CUSTOMER OWNED BANKING ASSOCIATION

5 November 2018

Senate Economics Legislation Committee
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Parliament House
CANBERRA ACT 2600

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Dear Committee members

Inquiry into the provisions of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018

The Customer Owned Banking Association (COBA) welcomes the opportunity to provide a supplementary submission to assist the Senate Economics Legislation Committee (the Committee) in its Inquiry into the provisions of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (the Bill).

This submission responds to certain comments about basic deposit products made by some stakeholders at the Committee's Public Hearing in Melbourne on 31 October 2018 and 1 November 2018 (the Hearing). The Appendix of this submission provides COBA's responses to two questions from the Committee that COBA took on notice during its witness appearance at the Hearing on 31 October 2018.

COBA response to stakeholder comments

Parliamentary debate about the Design and Distribution Obligations (DDO) has focussed on addressing instances where consumers have been "ripped off" and "exploited". Consumer groups have focussed on "unsafe products" and "worst practices". Our view is that the simplest and safest category of financial products, basic deposit products, do not belong in this debate.

Basic deposit products such as transaction accounts or term deposits are very low risk and funds are available at call or subject to a short notice-of-withdrawal period of no more than 31 days.

Term Deposits

At the Hearing on 31 October 2018, consumer group representatives expressed the following view, suggesting that consumers are unable to withdraw their money from their term deposit investments:

> "I think term deposits are a good example, because there's an age consideration or a life-stage consideration that can really hit people. CHOICE has had older Australians come to us with issues with term deposit rollover. **They thought they had an opportunity to access their money**. There was an automatic rollover. They missed it. They didn't understand necessarily they impact that would have, particularly when they hit a retirement phase or a different phase within their retirement." [Emphasis added].

Any suggestion that an investor is unable to withdraw their money from a term deposit that is a basic deposit product is incorrect. As noted above, for a term deposit to qualify as a basic deposit product, the funds must be available either at-call or subject to a notice-of-withdrawal period of no more than 31 days[1]. Any investor who is unhappy with the interest rate on their term deposit can withdraw their funds and put them in a different term deposit with a higher interest rate.

ASIC expressed the following view at the Hearing on 1 November 2018, suggesting that the DDO would affect interest rates on term deposit products:

> "In that term deposit example that we gave, certainly the institutions we looked at, when they had those practices in place, were getting an enormous number of complaints from their customers. For most of those customers, they would agree: 'We're sorry this happened. Instead of a six-month deposit, we'll put you in a five-month deposit, which happens to have a much higher rate.'"

As far as COBA is aware the DDO is not intended to regulate investment returns. Indeed, as the Committee will recall from the Hearing, ASIC confirmed at its appearance that every rollover of a term deposit would be treated as a new term deposit:

> "Contractually, it is the issue of a new product, yes."

It is not clear why ASIC would suggest that the DDO would affect interest rates on term deposit products. Indeed, if ASIC continues to make this suggestion, COBA strongly encourages the Committee to reach out to ASIC and the Treasury to seek policy clarification.

The issue raised by ASIC in relation to term deposits is with investors taking a 'set and forget' approach to their term deposit investments. Again, it is unclear how the DDO would help address the issue of investors being uninterested in their investment return.

Transaction Accounts

COBA notes the example provided by ASIC, from Royal Commission case studies, regarding consumers from indigenous communities being provided with transaction accounts that are not a good fit for their needs.

Our view is that a significant new layer of complexity and cost, through applying the DDO to basic deposit products, would not be an appropriate or proportionate response to address this problem. It may be an isolated problem and would be more effectively dealt with through provisions in industry codes.

As noted in the Royal Commission's Interim Report: "To participate in the economy, to participate in everyday life, Australians need a bank account."

Policymakers should be careful not to impose unnecessary costs on providers of such a basic requirement for all consumers.

Increasing regulatory complexity and cost will detrimentally impact all consumers, as noted in Treasury's July submission to the Royal Commission, which observed that regulatory costs:

> "…are borne by financial firms and, in turn, by consumers either directly through higher costs for financial products and services, or indirectly through the impact of such costs on competition or innovation in the choice and quality of products and services that consumers can access."

It is important for policymakers to think carefully about the observation in the Royal Commission's Interim Report that:

> "given the existing breadth and complexity of the regulation of the financial services industry, adding any new layer of law or regulation will add a new layer of compliance cost and complexity. That should not be done unless there is a clearly identified advantage."[2]

COBA is concerned that ASIC and consumer groups, in supporting extension of the DDO to basic deposit products, are ignoring or downplaying compliance costs and the impact of compliance costs.

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[1] See ASIC Class Order [CO 14/1262] Explanatory Statement.

[2] Section 3.1 of the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Volume 1, section 3.1. Pages 290-291 refer.

Given the observation about regulatory complexity in the Royal Commission Interim Report, it is disappointing that such important stakeholders apparently continue to view new regulation as the answer to all perceived problems irrespective of the scale and nature of the problem.

