COMMONWEALTH OF AUSTRALIA

Proof Committee Hansard

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS

Australia's four major banks and other financial institutions: smaller banks

(Public)

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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS

Thursday, 1 July 2021

Members in attendance: Ms Hammond [by audio link], Mr Laming [by audio link], Dr Leigh [by video link], Dr Mulino [by video link], Mr Simmonds [by audio link], Mr Tim Wilson [by video link].

Terms of Reference for the Inquiry:

The Standing Committee on Economics will review Australia's four major banks and other financial institutions. Specifically, the committee will inquire into matters relating to:

- how financial institutions deal with their customers, including indigenous customers, on specific issues and ensure they do not charge default interest on loans secured by agricultural land when there is a drought or natural disaster declaration (recommendations 1.8 and 1.13), and to deal appropriately with distressed agricultural loans (recommendation 1.14);
- the approach taken by financial institutions to review and regularly assess culture, governance and remuneration arrangements, as required under recommendations 5.4 and 5.6, to ensure that these not only comply with the law but also meet community expectations;
- implementation of the recommendations of the Sedgwick Review as they concern staff remuneration (recommendation 5.5);
- remediation of customers in a fair and timely manner following conduct that has fallen short of the law or community expectations; and
- actions being taken by institutions to put customers at the heart of their business and to achieve the letter and spirit of the Royal Commission's recommendations.

WITNESSES

BLIGH, Ms Anna, Chief Executive Officer, Australian Banking Association [by video link]

Committee met at 09:15

CHAIR (Mr Tim Wilson): I declare open this hearing of the House of Representatives Standing Committee on Economics for the review of the four major banks and other financial institutions. Today we are focusing on the smaller banks sector. The committee last heard from the sector in November 2019, so there's been a fair reprieve. Today the committee will hear from the Australian Banking Association, the Bank of Queensland, Beyond Bank, HSBC Australia, ING Australia, Judo Bank, Volt, Teachers Mutual and Unity Bank. Smaller banks play an important role in Australia's financial ecosystem, whether they're customer owned banks or international banks operating in Australia. It's crucial that financial institutions are treating customers fairly at a difficult time for many Australians. To be frank, I think most people accept the banks have done a relatively good job, although there are always differences of opinion on that, and these hearings provide an important mechanism to hold the banks and other financial institutions to account before the parliament. Today, for the first time, we will also be scrutinising neobanks.

I would also like to outline a number of matters related to the conduct of today's hearing. It will be held via videoconference and is being broadcast. Proceedings can be viewed by members of the public from the parliament's website. The proof and official transcripts of proceedings will be published on the parliament's website. I remind members of the media of the need to fairly and accurately report the proceedings of the committee.

I refer witnesses and members to a House resolution relating to procedures for dealing with witnesses, at paragraph (9) on page 127 of the *House of Representatives Standing Orders*. The resolution provides that, should a witness refuse to answer a question, they shall be asked to state the grounds on which they object. The committee may either accept the objection or, alternatively, deliberate at a future private meeting on whether or not to insist upon an answer. If the committee does consider the matter in private, it may write to the witness with the outcome of this discussion.

During the course of the hearing, witnesses may be asked to provide documents at a later stage. If a witness subsequently refuses to provide documents, the committee may meet in private to consider the matter. Under standing order 236 of the House of Representatives, the committee has the power to compel witnesses to produce documents where the committee has made a decision that circumstances warrant such an order. So, basically, just tell us the truth and give us what we want and we'll move on.

First up, we have the representative from the Australian Banking Association present for today's hearing. I remind you that, although the committee does not require you to give evidence under oath, the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament. I now invite you to make an opening statement.

Ms Bligh: Thank you to the committee for the opportunity to appear before you today. As you noted, it's been almost two years since smaller banks and the ABA were called to give evidence, so I'm very pleased to provide you with an update in a range of areas before taking questions.

Like the rest of the nation, Australia's banks have come through a momentous period. Great challenges were met and great challenges were overcome in the interests of customers all over the country, and, as we've seen in recent days, more trials are upon us yet again.

Over the past 18 months, banks large and small have acted early, standing in the eye of the storm and absorbing the blows for their customers by deferring repayments on loans for almost a million families and small businesses. Together with the strong support from government, banks were able to get their customers through the worst. If ever we needed a demonstration of why a strong and stable banking sector is good for the country this was it. Without strong and stable banks this crisis would have been so much worse for so many. Banks are now helping Australians overcome the latest wave of the pandemic. They are offering individualised, tailor-made support for businesses and families that have been plunged into lockdown once more. Once we are through this, banks will again be ready to help their customers power out of the crisis and hopefully never look back.

Banks are reporting that economic conditions generally are good. Interest rates are at an all-time low. Lending and refinancing are at an all-time high. Cash and deposits at banks are at levels never seen before. It's sitting now at more than $234 billion, up from just $70 billion in February 2020. This means that more Australians are having the opportunity to purchase their own home or expand their business, and that's a good thing. Importantly, lending standards are solid. Banks understand the imperative to lend responsibly, and they are meeting that requirement.

As you noted, Chair, it's more than two years now since the final report of the royal commission was released. As I sit here today, I can report to you that a great deal has changed. The implementation of the vast majority of recommendations is either completed or is currently underway, and those still to commence are awaiting parliamentary approval. Banks are putting customers first. They have transformed their culture and their remuneration systems. They are complying with much stronger laws and they have been held to account.

I'm pleased to inform you that the former Public Service Commissioner, Stephen Sedgwick, has now completed his final review of the implementation of his recommendations for changes to the remuneration of frontline staff. Mr Sedgwick found that the industry's policies have indeed changed. Links between bonuses and sales are now rare. His report says: 'These are substantial achievements. The risk of misselling and poor outcomes for customers in retail banking are now substantially reduced.'

I am pleased to advise you also that the review of the Banking Code of Practice will commence today. This enforceable code was updated after the royal commission, and now the industry is acting to ensure that it remains up to date and relevant for the times. The independent review will be conducted by Mike Callaghan. Mike Callaghan will be known to the committee. He was a long-time Treasury deputy secretary and recently chaired the government's retirement income review. This review will aim to strengthen the Banking Code of Practice and make absolutely sure that banks continue to act in the best interests of their customers.

As an industry, we welcome the government's focus on deregulation and the digital economy. This is particularly important for smaller banks, which often don't have the resources of the majors to climb the mountain of regulation requirements and standards that are placed upon them. The banks that you will be talking to today bear the brunt of regulatory burden, with no adjustment for size in comparison to other regulated entities. They need an efficient, competitive and level playing field.

COVID-19 has achieved one good thing. It's pushed state, territory and federal governments to do away with laws and regulations that slow us down and make doing business or buying a home harder. Allowing the electronic execution of witnessing of documents was one of these changes. Witnessing and signing documents in person can add days to an approval process. It's a chore that no-one needs or wants and, frankly, in this day and age, it's just not necessary. The government was right to provide temporary relief, but that relief has now expired. We welcome the exposure draft legislation released by Treasury last week to make this change permanent and we urge the parliament to support it.

In conclusion, regional and international banks play a vital role in communities right across Australia. They stand ready to continue supporting their customers as we come out of the pandemic. I'm happy to take your questions.

CHAIR: Thank you very much, Ms Bligh. I will start on the initial purpose of this inquiry, which is implementation of the Hayne royal commission. You have touched on it already, and I accept the comments you have made regarding internal bank incentive structures and the like and remuneration. Could you outline, just for clarity, how implementation of Hayne recommendations across the sector are being reported within the ABA and its ongoing role and what work it is doing to support banks in their task.

Ms Bligh: Thank you for the question, Chair. The final report of the Hayne commission made 76 recommendations. Thirty-one of those were relevant to banks and eight of that 31 were for banks themselves to implement. The remainder require action by either regulators or the parliament. First of all, I should say that, in order to monitor the implementation, the ABA established within the first month after the report of the royal commission was received a sector-wide task force. Every member bank is represented at a senior level on that task force. It meets monthly to monitor progress, and every bank reports to that task force. It has, on occasion, met more frequently than monthly when there is, for example, a particular piece of legislation before the parliament that might require certain activity. But it has been meeting, as I said, every month since the royal commission report was handed down.

Of the eight recommendations that were specifically for banks to implement, five have been completely implemented. The other three are all in train. The first is the implementation of enforceable codes. As you would know, that legislation has now passed the parliament. The new Banking Code of Practice that will result from the review that I've just advised of you of will be the first industry code that will see the application of the enforceable codes regime. It's not because there's any delay or reticence about that. That's been passed. It will now be up to ASIC to determine when we submit our new code for their consideration to implement that legislation for the first time.

The second of the three is the small-business definition. I'm sure a number of your committee members will be very familiar with the debate about whether or not the definition should land at $3 million or $5 million of total lending. The industry at the time, in conjunction with discussions with the Council of Financial Regulators, took the view that there were competitive implications for smaller banks if it went to $5 million and that we should start with $3 million and build to $5 million and review that. That review occurred last year. All banks, regardless of size, have now agreed to move to $5 million and have agreed that that new limit will be included in the new code. That review is underway, but that issue has already been decided.

Finally, there was a recommendation on culture. That was that every bank should do a review of their culture, identify where there were failings or flaws or improvements needed and then implement those and then assess whether or not they were working. Every bank has conducted that review. They have recommendations. They are implementing them. On the question of whether or not they are making a difference, it's just too early.

Most of those recommendations were implemented by the end of December. Some of them are still in train. To have any meaningful assessment of whether or not they're making a difference you would probably need about another 12 months. They will be continually reviewed, as recommended by Commissioner Hayne. So even the three that aren't final are well underway and almost done.

CHAIR: Just for clarity, that will continue to be reported up to the ABA across the board so that that ongoing monitoring, as you said, will continue to drive continuous improvement and meet the expectations of the recommendations?

Ms Bligh: That's correct.

CHAIR: Just before we move on to other topics, there was some conjecture recently about the frequency with which banks appeared before this committee under the inquiry set out by the Treasurer and adopted by the committee. What is the position of the ABA around the continued appearance of not just itself but its members before this parliamentary inquiry?

Ms Bligh: Thank you for the question and for the opportunity to give consideration to this. I think Australian banks have demonstrated over the last couple of years, particularly post the royal commission, that they are determined to earn back the trust of the Australian people. That does require not only being held accountable for implementation of the royal commission recommendations but demonstrating that they have learnt some of the broader lessons. I think last year was an opportunity for Australian banks to demonstrate to the people of Australia that they had heard the message, that the Australian community expects them to put customers first. They certainly put customers well ahead of shareholders as they responded to the pandemic.

I do think we need to think about the circumstances in which this committee undertook these hearings. They started in 2017, prior to the royal commission. We've now had a full royal commission. We're very close to the full implementation of that royal commission. I do think there is a legitimate question about the ongoing role of this committee, particularly the frequency. Not that any of the CEOs of our banks, regardless of their size, have any concerns about being accountable, but I think there's a trade-off there about the amount of time that is spent and the value that the committee feels it might be getting from their considerations with the members. I would certainly like to think, particularly in 2021, that there might be some consideration to at least limiting the appearances to being annual or even less frequent.

CHAIR: That certainly is what I have proposed but I understand the deputy chair has a different opinion. It's also in the context of the efficiency of our time and outcomes. Frankly, to me, a lot of the hearings for the major four banks increasingly feel like versions of oversight in the way we have with the Reserve Bank, which is actually our responsibility.

Before I hand over to the deputy chair, who I understand has many questions for you—I'm sure you'll appreciate that—what is the work being done around stress testing of debt levels across the sector by the ABA? There has been a significant growth in the amount of credit being taken, principally for housing, but it raises broader concerns about people's capacity to finance that debt if there were to be movements in interest rates. There is a difference of views on that and the time frame, and the RBA governor continues to outline his focus and the board continue to outline their focus in that regard. What stress testing has been done to ensure that the banking sector is not letting Australians get into a situation where they will have too much debt if interest rates were to change in short order?

Ms Bligh: We're certainly seeing in markets right across Australia some very high levels of activity that are driving prices. I should say, in some respects, that's not a bad thing for those people who already own their properties, but it can be a very significant barrier to those who are trying to get in. The ABA doesn't conduct stress testing itself, but ABA members, when they are doing the credit assessment processes for any borrower or prospective borrower, whether it's for a first home buyer or an owner-occupier or an investor, they apply what is called a buffer. When they do the assessment, they consider your ability to service the loan at the proposed interest rate of the loan. They then do another assessment of your ability to service the loan if the rate were 2.5 per cent higher than it is now. Most new borrowers, at the moment, would be facing an interest rate of somewhere between two and 2.5 per cent, in some cases even slightly lower than two per cent. Those assessments are done on what it would look like for you and your ability to service the loan if your interest rate were to double.

I think we've all heard the Governor of the Reserve Bank make clear that it's his intention to reconsider the matter of interest rates in 2024. There's lots of conjecture about whether that might happen earlier. Our banks are acutely aware, particularly when you're looking at a housing loan, which for most people is going to be over a period of 10 to 30 years, that it's inevitable that interest rates will change if you have a variable interest rate and that they need to consider, in their assessments, that under any circumstances borrowers can continue to service the loan. I would also note that the Governor of the Reserve Bank has indicated he will look to change the cash rate when the economy meets the target inflation rate. In his view, that is unlikely to happen until we see wages growth of some 3.5 per cent.

You shouldn't see significant movements in the cash rate until you see significant movements in wage rates. That should assist current borrowers in three, four or five years time, if the interest rate moves. As I said, banks are required to consider the buffer. They apply it. And that's part of the supervisory process that APRA looks at when they consider how banks are meeting their required lending standards.

CHAIR: Thank you, Ms Bligh. Deputy Chair, for 10 minutes.

Dr LEIGH: Ms Bligh, I want to start off with the question of the frequency of hearings with major banks. Just to take you through a few of the events last year: ANZ made refunds to 3.4 million customers, the Commonwealth Bank agreed to pay fines of $700 million relating to money laundering and admitted that 41,000 of its staff had been underpaid, and Westpac had to pay a record fine of $1.3 billion for money laundering. It does seem strange, doesn't it, that, in that environment, you would be calling for less parliamentary scrutiny of major banks?

Ms Bligh: Well, I return to my previous comments: it's up to the members of this committee to determine what value they get out of the opportunity to question the CEOs of those banks. I'm not aware that any of the matters that you have just listed were matters that were identified by the committee; they were all identified by the appropriate regulators, doing their job of ensuring that they are enforcing the law and that banks are complying with it. It is, I would have thought, the job of the parliament to be providing oversight to those bodies that are charged with regulatory oversight, to ensure that they are effectively resourced and capable to do the job that is required of them. In all of the matters that you've just listed, banks are accountable and are held to account and enforced by the appropriate regulators as established by the parliament. As I said, banks are not seeking to walk away from any accountability mechanism. They are acutely aware that they've still got a lot of work to do to earn back trust. I just simply ask the committee what value they think they are getting, given that all of the matters that have been a problem for banks have been identified firstly by a royal commission and secondly by a very broad array of regulators, all of whom have extensive powers to investigate, to identify problems and to impose the appropriate penalties.

Dr LEIGH: I'm not suggesting that this committee is Inspector Clouseau, but I'm suggesting that—in an environment in which banks are paying back billions of dollars, paying fines of billions of dollars, and in which there are millions of customers being adversely affected and tens of thousands of bank employees being underpaid—it is frankly bizarre that you'd come before this committee saying that we shouldn't quiz the major banks' CEOs for four hours a year each but, instead, we should quiz them for two hours a year each. It's not as though this is a major imposition, and the ABA's role in attempting to water down parliamentary scrutiny seems problematic.

But I want to take you to another issue on which the ABA is currently campaigning, which is around responsible lending laws. We've got new lending for owner occupiers at record levels in Australia. There's a lot of credit flowing. And it's difficult for me to see that there is any lack of credit in the residential home market. We also know that the watering down of responsible lending laws is basically friendless on the Senate crossbench. There's not a single crossbench senator who has come out. One Nation, Jacqui Lambie, Rex Patrick, the Greens and Labor have all been critical of the attempt to water down responsible lending laws. Surely, in that environment, the ABA should cease its campaign to axe responsible lending laws?

Ms Bligh: I'm not aware of any campaign being run by the ABA. What we have said is that the current laws are laws with which banks are complying and will continue to comply, and should the government, through the parliament, change those laws, then we would welcome any changes to laws that would make the application and approval process faster, smoother and easier for customers. Whether or not those laws change is entirely a matter for the parliament [inaudible] bank. Through the ABA, they have said they believe that, as to the proposed changes, it's not so much related to the supply of credit. I completely agree with you: there is ample supply of credit going into the market. It is about the impost and the process and the efficiency of the process and the speed of the process for customers.

It is the view of the ABA that all of the responsibilities of prudent lenders can be met in a world that is rapidly changing when it comes to data and access to information about customers. We should be getting smarter about it. These laws are 10 years old; having a look at them and updating them is not a bad thing. But it is entirely a matter for the parliament. If the parliament changes the laws then banks will adapt their processes accordingly. If the parliament decides not to pass the laws then banks will continue to comply with the law as it stands.

Dr LEIGH: I'm just not sure it's a good look for the Australian Banking Association, in an environment in which credit is flowing freely to households, to be out there campaigning to water-down consumer protections.

I want to take you to another issue which is around the Financial Accountability Regime. The government has delayed the implementation of a financial accountability regime which would see executives potentially face civil penalty fines up to $1 million, deferred remuneration obligations and the potential of disqualification from operating as an accountable executive. As you know, that was an important recommendation of the Hayne royal commission. But the *Australian Financial Review* reported last year that the big four banks have stepped up lobbying of Treasury to abandon the proposal. Does the Australian Banking Association support the passage of a financial accountability regime?

Ms Bligh: Thank you for the question. Without the benefit of the AFR article that you refer to in front of me, I can't comment on it. What I can say is that the ABA has supported the implementation of this legislation from the outset when it was first recommended by the royal commission. I should note that the banking sector is already subject to the Banking Executive Accountability Regime on which the FAR is modelled. While there are some changes, this is already a well-established regime in the banking sector. One of the most important parts of FAR is that it will extend that accountability regime to other parts, the non-bank parts, of the finance sector.

I do note that the government set out a road map to complete the recommendations of the royal commission. As you'd be well aware, it was announced last year that the road map was delayed by six months because of the pandemic. I think that was sensible, reasonable and appropriate. But there is now a great deal of work happening in Treasury and within not only banking but insurance, superannuation and financial advice, to ensure that legislation is moving as fast as reasonably possible. I understand there's a proposal for an exposure draft of that legislation in the next one to two months. We'll have to see then how it proceeds through the parliament. But, as I said, banks are already subject to BEAR. While there are new parts in the proposed Financial Accountability Regime, it won't be as big a shift or as big a change for banks as it will be for all of those other parts of the finance sector who are not subject to BEAR.

Dr LEIGH: Does the Australian Banking Association support the Financial Accountability Regime?

Ms Bligh: In broad terms, yes. No-one has actually seen the final exposure draft, so of course we reserve the opportunity to have a look at that.

Dr LEIGH: Understood.

Ms Bligh: In broad terms, an accountability regime for executives is already in place; it's working. We look forward to seeing what the changes might be.

Dr LEIGH: The Australian Taxation Office and the Business Council of Australia have both said that firms which received JobKeeper assistance shouldn't have paid executive bonuses. I know that most banks didn't receive JobKeeper, but does the Australian Banking Association support, in principle, the view taken by the Business Council of Australia CEO, Jennifer Westacott, that if you were getting JobKeeper you shouldn't be paying executive bonuses?

Ms Bligh: It's not a matter on which the ABA formally has a position, as you alluded to. Certainly the major banks were precluded from receiving JobKeeper, but, in any case, there was no need for them and they did not need it in any way. I'm not aware of any ABA member bank that accessed or needed to access JobKeeper. It's my view that none of them did. So this is not really an issue in the banking sector. As a broad matter of principle, I do think that there's an expectation that, when the world is going to hell in a handbasket, there will be some cognisance of that within corporate Australia, and I certainly can understand the BCA's view on that.

Dr LEIGH: The SME loan guarantee scheme didn't work particularly well last time around. We saw overdrafts and other credit options being used in place of the SME guarantee. Do you think the SME guarantee 2.0 is going to work any better?

CHAIR: That's your final question, Deputy Chair.

Ms Bligh: It's very early days. What I can say is that the banking sector certainly welcomed the decision by the government to lift the level of guarantee to 80 per cent. That brought it into line with other jurisdictions globally, who had put in place similar mechanisms. I do think it's important to understand that it was an early response by the government to a concern about the fact that there may be some constraint on credit and/or that some businesses would be in such difficult circumstances it would be very difficult for banks to manage their risk appetite and to support their business customers. As it turned out, banks did have the capital and the ability, in conjunction with arrangements with APRA on the mortgage and other side, to provide relief. So I'm not sure that it's a big deal how businesses get the support. If they're able to get it through an existing line of credit and that's something they're familiar with and that's something that worked for them, and that enabled them to restock or to replace equipment during the crisis, then I'm not sure that's a big concern out there. But I would be surprised if we didn't see a bigger take-up now that the level of guarantee is higher. The point of that is to allow banks to go further up the risk curve for some businesses who continue during the pandemic, exacerbated by current and recent lockdowns, to have a high degree of uncertainty. That's really the point of that program. So we'll watch it with interest.

Dr LEIGH: Thank you.

CHAIR: Over to Ms Hammond now for seven minutes.

Ms HAMMOND: I want to follow a slightly different line of questioning. Forgive me: I may mess up the technical aspects of this a bit. I want to talk about least-cost routing and single-network debit cards versus multinetwork debit cards. I have been approached by a number of small businesses who are concerned about the push to single-network debit cards and a move away from least-cost routing. Can you help me, please, and explain this. The use of debit cards is on the increase in Australia, isn't it, as opposed to credit cards?

Ms Bligh: Yes.

Ms HAMMOND: But debit cards can actually be linked—you can do debit through a Mastercard or a Visa card?

Ms Bligh: Yes.

Ms HAMMOND: So that sort of card would be a multipurpose or a multinetwork debit card, would it?

Ms Bligh: This is an incredibly complicated area—

Ms HAMMOND: So it's not just me.

Ms Bligh: and I'll do my best; I would be very happy to have a full briefing with you at another time. Generally when people talk about multicards, they're talking about cards that can take not only Mastercard and Visa but also EFTPOS. EFTPOS is on different rails, if you like. There are a number of tracks or rails that you can route the payment through. All of the major banks have multirouting cards, and what that means is that the merchants who use their payment machines can choose which way they want to route their payments on the basis of what is the least cost to them. Without getting too technical, it really depends a bit on what kind of business you are, because different rails or routes charge on a different basis. I might get this wrong, but my recollection is that, if you're low volume, high price, selling fridges, versus high volume, low price, selling hamburgers, different rails will suit you or be cheaper for you. Some banks also offer you as a merchant what's called a bundled package. They might offer you a lower rate on the cost of using the rail, a bit like a telephone bundle package. You might also have your transaction account with them or you might have an overdraft with them. You might have a bundle of services. This has been quite contentious because it can be a more expensive proposal, particularly for smaller banks, to offer debit cards run on different rails.

I think the issue has gained some attention recently because the Reserve Bank completed a technical review of the payment system. I don't think it was a recommendation but they observed that maybe some smaller banks should not be required to have multi-routed cards. So I think it's an important discussion. The cost to merchants not only impacts merchants but also can impact the price of the goods or service, and that impacts customers. Least-cost routing is something that all of the major banks have now implemented—that is, they have the option for their merchants to adopt the least-cost method for the nature of their business. They have been promoting that to their merchants. They have more and more merchants changing to ways that suit the particular nature of the business they operate.

That's a pretty high level, simple explanation, which I hope helps, but I'd be very happy at a separate time, with the person in my team who works on this in depth, to come and walk you through it in detail to give you a much better understanding, because it's a really important issue for small businesses.

Ms HAMMOND: Thank you very much for your answer on that. Yes, I've got greater clarity on it. When we talk about least-cost routing, is EFTPOS cheaper than the rail or what you call the—

Ms Bligh: The Mastercard. My understanding is that it depends on the kind of business you operate. For a number of businesses, EFTPOS would be the cheaper. For others, it could be that Mastercard or Visa offer a different package. That's why, I think, for a number of small businesses, and for EFTPOS itself, they feel it's very important that both options are offered. From the material I've seen, it really does depend on the kind of business you operate—as well as, perhaps, the kind of package or bundled deal that your bank might provide to you—which is cheaper. But there are certainly many businesses for whom EFTPOS will be the cheaper and, understandably, they're keen to keep that option.

Ms HAMMOND: You said the big four banks have been pushing least-cost routing or offering it to all of their customers. Who owns EFTPOS? Am I correct in thinking that it is the big four banks?

Ms Bligh: Yes, but not on their own. I don't want to mislead the committee. There are a couple of very big retailers. From memory, I think it's Wesfarmers or Woolworths. I'd be happy to provide that to you. EFTPOS, BPAY and the New Payments Platform all have multiple owners, and the banks are all part-owners of all of them. So, yes, EFTPOS does have ownership by, I think, just the four majors, but there are other significant retailers in there as well.

Ms HAMMOND: Do the ABA or banks have to keep data on their rates of renegotiation or the rates and time frames of somebody who wants to refinance? Say a merchant wants to refinance and they start to do it. Are the ABA or banks required to keep records of those?

Ms Bligh: Sorry, if I can just clarify, do you mean when they want to refinance their loan?

Ms HAMMOND: Yes, to refinance their loan. Let's say a small business wants to move from one bank to another. Do the banks keep records on that and time frames?

Ms Bligh: Yes, they do. That data is provided to both or either the RBA or APRA. I'm 99 per cent sure that APRA is the recipient of that data, which is public data, in both business and mortgage lending. Last year we saw the highest-ever rate of refinancing in the history of the data being kept, so there were a lot of people voting with their feet and going for cheaper interest rates. Forty-seven per cent of all lending last year was refinancing. It's dropped to 33 per cent but that's still much higher than we saw prior to COVID.

Ms HAMMOND: Sorry—was that both personal loans and business loans?

Ms Bligh: Yes, it was. And, I'm sorry, I don't have it broken down, but it would be available—the data is available.

Ms HAMMOND: Thank you very much, Ms Bligh.

CHAIR: Thank you, Ms Hammond. Dr Mulino.

Dr MULINO: Thanks for attending today to give evidence, Ms Bligh. I have a couple of questions firstly on the TFF, which is winding up soon. When you look at data presented by the RBA, the number of ADIs accessing that grew quite quickly early on, and I think that a lot of that was activity by small and medium banks. I'm just interested in your observations on: what were some of the benefits of being able to access the TFF and, potentially, some of the challenges in the way it was set up—in particular, for small and medium banks?

Ms Bligh: I think that might be a question best directed at some of the other witnesses today, because it was them that were actually doing it. I can certainly make observations at a high level. It was a very important source of very cheap or low-priced funds that enabled banks to have absolute certainty about the cost of funds and to offer—particularly, I think, last year—business loans at very competitive and affordable prices. It certainly has been one of the things which I think has contributed to a strong flow of credit into the economy at a time when it does need to be stimulated and was one of the policy settings that the RBA very early on identified as an important source of funds. In terms of how banks might have actually found the process of accessing it, you'll appreciate there are commercial arrangements with the RBA, and I would direct your question there—

Dr MULINO: I can chase it up with the individuals, yes. On AML/CTF: obviously, AML/CTF is of growing importance, and we know all the banks are increasing their investment in this. One aspect of getting on top of AML/CTF is that it involves high fixed costs, in AI, in big data analysis and so on—even something as simple as know your customer. So I am interested in your higher-level assessment of the challenges of AML/CTF in relation to the challenges for smaller banks—and this is one area where regulatory compliance is extremely important but might be more challenging for smaller banks. So that's the first question: the kind of overarching challenge and how it affects smaller banks.

