capital framework.

This recommendation broadly aligns with the banking industry's input to the Inquiry for the development of internationally harmonised capital ratios to aid transparency and comparability across jurisdictions.

The banking industry notes that the Inquiry has not sought to determine the exact capital position of Australian banks relative to banks in other countries, in part because:

> *"it is a very complex area given the varied national discretions taken by different countries"*[10].

The industry agrees with the Inquiry's view that it is a complex task. The banking industry will continue to work with APRA to develop a harmonised capital ratios template to be used for the comparison of Australian banks to the Bank for International Settlements (**BIS)** standards.

However, the industry notes that the recommendation for the development of a template that is transparent against the minimum Basel capital framework will not advance the stated objective of facilitating the comparison of Australian ADI capital ratios to international peers. This difficulty was noted in the industry response to the Inquiry's Interim Report. The complexity lies in the adjustments necessary to account for differences between countries in the way the Basel standards have been implemented. Comparisons across jurisdictions will require the development of an internationally agreed disclosure.

Further, there are likely to be considerable changes to capital requirements flowing from the ongoing BCBS consultations. It would be appropriate for these developments to be taken into account in finalising the template for international comparisons.

Recommendation 5 (p79): Crisis management toolkit

Complete the existing processes for strengthening crisis management powers that have been on hold pending the outcome of the Inquiry.

The banking industry is in broad agreement with this recommendation.

There are benefits to system stability and stakeholder confidence in having clearly defined and transparent protocols in place in the unlikely event of a financial system crisis in Australia.

The banking industry welcomes consultation with the authorities on these proposals and in particular a focus on, and resolution of, the significant practical and legal issues.

Recommendation 6 (p82): Financial Claims Scheme

Maintain the ex post funding structure of the Financial Claims Scheme for authorised deposit-taking institutions.

The banking industry supports this recommendation.

The proposal to adopt ex-ante funding for the FCS announced by the former government[11] would have imposed an ongoing tax on depositors of all ADIs. In contrast, the ex post funding structure provides that in the very unlikely event of a failure of an ADI, the Government provides the

[10] FSI Final Report p48
[11] Economic Statement, (August 2013), statement by the Hon Chris Bowen MP and Senator the Hon. Penny Wong, Canberra

necessary funds to protect deposits and then reclaims them from liquidating the institution. The levy for the "insurance" provided by the Government is paid only if the FCS is activated and there are insufficient funds recovered through liquidation to recover the costs.

The banking industry notes that the 2013 Mid-Year Economic and Fiscal Outlook observed that proceeding with the ex-ante funding model was subject to the outcomes of the Inquiry[12].

The levy as originally conceived would apply from 1 January 2016, and cost $733 million over 18 months or almost half a billion dollars a year.

The Government must announce this tax on depositors will be scrapped.

Recommendation 7 (p84): Leverage ratio

Introduce a leverage ratio that acts as a backstop to authorised deposit-taking institutions' risk weighed capital positions.

The Final Report recommends a three tiered approach to lifting the already high resilience of the Australian banking industry:

- higher capital requirements;
- additional loss absorbing and recapitalisation capacity; and
- a leverage ratio.

The banking industry believes a key requirement of prudential regulation must be simplicity and clarity, with each regulatory requirement designed to address a particular prudential goal.

The banking industry contends that the degree of leverage in a bank's balance sheet can be adequately managed through relating capital requirements to risk.

The industry recognises however, that a leverage ratio is likely to become an international requirement. In this case, adoption in Australia needs to be in a manner and at a time that suits Australia's needs.

In this regard the industry notes that APRA has introduced a requirement to disclose bank leverage ratios using an internationally standardised definition from 1 January 2015 for certain IRB institutions and that a decision on when and how to introduce a minimum leverage ratio requirement in Australia will be taken after the BCBS has completed its deliberations.[13]

Risk sensitive capital measures and not a leverage ratio must remain the primary measure for managing risk. The industry supports the recommendation that the leverage ratio should be a backstop to risk-weighted capital requirements.

12 2013-14 Mid-Year Economic and Fiscal Outlook, p257
13 APRA, (September 2014), *Basel III disclosure requirements: leverage ratio; liquidity coverage ratio; the identification of potential global systemically important banks; and other minor amendments*

Recommendation 8 (p86): Direct borrowing by superannuation funds

Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds.

The banking industry, in principle, supports restricting direct borrowings by self-managed superannuation funds (**SMSFs**). As a general principle, an unleveraged superannuation system provides stability benefits as was evidenced during the Global Financial Crisis.

The industry notes that much of the focus on borrowings by superannuation funds concerns direct borrowings by SMSFs, particularly for the purchase of residential property. The scope of this recommendation could, however, be construed as applying more broadly to APRA-regulated superannuation funds.

In this context, the industry raises some concerns:

- Restricting direct borrowings by superannuation funds could have a significant impact on the commercial property sector and infrastructure development projects.
- Restricting investment in assets which use gearing, such as geared unit trusts or corporate entities, particularly in the mining and resources sector, could restrict corporate investment options and diversification. For example, a superannuation trustee may decide to invest in a geared unit trust or geared corporate entity as part of a broader investment strategy.
- There are circumstances where use of products which have embedded or synthetic borrowings can assist the operation of all superannuation funds, including SMSFs. For example, structured products and derivatives for managing interest rate, foreign exchange and other risks, and equity warrants.
- There are also circumstances where short term direct borrowings may be necessary to facilitate the rebalancing of asset portfolios.

