

ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

MACQUARIE GROUP LIMITED (ACN 122 169 279)

RESPONSE TO INTERIM REPORT

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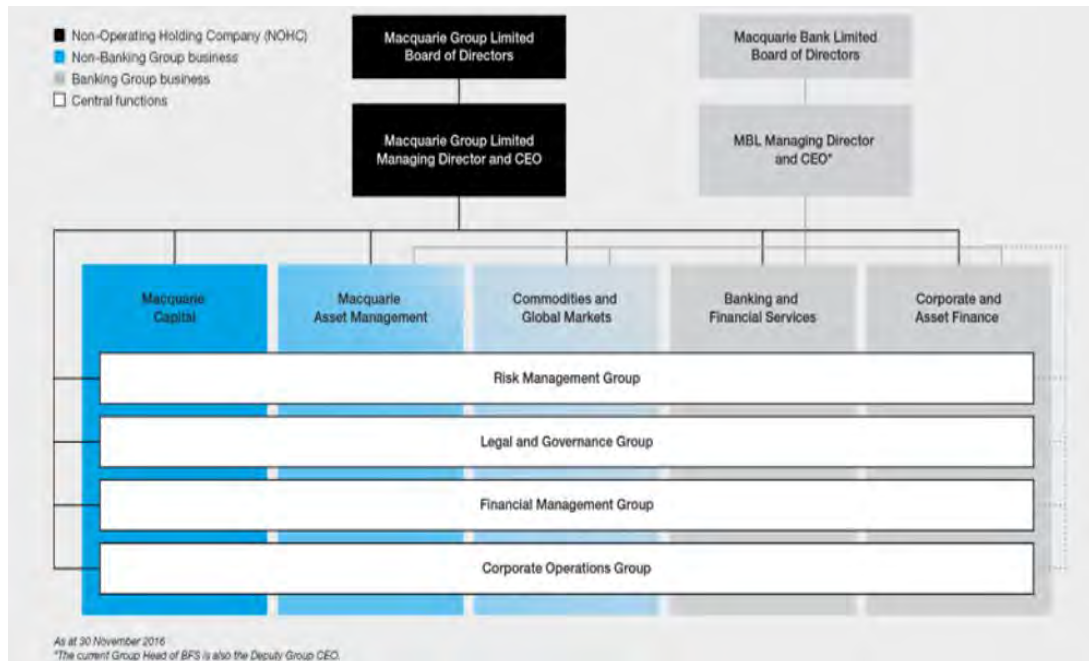
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A. Introduction

1. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Commission**) has invited individuals and organisations to make submissions in response to its Interim Report, published on 28 September 2018.
2. This submission is made by Macquarie Group Limited. It is focussed on three policy issues identified in the Interim Report where Macquarie Group considers that it has information and a perspective that may be helpful to the Commission in formulating its final report and recommendations.
3. The three particular policy questions are:
 - (a) How far can, and how far should, there be a separation between providing financial advice and manufacture or sale of financial products?
 - (b) What steps, consistent with responsible lending obligations, should a lender take to verify a borrower's expenses?
 - (c) Should ASIC's enforcement practices change?
4. Macquarie also makes a brief submission about the role of intermediaries.

B. Background on Macquarie Group

5. The corporate structure of Macquarie Group is shown in the structure diagram below.



6. Operating groups relevant to this submission are:

(a) The **Banking and Financial Services (BFS)** Operating Group which has the following relevant divisions:

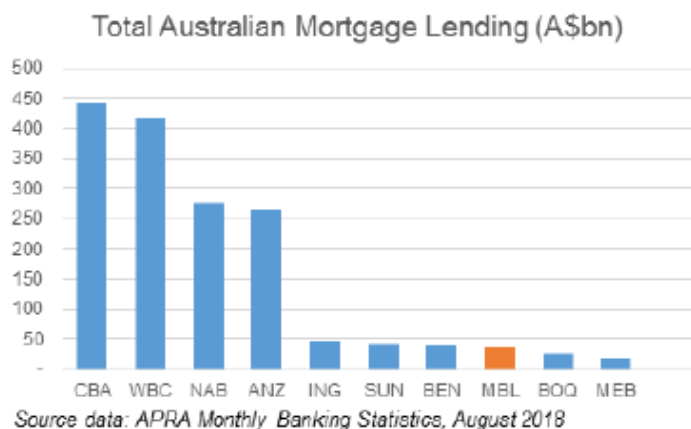
- (i) **Personal Banking** – distributes consumer banking products, including mortgages and credit card products governed by the *National Consumer Credit Protection Act 2009 (Cth) (NCCP)*.
- (ii) **Wealth Management** – distributes wrap platform, cash management services and other wealth products through independent financial advisers and provides financial product advice to its clients; and
- (iii) **Product and Technology** – designs and builds products (including mortgage products, credit card products and Wrap platform products)

distributed by BFS's client-facing divisions and by third parties, such as mortgage brokers, dealer groups and independent financial advisers.

