

Recommendations

Dual-network debit cards and tap-and-go payments

Recommendation 1

- 2.1 **The committee recommends that banks be required to give merchants the ability to send tap-and-go payments from dual-network debit cards through the channel of their choice.**

Merchants should be able to choose whether to route these transactions through eftpos or another channel, noting that consumers may override this merchant preference if they choose to do so.

If the banks have not facilitated this recommendation by 1 April 2018, the Payments System Board should take regulatory action to require this to occur.

Background

- 2.2 Dual-network debit cards are debit cards that allow payments to be processed through either of two networks in one physical card. In Australia, dual-network debit cards can route payment transactions through either the eftpos network, or via the networks of MasterCard or Visa – the international schemes. Dual-network debit cards can be identified as typically having logos of both schemes; often one network on the front of the card and an alternate network on the back.¹

¹ Reserve Bank of Australia (RBA), *Dual-Network Cards and Mobile Wallet Technology, Consultation Paper: December 2016*, p. 3.

- 2.3 As of mid-2015, around 63 per cent of debit cards issued in Australia were dual-network, with the remainder being solely eftpos cards.²
- 2.4 While debit transactions processed by eftpos and the international schemes achieve the same outcome for the cardholder, the networks have substantially different costs for merchants, with the international schemes typically charging more than eftpos.
- 2.5 As of September 2017, the average total merchant fee for a debit transaction was 0.26 per cent with eftpos, and 0.58 per cent with the international schemes.³
- 2.6 With contact payments, also known as 'dip and PIN', the cardholder can choose which network processes their debit transaction. The cardholder does this by selecting SAV/CHQ for eftpos or CR for the international schemes.
- 2.7 However, with tap-and-go payments, also known as contactless payments, neither merchants nor cardholders are given this choice. Instead, the programming of dual-network debit cards is set such that the transaction is automatically processed through the international schemes rather than eftpos.
- 2.8 Tap-and-go technology was pioneered by the international schemes and, as a result, banks originally were only able to offer tap-and-go debit transactions through the international schemes. However, as eftpos now offers tap-and-go payments,⁴ banks have the ability to program terminals to route tap-and-go payments through the eftpos or international schemes.
- 2.9 At present, banks do not allow merchants to choose the route through which tap-and-go payments are processed.
- 2.10 It is likely that banks deny merchants this choice for commercial reasons.
- 2.11 As card issuers, the major banks receive higher interchange fees from international scheme debit transactions than from eftpos transactions. Interchange fees are fees paid by the merchant's bank to the cardholder's bank. These fees are set by the payment networks and are used as a way to encourage banks to issue their cards.
- 2.12 While the Reserve Bank of Australia (RBA) sets benchmarks for the average interchange fee that can be charged for debit card transactions, there is significant scope for payment networks to set fees below the benchmark.

2 RBA, *Dual-Network Cards and Mobile Wallet Technology, Consultation Paper: December 2016*, p. 3.

3 RBA, *Average Merchant Fees for Debit, Credit and Charge Cards – C3*, <<http://rba.gov.au/statistics/tables/xls/c03hist.xls>>, viewed 14 November 2017.

4 Eftpos Australia, *eftpos Tap & Pay™*, <<https://www.eftposaustralia.com.au/products/eftpos-tap-pay/>>, viewed 14 November 2017.

- 2.13 Traditionally, eftpos has set interchange fees significantly below the benchmark while the international schemes have set interchange fees near the benchmark. As highlighted by the RBA in March 2015, this interchange fee differential has indeed made issuance of international scheme debit cards more attractive for banks:

In the debit card market, there has been a steady fall in the market share of the domestic eftpos system and a rise in the share of the MasterCard and Visa schemes. While eftpos has long been priced more favourably for merchants, interchange fee differentials have made issuance of international scheme cards more attractive for banks and other financial institutions.⁵

- 2.14 It has been estimated that processing tap-and-go transactions through the international schemes costs merchants an additional \$290 million annually.⁶
- 2.15 These additional costs significantly increase the expenses of businesses, leading to higher prices for consumers.

Discussion

- 2.16 The ANZ Chief Executive, Mr Shane Elliot, was alone amongst the witnesses in agreeing that merchants should be able to choose the lowest cost channel through which to process tap-and-go payments:

...until now there really hasn't been a choice. I think Brian [Hartzer] made the point: if you insert the card, you get to choose, but with contactless [tap-and-go], you don't, so it's defaulted to Visa. It's the machine that sits on the shop counter that makes the decision.