Prohibition of these types of borrowings by superannuation funds would have significant implications for the management of superannuation funds and could increase, rather than decrease, systemic risk. This is a complex area and the industry would welcome further discussion and consultation.

The industry agrees that any implementation of the recommendation should apply prospectively.

Recommendation 9 (p95): Objectives of the superannuation system

Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.

The banking industry fully supports seeking political consensus on the objectives of the superannuation and retirement income system. However, enshrining the objectives of the superannuation system in legislation should only be done after a period of broad political consultation. Only through full consultation and bi-partisan agreement can the community build the confidence to make mandatory and voluntary contributions into a system that needs to be stable for 40 years.

That said, the banking industry's initial view is that the superannuation and retirement income system should seek to:

- provide income in retirement to ensure an adequate standard of living; and
- reduce reliance on Government funded pensions and contribute to the sustainability of the Federal budget.

These objectives can be achieved through a system which maximises savings for members through their working life to ensure they are able to provide for themselves during their retirement, and which enables them to access their monies in ways and means that suit their retirement circumstances and needs.

Additionally, the banking industry believes that the superannuation and retirement income system should reflect the guiding principles of simplicity, flexibility, adequacy of saving, literacy, stability and certainty, and transparency.

The banking industry suggests it would be appropriate for the objectives, guiding principles and legislative structure to be established via a review conducted by the Parliamentary Joint Committee on Corporations and Financial Services.

Recommendation 10 (p101): Improving efficiency during accumulation

Introduce a formal competitive process to allocate new default fund members to MySuper products, unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.

The banking industry believes that the existing model for assessing and selecting default superannuation funds is flawed and should be amended to ensure competition across the superannuation industry.

Specifically, the industry agrees with the conclusion made by the Productivity Commission[14] that the existing system for assessing and selecting default superannuation funds is not transparent or contestable. Therefore, the industry supports a review being conducted by the Productivity Commission into the efficiency of the default fund system.

The industry strongly believes that increased competition will drive better outcomes for members.

[14] http://www.pc.gov.au/projects/inquiry/default-super/report

Recommendation 11 (p117): The retirement phase of superannuation

Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.

The banking industry supports initiatives to promote better transition from the accumulation to retirement phase. A pre-selected income product should seek to simplify decisions at retirement and address longevity risk.

The industry supports superannuation trustees pre-selecting a default retirement income stream and enabling a member to "opt-in" to this selected default. This approach ensures that a member is able to change their instructions and elect to take their benefits in another way upon retirement pending their needs and circumstances.

The banking industry believes that a review of the tax policy setting for income products should be conducted as part of the Tax White Paper and with a view to encouraging more competitive product offerings and more consumer-attractive annuities and other income stream products.

Recommendation 12 (p131): Choice of fund

Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.

The banking industry supports "Choice of Fund" being available for all employees so they are able to elect the fund for their Superannuation Guarantee contributions. No third party should be able to override an individual's capacity to make their own decisions on how and where they want to invest their retirement savings.

Restrictions impacting employees subject to enterprise agreements, workplace determinations and state-based awards can result in inefficiencies and unnecessary costs, including multiple superannuation accounts with multiple fees and insurance premiums. Lack of choice can also contribute to disengagement with superannuation.

Recommendation 13 (p133): Governance of superannuation funds

Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.

The banking industry believes that given the importance and compulsory nature of superannuation, the same best practice governance standards that currently apply to ASX listed entities should apply to APRA regulated superannuation entities. In this light, the industry notes that APRA requires boards of banking and insurance companies to have a majority of independent directors and an independent chair.

The definition of “independence” is critical to this recommendation. The industry suggests the definition of independence could be based on the Financial Services Council Standard 20.

The industry also suggests a period of two years should be allowed for affected superannuation funds to transition their governance arrangements.

Recommendation 14 (p147): Collaboration to enable innovation

Establish a permanent public-private sector collaborative committee, the ‘Innovation Collaboration’, to facilitate financial system innovation and enable timely and coordinated policy and regulatory responses.

The banking industry is in broad agreement with this recommendation.

As a general principle, the banking industry in Australia welcomes competition and supports innovation in banking and financial services. Innovation is a key driver of efficiency and productivity and the advancement of economic growth and prosperity. Innovation also ensures the financial system can continue to meet the needs of customers as those needs evolve and change.

Banks in Australia constantly monitor developments in financial services, including the emergence of new technologies, products and services, and are in regular dialogue with the relevant authorities and regulators. Banks are key innovators in the provision of financial services and would welcome a lead role in collaborating with the government on innovation.

Technological change and innovation is difficult to predict and to monitor, a more structured collaboration between industry and government would facilitate this process.

It would also provide an early opportunity for the banking industry, government and regulators to consider the need for appropriate safeguards to protect the safety and soundness of the financial system and ensure similar consumer protections apply to similar technologies, products and services irrespective of the provider or issuer

Recommendation 15 (p151): Digital identity

Develop a national strategy for a federated-style model of trusted digital identities.

The banking industry supports this recommendation as a means of complementing financial system innovation, lowering costs and lowering risks for the industry, customers and other stakeholders.

The design and implementation of a national strategy should be done in full consultation with the banking industry.

A number of parameters for implementing a digital identity strategy would need to be resolved in advance, including the revenue model and the liability framework of the trusted digital identity system.

Recommendation 16 (p161): Clearer graduated payments regulation

Enhance graduation of retail payments regulation by clarifying thresholds for regulation by the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority.