A second, more specific question is in relation to tranche 2, which the government's committed to—and it will be an important step forward but will involve its own set of regulatory challenges—and how that might play out for smaller banks in particular.

Ms Bligh: On your first question: as I outlined in my opening statement, there is a raft of new regulation and compliance requirements, right across the industry, and they are largely applied uniformly, regardless of the size and resources of the entity being regulated. This is a particular burden for non-major banks. Every bank takes very seriously its responsibilities to play an active role, working with AUSTRAC, to help identify instances of money-laundering and counterterrorism activity—they take that very seriously. But, as you alluded to, there is a fixed cost in ensuring that they can meet that capability. I don't have to hand something that would give you a taste of what that fixed cost means as a percentage, for example, of a bank's annual operating or capital costs, but I'd be very surprised if some of the bank representatives who are appearing before you today couldn't assist you with a bit more detail on that, and I'd encourage you to have that conversation. On the second—

Dr MULINO: Just on that very specific point, when it comes to the impact on smaller banks and that fixed cost challenge, for them, in particular, it may be that a better resourced regulator may be more important in order to balance those challenges than it might be for a bigger bank that is able to beef up its own internals. So having a more proactive, well-resourced regulator may be more important for a small or medium bank where those fixed cost challenges are critical.

Ms Bligh: That's a very apt observation, and I suspect you'll find broad agreement on that issue from all of the banks that you're speaking to today. I think we and the parliament also have to be prepared to consider at some point innovations in this space. The fact that we're doing it the way we are right now doesn't mean it's the only way it can be done. I don't have an alternative to put to you, but, as we see more and more innovation, we see more and more regtech and fintech activity. I would expect that, over time, some of the current costs and processes that are required to meet the requirement to know your customer, in a world that is getting increasingly data rich, would over time lead to mechanisms that are just as, if not more, reliable and safe but at a considerably lower cost. There may even be some options that could provide for almost a utility model around knowing your customer. So I do think that's something that is a challenge for the industry going forward.

On your second question, in relation to what's known as tranche 2 of the AML regime, I think this is a really important area and I encourage the committee to take an interest in it. I'm sure you'll be familiar with the Financial Action Task Force, which is a global task force that works to ensure consistency and reliability in these systems globally. Australia agreed to 40 recommendations that FATF put in place in 2021. In 2015 FATF undertook a review and found Australia had a mature regime but certain areas remained unaddressed. Progress was made on seven of them, but a further review will take place in 2022. To the extent that we have—

Dr MULINO: But tranche 2 is outstanding.

Ms Bligh: To the extent that any part of tranche 2 is outstanding, there'll be a day of reckoning in 2022 by the global players on this. Australia is a net importer of capital. We always have been. Our ability to meet global standards is absolutely critical to our ability to access well-priced funds at competitive rates and with some level of certainty and reliability. So the banking sector certainly supports tranche 2 and hopes that we would see the government moving to get this done as quickly as possible.

Dr MULINO: Thanks. I'm conscious of my time, Chair.

CHAIR: Yes. I'm trying to be generous and keep it equal, but we are kind of out of time.

Dr MULINO: Your generosity is remarkable, as always!

CHAIR: I am a giving man!

When it comes to questions, of course members can submit questions to witnesses, and I'm sure, Ms Bligh, you'll be very excited to receive them. I did have just one quick question: is the ABA in the process of incorporating?

Ms Bligh: Yes. We were an incorporated organisation registered with the NSW Fair Trading. They did a review of a number of organisations and put to them that they thought they would be more appropriately structured as companies limited by guarantee. We did that last year at our AGM.

CHAIR: Why?

Ms Bligh: From the point of view of the department in New South Wales, they thought that we had reached a size that was not as suitable to an incorporated association simply because a company limited by guarantee has higher levels of accountability around things like audited papers, publication of audited financial accounts and the responsibility on directors. So it was a structural change to comply with our requirements as an organisation.

There was total support for it across the industry. I think it marks the difference between, perhaps, where the association started several decades ago and where it is now.

CHAIR: Thank you for your attendance today. As I said, if you want to go back and become Premier of Queensland, you are most welcome! The committee secretary will be in touch with you in relation to any matters arising out of today's hearing. You'll be sent a copy of the transcript, to which you can make corrections of grammar and fact. Thank you very much.

FRAZIS, Mr George, Chief Executive Officer and Managing Director, Bank of Queensland [by video link]

SCREEN, Mr Chris, Chief Product Officer, Bank of Queensland [by video link]

[10:04]

CHAIR: Welcome. I remind you that the committee does not require you to give evidence under oath. These are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament, and we don't want that. I now invite you to make an opening statement.

Mr Frazis: I would like to thank the chair and the committee for the opportunity to appear today. When I last appeared in November 2019, I had recently joined the bank as its new CEO and managing director. I subsequently launched a new group strategy to transform the bank to deliver better outcomes for our customers, shareholders and people and, quite simply, we set out to make us a better bank. It's already delivering benefits. We have simplified our home-buying processes, reducing our time for a conditional yes. We are putting more people into their own homes and helping more people to start or grow their businesses. We also recently launched the Virgin Money digital bank, paving the way for BOQ's new digital experience.

In February we announced the acquisition of ME Bank, which is expected to be completed at some point today. The acquisition will deliver material scale, broadly doubling the size of our retail bank and increasing customer numbers from 900,000 to around 1.5 million. Importantly, we will also diversify our geographic footprint, more evenly balancing our loan book across the eastern states. Together through our distinctive brands of BOQ, Virgin Money and ME Bank and through our combined 4,176 people across the group, we are able to offer Australians a genuine alternative to the major banks.

Of course since my last appearance we have also seen the dramatic impact of a global pandemic. We credit the federal and state governments for taking decisive action to protect Australia from the worst impacts of the COVID-19 crisis. We are currently seeing a swift economic recovery, which few had anticipated. Unemployment has fallen to below pre-pandemic levels, house prices have increased and business confidence is strong. While events of recent weeks have shown that the path will be bumpy, we expect that the economic situation will continue to improve, particularly as the vaccine rollout picks up pace.

At BOQ we acted quickly at the outset of the crisis to grant our customers repayment relief. In total approximately 11,000 or 12 per cent of our home loan customers and 13,000 or eight per cent of our SME customers were granted relief by BOQ. Given the resilience of our customers, 95 per cent of our home loan customers and 99 per cent of our SME customers have returned to making normal repayments. As the latest COVID situation continues to unfold, BOQ stands ready to assist any customers who are requiring financial assistance at this time.

I am proud of the role that our bank has played and continues to play in supporting small and family businesses and helping people into their homes. It is in these ways that we can make a real and positive difference to the lives of our customers and their communities. But we believe more can be done to foster a competitive and diverse banking industry which will support the flow of credit and deliver better outcomes for all customers, whoever they choose to bank with.

The major banks are enjoying the funding cost benefits associated with the implicit government guarantee, which is conservatively estimated to be worth 20 basis points. One way to partly offset this is by increasing smaller banks' access to covered bonds from eight per cent to 15 per cent. The big four and Macquarie also enjoy a significant capital advantage, applying risk weights as low as five per cent to low-risk home loans while smaller banks, like ours, are required to hold a minimum of four times that level. Although APRA has gone some way to reduce the differential, this demonstrates there is more to do to level the playing field and create a more competitive industry.

Finally, we are strong supporters of the government's proposed responsible lending reforms, which will simplify processes for both personal and small-business customers and improve the customer experience, without eroding protections. I continue to engage with regulators and politicians on these issues, as ultimately these improvements will ensure that all Australians can enjoy the benefits of a robust, vibrant and diverse banking sector. Once again, thank you for inviting us to appear before you today. We look forward to answering your questions on these issues or any other matters that the committee raises.

CHAIR: We always like it when CEOs say they're looking forward to answering questions! Thank you, Mr Frazis, for that opening statement. Can I begin with the standard question to the banks and other entities who come before this committee. How is Hayne implementation being reported to the board so that we can have confidence not just that actions have been taken but that they continue to be monitored throughout the organisation?

Mr Frazis: Firstly I should state that we are supportive of all of the Hayne recommendations. There were in the order of 25 recommendations that were applicable to BOQ. Nine of those have been fully implemented. The other 16 require legislative changes. Our objective is to implement those as soon as the legislation is changed. We have been regularly reporting back to the board and monitoring our progress. But, as I said, the ones we were able to implement and which were applicable to BOQ have been fully implemented.

CHAIR: I just need to be clear because we have gone back and forth a bit on this. What is the current state of the ME Bank merger with BOQ?

Mr Frazis: We are literally in the process of completing that acquisition today. So, at some point later today, that will be completed. I should state that, right up to that point, we remain competitors, given the ACCC requirement, but we are really excited by the acquisition.

CHAIR: I'm glad you are excited, but, just for clarity, does that mean you are in a position to answer questions for them or not?

Mr Frazis: Not in regard to ME Bank at this stage because, as I said, until that's completed, we remain competitors.

CHAIR: I have a number of questions in the context of ME Bank, but you are not in a position to be able to answer them. If I were to submit them on notice to you now, in light of the fact that later in the day you would be in a position to answer them, would you be happy to answer them then?

Mr Frazis: Yes.

CHAIR: The first thing I am curious to know is this. ME Bank paid a dividend just before this merger. It's the first dividend they have ever paid. We have asked for it previously. I want to know the total and then the dividend that was paid to each of the shareholders, broken down, because it has never done so before, including when we have raised this previously in front of the committee. The question in addition to that is what the attitude of BOQ is in terms of the value of the purchase of ME Bank and, as a consequence, the payment of that dividend and also the attitude of BOQ in the context of the 62 charges that have been made against ME Bank over its mortgage issues, which I can submit formally on notice, if you wish, around the adjustment of home loan rates and the like which led to the former CEO essentially having to resign after questioning from this committee.

The other question I have is around responsible lending laws. You made the remark that you were in favour of the responsible lending laws. What are the current barriers to responsible lending laws for BOQ and its capacity to service its customers?

Mr Frazis: The starting point is that responsible lending laws directly impact on personal customers. But I have to say that they do also impact on small businesses, which is a point that sometimes is missed. That is because for very small businesses, which are a big part of our banking operations, the personal and the business requirements of that customer are interlinked and are blurred. That creates onerous processes for those small businesses to actually get credit to either support their businesses or grow their businesses.

Whilst we're supportive of the changes, firstly, we don't think it reduces any customer protections. It does simplify things in terms of having primarily one regulator, which is APRA, dealing with responsible lending requirements, which are already the requirements from APRA. I want to stress that, from our perspective, lending standards have remained high and will continue to remain high. Our objective will always be to do the right thing by our customers.

The issue with responsible lending laws at the moment is that they require onerous reporting of information. Even as a bank which has had a longstanding relationship with our customer we're required to ask those questions again. It does create quite a burden on our small businesses and also on our personal customers who have been banking with us for some time.

CHAIR: I just realised that I assumed something in my question before. Was BOQ aware that ME Bank was paying a dividend to its shareholders during the process of its sale to BOQ?

Mr Frazis: We finalised the actual acquisition terms in February this year. There was then a period where ME Bank continued to operate and deliver its profits. All those adjustments are made today. Those are the things which finally get settled today in terms of the ins and outs of that adjustment. We knew that there was an intent to pay a dividend if the performance of the bank continued the way it did, and that's actually adjusted in our purchase price.

CHAIR: So you knew it was to be the case. What's the adjustment in the purchase price?

Mr Frazis: I'd have to come back to you on that specifically, because that's all being worked out today. I'll take that question on notice.

CHAIR: Okay. You'll give clarity on the totality of the dividend, the dividend to each of the shareholders and the adjustment price it has for ME Bank on notice and come back to a committee. That would be very helpful.

Mr Frazis: Yes.

CHAIR: Thanks very much. We went through this with the major banks as well—electronic signatures on bank documents. As we heard before from the ABA, there's a proposal to update the law in the context of the temporary measures that were introduced. What's the impact of that electronic signature for BOQ in terms of delays, on average? We had large banks saying that it was impacting for up to 10 days with a contract signing. What's the example for BOQ?

Mr Frazis: It is around 10 days, so we're very supportive of electronic signatures. If you think about our business, a big part of that for our BOQ brand is broader Queensland. About 30 per cent or more of our operations are in regional and rural areas. So actually being able to have electronic signatures which avoid that physical postage of documents is a big positive in getting decisions to customers earlier. As a customer, if you're a small business—and we know even for customers waiting for approval for a home loan—any delay in that creates a huge amount of anxiety and it also delays them in getting on with their business. Electronic signatures definitely improve that process. It's in the order of about 10 days, but it depends on where the customer is located.

CHAIR: Would it be fair to say that there's a disproportional impact on rural and regional customers because, obviously, of time delays, whereas electronic signatures would truncate the challenges faced by BOQ and rural and regional customers significantly?

Mr Frazis: That's absolutely right. This creates a huge benefit for customers who would have to travel long distances to a branch. There's a big advantage for regional and rural areas.

CHAIR: Alright. Deputy chair.

Dr LEIGH: Thank you. I want to start off with the issue of credit card interest rates, gentlemen. The current cash rate in Australia is 0.1 per cent. The Bank of Queensland's platinum Visa credit card is at 20.74 per cent. Have you ever cut the interest rate on that card?

Mr Frazis: We do adjust the interest rates on our credit cards. I would have to say that we provide a number of choices for customers. Those customers who want either—

Dr LEIGH: You're not answering my question, Mr Frazis. Have you ever cut the interest rate on that Visa credit card?

Mr Frazis: On that particular credit card? That credit card is provided by Citibank, so it's a white-label operation from our perspective. Effectively, what those rates are is a decision for Citibank.

Dr LEIGH: Do you think it's fair to be charging credit card customers 20.74 per cent, or more than 200 times the cash rate?

Mr Frazis: Again, this is a decision for Citibank. But what I would say is that—

Dr LEIGH: You're selling the product.

Mr Frazis: No, what we do is provide choices. It's up to us, No. 1, to advise customers on what's the right choice for them. On the high rated cards there tend to be a number of other benefits that customers really value, and it's up to the customer to have that choice.

Dr LEIGH: But it seems an insane interest rate. The last time anyone was talking about 20 per cent interest rates I was running around in short pants in school. This is an interest rate from another era. It's an interest rate that you would expect to see in countries with rampaging inflation, not a country where the cash rate is 0.1 per cent. [inaudible] selling a car with a 20.74 per cent interest rate?

Mr Frazis: There are alternatives, and I have to say we actively advise our customers to make sure they're taking the credit cards that are suited to them. At the end of the day which credit card the customer chooses to take up is their choice.

Dr LEIGH: Your organisation was technically eligible for JobKeeper in the sense that you didn't pay the major bank levy, so you weren't ruled out like the major banks. Your annual report talks about a 30 per cent revenue job but then says that you didn't pay JobKeeper. Was that because you just fell short of the threshold, or did you make an active decision not to opt in to the JobKeeper program?

Mr Frazis: Our intention was not to opt in to the JobKeeper program. I should state that JobKeeper was very critical in terms of supporting a number of our customers through this, which I went through in my opening statement, particularly if you look at our SME customers where we had in the order of eight per cent of our customers on deferrals. For many of those customers JobKeeper was critical.

Dr LEIGH: I appreciate that. I'm just going to BOQ's particular decision, though, given the short amount of time we have the pleasure of your company. You're telling me you were technically eligible but you chose not to take it?

Mr Frazis: I'm not sure we were technically eligible, but I would say we would have actively chosen not to take that regardless.

Dr LEIGH: Could you take that on notice for me, please, and get back to me as to whether you could have claimed it if you chose not to?

Mr Frazis: I will do that.

Dr LEIGH: Tell me about the ethical decision. Why did you not feel it was the right ethical decision for Bank of Queensland to claim in the event that you were eligible?

Mr Frazis: A big part of the drop in our profits is the overlay provisions that we put in because of the crisis. That is a prediction of what we think those losses are; it's not an actual loss that we incurred. In fact, some of those were written back. So I would say, as a board and as a management team, we would have wanted to see that through before we felt that we were actually impacted directly by the crisis.

Dr LEIGH: So you saw that as potentially being a temporary hit rather than an ongoing hit to your financial sustainability?

Mr Frazis: Back then there was a huge amount of uncertainty, and with all the scenario planning that was put in place—and that's why we had to put in the provisions—we wouldn't have expected the quick turnaround. But, having said that, we were comfortable with the ongoing performance of our business. We continued serving our customers. We were supported by the Reserve Bank when it came to our capital position, so we were fine in terms of how we were managing through the crisis.

Dr LEIGH: You spoke in one of the interviews about the MA deal about the importance of BOQ being 'very competitive from a customer service and a productivity perspective'. But isn't it the case that every banking acquisition just makes the banking sector a little less competitive and that we already have one of the most concentrated banking sectors in the world?

Mr Frazis: We personally would not be supportive of any further consolidation if that could be avoided with the four majors. If you look at the combination of BOQ and ME Bank, which is strategically very compelling, that does create a much more competitive environment. But even with that combination our combined group has in the order of about a three per cent share of the banking sector. So we are still quite a small player. But, importantly, this enables us to invest heavily in terms of our digital transformation. This enables us to leverage this across a much broader base, enabling us to be more competitive in terms of the services we're providing for customers that choose to bank with us.

Dr LEIGH: Should we be concerned if fintechs emerge with the notion that ultimately they will be bought up rather than with the idea that they'll be strong entities in their own right? That kind of innovation doesn't seem as though it would be good for banking as a whole.

Mr Frazis: At the end of the day, it's hard to judge what decisions individual companies make during their options in terms of strategy. It's important that regulators have recognised and government has recognised the importance of competition in banking. We are very supportive of measures that support competition. Fintechs, on a regulatory basis, don't have to abide by the onerous requirements that even a bank like ours requires. We're supportive of that because, effectively, they can be barriers to entry. But, at the end of the day, each company's got to make its own commercial decision in terms of what's right for it.

Dr LEIGH: No, I understand. It's perhaps unfair to ask a market player for your views on competition in the sector, but it is something that concerns me. In June of last year, you conceded that a number of contracts you'd signed with small business customers were unfair. Do you support the banning of unfair contract terms?

Mr Frazis: We do support that. In fact, we have made changes to our contracts to abide by the requirements of ASIC, which we support. I have to say that, even though there were unfair contract clauses in our contracts, that didn't actually negatively impact any of our customers. We did a review of that to make sure that was the case, and our contracts have been amended as a go-forward position.

Dr LEIGH: But it could have adversely affected them. There were things like allowing you to unilaterally determine if a default had occurred. Potentially, that could have adversely affected customers; it's just that none of them found themselves in those circumstances. So I'm pleased to hear that you—

Mr Frazis: It definitely wasn't our intent. As I said, we're very supportive of the changes.

Dr LEIGH: Chair, I'm aware we're tight on time. Let me wrap there and come back at the end if there's more time.

CHAIR: Sure. We had one more minute for you, but that's fine. Ms Hammond.

Ms HAMMOND: Very quickly on least-cost routing, has BOQ made a submission on this or have a view on the current discussions that are taking place?

Mr Frazis: We are supportive of least-cost routing, and we do provide that through our service providers. In fact, we were one of the first banks to do so. I should state that a bank our size can handle the additional cost of providing choice. I would understand that if you had either a fintech or a smaller player coming into the market it is an additional cost and additional complexity to provide that choice. But, from our perspective, we're supportive. But, from our perspective, we're supportive.

Ms HAMMOND: Can you explain to me what sort of costs we're talking about here?

Mr Frazis: It depends. The costs can be quite substantial. I'd have to take that on notice. It would depend on the fintech and what operations they had in place, but the costs can be quite substantial, in millions of dollars. So, for a startup, that would have an impact.

Ms HAMMOND: In terms of support, what products do you offer merchants?

Mr Frazis: We provide merchant facilities, so the full services that a merchant will require. I'd have to say that we're not a large merchant bank. We're primarily an acquiring bank, just to be clear. But if a customer requires it, we've got the full services.

Ms HAMMOND: Okay, thank you. I'm sorry, I didn't get them down at the time. What's the percentage of your loan portfolio between personal and business?

Mr Frazis: If I look at the combined group with ME Bank, which is yet to occur, effectively, that balances our business 50-50 between small business and personal customers. Pre-ME Bank, in the order of 60 per cent of our business is small business and 40 per cent of our business is personal banking.

Ms HAMMOND: So the acquisition of ME Bank was because you wanted to increase your personal banking or diversify your portfolio a bit more?

Mr Frazis: It is one of the key benefits of the acquisition. It balances us geographically, so we'll be better balanced between Queensland, New South Wales and Victoria. It also balances our retail and business bank. Because it increases our capital base as a whole, it enables us to do more in the small-business side of things. The larger base of capital enables us to grow on both sides of our business.

Ms HAMMOND: You gave statistics earlier on as to how many of your customers in both personal and business had to defer loans or take other initiatives. Can you take me back to those again? Sorry, I didn't get them down.

Mr Frazis: If you look at our home loan customers, we had in the order of 11,000 customers that were on deferral. That represented roughly 12 per cent of our customers, so quite a large number. We had in the order of 13,000 of our SME customers go on deferral—again, quite a large number. That represented eight per cent of all of our SME customers.

Ms HAMMOND: How many of those, on either side, are still in some sort of relief package?

Mr Frazis: Presently, 99 per cent of those on deferrals, SME customers, are back on normal repayment terms, and 95 per cent of our home loan customers that were on deferrals are back on normal repayment terms.

Ms HAMMOND: For the personal loans, how much longer do you anticipate that you'll keep extending the deferral and/or that it will be needed?

Mr Frazis: For the remaining five per cent, it's not an automatic extension. We look at the customer individually to work out what's best for them. It is important for us to make sure we're providing the right advice to the customer to make sure that they're preserving equity. There's no doubt that two elements have made this easier for customers and us as banks supporting them. One is the appreciation of house prices. That is an important element. But even more important is the reduction in the unemployment rate. If you look at what generally creates a customer having an issue in terms of repaying their home loan, about 40 per cent-plus of those that struggle tend to be customers that have lost employment, or someone in the household has lost employment.

Ms HAMMOND: I thought that house prices in Queensland had stalled or gone backwards. I might have got the wrong information there.

Mr Frazis: You're right in terms of the start of the crisis. Queensland went through a reduction in house prices. That bottomed out. But effectively you've got house price appreciation in all states.

Ms HAMMOND: Are you participating in the first home loan scheme?

Mr Frazis: At this stage we're not. The key reason was what was required from a technical perspective for us to participate. We are looking to see if we can accelerate the changes that are required technically to participate and see if we're able to enter the scheme at some later date. But we're supportive of the scheme generally.

Ms HAMMOND: What are the technical requirements?

Mr Frazis: It required changes in our system to be able to provide that product.

Ms HAMMOND: Thank you. I will leave it there and give ground to others.

Dr MULINO: Thanks for coming today to give evidence. Did Bank of Queensland participate in the Term Funding Facility?

Mr Frazis: We did participate in the Term Funding Facility. I should start by saying that that was a very important initiative by the Reserve Bank. It was a facility that was provided to all of the banking sector. It effectively translated to roughly 12 months worth of the wholesale funding requirements of the bank. While we had a dislocation in wholesale markets, it meant that we were able to actually continue our operations and support our customers through the COVID crisis. If I contrast that to the global financial crisis—where it wasn't as clear, as a smaller bank, during that crisis—we were less able to lean into supporting our customers. So, the TFF has been a great initiative from the Reserve Bank.

Dr MULINO: Are you able to, on notice, provide some details around when you accessed it and how much and some of those more technical details?

Mr Frazis: Happy to do that, Dr Mulino.

Dr MULINO: One of the issues that small and medium banks have raised over many years has been differences in funding costs for small and medium banks versus the large banks. You've raised the issue of the implicit guarantee and all sorts of other structural issues. The TFF is coming to an end, I think today. What are your views on what should occur going forward?

Mr Frazis: The TFF had to come to an end at some point. What we've got now are wholesale markets that are back to normal operation, so there's no requirement for the Reserve Bank to be supporting that. While we do have a situation where the TFF effectively will come [inaudible] for refinancing over the next two to three years, depending on when it was drawn down—as a bank, we drew down our full capacity of the TFF—that's going to have to be carefully managed. If we look at it in terms of what it represents of our total funding, it's about four per cent of our total funding. It's not something that can't be managed, but it is something that will need to be carefully managed.

Dr MULINO: What do you think of the policies or mechanisms that should be explored going forward, to level the playing field?

Mr Frazis: That's a very good question. We have started discussions with Treasury and APRA. One of the things that we have proposed, which Treasury and APRA are generally supportive of, is for smaller banks to increase the covered bond ratio that we're allowed to raise. To give you a sense of that: at this stage there is a limit of eight per cent, and we're proposing 15 per cent. Covered bond issuing does a couple of things. It helps reduce the differential cost advantage that the majors have. On average, let's say they have got a 20-basis-point advantage. The covered bond increase would reduce about four basis points of that disadvantage. It doesn't completely take away the advantage the majors have, but, more importantly, the thing with covered—

Dr MULINO: [Inaudible] the differential?

Mr Frazis: Yes, it does reduce the differential, but, more importantly, the covered bond market is more accessible when there's an element of stress or issues in the wholesale market. It just means that, as a smaller bank, we're much more resilient through those situations.

Dr MULINO: Thanks. I have a couple of questions in relation to AML/CTF. This is an area where all banks are investing more—it's a growing issue across the board—but there are some fixed costs involved, particularly with AI, big data analysis and even aspects of KYC. What are some of your thoughts around how to deal with that challenge? Is a greater role from the regulator perhaps one way to deal with that, rather than expecting banks of all sizes to invest substantially in some of those fixed costs?

Mr Frazis: I should start by saying that we're very supportive of what AUSTRAC is attempting to do with AML and CTF. Obviously none of us want to be providing any services that potentially assist in criminal behaviour. We have invested heavily in terms of our AML and CTF; but, you're right, it does require quite a large investment, both in dollar terms and in finding the right people to be able to do this. That said, the key thing for me, and I'm sure AUSTRAC has a similar view, would be that there is potential to simplify the legislation and the rules and not to, in any way, lessen the ability to identify and capture criminals, but also to make sure that the rules are clearer and easier to actually abide by. That way will actually reduce the costs for all players in implementing the AML/CTF requirements.

Dr MULINO: What are your thoughts on tranche 2, not only the need for it but also some of the potential challenges given the substantial increase in the number of entities that would be covered?

Mr Frazis: We are broadly supportive. As a bank, we take our AML/CTF requirements really seriously. But I would have to say that if we look at smaller SMEs that are potentially covered by tranche 2, that could be problematic for them. That is why I would personally recommend a simplification of the legislation being a priority as a first step.

Dr MULINO: In terms of the open banking rollout, do you have any observations on some of the particular issues for smaller and medium sized banks?

Mr Frazis: Again, we are very supportive of open banking. I think this is going to create a much more competitive environment and better outcomes for our customers, particularly with the protections on privacy et cetera that are in place. It also makes [inaudible] for smaller players to cooperate together through the open banking requirements more compelling. So we are very supportive. Again, open banking requires investments in technology. So, for smaller players, we would ask that there be more time to abide by those obligations. But that's not to say we are not very supportive.

Dr LEIGH: Mr Frazis, according to my numbers, you've got 896,000 customers and an annual profit in the vicinity of $225 million, so the back of my envelope would say you're making a profit of around $250 per account. Would you expect that number to rise or fall following the ME Bank acquisition?

