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General Manager

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To the General Manager

RE: The Banking Executive Accountability Regime - Consultation on Product Responsibility

The Australian community expects banking executives to be held to account when they do wrong. CHOICE welcomes greater personal accountability for banking executives and directors for the end-to-end management of the products they sell. This proposal is an important step forward in strengthening the Business Executive Accountability Regime (BEAR).

Unfair or poorly designed financial products affect millions of Australians. For example, 1.9 million Australians are currently struggling with their credit card debt, with almost a million people trapped in a cycle of persistent debt.¹

For too long, the banks have hidden behind ambiguous phrases such as ‘administrative error’ or ‘processing errors’ that seek to minimise personal accountability for misconduct. These seemingly innocuous errors have real and sizeable effects on people and the Australian community. As an illustration, ANZ’s self-described “processing error” of home loans cost people over \$239 million in excessively charged fees and interest.² Shockingly, the failures were first identified in 2003 and have still not been adequately rectified.

Banks have been granted a social license to operate in Australia. People expect that those at the top be held to account for the products they sell and administer. Banks must ensure that the products and services they sell and administer are fair and fit for purpose for their customers. They must also ensure that in the event of misconduct, remediation occurs in a prompt and expedient manner. Failure to do so must be met with strong enforcement, with the accountable person and institution expecting APRA to use these powers to prosecute them.

¹ ASIC 2018, REP 580, Credit card lending in Australia

² Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, Final Report, p.114

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APRA has a unique opportunity in the BEAR to bring a renewed focus to the impact that financial misconduct has on people. Australians expect APRA to be a bold regulator that effectively and regularly uses its BEAR powers against bad actors. APRA must also focus on the harm that financial products have on people, rather than exclusively focusing on the prudential impact of poor product management.

This renewed focus can be achieved by APRA if they adopt the following recommendations. APRA should:

- prosecute conduct issues by banks and accountable persons through the accountability obligations in s37CA(a) and s37C(a) of the *Banking Act 1959*
- clearly state that the accountable person responsible for the end-to-end management of products has a responsibility to proactively ensure these products are fair and fit for purpose;
- explicitly state this proposed accountable person is responsible for the conduct of intermediaries it engages with, including and not limited to, mortgage brokers and financial advisers;
- be proactive in addressing delayed or unfair remediation processes;
- publish case studies of previous examples where it would have used the BEAR powers had they existed then to prosecute banks and accountable persons; and
- always consider the financial and non-financial impacts on people who are affected by poor product design and management.

Focusing on consumer protection issues

The BEAR needs to be expanded to explicitly include consumer protection issues. We acknowledge this is not within the scope of this consultation. However it is important to draw APRA's attention to this important point. The accountability obligations need to explicitly refer to taking reasonable steps to prevent misconduct that pertains to consumer protection. This can be achieved by expanding the accountability obligations in s37C and s37CA(1) of the *Banking Act 1959* such that ADI's and responsible persons have to take reasonable steps to 'prevent regulatory breaches, including breaches of regulations related to consumer protection, in the areas of the bank for which they are responsible.'

However, in lieu of legislative change, the Royal Commission identified that the current BEAR laws have "both a conduct and prudential outlook".³ In relation to conduct regulation, accountable persons and banks have an obligation to conduct their business with "honesty and integrity, and with due skill, care and diligence".⁴ A number of case studies from the Royal Commission - from inept remediation processes to widespread inappropriate lending - clearly exhibit behaviour that breach these obligations. APRA should prosecute misconduct or behaviour that falls below community standards and expectations with these obligations. A failure to do so would greatly limit both the power of BEAR as well as APRA's enforcement ability and reputation.

³ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, Final Report, p.456

⁴ *Banking Act 1959* s 37CA(a) and s 37C(a).