What we're doing now is saying: if those merchants want to default it somewhere else then we will do that for them. If that's our customer, we're happy to do that...at ANZ we've had one merchant who has come to us to ask us, 'Could you please switch the default?' We will do it. We'll work with them.⁷

- 2.17 All banks should be following the example set by ANZ to give merchants a choice in how to route tap-and-go payments made by dual-network debit cards.
- 2.18 CBA declined to give an assurance that it will give merchants the ability to route tap-and-go payments through the lowest cost option, and instead

5 RBA, *Review of Card Payments Regulation, Issues Paper: March 2015*, p. 16.

6 The Australian Retailers Association, 'ARA supportive of ANZ dual network routings', *Media release*, 19 October 2017.

7 Mr Shane Elliot, CEO, ANZ, *Transcript*, 11 October 2017, p. 44.

indicated that it would look into the matter from a consumer and technological perspective. CBA added that if routing transactions through the merchant's preferred payment network was found to be 'the best thing to do' then it would provide this service.⁸

2.19 Similarly, NAB indicated that while it would be working with merchants, it would not give an 'absolute commitment' to rerouting payments 'through different rails on the spot without knowing all the consequences of that decision.'⁹

2.20 Westpac was less willing to look at the issue, stating:

It's [routing transactions through the lower cost route, unless the cardholder expresses otherwise] more complicated than that. We don't know which card the customer wants to use and which account the customer wants to use. I think it's important to say that merchants get benefits out of the fact that Visa and MasterCard are there and provide this technology.¹⁰

2.21 When it was raised that customers do not have the ability to choose which network processes their tap-and-go debit transaction, some of the banks argued that customers choose by selecting a particular card. Westpac commented that 'today the customer chooses, depending on which card they pull out of their wallet.'¹¹ The committee disagrees with this assertion.

2.22 As tap-and-go payments are effortless and expedient, the cardholder is making this decision out of convenience, not as an active decision to route their payment through the international scheme.

2.23 While card schemes can compete on non-price value, eftpos has provided similar chargeback rights to the international schemes since November 2015. Generally, loyalty rewards are not offered by the international schemes for transactions on debit cards.

Conclusion

2.24 The committee is concerned by the increase in transaction costs merchants now face as a result of the shift to tap-and-go payments. These costs are ultimately borne by customers.

8 Mr Ian Narev, CEO, CBA, *Transcript*, 20 October 2017, p. 77.

9 Mr Andrew Thorburn, CEO, NAB *Transcript*, 20 October 2017, p. 10.

10 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 11.

11 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 27.

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- 2.25 The committee rejects the implausible contention of Westpac Chief Executive Mr Brian Hartzler that, by using a dual network card, the consumer has chosen to use the international scheme, rather than eftpos.
- 2.26 The committee acknowledges ANZ's commitment to offer least-cost routing to merchants, and recommends that the other banks give merchants the ability to send tap-and-go payments from dual-network debit cards through the lowest cost channel.
- 2.27 If the banks have not implemented these recommendations by 1 April 2018 the Payment System Board should introduce standards requiring banks to allow merchants to choose which channel through which to route a tap-and-go payment.
- 2.28 Consumers should retain the right to override the merchant's choice of channel.
- 2.29 Consumers should be made aware of the manner in which each tap-and-go payment is processed. If the default method is eftpos, the consumer can override that default by selecting the international scheme at the point of sale.

Repricing of interest-only mortgages

Recommendation 2

2.30 **The committee recommends that the Australian Competition and Consumer Commission, as a part of its inquiry into residential mortgage products, analyse the repricing of interest-only mortgages that occurred in June 2017.**

Background

2.31 On 31 March 2017, the Australian Prudential Regulation Authority (APRA) announced a 30 per cent limit on the share of new mortgages which could have interest-only repayment. This means that of 100 new mortgages, a maximum of 30 could have an interest-only repayment schedule. This built on measures announced by APRA in December 2014.

2.32 Interest-only mortgages are typically considered to be more risky than principle-and-interest mortgages because:

- customers are not required to make principle repayments during the interest-only period; and
- repayments increase at the end of the interest-only period when consumers start paying principle as well as interest.

2.33 Given risks stemming from high house prices, rising household indebtedness and low interest rates, APRA considered it prudent for banks to shift away from interest-only mortgages and towards principle-and-interest mortgages.

2.34 At the time of announcement, mortgages with interest-only terms represented around 40 per cent of mortgage lending.¹²

2.35 Following the March 2017 announcement by APRA, the major banks announced rates increases on interest-only mortgages of 30 basis points (bps) or more. At the same time, they either left rates unchanged or decreased rates on principle-and-interest mortgages (Table 2.1).¹³

12 APRA, 'APRA announces further measures to reinforce sound residential mortgage lending practices', *Media release*, 31 March 2017.

13 Several mid-tier banks also increased rates on interest-only loans over this period.

Table 2.1 June 2017 repricing of standard variable rate mortgages

	Owner-occupier interest-only	Investor interest-only	Owner-occupier Principal and interest	Investor Principal and interest
ANZ	+30 bps	+30 bps	-5 bps	-5 bps
CBA	+30 bps	+30 bps	-3 bps	no change
NAB	+35 bps	+35 bps	-8 bps	no change
WBC	+34 bps	+34 bps	-8 bps	no change

Source: Bank media releases¹⁴

2.36 The major banks' media releases that accompanied the price changes stated that the changes were required to meet the new regulatory requirement, including:

- CBA's media release on 27 June 2017 that stated: 'To meet our regulatory requirements, variable interest only home loan rates for owner-occupiers and investors will increase by 30 basis points.'¹⁵
- Westpac's media release on 20 June 2017, which stated:
APRA's limit on new interest only lending is 30% of new residential mortgage lending, so we have to continue to make changes to our interest only rates and lending policies to meet this benchmark.¹⁶

2.37 While the media releases indicate that the rate increases were primarily, or exclusively, due to APRA's regulatory requirements, the banks stated under scrutiny that other factors contributed to the decision. In particular, banks acknowledged that the increased interest rates would improve their profitability.