Mr Frazis: If you look at the logic behind the ME Bank acquisition, it was both strategically and financially very compelling. Our objective will be to create shareholder value and also improve the services to our customers. And our strategy, by the way, is one of growth; it is about growing our business and being more competitive and being more relevant to more Australians. We are very committed to the multibrand approach. We love the ME Bank brand and it's something we're going to keep. It's got a centre in Victoria, but we will also be providing services through our VMA and BOQ brands. But critical to that growth is our ability to invest more in technology and digital transformation and remain competitive against the major banks.

Dr LEIGH: When we next get together, should I expect that profit of $250 per account to be higher or lower?

Mr Frazis: Our objective is to increase our profits in a sustainable way and, more importantly, to increase the customers we are serving and the types of service we provide to them.

Dr LEIGH: I don't think that's an answer but, in the interests of time, let me hand back to you, Chair.

CHAIR: My final question is consistent with the question I asked before around electronic signatures. We have heard from BOQ as well as other smaller banks that, firstly, the impact of deregulation disproportionately hits you because, particularly in a space where you need specialists, the bigger banks are able to employ people earlier and faster—and geography also plays a role in that. The trade off is that, often, you get the benefit of a lot of their systems design work—for want of a better word, you freeload on their work. But that means it's delayed for you. What are the areas of red tape and regulation that are presently holding the bank back from being more competitive and servicing customers better? I'm happy for you to take the question on notice on the basis that you provide a more detailed response to the committee so that we can get the parliament making a recommendation to the government focused on specific areas. In this last minute, is there anything that stands out that you want to make a point about?

Mr Frazis: I am happy to take the question on notice to provide a fuller answer. But I would have to say that anything that enables productivity through digital, particularly government services, makes a big positive. Again, anything that really focus on SMEs or impacts small businesses is something that we care about quite a bit. I have already stated that the responsible lending recommendations that the government is proposing were supportive. Again, this is all about improving productivity for the SMEs, where, basically, personal and business banking blur. Again, on competition, the covered bonds and the reduction of the risk-weighted assets and the capital that we have to hold, particularly for low-risk home loans and low-risk SMEs, is another avenue that would improve competition.

CHAIR: Thank you, Mr Frazis. We look forward to getting a more fulsome answer with as much detail as possible—as well as on the issues that have been previously. Mr Screen, you got to appear on screen but you didn't get to make any contribution. If you want to say something so that you can appear in the transcript, that's up to you.

Mr Screen: Thank you.

CHAIR: Your name is now in *Hansard*! Thank you for your attendance here today. The committee secretariat will be in touch with you in relation to any matters arising out of today's hearing. You will be sent a copy of the transcript of your evidence, to which you can make corrections of grammar and fact. Thank you.

Mr Frazis: Thank you, Chair.

Mr Screen: Thanks very much.

Proceedings suspended from 10:46 to 11:00

KEOGH, Mr Robert, Chief Executive Officer, Beyond Bank Australia [by audio link]

MATTERS, Mr Wayne, Deputy Chief Executive Officer and Chief Financial Officer, Beyond Bank Australia [by audio link]

CHAIR: We will resume this hearing by the House of Representatives Standing Committee on Economics into small banks. We now have representatives from Beyond Bank present for today's hearing. I remind you that although the committee does not require you to give evidence under oath, the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. I now invite you to make an opening statement.

Mr Keogh: Good morning, Chair and committee members. Thank you for the invitation to attend this hearing. I though it important to provide the committee with some background on Beyond Bank Australia and the approach it takes to its operations.

Beyond Bank Australia is a 100 per cent customer owned bank. All of the customers are equal owners of the bank. We have a long and proud history that dates back 63 years to when a group of public servants formed a credit union due to their concern that the banking system at the time did not adequately cater for their needs. In 2013, on the back of the government's objective to increase competition in the financial sector, we became a mutual bank.

The cooperative philosophies upon which our organisation was founded are deeply embedded in the culture and operations of the bank today. We strongly believe that these cooperative elements are more important today, given the significant challenges we have all faced in this pandemic. It has also reinforced the importance of community, collaboration, the recognition that there are some in our communities who need support and the power of collective endeavour.

Beyond Bank Australia is an $8 billion business, with 273,000 customers. The bank employs 660 staff across the country via a distributed operating model. Our business is focused primarily on individuals and their financial needs. We also do some small-business banking activity, which represents about 3.5 per cent of total loans. We have partnerships with 5,000 not-for-profit community organisations across Australia. Our operations span metropolitan and regional markets, supported by 45 branches, a digital platform and three onshore contact centres under a follow-the-sun model.

We are a values based bank, with our purpose being to create and return value and, through this, to help change people's lives. Through the Beyond Bank Foundation and our community development approach we have contributed around $27 million to support communities and assist in natural disasters since the foundation's inception. Our culture is centred on doing the right things, doing them the right way and exceeding expectations. In 2015 we were the first bank in Australia to become a registered B corporation. This is an international movement which supports doing business a better way, with a focus on stakeholders, not just shareholders, and using business as a force for good. It is a certification that indicates that the bank meets high standards of social and environmental performance, accountability and transparency.

Communities rely on financial institutions to help them with the challenges they face. Customers, quite rightly, are seeking banks they can trust and that are responsive to their needs. The financial wellbeing of our customers across their life stages is at the centre of everything we do. Our operating philosophy is not about being the best in a community. Rather, it is about being the best for our customers and the communities in which they live and work. This background has informed our response to the recommendations flowing out of the banking royal commission. We reviewed the commission's recommendations, and the matters identified form part of a detailed action plan overseen by the board via standing committees. Subject to items requiring further regulatory changes to be enacted and code approvals, these actions are complete. The recommendations of the Sedgwick report were also reviewed, and it was concluded that the bank was in compliance.

Building strong relationships with our customers, our employees and their communities is paramount for the bank. The service proposition we provide is aimed at being there for our customers and supporting their needs. We measure the satisfaction of our customers daily, and currently it is running at 94 per cent. Independently, Roy Morgan Research recently announced Beyond Bank was the best bank in the country for customer satisfaction in 2020. Canstar also has awarded Beyond Bank, as having the best mobile banking application in the mutual sector.

The past 18 months have been a period of tremendous challenge. However, at no time during that period has the bank swayed from its purpose to create value for its customers through the provision of relevant and meaningful products and services, nor have we deviated from our commitment to return value through personal engagement and support for our customers. We are a small bank when measured against the financial balance sheets of our larger competitors. However, we believe that our contribution to the critically important social balance sheet is significant when one considers the resources we have available to us. With me today is Wayne Matters, the deputy CEO. Thank you, and I'll pass back to you, Chair, for any questions.

CHAIR: Thank you very much, Mr Keogh. I will congratulate you, firstly, on being awarded as bank of the year by Roy Morgan Research. I was actually just reading about that. That is a not insignificant achievement. You've outlined already some points related to the Hayne royal commission. While I acknowledge the high customer satisfaction rate—you're obviously getting good external validation for that—could you perhaps give us some clarity of how that, the Hayne implementation, is being reported to the board and monitored, so that we can get an understanding around the cultural aspects, the accountability and the ongoing management of the issues addressed and raised through the Hayne royal commission into the sector.

Mr Keogh: What we do each month, first of all on customer satisfaction, is go out to our customers every day. We ask them their opinion of the experience they have received from the bank and any of the services we have provided and their dealings with our people around that. Through that, we also engage with our staff internally about how the customer, the internal customer, works within our organisation. We also engage with our staff in an engagement survey, which we run on a quarterly basis. Also on a quarterly basis, we do a risk overlay within our business, and, out of that, we determine what people are thinking about risk and are doing about risk in our organisation. With those four elements we have built what we call a customer barometer. That customer barometer is the subject of a monthly review by the executive of the organisation and is the subject also of a board review on a monthly basis. That information flows up into the board. We have set benchmarks around where we want to see the organisation sitting around that customer barometer, and it's from there that the organisation operates and makes changes, if we think we need to make changes.

CHAIR: One of the strengths of smaller banks is the capacity to be nimble. You started right from the outset saying you're not as large as other banks, but where you focus our energy is on customer service and delivering for your customers. As I said, I acknowledge the external as well as the internal validation. What I'm really interested in is what it is you are currently doing not just to help your customers but also to influence the direction of the market. I notice you have a partnership with the fintech Frollo to develop an online proposition, a white label personal finance management platform, for those. What other types of investments are you making with smaller entities to be part of a parcel of the product you're providing, and how are you providing oversight or guarantees around making sure they're meeting customer need?

Mr Keogh: Our ability to influence the market, largely given the size of our organisation is very, very difficult. As you mentioned, we have entered into an arrangement with Frollo to support us in building a financial management tool. That is part of a pathway that we are on, which is about trying to support our members in building wellbeing and helping them in building their financial health into the future.

We are also part of a broader collaborative network within the mutual sector whereby we share our data resources. Again, we are a small institution; to do that on our own is very, very difficult. So we're part of a group of mutuals that run a data centre. We are also a shareholder in cascade payments, which support us in the payment space around NPP, soon to be mandated payments, and the activity that goes on within that.

CHAIR: In terms of the regulatory environment, we had BOQ before us this morning saying they were strongly supportive of the government's efforts to reform responsible lending legislation to put them in a better position to support their customers. Do you have a view?

Mr Keogh: We're owned by our customers, so whatever we do has to be in support of our customers. We are supportive of doing the right thing around regulation for organisations to operate under. Having said that, we are also mindful that we do not want to create an environment where it is very difficult to work with customers. Our current approach is that we sit down—they own our business, so therefore we have to support them in every way we can. Our objective in our assessment process is to, firstly, understand their needs, and then go through an assessment process which is about their income, which is about their expenditure and their living expenses, and which is about what they're trying to achieve and whether the product that we have on offer is appropriate for them. So, in that regard, we're very supportive of responsible lending obligations. However, we also believe that we need to be mindful of the fact that we do not overcomplicate the process of lending.

CHAIR: That's a general statement of principle with which I think everybody would agree. The question then is about the practicalities and the relationship, particularly in some of the issues that have arisen out of guidance notes and the like; we will leave that to one side.

We have had major banks raise concerns with us around the consequences of the delay in the implementation of e-signatures. BOQ said this morning—and other major banks have said similar things—that it can add up to 10 days for the successful processing of mortgage documents and the like, and contracts generally. What is the experience of Beyond Bank and its utilisation of e-signatures?

Mr Keogh: I would have to take that point on notice. I'm happy to come back to you on that. We would be supportive of any approach that would facilitate the efficiency and the effectiveness of processing of lending. In relation to e-signatures, I would have to take that on notice and come back to you on that.

CHAIR: But I presume you utilise e-signatures as available?

Mr Keogh: Yes, we do. We utilise e-signatures for contracts and so on. In relation to mortgage documentation, I would like to get a little bit more—

CHAIR: I was talking about contracts more generally, using mortgage documentation as one example.

Mr Keogh: Sorry.

CHAIR: That's okay; I would be happy to have that data. Banks have outlined that the absence of that simple measure can add substantial delays in the vicinity of around 10 days per contract, in terms of a pathway from it being provided to it being approved by customers, and the consequences that then has. Is that a generally indicative reflection of the experience of Beyond Bank as well?

Mr Keogh: The point I would make around that is that we rely on manual signatures completely. Our members reside across the country, and, as a consequence of that, those delays can be quite lengthy. We would be supportive of furthering the ability for us to use e-signatures, and that would certainly facilitate processing.

CHAIR: Who are your members? Is there a distinctive trend around the base of the membership?

Mr Keogh: We still have a large predominance of public servants in our membership base. We originally started as a public service credit union, and therefore they are still with us. We still have, within the markets that we operate, many public servants as members. Having said that, we have since moved into the broader community. Within that, our membership comprises of everyone that might be in a community. There's no-one that would not be able to join Beyond Bank. So it's a broad distribution of the people within the community.

CHAIR: Thank you.

Dr LEIGH: Mr Keogh, as part of our preparation for these hearings, typically we will look through the media to see what stories have come up. When I looked through it for the major bank hearings, there were stories about the billions of dollars they have repaid, the millions of customers who have been wronged and the tens of thousands of employees who have been underpaid. When I did a similar search for Beyond Bank, I found stories around how you're hiring in regional areas and how you have been ranked No. 1 in customer satisfaction across the banking sector. You are ranked in the top five Australian banks in a Forbes survey of the world's best banks. If we look back to the royal commission, you made a submission, but, as I understand, there were no adverse findings against you. Would it seem strange if we had the major banks on the same hearing schedule as the smaller banks?

Mr Keogh: Could you clarify that for me?

Dr LEIGH: At the moment we have the major banks come before us more frequently. That strikes me as pretty sensible. They're pushing to be put on the same hearing schedule as you, despite the fact that the royal commission focused overwhelmingly on the activities of major banks, and, as best I could tell, the customer owned banking sector came away with a clean bill of health.

Mr Keogh: From Beyond Bank's perspective, we would have no problems presenting ourselves to whatever forum was deemed appropriate to share the Beyond Bank story. As far as we are concerned, transparency is central to what we do. If it's considered that we appear in conjunction with the major banks, I would certainly have no difficulty whatsoever around that.

Dr LEIGH: That's good to hear, but I'm not sure why we shouldn't be scrutinising the major banks more often—unless someone is running a protection racket to get less scrutiny on those major banks.

Can I go to figures around account profits per member. I just put to Bank of Queensland that their profits and membership figures suggest that they're making an average of $250 a member. If I look at Beyond Bank's numbers, a $25 million profit for over 250,000 customers gives us a profit of $100 per account. Then, quite systemically, if we look at Teachers Mutual and Unity the profit per account seems to be lower. Can you tell me in a systematic sense why it is that the customer owned banking sector has a lower level of profit per account than the for-profit sector?

Mr Keogh: The issue for mutuals, particularly Beyond Bank, is that profitability is our only source of capital. So, therefore, it's important for us to generate sufficient profitability within the organisation to maintain the appropriate level of capital to support the growth that we need to undertake as a business. What happens in the mutual setting is that there is no leakage, if I can put it that way, around the profitability of our business. All of the capital, all of the profit, that is generated in our organisation goes back into the business to support the operations of the business through improved products, improved services and improved staff, if you like. So there's no leakage to shareholders outside of our organisation. Everything remains inside the business.

Dr LEIGH: In terms of the effect of house prices on your bottom line—bearing in mind that your bottom line ultimately goes back to your customers—in April, Matt Comyn said that, as a rough rule of thumb, a 10 per cent increase in house prices flowed through to about a five per cent increase in the size of the Commonwealth Bank's loan book and about a three per cent increase in the Commonwealth Bank's profits. Would those numbers hold broadly true for Beyond Bank as well?

Mr Keogh: I'd need to take that back and look at the numbers as that applies to Beyond Bank. I'm happy to take that question on notice. Suffice it to say that growth in property prices does add to the wealth perceptions of individuals, and, as a consequence of that, there is an improved level of confidence, and with that improved level of confidence comes an increase in the lending demand and so on and so forth. That is apparent today, given what has happened over the last 18 months and what we're actually seeing in the market today. In terms of the precise numbers, however, I'd like to take that on notice, if you don't mind.

Dr LEIGH: Sure. I'd be grateful if you'd do that. Presumably, there's also just the mechanical effect that, when houses cost more, people have to borrow more.

Mr Keogh: That's right.

Dr LEIGH: What's your assumption as to the yearly increases in value that we're going to be seeing in the housing market? The big four are estimating around a 10 per cent annual increase. Does that seem right to you?

Mr Keogh: I think probably predicting the future of house prices is a very, very difficult thing to do—

Dr LEIGH: Absolutely, but presumably you have people paid to do that within your organisation, given the impact on your bottom line?

Mr Keogh: We use external sources, such as CoreLogic, to provide us with information around where we think the direction of house prices will be. There's no doubt that that will be up. But, as an organisation, we do not specifically sit down and try to predict what the percentage increase in house prices will be as we move forward. We actually are very much a taker in the market, and we respond to the direction of the market at the time.

Dr LEIGH: How competitive are Beyond Bank's loan offerings, compared to bank and non-bank lenders in the mortgage space?

Mr Keogh: We'd like to think that we are reasonably competitive, relative to the other operators in the market. We meet regularly as a pricing committee to look at where our rates are positioned. We are not always the best priced in the market and nor do we desire to be the best priced in the market. However, we also believe that it is important for us to offer a competitive interest rate, together with a high level of service that's attached to that. So, in short, I'd like to think that our rates are as competitive as anyone else's out there.

Dr LEIGH: What's the current comparison rate for an owner-occupier mortgage taking out a variable interest rate loan with Beyond Bank at the moment?

Mr Keogh: I'll pass that to Wayne Matters, if you don't mind.

Mr Matters: On our basic variable rate loan, it's 2.52.

Dr LEIGH: That feels a little above the best practice in the market. Some of the best comparison rates are closer to two than 2½.

Mr Matters: Yes. We do have fixed rates that are closer to two, but, as Mr Keogh said, our proposition is built around the total package that we offer to our customers, of which the rate is just one aspect. As with the awards that Mr Keogh has outlined, the service component is a core part of our strategic positioning as well.

Dr LEIGH: Yes, although in my experience the degree of benefit I get from what you call the service component of a loan is pretty trivial compared to the cost of the mortgage. But those are commercial decisions for you and the board.

Ms HAMMOND: Mr Keogh and Mr Matters, thank you both for appearing today. You made comments at the beginning about your customer barometer, which sounded like a really interesting and really useful tool. I'm wondering whether you do a similar thing with staff. Do you have a staff barometer at all?

Mr Keogh: Yes, we do. We call it our culture barometer. Our culture barometer comprises, as I said, four components. First of all, there's the external customer, who we measure. We do that on a daily basis. Secondly, we measure the internal customer. Simply put, the philosophy within the business is that, if you're not serving a customer, you had better be serving someone who is. Staff have the opportunity, if they're working with another part of the business, to make comments about that level of satisfaction. We also measure that daily. Thirdly, we measure the engagement score of our people as part of that barometer. We do that on a quarterly basis, when we ask staff about a whole range of issues in relation to what's going on in the business. And, finally, there's our risk culture survey. Those four components add up to what we call our culture barometer for the business, and it's against that that we have set benchmarks. In fact, we've set benchmarks against each of those four components. But we've also set a benchmark that we expect for the organisation against the total culture barometer.

Ms HAMMOND: How often does that get reported to the board or discussed at board level?

Mr Keogh: The culture barometer goes to our executive team as part of our performance meeting every month. That culture report also goes into our board papers every month, and that gets considered by the board as well. It also forms part of the oversight by our risk committee so they can get a reading in terms of what's going on in the organisation around the broader culture within the business.

Ms HAMMOND: I think you mentioned that you have 660 staff. Where are they dispersed across the country?

Mr Keogh: Yes, we have 660 staff. We operate with what we call a distributed operating model. A larger proportion of staff are in our biggest administration centre, which is in Adelaide. However, we run regional offices right across the country—in Perth, Sydney, the ACT, the Hunter Valley and Melbourne. Within that we have not only customer-facing staff but also people that operate in our back office. That's the approach that we take around that. We have about 44 per cent of our people operating in our back office. We have around 56 per cent of our people operating in customer-facing roles. As I said, a large proportion of that 44 per cent is located in Adelaide. However, in regional offices there are a number of back-office roles. Our philosophy around this—particularly given the challenge that many organisations, whether they be financial institutions or not, face in recruiting people—is that we will recruit people from wherever we can, whatever the roles are, and we can operate from whatever location we need to operate from.

Ms HAMMOND: That leads me to two different threads of questions, so I hope the chair gives me enough time here. The first one is about your remuneration practices. Do any customer-facing staff get paid bonuses, or is any of their remuneration linked to attracting new customers?

Mr Keogh: No. Beyond Bank is primarily a fixed annual reward organisation, and there are no customer-facing staff that are on bonuses or rewards to drive levels of business.

Ms HAMMOND: Do you employ financial planners?

Mr Keogh: Yes, we do.

Ms HAMMOND: Do those financial planners offer a limited array of services, a limited selection of, say, life insurance products?

Mr Keogh: I'll pass to Wayne Matters to respond to that, if that's okay.

Mr Matters: We have an approved product list for our financial planners. It's a fairly broad list of products, but they need to be researched and approved. They can't just offer anything.

Ms HAMMOND: Do the financial planners get any reward bonuses?

Mr Matters: There is an incentive scheme for the financial planners. It's relatively modest, less than 10 per cent of their fixed pay, and it's not based on revenue generation. It's based on a balanced scorecard of other factors, including compliance, client satisfaction et cetera.

Ms HAMMOND: Are they the only employees in the organisation that have that flexible remuneration?

Mr Matters: We have a similar pool scheme for our senior managers and executives. Again it's relatively modest, roughly three per cent of fixed remuneration, and again it's based on a balanced scorecard [inaudible].

Ms HAMMOND: You make the balanced scorecard public in your public documents, do you?

Mr Matters: Yes, it is.

Ms HAMMOND: The other avenue that that question leads me to, and it's also linked with your new arrangement with Frollo, is your cybersecurity steps. How and to what extent do you ensure cybersecurity in the organisation, not only if you have staff dispersed but also in relation to new products?

Mr Keogh: Wayne, would you like to respond to that?

Mr Matters: We have a team in our IT area that's focused purely on cybersecurity, led by a manager in that area. We adopt Australian standard ISO 27001. We apply what's called a layers-of-defence model. That's the technical side of cybersecurity. I think that probably the weakest link is always the people, and we're very conscious of making sure our staff and our customers are informed about cybersecurity issues. We also regularly communicate with both sets of stakeholders around cybersecurity awareness to make sure that they're not clicking on links that they shouldn't.

Ms HAMMOND: But with, say, the relationship you've entered into with Frollo, what sort of due diligence do you do on the product? I imagine you're just bolting on to what they've already got, so what due diligence do you do in that regard?

Mr Matters: As part of our cybersecurity framework we have an information asset register. We assess where all of our information is, including where it is going into a new partner; the sensitivity of that information; and its technicality. That will drive the degree of the due diligence work that we do. While it hasn't started yet, we are doing work with Frollo, and we have done an assessment of their cybersecurity capability to make sure that we're satisfied with it before we enter that partnership.

Ms HAMMOND: Is Frollo an America based organisation?

Mr Matters: To the best of my knowledge, they're an Australian business, but I'm not 100 per cent sure. They perhaps have a holding company that I'm not aware of.

Ms HAMMOND: So with your due diligence you'd find out where the data is going to be stored?

Mr Matters: Absolutely, yes. Our position at this stage is that we don't allow any of our customer data or corporate data to be stored offshore. Where there is data stored by a third party, it needs to be stored in Australia.

Ms HAMMOND: Thank you both very much.

Dr MULINO: Thank you both very much for attending today to give evidence. Firstly, did you access the TFF?

Mr Matters: Yes, we did access the TFF for both tranches, or phases, and we drew down our final tranche just a week ago.

Dr MULINO: Would you mind providing on notice details of how much and when?

Mr Matters: I do have that detail here in front of me if I can just dig that out.

Mr Keogh: I think the facility was about $289 million.

Mr Matters: It was $289 million and it was roughly in two halves. I know we drew the second half in May and June in equal instalments. With the first half, I'd have to take on notice the exact timing, but we drew that in two instalments as well.

Dr MULINO: Obviously some aspects of the crisis have passed, but there remain—certainly according to many small and medium banks—ongoing systemic issues around funding costs. What are your thoughts around what appropriate responses might be? We've already had a suggestion raised earlier today around greater access to covered bonds. I am interested in your thoughts as to what sensible ongoing approaches might be.

Mr Keogh: As I said earlier, our source of capital is driven by the profitability of the organisation. We also have provision within our constitution to raise other capital, but we don't see a need for us to do that. It's just there in case we need to go down that pathway. In terms of covered bonds and the like, we don't have an appetite for that type of capital. Indeed, we wouldn't look to raise it as we move forward.

Dr MULINO: If funding costs for you are not a material issue in terms of your capacity to compete against the majors—

Mr Keogh: Funding costs are always an important issue for us, and we do need to make sure that we manage our funding costs in a way that enables us to compete, so there's no doubt about that. We're certainly seeing margins fall. We have seen them fall consistently since 2000. Funding costs are critically important, because that's the other part of the equation in your ability to lend and be competitive in the marketplace. So they are critically important, yes.

Dr MULINO: On another issue where there are potentially regulatory issues that are of uneven impact on small and medium banks versus the big four, in the realm of AML/CTF, I think it's fair to say that all banks are committed to increasing their capacity and resilience, but arguably the presence of fixed costs makes it more of a challenge for some of the smaller players. I'd be interested in some of your thoughts around how the regulatory regime and the legal regime might best deal with some of those challenges.

Mr Keogh: We have recently undertaken some internal work within the organisation whereby we looked at all of the work that we're required to do around regulatory matters, around programs that the government want to implement and so on. It was a substantial piece of work. We costed all of that out in terms of the employees, or the FTE equivalent. That worked out to be: at any one point in time, we've got 37 full-time equivalent people working on regulation and government related programs. That is spread across our organisation in a whole range of areas. But the critical thing for us is that, through a standard costing arrangement, we applied that to the work that we're doing, and our estimate is that that cost is in the order of around $8 million a year. For a larger institution, that might not amount to much, but in a smaller institution, where we've got a staff complement of 660 people, it is a substantial cost to us.

How does that play out? The cost is there and you live with that. I want to make the point that we are very supportive of building a strong and competitive financial services sector. However, the issue for us is that every dollar we spend on the important regulation and government initiatives is a dollar we cannot spend on building our organisation out in terms of the strategic objectives, the investments that are critical in terms of financial wellbeing for people, the investments in the communities to make them stronger. So that's the flow-on effect of that.

I think the government can help in that regard. Agencies, clearly and importantly, have objectives to deliver certain programs and so on and so forth—and we're supportive of that. However, what would be really helpful is for the government and regulators to look across everything that is being done and the impact all of that is having. So, rather than taking a stovepipe effect to things, could we develop a more matrix approach? That's not to say that the work is not to be done—not at all—but it would help in terms of smoothing out the challenges, certainly within our organisation and possibly in other organisations as well.

Dr MULINO: Obviously in this space there are a lot of developments—a lot of the actors that are trying to launder money are investing more on their side, which is making the challenge greater for banks. You've also got, for example, the looming implementation of tranche 2, which has been in the pipeline for a long time. And I think it's widely accepted that it's important and necessary, particularly given that so many other jurisdictions have already implemented that—the UK, Singapore, Canada and so on. If anything, that raises challenges in that there are going to be rising costs; and, as you said, for some of the smaller players, it is going to require an approach from government that takes that into account.

Mr Keogh: That's correct. I'd agree with that.

CHAIR: Mr Keogh and Mr Matters, thank you for your time and for your attendance here today. The committee secretariat will be in touch with you in relation to any matters arising out of today's hearing. You will be sent a copy of the transcript of your evidence, to which you can make corrections of grammar and fact. It is also possible that committee members may choose to submit questions on notice; and we would appreciate it if you would respond to that in the appropriate time frame. Based on the answers today, I don't expect that to be the case—beyond what has already been flagged. Thank you very much to the representatives of Beyond Bank.

MCLEAN, Mr Kaber, Chief Executive Officer, HSBC Bank Australia Ltd [by video link]

POWER, Ms Jessica, Head, Wealth and Personal Banking, HSBC Bank Australia Ltd [by video link]

[11:43]

CHAIR: Welcome. I remind you that, although the committee does not require you to give evidence under oath, the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament—and we don't want that; it's not good! I now invite you to make an opening statement.

Mr Mclean: Thank you, Chair. Hello, everyone. As this is our first time in many years in front of the Standing Committee on Economics, I will start with an outline of the size and shape of HSBC in Australia to better contextualise my answers to the committee's questions. I will then cover our evolution in the context of the royal commission, some of our key actions during the pandemic and our views on the Australian economy going forward.

