

Financial Systems Inquiry submission

INTRODUCTION

ING Bank Australia Ltd trading as ING DIRECT wholeheartedly endorses the remit of the Financial Systems Inquiry ("Inquiry") to refresh the philosophy, principles and objectives which underpin the development of a well-balanced Financial System in Australia.

ING DIRECT, being a significant participant in the Australian financial services system (and part of a global financial services operation) strongly believes that the following should be key prerequisites of the financial system in Australia:

1. *Customer choice*
2. *Cost efficiency*
3. *Customer control and system resilience*

By customer choice we mean:

- Easy switching – taking the effort out of the switching process for customers will drive competition and innovation.
- Genuine alternatives – real options for customers rather than simply a proliferation of commoditised products and services.

We see cost efficiency to include:

- Lower cost business models, processes and systems – such as digital distribution, access and control through systematic improvement and innovation. Digital process and delivery is fundamental to lowering costs for customers.
- Free election on the part of institutions and customers to bear explicitly identified costs - in the absence of alternatives inefficiencies are grudgingly tolerated.

We believe customers want more control:

- Customer demand is changing at a rapid pace influenced by their broader digital experience outside of the banking sector. Customers will increasingly demand 24/7 availability, mobility and portability from their financial services provider.

- Customer discontent with banks is partly based on a feeling of a lack of control. Our internal research shows customers want more control of their finances and are looking for ways of gaining that control. We believe control can be delivered by way of financial literacy (improving understanding of finances), enabling choice and providing the necessary technology to make end to end processes easy.

Resilience requires:

- A robust overall model - one that is able to withstand systemic shocks.
- Well-governed individual institutions - adequate capital and effective risk management frameworks.
- A self-sufficient funding model for Australian financial services companies.

ING DIRECT cites the above as prerequisites and we believe that, as a result, the Inquiry will need to address the issues of:

1. *Promoting market discipline*
2. *Effective risk management contributing to the funding of Australia's future*

ING DIRECT will focus its submission on customer experience on the understanding that the Inquiry will receive a more comprehensive overview of financial services from the Australian Bankers Association.

1. PROMOTING MARKET DISCIPLINE

Promoting market discipline is a more sustainable alternative than heavy-handed regulation. Market discipline entails informed customers having easy access to alternative products and services and the market responding in a competitive way. It is a fact that Australians don't switch banks readily. It is simply too hard and there has not been the will to date to make it easier. Similarly, competitive tension in business operating models occurs when well informed 'make versus buy' decisions are made. This is in stark contrast to a situation where all the required capabilities and services are generated internally and the costs and efficiencies are not tested by the market.

The following attributes we believe are essential:

- a. Reducing customer effort (e.g. account switching, online identification, real time payment system and e-conveyancing)
- b. Enhancing customer scrutiny (e.g. simplifying product disclosure and increasing financial literacy)
- c. Only a 'necessary and sufficient' compliance burden (since the cost of compliance is ultimately borne by the customer)

d. Facilitating institutional 'make versus buy' decisions at the functional level (e.g. distribution through mortgage brokers rather than tied branches)

e. Facilitating digital commerce and technological improvement. Technological advancement to improve the customer experience and meet customer expectations.

1a Reducing customer effort

1a(i) Account switching:-

The current Account Switching Package in Australia requires too much customer effort and has not delivered a 'real choice' to the customer. In the 11-month period from its inception on 1 July 2012, Treasury has reported only 15,500¹ people have switched accounts using the account switching package. Put simply Australians don't switch banks like they do with other service providers such as telecommunications. (e.g. since mobile number portability was introduced, Australians have embraced choice with close to 17million³ ports completed from September 2001 to June 2013. On average, 6.8%⁴ of all mobile phone services are ported each year between providers).

Previous attempts at reform in this area have been seen as too hard. In his report² 'Banking Services: Cost-effective Switching Arrangements' Bernie Fraser, a former RBA Governor, found that no other country had implemented full account portability and estimated the implementation costs to re-engineer Australia's retail payment system - to achieve full account portability - as uneconomical. We do not agree with this conclusion on the basis that the current policy and practice in other jurisdictions is leading to a more simple way of switching.

There has been progress in simplifying the switching process in other jurisdictions and we believe Australia could learn from their experience.

- In the **UK**, the Payments Council launched a new automated account switching service in September 2013 called the 'Current Account Switch Service'. The service sets a standard service level for those switching providers. The free service allows a customer to use their old card right up until the nominated switch date. On that date all direct credits/debits are switched over and the old account is closed. Customers are provided with a guarantee that they will receive a refund if they are disadvantaged as a result of a bank making a mistake with the switching process. Progress in the UK has been very encouraging with over 300,000⁵ accounts switched since the launch from September 2013 until the end of December 2013. The rate of switching increased by 17%⁶ in January 2014 compared to January 2013.

- **Sweden** has implemented a hybrid system using a unique customer number ('*bankgiro number*') that points to the equivalent of a customer's BSB and account number. While the actual BSB and account number is not portable, the *bankgiro* number is portable and can be used to remit and receive payments.
- The **Netherlands** has simplified the switching process. The customer fills out a single form and sends it to the new bank. The new bank processes the form and through a third party payments provider (Equens) the switch is made. All traffic is redirected via "Equens" to the new bank account number for the next 13 months.