2.38 A key reason for such an improvement is that the major banks increased rates on both new and existing interest-only loans in June 2017. This is despite APRA's interest-only measure only targeting new lending.

2.39 As of 6 October 2017, analysts at CLSA estimated that the banks' net interest margins increased by up to 12 bps (Figure 2.1) following the rate increases announced in June and March.¹⁷

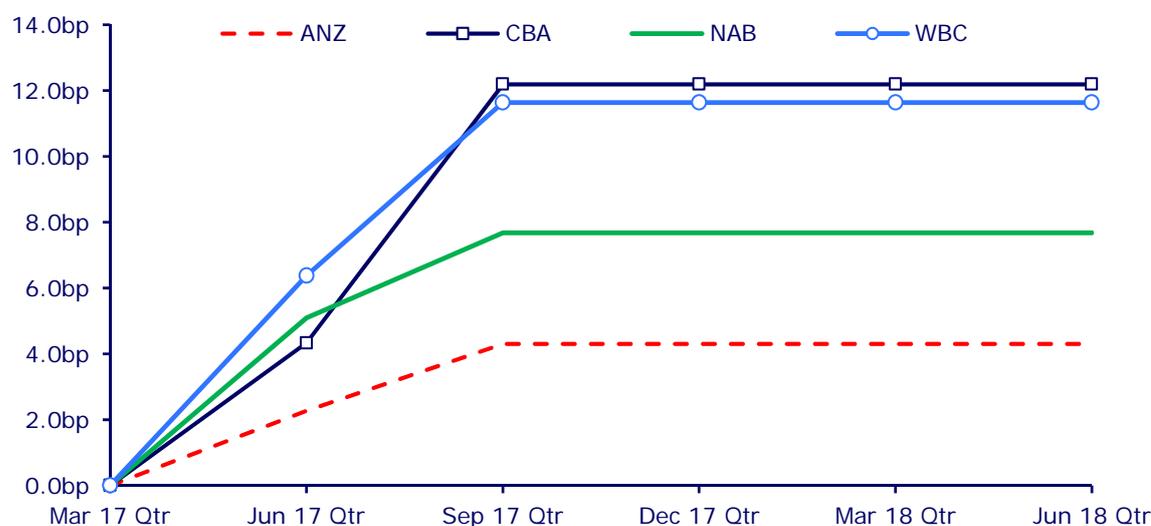
14 ANZ, 'Update on ANZ interest rates', *Media release*, 9 June 2017; CBA, 'CBA changes home loan interest rates', *Media release*, 27 June 2017; NAB, 'NAB announces changes to variable home loan rates', *Media release*, 23 June 2017; and Westpac, 'Westpac adjust home loan interest rates', *Media release*, 20 June 2017.

15 CBA 'Commonwealth Bank changes home loan interest rates', *Media release*, 27 June 2017.

16 Westpac, 'Westpac adjusts home loan interest rates', *Media release*, 20 June 2017.

17 CLSA, Australian Banks Sector Outlook, *Housing Repricing Impacts*, 6 October 2017, p 5.

Figure 2.1 Housing repricing impact on net interest margins



Source: CLSA

2.40 The improvement in net interest margins is forecast to be so beneficial for Westpac that several analysts upgraded their outlook following the price announcements in June 2017:

- Upgrade to outperform ... So far WBC appears to be the key beneficiary of the industry's successful mortgage repricing (WBC putting through larger mortgage rate increases in relation to a relatively large portion of their portfolio).¹⁸
- Upgrade to overweight ... In our view, WBC is a bigger beneficiary than its major bank peers of the accelerating trend towards differentiated repricing.¹⁹

2.41 While the reaction does not appear to have been as strong for other banks, analysts still suggest the changes will improve profitability. Macquarie suggested that 'the timing of recent mortgage repricing provides a material tailwind to CBA in FY18' and estimated approximately \$500 million revenue uplift.²⁰ Morgan Stanley forecast that:

In the near term, re-pricing supports [NAB] group margins, which we forecast to expand to 1.85% in 2H17 and 1.89% in 1H18 from 1.82% in 1H17.²¹

18 Credit Suisse, *Westpac: "Winners and Losers" pricing is a winner*, Analyst report, 22 June 2017, p. 1.

19 Morgan Stanley, *Westpac: Upgrade to Overweight*, Analyst report, 19 July 2017, p. 1.

20 Macquarie, *Commonwealth Bank: Down But Not Out*, Analyst report, 12 September 2017, p. 1.

21 Morgan Stanley, *National Australia Bank: Beyond the Turnaround*, Analyst report, 10 September 2017, p. 1.

- 2.42 While banks are commercial entities that will seek to drive financial results, it is critical that their public statements about interest rate movements are accurate and not misleading or deceptive.