HSBC is an international bank headquartered in the UK, serving more than 40 million customers and employing around 226,000 people across the globe. HSBC has been in Australia since 1965. We provide institutional and wholesale banking services across global and commercial banking customer segments, including a significant markets, custody and sustainable finance business. We offer premier retail banking services online, over the phone and at 40 physical branches. We're headquartered in Sydney and we employ approximately 1,800 people across the country.

In terms of our business mix, approximately two-thirds of our business is wholesale and approximately one-third is retail. Our ambition during our more than half a century in Australia has been to be our customers' preferred international partner. Allow me to provide some more colour as to what we mean by that. Our purpose is to support Australia's best corporations in their global ambitions and assist the flow of capital and investment into Australia—essentially, connecting Australian companies to global international opportunities and vice versa. As such, we tend to focus on the larger end of the wholesale and institutional market, and there are segments which we do not pursue; we do not target SME customers and we have no small business banking offering. Our retail offering is similarly concentrated at the more affluent end of the market in major cities and is deeply internationalist. A key part of what we do is assisting generations of new Australians as they establish their lives here—from international students to the employees of multinationals doing their stint here, all the way through to those making Australia their permanent home—and clearly we help internationally-minded Australians in their overseas journeys.

I would now like to cover how the outcomes of the royal commission have impacted the evolution of HSBC's conduct, controls and culture in Australia. Firstly, I think it is worth pointing out that some parts of the royal commission covered financial services that we do not offer to retail customers here—notably, the advised wealth business and superannuation. Many of the components of the royal commission—for example, culture and incentives—were indeed very relevant to our business, and we have performed a detailed read-across from the commission outcomes and implemented specific changes where required. The context for us, and the reason why the royal commission outcomes were in some ways more easily digested, is as follows: as part of a global bank, with many lessons learned from the prior decade, including the GFC, many of the areas covered by the commission had already been subject to significant internal programs of action during the preceding years. In summary, whilst we never claim perfection, the recommendations of the royal commission reinforced work we had done, and assisted in the direction of travel already underway.

Bringing the conversation to COVID-19, I am very proud of the resilience of our operations, our people and our customers in Australia. We remained fully operational throughout, given our solid contingency planning, and clearly we continue to be fully operational during the current lockdown. I would like to take this occasion to publicly thank all of our staff in Australia for their outstanding work. Like our peers, we played our part throughout the pandemic. We supported our wholesale customers by facilitating cash flow and debt capital access, and we managed an orderly deferral process for our retail customers. Owing to the more affluent nature of our retail portfolio, our total housing loans, subject to deferral arrangements, peaked at around 6.5 per cent in August 2020, below the industry average of about nine per cent. Because of the nature of the retail portfolio that we have, we have been able to directly contact the vast majority of those customers through that period—about 97 per cent of them—to ensure the response was appropriately calibrated. Happily, 99 per cent of those customers have moved off the deferral program.

Australia has managed the medical crisis and the subsequent regulatory and economic response in a way that minimised economic damage and promoted a rapid rebound. It has been a strong performance and we remain upbeat on Australia's overall economic—

Videoconference interrupted—

CHAIR: We have lost Mr Mclean, just before we were to ask questions. Hopefully he will reconnect. Ms Power, are you in a position to answer any questions? I do believe that Mr Mclean was towards the end of his opening statement.

Ms Power: Yes, it does look like he was towards the end. I can definitely try. I am very happy to answer if I can. If not, we can hold for Kaber.

CHAIR: Murphy's Law says that, as soon as I start to ask questions, he will jump back on. Let's start with you, Ms Power, simply because I am interested in the retail bank side. You may not be able to answer this; it might be a question for Mr Mclean. He touched on the issues around the Hayne royal commission implementation, acknowledging the fact that a lot of the recommendations didn't target HSBC or weren't specifically relevant to the bank. That doesn't change the fact that our role is to make sure you're implementing what is relevant and necessary associated with the bank. Can you give us any guidance about the internal ongoing monitoring of the implementation of recommendations but also more critically around staff culture within the organisation so that incentives are in alignment with the best interests of customers and remuneration et cetera all fulfil and are focused on the best interests of customers and how that is ultimately reported up to either management or the board?

Ms Power: Yes, I'm very happy to answer that. I'm sure Kaber can add something if he joins us. There were recommendations that were relevant to us. I should say, similar to Beyond Bank, we weren't actually mentioned in any of the findings but the recommendations were highly relevant. Any recommendation we can implement has either been implemented or will be implemented by the due date.

In terms of how we track it, we actually have a care program where we have improved a whole lot of culture. Things like the Hayne commission findings, the Sedgwick findings and our philosophy on our overall conduct and maturity all come into this care program. We actually report to the CEO on that monthly, and I personally report to the board on that each quarter. Also, at a group level, we have a culture-of-values committee which reports to the board, and we also discuss that each quarter. We do have quite a robust response in terms of making sure that we implement not just the actual findings but also the spirit of them as well. We're really focused on making sure all of our leaders understand why we are doing this and are training to ensure that all of our people understand the culture we want to have here and implement that as well.

CHAIR: Thank you for that answer. Can I go now to your retail bank side, particularly the issues that were raised before Mr Mclean dropped off about deferrals and loan deferrals. It was outlined that 6½ per cent, if I recall correctly, of the portfolio for mortgage products was deferred as a consequence of COVID-19. That has now dropped down, if I'm not mistaken. Is that 99 per cent of all or 99 per cent of the 6.5 per cent that have resumed?

Ms Power: It's of the 6.5 per cent. But we didn't have any other deferrals. So you could say it would be a higher number, closer to 100, I guess. But it's over 99 per cent of the portfolio, anyway—absolutely.

CHAIR: I'm not going to split hairs; I'm quite relaxed about that. For the remaining percentage who do still need deferrals, how is HSBC supporting those people? Is the preference to continue to restructure their debt or is it to move it towards a pathway of liquidation? Are there any insights you can give this committee, because this is a consistent issue across all banks, although obviously it's a smaller share of the portfolio for you versus other retail banks?

Ms Power: Sure. Right through the deferral process, we made sure that we had regular contact with our customers—not just at the key points where we had to but also right through the process—to make sure that deferrals were right for them. Some customers actually could afford to make some of their repayments and decided to do so, for example, and others needed a different type of restructuring. For all of the customers we currently have that are experiencing any sort of hardship—and we actually put out the call, given the current lockdowns, for any customers experiencing hardship now to let us know—we take that on a case-by-case basis. We are really trying to make sure, particularly now that it is a more manageable number, that it's not just a 'one size fits all' deferral process but that we do work with those customers.

CHAIR: I presume that a large chunk of those—oh, hello, Mr Mclean.

Mr Mclean: I'm incredibly sorry. We're not sure what happened, but I'm on the phone.

CHAIR: It is technology. It happens. Did you have any further comments on your opening statement? I think you were pretty much towards the end. Is that correct?

Mr Mclean: I hope so. I was basically outlining our robust view on the economic status of Australia but with a little caution on border reopening. If you heard that, you heard the majority of it.

CHAIR: I didn't hear about the border reopening, so why don't you give us that, because that may be of interest to the press? If you could provide a full copy of your opening statement to the secretariat, that would also be helpful. Do you want to make your concluding remarks?

Mr Mclean: Yes, certainly. Thank you. Following a very strong half, our year-end 2020-21 GDP growth forecast is just over five per cent. That forecast doesn't yet take into account the current lockdown; we're still crunching the numbers. Clearly, beating the current outbreak is the priority. However, echoing the views of our chief Australian economist, Paul Bloxham, we see the development of a clear pathway to international border reopening as critical to cementing our longer-term positive view. I think that does it.

CHAIR: Thank you. Just for clarity, when you say 'border reopening', on what time frame?

Mr Mclean: I'm not advising what the policy should be on border reopening or lockdown. It's really pointing out the economic facts and the maths. We're still digesting it, but it's very much reflected in the *Intergenerational report* that came out. In the five or so years in the run-up to the pandemic, approximately a third of Australia's GDP growth was from net migration, so it is a significant component of GDP growth in the past. So that has to have an impact on the future growth pathway.

The other thing that's very important is that it's something of an experiment. Although Australia has been very good at moderating net migration over many, many years, a complete cessation for three-plus years is going to have an impact. But I would also contextualise this—and it's what we've talked about in terms of Australia's overall economic trajectory—by saying this isn't a doom-and-gloom scenario that we're painting. What we're saying is that there's a difference between being positive about a very, very strong and robust economy and being very positive about it, and that's the gap we're talking about.

CHAIR: Okay. I see HSBC has given broader analysis about the region—in particular, growth in Asia. It's very much contingent, obviously, on the vaccine rollout. The same obviously applies, to a certain extent, with us. To what extent has HSBC done modelling on potential variants of the virus and the potential that they could lead to strong border closures and/or other measures, such as lockdowns, which could constrain that growth?

Mr Mclean: We have not, to my knowledge, produced any research specifically modelling that. It's clearly a risk, but what we would say is that the current suite of vaccines that are on offer and the mixes that are on offer, even in countries which haven't managed the medical emergency nearly as well as Australia, still seem to be very effective in being the light at the end of the tunnel and being able to assist people to get back to some form of normality.

CHAIR: We've jumped over to you from Ms Power. Please don't take this as showing any disrespect, Ms Power. One of the things I'm very interested in—and Ms Power was touching upon it in the context of home loan deferrals, and, for your clarity, Mr Mclean, she was doing an excellent job—is the trend signs around home loan deferrals, particularly for your customer base. For the overwhelming majority of people who faced challenges throughout the pandemic and needed home loan deferrals—right from the start, you outlined that a lot of them are high-net-wealth individuals in a situation where traditionally cash flow was a problem—was it principally as a result of cash flow issues, or were there some other overriding factors that emerged?

Mr Mclean: Because of the nature of our portfolio, you'd expect us to have a slightly different subset of those people who are seeking assistance. While we may have seen fewer of those in the food and beverage or SME sectors of the economy, what we did see was that the pandemic had a big impact on service employees, consultants and IT personnel, which are absolutely part of our customer cohort. As they readjusted their lives, and as contracts were adjusted, quite a few of them would have come forward for assistance. Happily, an awful lot of this was what I would describe as precautionary. That's what we've seen on the happier side of things.

CHAIR: In terms of other debt restructuring that occurred at that time, you would have had home loans, but you've also talked a lot about the other space in which you invest—particularly business banking. What other trends were you seeing in restructuring of finance and debt in light of the pandemic, and how is that now progressing?

Mr Mclean: In terms of business banking, we don't have any offering at all on the smallest end of businesses, and we have almost no SMEs, so my comments really relate to what I'd describe as—

CHAIR: Wholesale.

Mr Mclean: Yes, the largest customers in town. What we saw through this pandemic was, I'm happy to report, extremely sensible. Australia's experience of the GFC was pretty light, although it might not have felt like it to Australians. The lessons were learnt, so corporate boards were extremely sensible. They didn't wait until the last minute to do sensible things like go to the markets, raise capital, raise equity and talk to their bankers. Equally, they didn't do unhelpful things like draw down on all of their committed lines. It was an extremely orderly process for people to shore up their balance sheets to make sure that they could come out of the pandemic in good shape. I think that was helped by the backdrop of both the regulatory and the RBA's actions of assuring the liquidity of the system—that concern of assuring the liquidity of the system disappeared almost instantaneously.

CHAIR: In terms of the debt facilities options that some companies at least looked for in the middle of the pandemic, I presume most of these weren't exercised.

Mr Mclean: I wouldn't say that—there was an enormous amount of activity.

CHAIR: There was an enormous amount of activity, but in terms of the degree of dependence that businesses needed—that's probably a better way of putting it—it was temporary and had receded.

Mr Mclean: Yes. The vast majority of the corporate balance sheets that we interact with are now in at least as good a shape. Not only has there been a plentiful supply of liquidity in Australia for good Australian businesses but also, because of the relative strength of the Australian economy and its performance in the pandemic, Australia has been and continues to be a strong attractor for overseas capital. In terms of international debt capital markets assurances, which we manage a lot of in our company, the spreads that have been going out the door are at all-time lows.

CHAIR: A comment was made recently by an HSBC economist which said that rising house prices—and not just in Australia—are 'a huge challenge—a problem in terms of financial stability but a huge socio-economic problem too'. How does HSBC see the impact of rising house prices on financial stability and socio-economic problems as outlined in that quote?

Mr Mclean: I'd like to answer that from two perspectives—firstly, as a banker with a prudential requirement. In terms of Australia, we see the current house price growth as part of the design for the recovery—let's be straight about that. It's to bring back householder wealth and get the economy going. So there is a sensible component to that. We think it will moderate, for the reasons that we've discussed, in terms of, longer term, the border reopening et cetera. But, as bankers, we haven't relaxed our lending standards as a result of that. The risk envelope that we apply, in terms of lending standards, has reverted to where it was pre pandemic. It was tested during the pandemic and found to be very, very robust, and we've reverted to that. We haven't, if you like, let the rope out, in terms of our prudential standards.

In terms of the actual house price increase: it's entirely natural that, with savings and cash actually at quite a high level for households, and with very, very low rates, the corollary of that is that, without additional supply, house prices are going to go up. I'm just stating the obvious here. For the wider issue, the sort of intergenerational issue, the issue is surely supply, and that's where I think the conversation needs to go, in terms of the provision of supply. That's the longer term thing; it's going to be people to housing stock, not endless provision of financing or cheap financing.

CHAIR: [inaudible] on that, we will not disagree. Thank you very much. I will hand to the deputy chair.

Dr LEIGH: Mr Mclean, HSBC and Citi both came into Australia in the mid-1980s, after Paul Keating allowed foreign banks to enter the market. I think, at the time, there was a sense that an injection of competition from foreign banks would really transform the Australian banking sector, but it hasn't really worked out that way, has it? We've now got Citi looking at exiting the market. Your market share is a lot lower than what many savvy economic policymakers would have hoped in the mid-1980s. What do we learn from this about attempts to inject competition into Australian industries by opening up to foreign competition? Why hasn't HSBC grown into a major bank over that period, as it is in many other countries? Do we simply learn that banking is a pretty local market and that it's hard to expand in other countries? I suppose that would be the lesson ANZ learned when it pulled back from overseas markets.

Mr Mclean: I'll answer that in two ways. First of all, I'll give you a little bit of colour as to what we are here, because, in some of the sectors in which we operate, we've quite a decent share of the market, and I will come to that. Secondly, I'll address the overall, ongoing challenge between competition and regulation for safety.

Firstly, you're absolutely right in terms of our retail component. We are very proud of our retail bank here; it's a very, very good operation, but it is only about 1.2 per cent of the market, and you're quite right about that. The thread that runs through both the retail and the wholesale operation that we have here is the international element. That's when we become relevant and competitive for our customers, because, if you don't already have the quantum, the scale, it's very, very, very difficult to be a mass-market bank in retail. Those are just the facts of life. I'll spin back to regulatory safety versus competition in a minute.

On the wholesale side, in the institutional and the corporate space that we choose to compete in, we actually are a very major competitor. I won't turn this into a marketing call I promise you, but we're a top-three capital market house here. So, in the wholesale space, we are very, very significant. We're very, very significant in the custody space. It's just that that doesn't necessarily hit the headlines in terms of where we are in retail.

The second part of my answer is in terms of your million dollar question as to: Why isn't competition more ferocious? Why don't the players move around more? I think this is partly to do with the somewhat unique nature of it: a not completely new but certainly an essential role that banks play within the market. But I think it's also recent history in terms of, particularly, the GFC. You've seen a very natural drive from politicians—and, therefore, that flowing through to the regulators—for the emphasis to be on: 'Don't let banks fail. Raise capital. Regulate for safety.' And that's entirely understandable. But, as that has been the direction of travel for the last 10 years, since the GFC, just by the very nature of regulatory barriers you have to be big to deal with the weight of regulation that arrives on you. We're fortunate in that we're a significant player but we're not a major player in the retail bank, but we benefit from the infrastructure that HSBC globally gives us.

Dr LEIGH: In other markets we've seen dual-currency accounts emerging. We particularly see this in the United States and Mexico, where customers can simply deposit money into one ATM and pull it out at another ATM, and the account balance is continually available in two different currencies and the exchange rates are good. Why haven't we seen HSBC offering products like that in the Australian market?

Mr Mclean: We do. At the risk of you allowing me to turn this into a marketing call, we have something called Everyday Global, which has multiple currencies, and it operate exactly like that across the world. Jess is probably better at describing that product.

Ms Power: Yes, we do have an account that does that. You can actually have up to 10 currencies on that account and, yes, if you are travelling in the future, you can actually take currency out at an ATM overseas as if you're a local. It will not actually have the—

Dr LEIGH: Will it be at the mid-market rate, though, Ms Power?

Ms Power: Sorry?

Dr LEIGH: Do you get the mid-market rate when you do that?

Ms Power: If you have money in your UK account, for example, there will be no foreign exchange charge. You'll just take the money out as if you were taking it out of an actual UK account.

Dr LEIGH: At the mid-market rate?

Ms Power: We won't be actually transferring currencies to do that. You actually have money already in a UK pounds account. When you do transfer money into that account initially, you can actually transfer it in from another pounds account and then have no foreign exchange. If you transfer it in—say, from an Australian account into a pounds account—then there is an effects margin on that. Does that make sense?

Dr LEIGH: But if you move between currencies, are you moving at the mid-market rate? Or are you getting a mark-up on the mid-market rate?

Ms Power: I can provide you those rates on notice. I don't actually have them to hand.

Dr LEIGH: But that's the key question, isn't it? Anyone can allow customers to transact once you've padded a profit margin off the mid-market rate. The question is whether you can offer customers the ability to move money around at the same rate that they would see if they went to Google Finance or Yahoo Finance.

Mr Mclean: Can I just interject and give an example of the use test of what Jess describing? If you, as an Australian citizen, had a UK rental property, instead of receiving the rent into your account and repeatedly moving sterling into Australian dollars and then paying your UK-arising tax or your bills or your local taxes in the UK, and having foreign exchange on all of those, you can move that through a UK account which you can completely control from Australia so you don't actually have those changes. But when you initially fund it, yes, what we do is charge you a market rate plus a rate based on the size of that transaction, and that's a competitive foreign exchange market that we play in, and we seek to continue to be competitive on those rates.

Dr LEIGH: Actually, I would argue that, for retail customers, the market for foreign exchange is potentially one of the most uncompetitive markets around, largely because the way in which prices have to be compared is highly opaque. Very few transfers allow people to compare apples with apples. People typically have to look up the mid-market rate, work out what the spread is for the mid-market rate and then add in any applicable foreign exchange fees. So I think it's a market which could do with a whole lot more transparency to boost competition. I want to take you to a couple of environmental issues. You've operated a project with the Nature Conservancy, involving the issuance of blue impact bonds. Also, you bought reef credits, allowing farmers to reduce polluted run-off into the Great Barrier Reef. Mr Mclean, can you tell me why it is in the interests of your shareholders to be engaging in these sorts of environmental projects?

Mr Mclean: Yes, definitely. What we have is basically a continuum from existing sustainable business. That is things like green bonds, which we've been around for a number of years. We issue debt for our customers and help them structure those. We do a lot of that business. We also have a very significant sustainable loan business, which is a very innovative area in Australia—generally Australia is probably the fastest moving market in Asia Pac for these bonds—and this is basically sustainably linked bonds linked to a variety of KPIs. The exciting thing is that those performance criteria are moving away from purely the very good things that are done for net zero and carbon; they are being much better tailored to the businesses they are being issued for. For example, a business might not be able to credibly offer carbon reduction but it can do something very effective on waste management, recycling or employee health and wellbeing. That process of innovation is at the end of a lot of 'financial laboratory' work.

On the two things you have pointed out as examples, we reinvest some of our corporate sustainable resource budget in these things because our hope is that, ultimately, these will become financial products which drive real genuine sustainable behaviour at the end of the day. I'm particularly attracted to the reef credits. Just to be very clear on what it is: One unit of reef credits as an outcome; it is a one kilogram reduction in nitrogen run-offs. It is not a program that 'hopes' to do something; the payment is on the outcome. We want to expand the tools that are available to corporate and retail Australia to get behind this transition.

Dr LEIGH: Thank you. That's very useful. As a bank that operates overseas, you have good visibility into how other countries are managing the pandemic. How would you characterise Australia's vaccine rollout?

Mr Mclean: I am wary of getting into political commentary. I think it's entirely clear that Australia has managed the medical pandemic and the economic response very well. But the benefits—and this is reflected in what our economists have written—of being an island with well-controlled borders and an effective containment policy are up-front; the longer-term economic consequences come towards the end.

Ms HAMMOND: Thank you, Mr Maclean and Ms Power. Mr Maclean, when you were offline, Ms Power was addressing a question from the chair about culture and remuneration. I want to pick up on that. Has HSBC implemented all of the recommendations from the Hayne report—and you have [inaudible] Sedgwick review, yes, we have implemented all of Sedgwick, I understand.

Mr Mclean: Just to give you some context of that: In my opening statement, I talked about lessons learned in the previous decade, particularly out of the GFC. In the period from 2011 to 2012, following the GFC, really driven by the UK regulator the UK had already started to have banks remove direct incentives. And we implemented our first culture and behaviours program back in 2012. When I said like Sedgwick come along and assisted in the direction of travel: we weren't perfect, there were still things that we needed to do and tidy up, But we have been on the journey for well over half a decade.

Ms HAMMOND: There are no sales linked rewards?

Mr Mclean: No.

Ms HAMMOND: No—across the organisation. Is HSBC Australia a subsidiary of HSBC, or is it a completely independent organisation?

Mr Mclean: We operate through two main operating subsidiaries: a full subsidiary, with a full board, and a branch of the Hong Kong and Shanghai Banking Corporation. So we have two operating entities.

Ms HAMMOND: Those are in Australia?

Mr Mclean: Yes.

Ms HAMMOND: I'm leading into questions on cybersecurity. Where are data and information on your customers stored?

Mr Mclean: That's a very good question. We have very, very careful privacy controls across all of our data, and, to the extent that we use either offshore services or cloud web services, we go through a process of approval to have that approved by the relevant regulator. But, just to be very clear, HSBC as an organisation uses data centres in Australia and in other countries and cloud services. We view that as a key component of our cyber-resilience.

Ms HAMMOND: But there's also the cybersecurity element. Is there a global team that oversees your cybersecurity, or do you have teams in the Australian subsidiary?

Mr Mclean: We have both. We have a very significant ecosystem of cybersecurity. It covers all of the tech things that you'd expect, such as identifying all the network points of access into HSBC, including our third parties. It includes all of the trawling and defence software and keeping that up to date. And, of course, we test all of those controls. Internally, there is what we call 'second line', so IT do their own tests and audit; and we use external, professional tests—what I would call 'stress tests'—using friendly hackers, to see whether they can break into us.

Ms HAMMOND: How often do you do that?

Mr Mclean: They're all ongoing programs which look to stress different components of the environment, so you don't just go for one and then try the same thing next year. These guys move across the different points of entry that we could have.

Ms HAMMOND: If stressors are found, what sort of remediation is there? Do you report any of these? Have you got a requirement to report any of these to APRA?

Mr Mclean: Sorry, that broke up a little bit. Would you mind repeating that question?

Ms HAMMOND: If you do find stressors when you're doing these tests, what are the requirements on you in terms of remediation and reporting?

Mr Mclean: We have a very clear requirement to get approval for any significant outsourcing—for example, outsourcing programs out to the cloud. And, clearly, if we have an actual data loss and an actual breach, we would report that to the relevant regulator. But what I would say is that, like other banks, we are subject to these attacks routinely. Every other day there's a phishing attack. There are DDoS attacks rolling through the system all the time. The vast majority of those don't result in any real impact to us at all, and we don't bombard the regulator with those. It's only if there has been an actual loss of data.

Ms HAMMOND: So you'd only report an actual loss of data?

Mr Mclean: Yes, if something has actually gone wrong. What I'm saying is that we don't report the attacks.

Ms HAMMOND: Is that just because there are so many of them? I'm not saying against you specifically, but—

Mr Mclean: Yes. I don't think the regulators want to know about every other day's phishing attack. That would be very dull for them.

Ms HAMMOND: A phishing attack, yes; but, beyond phishing attacks, do you have other potential cyberthreats?

Mr Mclean: Yes. I guess what I should do is make a very clear distinction between the very clear breach reporting that we do where there is an actual loss of data—we will follow the regulatory rules to report that—and keeping the regulators up to date and aware of what's going on, which we also do as part of our routine interaction with them.

Ms HAMMOND: Okay. Do you report all of them up to the board?

Mr Mclean: Yes, the board will be made aware through our risk management committees as these are captured.

Ms HAMMOND: Great. Thank you.

CHAIR: Do you have further questions, Ms Hammond.

Ms HAMMOND: No. Thank you both very much.

Dr MULINO: Thanks very much for attending and giving evidence. I have some questions on AML/CTF. There were some reported breaches. I think you made contact with the regulator in December 2019, and there was some reporting of this in April and May of last year. I'm just wondering what the status of that series of breaches is and also what changes it led to in the organisation.

Mr Mclean: I will answer in two stages. First, I will answer on the changes in the organisation, in terms of the context of HSBC overall, and then I will talk specifically to the IFTI self-reporting, which I think is the subject of your question.

I will just go back to some context for HSBC, and this refers back to something that I said in my opening statement about some of the events around not just the royal commission but the action around the commission, particularly AML action in Australia. We were in better shape than most of the local financial institutions, and the reason for that isn't necessarily a good reason. It's because we had our professional wake-up call back in 2011 and we entered into a deferred prosecution agreement with the Department of Justice which lasted from 2012 to 2017—a five-year agreement. Over that period, the organisation spent many billions of dollars to upgrade its

AML/CTF systems to get them to where they are now, which is world-class for an international bank. We're very proud of where they are, although, again, we never attain perfection and this is an ongoing arms race against the bad actors in the system. We've been upgrading our AML processes and the ecosystem that we have around those controls for a decade now.

The specific disclosure that we put in our local results was for a small subclass of international financial payments. For those who are into it, it was a subclass of MT202 SWIFT payments between financial institutions. There had been some ambiguity as to whether they were included in the reporting or not. We looked at it again and identified that we probably should be including them. We notified AUSTRAC immediately. With AUSTRAC's agreement, we over-reported those for a period of time until we refined our systems. As at today, that has been implemented.

Dr MULINO: I've asked this of all the big four banks: it would be useful if you were able to provide some data on HSBC's investment in AML/CTF in terms of both headcount and dollar expenditure on IT, for example, for the last decade or so, just for us to get a sense of trends in the investment by the firm in capacity and resilience in relation to this set of risks.

Mr Mclean: We'd be very happy to follow up with that data. I don't have the data off the top of my head.

Dr MULINO: That's fine. Another specific issue which I've raised with others, including, of course, the big four, is tranche 2. HSBC is in a position, through its connections through related entities, to have a sense of how this has played out in other jurisdictions. While Australia's AML/CTF regulation was, in broad terms, given a tick by FATF and other regulators, the FATF, along with the IMF and the OECD, have highlighted tranche 2 as an area of potential weakness and noncompliance. I'm just interested in your observations on where Australia sits there. The government has committed to fixing tranche 2, to implementing regulations in relation to tranche 2. Obviously, through your parent organisation or related organisations, you've seen tranche 2 implemented in other jurisdictions—in the UK, Singapore, the US, Canada and so forth. What are your thoughts on that and the potential exposure in Australia?