- (b) The **Corporate and Asset Finance** Operating Group contains an **Asset Finance** division. The Australian operations of the Asset Finance sub-group provide finance and rental services for particular classes of assets (principally motor vehicles and technology equipment).
- (c) The **Macquarie Asset Management** Operating Group includes the responsible entity of a number of managed investment schemes, including some managed investment schemes that are available for investment on Wrap platforms manufactured by the Product and Technology division of BFS.

7. Macquarie Group's consumer lending divisions have a relatively small share of the Australian market. For example:

- (a) the Personal Banking division of BFS represents about 2% of the Australian domestic mortgages market:



- (b) The Personal Banking division has approximately 1% of the market in Australia by number of accounts for credit and charge card accounts. It has approximately 0.14% of the Australian market by number of accounts for transaction and offset/deposit accounts which use a debit card.

- (c) The Asset Finance division of Corporate and Asset Finance has about 8% market share of the automotive finance market.

C. How far can, and how far should, there be a separation between providing financial advice and manufacture or sale of financial products?

8. Macquarie Group's experience is that financial product manufacturers and financial advisers can operate within the same corporate group without resulting in a disproportionate volume of the manufacturer's products being recommended by its financial advisers. As illustrations:
- (a) The superannuation products offered to new clients by BFS (*Macquarie Super and Pension Manager, Macquarie Super and Pension Consolidator and Macquarie Super Accumulator*) require clients to have a financial adviser at account inception. As at June 2018, 94.6% of the financial advisers of current members are unaffiliated with Macquarie Group.
 - (b) As at 30 June 2017, those products offered members a choice of 1,511 products to invest in. Less than 6% of managed investment schemes (representing approximately 3.9% of funds under administration for the platform products) and less than 3.3% of the investment options offered by the platform products were Macquarie Group products.
 - (c) The same product list is available for financial advisers of the Wealth Management division to recommend to clients (with its wrap clients generally investing using the Macquarie Wrap platform).
9. Macquarie Group financial advisers are not a dominant distribution channel for Macquarie Group financial products and Macquarie Group financial products do not dominate the recommendations of Macquarie Group financial advisers.

10. At the conclusion of the Round 5 hearings of the Commission, Counsel Assisting posed this question:

There are obvious and very significant challenges with mandating structures or structural changes and an important question is can it be really said with any confidence that conflicts that arise from structures are so unmanageable as to warrant legislative intervention where one would think that ordinarily the very strong preference should be away from any form of legislative intervention in particular corporate structures.

11. Macquarie Group does not think that there are conflicts so unmanageable as to warrant legislative intervention in particular corporate structures. It is possible for financial advisers to comply with their duties to clients, including the duty to act in the best interests of the client, in circumstances where a related party of their employer also manufactures financial products.
12. Organisations can have in place arrangements that minimise (or eliminate) and otherwise manage the potential for any conflict between interest and duty and can take steps to ensure that representatives comply with financial service laws. Some examples include:
- (a) ensuring that there are no direct financial (or other) incentives for financial advisers to recommend related-party products rather than competing products;
 - (b) an approved product list that contains a suitably broad array of financial products – more than 94% of the managed investment schemes and 96.7% of the investment options on Wealth Management's approved product list are manufactured by independent companies;
 - (c) suitable tools to assist financial advisers in comparing products – for example, Wealth Management provides a Platform Benchmarking Tool that provides advisers with information that allows them to compare wrap platforms and master trusts of Macquarie and other organisations; and

- (d) monitoring and supervision to identify instances of inappropriate advice, including compliance file reviews that are undertaken for each adviser at least once each financial year, and consequence management processes that will provide disincentives to providing inappropriate advice.

