Submission

to the

Finance and Expenditure Committee

on the

Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

13 July 2018

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About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following seventeen registered banks in New Zealand are members of NZBA:

   - ANZ Bank New Zealand Limited*
   - ASB Bank Limited*
   - Bank of China (NZ) Limited
   - Bank of New Zealand*
   - MUFG Bank, Ltd
   - China Construction Bank
   - Citibank, N.A.
   - The Co-operative Bank Limited*
   - Heartland Bank Limited*
   - The Hongkong and Shanghai Banking Corporation Limited*
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited*
   - Rabobank New Zealand Limited*
   - SBS Bank*
   - TSB Bank Limited*
   - Westpac New Zealand Limited*

3. Of those seventeen banks, the eleven marked with an asterisk are involved in the matters addressed in this submission.

Introduction

4. NZBA welcomes the opportunity to make a submission to the Finance and Expenditure Committee (**Committee**) on the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Australian Royal Commission**).

5. We support the Committee's efforts to explore whether the problems faced by the Australian banking industry exist in New Zealand, so that New Zealanders can continue to have confidence in the banking industry.

6. This submission addresses:

   (a) The contribution New Zealand banks make to the economy and the community.

   (b) The Australian Royal Commission's process to date.

(c) The process of the Regulator Review to date.

(d) The significant regulatory, governance, and cultural differences between New Zealand and Australia which mitigate the risk of conduct issues going undetected.

(e) The steps New Zealand banks are currently taking to ensure that public trust and confidence in the industry is maintained.

7. If you would like to discuss any aspect of the submission further, please contact:

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New Zealand banks' contribution to the economy and community

8. New Zealand banks make a significant contribution to the economy, providing credit to businesses, families and community groups throughout the country. Current lending to households is $240b and businesses is $160b (as at December 2017).

9. Our banks spend almost $5b running their businesses in New Zealand, employ more than 25,000 people, and pay around $2b in tax.

10. They are also integrally linked to the community, running a range of community programmes such as financial literacy education and community finance, as well as supporting charitable organisations.

11. In recent years, New Zealand banks have also provided significant support to their customers in times of hardship, for example, during the global financial crisis, the Christchurch earthquake recovery, the Kiwifruit industry PSA outbreak, the dairy downturn, droughts, and the mycoplasma bovis outbreak.

Australian Royal Commission

12. NZBA and the New Zealand banking industry have been concerned by the conduct issues that have arisen in Australia over recent years, and that have resurfaced through the Australian Royal Commission. We understand the desire from regulators and politicians to provide an assurance that these issues do not exist in New Zealand.

13. While the findings of the Australian Royal Commission are still some time away, the Australian banking industry has admitted it will need to win back the trust of customers and the public. That trust will take some time to recover and economic confidence may be negatively affected.

14. New Zealand's banking industry has enjoyed high levels of public trust for many years. That is because the market is highly competitive, products are fewer and simpler, and bank staff are better connected to the communities in which they work. Our banks work hard to retain that trust.

15. Additionally, there are a number of significant regulatory, governance, and cultural differences between New Zealand and Australia which mitigate the risk of similarly pervasive and systemic conduct issues going unnoticed here. (Those differences are set our below at paragraphs 26-44).

16. NZBA recognises, however, that New Zealand banks must continue to proactively monitor international trends. In particular, banks must ensure any mistakes observed internationally aren't repeated in New Zealand. We consider that the New Zealand financial services industry is advanced in its approach to conduct and culture. However, the industry is constantly evolving and our banks are committed to being responsive to the lessons coming out of other jurisdictions, keeping processes and practices under review, and being sensitive to customer concerns.

17. The banking industry's conduct and prudential regulators – the Financial Markets Authority (**FMA**) and the Reserve Bank of New Zealand (**RBNZ**) (together, **Regulators**) – are watching the Australian Royal Commission closely. They have initiated a review of the New Zealand banking and insurance industries to assess whether the recent conduct issues which have been revisited by the Australian Royal Commission are present here (**Regulator Review**). (The Regulator Review is discussed in further detail below at paragraphs 19-25.)