Mr Mclean: I'm wary of commenting upon the internal preparedness of our competitor banks. We know they take it extremely seriously. This is an evolution from the rest of the world. All international banks have been spending very heavily on this for over 10 years. I guess there is probably a component of catch-up here, just because of the time spent. But I'm afraid I don't have any specific critique to offer you which I think would be useful.

Dr MULINO: That's fine. Your entities in other jurisdictions have dealt with the implementation of tranche 2, and most banks in Australia seem to be saying—the ABA certainly said this morning—that they're supportive of tranche 2 being implemented here. As you say, there's a bit of catch-up. Some entities in Australia are supportive of it as an area where there's a need for regulation to be strengthened, but you in a sense have a perspective where you've seen it implemented in other jurisdictions and of how it can be done well. Any observations you might have on notice around this, learning lessons from HSBC and other jurisdictions, would be useful.

Mr Mclean: Certainly. We will come up with that.

Dr MULINO: Thank you.

CHAIR: In light of that, and there being no further questions—and it is 12.30, and people are no doubt hungry!—we appreciate your appearance before the committee today, Mr Mclean and Ms Power. Ms Power, thank you for your preparedness to step up in Mr Mclean's absence; you are most welcome to offer any comments, if you want to, on any matter. Be mindful that additional questions on notice may be presented by committee members. Thank you for your attendance here today. The committee secretariat will be in touch in relation to any matters arising out of today's hearing. You will be sent a copy of the transcript of your evidence, to which you can make corrections of grammar and fact.

Proceedings suspended from 12:32 to 13:29

EVANS, Ms Melanie, Chief Executive Officer, ING Australia [by video link]

GIBSON, Mr Glenn, Interim Head of Retail Banking, ING Australia [by video link]

HO, Mr Charles, Head of Wholesale Banking, ING Australia [by video link]

CHAIR: Welcome. Although the committee does not require you to give evidence under oath, the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament. I now invite you to make an opening statement.

Ms Evans: Thanks, Chair. Thanks for inviting ING to appear before the committee. As is this our first appearance, I would like to make an opening statement with some details about who we are, our position in the market and how we serve our customers. ING is a fully owned subsidiary of ING Group, which is based in the Netherlands. ING launched in Australia in 1999 as the country's foremost digital bank, with simple online savings and home loan products. We started off as a secondary bank for our customers, and since then we've expanded our offering. We now also bank wholesale and institutional clients. Our strategy is to be our customers' main bank, and to date, we've attracted more than six per cent of main-financial-institution consumers in the market, making ING the fifth-largest consumer MFI bank in the country. That's circa 1.25 million Aussies who consider ING their main bank. According to APRA data, we're the sixth-largest mortgage lender to households, with 2.83 per cent of mortgage share, and the fifth-largest household savings bank with 3.7 per cent of household savings market share.

We believe the basis on which we compete is by being different. We're the most recommended bank in the country, as mentioned by monthly industry-wide RFi research, and also, for two years running, we've been acknowledged by Roy Morgan Company Consumer Research as the most trusted bank. Put simply, we attract most of our customers by word of mouth and good service, all while we are a digital bank. Ninety-nine per cent of our customer interactions take place through our mobile app or our web based services. Our contact centre, on the Central Coast in New South Wales, is available 24 hours a day, seven days a week for customers who need help or prefer to speak to someone. While we are primarily a retail bank, we do have a wholesale bank presence, and wholesale banking now represents 12 per cent of our overall lending in Australia.

I hope that gives you a good summary of ING in Australia and how we go about doing business, and, given our focus on retail and wholesale customers, today with me are the leaders of those two customer facing business units: Glenn Gibson, who heads our retail banking team, and Charles Ho, our head of wholesale bank. Thanks, again, for the opportunity today. We'd be happy to answer any of the committee's questions.

CHAIR: Thank you, Ms Evans. Do Mr Gibson or Mr Ho want to make any opening remarks?

Mr Ho: No, thank you.

CHAIR: Fine. The basis of this inquiry initially was oversight of the implementation of the Hayne royal commission, particularly those recommendations relevant to the different sectors, including how there's an ongoing observance and monitoring of different practices. Can you give me an outline of how ING has responded to the royal commission, of the measures it is taking and is implementing and of how they're monitored across the company, including through reporting to management and board structures?

Ms Evans: Absolutely. We have a local supervisory board based here in Australia that comprises four independent directors. Of the 75 recommendations that were moved forward, 28 were applicable to ING's business model here in Australia. We were already meeting or have already implemented 13 of the recommendations to date, meeting all of the regulatory timetable so far. For the remaining 15, we're waiting on detailed regulation or indeed, in some cases, legislative change or clarity so that we can move forward and implement by the implementation date. But we've done everything that we've needed to do, and we're ready to go once that clarity is received.

In terms of what happened post the royal commission—and I should say ING did a submission to the royal commission on request, but we were not called to appear during the time of the commission—our supervisory board started the board customer experience committee, largely as a result of the findings of the royal commission. That is our customer-facing business units' key accountability check, if you like, not just about the formal recommendations of the royal commission but also for us to track their very important information about culture, conduct, service levels, advocacy scores, customer satisfaction scores and the like. So the committee can be very confident that we have management reporting in place, as well as board oversight on our progress against the royal commission recommendations.

CHAIR: Thank you, Ms Evans. You said before—just to go broadly to the operations of the bank—that you are largely based on word of mouth and customer satisfaction. I'm not contesting that, but as I recall—I don't watch television that much these days, to be honest—ING used to spend a fair bit on advertising. Is that no longer the case?

Ms Evans: Like most commercial organisations, we do advertise. The point I was making is that that's our point of differentiation with the rest of the market. We are an industry leader in terms of trust and customer advocacy, so that's indeed our point of differentiation on which we believe we compete, and it's why customers choose to move their banking to ING.

CHAIR: One of the critical concerns with essentially web based banks—although it is, of course, also absolutely true for those with a physical basis—is the increasing risk of cyberattacks. Last week, we had insurance companies before us dealing with some of the issues around ransomware. That obviously has a potential tail effect for your business as well. Can you give us an insight into the extent of cyberattacks on ING and the impact they are having on your business?

Ms Evans: Yes. For us, as a digital bank, clearly cybersecurity is at the centre of our business, and that's not unique to the Australian franchise in the ING Group. It goes without saying that that is common right across our global network, and the fact that we have that in common with our global network also allows us to keep abreast of any changes or movements or improvements that we could be making here locally. To give you a sense, in May 2021 we intercepted 250 malware emails, 6,050 phishing emails and close to half a million spam emails. So that gives you a sense of the volume of attacks, if you like, or suspicious matters that our cybersecurity teams are dealing with.

I would also point out to the committee that in this space we're not only focusing on the bank protecting itself but also doing a lot of work to educate our customers about scams. While the definition of 'cybersecurity' can be very broad, what we are seeing is an increase in the number of customers reporting scams to us. Indeed, we are concerned not just about protecting our own business but also about helping to educate customers about their own cybersecurity.

CHAIR: Thank you very much, but can you just give some clarity on two things? One is that you said that the bank is doing a lot to educate its customers. Can you give us an outline on that? Secondly, to what extent or on what scale is the bank investing in its own infrastructure to address the risks of cyberattacks?

Ms Evans: Sure. They're two different issues. In terms of what we're doing with customers, we're using both one-to-one communication and our social media networks to help educate customers about scams. We can write to customers. We can try and make sure. Not surprisingly, we use digital methods. We can really target our communications to customers who we believe are most at risk of scams and identity takeover, particularly in a digital environment. And, secondly, it's really important that we use our social media networks, because many of our customers also follow us on Facebook and Twitter. So we're also using our social media networks to educate customers about what to look out for and to provide more detailed content and education around what to be sensitive to.

Internally, in the bank, with scams, we have a big program running at the moment. We run call listening for everyone in the bank so that they can listen to phone calls. Over the last few months, our focus has been on ensuring that all of our team members get to listen to some of these phone calls. That's not just to understand the risks that are involved but also to really understand what a customer goes through in terms of the stress that it puts on them so that we can better work out how we can support customers through the long term.

The first part of the question was: how much are we investing in cybersecurity? Cybersecurity, much like our regulatory program, has increased both in absolute and in percentage terms. Obviously, we have obligations and, now, standards to which APRA are holding us. So it's not only an investment in terms of improving our defence mechanisms but we're also doing a lot of work in terms of understanding what those new standards are and whether we're meeting those standards. I should also say that, being part of a European bank, we're held to the standard of our internal group, which means that we've got European Central Bank standards as well. So we've got many regulatory watermarks that we need to get to when it comes to cybersecurity, privacy and those sorts of things.

CHAIR: I see that ING has become a major investor in Divido, if I'm not mistaken—a buy-now pay-later operation.

Ms Evans: Yes.

CHAIR: To what extent is ING planning to run out its own product in the buy-now pay-later sector using that platform, or is it a simple straight investment?

Ms Evans: At the moment, it's a simple straight investment. There are no plans to roll out an ING-branded version of that product. We have investments in fintechs as part of our group strategy. We also have a lab concept, where we have groups of ING team members creating new concepts in the digital space, and that fits within that strategy.

CHAIR: How big is your loan book for mortgage products?

Ms Evans: I need to dissect the loan book, per se. Are you talking about mortgage lending?

CHAIR: Mortgage lending, yes.

Ms Evans: Okay: around $40 billion.

CHAIR: How many deferrals were required last year for ING customers?

Ms Evans: Mortgage deferrals hit a peak in May 2020, with 12,717 customers on deferral. That's about six per cent of our mortgage book. At the moment, at the end of May, that was down to 632 customers, which represents 0.28 per cent of retail mortgage customers.

CHAIR: That's still quite a high percentage to have on different deferrals, actually, compared to a lot of other banks. Can you give us some clarity about how you're managing that?

Ms Evans: We're managing that as we would any hardship case. How we manage hardship, from a bank perspective, is relatively clear. We have a framework in which we look at the situation that the customer is facing. That framework gives us direction in terms of whether or not the appropriate action is to be immediate or to wait and whether or not the right outcome is to restructure the loan, or to move to part payments or to move a customer back to full payments. We shared that framework with both APRA and ASIC early on last year, before we went through COVID.

From our perspective, those statistics are actually not large relative to the industry—0.28 per cent of the book currently on pause relative to others—

CHAIR: How many mortgages do you have out?

Ms Evans: About 200,000. We don't see this as the higher end of the industry. In fact, we probably see ourselves quite at the other end of the industry, in terms of mortgage deferrals. Certainly, industry data around 90-day arrears or three or more past payments due also are at 0.27 per cent of the mortgage book, with industry sitting between 0.6 and 0.7 per cent. Our industry benchmarking would suggest that we are much more at the conservative end of the spectrum than the other end.

CHAIR: To what extent as a bank do you track transfers for the purchasing of Bitcoin?

Ms Evans: We don't track that.

Dr LEIGH: Ms Evans, you spent much of your career at Westpac before coming across as chief executive officer of ING, so you're probably better placed than anybody else in the country to answer the question about differences in loan approval times. The February 2021 Broker Pulse survey found average time to initial credit decision to ING was four days, equal first with Macquarie Bank. At the other end of the spectrum we have Westpac, at 20 days, so Westpac is taking five times as long as ING to approve loans. I hear that a lot of that really blows out for people who don't have any ongoing relationship with the bank—that is, they're just turning up fresh. Given that you're getting, possibly, more fresh faces in your door than Westpac, that would make the comparison look even worse for Westpac. Why is it that Westpac does so badly compared to ING, in terms of time to initial approval?

Ms Evans: Let me talk about ING; that's what I'm here to talk about. I would say a few things there. This is a metric that matters to us and it's something on which we compete. I said in my opening remarks that we pride ourselves on being trusted and by providing exceptional service to customers. There is no more important metric—there might be a few others that come in to certain customers—decision set than giving them a firm view about whether or not they are able to buy the house, upgrade, enter the housing market. It is a number that, I dare say, we obsess about. We make sure that we resource our teams appropriately. We've spent significant time with those members of our own team who are responsible for that process, making sure that our back-end systems, our data, our use of digitisation and, most importantly, our use of communications with customers when they're going through the home loan approval can provide that certainty more quickly.

CHAIR: Forgive me for pushing you a little on this. I suspect if we'd had you before us in your previous role at Westpac you would have said much of same: 'Home approval times are important to us. We invest in technology. We aim to iron out the bugs.' Yet ING is succeeding in that, doing it five times as fast, and there does seem to be a disparity when I look at the kinds of institutions that are at the top: Macquarie, ING and Adelaide. Down the bottom we have the Commonwealth Bank at 15 days, ANZ at 17 days, St George at 20 days and

Westpac at 20 days. What is it, systematically, that's going on? I suppose I'm asking you not only to talk about what ING is doing but also what on earth is happening in the sector that has a huge spread between the best and the worst performers?

Ms Evans: I think there are a number of things, I would hypothesise, that drive those differences. The first is how important that measure is to you. We have our mortgage operations team onshore here in Australia. That means that, if the cycle time or 'time to yes' time starts creeping out well beyond the three to five days, we're able to move team members who are cross trained in providing that service into that workflow so that we can manage our customer experience. If you are committed to that number and you're managing it tightly, then you're making decisions about where you're putting your money and resources and ensuring that you're aligning those to the processes or customer experiences that matter the most.

During COVID, we were able to very quickly benefit from the use of digital signatures. We had a digitisation program going on in the bank that was already looking at that. When the changes were made that allowed us to move to digital signatures, we pretty much turned that on straightaway, which meant there was no snail mail and no scanning and sending of documents. We moved to digital signatures for home loan approvals very quickly. I'd compel the committee to look at what we can do in terms of the settlement process as well, because I think we can all make that an easier and more simple process for customers.

There is probably a theme here in terms of the composition of the customer base, which might be driving some of those differences, but, to be frank, I haven't turned my mind to it in great detail. Definitely, how complicated your customer's needs are and how ready they are to go through the application process can drive whether or not the customer gets it right the first time or needs to resubmit. I'm sure that has something to do with it as well.

Dr LEIGH: I certainly get that a smaller organisation can be a little bit more nimble when it comes to ironing out the processes. My guess is there's another big factor, which you're quite politely not drawing attention to, and that is that Westpac has much more of a captive market. Existing customers who have a banking relationship with Westpac are putting in an application for a Westpac loan and waiting to see what Westpac says. Meanwhile, there's another bunch of customers who are approaching a whole lot of organisations, of which ING is one. You're in a bit of a race for their custom, and, if you don't move quickly, you're likely to lose their business. Does that sound fair to you?

Ms Evans: You would have to ask the leadership of the banks that you're referring to why they're not moving as quickly as the rest of us. We are certainly hungry for business, so I can suggest to you why we do things. Those questions are best asked of the leadership of those groups.

Dr LEIGH: But you've got hardly any deposit holders, so you don't really have the captive market that a big four bank has, right?

Ms Evans: We certainly have a smaller market share than the big four banks.

Dr LEIGH: In terms of IT issues, the chair took you to some, but I wanted to ask you specifically about a problem that occurred on April Fool's Day this year, which did have impacts on customers. You were quoted in an article by James Frost in the *Financial Review* on 7 April as saying:

ING has not yet disclosed what caused the issue, a timeline for a fix or when customers can expect to be reimbursed.

Given we're now a few months on, are you able to shed some light on that? What caused it? Have customers been reimbursed? Has it all been fixed?

Ms Evans: We had an IT error on the evening of 30 March, ticking over to 1 April. What it meant was that, for some of our customers who had a home loan attached to an offset account, that linkage, essentially, was broken and therefore an incorrect interest rate was applied for some customers. There were about 75,000 mortgage customers who were impacted by the issue. We have remediated all but 1,150 of those customers. The remaining customers we haven't remediated were customers who did a variation within the period the code was not fixed. In other words: they might have refinanced out of ING, and, therefore, we need to send them a cheque; or they may have split their home loan across fixed and variable rates—so on and so forth. They require a more manual and one-to-one solution. This isn't just about crediting the customers with a dollar value; we actually need to ensure that we get their amortisation schedule and their principal back to where it should be. That's a philosophy that we take whenever we have remediations in the home loan book. We have a team working on that. So 98.5 per cent of those customers are fixed; 1,150 are underway. To give you a sense of what we do in those situations, I get a daily email from the remediation team working on that. They report to me. I provide verbal updates to the board every time the board meets. It's a good indication of how we work when we have issues. It means that, instead of solving remediation issues in five or 10 years time, we put a crack team on it immediately, and we get it fixed in those first three or four months—a good customer experience, the right outcome, and we've got a culture of accountability.

Dr LEIGH: Ms Evans, we had a hearing with the four major banks recently. Each of them sent along two people. We had eight blokes, one after the other. You're rare in being a woman who's a CEO of a major bank, or a significant bank, I should say. You're not technically one of the major banks. I want to ask you what we need to do to get more women into leadership roles in the banking sector.

Ms Evans: It won't surprise you that I haven't worked for a female directly in banking and financial services since 1999.

Dr LEIGH: Wow.

Ms Evans: I'm here because, thank goodness, there are great male leaders in the sector who don't look at gender; they look at performance. I want to start out by saying that. I think there are a number of things—and it's a very complicated topic to touch on briefly in the time allowed—but, when I was at school, we were not encouraged to become captains of industry. So I'd start there. It's a bit like the same challenge that we've got with young females and trying to get them into STEM. We spend a lot of time and effort on this at ING, in particular; being a digital bank, it's our space. I think you have to start young, and you have to encourage women to actually think that they can be in industry. I would say that the complexion of financial services, if you look at the CEW census, pretty much reflects ASX200 companies. Financial services in corporate Australia, unfortunately, is not unique. I was incredibly lucky to work for a great group of leaders who spent time and energy developing me and to work for leaders who gave me an opportunity because, hopefully, I worked hard and performed, if you'd like. But I think we need to encourage more females to pursue careers in financial services. It would certainly benefit a large number of people. ING itself, by way of example, has just gone through and updated a whole raft of parental leave and caring policies and flexibility and all the rest of it to make sure that we keep women in that middle manager period, 25 to 40. When people are starting their family, when they're doing the juggle, when everything else is going on, it's really important that organisations look at the long term and make sure that it's okay for life to be a bit messy. What you measure people on is what they bring to the organisation, what they deliver and how they work. We're certainly trying to make a difference. A third of our executive team at ING are women. The next level down is about fifty-fifty, and our key leadership group is at least 40 per cent females. It can be done.

CHAIR: We're going to hand over now to Ms Hammond.

Ms HAMMOND: Thank you for that response to that question, Ms Evans. I suspect your time at school was a lot more recent than my time at school, but I had a similar experience. Both the chair and the deputy chair have covered a number of issues that I was going to pick up on. Along the same vein as Dr Leigh, when he wanted you to draw your comparisons with your time at Westpac in the context of loan approvals, I want you to do it in the context of culture. You've just said that a third of the execs at ING are women, then the next level down is fifty-fifty, and there are 40 per cent in senior management. What do you think about the cultural problems that we saw come through in the Hayne report, and how are you addressing them within your own organisation or making sure they don't arise?

Ms Evans: I think there are a number of clear recommendations around conduct and culture coming out of the Hayne royal commission. Obviously, probably the most pertinent and the most topical today would be the recommendations to implement the remuneration recommendations of Sedgwick. That would be things like no direct linkage between sales and remuneration; don't have accelerators; measure people on their whole of scorecard—all of those principles. I have to say, proudly, from an ING perspective, that we did have to make some changes to our remuneration practices. We did use leader boards, by way of example. But, on the flip side, we did measure people on whole of performance and things like that.

So I think we all looked at Hayne—and I'm talking Sedgwick here. We all had to look deep into the way that we remunerate and reward our people, and we had to change things. That amount of change or the scale of change was very different, according to what organisation you were part of at the time. We've just had the recent review of the Sedgwick report. I sit on the ABA Council. So I was there when Sedgwick came in and sort of presented his views, and we had a very constructive conversation about it.

Pleasingly, I think there are two or three relative graphs in that report that report on how staff members see their remuneration, whether they see their remuneration as sitting in the customer interests or sitting in the bank and the shareholder interests. And I'm very pleased to say that, on that continuum, ING is one of the top 2 in the customer interests. I'm not suggesting that we would have been there three years ago. We did have to make change. We did have to change the way that we remunerated people. But we did always have an underlying culture around caring for customers and doing the right thing. That's obviously reported through very formal structures in our organisation. We have a rem and noms committee; we have the customer experience committee, which I just spoke to. But nothing beats managers and leaders walking the talk, showing that there are consequences if lines are crossed or things are being done the wrong way.

I know that this committee is very interested in the formal board reporting lines, and I'm happy to go into that in further detail. But I do think day-to-day culture and I do think just the simple practices of consequence management, having an open conversation, having a culture where you can put your hand up and say, 'Actually, this doesn't look or feel right, and I think it needs to be fixed,' all those things—

Ms HAMMOND: Do you support that at ING?

Ms Evans: Yes, we do. We encourage people to put their hand up and talk to people. We have a saying: if it doesn't look or feel right, it probably isn't. Colloquialisms like that really drive a behaviour where people are very comfortable putting their hands up. I should say that consequence management is not about putting your hand up and telling us that you have a problem. You want a culture that does the opposite of that. You want a culture where people can do that very safely across a whole range of things. So, as much as we can talk about accountability and board reporting—and, as I've said, we've got that very formal structure in place; we're very pleased with the movement that we've seen as a result of the Sedgwick review—I think that you do need to think about what the culture looks like further down in the organisation. I think the Sedgwick review, which was just done, does that, because he went and spoke to people in the organisation. That's not a CEO's view or the board's view. It's the people who work in the organisation who have delivered those results.

Ms HAMMOND: Did the Sedgwick report pick up on whether staff felt that they were being valued? That also goes to culture.

Ms Evans: I think most of us would be tracking that OHI, as I call it. I'm using ING language. OHI is organisational health index, or our own staff reports. The recent review into remuneration practices was more about that conduct—whether or not you are encouraged to operate in the customer's interests and whether you are remunerated and encouraged to do so.

Ms HAMMOND: Yes. On the balance scorecard or the whole scorecard thing, what are the key elements that ING uses? There is some aspect of sales, isn't there?

Ms Evans: Yes. With our scorecard, there are what I will call buckets, and there are three buckets. They're evenly weighted. The first is jobs. That's about whether you're performing the duties that your job—and I should say that the scorecard construct for ING is the same no matter what role you have in Australia. The first bucket, jobs, is a third of your rating. The second third of your rating is what we call orange code. That's behaviours. It's how you get there. It is trust, valuing others, admitting mistakes, stepping up, taking responsibility—those sorts of things. The final third is what we call stretch. That's about long-term future goals—so not in the here and now but things that you're not going to get done in a 12-month performance period, but you want to make a difference to how your team operates or how the bank operates, and we call that stretch. Each of those pillars is worth exactly the same in terms of your overarching performance outcome.

Ms HAMMOND: Are performance reviews done annually?

Ms Evans: We have six-monthly reviews. The performance year is a calendar year. There is a formal six-month check-in. Obviously, good leaders don't wait six months; they are doing that often. But, yes, there is a formal six-month check in and at end of year.

Ms HAMMOND: Before the chair chucks me off, as he is wont to do, I just want to pick up on an answer you gave—a completely different thread—in response to Dr Leigh about time frames for approvals and the speed of them. He was positing why it might be faster with you. I'm assuming you do, but do you link time of approvals against rates of default—

Ms Evans: No.

Ms HAMMOND: or rates of mortgage stress? Wouldn't that be something that would also be worth measuring?

Ms Evans: I'm trying to think about what insight we would be looking for.

Ms HAMMOND: Well, speed of approval is great, but if speed of approval means that bad approvals are being—

Ms Evans: Okay, I've got it.

Ms HAMMOND: That's what I'm getting at.

Ms Evans: We have exactly the same credit standards that we apply to customers no matter what channel you come through. So we're completely agnostic. Things like the way that we look at your income and expense verification, the way that we benchmark you against expense benchmarks and the debt-to-income ratio caps that we apply are consistent no matter what channel you come through. For us, that probably wouldn't make a difference, because we're following the same application of our credit standards no matter how you are coming in or how quickly we're able to approve you.

Ms HAMMOND: Are your credit standards the same as those of other banks, do you think?

Ms Evans: I would say that we're all very different in our credit standards. By way of example, we have a 2.5 per cent buffer rate, but our floor assessment rate is 6.1 per cent. We're well aware that some banks that have been on record in this committee have floor assessment rates between 4½ and five per cent, by way of example, with those sorts of things. What that means is that we do end up with a relatively different complexion of book. In terms of our mortgage book, by way of example, 83 per cent of our customers are owner-occupier. We have less than 10 per cent who are paying interest only. So we end up with a very different customer base as a result of those standards that we hold customers to.

Ms HAMMOND: Okay. Thank you, Chair.

CHAIR: Yes, you are definitely out of time, Ms Hammond. Dr Mulino.

Dr MULINO: Thanks very much for providing evidence today. I want to follow up on that question on the composition of your retail customer base and your mortgage book. I just want to preface this question by saying, firstly, I think digital services are extremely important and, where there's innovation, can provide great benefits. Indeed, I think government is often in need of going down that path. Secondly, I think segmentation of markets and different companies appealing to different groups is fine. I'm asking questions from the perspective of a policymaker who's interested in how different service types fit into the overall market. Given that you're a largely digital or digital focused company, does that end up having an impact on your customer base in terms of, for example, the age of your clientele and their educational background? For example, how many people from the CALD community might feel as comfortable with a digital approach?

Ms Evans: Let me talk about age. That is something I do know a little bit about. I haven't benchmarked people's socioeconomic or educational standards, but, by way of example, well over 30 per cent of our customers are over the age of 45. So I do think there's somewhat of a misnomer that digital banks only attract gen Zs and people under the age of 20. I think that, if you can provide good service—and I remained the committee that we do have a 24-hour-a-day, seven-day-a-week contact centre up on the Central Coast of New South Wales. So, yes, we are predominantly a digital bank, and that's how customers choose to interact with us, because they want easy, simple, digital services and they don't need the other stuff.

But we do provide human service. In fact, we actually advertised. I should have mentioned that in my comments around marketing. Last year, in the middle of COVID, we were advertising and telling people to call us, that we were there for a chat. So we do actually have quite an evenly spread customer base when it comes to age.

Our approach is to be as open and accessible to as many people as we can. Given the prevalence of mobile usage in Australia—I think we have one of the highest usage rates per capita in the world—we would expect that trend to continue.

Dr MULINO: Again, this isn't meant to be an implicit criticism; for me it's more an interesting empirical question. You are right: age is an interesting one, and some people's presumption might be that younger people are more comfortable, but I would have thought educated older people would also be comfortable. For me the gaps probably are going to be people who aren't so computer literate and people potentially with language issues.

Is this an area of interest to the firm in terms of the more granular empirics? As a cutting edge firm in this space—and government is facing a lot of the same challenges—have you thought a lot about how you can empower a broader set of people to engage with services that are increasingly online? What kinds of strategies have you found work?

Ms Evans: I have to say we're pretty clear about being a digital bank. We are not giving any thought to being anything other than a digital bank with an excellent contact centre. I should say our contact centre also does messages and stuff like that. It's not all phone. So that's the answer to the first question.

In terms of being more accessible to more people, we have quite a large design function in our business. We call it human centred design. One of our principles of design is being frictionless, easy and simple to deal with. Our products and our business model are pretty simple. There's one daily banking account that doesn't have account-keeping fees. There's a simple mortgage offset account. There's a simple mortgage account without an offset. We don't tend to have a proliferation of products and services. Even in terms of what we offer, we try to be simple and accessible. I would hope that means that we wouldn't have that bias that you're referring to. But it's not something that we've turned our minds to. I'm sorry.

Dr MULINO: These are a couple questions I'm asking of all the banks giving evidence today. I'm interested in issues surrounding AML/CTF. This is an issue where all the banks are committed to having more capacity and being more resilient, but obviously, because of fixed costs and other factors, it is a challenge in many ways for small and medium banks above and beyond the big four. I'm interested in your observations on that space generally but also specifically on potential moves to tranche 2, which has been the books for a long time. With the significant increase in the number of entities that might capture, I'm interested in your observations of the challenges and upsides.

Ms Evans: Let me talk about ING first, and then I'll cover tranche 2 and how we're seeing our role in terms of tranche 2. I think commentary has been well positioned today around not just the size and rate of regulatory change in AML/CTF but more broadly. So the challenge is not just a particular area of regulation. It's actually that, when you map them all together, you get a sense of just how much you need to deliver. The way that I describe it is that, when you're trying to meet a regulatory benchmark, the cost is fixed. It's a fixed cost. Then from there it becomes a variable cost and it becomes more related to the size of your business. So the amount of transaction monitoring that you do is a variable cost according to your market share or how often your people transact. But getting to that standard is a fixed cost that's more of a function of how many systems you've got to put through the pipe rather than anything else. So I think it's fair to say that we share the same views. I will give you some insights. I'm happy to share this. Twelve per cent of our people that we hire in Australia are now dedicated to KYC, AML and CTF.

Dr MULINO: That's huge.

Ms Evans: Right. Between building for what we currently need to build and building for the future, that includes that group of people but also those people who are involved in the ongoing operations of customer due diligence, on-boarding customers and transaction monitoring. That gives you a sense of the complexion and the size of this. We estimate that just under 10 per cent of our operational expense would be in this space as well. So it's big. That's just KYC, AML and CTF. It's significant.

What have we done about it? We made a decision that we couldn't stop doing the other stuff, that we still needed to invest in the future of our business, so we increased our investment pool. We're now spending more money on change—regulatory and non-regulatory—rather than eat into what we would have spent, because it just would have paralysed the future of the business if we hadn't increased the investment pool. So we made a decision to increase how much we spend on the business and absorb the immediate costs of all of those things.

I will just touch on tranche 2. The challenge for all of the banks—and I don't want to see it so much as a challenge—is that those other intermediates often bank with us. The way we look at tranche 2 is: what happens to things like transaction monitoring and those sorts of things when more of those intermediaries are captured? At ING we don't do transactional banking for small to medium business, so it might be a better question for some of the other organisations.

Dr MULINO: Thanks. For me one of the interesting regulatory challenges—and this is more of an ongoing issue; I think tranche 2 has to happen at some point—is this broader question you raised of the fixed costs. In a sense, part of the way to get through that may be greater functionality or pro-activeness through the regulator, which might help smaller entities not have to put so much in themselves. But it's a difficult regulatory challenge, I think.

Ms Evans: I'm probably more of the view that, if we have a regulatory obligation, we need to be accountable for that. I think AUSTRAC are doing great work on pulling in all of the data and being more pro-active, delivering us to the archetypes of the transactions, individuals or structures that we should be looking for. But, given our experience in Europe and also obligations to its ECB, we're probably more likely to lean towards making sure we build proprietary, robust services for money laundering.

Dr MULINO: Thanks.

CHAIR: We are out of time. Thank you for your attendance here today; it was most enlightening and useful. The committee secretariat will be in touch with you in relation to any others matters arising out of today's hearing. You will be sent a copy of the transcript of your evidence to which you can make corrections of grammar and fact. Thank you.

HEALY, Mr Joseph, Chief Executive Officer, Judo Bank [by video link]

WESTON, Mr Stephen John, Chief Executive Officer, Volt Bank [by video link]

[14:20]

CHAIR: We now welcome representatives from Judo Bank and Volt. I remind you that, although the committee does not require you to give evidence under oath, hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament. I now invite you to make an opening statement. I'll start with a question as well: in order to be a neobank, do you have to have a four-letter title?

Mr Healy: I'll lead off. First of all, I'd like to thank the committee for the opportunity to appear today. In answer to the question from the chair, no, you don't need to have a four-letter name, but the shorter the name, the better, I think. It enables greater understanding and appreciation from people. I would like to spend a couple of minutes giving the committee some background on Judo. We describe ourselves as a specialist SME bank focused exclusively on the small to mid-sized business economy. We defined SMEs very broadly as businesses with a turnover of up to $100 million per annum. We will lend individual SMEs up to $20 million—from $250,000 up to $20 million. Our average loan size as of today is about $2½ million.

Judo began life as a power point on an idea back in 2016 and was granted a banking licence in April 2019, just over two years ago. The genesis of Judo was a belief that there was a market failure in the provision of credit to the SME economy by the banking system. The banking system in Australia, particularly since the introduction of Basel II around 2006 or 2007, had become heavily biased towards lending to the household sector, particularly to residential mortgages, and there had been a de-emphasis on the SME economy. This is a statistically validated fact, not a question of opinion, as is the high level of dissatisfaction that a lot of small to medium-sized businesses had with the service that they were getting from the very heavily concentrated banking system.

When you look at the banking system today, the stock of SME lending from the banking system is about $400 billion, but that has been shrinking both as a percentage of GDP and as a percentage of total bank lending over the course of the last 20 years. Whereas if you look at bank lending to mortgages, for example, that has grown exceptionally, and it now stands at about $1.8 trillion, about the same level as our GDP. So SME lending, at 22 per cent of GDP, has been on a southbound trajectory for many years, even though all banks will claim—correctly so—that SMEs are the engine room of the economy. We estimate that the unmet demand for credit from the SME economy is in the order of about $120 billion. Even if 50 per cent of that unmet demand were unbankable, it still leaves about $60 billion of unmet demand in a market size of $400 billion. This has been a significant influence behind the arrival of Judo into the market. We saw this market failure and we saw that the banking system, in the way that it was allocating capital across the economy, was very biased towards household sector. That came, in our view, with a high opportunity cost in terms of economic outcomes.

It's against that backdrop that we established Judo with a very strong sense of purpose. That purpose is to be the most trusted SME bank in Australia. Since acquiring its banking licence over two years ago, Judo stayed true to its purpose, and as of today we've got outstanding loans to the SME economy of $3½ billion across the economy. The pipeline of loans in our system is in excess of $1½ billion. Of the $3½ billion of lending that we've done thus far, $2 billion of that has been done in the period since March 2020. In other words, during the COVID environment when we saw the significant withdrawal of credit by the banking system, Judo stepped in and was there to support small- to medium-sized businesses. There's evidence of that statement if you look at the APRA stats to the end of April. There you'll see that total bank lending to the business sector shrank about two per cent, whereas Judo's lending to the business sector has grown significantly.

We have hired over 300 staff in the last three years and indirectly employ a lot more through the third-party arrangements that we have. We have offices in Sydney, Melbourne, Perth, Brisbane, Canberra, Hobart and Adelaide, and we have started to open up satellite offices in places like Newcastle, Geelong, the Gold Coast and other part of the country. To support our presence in the market, we have raised over $1.2 billion of equity capital over the last three years. We have $1.5 billion of wholesale funding lines available to us and over $2½ billion of wholesale and retail deposits. Our most recent capital raising, which closed three weeks ago, valued Judo at just over $1.9 billion.

The other thing I would highlight is that Judo turned profitable last October. We were one of the few newly established banks anywhere in the world that has turned to profitability within four years of operations. We're very proud of that fact because it represents the service and the value that our SME customers have seen in what Judo has to offer.

On the question of technology, because a lot of new banks emphasise technology as being at the core of what they do, we see technology as being a critical enabler of how Judo serves its customers. We define ourselves as a traditional relationship bank with skilled and passionate SME bankers across the country able to talk to customers. We emphasise what we call the 'four Cs of credit' when it comes to lending to businesses. First of all, we emphasise the character, reputation, track record and integrity of the business owners. The second C is an emphasis on the capacity or the cash flow in the business. The third C is capital that sits on the balance sheet to support debt. And the fourth C is the collateral that sits there to support any new debt. I emphasise the four Cs because the banking system in Australia, when it comes to SME lending, has defaulted predominantly to the fourth C, and 95 per cent of all lending that is done is predicated on the availability of residential or commercial property as security. Much of our lending has security of some kind, but our philosophy in lending money to businesses is that we would not lend any money to any business where there was a question mark over the character of the business owners, regardless of how much security might be available to us.

In building Judo, we believe that great institutions are built on beliefs. Our first belief is that the SME economy deserves a much better service from the banking system than they were getting, largely, from the four major banks. That was the reason we set Judo up: to provide a much better service than they were getting previously.

The second core belief is that being a bank is a highly privileged accreditation. The licences are issued by APRA on behalf of the government, and with that privileged position comes obligations and the responsibility to conduct business in a manner consistent with the concept of a social licence. Banks are unique institutions and have unique expectations placed on them by the society that they are there to serve.

When we look at the banking system in Australia, which remains one of the most profitable banking systems in the world, there are three things which we believe are important from a public policy perspective. The first thing is the importance of competition to drive choice, innovation and better customer outcomes. The banking market today lacks meaningful competition in key segments and sectors. The second core belief is the need for a public policy environment that is pro competition. The prevailing policy environment could do a lot more to promote competition in banking. And, thirdly, is a recognition that as new entrants enter the banking market not all of them will succeed and there'll be some institutions which fail. That's normal. The key is not to look at those failures as reasons for preventing new entrants but to look at those failures as an opportunity to learn lessons that are put to good use in future policy.

Having said that, we believe that new entrants into the banking system must have what we describe as the 'three must haves'. One is access to material levels of capital for the first five years of operation. When we were raising capital at Judo four years ago we made it clear to our investors that we were going to need a billion and a half in capital over five years, so if they were going to invest in Judo it had to be on that understanding. Having access to capital as you grow is critical.

The second thing that's critical to success is a clear, sustainable competitive advantage. You need to demonstrate that you're meeting a need in the market that isn't currently being well served and that you have a competitive advantage you can sustain over time which is anchored in a strong sense of purpose. The third thing you need is a very strong management team that understands the business and the risks that banking entails. They must have a demonstrable track record in all aspects of banking. Banking is not a business for novices or P-platers; it's a serious business with a high level of risk.

Finally, if there were a single important question we would recommend that policymakers consider it's this: is the policy environment conducive to greater competition in banking, for the good of customers? Much has been done in recent years to encourage greater competition, but there's much more that can still be done.

On that note, I'm very happy to take questions later or to elaborate on anything that I've said. I thank you for listening to me.

CHAIR: Mr Healy, that was a very comprehensive opening statement. We'll have questions, but we'll go to Mr Weston now for a succinct opening statement.

Mr Weston: Thank you. I would like to begin by thanking the committee for the opportunity to appear today. I am the co-founder and CEO of Volt Bank. In January 2019, Volt became the first challenger bank in Australia to get a full banking licence under APRA's phased ADI licensing framework, which was introduced in May 2018. Our ambition is to show that customers can get better deals from banks, as can other stakeholders. To us, this means helping customers to be better off and allowing them to bank in a way that's most convenient to them.

Volt is considered a neobank. We don't have branches and our products and services are offered online or via our app. This improves convenience and allows us to offer competitive deposit and loan rates by leveraging our comparatively lower operating costs. We have a fundamentally different business model to other neobanks and the incumbents. Our key points of difference are how we acquire customers and the configurable design of our products and processes.

To expand on this a little: the majority of our customers will be acquired through business partners rather than through the marketing methods which are traditionally employed by banks. In the future, we expect that customers will do more of their banking with businesses they already engage with, such as technology firms, retailers, airlines, mortgage brokers and the like, rather than directly with banks. To enable this, Volt has built a banking-as-a-service platform driven by cloud based API technology to allow businesses to partner with us and plug into our platform. This facility will allow Volt to bring more competition to the Australian banking market than if we had adopted a more traditional direct consumer business model.

Our products are designed to provide simplicity, transparency and value. Already our first product, the Volt safe deposit account, has won industry awards for our transparent, no-catches interest rates. That's something we encourage other banks to offer to their customers. The committee may be interested to note that Volt's approach has resonated well with customers of all ages, particularly those approaching or in retirement, with nearly two-thirds of our deposit balances held by customers over the age of 45. Volt uses technology and data analytics to provide much quicker response times on processes like home loan approvals. One of our banking-as-a-service partners, a leading mortgage aggregator, Australian Finance Group, recently stated that the current average time for their customers to obtain unconditional home loan approvals was 27 days. Volt has been able to provide verified approvals in under 15 minutes. Whilst this is much quicker than most other lenders, Volt's underwriting processes are rigorous and provide prudent and responsible lending decisions. This demonstrates the power of using modern technology and data analytics to provide better customer outcomes.

We've followed commentary from the major banks since the royal commission around putting customers at the centre of what they do. Volt's approach delivers transparent pricing of deposits and loans and will help customers live better financial lives—an approach we hope other banks would follow. There has been some media coverage questioning if the neobanking experiment has failed because one licence was handed back to APRA and another operator was acquired by a large incumbent. I think this conflict is off the mark, and I would be happy to talk further to the committee on why Australia's neobanks have a bright future.

Finally, on regulation, Volt is supportive of APRA's changes to strengthen the licensing framework for new entrants and the need to balance competition and stability in the system. I would be pleased to expand on these issues and answer any questions. Thank you again for the opportunity to appear.

CHAIR: Thank you very much. Both Mr Healy and Mr Weston spoke about the need for competition in the sector and, in particular, what needs to be done to promote competition. Starting with Mr Healy and then Mr Weston, can you give us an outline of what you think needs to be done to provide greater competition in an environment not just for new banks but in terms of the role that neobanks can play in competition against established interests?

Mr Healy: From a policy perspective, it's having a pro competition policy environment, which we don't really have here. We have a regulatory environment that emphasises financial stability—a regulatory environment that, in part, maintains the status quo in the sense of not allowing more consolidation, which is welcome—but it's actually having an environment that actively encourages a pro competition agenda. This is an issue that the Productivity Commission highlighted in its review of the banking system two or three years ago, so it's a much more explicit statement about creating an environment where competition is encouraged and then looking at some of the barriers that exist today and assessing the degree to which those barriers can be adapted to encourage more competition. An example that I would offer to the committee is that, when you look at the UK, for example, where there has been an emergence of a significant number of new entrants into the banking system since 2008, the regulatory environment there has a very phased approach—the UK equivalent of APRA. It looks at regulation in three stages. It says that, in year 0 to year 3, we expect to see businesses developing the risk management frameworks and governance frameworks; in year 3 to year 5, we expect to see greater maturity; and, in year 5, we expect to see best practice consistent with banks that have been around for 100 years. So it's a much more customised approach that is more encouraging of new entrants versus, perhaps, prior to the introduction of that regime in the UK—very much a one-size-fits-all approach.

Mr Weston: I'll try not to duplicate anything that Mr Healy has said, but there are a couple of points that I would make. One is that, once you see the new challenger banks in the market, they will show you the difference that they can make to competition. Judo is clearly showing that today and Volt, with its 'banking as a service' model. There clearly is a growing demand, both globally and domestically, for banking as a service, and, apart from Westpac, that largely doesn't exist in Australia today. In the way that the new players design products and processes to make them more customer-friendly and to make them quicker, you don't need to become the fifth-biggest bank in the country to be an example to others about how they should be operating. Then, in terms of policy, items like open banking continue to keep a focus on those sorts of activities, equalising capital requirements between the larger banks and the smaller banks for the same sort of customer risk—all of those things will help competition.

CHAIR: One of the things that has been raised with us previously is around capital requirements and limitations that it can place on neobanks and their capacity to compete—at least, in some cases where it has led to larger banks purchasing neobanks because of the need to provide capital as the basis for them to continue to expand their products. Can you give us guidance on how you see capital obligations as a limitation or a restriction on the expansion of your businesses—I know there were remarks made about it before—particularly in the context of making sure that larger banks don't end up consuming neobanks, who are supposed to be competitors not merely funky brand labels and faces for old institutional interests?

Mr Healy: I think it's entirely appropriate that there are higher levels of capital required of new banks as they enter the market, because naturally new banks are riskier in nature than more established larger banks. So the idea of higher levels of capital makes an enormous amount of sense. But over time there should be a fading of that capital requirement as the businesses mature and demonstrate sound risk management and good management generally.

The second part of the question, which I think is a big issue, is around the significant advantage that large banks have when it comes to capital weighting, or risk weighting, on loans that, in terms of risk, are of a very similar nature to the loans that small banks might write. You can have an individual go to a large bank and get a mortgage and service that mortgage for 10 years, and that large bank might have a capital weighting of, say, 25 per cent against that mortgage. The customer then might want to refinance it, in more attractive terms, to a smaller bank, but the smaller bank, for the same risk, has to allocate three or four times as much capital to that same customer. That creates a significant impediment to real competition. It creates a significant advantage to incumbents, and the risk weighting metrics that are used are not supported, in my view, by any strong evidence or science other than smaller banks should be using standardised models and larger banks should have the advantage of more advanced models. It is an anticompetitive element of the current structure.

Mr Weston: There is an APRA draft paper that was published in December 2020 that looks at addressing some of the competitive disadvantages in the capital framework that still need to play out. Not to reiterate the points that Mr Healy has made, clearly capital for any new business can be a challenge, and for banks they are different: you need two different sorts of capital at different stages of your evolution. The first type of capital is the startup capital: it helps you get a licence, build your technology and so on. We've raised $160 million primarily of that sort of capital today. From this point on, as we commence our lending activities, we'll need to raise over $600 million by the end of next year, much in the same way that Judo has. That comes from a very different cohort of investors. It comes from funds. So your early-stage VC investors in Australia, where the market is light, go, 'Wow, we can't provide you venture capital because you need this ridiculously high amount of capital.' Then you go to the providers of regulatory capital early on and they go: 'You don't have enough capital for us to put in the effort for DD. Come back to us when you do and we'll talk.' So you need to transition from startup to bank, and that position is easier said than done. That's something Volt is going through at the moment and something Judo has already transitioned to.

CHAIR: From what I understand of your comments, you're saying that essentially capital requirements can act as a barrier, but, by going to market, you're in a position to raise the revenue to address those concerns rather than becoming consumed by larger banks. But, if I'm not mistaken, Mr Healy's comments are that over time those capital requirements should diminish, reflecting the established nature of the operation as it grows, against deposits.

Mr Weston: That's correct.

Mr Healy: Yes.

CHAIR: There are a couple of other quick questions. I'll leave the question about cyber to Ms Hammond, but obviously cyber is a big concern for the committee. But I will ask: to what extent do you track the depositors with your bank and the like in terms of purchasing bitcoin?

Mr Weston: Maybe that's more at the consumer front than it is in the SME space. We have only launched a savings account at the moment. Our other deposit accounts are in testing. We don't specifically track and try to stop payments, and the like, like some banks have done. In fact, we expect to have digital currency exchanges as banking service partners in time but operating very simple products, Australian dollar cash management products. The digital currency exchange will need to be AUSTRAC registered, like banks are. We put them through a pretty intensive DD process before we will bring them on as a banking-as-a-service partner, but there is no doubt we are seeing a pick-up in the level of customers wanting to trade and hold digital currencies. Whilst we're not in that space per se, banking digital currency exchanges and their customers, we think, is an attractive space for a new player like Volt and it's something that we will look at in the months ahead.

Mr Healy: It's not a feature of our business model at this stage. Whilst we lend to small to mid-sized businesses we do collect deposits from both wholesale businesses and retail consumers, but we don't offer any transaction banking accounts. It's very much an online term deposit facility that we offer, and the nature of the products and the function of the accounts are very simple. They do not involve any Bitcoins or other types of currency proxies.

Dr LEIGH: Mr Healy, I want to start with you and your fascinating book, *Breaking the Banks*, which I enjoyed a great deal. You talk in there about the oligopoly in Australia's major banks and the attitude to the regulators. You have a passage where you say: 'Banks with a deeply ingrained sense of invincibility, even after the criticism of the royal commission, have a deep-seated dismissive attitude towards regulators. This almost unconscious arrogance is exacerbated in a closely knit and shallow business community where powerful people regularly bump into each other.' Do you still see that as a problem, and, from the standpoint of policymakers, how should we inoculate ourselves against the tendency to dismiss the hard work of regulators in the banking system?

Mr Healy: It's a great question, and, of course, it's a verbatim quote from the book. I think there has been a change in attitude and culture within the banks, influenced by the royal commission into conduct but also by other scandals that have hit the public domain that are not just royal commission related. There's a much greater awareness at board level about the social licence, the privileges that banks have, so I do sense a change.

The question is, and only time will tell, 'Is that change sustained in nature?' Changing culture and attitudes within large organisations where the cultural concrete is largely set is a very difficult thing to do. But I do have to acknowledge that there have been serious efforts made, certainly in the public utterances by the major banks, that suggest there has been a change in attitude. I think, positively, things have moved on since my comments were made, but the $60,000 question is, 'How sustained is that?' because the industry is a very cosy club. There is not a lot of difference between the four major banks.

Having worked inside two of the four major banks, I would say you could remove the logos from outside the buildings and they're very similar, in nature, in the way that they operate. The cultures that sit within the organisations are very similar. That's why I put a lot of emphasis on not so much a regulatory solution to this problem but a pro-competition solution, because it's competition that will drive change, as I mentioned earlier, much more so than more and more regulation.

Dr LEIGH: Yes, and I loved your antidote there about the auditor who turned up at the wrong British bank and only realised after several hours that he had been auditing a competitor by mistake. You talk also in your book about the role of the Scottish banking culture. I'm really fascinated to hear what you think about the role of neobanks in cultural terms. I think most of the public perception of neobanks has been that they're predominantly a technology play, but you seem to be arguing that a strong underpinning of values is important to making a neobank work. I'm really fascinated by this idea that, in order to succeed, a neobank needs to look back to a sort of old-fashioned Scottish model of high-quality vanilla banking done well.

Mr Healy: You can tell from my accent that I have a Scottish background, so there might be some bias there. When I grew up in the banking system in the mid-1980s there was a huge emphasis on professionalism. To be a banker you had to go through a professional qualification course with the institute of bankers. Banking was seen as a highly respected integral part of the community and a highly respected profession. The industry obviously has changed dramatically. I feel that the undercurrent of why we've seen so many problems in the industry is that that professionalism was lost to the industry. Even though there were more highly educated people coming into the industry, a lot of them had little background in the industry and little appreciation for the professional ethos of being a banker. In fact, there are more professional hurdles placed on becoming an estate agent than there are on being a banker.

Having said that, I do want to acknowledge the good work of FINSIA, in conjunction with the Chartered Banker Institute, in trying to install greater professional standards in the industry. To my mind, for the industry to address the deficit of trust that it has with the community it has to embrace professionalism. Bankers have to be properly trained in the craft and art of banking and on topics around ethics, the role of the banks and understanding customers. This is what I learnt when I came into the banking industry. It has largely been lost to the banking industry over the last two or three decades. I think it's important that the banking industry embraces professional education in the same way that lawyers, accountants and other professions see that as a fundamental ticket to a career. The banking industry has not seen it that way, and I think that's one of the underlying reasons why we've seen the sorts of cultural problems that have plagued the industry and have undermined societal trust and confidence in the way that the banks have conducted themselves.

In closing, banks are, as I mentioned in my opening remarks, unique institutions. There's no other industry that has the same privileges that the banking industry is granted by virtue of a banking licence. The concept of a social licence, which is often talked about and sometimes dismissed in business, is very relevant to banking. In many ways you could argue that banks, whilst they believe themselves to be private actors in a market economy, are in many ways quasi-nationalised institutions because of the way that the government and the taxpayer essentially backstop them in the event of a crisis and the way the government and the taxpayer guarantee deposits. These are quite unique characteristics and, therefore, I think are legitimate reasons why banking should be seen as different, why the concept of social licence be seen as critical and why a minimum expectation of professionalism—

Dr LEIGH: Mr Healy, let me break through there because there's one more question I want to ask you and I'm about to run out of time. The ACCC last November brought down a report in which it said that if you're refinancing then your existing lender should take no more than 10 days to discharge the loan. You've said that for Judo the typical delay is 52 days.

Mr Healy: Yes.

Dr LEIGH: Would you be urging the government then to act on the ACCC's recommendation?

Mr Healy: Yes, I would. This is not a problem specific to Judo, because, after the comments to the media I made a month or so ago, I was approached by several smaller banks and non-bank lenders who shared the exact same frustration. It's anticompetitive behaviour to take almost 60 days to do something as simple as providing a settlement figure and a discharge of existing security, allowing businesses and consumers to make choices about transferring to other lenders.

Dr LEIGH: Yes, you quote 'Hotel California' there: 'You can check out any time you like, but you can't ever leave.' Mr Weston, do you agree?

Mr Weston: I do, and the same applies for home loans. Quite often a customer will go to a mortgage broker and say, 'I want a better deal.' The first thing the broker will do is get on to the existing lender and say, 'Can you give a lower rate?' and the lender says, 'No, we can't.' So the broker goes and helps the customer refinance, and that takes time. They wait three weeks or whatever to get an approval and then request a payout figure and a discharge of mortgage from the incumbent lender. Then after a couple of weeks the incumbent lender hands the matter to their retention team. The retention team will phone the customer and match the rate they couldn't a month or so earlier, and of course everyone is frustrated. In our case, not only can we approve mortgages for a reasonable percentage of customers in 15 minutes; we can discharge the mortgage for a number of lenders within two days or within a day using a different method—that is, you don't wait for the payout figure; you pay them out and you write to the bank and say: 'We have paid you out. Please prepare the discharge of mortgage.' That's only come about because of the delays in discharge and the frustration with retention teams coming into play at the last minute.

CHAIR: Dr Leigh, I have to say I am not a huge fan of your comedy efforts!

Dr LEIGH: I shouldn't claim credit for this, Chair; I was quoting Mr Healy. He's the Eagles fan among us!

CHAIR: Even then, I'm sorry, Mr Healy, it's not winning favour in my quarters!

Dr LEIGH: Millennials—what can you do!

CHAIR: It's a problem with bankers!

Ms HAMMOND: There are a number of different things that have been said in the last half an hour that really fascinate me, but I've got absolutely zero time to pursue them.

CHAIR: Just to be clear, you do have 10 minutes.

Ms HAMMOND: Yes, I know. That's not nearly long enough, Tim. Mr Healy, you're appearing as an old-school traditional-style banker who is doing something different by going back to traditional values of the past, which I think is quite fascinating. I also make the observation that I think all of the comments you made about professionalism in banking as needed to restore trust could be applied to increasing professionalism across politics. I want to ask both of you—getting back to your ADI licences, because you did make the comment that competition will drive change, not more regulation—how long it took you to get your full ADI licences.

Mr Healy: It took the best part of nine months. We got a licence at the end of April. It would be close to a year.

Mr Weston: The new measures that would allow a start-up to get a banking licence were introduced in the budget speech of the now Prime Minister in May 2017. We received the licence in January 2019, so a little over 12 months—18 months.

Ms HAMMOND: Right. So you were engaging with APRA that entire time?

Mr Healy: Yes. I should say that the process was rigorous, as it should be.

Ms HAMMOND: Appropriately rigorous?

Mr Healy: Absolutely rigorous—I think they were discharging their duties and responsibilities in an exceptional way.

Ms HAMMOND: Was that Volt's experience as well?

Mr Weston: It was. It's not a process I would ever want to go through again, but it was appropriate.

Ms HAMMOND: On that point about competition driving change, which I do agree with, I think there are about 98 Australian owned ADIs currently registered with APRA. How big do you think we need to get, or how much diversity do you think we need, to ensure that there is real change and that cultural change you were talking about earlier?

