C. Dissenting Report - Greens' Member of the committee

This inquiry has confirmed that the big four banks enjoy a cosy and privileged position in Australian society, making large profits off the back of the kind of implicit (and explicit) taxpayer support other businesses can only dream of.

This inquiry has also confirmed the big four banks think there is nothing wrong with the core of their vertically integrated business model, a model that creates a potential for conflict of interest between the customer's best interest and subsidiaries encouraging people to buy financial products.

This committee's Inquiry into the big four banks has also thrown up new areas of concern, suggesting that growing household debt underpins in the high levels of profit the banks say they need to make for their shareholders, meaning that their business model is increasingly premised on housing remaining unaffordable for many young people.

This inquiry has generated more questions than answers, reinforcing the need for a wide-ranging Royal Commission into the big four banks and the broader financial sector.

Unfortunately, the committee's report does not address any of these fundamental issues. In the short time available to consider and respond to the committee's report, the Greens have been unable to endorse its sentiments and draw attention here instead to some crucial issues that require further action.

1. Leaners, not lifters

Australia has one of the most concentrated banking sectors in the world. Together, ANZ, CBA, NAB and Westpac have over 80 per cent of the market in home loans, hold $3.6 trillion in assets and make around $40 billion per annum in profit. The big four banks enjoy incredible market dominance, which gives them extraordinary power.

What makes this situation even more concerning is that the taxpayer underwrites the big banks' privileged position, giving them a license to print money.

A study completed by the RBA, and released under a Freedom of Information request, states that Australian banks' credit ratings are benefited by the "rating agencies' perceptions that the Government would support them if they got into trouble". According to the RBA, in 2013 Australia's major banks received a subsidy worth up to $3.75 billion from the Federal Government.

During the inquiry, the banks made it clear they knew they get a financial benefit from the public underwriting them, as this exchange shows:

> Mr BANDT: Thanks. On another matter, as one of the big banks you get to borrow funds to fund your operations and your subsequent loans more cheaply than your competitors. Is that a fair statement?
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> Mr Narev [CBA]: In some aspects, yes—part of which was redressed from the capital costs by the recommendations of the financial system inquiry, where the four major banks raised $20 billion of capital and the next banks did not have to raise any.
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> Mr BANDT: But even after that, on the whole wholesale funding is still cheaper for you than it would be for smaller banks or credit unions?
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> Mr Narev: In most cases, that is right.

It is also clear they are not prepared to return anything further to the public purse in part compensation for this support:

> Mr Hartzer: … I do not think we should aspire to have a banking system like the rest of the world.

> Mr BANDT: I do not think anyone is suggesting that. We are wanting you to be stable and successful, but when you are making world-leading record profits off the back of implicit government support, the public is entitled to ask for a bit of it back, aren't they, rather than bearing all the costs themselves?
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> Mr Hartzer: I would take issue with the assumption of that. We pay, already, for the CLF and the RBA. We, as domestically significant banks, are required to hold higher capital than the smaller banks are. I would just make the observation that if you were to start to charge banks for an implicit guarantee, you are effectively making that an explicit guarantee, and I think the government would want to be pretty careful given that we do not actually guarantee our large banks to make that an explicit undertaking.

It is time to call a spade a spade. If we have a de facto policy that the public will step in and support the big four banks if they ever get into trouble, as the government did during the GFC, then the big four should make appropriate recompense back to the public purse. Any other business in Australia would love to know it had the government's backing if it ever got into trouble. But if we're not offering guaranteed financial security to businesses in the manufacturing sector, renewable energy or tourism, why do we decide that large banks deserve government help?

Recommendation: That a levy of 0.20 per cent be applied on the asset base of institutions with an asset base greater than $100 billion.

The rate of this levy is equal to the lower bound of the RBA's estimate of the value of an implicit government guarantee. It is also the value suggested by the IMF based on the average benefit of implicit guarantees throughout the G20.

2. Vertical Integration and Conflicted Remuneration

The catalyst for this inquiry is the seemingly endless spate of scandals within the financial advice arms of the big four banks over recent years. These scandals have seen tens of thousands of Australians lose money, and have eroded trust in the financial services sector.

The genesis of these scandals can be found in the 'vertically integrated' business model that has been universally adopted by the big four banks. Investment advice and insurance products are now part of the same business as conventional deposit and loan services. This creates a conflict of interest between what is good for a customer and what is good for a bank.

It is not just the Greens raising these concerns. The RBA and ASIC have both drawn attention to the inherent risk with vertically integrated banks. The former head of the Financial Services Council, John Brodgan, put it bluntly when he said “vertical integration and flawed remuneration policies are plaguing the banking and financial services industry.”

The Senate in its inquiries has also established a strong prima facie case for a Royal Commission.