18. NZBA supports this response. While there has not been any evidence of systemic misconduct issues in the New Zealand banking industry, it is important that a process is undertaken to confirm that. The Regulators are the right group to do that – they have the relevant technical skills and industry knowledge.

Regulator review

19. On 30 April 2018 the NZBA Council met with the Regulators to discuss issues arising from the Australian Royal Commission.

20. On 1 May 2018 NZBA, on behalf of its members, wrote to the Regulators setting out the regulatory differences between New Zealand and Australia, and proposing a series of industry initiatives aimed at maintaining public trust in the industry. The industry's progress against those initiatives is set out below at paragraphs 45-63.

21. On 4 May 2018 the Regulators sent an information request to the chief executives of ten retail banks in New Zealand. The purpose of that information request was for the Regulators to understand how banks look to assure themselves that misconduct of the type taking place in Australia is not also happening in New Zealand. The deadline for written responses was 18 May 2018.

22. Ten banks responded by the deadline, with an additional bank volunteering to respond to the information request also. Those banks are varied and include domestic banks with head offices in provincial New Zealand, and subsidiaries of global banking groups with parent bodies in Australia, Hong Kong, and Europe.

23. On 30 May 2018 the Regulators appeared in front of the Finance and Expenditure Committee and reported: "In our monitoring work to date we have not seen evidence of widespread, systemic issues to warrant a commission of inquiry in New Zealand."

24. The Regulators are continuing to work through the responses with the banks and will likely issue a report in October.

25. For completeness, we note that the FMA has issued a confidentiality order to the banks involved in the Regulator Review. NZBA is unable to comment specifically on

bank responses to the Regulators, however, we are able to comment from a whole of industry perspective.

Differences between New Zealand and Australia

Regulatory differences

Consumer-focused financial regulation

26. In the last seven years New Zealand has undertaken a significant overhaul of its financial services regulation, primarily in response to the global financial crisis and the collapse of a number of finance companies. In particular, the finance company collapse was a wake-up call for Parliament, regulators, and the wider industry. Those events have resulted in, among other things, the Financial Advisers Act 2008, the establishment of the FMA under the Financial Markets Authority Act 2011, the Financial Markets Conduct Act 2013, and the changes to the Credit Contracts and Consumer Finance Act 2003 (including the strengthening of responsible lending obligations). These changes have a consumer focus.

27. Australia did not suffer from significant finance company failures in the wake of the global financial crisis and, as such, was not driven to undertake a similar overhaul of its legislation.

28. New Zealand legislation has been regularly reviewed (and is currently under review by way of the Financial Services Legislation Amendment Bill and the Ministry of Business, Innovation and Employment's (**MBIE**) discussion paper: *Review of Consumer Credit Regulation*) to ensure it remains fit for purpose and focused on the right customer outcomes.

29. In most cases the House and select committees took a bipartisan approach and such legislation passed with near-unanimous support. The willingness to act, and comparative efficiency of the New Zealand Parliamentary system, has ensured regulation keeps pace with market dynamics and best practice. This sets us apart from the more cumbersome and recently adversarial political scene in Australia.

Proactive agenda of regulators

30. The New Zealand regulatory framework enables regulators to act dynamically and quickly before, or shortly after, issues become apparent, compared to the slower, less agile pace witnessed in Australia. Regulators have made the best use of that framework in recent years, taking a proactive and engaged approach when necessary.

31. The FMA's guidance on KiwiSaver practices is a good example of this, as is its review into sales incentives in vertically integrated firms.

32. We have also seen an example of that foresight and adaptability in RBNZ's use of loan-to-value ratio lending restrictions, which proved effective in managing the escalating housing market and the associated economic risk.

