Michael R P Smith OBE | Chief Executive Officer

March 31, 2015

Hon Joe Hockey MP
Treasurer
House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Treasurer,

ANZ is pleased to provide this submission on the Final Report of the Financial System Inquiry.

We agree with the Report that Australia has a sound financial system which is adapting to community needs and which provides a strong platform for the Australian economy. As the Report notes, our banking system is significantly stronger following implementation of substantial regulatory changes post-GFC.

ANZ agrees with the Report that our banks should be unquestionably strong. Capital is one indicator of strength, but not the only factor. Assessment of strength should also take into account other critical factors such as regulatory supervision and frameworks, financial performance, balance sheet composition, liquidity, management performance and business model.

ANZ recognises that Australian regulation will be impacted by international developments. ANZ is particularly concerned that recent proposals from the Basel Committee on Banking Supervision (referred to as Basel IV) are taken into account in implementation of the FSI.

In our view, FSI capital related recommendations should not be implemented before there is clarity around Basel IV and Australia's response. Basel IV proposals may have wide-ranging implications for how banks manage capital, quantify and manage risk and the pricing of customer products. As the proposals currently stand, they fail to recognise the structural benefits of a strong financial and legal system such as Australia's, with proven effective regulation and sound institutional management.

The potential consequences of these proposals require thorough and careful consideration. Regulatory proposals which require banks to hold excessive levels of capital are inefficient and will impact both the price and the capacity of banks to lend.

ANZ will be arguing that Basel IV should permit national regulators discretion to take into account the range of factors affecting bank strength in the particular jurisdiction.

ANZ is committed to work with the Government to ensure that the policy objectives of the Final Report are successfully implemented.

Yours sincerely,

Mike Smith

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RESPONSE TO THE FINAL REPORT OF THE FINANCIAL SYSTEM INQUIRY

ANZ
31 MARCH 2015

EXECUTIVE SUMMARY

ANZ welcomes the release of the Final Report and agrees with its broad objectives to promote efficiency, resilience and fairness in the financial system.

The Final Report states that Australia's financial system has performed well in the two decades since the Wallis Inquiry. The system is competitive with sophisticated capital markets and firms that adopt new technologies, improving customer outcomes. The Final Report acknowledges that Australia's financial system held up well during the Global Financial Crisis (GFC) relative to its international counterparts. Australian taxpayers did not bail out an Australian Authorised Deposit-taking Institution (ADI) during the GFC. In response to the GFC, Australian banks and regulators have taken material steps to increase the resilience of the financial system.

This submission, ANZ's third submission relating to the Financial System Inquiry (FSI), includes suggestions on how to build on the foundation of a robust and efficient financial system. The structure of the submission follows the FSI Final Report. ANZ has responded to each recommendation with particular emphasis on key recommendations including those relating to 'resilience'. ANZ's response to the Interim FSI report contains material that is relevant to this submission but is not replicated here.

Resilience

ANZ fully supports the suggestion that the Australian Prudential Regulatory Authority (APRA) be granted responsibility for the development and implementation of the recommendations relating to resilience, if adopted by the Government. Given the importance and potential impacts of these recommendations on the financial system and the broader economy, it is essential that the Reserve Bank of Australia (RBA) and other members of the Council of Financial Regulators (CFR) are also involved in this process.

There must be a clear objective to minimise the frequency of regulatory change. This would reduce costs to consumers and provide banks with certainty to continue to invest in new products and business development, which will maximise growth and employment opportunities. Banks have implemented significant regulatory change since the GFC. Capital ratios are already approximately double pre-GFC levels. The implementation of Basel III reforms for liquidity has also been an important development in ensuring the Australian financial system is significantly more resilient to a shock than in the past. Further increases in capital requirements will have a diminishing marginal benefit for stability and resilience. Excess capital requirements result in a real impact on the economy, not just through the additional costs, but also because higher capital constrains Authorised Deposit-taking Institutions' (ADI) capacity to lend to both the consumer and business segments.

Australia's membership of the Basel Committee on Banking Supervision (BCBS) means that, even putting the FSI recommendations to one side, Australian banks are already facing additional regulatory change. This includes the introduction of a Leverage Ratio, the Net Stable Funding Ratio and potentially Total Loss Absorbing Capacity (TLAC). Recent announcements from the BCBS suggest the pace of regulatory change is not slowing, and arguably, some of the most material changes are still to occur. This includes significant revisions to standardised Risk Weighted Assets and the proposed introduction of capital floors (already being referred to as 'Basel IV').