In all three of these instances, Government and regulators have proactively intervened to ensure the process is simplified for the customer. Regulators and governments in these jurisdictions clearly believe an effective switching mechanism is a driver of competition.

1a (ii) Online verification of identification:-

Online verification is a foundation for giving Australians simple and easy access to financial services.

ING DIRECT created a new category in banking by introducing Australia's first high interest online savings account, the Savings Maximiser, in 1999. We demonstrated that it is possible to have an interactive banking relationship with customers without branches. Efficient digital delivery of banking services, however, is reliant on effective and robust electronic verification of customers.

ING DIRECT pioneered end to end electronic verification of savings customers in 2009, which facilitated Australia's first seamless, real time digital account opening. However electronic verification relies on availability of and access to public databases. As customers move from simple savings accounts to more complex banking products, the identification requirements increase. To meet the requirement banks need access to a wider range of databases. Globally other jurisdictions have met the challenge.

We refer the Inquiry to some of the robust electronic verification measures developed globally as a guide for reform in Australia

- In **Turkey** financial institutions can verify customers by way of a Government owned citizen database (*MERSIS*) for a nominal fee of around 5 cents per query. This innovative solution drastically reduces the operational cost and customer reluctance which traditionally besets multiple provider on-boarding processes. The capture of identity data is performed on a once only basis and can be seamlessly migrated for access with the customer's consent, by future providers, without the need to involve the customer in the verification.

- In **Belgium** customers can be electronically identified by way of a national identification card with an electronic chip. The card enables the customer to easily and efficiently use and choose financial services. (We include the example of an identification type card only for the purpose of drawing attention to the willingness of other jurisdictions to improve electronic processing. We appreciate and accept community sensitivities around a national identity type card for Australia.)

In Australia the Attorney General's Department established a Document Verification Service. However by comparison the service is fragmented and yet to be introduced nationally.

We call on the Inquiry to investigate introducing a Government controlled system with restricted access to the Australian Taxation Office database to verify customer identity. We envisage, for example, a Government owned, secure, controlled and up-to-date system that would be more effective for all Anti-Money Laundering identification requirements and enable customers to access and choose financial products easily and efficiently. We understand implementation of an identification card in Australia would be difficult.

1a (iii) Real time payment system:

Today the Reserve Bank of Australia is in the process of implementing the real time payment process. The intent of the proposal is to make the process as seamless and as convenient to the consumer as using cash or sending a text message.

For this to succeed we need to create complementary regulatory change to support a new innovative payment platform and regulatory change to support the innovation. If not, the process will remain fragmented.

We call on the Inquiry to investigate reforms made in other countries:

- **In the UK** - the Payments Council is launching a mobile payments service in 2014 which will enable secure payments to be made directly to or from an account without the need to share detailed account information. Customers can send money to one another by simply entering their mobile number as a proxy.

1a (iv) Electronic conveyancing

Australia has been working on introducing a national e-conveyancing scheme for more than 6 years. It will provide customers with cost efficiency.

Unfortunately the fragmented state legislative process in Australia is delaying the process with no completion date in sight. The deadlock will only be broken by the intervention of a national regulatory framework.

1 (b) Enhancing customer scrutiny

Market discipline entails customers freely electing to bank with an institution that provides products and services suited to their needs. Our research shows, for example, that customers want control over their finances and we believe control is delivered by way of easy access to products and services. We believe an efficient market results from customers gravitating to those that best address their needs. Those that do this less well will suffer a loss of business. This customer sanction is a viable alternative to some complicated and intrusive regulation. Indeed there is evidence that more intrusive regulation has unintended consequences by removing customer responsibility which in turn diminishes control and increases system costs.

We believe the following are examples of inefficient regulation:

- The Product Disclosure Statement (PDS) – The objective of a PDS is to disclose the key features of products. It should be simple to understand. Prescriptive regulatory measures have resulted in these documents being impossible to read. They ‘tick the regulatory box’ but are of little use for the customer. The recent Shorter PDS Regime legislative changes, designed to reduce the length of a PDS, have not been as useful as expected.
- Disclaimers – To ensure compliance with the various pieces of legislation such as the Corporations Act, National Consumer Credit Protection Act etc, each advertisement now requires long, complex disclaimers simply ignored by most customers.
- Financial Responsibility - Recent regulatory change has moved towards removing personal responsibility and accountability of the consumer and in place has imposed the obligations and associated liability on financial institutions providing services.

The EU has experienced a similar trajectory. The simplified Prospectus introduced in 2001 has been criticised both for its attendant cost as well as lack of user-friendliness.