33. There are other instances of proactive reviews we consider well aligned to global best practice.

Governance differences

34. All foreign owned New Zealand banks (including Australian-owned New Zealand banks) are governed by local legislation. The independent management teams and boards of those banks are expressly required, as a condition of registration, to act in the best interests of the local bank. The conditions of registration require directors to attest that their banks are compliant with RBNZ's regulatory requirements. This is a duty that directors take very seriously.

Cultural differences

Banking culture

35. The culture of New Zealand's banking industry is driven first and foremost by the New Zealanders who work in them and the customers who bank with them.

36. It is also driven by the New Zealand-owned banks. For example, Kiwibank has made a significant difference to the New Zealand banking industry, particularly in the years since it was categorised as systemic (in 2013). Other domestically owned and incorporated banks such as TSB and the Co-operative Bank feature highly in customer service surveys across the industry.

37. While four of our banks are Australian-owned, they are all long-established New Zealand companies and trace their roots to the early development of the country. Because of that, they have banking cultures quite separate and distinct from their owners and there is a strong sense of independence.

38. Additionally, the New Zealand banking industry tends to have a different banking culture to Australia more broadly. This is due to a range of factors, including a less diverse and complex range of products and services, a more conservative approach to doing business and significantly smaller sized banks.

Superannuation

39. Issues relating to financial advice and third parties have attracted considerable attention from the Australian Royal Commission.

40. The compulsory superannuation scheme in Australia has been in existence since the early 1990s. It is an extremely large industry managing trillions of dollars. This means that almost every Australian needs to access some sort of financial advice, which has resulted in a whole industry of advisers that doesn't exist in New Zealand. There are also aspects of the superannuation industry that add complexity to both the product and advice required; for example, self-managed super funds or schemes with deferred benefits. That makes regulation and enforcement difficult.

41. In contrast, New Zealand's KiwiSaver scheme is much younger and less complex than Australia's scheme. KiwiSaver has been successful because the Government of the day made a deliberate decision to have the bigger banks (with their branch distribution networks) as default providers. The scheme has grown and evolved alongside the modernisation of the regulatory system. The FMA has also had a strong and effective focus on KiwiSaver, ensuring the growing financial advice industry is well-regulated.

42. This area is being looked at as part of the Financial Services Legislation Amendment Bill currently before Parliament and relevant lessons from Australia could still be incorporated into it.

Size

43. New Zealand is a smaller country than Australia and our communities are well connected. As a result, any customer concerns are more visible and become obvious more quickly.

44. Accordingly, we believed that if there were widespread or systemic issues relating to the poor treatment of customers then NZBA, the Regulators, the Banking Ombudsman and Parliament would know about it.

Steps currently being taken by banks to maintain confidence

45. In NZBA's letter to the Regulators dated 1 May 2018, the industry committed to several initiatives in order to maintain public trust in, and support for, the industry. They are summarised below, along with an update on progress.

Consider how to adopt the findings of the Australian Retail Banking Remuneration Review (**Sedgwick Review**) where appropriate

46. The April 2017 Sedgwick Review made a series of recommendations regarding conduct and incentives. Taken as a whole, the review requires a broad review of the approach to incentives and performance management. The Sedgwick Review advocates for a focus on customer experience, and incentive schemes with no direct links to sales targets.

47. While some of the recommendations may not apply in New Zealand, or may be unable to be adopted due to local legislative requirements, the industry is committed to adopting the rest of those recommendations, as appropriate for each bank.

Progress

48. In Australia, banks were given until 2020 to implement the Sedgwick Review's recommendations.

49. All New Zealand banks have chosen to voluntarily implement the recommendations as appropriate and are mostly well ahead of that deadline. Each of the New Zealand banks is at a different stage of implementation.

50. All New Zealand banks have, or are moving to, a 'balanced scorecard' approach where staff are incentivised across a variety of outputs, including customer feedback, product knowledge and values and behaviour.

51. This change in approach is significant and will take frontline leaders in some banks some time to adapt. Our banks are committed to this cultural change because they believe that what is in the interests of their staff and customers is also good for long term sustainability.