Strengthen consumer protection by mandating the ePayments Code. Introduce a separate prudential regime with two tiers for purchased payment facilities.

There is a potential benefit for competitive neutrality and consumer protection for the ePayments Code to be mandated so that those payments providers which are not currently Code subscribers become Code subscribers irrespective of whether they are required to hold an Australian Financial Services Licence (**AFSL**).

This should not be done in a way that increases the regulatory burden on current subscribers in complying with the Code. The Code should continue to operate as a co-regulatory mechanism.

The banking industry supports the lightest touch regulation in principle. However, it notes there may be risks for systemic stability and consumer protection in having different degrees of regulation across competing payment systems. Differential regulation could allow disruptive technology entrants, subject to the lighter regulatory regime, to quickly expand at the expense of more heavily regulated traditional providers.

Consumer interests should be protected for those payments systems subject to lighter touch regulation or no regulation through public education, transparency and disclosure.

The industry requires further information about the separate prudential regime for purchased payment facilities and would welcome discussions on this issue.

Recommendation 17 (p168): Interchange fees and customer surcharging

Improve interchange fee regulation by clarifying thresholds for when they apply, broadening the range of fees and payments they apply to, and lowering interchange fees.

Improve surcharging regulation by expanding its application and ensuring customers using lower-cost payment methods cannot be over-surcharged by allowing more prescriptive limits on surcharging.

The banking industry notes that in response to this recommendation the Reserve Bank of Australia (**RBA**) has commenced a review of the regulatory framework for card payments. This is appropriate given the RBA has been responsible for payments regulation, including card interchange, since the last major Inquiry into the financial system, the Wallis Review, in 1997.

The industry will work closely with the RBA in this review.

The existing regime for interchange fees and customer surcharging is highly regulated and complex although the banking industry believes it works well and is well understood by the industry. Amendments to the interchange model and how fees are applied should avoid adding complexity into this environment.

Regulatory changes impose large costs on the industry and take considerable time to implement. Specifically, there are many contractual and structural elements in place to support current payments regulation and which are also embedded in product design. Changes to both the type of regulation (i.e. a hard CAP vs. weighted average CAP) and also a significant change to the level of interchange will have implications and will disrupt existing card payment products.

The current interchange environment differentiates payments products issued to consumers versus business and corporate/purchasing card holders. It remains appropriate to exclude business and corporate/purchasing card holders from the current interchange recommendations.

Interchange is an important part of providing the consumer with a valued product, whilst at the same time providing incentive to use more efficient payment channels. This is particularly relevant to reward products and other accepted features offered in the industry. Significant reduction in interchange will directly affect these features and change basic product design by reducing the available value that can be passed on.

Implementation of restrictions to prevent merchants from overcharging is operationally difficult. Rules to limit surcharging would need to be simple to communicate and straightforward to implement.

Recommendation 18 (p177): Crowdfunding

Graduate fundraising regulation to facilitate crowdfunding for both debt and equity and, over time, other forms of financing.

The banking industry supports the development of diverse funding sources and the principle that the intensity of regulation should be set to meet the risks to the system and to consumers.

However, it notes that differences in the intensity of regulation applying to competing sectors of the financial system will inevitably create incentives for activities to migrate to the least regulated channels and markets. Also, the close integration between sectors of the financial markets heightens the risk that failures in one sector, even if small, will have contagion effects more widely.

Protecting the interests of consumers and investors and the stability of the system, and ensuring a level playing field between different sectors, requires that the differences in regulation and protections between sectors are clearly communicated and understood.

Recommendation 19 (p181): Data access and use

Review the costs and benefits of increasing access to and improving the use of data, taking into account community concerns about appropriate privacy protections.

The banking industry supports the Productivity Commission conducting a review of the costs and benefits of increasing access to and improving use of data. Increasing access to data will enhance consumer outcomes by facilitating better informed decision making, and more targeted and tailored product and service offerings, allowing customers greater autonomy with their products and services and promoting innovation and efficiencies in the financial system.

However, the industry notes that business and customer relationship data is a valuable commercial asset and subject to extensive privacy and other obligations. Changes should not be made that affect the ability of businesses to manage their data in the interests of customers and owners.

Recommendation 20 (p190): Comprehensive credit reporting

Support industry efforts to expand credit data sharing under the new voluntary comprehensive credit reporting regime. If, over time, participation is inadequate, Government should consider legislating mandatory participation.

The banking industry is working to expand permissible credit data sharing under the voluntary comprehensive credit reporting regime. Finalisation of an agreement between industry participants is being processed under the guidance of the Australian Retail Credit Association.

The banking industry believes these efforts will go a long way to improving imbalances between lenders and borrowers and improving access to credit for borrowers, including small and medium businesses.

The banking industry does not support mandatory participation in the scheme. It would impose additional compliance costs on the industry and it is not clear the benefits would justify the additional impost. Also, for a credit provider to be required to participate in a reciprocal sharing arrangement of any credit data of its customers could increase community concerns generally about privacy, despite the protections in the Privacy Act.

Recommendation 21 (p198): Strengthen product issuer and distributor accountability

Introduce a targeted and principles-based product design and distribution obligation.

The banking industry broadly supports a principles-based approach to ensuring a range of factors are taken into consideration with the design and distribution of financial products. The outcome of the recommendation, however, is not clear and could have a substantial and adverse impact across all financial products and offerings. Any new obligation should be a clear duty in its own right and be based on a clear and defined policy intent.

The industry supports the position that any additional legal or regulatory obligations would not apply to consumer credit products, that the requirements are scalable depending on the nature of the financial product, and that an individual suitability test would not be imposed. This position would limit any impact on the offer and sale of financial products by managing unreasonable increases in product design and distribution costs, particularly for simple, low-risk products, such as retail banking products, and by ensuring appropriateness of product design and distribution practices.

In developing any principles-based approach in relation to the product design and distribution, the industry proposes that a number of factors are considered, including existing legal and regulatory obligations, preserving prudent commercial decision making, and taking into account implementation and operational factors associated with the offer of financial products.

The industry notes that individual suitability issues are addressed by requirements of the Corporations Act, including the Future of Financial Advice (**FOFA**) obligations, and there are other sources of obligations relating to superannuation, margin loans and certain complex products. These existing obligations should be taken into account to avoid duplication or conflict with any new principles-based approach.

Importantly, product design is a commercial decision, and regulatory intervention to standardise or prescribe certain product features, can create other problems for competitive product offerings by increasing product costs or decreasing product offerings for consumers. Therefore, the industry believes that the obligation should be scalable depending on the nature of the financial product, take into account factors such as the complexity and investment risk of the financial product, and be cognisant of any practical and operational issues, for example, identifying customers' interests, and implementing due diligence and compliance processes.

Consideration of these legal, practical and operational factors is critical to this recommendation.

The industry notes that the International Organization of Securities Commissions' final report, *Suitability Requirements with Respect to the Distribution of Complex Financial Products* and the Australian Financial Markets Association (**AFMA**) guide, *Principles relating to product approval – retail structured financial products,* both outline a number of relevant principles in this regard. We also note overseas experiences with a similar duty and the implications for product manufacture where it has created unnecessary costs so that some products have become uneconomical.

The industry believes that it is essential that all investors, once they have received suitable advice and appropriate disclosures from an intermediary or they have chosen not to seek advice, evaluate any information provided to them, educate themselves about the products in which they invest and, ultimately, take responsibility for the risks of their choices. Product issuers, intermediaries and investors all have responsibilities. It would be a concern if efforts in this area undermined this principle. The industry suggests that the Government, industry and consumer representatives should convene a roundtable to discuss whether prescriptive approaches in this area may be adverse and whether alternative approaches are more desirable and appropriate.

The industry believes that implementation of the recommendation should apply prospectively.

Recommendation 22 (p206): Introduce product intervention power

Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

The banking industry, in principle, supports a targeted product intervention power where there is a risk of significant detriment or harm to consumers, particularly where products have been mis-sold in a reckless, fraudulent or negligent manner. The industry proposes that the scope of the power be consistent with the principles proposed in Recommendation 21 and apply to financial products. Any new power should be based on a clear and defined policy intent.

The industry recognises that neither consumers, nor the industry, benefit when inappropriate financial products are available in the market. We consider, however, that introducing default products or prohibiting distribution of certain classes of products to investors would have a significantly adverse impact on the offer and sale of financial products by reducing innovation and restricting consumer choice.

The industry proposes that in developing any product intervention power, existing legal obligations relating to advertising and marketing, terminology and labelling, regulated disclosures and other disclosures by product issuers are taken into account, and existing regulatory engagement protocols where concerns have been identified are preserved.

Implementing product bans and distribution restrictions could have significant implications for product issuers and investors, including existing retail investors. Any product intervention power should manage unintended consequences and adverse implications for consumers invested in the relevant product. Implications for product issuers if compliance, risk controls and commercial decisions are disrupted, should also be considered.

The industry believes that the power should apply where there is “significant consumer detriment” and be used only as a last resort; the regulator should provide clear explanation on how and when the power will be used; be transparent in the use of the power; be accountable in the use of the power and ensure appropriate safeguards; and the exercise of the power should be subject to administrative and judicial review.

The industry notes that the power should be applied on a temporary basis (i.e. 12 months) but in the circumstances this may be insufficient for establishing a permanent resolution.

As noted above, the industry suggests that the Government, industry and consumer representatives should convene a roundtable to discuss whether prescriptive approaches in this area may be adverse and whether alternative approaches are more desirable and appropriate.

Furthermore, the banking industry supports ASIC conducting a review of current market practices and the establishment of a commonly understood language, notably for structured products, in consultation with industry and stakeholders. Changes to improve use of language should also involve consumer testing and research to ensure that language adopted by the industry is readily understood and based on principles to assist in improving consumer understanding.

The banking industry also supports ASIC adopting more formalised market-wide surveillance programs. For example, ASIC conducts reviews into certain market and industry practices. The results of these reviews should be the subject of consultation with industry and stakeholders to identify any systemic issues. Where the reviews do not uncover systemic issues, these matters should continue to be addressed via targeted consultation and/or direct action between the regulator and the financial institution or regulated entity.

Importantly, the industry supports improvement to the regulator's financial resources and technical capability (Recommendation 29) to promote more effective regulation with existing powers. These enhancements may enable greater utilisation of market surveillance and other proactive activity that will manage risk to consumers, without requiring recourse to a product intervention power.

The industry believes that implementation of the recommendation should apply prospectively.

Recommendation 23 (p213): Facilitate innovative disclosure

Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.

The banking industry supports clear and effective product disclosure and communication with consumers. Effective disclosure is dependent on consumers being able to understand and apply disclosures to their financial needs and situations. Interactive disclosures, such as assessment tools and calculators, and better use of online communications, offer significant opportunities to raise levels of awareness and assist informed decision making by investors.

However, disclosure obligations on industry must be balanced with the costs and benefits of industry providing these disclosures. Disclosure principles should seek to promote efficiencies in delivery and effectiveness of disclosures and communications by focusing on removing regulatory impediments to interactive disclosures rather than imposing obligations on product issuers and intermediaries.

Importantly, removal of regulatory impediments for industry to provide disclosures to consumers according to customers' preferred communication channels, for example, electronic, online or digital technologies, will complement the disclosure mechanism. Legislative changes should be made so that customers can opt-in to receive disclosures and communications in writing, but that the default is via electronic or digital channels.

Removal of regulatory impediments for industry to adopt a layered approach to disclosures will also ensure disclosures and communications are more effective. A layered approach to disclosure accommodates varied consumer interests and needs as well as different levels of understanding. The banking industry believes that a layered approach can provide consistent and simple disclosure for basic retail banking products where consumers are seeking minimal, but sufficient, information and advice as well as in a wealth management context, where customers may receive multiple regulated disclosures.

The banking industry also supports improved disclosure of fees and risks. There are already significant and prescriptive legal obligations, therefore, we consider that industry efforts to simplify disclosures while maintaining consistency and comparability objectives should be pursued.

The banking industry also supports the Government conducting a review of current regulated disclosures. A review should include consumer testing and research to ensure disclosure is meeting its purpose in terms of content, presentation and format, and in particular, whether improvements can be made to Financial Services Guides (**FSGs**) and Product Disclosure Statements (**PDSs**) which enhance consumer engagement with these regulated documents. Certain insights from behavioural economics may also be a useful contributor to research into ways to improve regulated disclosures.

Having said that, the industry notes that changing product and disclosure rules involves considerable expense for the industry - the benefits must be weighed carefully against the costs. Consumer testing is essential to ensure any changes are meaningful.

Recommendation 24 (p217): Align the interests of financial firms and consumers

Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.

The banking industry supports the introduction of a new power to ban individuals from management. The extension of the current enforcement requirements and actions that apply to financial advisers and to those managing a financial service business, provide an additional mechanism to enhance consumer confidence and trust in the financial advice industry, and the financial services industry more broadly.

Recommendation 25 (p222): Raise the competency of advisers

Raise the competency of financial advice providers and introduce an enhanced register of advisers.

The banking industry supports the introduction of a new financial adviser register and has been working closely with the Government and ASIC on preparations for providing data on individual employee financial advisers to populate the register. The register was launched in March 2015.

Furthermore, the banking industry supports raising the competency of financial advisers. The banking industry has been working closely with the Government as part of its review of professional standards and has been participating in the Parliamentary inquiry into proposals to lift the professional, ethical and educational standards in the financial services industry.

The banking industry believes that the main elements of new education, qualifications, training, and competency standards should establish a minimum entry qualification standard (learning), practising certificate (evidence of learning), supervision requirement and continued professional development for financial advisers providing personal advice on Tier 1 products to retail clients. It should also establish appropriate standards of conduct and behaviour for all financial services professionals. The industry is also of the view that other elements of professionalisation which go beyond education to practice are essential, including establishment of best practices and ethics; membership of professional bodies; the role of self-regulation and codes; leadership and mentoring within the industry and other aspects which influence conduct and behaviour.

Recommendation 26 (p227): Improve guidance and disclosure in general insurance

Improve guidance (including tools and calculators) and disclosure for general insurance, especially in relation to home insurance.

The banking industry supports improving disclosures relating to general insurance, especially home insurance. The industry has voluntarily adopted practices to raise awareness of borrowers' obligations to maintain adequate insurance for their homes and properties as part of lending disclosures.

The industry notes that information and advice about general insurance in particular must facilitate consumers seeking various options and product solutions. For example, there is demand from some consumers for affordable policies which do not provide full replacement value.

Therefore, the industry believes this objective is best achieved through industry initiatives to improve disclosure and financial literacy rather than the introduction of a prescriptive regulatory requirement.

Recommendation 27 (p239): Regulator accountability

Create a new Financial Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates.

Provide clearer guidance to regulators in Statements of Expectation and increase the issue of performance indicators for regulator performance.

The banking industry is supportive of a formal mechanism to ensure regulators are held accountable for the performance of their mandates. However, it believes this should not require the establishment of a new and separate regulatory body, but rather could be achieved through the existing mechanisms of Parliamentary oversight and departmental review.

The industry is supportive of the institutions which are regulated having a role in evaluating the performance of regulators.

The industry notes that as public accountability is a core function of public institutions, any additional expense should not be funded by levies on industry participants. Rather, it should be accommodated within the budget appropriations of the relevant government department and Parliamentary process.

Any assessment of regulator performance should also include the review of the existing body of regulation with a view to an ongoing process of reducing compliance and reporting costs. This could be achieved through eliminating redundant regulations and reports, codes of conduct and advisory instruments and through simplifying requirements. There could also be consideration of the potential for greater automation of reports. These steps would contribute to the Government's deregulation agenda.

The banking industry would welcome working with the regulators on these initiatives.

Recommendation 28 (p246): Execution of mandate

Provide regulators with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake periodic capability reviews.

The banking industry supports the principle that regulators should be adequately resourced to perform their functions.