D. What steps, consistent with responsible lending obligations, should a lender take to verify a borrower's expenses?

13. Fulfilment of a lender's responsible lending obligations requires a multi-faceted approach that is adapted to the circumstances. Determining what inquiries will be reasonable and what steps to verify a consumer's financial position will be reasonable, as part of that process, is also shaped by the circumstances. Macquarie Group agrees with the views in the Interim Report that bank statements of consumers can provide a useful and important tool because the transactions recorded in the statements may evidence or corroborate aspects of a consumer's financial position.
14. The tools and technology available to establish transaction data are in the early stages of significant change. The Australian Government has committed to implementing Open Banking reforms that will require major banks to make data available (with a consumer's authorisation) on credit and debit card, deposit and transaction accounts by 1 July 2019 and mortgages by 1 February 2020. Data on all products recommended by the Review will be available by 1 July 2020. All remaining banks will be required to implement Open Banking with a 12-month delay on timelines compared to the major banks.
15. Macquarie Group has been at the forefront of Open Banking and believes that the Open Banking initiatives will provide significant opportunities for efficiently accessing transaction data of prospective borrowers where necessary and for the development and evolution of systems to analyse transaction data.
16. The implementation of Open Banking is relevant to the practical effect of an increase in the extent to which lenders must verify expenses by reference to transaction data statements.

At present, the burden of locating and providing bank statements falls on a borrower unless all of his or her accounts are held with the proposed lender. The desirability of avoiding this burden is likely to increase the relative attraction of borrowing from one of the major banks, which more borrowers will bank with and which are more likely to hold all of a borrower's accounts. Open Banking ought to help level the playing field between major retail banks and others by reducing the significance of this point of difference.

17. Macquarie Group submits that any change to responsible lending obligations that increases the extent to which lenders must have regard to bank statements should be synchronised with the implementation of Open Banking and the development and evolution of systems to analyse transaction data made accessible by Open Banking. This ought to make it easier for both borrowers and lenders to deal with the verification of expenses and minimise any adverse effect on competition.
18. Further, in making any change, due regard should be had to both the difficulty of verifying expenses by reference to bank statements and the potential inconclusiveness of the process. Some factors of relevance in considering those issues include:
 - (a) The amount of data to be collected and analysed would be considerable – there are currently approximately 37 million debit card accounts and 16 million credit and charge card accounts in Australia (implying an average of about 2.65 accounts per person or 5.3 accounts for a couple).¹ There are approximately 240 million credit card and 568 million debit card transactions per month in Australia (implying an average of 485 transactions per person per annum (or 970 for a couple)².
 - (b) The transactions recorded may not provide a complete or conclusive view of the expenses incurred by the consumer as:

¹ Reserve Bank of Australia Payments Statistics (<https://www.rba.gov.au/payments-and-infrastructure/resources/payments-data.html>) accessed 25 October 2018. Assuming there are approximately 20 million Australians over the age of 15.

² Ibid.

- (i) The consumer may not provide access to all accounts held by them.
 - (ii) The transactions will not reveal how any cash withdrawals are spent. Where a withdrawal is in cash (there are approximately 50 million withdrawals (valued at over \$11 billion) per month in Australia at ATMs alone)³ there will be no meaningful information about how the cash was spent.
 - (iii) Interpreting or deciphering what particular entries relate to is difficult and time consuming.
 - (iv) It will often not be possible to assign particular transactions to categories that reflect the distinction between necessities and discretionary expenditure, for example a credit card purchase at a department store could be for food, clothing or whitegoods.
- (c) Unless the lender is to rely on the borrower's assurance that the account statements provided record all the borrower's expenses, it will also be necessary to reconcile the expenditure with the borrower's opening and closing balances and income. The difficulty of doing that will be compounded in many circumstances, for example where a couple with separate bank accounts and incomes are applying jointly for a loan, or where a person is applying for a loan when they hold a joint account with their partner.

E. ASIC Enforcement practices

19. Macquarie Group considers that it is important for regulators to have a range of regulatory tools to carry out their enforcement functions. Those tools should allow the regulator to adapt its approach depending on the nature of the issues being addressed, the size of the business and organisation involved, the impact on customers and the change or outcome which the regulator wishes to effect.

³ Ibid.

20. It is Macquarie's experience that an enforceable undertaking can achieve effective regulatory outcomes and facilitate change more quickly and broadly within its business than may be the case had a litigation route been pursued first or in the alternative. It considers that an enforceable undertaking is well suited to circumstances where an organisation accepts that remedial steps ought to be taken and where it is willing to work with the regulator and accept conditions to ensure that those steps are taken in a timely and orderly way.