The Basel IV proposals will potentially have material impacts on the way ADIs quantify and manage risk, invest in risk management capabilities, and structure their products and balance sheet, as well as the pricing of customer loans and deposits. The proposals may widen the gap between actual risk characteristics and the risk implied by capital requirements. A wider gap encourages the movement of lending from regulated to unregulated sectors and is economically inefficient in the allocation of capital resources.

As the proposals currently stand, they actually incentivise banks to reduce exposure to certain low risk sectors and portfolios, increasing the overall risk profile. The exact impact of these proposals will not be known until any new requirements are finalised by the BCBS and the capital floors are calibrated.

The potential consequences of the Basel IV proposals need to be carefully considered. In the residential mortgage market, for example, the proposals may encourage ADIs to implement much greater differential pricing between customer groups than currently occurs in the Australian market, to reflect the wider spectrum of capital requirements. This may include higher pricing to customers with higher loan to value ratios. It is important that the customer and economic impacts of these proposals are thought through and considered fully.

The Basel IV proposals also take a ‘one size fits all’ approach to capital requirements. As detailed in ANZ’s submission to the FSI Interim Report, Australia benefits from significant structural strengths. These include full legal recourse on lending (not prevalent in parts of weaker offshore mortgage markets, as evidenced during the GFC), the banks’ business models, strong financial performance, the strength of the sovereign credit rating, Australia’s robust legal and insolvency framework, and active and effective supervision by APRA. Australia’s structural benefits are not recognised in the recent Basel proposals. It is critical that if the proposals are implemented there is scope for appropriate national discretion and flexibility in setting the capital floor to reflect these benefits accurately.

Given the potential impact of these Basel IV proposals and the fact that the BCBS consultation process has only just started, it is critical that the work by the Committee is finalised before the Final Report’s recommendations in Chapter 1: Resilience are considered by APRA. Otherwise, the FSI recommendations may be obsolete before they are implemented.

Superannuation and retirement incomes

The efficiency of the superannuation system is fundamental to the ongoing welfare of all Australians. The superannuation system could be strengthened by further clarifying that the objective of superannuation is to provide retirement income.

Opening default funds to all MySuper products will help create a more competitive and accountable superannuation system. Improving employees’ choice of funds and strengthening the governance of funds by requiring funds to have a majority of independent directors would also improve outcomes for fund members.

A requirement for trustees to preselect a comprehensive income product which members could select if they wish, may particularly assist low income earners or retirees who do not wish to seek independent financial advice.

Innovation

ANZ supports measures that remove impediments and foster an environment for innovation in the provision of financial services. Crowd funding, comprehensive credit reporting and improved access to public sector data should bring efficiencies to the market for financial services. ANZ welcomes the RBA review of payment system regulation now underway and looks forward to further consultation with the industry and consumer groups given the complexity of these issues.

Consumer outcomes

ANZ supports further measures for improving consumer outcomes, noting that there has been extensive regulatory change affecting the financial services sector in recent years.

The recommendations dealing with competency of advisers and facilitating innovative product disclosure will aid the delivery of quality financial advice and greater financial literacy. ANZ is aware of the need to improve arrangements in these areas and is taking steps to progress the adviser register and enhanced educational requirements for financial advisers.

The strengthening of product issuer and distributor accountability is a significant change to current arrangements and care needs to be taken in the implementation of these proposals. Industry is keen to work with Government on the design of these proposals.

Regulatory systems

ANZ supports the Final Report's endorsement of the current regulatory framework for the financial sector. We agree that there are steps that can be taken to improve regulator performance through greater accountability for the exercise of their powers.

ANZ RESPONSE TO THE
FINANCIAL SYSTEM INQUIRY FINAL REPORT

CHAPTER 1: RESILIENCE

> ***Recommendation 1:*** *Set capital standards such that Australian authorised deposit-taking institution capital ratios are unquestionably strong*

ANZ supports the principle that Australian banks should be 'unquestionably strong'. In determining this, capital levels are important, however as the Final Report notes, many factors are important, including but not limited to liquidity, business models, legal structure and the strength of the sovereign. ANZ encourages the Government, and other members of the CFR, including APRA, to ensure that judgements about the 'strength' of the banking system take account of all these factors. Focusing on regulatory capital alone can produce misleading outcomes.