Mr Healy: I don't think it's necessarily a question of the number of registered ADIs. It goes more to the nature and strategy of the incumbents and the new entrants. You might argue whether we need another new bank lending into mortgages. What Volt is doing is very innovative, but you could argue there's quite a lot of competition in that segment of the market, whereas, in the SME economy, there is a lack of competition. It's a more complicated segment of the economy to bank in. It requires a very different set of skills. Economists describe the SME economy as a market inefficient segment that requires human judgement and doesn't lend itself to [inaudible]. So I think the questions are: What type of competition? How many banks are capable of disrupting the status quo? I think that's what the emphasis should be on rather than the quantum of registered banks.

Mr Weston: There are a number of things that you will see the new entrants do that will be exemplars for the rest of the industry. If I pick a very simple deposit account and if we were to ask the CEOs of the major banks post the royal commission, they would be saying they want to put customers at the centre of what they do. Ask a simple question, 'What percentage of your savings account customers are getting a decent interest rate?' You can get a decent interest rate for three to four months, and then you go to a lousy rate or you can only get the good rate if you deposit a certain amount each month or you make a certain amount of transactions. That is banking of yesterday. You ask the incumbents, 'Why do you do that when you say that you want to put the customers at the centre of what you do but you know most of them will be getting a deal?' Their response would be like this: 'Everyone does it. We're going to keep doing it.' Or they may say: 'We don't break any rules. The terms and conditions clearly say that. So we'll just keep doing it. If the customer is silly enough to forget about it, that's their fault.' That's banking of yesterday. Putting them at the centre of what they do is change of product design. Light bulb: 'Customers, here's the interest rate. What you see is what you get, and you don't have to jump over any hoops to get it.' Those sorts of things will help drive competition as well.

Mr Healy: Can I add a footnote to the comments Mr Weston made. I entirely agree with him. What you have in the market today is a significant inertia in customers moving to new banks. The transaction costs and the hassle of switching are not immaterial. Making it easier for people to move banks and creating options and choices is really at the centre of a more competitive banking system. The reality today is that, whilst banks are aggressively pursuing new customers at the low interest rates, their loyal customers are paying a loyalty penalty. They're getting charged sometimes two to three per cent higher than a new customer, and that state is always allowed to continue, because the choices open to customers are not attractive enough.

Ms HAMMOND: Are their legislative changes which might help making the switch easier for people?

Mr Weston: Open banking certainly would. In Volt's case, it doesn't exist today. But as of 1 July we're one of 10, I think, banks that are on the right track. The second tier banks had to release their data today. What we'll do is enable customers to see all of their bank accounts, credit cards and loans through the Volt banking app. Then we'll show that we can give them a better deal. In time, one of the open banking use cases will be: 'We know it's a hassle to switch. But, really, opening a bank account with Volt, if you have the identification, is a job of a few minutes. Then we'll let you will log into your existing bank and click on all the payment records you want to transfer,' which is usually the driver of that inertia. So the tools are becoming available, and that's why a small competitor can go and make quite a big song and dance to go, 'Why is it they can make it so easy to switch, why is it that they can show me all of my bank accounts, and why can they show me how they do against what I'm getting now? That'll move on to energy bills and mobile phone plans, and they'll think, 'Why can't my bank do that?' That will take a little time, though.

Ms HAMMOND: Do you want to add to that, Mr Healy?

Mr Healy: I agree with Mr Weston. I'll just go back to my earlier comment about the time that it takes for banks to release customer records, because these are customer records where customers want to transfer from one bank to another. Taking close to two months to do that is quite disgraceful, and that should be a focus—

Ms HAMMOND: Surely those records at law would be owned by the customer.

Mr Weston: Yes.

Ms HAMMOND: Mr Healy, you said in your opening presentation that you use the four Cs, I think, and that you would look at the character of clients or customers. Can you please explain how you assess that and what you mean by that?

Mr Healy: It's obviously a subjective assessment. We will look at the track record of a business owner. We'll do reference checks and market facts soundings using formal information sources and informal information sources. We'll also visit the business and visit the business premises and take a view on the track record, character, reputation and integrity of the business owner. It's subjective in nature. It requires skilled banking expertise to do that. It's judgement based. As I said, we will not lend to just anybody. I mentioned the hierarchy of character, capacity, capital, collateral. You have to pass the character test, so there should be no evidence that you have questionable business practices or a lack of transparency around ownership of your business. A lot of small businesses, for example, might have trust companies or complicated ownership structures that make it difficult to see who is actually sitting behind the business. That would be part of how we would assess character.

Ms HAMMOND: So it's not based on whether you like somebody or don't like somebody. I'm concerned about discrimination laws here.

Mr Healy: It's not that type of character assessment. It's a risk based assessment, not a question of discriminating. It's a question of applying judgement to the track record and reputation, the credentials, of a business owner to make sure that you're satisfied that they pass a character test. But there's no question of discriminating in any way. You have to have evidence to support any question marks that you might have over somebody. But it goes beyond saying that such and such is a good bloke because that's not a test of character.

Ms HAMMOND: Yes.

Mr Healy: I think that's central to banking. You mentioned traditional values, but you shouldn't lend money to people that you can't trust or you don't think you can trust, no matter what security they've got.

CHAIR: Ms Hammond, I'm sorry but we're out of time. Dr Mulino has been very patient and I'm trying to be bipartisan.

Ms HAMMOND: As always.

Dr MULINO: Thank you both for your evidence today. It's a fascinating area of banking and financial services more generally. My first question to some degree is going to double-up on issues you've already touched on. For me there's a really interesting tension between a number of sometimes conflicting public policy goals. It might be encouraging innovation and encouraging competition on the one hand versus, say, consumer protection or systemic reliability on the other hand. You've talked a little bit about how you model risk and how you should do it in a way that is flexible enough that it's not creating an unlevel playing field. I'm interested, on a more principles based level, in how you feel that regulators and legislators should, in this context, deal with some of those tensions. Should we state certain principles and then, when we're designing specific policies, acknowledge trade-offs and try to balance it on a case-by-case basis? What are some of the best-practice regulations around the world that you've seen to deal with these tensions?

Mr Healy: I might make a start on that question, which is a great question. I go back to my comment that the guiding principle should be that consumer interests in society are best served where there is more competition, more choices, and so having a policy environment that makes it attractive for competition to emerge is critical. I don't subscribe to the view that having more entrants into the banking system potentially adds to instability in the banking system, because the standards that new entrants have to meet should be set very high, but I do feel that competition would be greatly aided by moving away from what is largely a one-size-fits-all framework today, which will treat the small entrant in the same way that it will treat the bank that's been around for 150 years, to a much more specific, or tailored, approach. I mentioned in my opening remarks, for example, that in the UK banking regulatory environment they issued a paper in June 2020 that outlined a new framework for the supervision of banks. It identified that small, new banks are very different from large, mature banks and that, to encourage competition and allow success whilst ensuring good risk management, there should be a tailored approach that identifies the different stages of maturity. I think that type of approach to regulation or to policy would be a great boost to potential new entrants.

Dr MULINO: Mr Weston?

Mr Weston: I don't think that competition and stability are mutually exclusive and, from a policy setting, I think we are on the right track. Sometimes it's the interpretation of those policies that needs some work: 'I've done the job as a regulator this way for so long, and now others are trying to push for competition. I'm not so sure.' We've had some of those frustrations. Typically, though, when they've been escalated to the appropriate level they've been addressed satisfactorily. That's even with things like: 'How is it that a new entrant can process mortgage approvals in 15 minutes when the industry is taking weeks?' A traditional answer may be: 'It has to be assessed by a person.' When we walk the regulator through the process that we undertake and show them how we identify over 100 data points that are based on many years of lending history to identify potential default characteristics, how we value homes using data algorithms and how we identify people, they go: 'Actually, I think this new data and technology in this new competition probably are as safe as the way we're familiar with.' But, as the guinea pig, the first horse in the race, you get quite a rigorous assessment to make sure that you are making healthy lending decisions. I'm not sure that there is an easy answer but I think that over time, if a Judo and a Volt can pave the way, it will be easier, hopefully, for future neobanks.

Dr MULINO: I certainly would agree that competition and stability aren't mutually exclusive but I do think that occasionally you can get tensions between them.

Mr Weston: Yes. I agree.

Dr MULINO: This is a question I asked of the previous witness, ING. I'll just stress again that this is not meant as a criticism at all; it's simply an empirical area of interest for me because, in a sense, it's of relevance for somebody looking at the system as a whole. I imagine there's some scope for neobanking, and digital services more generally, to expand in scope quite quickly over coming decades, but my sense is that there will be some segments of society that are going to struggle with it. You mentioned that there doesn't seem to be a simple relationship with age, that two-thirds of your clients are over 45. I have no evidence for this but I suspect there are pockets of society with low education, low computer literacy and, potentially, language issues that would struggle with digital services and, potentially, neobanking. I'm interested in your thoughts on that. I raise it more generally as a question for people who are looking at the system as a whole, and in just being aware of services and areas that might grow fast for some demographics and perhaps not for others.

Mr Weston: We have a very different business model where most of our customers will be acquired through business partners—large retailers, mortgage brokers and the like. They have the customer relationship today. What they will do now is offer banking products and services where they can tailor their solutions to their customers in a more effective way. They can remove friction around payments. They certainly will have a commercial motivation as well. Typically, as a banker, you want to own that customer; you want to wrap your arms around them. The next evolution of banking will be: 'Hey, that customer is owned by Google or Apple or an airline or a technology firm.' If you can't get your head around that, don't go down the banking-as-a-service path. But if you can and if you can architect your technology in a way that can work with those business partners, there is a far less contested banking market. For someone like Volt to build a banking-as-a-service platform, as we have, it will give us a much greater chance of introducing competition in a new way than if we had gone with Google and Facebook marketing and television ads and things that banks have typically undertaken to attract customers.

Dr MULINO: Will there be any—bias is not the right word—correlation, in a sense, with those relationships, or do you think those relationships will be networked so densely across society that that is not really going to create those gaps that I'm alluding to?

Mr Weston: There's no doubt that the demographic that's most likely to open an account with a digital bank or via a business partner will be the younger demographic. But at the moment, most often they're not those with the large deposits and mortgage requirements; that comes later. Even the millennials in the next five years will become the biggest banking profit pool that exists. So they may not be today, but they will be tomorrow. In our case, we have been bowled over by demand from retirees saying: 'Thank goodness someone is bringing a simple savings account. I don't have to go from bank to bank to bank. Open my account. There's the deposit.'

Dr MULINO: One final question, and feel free to take this on notice, because a couple of paras would be fine. I've asked everybody about AML/CTF. I'm interested in challenges in your sector. Obviously you're small, so some of the fixed cost issues are significant. In a sense, because you are building on existing relationships, maybe the KYC side of it is less of an issue. So I'm interested in how the AML/CTF challenge is playing out for neobanks.

Mr Weston: Would you like me to take it on notice or to do a quick one-minuter?

Dr MULINO: Do a one-minuter until the chair shuts you down.

Mr Weston: No problem. It's a big focus for us. As a new entrant, a new digital bank, we have got a target on our back. So we make sure that we know who the customers are and that we comply with all of the regulations. That means partnering with best-in-class providers—they don't come cheap—and recruiting really talented staff in these areas. It doesn't come cheap when you're looking to build a bank and not generating revenue until you begin lending. But there is no way to avoid it. Cyber and AML are going to be central to any bank, and I think that is more so with a new digital bank like Volt. I will come back to you with more information and more specifics about what it is we are doing.

Dr MULINO: That would be great. Thanks.

Mr Healy: My comments would be very similar to Mr Weston's comments, particularly around KYC and AML. For us, these are critical issues to get right because as a young bank your reputation arrives on the back of a tortoise and leaves on the back of a galloping horse. It would be significantly damaging for us to find ourselves in breach of any of the KYC or AML obligations. They are costs of doing business in the sector, and you have to accept them.

Dr MULINO: Tranche 2 might help you. If all those intermediaries come in and you are then getting business off them, it makes the whole system more rigorous.

Mr Healy: Yes.

CHAIR: Thank you, Dr Mulino. I like that analogy about the tortoise and the horse. Thank you for your attendance here today. It's been most useful and has informed a broader discussion than just on the rigidity of the banking sector, so we appreciate that. The committee secretariat will be in touch with you in relation to any other matters arising out of today's hearing. You will be sent a copy of the transcript of your evidence to which you can make corrections of grammar and fact.

Proceedings suspended from 15:18 to 15:33

JAMES, Mr Stephen Clive, Chief Executive Officer, Teachers Mutual Bank Limited [by audio link]

ACTING CHAIR (Dr Leigh): The chair has just told me that we may as well get started without him and dive into opening statements. Mr James, I invite you to make an opening statement.

Mr James: Good afternoon and thank you for the opportunity to make a short opening statement and provide some background on Teachers Mutual Bank Limited. Teachers Mutual Bank Limited is the fifth-largest mutual bank in Australia, and 2021 marks our 55th year of operation. From our humble beginnings, we've grown at a steady pace, and today we have more than 220,000 members and $9 billion in assets. We have 598 staff members across 11 offices across Australia. Under Teachers Mutual Bank Limited, which is the corporate entity, we have five divisions. We have Teachers Mutual Bank, the original; Firefighters Mutual Bank; Health Professionals Bank; UniBank; and our newly added Hiver Bank.

Our common bond serves Australian workers, in the education, emergency services and healthcare sectors, and their families, as well as university students and graduates going forward. As a mutual bank, customers are at the core of our business model. Our members are shareholders, and each member holds one equal share in the bank. This means that our members need to align with what we deliver. We are constantly acting with our members' best interests at front of mind, and our members are highly engaged with the bank and regularly contact us with feedback.

We are a values based bank. In 2017, we became the second Australian bank, alongside Bank Australia, to be granted membership of the Global Alliance for Banking on Values. This is an independent network of banks from around the world that are committed to using finance to deliver sustainable economic, social and environmental development. Joining the Global Alliance for Banking on Values reflects our desire to promote our values globally and work collaboratively with international financial institutions.

The COVID-19 pandemic, like others, has brought many new and unexpected challenges to our bank and to our members. Due to the nature of our common bond, many of our members are on the front line of the pandemic and have also been on the front line of bushfires and floods throughout Australia that have impacted the country. We take great pride and feel the responsibility that comes with serving essential workers in education, emergency services and health care and their families.

During the pandemic, we acted quickly to assist members who had been adversely affected financially from COVID-19. We supported something like 960 borrowers with a repayment pause on their home loans. As of 31 March 2021, the majority of our members on repayment pause had resumed their loan repayments without any foreclosures and without any additional help. Additionally, we've helped close to over 400 members who've experienced a range of challenges to navigate their changing financial circumstances. While our repayment pause numbers are lower than other banks, this can be attributed to the fact that our common bond results in lower exposure to the hardest hit industries such as travel and hospitality. We do not offer commercial loans and therefore had no business loans that required any financial assistance. In response to the recent restrictions across the states and territories, we have activated a range of support measures for any members that have been affected by the stay-at-home orders, and we encourage our members to contact us directly if they need assistance so that our financial hardship team can work with them to find the right solution going forward.

The wellbeing of our staff has also been a key concern during the COVID-19 pandemic. From March 2020 to April 2021, approximately 85 per cent of our staff worked from home full time. Our branch staff continue to come to the office to serve members during this time. We've obviously added safety precautions such as face masks, sanitisation stations, sneeze guards, social distancing guidelines and those types of things.

We continue to deliver on our members' expectations. We've recently implemented a range of new initiatives, including the introduction our new digital bank, Hiver. Hiver will feature new banking technology delivered by Ultradata, our core banking provider. The Hiver app has been designed with modern convenience at front of mind to meet the needs of essential workers in education, emergency services and health care. Our consumer research has found that 37 per cent of essential workers are likely to choose a digital bank as one of the financial institutions they bank with over the next three years. We believe that essential workers deserve a bank that understands them. As they do so much for our communities, the Hiver app will be available to prospective members from 27 July going forward. We plan to roll out the technology to the rest of the membership towards the end of August.

We've also just recently refreshed our home loan portfolio, which streamlines six products into one. We understand that choosing the right home loan is a significant and potentially overwhelming decision for any person to make, and our new design ensures that we're doing all we can to offer products that are easy to understand. We've always been leading the industry with our social responsibility credentials, and we currently have all our wholesale as well as retail mortgage and deposit products certified by the Responsible Investment Association Australasia. We understand the objective of the committee is to review the implementation of the Hayne royal commission recommendations. Teachers Mutual Bank Ltd was not called upon throughout the royal commission or mentioned specifically in the final report. However, we welcome the report and the recommendations and we're pleased to participate in consultation today to ensure ongoing implementation of the recommendations across the financial services industry. We're happy to answer any questions you might have.

CHAIR: Thank you very much, and apologies to you for my absence at the start. Unfortunately I had a technology issue. Thank you, Deputy Chair, for stepping in. Mr James, you may have said this at the start, and I presume it's self-evident, but I presume the overwhelming base of your customers are teachers; what percentage are teachers?

Mr James: The percentage of teachers is probably around 60-odd per cent. Then we have firefighters and family members and people from the universities—and that brand has grown really well, both students and lecturers at universities. And we've just recently gone into health, with Health Professionals Bank, and we've got about 2,000-odd members just in the health industry. We really look after essential services—in the teaching area, the emergency services area and the health sector. Those are the main areas, plus universities.

CHAIR: Just going to the point around the Hayne royal commission that was the instigator of the establishment of this inquiry: while you weren't named, and I understand that, the reality is that there were recommendations from the inquiry that apply to pretty much all financial services firms in different capacities, including small banks, particularly around alignment of remuneration practices. What I'm keen to know is: what steps have you taken, as a mutual, to acknowledge the recommendations of the Hayne royal commission? What are the reporting mechanisms that exist within the mutual to be fed up to the board so that there is ongoing maintenance and observation of practice?

Mr James: We've taken it very seriously as we've gone forward, between the management and the board of Teachers Mutual Bank. Of course we welcomed the report and the recommendations. Being a mutual, we believe in the spirit of the royal commission's recommendations. What have we done during this period? The first thing we did was we made changes to our consumer credit insurance sales prior to the royal commission, and we no longer offer that product going forward, sold by the bank. We continue to report to the board regularly—on a monthly basis actually. In 2019 APRA invited us to undertake risk governance self-assessment prior to a wider rollout of a process. To do this, we hired external consultants to independently review our corporate risk governance. This review resulted in something like 54 recommendations to improve our corporate governance. This was back in 2019. The majority of those have now been implemented and completed. We've now engaged the same consultants to complete another independent review to assess whether we have adequately implemented all the recommendations going forward. This is regularly reported in a report to the board, on a monthly basis, at board meetings, and we will continue to do that. We've also completed a comprehensive review of our remuneration processes in line with the recommendations of the Sedgwick review, and variable reward payments do not form any part of remuneration packages for any level of staff throughout our organisation. We certainly had some prior, but we do not have any variable remuneration whatsoever.

CHAIR: Thank you for that. There was an issue I think in the middle of this year where you suspended the provision of finance to off-the-plan developments for individual consumers to purchase a home off the plan. Can you outline, firstly, the motivation for that decision, and, secondly, what the consequences were and how long that will remain in place.

Mr James: Yes, that's still in place at this stage, and we did very little of that type of lending anyway.

CHAIR: Why, and how long is it going to be in place for?

Mr James: The main reason was the uncertainty of the valuations coming through. I'll have to get back to you on that. We can supply that in writing, if you like. But, at this stage—

CHAIR: Politely, this is a core bit of business which is around you not providing certain types of financial products to the marketplace. Are you saying it's because you get valuations back from valuers and you can't rely on them? Why is that specific only to off-the-plan developments, considering what's happening in the rest of the market?

Mr James: It was only due to the uncertain economic conditions that applied through the COVID period. But, as soon as things normalise again, we'll certainly get back to that type of lending.

CHAIR: When was this decision initially taken?

Mr James: I'll have to take that on notice and get back to you, but I think—

CHAIR: I don't need the exact date, meaning 'it's 19 January', but was it taken this year or last year?'

Mr James: It was taken in 2020.

CHAIR: Was it taken in the first half of the year or the second half of the year?

Mr James: Approximately, I would say it was taken in the first half of the year.

CHAIR: So now we're going back technically two financial years ago. So the decision was taken somewhere within in the time frame of March, April, May, June, July? And you can come back to me with a specific date?

Mr James: It was roughly in May 2020 that we took that.

CHAIR: But it's still in place?

Mr James: Yes, well, the borders are still closed at the moment, so it's still in place, but certainly we will take that back to the board as soon as we have an opportunity to do so.

CHAIR: Just on that, though, I'm not arguing you should or you shouldn't. That's a decision for you as an organisation. I'm just trying to get to the bottom of the rationale of the decision-making. You made a decision not to offer a product in the marketplace. The rationale you've just outlined is something to do with concern around valuations. No-one's arguing that, particularly in May 2020, anyone was 100 per cent sure where the property market was going to go. Some people were very pessimistic, and not many people were very optimistic. The situation has obviously reversed. I presume that's on the basis you not wanting to experience risk exposure. But I would have thought that most people would accept now that the risk exposure has diminished somewhat. What's the process that was taken to make that decision? Was it one made at a board level?

Mr James: I think it was the uncertainty of the economic conditions—all those things you mentioned before.

CHAIR: It's not a question about why it was taken; what I'm asking is a question about how it was taken.

Mr James: It was taken through to the board at the time for a decision, because of the uncertainty, the fact that we had reports, even from APRA at that stage, that certainly property prices could fall up to 10 to 20 per cent going forward, at the beginning of 2020. Of course that didn't happen. In hindsight, property prices will probably go up 10 per cent this year, going forward. But, at the time of the uncertainty, in the middle of COVID, we thought it was prudent as an organisation to take that measure.

CHAIR: How often has that been reviewed?

Mr James: In light of the circumstances, where property prices are actually increasing, we probably need to review it at this time.

CHAIR: So you're saying that, between May 2020 and now, there was no review of your decision to stop lending for off-the-plan purchases?

Mr James: We do general reviews as we go through, but, on this particular case, it hasn't been back to the board for approval to change that recommendation.

CHAIR: I find that quite surprising, but of course it's your business; you run it as you see fit. I doubt that many people would think that was logical; it questions the nimbleness, shall we say, of Teachers Mutual. Just quickly, one of the biggest issues that's come up consistently is around cyber-risk. You're obviously a much smaller institution and you'll no doubt attract much less attention in comparison to larger organisations, but that creates a flipside which is that the capacity to invest in your cyber-resilience diminishes in comparison to the scale of the business because of the volume of customers. What steps are you taking and how much are you spending on cyber-risk to protect the interest of your customers and of course the organisation?

Mr James: We certainly spent a lot of money on cyber-risk. It's really important going forward. We have regular tests of our IT security, and cyber-risk is a major part. This is also a focus for APRA going forward. I haven't got the actual figures that we spend on cyber-risk, but it's very important to the organisation going forward. We do penetration testing on a regular basis and we do ethical hacking. We do all of the things that we need to under cyber-risk. But if you want a figure that we spend towards cyber-risk we can certainly bring that back to the committee.

CHAIR: I would appreciate that, because it's one of the areas of growing concern for all of us. I'll hand over to the deputy chair for 10 minutes or so.

Dr LEIGH: Thanks, Chair. Mr James, I'm interested in a particular offer that you're making through Hiver of 1c cashback on essential purchases.

Mr James: That was an error. It was one per cent cashback on essential purchases.

Dr LEIGH: Great. I take 1c and one per cent to be the same in this context. This is something that's common in the United States but almost unheard of in Australia. Why is it that cashback schemes haven't operated in Australia? What are you doing differently to make them work?

Mr James: As I said, it's one per cent on—it's an introductory offer at this stage; we'll see how it goes. Obviously we're launching the Hiver bank from scratch, so we're expecting about 5,000 new members over the first 12 months. We believe that we'll learn from offering this one per cent cashback. It's on the main savings account of Hiver and it should be attractive to essential workers going forward, as will be the fact that we'll have electronic wallets on the site and you can join Hiver electronically and have electronic visa cards put into your account within the first 90 seconds. There will be a whole lot of new improvements, but we're testing a whole range of new products. If they're successful, then they will obviously flow back into Teachers Mutual Bank, Health Professionals Bank, Firefighters Mutual Bank and UniBank.

Dr LEIGH: Presumably the economics of this is that someone is clipping the ticket and giving you more than one per cent of each transaction, and you're then able to feed back one per cent to the customer? Is that how I should understand it?

Mr James: No. As I said, it's an introductory offer at this stage to attract people to the Hiver product. We believe, being a totally digital bank—some people call them neobanks, where everything is straight-through processing—that the savings we'll get by using this type of development will allow us to pay that one per cent cashback.

Dr LEIGH: Hang on—now you're effectively saying that this is a loss leader? I assumed that there was effectively some commission that was being paid in the context of a debit transaction, and that you're able to pass a share of that commission on to the customer—am I not correct about that?

Mr James: Not correct. It's an introductory offer.

Dr LEIGH: So where's the money coming from?

Mr James: It will come out of the savings. This is a purely digital bank, going forward, so it will come out of the savings. We have a lot of manual transactions and a lot of legacy systems in our current brands. This will be brand new and it will have reduced transaction costs, so it's coming out of reduced transaction costs for the bank.

Dr LEIGH: Right. But the RBA cash rate is at 0.1 per cent and, presumably, you're not charging interest to your deposit customers, so your scope to make significant profits from deposit holders is minimal. From what you're saying it sounds like this isn't sustainable in the medium term, that this is simply going to operate as an introductory offer and that it will then go away. Is that how I should think about it?

Mr James: We'll see how it goes, but we're treating it as an introductory offer at this stage.

Dr LEIGH: How could it be sustainable?

Mr James: By reducing our total costs in running the operation. If we can reduce those substantially by using our digital focus going forward then we'll certainly save quite a deal of money in the back office and in transactions flowing through the organisation.

Dr LEIGH: Yes, I get that doing things online is cheaper than doing things on paper. But in order to be sustainable I would have thought that you need to have some revenue stream that you're tapping into. Saying, 'We're going to pay for it through cost savings,' seems illusory to me.

Mr James: We have both deposits and loans. Hiver members will be taking loans with us going forward and they'll take credit cards. There'll certainly be income flowing from the loans—

Dr LEIGH: Do you expect that Hiver will be offered as a white-label service to other financial institutions?

Mr James: Hiver is our brand going forward, but the software, which is being developed by Ultradata, could be used by other mutual financial institutions or other financial institutions into the future. It won't be labelled 'Hiver'. At a certain date they'll have their own brand, but it's being provided to us by our core banking provider.

Dr LEIGH: What limitations are there on what customers can do? For example, can they deposit an Australian dollar cheque into their account? Can they deposit a foreign currency cheque into their account? What are the limitations of a purely digital bank?

Mr James: From a digital perspective, we're looking at transactions. They'll have cards which will enable them to tap and go, like normal. They'll be able to do any transactions via internet banking or mobile banking. They'll be able to do those transactions. Again, they'll be able to deposit into their accounts. There will be all the normal functions but, basically, they'll be digital. Their payrolls will be paid into their Hiver accounts—

Dr LEIGH: Forgive me, Mr James, but I'm on a tight time frame. My question was not about what they can do but about what they can't do. Specifically: can they deposit an Australian dollar cheque and can they deposit a foreign currency cheque?

Mr James: I believe so, yes.

Dr LEIGH: To both of those questions? How do you deposit a cheque when it's a digital-only bank? Do you just take a photo of it? Do you have to post it somewhere? How does it work?

Mr James: In the first instance, we're focusing on digital banking and what benefits that can bring. Our customers—all our customers—are increasingly using digital these days anyway, especially during the COVID—

Dr LEIGH: Mr James, you're not answering my question. Please, I'm on a tight time frame. I need you to answer my questions.