Macquarie Equities Limited Enforceable Undertaking

21. Between December 2011 and August 2012, ASIC conducted surveillance of the business of Macquarie Equities Limited (*MEL*), part of the Wealth Management division of BFS, and identified a number of deficiencies with adviser record keeping including advisers failing to demonstrate a reasonable basis for advice.⁴
22. Following that review, in January 2013, MEL entered into an enforceable undertaking (the *EU*) with ASIC to address a number of concerns identified by ASIC.
23. As part of the EU, MEL developed a two-year plan to address deficiencies in its compliance risk management system. Through implementation of that plan with close oversight from ASIC and an ASIC-appointed independent expert, MEL's business and compliance framework, and the risk culture within its business, has undergone significant positive change to the benefit of its clients. The scope of the change has not been limited to the deficiencies identified by ASIC that initially led to the EU.
24. Among other things, the improvements to MEL's business have included:
- (a) the employment of new technology to assist with record keeping and monitoring of client files;
 - (b) the appointment of a new management team and additional compliance staff;

⁴ See ASIC Media Release [13-010MR](#).

- (c) the implementation of a multi-faceted supervision and monitoring framework which adopts a 'Three Lines of Defence' model to risk management and synthesises a range of measures to prevent, detect and remedy poor behaviours;
 - (d) a rebuild of the program through which MEL reviews advisers' clients files for compliance with internal, regulatory and legal obligations; and
 - (e) the design and implementation of a client remediation program (overseen by ASIC and an internationally recognised professional services firm) which involved over 189,000 letters being sent to more than 160,000 clients and a review of more than 4,700 client files.
25. The EU was a catalyst for efforts that have produced a substantial shift in the way in which BFS staff view compliance and risk, particularly in the Wealth Management division.
26. The improvements to MEL's business and culture extended beyond the scope of the deficiencies initially identified by ASIC that led to the EU. The EU provided an opportunity for MEL, with ASIC's oversight, to reflect more broadly on the adequacy of its compliance arrangements and to implement lasting changes in a relatively short period of time. Had ASIC chosen to pursue the deficiencies it had identified by way of litigation, there is a real possibility that such an expansive outcome would not have been achieved or in a similar timeframe.

General deterrence effect of enforceable undertakings

27. The general deterrence effect of enforceable undertakings should not be underestimated. The cost of implementing the EU was significant, in the order of \$49 million.
28. Entry into enforceable undertakings is also widely publicised, as was the case for the MEL EU. ASIC publishes the terms of enforceable undertakings and releases periodic media releases to update the public on their progress and outcomes. The press releases attract significant media attention.

29. Outside of its own experience with enforceable undertakings, Macquarie Group also pays careful attention to the terms of enforceable undertakings entered into by other organisations and evaluates whether it should make changes to its business in light of the concerns expressed by ASIC and the undertakings given. These assessments are made in substantially the same way that Macquarie Group evaluates the impact of case law and guidance issued by ASIC and Macquarie Group's other regulators.

F. Role of intermediaries

30. In the Commission's *Background Paper 24: Submission on key policy issues*, Treasury notes that requiring consumers rather than lenders to pay brokers could threaten the viability of the mortgage broker distribution channel.⁵

31. In Macquarie's experience, honest, professional and competent intermediaries (including mortgage brokers and dealers) bring real and significant advantages to consumers in terms of convenience, and to the market and consumers in terms of competition.

32. In the 1990s, Macquarie introduced mortgage securitisation to the Australian market. This enabled non-bank participants to compete in the mortgage market. That competition ultimately resulted in a 2.50% reduction in interest rate spreads paid by consumers.⁶

33. This could not have occurred without the mortgage broker distribution channel. Brokers and other intermediaries are particularly important to lenders, like Macquarie, that do not have an extensive branch network. They also important to non-bank lenders. According to APRA, as at June 2018 there were 5,609 locations at which ADI's provided a branch level of service.⁷ Macquarie operates from only five such locations. The four largest ADIs operate from many hundreds of locations. A decline in the intermediated distribution channel would increase the comparative advantage of the operators of those branch networks.

⁵ Paragraphs 260 and 261.

⁶ See also page 19 of Deloitte Access Economics *The Value of Mortgage Broking*, July 2018.

⁷ APRA Statistical Publications *ADI Points of Presence*, 23 October 2018

(<https://www.apra.gov.au/publications/authorised-deposit-taking-institutions-points-presence>) accessed 25 October 2018.