Discussion

- 2.43 During the hearings, the banks claimed that APRA's regulatory requirement was a key reason for the changes in interest rates announced in June 2017. CBA stated:

...we made the change in order to meet our regulatory requirements is a correct statement – that was the motivation and absent that change in regulatory requirements the change in pricing would not have been made.²²

- 2.44 However, the banks indicated that the changes were also aimed at moving existing customers towards paying principal and interest. Westpac outlined its dual objectives as:

...one was to meet the APRA requirement, and the other was to reshape the mortgage portfolio to have less interest-only, which required some back book switching.²³

- 2.45 Similarly, NAB stated its 'focus was absolutely on meeting the 30 per cent of flow' APRA requirements. However, it also 'took the opportunity to reposition the back book to encourage our customers to switch from interest-only to P&I.'²⁴

- 2.46 The banks suggested that it was prudent to encourage existing customers to repay principal in addition to reducing the flow of new interest-only customers. Indeed, some highlighted that they had made some adjustments to orientate customers towards paying principal before APRA's requirement was announced on 31 March. For example, ANZ stated:

We started changing our approach in terms of lending standards, policies and pricing well before APRA put in place that speed limit. In fact, our first changes around interest-only loans started in April 2016.²⁵

- 2.47 Noting the Australian Competition and Consumer Commission's (ACCC) mortgage price inquiry, the banks were asked whether the ACCC would

22 Mr Ian Narev, CEO, CBA, *Transcript*, 20 October 2017, p. 48.

23 Mr Peter King, CFO, Westpac, *Transcript*, 11 October 2017, p. 9.

24 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 7.

25 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 42.

find that the public statements were entirely consistent with their internal analysis. The banks stated they will. Westpac stated:

The statements are accurate and they will be seen to be accurate, but they do reflect judgement. It's not a mathematical formula; it was a judgement that we made.²⁶

2.48 Westpac claimed that while it considers 'commercial issues', it stressed that the 'primary driver' for its rate increases was to 'meet the APRA requirements while preserving choice for customers.'²⁷

2.49 Similarly, NAB argued that the focus of increasing its interest rates was on meeting the APRA requirements. NAB stated:

We undertook a lot of scenario modelling to understand how this may play out financially, but our core focus was in response to the requirement from the regulator.²⁸

2.50 Further, the banks suggested that the ultimate impact on profitability was difficult to forecast because it was hard to predict switching. Westpac stated:

...we made a forecast, but the truth is that whereas often our forecasting is pretty accurate, in this case, we found and continue to find it very hard to know what the net effect is going to be, because we don't know what the switching is going to be.²⁹

2.51 Within this context, the banks were asked whether they had modelled the financial consequences of the decision. The banks indicated that they had undertaken extensive financial analysis, with the primary focus being the likely response from customers under a range of price differentials. For example, NAB stated:

...we undertook modelling to try to understand where our competitors may move and what we would need to do to ensure that we met the 30 per cent.³⁰

2.52 The banks noted that they also examined the financial impact of a range of scenarios. Westpac stated:

We made estimates as to how big of a differential we would need to change in the different rates in order to achieve the regulatory outcome that we were striving to achieve, which was the primary

26 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 9.

27 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 6.

28 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 6.

29 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 9.

30 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 7.

driver. Then, yes, of course, we update our forecasts, financially, as a result of those changes – not the other way around.³¹

2.53 After repeated scrutiny during the public hearings, NAB acknowledged that under its best estimate, the price changes would likely lead to an uplift in revenue, stating:

...we've done some assumptions; we've done our best prediction; the next day it'll change; but the best estimate would've been positive.³²

2.54 While it is accepted there may have been a range of factors that led to the banks increasing the interest rates of interest-only loans, there is significant concern that the public statements made by the banks may have led customers into believing that the interest rate increases were solely due to regulatory requirements.

Conclusion

2.55 The ACCC is currently conducting an inquiry into residential mortgage products. This inquiry was established to monitor price decisions following the introduction of the Major Bank Levy.

2.56 As a part of this inquiry, the ACCC can compel the banks affected by the Major Bank Levy to explain any changes to interest rates in relation to residential mortgage products. The inquiry relates to prices charged until 30 June 2018.

2.57 The committee recommends that the ACCC analyse the banks' internal documents to assess whether or not they are consistent with their statements in their June 2017 media releases and subsequent public commentary.

2.58 In particular, the ACCC should analyse the banks' decisions to increase interest rates on existing borrowers despite APRA's measure only targeting new borrowers.

2.59 Further, the ACCC should consider whether the banks' public statements adequately distinguish between new and existing borrowers. The ACCC should consider whether the media statements suggest rates on existing interest-only mortgages rose as a direct consequence of APRA's regulatory requirement.

2.60 It will be important that the ACCC conducts granular analysis of the financial modelling of the banks. The ACCC will need to understand the

31 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 9.

32 Mr Andrew Thorburn, CEO, NAB *Transcript*, 20 October 2017, p. 23.

true financial impact on the banks of APRA's regulatory changes, and assess that impact against the public statements of the banks.