The structural strengths of the Australian financial system are set out in ANZ's submission to the FSI Interim Report (pages 2, 3 and 4). It would be quite reasonable for the regulator in certain jurisdictions to set relatively high capital minimums in order to compensate for structural weaknesses in the financial system. This might apply to a financial system that, for example, allowed limited recourse debt, had firms with complex business models, faced macro-economic challenges, and was not actively supervised by the regulator. This does not describe the Australian financial system. A financial system's overall resilience is determined by a combination of capital levels and other structural factors. This in turn affects an ADI's ongoing access to capital markets, including in the wake of an economic shock and dislocation.

Evidence of what 'unquestionably strong' means can be gauged from other sources including the financial market and credit rating agencies' evaluation of an ADI's riskiness. Whilst these measures have their limitations, they take a far more holistic perspective of ADIs strength than capital levels alone. In order to maintain access to funding markets including during challenging market conditions, it is important to look at all the measures the market actually considers when they evaluating the riskiness of a financial institution and therefore, their willingness to extend funding. The additional factors include financial performance (including profitability and organic capital generation), balance sheet composition, liquidity, the competency and track record of management and the riskiness of the markets in which the ADI operates. These factors are built into a bank's credit rating. The four major Australian banks are in the AA ratings band (only eight other banks globally are in this band).

The correlation between capital levels (Common Equity Tier 1 or CET1) and the markets pricing of 'riskiness' (ie Credit Default Swaps), suggest the relationship between the two is relatively poor (see ANZ submission to the Interim Report – page 8).

ANZ agrees that if this recommendation is adopted, it is appropriate for APRA to take carriage of the determination of what 'unquestionably strong' means and the implementation. APRA have strong expertise in this area and have the greatest awareness of and engagement in the international debate and developments.

In any implementation of this recommendation, ANZ encourages APRA to consider the 75th percentile objective alongside the suite of other important measures currently used (such as stress testing) to determine the appropriate capital levels for Australian ADIs and the system. This could occur within the existing frameworks (not publically disclosed) such as the Internal Capital Adequacy Assessment Process (ICAAP). If the objective is implemented as a new explicit 'limit', Australia will effectively have outsourced this aspect of the determination of capital minimums to other jurisdictions. While we understand the need for Australian banks to be among the stronger institutions accessing capital markets, capital levels for Australian ADIs should not simply become a function of the work undertaken in other jurisdictions to determine the appropriate capital levels for those jurisdictions (reflecting their locally specific conditions and concerns). The primary focus must remain on the 'right' amount of capital not the 'relative' amount of capital.

ANZ recommends that the appropriate comparator set of ADIs is reflective of the size and structure of the Australian ADIs. We suggest that the comparator group of global ADIs should operate within similar regulatory and market structures and be limited to those with the following characteristics: they have primarily retail/commercial bank business models (ie should not include ADIs that have material investment banks); are active issuers of debt products into international capital markets (as opposed to being 'internationally active'); and are of sufficient size (the BCBS Group 1 banks require only EUR3 billion in Tier 1 capital).

It is critical that the capital ratios of the comparator ADIs are standardised to the greatest extent possible. ANZ recognise that this is not a simple task. Standardising for the varied implementations of the Basel capital rules should include adjustments for both explicit super equivalents relative to the Basel minimums, as well as practice differences (as highlighted recently by Basel concerning excessive RWA variability). Material impacts due to different implementation and accreditation standards of the internal ratings-based (IRB) models, cannot be ignored even though it is difficult to quantify with absolute precision.

In regard to the funding cost implication of higher CET 1, ANZ notes that the Inquiry concludes that the cost of a one per cent increase would likely be less than 10 basis points. This is in part informed by the example in Box 7 of the Final Report. ANZ wishes to highlight that target return on equity (ROE) of 15 per cent should be used in this analysis as a post-tax rather than pre-tax ROE. ROE is measured on a post-tax basis (ie it uses NPAT as the numerator). