26 October 2018

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Bendigo and Adelaide Bank's response to the Interim Report

Bendigo and Adelaide Bank welcomes the opportunity to respond to the Commissioner's interim report of 28 September 2018 (***Interim Report***).

Australia's banks have a privileged role in society because they are licensed by the government to provide a service that is fundamental to the operation of the economy, and to society more broadly. In recognition of this privilege, financial transactions should benefit all parties, including the customer depositing the funds, the customer borrowing the funds, the bank's shareholders who bear the risk of the borrower not being able to pay, and society itself through increased productivity – or even more directly, as with Bendigo and Adelaide Bank's **Community Bank**® model.[1]

Banks were formed to feed into community prosperity this way – to accept cash from savers to lend to borrowers who could use that money to add value. The bank charged the borrower a bit more than it paid the depositor, and returned the risk margin to its shareholders as dividends. The extra value added along the way was beneficial to society – people gained employment, houses were built, businesses started and public infrastructure funded. Importantly though, for a bank to be successful over the long term, this value must be

[1] A publication written by young people from 22 towns in which Community Bank® branches have opened through engagement by the local community with Bendigo and Adelaide Bank provides an insight from a community perspective into the positive impacts of community banking in those communities: Tucker, L (ed), "Banking on community spirit: 22 Australian communities using common cents for local benefit", Potentially Famous, 2004.

balanced between all its stakeholders – shareholders, customers, staff, partners and communities (including government).

Why did it happen?

In our view, many of the issues identified by the Commissioner in his Interim Report, including the prioritisation of short-term profits over longer term benefits, reflect a departure from the simple notion that banks perform a fundamental service to society, which should benefit all parties. Significant factors that have contributed to this departure have included the structure of the industry, the expectations of shareholders, and the regulatory framework that has emerged over time.

As the Interim Report correctly identifies, a major cause of the industry's problems has been remuneration arrangements that incentivise management to maximise profit for shareholders, particularly over the short term. While some attempt has been made to move to a more balanced view of performance, for example by including customer targets in long term incentive plans, institutional shareholders and proxy advisors typically require executive remuneration to have a substantial weighting towards incentive-based pay that is directly exposed to financial performance and share price performance, and criticise remuneration structures that do not do so. This poses a significant dilemma for boards, in balancing the short-term objectives of some shareholders against growing the business for the long term by satisfying customers and building reputation.

In our view, weighting remuneration towards short-term performance can adversely affect banks' long-term sustainability, including by creating conflicts of interest, and risking the development of a poor culture that loses sight of the interests of customers. Accordingly, Bendigo and Adelaide Bank limits the proportion of incentive-based pay, particularly staff bonuses, to levels that are relatively low compared to its peers, and has done so for some time.

Whilst remuneration issues are not confined to the Australian banking industry, it is the lack of true competition in Australian banking that has allowed the major banks to concentrate their efforts on shareholder returns, without the usual counterbalance towards the customer that exists in a genuinely competitive marketplace.

This lack of effective competition has been compounded by a series of regulatory and legislative changes. The large volume of new regulation introduced this century has made it significantly more difficult for smaller banks to compete effectively, as the relative cost of implementing the changes required to meet new regulation is far greater for these entities. The introduction of a two-tiered prudential regulation system in 2008, where the major banks are given a significant capital advantage, further entrenches their dominance.

The implementation of the guarantee for Australian banks in response to the global financial crisis was also flawed. By charging the major banks the least, the guarantee increased the advantages they already had, through cheaper access to funding. It would seem that rather than promoting competition to ensure that customers have choice, the system and the regulatory approach has actually created barriers for those who could have otherwise provided that competition.

What now?

The challenge now is to find a way to rebalance the value that banking offers for all stakeholders. In this regard, we consider the questions posed in Chapter 10 of the Interim Report are important. While Bendigo and Adelaide Bank has not provided individual responses to those questions here, we have contributed to the preparation of the detailed submission of the Australian Banking Association.

In considering these questions, we believe that it is important that there is an understanding of what the community's expectations are of its financial system. From our perspective, as we submitted to the Commissioner in January, we believe that the community expects that banks will strive to:

- Act honestly and fairly.
- Listen to customers and respond to their needs.
- Act for the long term benefit of community.
- Promote financial inclusion.
- Securely hold customers' money and personal information.
- Derive a fair return on the shareholder capital provided by the community.
- Pay a fair share of profit in tax.
- Operate within the law.
- Ensure staff are fairly rewarded.
- Provide staff with a safe workplace, free of harassment, discrimination and bullying.

In seeking to deliver on those expectations, banks should aim to meet the following standards:

- Price products and services in a manner that balances the interests of all stakeholders.
- Protect customers from unfair terms and conditions and fees.
- Provide information that assists customers to understand and compare the different products banks offer, including the inherent risks in products.
- Assist customers when they are in difficulty and take account of individual circumstances (including unforeseen hardship) when collecting on money loaned out.
- Continually work to protect customers from fraud and, increasingly, cybercrime.
- Invest in new technology and processes to improve the customer experience.
- Ensure customers have access to their cleared funds as and when required.

- Ensure staff are properly trained.

- Hold staff accountable for their behaviours and decisions.

- Not allow staff to be conflicted in customer dealings, including through remuneration practices such as volume-based bonuses.

Of course, we do not always meet the community's expectations, but we endeavour to do so. We also acknowledge that the Commission has identified areas where we need to improve.

Our long-held belief – which forms a core part of our values as an organisation – is that the role of a bank is to feed into community prosperity, not off it. The expectations and standards of conduct described above are consistent with this belief, and the notion that banks perform a fundamental service to society, which should benefit all parties. We hope that these principles help inform the Commissioner's inquiry, and assist in forming recommendations to address the many specific questions raised.