- 2.61 The committee welcomes recent confirmation from the ACCC that it will analyse the June 2017 announcements,³³ and looks forward to the outcomes of the ACCC's investigation on this matter.

33 Article: Richard Gluyas, 'Hints for ACCC as David Coleman Follows the Money', *The Australian*, 12 October 2017.

Comprehensive Credit Reporting

Recommendation 3

- 2.62 **The committee recommends that the Government introduce legislation to mandate participation in Comprehensive Credit Reporting as soon as practicable.**

Background

- 2.63 In March 2014, the *Privacy Act 1988* was amended to enable a more complete view of a person's credit history to be included in a credit report, known as Comprehensive Credit Reporting (CCR).³⁴
- 2.64 Before CCR, a person's credit report only provided limited information about the credit history. This mostly included negative information about that credit history, such as overdue debts, bankruptcy or court judgements.
- 2.65 CCR also allows for the positive characteristics of a consumer's credit history to be reported in full. For instance, a customer who has always paid their credit card account and mortgage on time will have this reflected in their CCR report. This positive history will be beneficial for that customer when financial services providers assess the terms on which to offer them financial service products.
- 2.66 With the introduction of CCR, credit reports can include more information about the credit products a person has, and how they have managed their credit. This includes information about the number of accounts a customer has opened, credit limits on those accounts, and details of monthly payments.
- 2.67 The CCR system gives financial institutions access to a deeper, richer set of data, encouraging competition for small businesses and retail customers with positive credit histories. In addition, the CCR system allows financial institutions to better serve customers, and assess their borrowing capacity.
- 2.68 As noted by the Financial System Inquiry (FSI), the net benefit of CCR increases as the regime covers more customers. However, the major banks have little incentive to participate because the cost of sharing their data

34 Office of the Australian Information Commissioner, *Credit Reporting*, <<https://www.oaic.gov.au/privacy-law/privacy-act/credit-reporting>>, viewed 14 November 2017.

with competitors is likely to be greater than the benefit of gaining access to their competitors' data. As the owners of most of the key data, the banks have limited commercial incentive to share this information with smaller financial services companies.

- 2.69 Due to this situation, in December 2014 the FSI recommended the Government mandate participation in the CCR regime if voluntary uptake remained inadequate.
- 2.70 Following the FSI's recommendation, in May 2017, the Productivity Commission recommended that the Government adopt a minimum target for voluntary participation in CCR of 40 per cent.
- 2.71 The Productivity Commission recommended that if the target was not met by 30 June 2017, the Government should circulate draft legislation by 31 December 2017 to impose mandatory participation in CCR.
- 2.72 In response, on 9 May 2017, the Government announced it would legislate for a mandatory CCR regime if credit providers were not reporting at least 40 per cent of their data by the end of 2017.
- 2.73 Despite this, as at June 2017 the volume of CCR data being reported in public mode, meaning it is accessible by other credit providers, remains small.³⁵
- 2.74 On 9 October 2017, NAB announced it will implement CCR and publicly report data from February 2018.³⁶ NAB intends to phase in its implementation of different credit products, commencing with personal loans, credit cards and overdrafts. On 9 October 2017, CBA also committed to participate in 2018.³⁷
- 2.75 On 2 November 2017, the Treasurer announced that the Government will legislate for a mandatory CCR regime to come into effect by 1 July 2018.³⁸

Discussion

- 2.76 During public hearings, the banks committed to participating in the CCR in 2018:
- [Westpac] it is our intent to join that regime and for it to probably be live mid next year³⁹

35 Australian Retail Credit Association, *ARCA Credit Data Fact Base, Volume 2*, June 2017.

36 NAB, 'NAB announces start to Comprehensive Credit Reporting', *Media release*, 9 October 2017.

37 CBA, 'CBA confirms support for Comprehensive Credit Reporting (CCR)', *Media release*, 9 October 2017.

38 The Treasurer, The Hon. Scott Morrison MP, 'Mandating comprehensive credit reporting', *Media Release*, 2 November 2017.

39 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 35.

- [ANZ] we will start sharing comprehensive credit data next year⁴⁰
 - [NAB] we go live in February⁴¹
 - [CBA] we'll be participating fully in the comprehensive credit reporting regime in 2018.⁴²
- 2.77 The banks were questioned on whether they would follow through on this, noting that they have previously made similar statements, and the timelines for delivery had often been revised. For example, in response to the FSI's Interim Report, on 29 August 2014 ANZ stated:
- Comprehensive credit reporting (CCR) is a major improvement to the availability of information and will provide significant benefits to financial institutions, consumers, and small businesses over time. ANZ is implementing CCR systems and would expect the market will inevitably move towards the inclusion of SME lending in CCR.⁴³
- 2.78 Then in response to the FSI's Final Report, on 31 March 2015 ANZ stated:
- ANZ is making major investments in the CCR capabilities and anticipates it will be able to 'use' or 'provide' CCR data by 2016-17.⁴⁴
- 2.79 Again, in response to the Productivity Commission's Issues Paper on Data Availability and Use, on 29 July 2016 ANZ stated:
- As noted in our submission to the Financial System Inquiry, ANZ supports CCR and is making a significant investment in its reporting capabilities. We expect to be providing and receiving CCR data in 2017-18.⁴⁵
- 2.80 Finally, in response to the Productivity Commission's Draft Report on Data Availability and Use, on 12 December 2016 ANZ stated:
- We have few concerns with the Commission's recommendation [to mandate participation if voluntary uptake remains below 40 per cent] on comprehensive credit reporting.⁴⁶

40 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 39.