Mr James: Okay.

Dr LEIGH: Can you please answer my question as to how a customer in a digital-only bank deposits a cheque? If you don't know, that's okay; just say you don't know, and we'll move on. I am on limited time, and I really need you to address the questions I'm putting to you.

Mr James: I guess we didn't expect that members who were going to use a fully digital bank would be depositing cheques. But, if that becomes a normal practice, we'll be able to use Teachers Mutual Bank Limited branches and the types of operations we use for those cheques now to aid the Hiver bank going forward.

Dr LEIGH: Chair, we're tight on time. Let me hand over to our colleagues. I'll circle back if there's time at the end.

CHAIR: Thank you very much, Deputy Chair. I am sure all of the millennial cheque users will be excited. Ms Hammond.

Ms HAMMOND: Thank you very much, Mr James. I want to pick up on two points, which both the chair and the deputy chair raised. One is in respect to the neobank that you're launching, Hiver. Who is building this for you?

Mr James: Our core banking provider is. We're working very closely with our core banking provider, called Ultradata. They're based in Victoria. We've been working with them for some time. They provide core banking services for something like 30 or 40 mutuals across Australia.

Ms HAMMOND: When you say 'core banking provider'—and, excuse me, this is because I actually have no idea—what do you mean?

Mr James: The main computer system that we use to look after members' funds and to do the processing of payments and all those types of things is part of our core-banking-provider software. Anything the member does, from internet and mobile banking through to using our digital wallets and putting their pay in, comes through the core banking software.

Ms HAMMOND: So they're a third party, and you're in partnership with them. Do they run the system?

Mr James: We run our own system, but they certainly provide the core banking software, the maintenance and the technical assistance going forward.

Ms HAMMOND: You have a licence to use, effectively?

Mr James: Yes, that's right.

Ms HAMMOND: Do you store your customer data, or do they provide storage for you?

Mr James: It's both. All our data is just stored in Australia; there's no data outside. The majority is on our own premises, but, really, all the data that we use, with any third party, is just stored in Australia.

Ms HAMMOND: So most of it is stored with you, but some of it is stored with them?

Mr James: Yes, that's right.

Ms HAMMOND: To get back to the points about cybersecurity that the chair was asking you about: when you undertake your own cybersecurity analysis and risk assessments, do you also do it for your third party?

Mr James: Yes. We have to do that. That's part of the procedures that APRA lay down for us to do that. We do that and make sure that any data is kept in Australia.

Ms HAMMOND: I'm not just worried about whether the data is kept in Australia; I'm worried about the protection around it. With data, it's good that it's stored here—that's very important—but attacks can come from outside. They're not geographically limited. Does somebody actually stress test Ultradata's systems?

Mr James: Yes. We use our own second line of defence, our own risk area, to make sure that vendors meet standards. With all our major contracts, we have to provide those standards to APRA going forward.

Ms HAMMOND: Do you ever engage external people to do the testing, either of your own system or Ultradata's?

Mr James: We have had some external people test, but we tend to use our own people within the organisation.

Ms HAMMOND: APRA doesn't insist on externals?

Mr James: They insist that we meet certain expectations going forward for our major contracts with third parties.

Ms HAMMOND: Does APRA ever do its own testing or check your testing?

Mr James: They come in and do cybersecurity testing, yes. We have regular meetings with APRA. During COVID we had weekly meetings and fortnightly meetings and monthly meetings. But, of course, during the COVID period, they haven't been on premises in the last 12 months. We also use third parties like PwC and Deloitte for some third-party testing just to make sure our cybersecurity is right up to date as well.

Ms HAMMOND: Do you know if this is something Ultradata are building from scratch, or is it something that they're adopting technology or a system for from somewhere else? Has it done this before?

Mr James: Hiver is part of what they call the Ultracs ecosystem that Ultradata has developed. It's just one module within that, and Ultradata have developed that themselves. They have the capability to develop the software, but it's part of a whole ecosystem that is part of the core banking system.

Ms HAMMOND: I've heard the word 'ecosystem' said about five times today. I'm loving the fact that the banking system has an ecosystem.

Mr James: It's an IT ecosystem.

CHAIR: To be fair, Ms Hammond, the system does have a lot of green flowing through it.

Ms HAMMOND: Yes. Are you aware of whether Hiver or the software behind Hiver—the system behind Hiver—has been used anywhere else?

Mr James: No. We'll be the first customer of Ultradata to use the Hiver software going forward. It's a module of their core banking software. As I said, there are about 40-odd credit unions and mutual banks that use their core banking system, but we'll be the first to use their, let's say, neobank software going forward.

Ms HAMMOND: What level of confidence do you have in it if it's never been used before?

Mr James: We've been testing it now for nearly 18 months and, certainly, we've been able to put some of our own staff on it, and it's working fine. Again, we'll be launching this towards the end of August. That's our launch date to the general public. We have every confidence, with what we've seen so far, that the software works perfectly and blends in with the rest of the core banking software.

Ms HAMMOND: And that it's secure?

Mr James: Absolutely.

Ms HAMMOND: Chair, I might leave it there.

CHAIR: That was very helpful. Thank you.

Dr MULINO: I have questions on a couple of themes. Thanks for giving evidence today. I've asked this of all of the banks who have attended today. It's around AML/CTF. It's an area where all banks, small, medium and large, are committed to capacity and resilience, but obviously there are some challenges. Some of the fixed costs involved in dealing with that can be onerous for smaller banks. I'm wondering whether you have any observations on your experiences. I'd be interested in how much you've invested in that and how that's tracking over time and what some of the challenges have been.

Mr James: Again, the bank obviously has an AML/CTF compliance program in place. We review and implement oversight and report on compliance. There have been no major issues identified going forward with the AML/CTF compliance. The bank obtains independent assurance going forward. We believe it's a key component of doing business these days and we're supportive of this. There are some challenges around the implementation, but they're not insurmountable. We think it's a really important practice and we've had no issues to date whatsoever.

Dr MULINO: Would you be able to give us on notice an indication of how much, in broad terms, you're investing in it by, say, headcount and dollars?

Mr James: Yes. We'll certainly provide that to the committee.

Dr MULINO: Thanks. A more specific question I had was around tranche 2, which the government is committed to and which has been in the pipeline for some time. Obviously, most comparable jurisdictions have gone down this path. Do you see it as necessary? Secondly, what do you see as some of the issues that might arise, given that it's going to substantially increase the number of entities covered?

Mr James: My understanding of tranche 2 is that it's for the SME industry going forward. We don't really lend commercially, going forward, so I don't think it would affect us dramatically. But any changes or recommendations, if we do ever move into that area, we'd certainly take on board.

Dr MULINO: I have a question around open banking. Obviously the smaller banks were on a different time line to the bigger banks in this space, and I noticed that some of the mutuals have joined up in relation to trying to get into this space. I'm interested in your thoughts around this. It's another area of regulation where some have pointed to greater challenges for smaller and medium players. What has been your experience with open banking?

Mr James: With open banking, to be truthful, we're a little bit behind in that area. As Teachers Mutual Bank, we certainly won't meet the CDR requirements on 1 July, which is today, but we're working closely again with Ultradata who, as we mentioned, was the core banking provider. We had, actually, a telephone conversation again with Ultradata yesterday, and we believe that we will be right to go and be able to do the CDR part of the thing by the end of August. That's the date. So we'll definitely be there well before November, as we're going forward. But open banking is a complicated issue. It's been difficult. We won't be the only small bank—or bank—that will miss the 1 July date for CDR, but we believe we'll certainly be in the time frame by the end of August at this stage.

Dr MULINO: Thanks. Thanks, Chair. That's all from me. I'm happy to give others a chance to circle back.

CHAIR: No. The Deputy Chair has outlined that he's done, and, unless Ms Hammond wishes to jump in, I think we're happy to say—as we trend towards the end of the day and we're all tired—thank you for your appearance and attendance today. The committee secretariat will be in touch with you in relation to any matters that arise out of today's hearing. You will be sent a copy of the transcript of your evidence to which you can make corrections of grammar and fact. As you know, you have some questions on notice already that have been submitted verbally but will be confirmed by the secretariat, and we're keen for those answers. Many of them are, I think, relatively straightforward questions that can be answered. Thank you.

PAVISIC, Mr Danny, Chief Executive Officer, Unity Bank [by video link]

[16:14]

CHAIR: Welcome. I remind you that although the committee does not require you to give evidence under oath the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament. I now invite you to make an opening statement.

Mr Pavisic: Thank you for inviting Unity Bank to this session. I've been in the role of CEO for just on 14 months but I've been a long-time employee of the bank. As far as I know, this is the first time that Unity Bank has appeared before any committee of parliament, so I would like to give you a little bit of background about Unity Bank.

CHAIR: We feel so honoured.

Mr Pavisic: Thank you. Unity is a mutual bank, having converted from a credit union nearly five years ago. We are a member of the Customer Owned Banking Association and our 40,000 members are spread throughout Australia. They are concentrated around the maritime industry, the coal and power generating sectors as well as having a large regional representation through central New South Wales, Queensland and Western Australia.

We have 123 staff and a balance sheet of just over $1.4 billion in assets, which is a fraction of our major competitors. Last year, due to the effects of COVID, we made a $2 million profit, although our underlying results are usually $3 million to $4 million. We have 20 branches and agencies around Australia and in five of those locations we are the only financial institution provider in town. We have a relatively simple business model, with product lines that focus on simple everyday savings, home loans and personal loans supplemented by a small but growing SME portfolio, which we are developing to diversify our revenue and to allow us to meet the needs of those individual members who have small businesses.

One area that the bank would like to participant more in is the first home buyer segments, where we remain willing to assist first home buyers into a home. Unfortunately, we are locked out of the First Home Loan Deposit Scheme as the panel of lenders in that scheme has not changed since 2019 and there are no plans to review that panel or add to it over the coming 12 months. Similarly, we are unable to participate in the Family Home Guarantee scheme as the participants in that scheme are the same as the First Home Loan Deposit Scheme. If the opportunity arose to participate in these schemes, we would welcome the opportunity to add further competition to the market.

Mutual banks are recognised by the financial industry, ratings agencies and the regulators as having conservative lending practices that deliver supervisor credit risks, and I'm proud to say that in the 51 years we have operated we have never foreclosed on a home loan for a member. That's not to say that sometimes our members don't get into difficulty, but we've strongly capitalised our balance sheet and we don't have any pressures to pay dividends to shareholders, so we're a patient and supportive bank that works with our members to find solutions to their problems.

This was never more evident than during the COVID lockdown of mid-2020, where our sole focus was on ensuring that we supported our members throughout the crisis. At its peak, our COVID support program had nearly 18 per cent of our loans under deferments, which is high in the industry. We made the program available to all our members, regardless of the type of loan they had, and we had no paperwork for them to complete. Pleasingly, as at the beginning of this year we had no members left in that program; they'd all returned to repayments.

We also instigated a call-out program where our staff and branch staff called approximately 18,000 of our most vulnerable members, just to see how they were coping through the lockdown. These weren't calls about selling banking products, although we did set up some internet banking and ordered cards for some members who had no services. This was more about inquiring about their health and to see if we could assist them in any way. We even had instances where we arranged home delivery of meals, for some members, but generally people were simply appreciative of the fact that we took the time to inquire about their wellbeing. We are proud of our ethos of putting members first, and we always do that.

Chair, thank you again for the opportunity. I welcome your interest in Unity Bank and the smaller segment of the industry. I'm happy to answer any questions as best I can.

CHAIR: I welcome your participation here today, and if this is your honorary first appearance then that's also welcome as well. I was particularly taken by the degree of personal service you provide, including providing meals to customers throughout the past 12 months. How many members does Unity Bank have?

Mr Pavisic: We have 40,000 members. Just to clarify that, we didn't provide meals to all—

CHAIR: No, I'm not suggesting you did to all, just to those targeted or people in need, is that right?

Mr Pavisic: That's correct.

CHAIR: Out of curiosity, out of the 40,000, how many did you provide meals to?

Mr Pavisic: I'm aware of one or two that we did that for through arranging home delivery of meals. But there were different needs for different people. Some members just wanted to have a chat and really appreciated that. Others needed some help with some of their digital banking. For most members, the purpose of the call was just to touch base with our members and make sure that they knew that we were there, that we were taking an interest in them and, if we could help them in any particular way, then we could. That's not to say that we could help, because everybody was in lockdown at that stage, but that was the purpose of it.

CHAIR: I understand. If I understand the history of your bank correctly, its origin is essentially from dock workers—maritime workers—is that correct?

Mr Pavisic: Correct. We were started 51 years ago by maritime workers; people who were working on the wharves.

CHAIR: I presume that's still the predominant point of entry for people who choose to use the bank, or not?

Mr Pavisic: No. Of our 40,000 members, about 12,000 of them are from the traditional maritime industry. We've got about 5,000 or 6,000 that were from the power industry and the coal mining industry. The rest are really spread throughout regional New South Wales, Queensland and WA, through different mergers over the years.

CHAIR: That makes a lot more sense around the mergers. Does that include the people who are spread in the coal industry?

Mr Pavisic: We merged with two credit unions in the coal industry sector, but we expanded our services generally to that sector about 14 or 15 years ago.

CHAIR: I don't know whether you even provided evidence to the Hayne royal commission or not, but, regardless, many of the recommendations and, of course, legislative changes that have happened or will continue to happen, will no doubt have an effect. To what extent is Unity seeking to implement those recommendations and have a reporting structure around the ongoing monitoring of them? Is that reported, including to the board?

Mr Pavisic: You are correct, we weren't invited or requested to provide any evidence to the Hayne royal commission. But obviously we took a great interest in the findings of the report. When that report came out, we actually did a complete gap analysis with the commission's findings and shared that with our board and also with APRA at the time. We found that most of our practices actually conformed with what Hayne recommended that the industry does. There were a couple of gaps that we looked at. The area around culture is an area that we're continuing to develop, and we're developing a cultural scorecard that goes up to the board. As for a lot of those formal reporting structures, once we completed the gap analysis and we identified that our reporting and our practices were actually in line with what Commissioner Hayne recommended, we felt pretty comfortable with where we were sitting. But I acknowledge the fact that one area that is particularly difficult for us as an institution, and which I think quite a few institutions struggle with, is this idea of how you measure culture. How do you assess culture? We—the board and management, as well as our staff—have always had the view that putting your members first is a great culture to have, but how do you actually assess that? I know there are different models out there, and people have tried—

CHAIR: One of them is to use satisfaction surveys.

Mr Pavisic: Yes.

CHAIR: To what extent have you done satisfaction surveys or analysis of complaints so that at least you know that, where there are issues, you're on top of them?

Mr Pavisic: In terms of regular surveys of members, because of our size, we only do that approximately every two to three years, let's say. The research company that we use always identifies us as either No. 1 or No. 2 in the industry in terms of member satisfaction, with 92 to 93 per cent satisfaction levels. We hold the world record at managing relationships with our members. We think that that is the key to our success. Our members love us. That's not to say we don't get complaints from members. Everybody always gets some level of complaints, but it's a case of how you respond to those and what the complaints are about. If it's a complaint about a fee, for example—nobody likes paying fees—we explain it to members, we show them how to avoid fees and, invariably, we'll refund that particular fee if it's an issue for them. But if it's a service issue—we don't tend to have too many of those, but things always break down—it's a case of how you respond to that, and we think we do it really well.

CHAIR: Of course. Everybody gets complaints; as you rightly say, it's how you respond to them. Believe it or not, some people might have complaints about the deputy chair, about Dr Mulino or, perish the thought, about me sometimes, and yet we all manage to survive! So we wish you well in that endeavour—particularly if you're delivering meals to people if that's the situation they face.

One of the challenges that we do face with smaller banks is making sure that your systems are properly designed to recognise both the legislative obligations that are imposed by the parliament and the emerging risks that are presented. Sometimes small banks can be a much clearer target in comparison to the sophistication of larger entities like Commonwealth or Westpac et cetera—the big four. What are you doing in the cybersecurity space to build resilience, particularly against increasing costs? How much are you spending, and how are you monitoring that ongoing activity to protect your members?

Mr Pavisic: I don't know the exact number, but I'll give you an approximate one. In terms of our sophistication, over the last three or four years most of our IT spend has gone into cybersecurity—the level of additional systems we've got in place, the scanning and trapping that we've got in place for malicious emails and the contracts we've signed with third parties to provide services in that area. We've added additional resources internally to manage that. That is a growth area. If I look at any part of our business, that is the part of our business where we've invested the most over the last couple of years. Really, it's an area where you just need to do that. It's just the cost of doing business these days. We will need to continually enhance our capabilities there and our sophistication. The training we give our staff is enormous, but it's mandatory.

CHAIR: Could you get back to us on notice in terms of how much you spend on cybersecurity and how much that's costing the bank—in the last financial year, just to give us an indication, and, if you can give us numbers for the past couple of years, that would be good to give us an idea of tracking and the consequences of that.

Mr Pavisic: Yes.

CHAIR: I don't want to steal Dr Mulino's thunder, because I know he's very interested in AML issues. I'm wondering about a similar sentiment: are you confident with your capacity as a bank to manage your AML obligations?

Mr Pavisic: Absolutely. AML is another one of these mandatories. Over the years we've doubled our capacity and level of training there. Within the last year we had a visit from AUSTRAC, who ran through our program. I think that was the first time we've had a visit from them, a one-on-one discussion about our program and what we do. That wasn't validation, but a really good point to see that we were actually covering off all the issues. We've had external reviews of our AML program from people like KPMG over the years, and there haven't been any issues identified. But, once again, that's an area in which we have certainly doubled our resources over the last couple of years.

CHAIR: You said you had a visit from AUSTRAC last year. When was the time before that that you had engagement with AUSTRAC?

Mr Pavisic: I don't believe we've had a one-on-one with them before.

CHAIR: Last year was the first time you had a one-on-one engagement with AUSTRAC? I presume that means you've had engagement electronically or over the phone? How frequent is that?

Mr Pavisic: That's right. We lodge SMRs, suspicious matter reports, on an ongoing basis. In terms of day-to day-interaction I really couldn't answer that particular question for you at this stage.

CHAIR: You can take that on notice. What's the volume of notices you provide to AUSTRAC?

Mr Pavisic: I don't have the exact figure, but it would be in the tens per month—10 to 20 a month.

CHAIR: Yes. I was just curious, as you can understand. Large institutions have very high volumes that they need to monitor but smaller banks have a risk profile where, if their systems aren't as strong and somebody wants to engage in certain types of activity—potentially; I'm not suggesting this is going to happen—they could become an easier target for being used as a kind of vehicle. I'll hand over to the deputy chair for 10 or so minutes.

Dr LEIGH: Mr Pavisic, I'm interested in the amount of profit that you make per member. According to your 2019-20 annual report, you made a $2.2 million profit off a membership base of 40,619 members. That means that your profit per member, if I'm doing my maths right, is $54, which is about a fifth of the $250 or so that Bank of Queensland reports. How is it that you're managing to continue to stay in operation while making a much slimmer profit margin than the Bank of Queensland?

Mr Pavisic: One big difference is the shareholders. I don't know the exact number, but I would suspect that the Bank of Queensland is distributing probably 70 to 80 per cent of their profit back to shareholders in the way of dividends. That level of distribution doesn't happen in a mutual bank—that is retained in the bank. If you look at what's left for the Bank of Queensland, it's substantially less than that figure you quoted is available to them.

The other area is that we're strongly capitalised; our capital ratios are around 16½ per cent. I don't know what Bank of Queensland's would be, but I would suspect it would be around 11 or 12 per cent. So we have excess capital in the business, which we think is important. That would fundamentally explain the differences between those two.

Dr LEIGH: As a mutual bank, what services are you able to provide to customers compared to what a for-profit bank would be able to provide?

Mr Pavisic: We provide a whole range of services to members and to the communities that we support. For example, we have what we call Gunthers Lane, which is a digital hub that we established out at Bathurst, for the Bathurst community. That cost us approximately $800,000 or $900,000 to set up. All it is is a facility where the community can come in, whether they're young, elderly or whatever, and learn about digital technology. We have the latest technologies there. We have 3D printers and virtual reality. People can come in and experience that. They can talk to an expert in those areas and really build up their proficiency or their comfort with digital—the digital economy, in essence. But they can't buy a banking product from there. There are no banking services in that. That's part of our social dividend, if you like, part of how we give back to the communities.

Dr LEIGH: Mr Pavisic, Unity has a fairly long history. You made a comment in your opening statement that you've never foreclosed on anyone in that time. I want to drill down a little bit on that. I have heard it said by other financial institutions that they've never foreclosed, by which what they in fact mean is that, when the customer got into strife, they sold on the debt and then someone else did the dirty work of foreclosing. Are you saying that hasn't happened either—that no customer of yours has ended up being foreclosed on by you or by a third party who bought the debt from you?

Mr Pavisic: No, we don't sell off any debts to anybody. We manage all of our loans.

Dr LEIGH: So what happens for somebody who is clearly unable to make repayments? How do you manage it and what can others in the sector learn from how you've managed that situation without resort to foreclosure?

Mr Pavisic: The key there is that you need to have a willing member, for a start, a member that's willing to talk to you and explain their situation. Generally speaking, that is the relationship we have with our members. Our members, as I mentioned before, trust us. But sometimes members get into a situation where there is no clear path to get out of the debt that they're in. So what we do with them is try and explain to members that sometimes the best option is to actually sell up and either downsize or look at some other options. But we always rather that the member does that and the member reaches that conclusion themselves, with our assistance. We can put them in contact with financial counsellors and so on, and we give members time.

I'll give you an example. We recently resolved a member that we were working with for three years. No listed bank is going to be that patient with a member for three years to allow them time to work through the issue, come to the conclusion that this is their best option and then give them time to sell the house on the market. It's not a forced sale. You don't ever want to be in a situation where you're forcing a member to take the first offer, if you like, or a subpar offer. That's the advantage of dealing with a mutual bank like Unity Bank, because, as I said before, we don't have the pressures on us to pay those dividends. If it means that it's going to take a little bit longer but be a better outcome for the member, then so be it.

Dr LEIGH: Thanks, Mr Pavisic. Chair, in the interests of time, I'm happy to hand to Dr Mulino now.

CHAIR: Thank you, Deputy Chair. Ms Hammond has departed, so it is over to you, Dr Mulino.

Dr MULINO: Thanks. I'll be brief. I just want to follow up on a couple of the chair's questions on AMLCTF. It was interesting that you've had one face-to-face visit, and it is good to see the regulator visiting to discuss some of your capabilities. I just had a question around how much you've invested in recent times in AMLCTF and what the trend is there.

Mr Pavisic: We've certainly invested in people. We've doubled the number of people that we've got in there. Our AML/CTF program is built into our core banking platform. You previously had the opportunity to talk to Steve James, from Teachers. We all use the same software supplier there. The rules that are in that program are pretty much across the mutual sector. In terms of an explicit investment, we've certainly upgraded our systems and versions of software over the years, but that all comes bundled into the software that runs the whole banking platform. So we're a little bit different from some other banks in that all of our products and services are run out of the one system. We have complete visibility right across the board for the members' banking.

Dr MULINO: Taking this on notice is fine. Would you be able to provide a bit of a sense of how much investment you put in by dollar and head count and how that's trended?

Mr Pavisic: Sure.

Dr MULINO: Thanks. One of the characteristics of AML—and to an extent this applies to cybersecurity and other IT-heavy and regulation-heavy areas—is there are arguably fixed costs, so the burden falls heavier on small and medium banks versus the big four. What's your sense of that? What do you think of the ways in which small and medium banks have coped with that?

Mr Pavisic: We've always been at the stage where we consider that the investment in those two areas is just part of being in business. It's an area that you can't afford to ignore or underinvest in. If it means that we need to invest more resources into those areas, we've just got to do that. There are smaller institutions than us around that would struggle with some of those investments, and you can never invest too much, particularly in the cyber area. At the end of the day, criminals have, unfortunately, a greater profit motive than us, because for a criminal it's a revenue stream but for a bank it's a cost item. But the protection of members' funds is very critical to us. You've asked me what keeps me up at night. If it's anything, it's in that area. It is not so much from the AML side, because I'm very comfortable that we've got the right people and the resources there. It's the cyber side. You need only one breach, and your reputation is trashed for a while.

Dr MULINO: On a different matter: you explored with Dr Leigh some of the strengths of the customer owned banking model. One of the challenges or limitations of that model arguably has been that the scope of operations has been limited by geography or by occupation in a sense, and that has limited scale. But you're an example of an entity that has overcome that through merging. Is that fair to say?

Mr Pavisic: Yes, mergers have been very important for us, but our mergers have been what we call niche market share. We really have stuck to the niches, the markets, the segments of the industries where we operate in the geographic spread that we're in. We really wanted to understand that. Each of those areas has their own peculiarities. We want to integrate ourselves into those industries, so we want to know what drives those industries and what drives those communities. We want to be the dominant partner in those areas and those markets we choose to operate in. And that's a strength, because nobody understands those segments better than we do. That's one of the reasons the close, intimate relationship we have with our members is valued not only by us but also by our members. When members are going through difficult times because of regional factors, drought or whatever the case may be, we understand that, and that these things are cyclical. We are a patient and supportive bank, and we'll be there for them.

Dr MULINO: So you'll be open to exploring opportunities for mergers in the future?

Mr Pavisic: We will, but mergers have to make strategic sense for us. We have declined mergers with some institutions that didn't have any connection to our existing membership base or strategies. Any mergers in the future will need to be aligned with our strategic objectives.

Dr MULINO: I asked this of Mr James: what are some of the challenges and opportunities in the open banking space? It's obviously a big opportunity for customers in a lot of ways, but some of the smaller banks and customer owned banks were given a bit of a longer time line because of the regulatory and compliance challenges. What's your status here?

Mr Pavisic: Our status is pretty much the same as teachers and a number of others. We are not compliant with open banking today. We have been in contact with the ACCC and have kept a very good dialogue with them. We are working towards a rectification schedule with them. I think everybody acknowledges that this has been a really complicated and complex technical solution. Some of the areas, from a technical perspective, are still unclear and there is some guidance that still needs to come out. The joint accounts issue is one area that is still to be resolved. We think that, having 40,000 members when some of the major banks have multiple millions, there is a great opportunity for us to gain some market share and make life easier for people who want to switch their banking over to us. We are very supportive of it—we're not quite there yet, but we will be.

Dr MULINO: Thanks very much for your evidence today.

CHAIR: Mr Pavisic, how many branches do you have?

Mr Pavisic: We have 20 branches and agencies around Australia.

CHAIR: What's the difference between a branch and an agency?

Mr Pavisic: A branch is where we have one of our staff servicing our members. Then we have three very small towns where we've got an arrangement with a local business to provide banking services to that community. Some of these towns might have only 250 to 300 residents.

CHAIR: I take it that these are communities which are predominantly created for the purpose of supporting a single industry—is that where most of your members or customers are?

Mr Pavisic: No. For example, we have agencies in Gulargambone, Trundle and Eugowra in regional New South Wales.

CHAIR: I have no idea where any of those places are.

Mr Pavisic: They're in central New South Wales. These are areas where the major banks have left those communities. In the 1990s or mid-2000s the government put in place programs to ensure that those communities had retained some banking services—RTCs, or regional transaction centres—and we run three of those.

CHAIR: Curious! Thank you for your appearance before the committee today. The committee secretariat will be in touch with you in relation to any matters arising out of today's hearing. You'll be sent a copy of the transcript of your evidence, to which you can make corrections of grammar and fact. We've also presented you with some questions which you have taken on notice, and the secretariat will provide you with further information on that front.

Resolved that these proceedings be published.

Committee adjourned at 16:49