Yet the banks do not see any problem:

> Mr BANDT: I want to put you that there is a common pattern developing and I want to lay out how that common pattern appears and invite your response to it. It seems now, after several days of this hearing, that the pattern is this: something goes wrong in the wealth creation arm—sometimes it involves fraud and sometimes it involves selling products to people that get them into trouble—and the bank does not publicly confess. That is left up to whistleblowers or journalists. The CEO fronts up to this committee and tells us that something went wrong and they wring their hands, but back at the ranch the same people are in charge of the wealth-creation side of the business and we are left with no guarantee that it will not happen again. It seems that the problems all stem from the same source: you are inherently conflicted. The wealth management arms of your business are about making as much profit as possible, including from those who are customers in your deposit arm. My question is this: given that this pattern seems to be recurring why shouldn't we consider fixing the problem at its source and separating the deposit-taking arms from the riskier wealth-creating arms?
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> …
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> Mr Thorburn: … Just in closing, I think there was just one other thing that you raised that I would like to cover. That is the splitting up you talked about. My view is that we are in the business, as a bank, of looking after clients and giving them financial advice. We believe in that, we think it is really important, and we think we do it, on the whole, well. When we do not, I will be the first person to be accountable and say we need to fix that, because it is not in our best interests as a bank that we do not have the trust and confidence of our clients. But with the trends that are likely to continue—volatility in

> international markets, an ageing population and the state's lack of ability to provide pensions at the level that people desire—Australians need to save more. There is a complexity of products, and it is important that people get the right advice. I think our bank is in a very good position to do that, with the scale, the resources, the transparency, the systems and the accountability that we have in place.
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> Mr BANDT: But at the end of the day vertical integration is the reason that you are sitting here, isn't it?
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> Mr Thorburn: I think I am sitting here because the community, through parliament, wanted to have a conversation with us about a range of things, including funding, conduct, interest rates and a range of things that your colleagues have been asking us about today.

In fact, the banks continue to argue that no further regulation is needed, as existing forms of self-regulation suffice:

> Mr Thorburn: I think that on the planners' side it is good that it is codified and is strong and clear. If you look at the banking and finance oath you will see the commitments that have been made there are quite strong as well. I think anything where individuals volunteer to say, 'This is a code of behaviour that I believe in personally,' is the most powerful, but I do think that the steps in recent years to lift the expectations of planners and their professional qualifications are important. The disconnect from public opinion is astounding. The public deserves to know that anyone advising them on and selling them financial products does not have conflicted interests.

In the face of this approach from the big banks, it is clear that a Royal Commission is needed. This Royal Commission should examine the role of vertical integration in leading to so many people being dudded by the wealth management arms of the big four banks and also look at 'breaking up the banks' to separate retail banking from financial advice and investment banking.

At an international level, this is not radical. Both the UK and the EU are making moves to restrict and tightly regulate vertical integration.

Recommendation: That the terms of reference for a Royal Commission into banking include the nature of vertically integrated business models, including: the integration of everyday banking, financial planning, wealth management and insurance within a single entity; whether the incentives provided encourage illegal

or unethical conduct; and whether the incentives provided are aligned with the duty of care to customers.

3. Housing

Housing is increasingly out of reach of many Australians. The Household, Income and Labour Dynamics in Australia survey found that the rate of adult home ownership has dropped from 64.4 per cent in 2002 to 59.7 per cent in 2014.

The facts are particularly stark for young people. In 1990 house prices were approximately six times a young person's income, but by 2013 that had doubled to approximately 12 times a young person's income.

Yet, once again, the big banks do not seem to see a problem:

> Mr BANDT: You think housing in Sydney and Melbourne is overpriced?
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> Mr Thorburn: No, I don't think so.

This view is unsurprising, as the hearing confirmed that growth in housing lending is a key part of the banks' maintenance of record profits.

Housing accounts for 60 per cent of the loans book of ADIs, which is very high by global standards. Growth in housing loans has averaged about 10 per cent per annum over the last twelve years, has outstripped growth in other loans over the last twelve years, and provides a good marker for the growth in profits for the big four banks.

However, not only are young people being priced out of the housing market, but the banks' love of housing poses a major risk to financial stability. The Financial Systems Inquiry (Murray Review) identified the banks' exposure to housing as one of four sources of potential systemic risk.

The growth in house prices, and the corresponding growth in bank profits and financial risk, is being underpinned by the generous tax concessions available to property investors. The strength of these incentives is being further exacerbated by the 'search for yield' in a time of record low interest rates, and the unwillingness of the government to provide an alternative investment avenue in the form of government borrowing for infrastructure.

The government cannot continue to ignore the distortionary effect of housing on the big four banks, let alone the generational wealth divide that is being created before our eyes.

Recommendation: That negative gearing for future housing purchases and capital gains tax discounts be removed, with the aim of making housing more affordable and helping shift banks' home loan profile towards owner occupiers and away from investors.

4. Other matters

The hearing explored a number of other issues, including allegations of mortgage fraud, allegations of fraud in overseas banks part-owned by an Australian bank, profits made from fees, the banks' response to climate change and whether banks pass on the benefits in cuts in their funding costs as quickly as the pass on increases. These matters will be pursued in further hearings. However, the Greens note that a House Committee inquiry offers limited opportunity to pursue these areas in the detail required, especially given the significant other matters requiring examination.

Mr Adam Bandt MP