41 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 24.

42 Mr Ian Narev, CEO, ANZ, *Transcript*, 20 October 2017, p. 40.

43 ANZ, *Response to the Interim Report of the Financial System Inquiry*, 26 August 2014, p. 15.

44 ANZ, *Response to the Final Report of the Financial System Inquiry*, 31 March 2015, p. 11.

45 ANZ, *Submission to the Productivity Commission: Issues Paper: Data Availability and Use*, 29 July 2016, p. 8.

46 ANZ, *Submission to the Productivity Commission: Data Availability and Use Draft Report*, 12 December 2016, p. [7].

2.81 In response to this line of questioning, the banks argued that the project was complex. They further argued that they wanted to ensure that their customers' data would be secure before proceeding. The banks stated:

- We've been in private mode for the last two years, sharing data with all three of the credit bodies. We've actually been in testing to understand: does all the information flow move correctly? There are still a number of questions outstanding at this point in time.⁴⁷
- The real issues and limiting factors are that there is a lot of process to change and there is a technology investment required.⁴⁸
- The second point has been more of a policy point, which is about protection of customers' data and protection from fraud...The reality of the digital world that we live in and the very real fraud risks and cyber-risks that are out there mean that we need to be careful about this, and it can go very wrong very quickly.⁴⁹

2.82 When scrutinised about the significant lapse of time, Westpac admitted that other projects had been prioritised over CCR and that this had resulted in its delivery being delayed:

The reality is we've had an enormous number of requests to us for data and improvements in technology and systems that, quite frankly, have been prioritised higher than this.⁵⁰

2.83 The banks rejected the committee's assertion that they had not participated because it was not beneficial from a commercial point of view. However, some banks admitted that the benefit is likely to be small. Westpac's CEO stated that 'my personal opinion is there will be a slight net positive for us'.⁵¹

2.84 Even with these clear delays, the NAB continued to argue against regulation:

Well, our view is that it shouldn't be regulated. We have already now stated we are moving in, so we've done it without regulation coming in.⁵²

47 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 37.

48 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 42.

49 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, pp. 35-36.

50 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 35.

51 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 36.

52 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 37.

Conclusion

- 2.85 Despite many commitments by banks in the past to implement CCR, little progress has been made.
- 2.86 As highlighted at the public hearings, other projects have often been prioritised over CCR, delaying its implementation. As a result, CCR should be mandated to ensure the major banks start reporting in 2018.
- 2.87 While banks have been able to participate in CCR since March 2014, it was disappointing to learn that not a single major bank will participate in CCR before December 2017. NAB is the most advanced of the banks, and it will only begin reporting in February 2018.
- 2.88 In this year's Budget, the Government committed to mandating a comprehensive credit reporting regime if providers did not meet a threshold of 40 per cent data reporting by the end of 2017.⁵³
- 2.89 Given the major banks represent around 75 per cent of the household credit market, the 40 per cent target set by Government will not be met. As a result, there is no benefit in waiting until December to mandate the regime.
- 2.90 On 2 November 2017, the Government announced it will introduce legislation to Parliament to mandate the CCR regime. It is important that this occur quickly given the years that have elapsed with limited action in this area.
- 2.91 In mandating participation, the Government should ensure it does not penalise credit providers that have moved ahead of the industry and are on track to report positive data in public mode shortly.

53 The Treasurer, The Hon Scott Morrison MP, 'Mandating comprehensive credit reporting', *Media Release*, 2 November 2017.

Anti-Money Laundering and Counter-Terrorism Financing

Recommendation 4

- 2.92 **The committee recommends that the Attorney-General review the major banks' threshold transaction reporting obligations in light of the issues identified in the CEO of AUSTRAC v Commonwealth Bank of Australia case.**

Background

- 2.93 The CBA is currently responding to serious allegations in the Federal Court. AUSTRAC alleges CBA contravened section 43 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (the Act) on more than 50,000 occasions. The allegations arise from CBA's introduction of Intelligent Deposit Machines (IDMs) in May 2012.
- 2.94 IDMs are a type of ATM that accept deposits in cash and cheque, and can automatically credit the nominated recipient account. The funds are then available for immediate transfer to other accounts both domestically and internationally. The CBA's IDMs can accept up to 200 notes per deposit, or up to \$20,000 per cash transaction. The CBA does not limit the number of IDM transactions a customer can make per day.⁵⁴
- 2.95 Under the Act, banks are required to report suspicious activity, primarily through threshold transaction reports (TTRs) for deposits made through an IDM. Banks are also required to take certain steps to manage their Anti-Money Laundering or Financing of Terrorism (AML/TF) risk.⁵⁵
- 2.96 AUSTRAC claims that, as a result of CBA's failure to comply with the Act, 'AUSTRAC and other law enforcement and designated agencies have been deprived of information which the Act is intended to provide', and 'the effect of CommBank's conduct in this matter has exposed the Australian community to serious and ongoing financial crime.'⁵⁶
- 2.97 On 4 September 2017, the first case management hearing was held in relation to AUSTRAC's allegations against CBA. The court ordered CBA

54 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Concise Statement*, NSD1305/2017, 3 August 2017.