Championing fair product design

CHOICE recommends that APRA clearly state that the accountable person responsible for the end-to-end management of products must ensure what they sell is fair and fit for purpose. The regulator should not wait for a bank to have poor product design or practices or for the Australian community to be harmed before they enforce the law. Instead the obligation should be proactive and accountable persons should be required to ensure the bank has fair product design in place at all times. This aligns with the underlying principles and norms identified by the Banking Royal Commission that must govern corporate conduct.⁵

This product responsibility should also explicitly include responsibility for intermediaries that the banks engage with, including but not limited to financial advisers and mortgage brokers. As the Banking Royal Commission revealed, the financial advice arms of the big banks have collectively stolen over a billion dollars from their customers.⁶ The industry has been plagued by widespread misconduct and theft. It is important that this is explicitly captured in the proposed change. Further, mortgage brokers account for a growing share of arranging residential loans for the banks. The major banks have effectively outsourced many responsibilities for arranging loans to the broking industry. It's essential that they are explicitly captured within the product responsibility of the accountable person.

Holding banks and executives to account for inadequate remediation

Business executives must also be held to account for inappropriate or delayed remediation process. Over the past decade financial institutions have committed widespread misconduct, leaving consumers billions out of pocket.⁷ The banks' remediation processes have been, and continue to be, woefully inadequate. A recent ASIC investigation found it took the major banks 2179 days from the start of a breach occurring to the first payment being made to affected customers.⁸ Banks are more than eager to take people's money but find it significantly more difficult to return people's money when it's stolen. APRA must be proactive in prosecuting accountable persons when banks delay or obfuscate remediation. A failure to do so by the banks is a clear breach of the obligation to conduct business with "honesty and integrity, and with due skill, care and diligence."

Ensuring rigorous enforcement of the BEAR

The BEAR is only effective if it is enforced and executives are held to account. Since the introduction of the BEAR, no banks or executives have yet been prosecuted with APRA's new powers. This is despite widespread and systemic misconduct revealed in the Banking Royal Commission and numerous inquiries.

⁵ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, Final Report, p.8

⁶ 19-051MR ASIC provides update on further reviews into fees-for-no-service failures

⁷ 19-051MR ASIC provides update on further reviews into fees-for-no-service failures

⁸ ASIC Rep 594, 2018, Review of selected financial services groups' compliance with the breach reporting obligation

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CHOICE recommends that APRA increase transparency by publishing clear guidelines indicating when it will use the BEAR powers. APRA should follow ASIC's recent example of providing illustrative case studies to identify when they may use their new product intervention powers. In their consultation paper, ASIC identified,

“case studies of past products or practices to illustrate the circumstances in which ASIC may have contemplated using the product intervention power (had it been available) to discuss consumer detriment identified at the time.”⁹

APRA adopting this approach will have a number of important benefits. First, it will sharpen APRA's thinking around conduct would likely invoke the BEAR powers. Second, it will encourage the regulator to be proactive when similar conduct identified in their research emerges. Third, it will provide a clear signal to the banks that they have to take the BEAR powers seriously.

As a starting case study, APRA should consider the high prevalence of interest-only loans in Australian banks' loan books. Westpac is estimated to have 45% of interest-only loans on their loan book.¹⁰ A high proportion of interest-only loans greatly affects the prudential stability of Australian's financial system. Further many Australians have been inappropriately sold into these riskier loans, placing people into financial hardship when the interest-only period elapses.¹¹

Ensuring the human cost of poor product design is prioritised

CHOICE acknowledges that APRA is asking stakeholders to report the “compliance impact” of this proposal, asking banks to identify any “direct costs to businesses”. It is important to remember this law exists for the betterment of society and not for the benefit of financial institutions. It is imperative that APRA consider the cost of poor or inappropriate product design and management on people. This also does not include the emotional and non-financial costs, such as stress, emotional hardship or time foregone, that people suffer from poor product design or management.

People face very real costs when banks break the law. A failure to adequately square the ledger will reinforce the view that APRA is too accommodative of banks' bottom lines, rather than prioritising the financial wellbeing of Australians.

For further information please contact CHOICE on pveyret@choice.com.au



Yours sincerely,

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⁹ ASIC 2019, 19-157MR - ASIC consults on new product intervention power use

¹⁰ <https://www.afr.com/business/banking-and-finance/westpac-s-grab-for-170b-mortgage-market-share-20190326-p517m3>

¹¹ ASIC 2015, REP445 Review of interest-only home loans