

SUBMISSION ON POLICY ISSUES IDENTIFIED IN THE INTERIM REPORT

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Consequent to the release of Kenneth Hayne's interim report, I would like to make a submission to the Financial Services Royal Commission. I am aware that in keeping with the protocol for such an interim report, a number of questions have been posed by Commissioner Hayne as points for thought and discussion.

While many of the questions relate to specific details of the banking practices examined in the hearings, Commissioner Hayne appears to indicate that it would be appropriate to consider the banking system as a whole. I would like to comment on some of the questions Commissioner Hayne poses in his interim report and present arguments to support my views around structural change.

Commissioner Hayne:

Is the law governing financial services entities and their conduct too complicated?

- Does it impede effective conduct risk management?
- Does it impede effective regulatory enforcement?

Many eminent and qualified people are now believing that the current laws are too complicated. Consider the on-coming risk of another financial crisis. I would quote former principal researcher for APRA, Dr Sy Wilson, *"I think the financial system is too complex for the regulators ... I think we need a much simpler system."*

Where there is denial of risk, there cannot be effective risk management. Why would the banks consider that destruction of customer's finances and businesses would constitute any form of risk to them? Up until now their practices have not materially affected their profits and they are under no risk of serious punishment from regulators. Behaviour "discovered" by the Royal Commission indicates that effective risk assessment to protect the public has clearly not been done or risks identified have been ignored.

It would appear that whether law governing financial entities impedes regulatory enforcement is obvious, given the scale of malpractice uncovered thus far. Clearly, laws covering fraud and theft are better suited to deal with what this sector has largely become within the areas it operates in.

Commissioner Hayne:

- Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?

The entire regulatory system needs to be re-thought and simplified. The ridiculous reports of buck passing between APRA and ASIC over who is responsible for what in regards to bank behaviour is proof enough.

Commissioner Hayne:

- Do the events that have happened raise any issue about business structures?
- Do the events that have happened invite consideration of whether structural changes should now be made?
- Do the events that have happened suggest that manufacturers of financial products should not be permitted to provide, whether by employee or authorised representative, personal financial advice in relation to products of a kind it manufactures?

What has happened thus far does considerably more "invite consideration of whether structural changes should now be made." The current structure, particularly that of the largest banks (vertical integration), has created obvious conflicts of interest between serving their customers, and exploiting their customers to maximise profits for shareholders. The banks have demonstrated they cannot be trusted to "manage" these conflicts of interest, and relying on more rigorous law enforcement is unrealistic. The conflicts of interest must be removed, by separating commercial banks from all other financial product businesses. The Bank Separation Bill 2018, raised by Bob Katter and seconded by Andrew Wilkie has

been raised in parliament and addresses this issue. The Greens have publicly stated similar intentions to that of the previously mentioned bill.

Commissioner Hayne:

- Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?

As stated above, if commercial banks were only allowed to take deposits and make loans, and kept separated from other financial services and speculation, the financial system would be much simpler, and therefore the regulators should be better able to do their job. Banks would not be too big to fail, so APRA would not be able to use “financial stability” as the excuse for allowing the banks to continue as they have been doing or develop new ways of gouging customers.

Commissioner Hayne:

“What can be done to prevent the conduct happening again?”

Unless you have experienced bad bank conduct personally, conduct uncovered thus far in the Royal Commission would beggar belief. Those of us that remember the Homefund Scheme in NSW in the 1980s understand that disreputable, deceptive, unethical and downright dishonest behaviour by banks is nothing new. The idea that bank behaviour problems involve just a few “rogue traders” cannot be used to justify the seriousness or extent of behaviour uncovered so far.

During my working life of almost 50 years in various Australian industries, I realised that work place or corporate “culture” actually does exist. As a young man I wrongly assumed that professionalism, ethics and character would largely ensure honest and ethical behaviour of banks and other businesses. I could have easily been sold the argument that self-regulation would work for the financial services industry. Better yet, regulators could police an industry like financial services and use appropriate measures to ensure that banks serve the public rather than the other way around. I later realised that I was completely wrong.