However, the industry recommends that regulators must be held to account for the efficiency of their activities and the outcomes achieved.

In this regard, additional resources or higher quality staff should only be provided where a clear improvement in the regulatory oversight can be demonstrated. The performance of regulators must be assessed regularly and benchmarked against their mandated goals and against their international peers. Stakeholders, including the banking industry and consumers, should be included in the assessment process.

Recommendation 29 (p250): Strengthening the Australian Securities and Investments Commission's funding and powers

Introduce an industry funding model for Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.

The banking industry believes that ASIC's powers should only be strengthened after an independent assessment determines in what ways ASIC's powers are deficient and how they should best be enhanced.

The banking industry believes it is essential that any adoption of the user pays principle or cost recovery by ASIC be accompanied by appropriate checks that industry contributions are utilised efficiently, and that there are limits on the size of levies to ensure they are reasonable and consistent with the services provided.

An appropriate governance framework is required. Government needs to be mindful that industry-based funding for public entities is a form of taxation and creates a situation where there are reduced incentives for governments to only regulate where necessary and for regulators to perform efficiently. Also, switching from a model where ASIC is funded from general government revenue to one where user pays, contributes to an improvement in the budget bottom line and those “savings” should be used for budget repair rather than retasked to fund other government spending.

The banking industry recommends that:

- Levies should be specifically linked to the provision of a particular service, and should only be able to be changed where there is a substantive change in the quantity or quality of services provided. All regulated entities - Australian Financial Services licensees, credit licensees, market operators, clearing and settlement facilities, and companies - should contribute. Levies need to be proportionate and equitable. Consideration could be given to some form of weighting to the nature, scale and complexity of financial services business, although there would be a trade-off with simplicity. There should be nothing that prevents an AFSL passing on costs, recognising that the benefits of regulation extend well beyond the regulated entity.
- Industry levies should be specified in legislation, such that only Parliament has the power to change them. Levies should not be able to be changed through regulations, either at the discretion of the Minister, the Department or ASIC itself.
- Appointment of ASIC Commissioners and appointments to the ASIC External Advisory Panel should be made on the basis of relevant commercial experience.
- ASIC should be regularly benchmarked against overseas peers to ensure the cost base and levies charged versus services provided do not exceed international best practice.

Recommendation 30 (p254): Strengthening the focus on competition in the financial system

Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of financial services and include consideration of competition in the Australian Securities and Investments Commission’s mandate.

The banking industry is supportive of strengthening the focus on competition in the financial sector through a periodic review.

Having said that, competition should not be an objective in and of itself - rather it is the benefits which flow from competition, such as lower prices and greater choice of products and services, which should be assessed. These benefits must be assessed against the costs, in particular the unintended consequences of regulatory interventions.

The banking industry agrees that a periodic and system wide review of competition would provide a more stable and planned basis for assessment as an alternative to the past somewhat ad hoc series of Parliamentary inquiries and external reviews in the sector. The banking industry welcomes further discussion on the appropriate frequency of this assessment and which body should conduct the assessment, for example the Productivity Commission.

Recommendation 31 (p257): Compliance costs and policy processes

Increase the time available for industry to implement complex regulatory change.

Conduct post-implementation reviews of major regulatory changes more frequently.

The banking industry supports the objective of reducing costs, complexity and unanticipated impacts of regulatory change.

It is always the case that the optimum outcomes will be achieved if sufficient time is provided to industry to implement and test the system and operational changes required to meet new or altered regulations. Appropriate implementation timelines also minimise disruption to customers by allowing the industry to advise customers in advance and ensure appropriate mechanisms are in place to assist customers affected by regulatory change.

The banking industry notes that the Final Report lays out guidelines on appropriate implementation timelines, but observes that liaison with industry and stakeholders should always be undertaken before setting phase-in periods for regulatory change.

Appropriate implementation timelines should be agreed once the primary legislation and regulations have been finalised.

Recommendation 32 (p261): Impact investment

Explore ways to facilitate development of the impact investment market and encourage innovation in funding social service delivery.

Provide guidance to superannuation trustees on the appropriateness of impact investment.

Support law reform to classify a private ancillary fund as a 'sophisticated' or 'professional' investor, where the founder of the fund meets those definitions.

The banking industry welcomes innovation in financial services, subject to appropriate regulation to protect the interests of consumers.

Impact investing allows investors to pursue opportunities that provide both social and financial returns. It provides a mechanism for investors to pursue investment objectives other than pure financial return. It may also provide an avenue for governments to achieve delivery of social services and income support other than through direct government spending.

That said, the banking industry does not support the mandating of certain investments or asset classes for superannuation funds.

Recommendation 33 (p263): Retail corporate bond market

Reduce disclosure requirements for large listed corporates issuing 'simple' bonds and encourage industry to develop standard terms for 'simple' bonds.

The banking industry welcomes initiatives to facilitate access to debt capital markets and broaden the sources of funding available to banks, and to reduce the costs associated with securities issues. We support the recommendation to simplify and standardise disclosure requirements for issuing bonds to retail investors.

Recommendation 34 (p264): Unfair contract term provisions

Support Government's process to extend unfair contract term protections to small businesses.

Encourage industry to develop standards on the use of non-monetary default covenants.

The banking industry does not support the Government's process to extend unfair contract term protections to small businesses, particularly in relation to credit contracts. No systemic issue has been demonstrated and it would be inconsistent with the current Government's stated approach to reducing regulation to impose the additional regulatory burden on the industry when there is no clear issue to address.