COBA notes that even the Treasury, the agency tasked with designing the DDO policy framework, appears to concede that implementing the DDO regime will involve significant complexity:

> Senator KETTER: "In that process of determining the target market isn't it almost axiomatic that they would have to identify who is not suitable?"
>
> Ms O'Rourke: "Like I said, it's a little bit **tricky** because there are the people for whom it is suitable and then there are **shades of degree** of people for whom it is not suitable. **I don't know if it's entirely binary**. There will be some people for whom it won't really work, but would it really be damaging? There will be other people for whom it is genuinely not suitable." [Emphasis added].

As the Committee would appreciate, if the Treasury is unable to clearly explain how the DDO would be implemented and operate in the real world, it is inappropriate to expect industry to be able decipher the regime provisions and implement the DDO with confidence and certainty.

COBA considers that it would be more appropriate and effective to have any concerns about transaction accounts addressed through industry codes of practice:

- the Australian Banking Association's (ABA) new Banking Code of Practice will require ABA members to investigate whether a customer receives a Commonwealth pension or concession and, if so, to provide information about low or no fee transaction accounts that are available[3].
- the Customer Owned Banking Code of Practice (COBCOP) is due for review and an independent review is expected to commence soon. The new Banking Code of Practice will be an important factor in the review of the COBCOP.

Finally, COBA would like to reiterate that we are not seeking a 'carve-out' for basic deposit products from the DDO. COBA is instead calling for basic deposit products to *remain outside* the scope of the DDO regime, rather than be forced into the regime through regulations.

Basic deposit products are automatically out of the DDO regime due to the regime, in terms of its scope, relying on product disclosure requirements in the Corporations Act.

Extending the DDO to basic deposit products would be a significant policy departure from the current treatment of these products compared to other financial products.

COBA would like to thank the Committee again for providing us the opportunity to appear and provide evidence to assist the Committee with its Inquiry.

If you have any questions or comments in relation to our supplementary submission, or any further questions regarding our comments at the Hearing, please contact Tommy Kiang, Senior Policy Manager, on [redacted]

Yours sincerely

[redacted]

MICHAEL LAWRENCE
Chief Executive Officer

[3] ABA Code of Banking Practice, Chapters 15 and 16. Pages 22-23 refer.

Appendix

COBA Responses to Questions on Notice

1. Question regarding compliance cost

> "**Senator KETTER:** The chair has already asked about the costs of compliance to your members. Are you going to provide us with any further information on that?
>
> Mr Kiang: I'll be happy to provide further information on that question."

COBA response

Due to the complexity of the reforms, COBA is unable to provide dollar estimates on the upfront and ongoing implementation costs associated with applying the DDO to basic deposit products. However, as the Committee would appreciate, there would be costs associated with:

- Determining the implications of the DDO regime for the business (e.g. costs incurred from obtaining external advice and internal staffing), including whether to cease providing certain products or product features.
  - COBA notes from the Hearing the extensive discussion about the need for ASIC guidance, given the complexity of the proposals.
  - Indeed, the complexity of the DDO and the need for ASIC guidance is underscored with ASIC commenting at the Hearing that guidance will be needed "to assist industry to get an understanding of what you can do"[4].
- Integrating the DDO with existing regimes and industry codes.
- Planning and implementation of changes to policies, processes, staff training and information systems associated with each of the components of the DDO:
  - design obligations:
    - to make a publicly available target market determination
    - to review the target market determination as required to ensure it remains appropriate
    - to keep records of the person's decisions in relation to the new regime, and
    - to notify ASIC of any significant dealings in a product that are not consistent with the product's target market determination.
  - distribution obligations:
    - not to engage in 'retail product distribution conduct' in relation to a product unless a target market determination has been made
    - not to engage in retail product distribution conduct where a target market determination may no longer be appropriate
    - to take reasonable steps so that retail product distribution conduct is consistent with the target market determination
    - to collect information specified by the issuer and complaints related to a product and provide both to the issuer, and
    - to notify the issuer of a product of any significant dealings in the product that are not consistent with the products target market determination.

[4] Proof Committee Hansard, Thursday 1 November 2018, page 25 refers.

Separate to the above, COBA notes that during the Hearing, the ABA provided the Committee with an estimate of $200million in compliance costs for its membership's implementation of the DDO for basic deposit products.

2. Question regarding term deposit investment risk

> "**CHAIR:** But are there any other warnings, other than ASIC's MoneySmart website and a quote from Mr Kell?
>
> Mr Kiang: I'd have to take that on notice."

COBA response

- We note that in its 2013 further review of term deposits, ASIC concluded that the ADIs it reviewed had improved their disclosure of the existence and risk of dual pricing, grace periods, and interest rates[5].
- With respect to risk of disclosure of dual pricing in a term deposit product (i.e. 'high' interest rate and 'low' interest rate term deposits depending on the term), ASIC found that all ADIs it reviewed disclose risk in terms and conditions documents and at least one mode of investor communications (e.g. pre-maturity letter, application form)[6].

[5] ASIC Report, REP 353 *Further review of term deposits*, released 4 July 2013. Page 5 refers.

[6] ASIC Report, REP 353 *Further review of term deposits*, released 4 July 2013. Table 1, Page 5 refers.