Experience taught me two things about “culture”.

1. The fish rots from the head first. This old Jewish proverb typifies the behaviours and actions of corrupt organisations. Senior leadership driven by greed or lust for power behave in an amoral manner. This “educates” their immediate subordinates to behave in a like manner. Staff and customers are subsequently mistreated, in the name of “shareholder value”, “competitiveness” or even individual manager’s bonuses. This “culture” is forced as far down the corporate structure as possible and those showing honesty, integrity, compassion or virtues found in decent human beings find it very hard to “force their way through”. They are prevented by the “culture” of those above them in the hierarchy from reaching the more senior levels of management that control policy and practice.

I have experienced this type of culture becoming toxic to the extent that profits decline and senior management are forced to try to rectify the situation. Often, this is a box ticking exercise aimed at “refreshing” the culture without any real attempt to address the moral dimension of the problem. This is because leadership really do not want to change. The leaders want to continue to “motivate” or otherwise manipulate subordinates by using the greed and ambition they have modelled for the subordinates to learn from. Look at the banks ridiculous attempts in the media where they try to portray themselves as having human virtues. The public are not fooled.

2. Those that make the rules do so in their own interest. Look at the individual work backgrounds of the so-called regulators such as APRA. There is a “revolving door” between the big banks and positions with regulators, just as there is a revolving door between politics and senior positions with the banks when they leave politics.

In summary, my view is that it is extremely difficult to change workplace culture, particularly when bad behaviour has been rewarded in so many ways over a long period of time. Drastic structural change is the only answer to this. Most of the misconduct examined by the royal commission stems from the banks being too-big-to-fail conglomerates of multiple financial services businesses. There are clear and obvious inherent conflicts of interest in the whole concept of vertical integration as applied to the financial services industry in Australia. More is required than just taking away the parts of current bank business showing the most obvious conflict of interest or most egregious behaviours. Completely separating commercial banking from investment banking is the only way to control the problem. It is simple (compared for example, to the Dodd-Frank Act of USA) and it protects people’s savings from being used as collateral to back the banks addiction to financial derivatives trading, which in my view is mis-use of capital.

Perhaps more importantly, bank separation prevents the “blackmail” conducted by banks against democratically elected governments. “Too big to fail, too big to jail” has been said in the US over the size and behaviour of banks there. Bankers have held governments to ransom by falsely claiming that the entire economic system will collapse unless they are “protected” by government bail-out or more recently bail-in involving confiscation of customer’s savings or their savings

converted to bank shares. The banking functions can be separated and the criminals can be gaoled, just as they were in 1930s USA under Franklin D. Roosevelt. Imprisoning bankers alone, however, will not solve the problem without addressing the root cause.

Let us look at the upside of bank separation. Without the incentives to concentrate most of their lending into speculating on the housing bubble, they would have more interest in lending to, and looking after, their small business and farm customers. Wouldn't that be good?

Commissioner Hayne:

- Are APRA's regulatory practices satisfactory? If not, how should they be changed?
- Are APRA's enforcement practices satisfactory? If not, how should they be changed?
- Does the conduct identified and criticised in this report call for reconsideration of APRA's prudential standards on governance?

Australian banks currently have the largest portion of their loan book value invested in housing of any country in the world. While this may sound impressive to some, it is not when one considers that bank practices around mortgage affordability for customers have been deceptive to the point of fraud. This has created a housing bubble when, combined with little wage growth and increase cost of living expenses, will soon burst with potentially disastrous consequences for the Australian economy. What is worse, is that rather than warning the government of this and prosecuting the banks appropriately, APRA and ASIC quarrel and buck pass over who holds responsibility for these things but *only after the Royal Commission has uncovered them!*

We then hear the same old "financial stability" argument from the regulators, as an excuse for being complicit in the bank's behaviour. The regulators have allowed the banks to engage in practices that maximise their profits, but at the expense of their customers. Australia now stands exposed to \$40 trillion in dangerous financial derivatives based on the housing bubble. This is the real threat to the financial system.