Discussions initiated by Treasury have concentrated on banks' small business credit facilities. Treasury proposes however, that the legislation would also apply to financial services of a non-credit nature, provided by banks to small businesses. This is despite no case having been advanced in submissions to Treasury to regulate these financial services contracts.

Instead, the onus appears to have been shifted to banks to make the case why financial services should not be regulated. An approach that suggests business will be regulated unless it can make a case against regulation is disappointing, particularly from the current Government. It also departs from the Consumer Affairs Australia and New Zealand Consultation Paper, dated May 2014, which called for submissions on the question whether the current consumer unfair contract terms should be extended to contracts for financial products and services.

The submissions made on behalf of small businesses to the Inquiry consultation process concerning credit facilities do not indicate a widespread market failure warranting regulation of banks' standard form credit contracts with small business customers. The cost to banks in reviewing and amending all of their standard form contracts would be significant and inconsistent with the Government's policies for reducing the regulatory burden on business.

To intervene by extending the existing unfair consumer contract terms legislation to banks and their small business customers could detrimentally affect small businesses.

It is important to understand that lending to a business is more complex and of higher risk than lending to consumers. In order to manage credit risk in the absence of certain non-monetary covenants, the banking industry may find it necessary to take measures to reduce its exposure to loss given default by small businesses and request additional or more frequent information from small business customers. The effect is more “burden” on those small businesses.

Foreseeably, impacts for small business customers could include:

- Changes in credit application processes making the application process more complex, lengthy and costly;
- Changes in product design such as more limited, less open-ended loan terms;
- A greater reliance on security including over a proprietor’s residence;
- Reduced access to credit for start-up and less experienced or less established businesses; and
- Reduced flexibility for the bank to deal with a financially distressed small business customer where the bank’s inability to rely on the contract means it must act earlier because of the risk that the business ultimately is found to be non-viable.

In essence, the proposals being considered by Treasury would reduce the ability of a bank to manage its risk exposures and therefore make lending to small business more risky.

Further, the issue for small businesses has been incorrectly characterised.

It is the circumstances in which reliance is made on certain non-monetary covenants in small business credit contracts and not the covenants per se, that industry considers requires attention. Recommendation 34 of the Final Report of the Inquiry was not so much concerned with contract clauses per se, as would be covered by proposed legislation, but with how some clauses may be exercised.

This leads the banking industry to give provisional support to developing standards on the use of non-monetary default covenants through amendments to the industry’s Code of Banking Practice, specifically as an alternative, but not in addition to the Government’s process to extend unfair contract term protections to small businesses.

Recommendation 35 (p265): Finance companies

Clearly differentiate the investment products that finance companies and similar entities offer retail consumers from authorised deposit-taking institution deposits.

The banking industry supports improved disclosure to ensure consumers clearly understand the difference between bank deposits and other financial products, such as debentures and money market funds. However, the industry notes that the costs for the industry in complying with any new regulatory requirement should be assessed against the benefits with the objective of minimising the costs of these proposals.

Recommendation 36 (p265): Corporate administration and bankruptcy

Consult on possible amendments to the external administration regime to provide additional flexibility for businesses in financial difficulty.

The banking industry believes the current voluntary administration (**VA**) regime has been shown to work well. This has also been the conclusion of previous specific inquiries[15].

The banking industry is opposed to the US Chapter 11 model. Previous inquiries have concluded this model would be unsuited to Australian conditions as a replacement for the existing VA regime, which the US does not have. Leaving the governance of a financially stressed or destitute business in the hands of the existing management under the supervision of the court – a “debtor in possession” model – would be an expensive alternative and pose increased risks for mainstream financiers of the business because of the postponement and subordination of a financier’s right to call in its debt. The US experience has seen some businesses survive only to later re-enter Chapter 11 bankruptcy administration (American Airlines).

It has also been shown to be very expensive and take an inordinate amount of time to administer (largely due to the US Bankruptcy Court having a substantial role to play at every step of the reorganisation process).

The possibility of a "safe harbour" for directors from insolvent trading laws where there are attempts by directors to facilitate genuine restructures, and from the operation of ipso facto clauses, should be considered in aid of the existing VA regime.

The Government has requested the Productivity Commission undertake an inquiry into barriers to business entries and exits including options to reduce these barriers where appropriate. This Inquiry will examine Australia’s personal and corporate insolvency regimes from a perspective of efficiency and economic growth in the Australian economy and is expected to report in the third quarter of 2015.

With respect to harmonisation of insolvency laws and regulation of external administration, the Government has released an exposure draft Insolvency Law Reform Bill 2014 for consultation.

Recommendation 37 (p267): Superannuation member engagement

Publish retirement income projections on member statements from defined contribution superannuation schemes using Australian Securities and Investments Commission (ASIC) regulatory guidance.

Facilitate access to consolidated superannuation information from the Australian Taxation Office to use with ASIC’s and superannuation funds’ retirement income projection calculations.

The banking industry supports providing retirement income projections on member statements. Lack of information about savings can contribute to disengagement with superannuation. We

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[15] e.g. CAMAC Report, (October 2004), *Rehabilitating large and complex enterprises in financial difficulty*

consider that meaningful projections can assist in raising awareness and financial literacy. However, such disclosures will only provide a partial view, therefore, we also support the provision of tools and calculators to assist members to understand their potential retirement income.