55 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Concise Statement*, NSD1305/2017, 3 August 2017.

56 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Concise Statement*, NSD1305/2017, 3 August 2017.

- to file its defence by 15 December 2017, with a further case management hearing to occur on 2 April 2018.⁵⁷
- 2.98 The committee will closely monitor the progress of this matter, and will fully scrutinise the CBA when the case is finalised.
- 2.99 In addition to AUSTRAC's case against CBA, APRA announced on 28 August 2017 that it would establish 'an independent prudential inquiry into the Commonwealth Bank of Australia (CBA) focusing on governance, culture and accountability frameworks and practices within the group.'⁵⁸
- 2.100 APRA advised that it will identify any core organisational and cultural drivers that have contributed to the recent incidents with CBA, and assess whether CBA's structure, culture, remuneration, or accountability frameworks are conflicting with sound risk management and compliance outcomes. A progress report for the inquiry will be submitted to APRA by 31 January 2018, with the final report to be submitted by 30 April 2018.⁵⁹
- 2.101 Further, on 9 October 2017, a class action was filed by Maurice Blackburn on behalf of investors who suffered losses due to the share price fall following the institution of legal proceedings by AUSTRAC against CBA. The class action claims:⁶⁰

When news of the AUSTRAC proceeding became public, CBA's share price fell from an intra-day high of \$84.69 on 3 August 2017 to an opening price of \$80.11 on 7 August 2017 (a fall of \$4.58 or 5.4%) – a significant movement for an otherwise stable stock.

The class action alleges that CBA knew about serious instances of non-compliance with the AML/CTF Act and that its failure to disclose that information to the ASX amounts to misleading and deceptive conduct and a breach of its continuous disclosure obligations under the *Corporations Act 2001* (Cth) and the ASX Listing Rules.⁶¹

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- 57 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Directions Orders*, NSD1305/2017, 4 September 2017.
- 58 APRA, 'APRA to establish independent prudential inquiry into governance, culture and accountability within CBA', *Media Release*, 28 August 2017.
- 59 APRA, 'APRA announces panel members and terms of reference for prudential inquiry into CBA', *Media Release*, 8 September 2017.
- 60 Zonia Holdings Pty Ltd v Commonwealth Bank of Australia Ltd, Federal Court of Australia – Victoria Registry, *Statement of Claim*, VID1085/2017, 9 October 2017.
- 61 Maurice Blackburn, *Commonwealth Bank of Australia class action*, <<https://www.mauriceblackburn.com.au/current-class-actions/commonwealth-bank-of-australia-class-action/>>, viewed 17 November 2017.

- 2.102 On 6 November 2017, orders were made by consent that CBA would file its defence for the shareholder class action by 23 February 2018, with a further case management hearing to occur on 16 March 2018.⁶²
- 2.103 The committee will closely monitor the progress of the shareholder class action, and the outcome of APRA's prudential inquiry into the CBA.

Discussion

- 2.104 The CBA was asked why the board did not disclose the alleged breaches before AUSTRAC initiated legal proceedings, given it was aware in 2015 that the bank failed to submit more than 50,000 TTRs. The CBA claimed that the board had met its continuous disclosure obligations based on its knowledge at the time.
- 2.105 Given CBA was aware in 2015 that the failure to lodge over 50,000 TTRs exposed them to a very large fine, it is surprising that CBA did not, at the very least, disclose the coding error which it has since rectified.
- 2.106 In addition, there is serious concern that the board did not identify any issues related to executive management conduct in 2015 that would result in the loss or minimisation of executive bonuses. Despite being aware of the failure to lodge 50,000 TTRs, the board's 2015-16 remuneration report did not identify any concerns that the bank was potentially exposed to billions of dollars in fines. In response to questioning on this issue, CBA stated:
- ...the determination [in relation to the remuneration report 2015-16] was made according to the processes that we apply in our remuneration framework and the elements that go into that, in terms of the risk review, and it included the regulatory matters at the time. We're confident that we've met our disclosure obligations and that, as I've said, the view that we formed around AUSTRAC and the failed TTRs, given our knowledge at that time, was the appropriate outcome.⁶³
- 2.107 When further scrutinised on the decision to award senior executives their executive bonuses in 2015, despite being aware of CBA's failure to lodge 50,000 TTRs, CBA maintained that it had made the correct decision on the basis of the facts as the board knew at the time.⁶⁴
- 2.108 The Australian Securities and Investments Commission (ASIC) Chairman has confirmed that ASIC is looking into the actions of CBA's board and

62 *Zonia Holdings Pty Ltd v Commonwealth Bank of Australia Ltd*, Federal Court of Australia – Victoria Registry, *Directions Orders*, VID1085/2017, 1 November 2017.