Consider adopting an industry-wide whistleblowers' standard

52. One of the most effective ways of tackling misconduct is by ensuring there are clear processes and safeguards for employees to raise issues safely.

53. All New Zealand banks have whistleblower processes in place. But to ensure they are appropriate NZBA is committed to reviewing them and, if appropriate, developing an industry standard.

Progress

54. NZBA is consulting with an expert from Victoria University of Wellington on the best way to implement and standardise these processes.

Create a bad conduct register

55. The industry initially proposed to work with FMA and MBIE to enable more effective reporting of individual employee conduct that falls below standards. The focus of this work has changed due to administrative and privacy issues. It is now proposed to follow the UK approach of requiring new employers to obtain written references from the candidate's previous employers (dating back six years).

Progress

56. On 22 May 2018 NZBA provided a supplemental submission on the Financial Services Legislation Amendment Bill for the Economic Development, Science and Innovation Committee to consider.

Promotion of NZBA's revised Code of Banking Practice

57. NZBA has recently published a revised edition of the Code of Banking Practice (**Code**), which has been in force since 1992. In the latest edition we have taken a high-level principles-based approach that is intended to make banks' existing customer commitments more accessible and easy to understand. We undertook an extensive consultation process on the fresh approach to the Code.

Progress

58. On 1 June NZBA launched its revised Code. It was approved by the Banking Ombudsman and supported by Consumer NZ and Internet NZ.

Industry funding for regulators

59. The industry is supportive of regulators having appropriate resources to undertake their supervisory functions effectively.

Progress

60. The industry is open to discussion with the Government on this point.

Provide information on internal dispute resolutions to Banking Ombudsman

61. The Banking Ombudsman scheme has been in existence for 26 years and is considered world leading. It is similar to other industry complaints systems – customers and providers try to resolve disputes between themselves first, and as a last resort the complaint goes to an adjudicator; the Banking Ombudsman in this case.

62. New Zealand banks have rigorous processes for both reporting and resolving complaints as quickly and efficiently as possible. We note the Banking Ombudsman finds in favour of the customer in around 10% of cases, which suggests banks are managing customer concerns successfully.

63. The industry has agreed to provide the Ombudsman with further information on individual customer complaints it receives.

Progress

64. Banks have provided the relevant information to the Ombudsman.

Competition and innovation

65. The best way to ensure New Zealanders get the best value and service from their banks is to promote competition and innovation, at both industry and government levels.

66. The landscape for banking is set to change significantly in coming years through digitisation and changes to marketplace entry. This provides real opportunities for broadening competition and customer choice.

67. Open banking is the most concrete example of this. It has the capability to spur innovation and business creation in the fintech industry. The banking industry is supportive of change in this area and is looking to learn from the work underway in other countries. Payments NZ (the body that governs New Zealand's core payment systems) is developing an API framework that will underpin open banking in New Zealand. Banks are keen to work with participants across the financial services industry to develop common standards.

68. It is important that regulators and legislators consider the impact and appropriateness of legal and regulatory changes on smaller banks to maintain their competitiveness and ability to provide alternative and diverse services to New Zealanders.

69. New Zealand has a thriving domestic bank industry. It is important to note that this part of the sector is quite different from the major banks. Its smaller size means smaller teams, less complex structures and a less diverse range of product sets. Regulatory burden can have a bigger impact on its resources and we note that prescriptive standardised approach to regulation (as opposed to an outcomes focused approach) will disproportionately impact this part of the sector.

Conclusion

70. The New Zealand banking industry works hard to maintain the trust and confidence of all New Zealanders. The trust that customers place in the banks with their hard-earned money is taken extremely seriously.

71. Banks recognise that trust must be maintained and cannot be taken for granted. They understand that to keep that trust, it is not enough to merely comply with the letter of the law and regulations. Banks must live up to and, where possible, exceed the expectations of the community.

72. As shown in Australia, trust can be lost easily. The New Zealand banking industry is determined not to make the same mistakes and will continue to work with regulators, Parliament and the public to maintain the standards expected.