The banking industry also supports promoting better superannuation resources and access to data via the Australian Taxation Office. We consider that further consultation with industry is needed before determining approaches to consolidated superannuation information.

Recommendation 38 (p268): Cyber security

Update the 2009 Cyber Security Strategy to reflect changes in the threat environment, improve cohesion in policy implementation, and progress public-private sector and cross-industry collaboration.

Establish a formal framework for cyber security information sharing and response to cyber threats.

The banking industry fully supports a greater focus on cyber security and increased private/public collaboration to share information and to identify and respond to threats. Protecting account management, trading, clearing and payment systems from cyber-attack is a key element in ensuring the integrity, safety and stability of the financial system.

Recommendation 39 (p269): Technology neutrality

Identify, in consultation with the financial sector, and amend priority areas of regulation to be technology neutral.

Embed consideration of the principle of technology neutrality into development processes for future regulation.

Ensure regulation allows individuals to select alternative methods to access services to maintain fair treatment for all consumer segments.

The banking industry fully supports initiatives to make regulation technology neutral, rather than mandating compliance or product delivery through a particular medium. This recommendation is consistent with efforts to facilitate innovation and streamline and modernise disclosures.

Given the multitude of devices and channels through which disclosure and communications are provided, any regulatory requirement should be structured to not preclude any form of legitimate technology rather than being a positive obligation on industry.

The industry would welcome the establishment of a working group to identify priority areas for attention and would support representation of industry and other stakeholders on this group.

Recommendation 40 (p271): Provision of financial advice and mortgage broking

Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures.

The banking industry acknowledges that general advice is not widely understood to be "financial advice" by consumers. Therefore, the industry believes there is merit in giving further consideration to different and more appropriate terminology and labels which more closely reflect the true nature of information that is termed "general advice" under the law.

Specifically, the banking industry supports clarification of the financial product advice framework and an examination of terminology and labels as part of the Government's review of professional standards. Consumer testing and research should be conducted into understanding consumer perspectives, expectations and engagement so any alternative terminology is appropriate and meaningful for consumers and the industry.

The industry believes that an alternative term could be "general financial information". While we support changing the term for these services, we do not support changing the underpinning nature of the associated regulatory obligations, including licencing obligations.

The renaming of general advice could be undertaken in conjunction with a more wide ranging review of the service "financial product advice", of which general advice is a subset. We note the concerns of consumer groups that the direct link to recommendations in relation to a financial product means that certain services, such as advice on aged care and estate planning or cashflow and budget management, outside of mainstream services provided by banks and other financial institutions, remains unregulated.

With regards to this proposed amendment to the law, the industry understands this change will result in compliance costs. However, we consider that these costs can be minimised by appropriate transitional arrangements and, as far as possible, could be cost neutral against the consumer benefit of greater clarity around this service and more broadly consumers' expectations with financial advice.

Additionally, the banking industry supports clear and effective disclosure of ownership structures across the financial services industry. We consider that adviser ownership structures will be better understood with a discrete disclosure on the new financial adviser register. However, we also support a review of regulated disclosures, such as FSGs, to ensure that disclosures are providing meaningful information to consumers.

The banking industry also supports improved disclosure of mortgage broking ownership structures. With regards to this proposed amendment to the law, the industry also understands this change could result in costs for the industry in complying with any new regulatory requirement. Additionally, regulatory requirements should be assessed against the benefits and the objective of minimising the costs of these proposals.

Recommendation 41 (p272): Unclaimed monies

Define bank accounts and life insurance policies as unclaimed monies only if they are inactive for seven years.

The banking industry supports the reversal of the 2012 change to the unclaimed monies regime which imposed a three year inactivity threshold for bank accounts and life insurance policies to be deemed to be unclaimed monies and transferred to Government. This has caused confusion and affected many customers whose money was not “lost”. The industry supports reversion to the seven year inactivity threshold and simplification of the regime, including maintaining and clarifying statutory exemptions. It is essential that any changes to the legislation allows sufficient time for banks to make the necessary changes to their compliance systems, reporting processes and communications with their customers.

Recommendation 42 (p273): Managed investment scheme regulation

Support Government’s review of the Corporations and Markets Advisory Committee’s recommendations on managed investment schemes, giving priority to matters relating to:

- *Consumer detriment, including illiquid schemes and freezing of funds*
- *Regulatory architecture impeding cross-border transactions and mutual recognition arrangements*

The banking industry supports the CAMAC recommendations to improve regulation of managed investment schemes.

Recommendation 43 (p274): Legacy products

Introduce a mechanism to facilitate the rationalisation of legacy products in the life insurance and managed investments sectors.

The banking industry supports initiatives to rationalise and provide exit mechanisms for investors in products which are now closed or have become uneconomic or out-of-date. Legacy products and the absence of a product rationalisation mechanism create additional administration and compliance costs.

The banking industry acknowledges the merit in initially limiting product rationalisation to managed investment and life insurance, but would welcome expansion to other areas of retail and wholesale products and investments. For example, the cessation of the First Home Saver Account scheme will no doubt cause legacy products in retail banking. Additionally, the industry sees merit in a cost recovery mechanism as long as fees are strictly set to only recover costs.

Recommendation 44 (p275): Corporations Act 2001 ownership restrictions

Remove market ownership restrictions from the Corporations Act 2001 once the current reforms to cross-border regulation of financial market infrastructure are complete.

The banking industry agrees that the rationale for special ownership restrictions on the ASX has passed and that it should be subject to the same ownership restrictions as other financial sector entities.