63 Ms Catherine Livingstone, Chairman, CBA, *Transcript*, 20 October 2017, p. 42.

64 Ms Catherine Livingstone, Chairman, CBA, *Transcript*, 20 October 2017, p. 43.

determining whether to pursue any formal action against the board collectively, or individuals within the board. The committee will monitor the outcomes of ASIC's deliberations in relation to this matter.

- 2.109 The CBA was questioned on allegations that criminals used a technique called 'structuring', where they made several deposits under the \$10,000 threshold to avoid triggering a TTR. In particular, the AUSTRAC statement of claim suggests CBA identified a suspicious pattern of activity on a number of occasions. However, CBA failed to provide AUSTRAC with appropriate reports in relation to the suspicious activity. CBA maintained it could not elaborate due to the AUSTRAC legal proceedings.
- 2.110 The banks were also asked how they determined cash limits on IDMs, noting that CBA had established a significantly higher limit than the others. The banks claim that the limits were an attempt to balance customer convenience with the risk of money laundering.
- 2.111 When it was suggested that setting a higher limit had a commercial benefit, such as increasing new business, the banks claimed this was not a primary motivation.
- 2.112 Confirmation was sought that the banks' machines were compliant with AML/TF laws. The banks unanimously claimed they were. NAB, Westpac and ANZ outlined their positions as follows:
- [NAB] With regard to intelligent deposit machines, IDMs our maximum cash deposit limit is \$5,000, and AUSTRAC has advised us they have no issues with our IDM approach.⁶⁵
 - [Westpac] We are confident that we're complying with regulations. We work very closely with AUSTRAC, and I think it's important to mention in the context of this that just having a limit of how much you take is not the start and end of your controls. We have very extensive computer analysis that goes on that looks at patterns and transactions, and for people trying to avoid the reporting by, for example, breaking up their deposit and structuring it into multiple packets.⁶⁶
 - [ANZ] AUSTRAC has advised us that it has found no evidence of noncompliance concerning our ATM network.⁶⁷
- 2.113 However, in its 2017 Annual Financial Report, NAB identified issues in relation to its AML/CTF compliance:
- The Group is currently investigating and remediating a number of identified issues, including certain weaknesses with the implementation of 'Know Your Customer' requirements and

65 Mr Andrew Thorburn, CEO, NAB, *Transcript*, 20 October 2017, p. 2.

66 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 3.

67 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 39.

systems and process issues that impacted transaction monitoring and reporting for some specific areas.

It is possible that, as the work progresses, further issues may be identified and additional strengthening may be required. The outcomes of the investigation and remediation process for specific issues identified to date, and for any issues identified in the future, are uncertain.⁶⁸

- 2.114 Finally, CBA was questioned about why it had chosen a fundamentally different limit on its machines to the others. CBA noted that the critical difference with its approach was that it allowed more notes to be accepted, claiming it wanted to help small businesses who need to deposit large numbers of low value notes.⁶⁹ CBA further claimed that setting a higher limit did not fundamentally increase the risk of money laundering because the IDMs would still generate appropriate reports to AUSTRAC.
- 2.115 In the initial period from June 2012 to November 2012, a total of \$89.1 million was deposited in CBA's machines. However, from January 2015 to June 2015, \$3.35 billion was deposited. Given the exponential increase, CBA was asked whether it had undertaken another money laundering risk assessment. CBA claimed that due to the legal proceedings with AUSTRAC, it could not comment.

Conclusion

- 2.116 The claims made by AUSTRAC in relation to CBA's failure to comply with the Act are very serious.
- 2.117 Under the Act, banks are required to report suspicious activity, primarily through TTRs for deposits made through an IDM. Banks are also required to take certain steps to manage their AML/TF risk.⁷⁰
- 2.118 However, money laundering and terrorism financing methods, by their very nature, continue to evolve and criminals will always look for new ways to exploit opportunities and avoid detection.
- 2.119 Technological advances, market developments, and the emergence of new products and services can create new and evolving risks that may fall outside the scope of the current TTR reporting obligations.
- 2.120 The committee recognises the work AUSTRAC has done in identifying failures under the Act, and in managing AML/TF risk.

68 NAB, *2017 Annual Financial Report*, 14 November 2017, p. 108.

69 Mr Ian Narev, CEO, CBA, *Transcript*, 20 October 2017, p. 51.

70 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre V Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Concise Statement*, NSD1305/2017, 3 August 2017.

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- 2.121 The committee notes the Government is consulting with industry on proposals to implement the recommendations from the report of the statutory review of the AML/CTF regime (April 2016). The report, which was released prior to AUSTRAC's allegations against the CBA, contains 84 recommendations to streamline and strengthen Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime.
- 2.122 To ensure that AUSTRAC continues to respond effectively to money laundering and terrorism financing in Australia, the committee recommends that the Attorney-General review the major banks' TTR obligations in light of the issues identified in AUSTRAC's case against the CBA.