A replacement concept of Key Investment Information Document⁷ is designed to be much shorter in length and capture:

- Objectives and investment policy
- Synthetic risk and reward profile
- Charges

- Past performance
- Practical information

1 (c) Only a 'necessary and sufficient' compliance burden

ING DIRECT acknowledges the importance of regulation, however it is essential that:

- **It is kept simple** - *clear policy intent for regulation is agreed on at the very outset & not changed during the drafting of the law to avoid confusion and increased compliance costs.*
- **It is not rushed** - *care to be exercised to ensure that consumers are not potentially pushed into hybrid type lending tools to finance their projects.*
- **It must come after meaningful consultation**
- **It must consider unintended consequences including cost**
- **It must apply uniformly across producers** – *banks, superannuation and other finance service providers.*

1 (d) Facilitating institutional 'make versus buy' decisions at the functional level

Market discipline can and should operate within financial institutions. A vertically integrated oligopoly is unlikely to be as cost effective as an institution which undertakes 'make versus buy' decisions at the functional level. ING DIRECT, for example, leverages a network of independent mortgage brokers and financial planners since we judge this to be a more cost effective way to access the market than creating another tied 'bricks and mortar' network. This is no different from the decision of others to outsource certain activities to access higher quality capabilities than are available internally and/ or economies of scale and scope. Suffice to say we believe that both quality and cost efficiency are bolstered by institutions freely exercising 'make versus buy' decisions.

2. Effective risk management contributing to the funding of Australia's future

A sound and resilient financial system is a key to a strong economy and the efficient and effective allocation of funds across the banking system.

Currently approximately 30% of Australian banking assets are financed through a combination of short and long term wholesale funding. These markets, especially short term wholesale markets, can vary in price and liquidity during times of crisis which exposes the Australian economy to potential shocks.

We can lessen our reliance on short term wholesale funding markets and sustain banking support for the Australian economy by channelling more savings into the banking system. We believe there is a need to:

2(a) Innovate (e.g. offer retail bonds backed by mortgage debt)

The asset base of the Australian banking system is distorted towards residential property assets. While this asset class generally performs strongly, it does mean the industry and the economy are vulnerable to downturns in the property market.

We propose the Inquiry looks at ways to expand the funding markets to include greater participation from retail customers. Various attempts have been made to establish a retail bond market, however more is required especially in the matter of simplified and straightforward documentation.

The opportunity for retail investors to directly participate in the funding of the mortgage market would stimulate competition and product innovation. We believe this could be done in the form of a listed fixed interest security (e.g. mortgage securities fund) or a type of housing bond.

2(b) Reform the securitisation market (e.g. Introduction of Master Trusts)

Securitisation is an important funding tool for financial institutions that lend to the housing market. Changes to APS 120 have been discussed for the past several years. Clarity and finalisation must be prioritised to reduce the cost impact on both the issuers and investors. In global markets, Master Trusts are a common feature of the securitisation market and the absence of these from the Australian market is a significant impediment to the further development of cost effective and efficient funding markets.

2(c) Promote deposits (e.g. eliminate the tax advantage of saving in super versus holding deposits)

Although the share of retail deposits in the overall funding mix has increased in recent years there is still some way to go. The relationship between personal savings and superannuation (compulsory and voluntary) is an important contributor to the shortfall of savings in the Australian financial system.

There are a number of issues, primarily tax related, that contribute to the inefficient allocation of capital and savings in the financial system. A level playing field across asset classes including superannuation will address this inefficiency; the Inquiry is encouraged to explore this topic.

Summary

At ING DIRECT, we believe that improving the financial services sector, and encouraging competition in the marketplace, will be natural outcomes of making it easier for the customer to do their banking.

We know from our research that customers are developing an appetite for taking control of their finances. They want to be able to do their banking in a simple and straightforward manner – and it's up to the industry to help them do so.

Making it easier for customers to switch their bank accounts is one aspect of this. If customers refuse to accept the status quo and are empowered to seek a better deal, this will force banks to act on customers' dissatisfaction – become more innovative in the way they do things; create a better value proposition for their customers and thus stimulate further competition.

We have deliberately focused our submission on the customer and left the wider discussion about the future of financial services to the Australian Bankers Association of which we are a member.

We thank the Government for prioritising this Inquiry and would welcome the opportunity to discuss our proposals in further detail during the consultation phase of this inquiry. Should you require any further information please do not hesitate to contact myself or David Breen on 02 9028 4347.

Yours sincerely,



Vaughn Richtor
Chief Executive Officer
ING Bank (Australia) Ltd

SOURCES

¹ APCA report – page 13 <http://apca.com.au/docs/annual-reviews/apca-annual-review-2013.pdf>

² Bernie Fraser Report, <http://banking.treasury.gov.au/banking/content/reports/switching/switching.asp>

³ Australian Communications & Media Authority, Annual Communications Report. Derived from the cumulative number of mobile numbers ported from 2001-2013.

⁴ Derived from the average number of mobile numbers ported over the number of mobile services from 2003-2013

⁵ Current Account Switch Service, Quarterly Dashboard.UK Payments Council. http://www.paymentscouncil.org.uk/files/quarterly_dashboard_-_16_jan_14.pdf

⁶ UK Payments Council Press release January 2014 http://www.paymentscouncil.org.uk/media_centre/press_releases/-/page/2798/

⁷[CFA Institute](#), Restricting Sales Inducements, December 2013 at page 4.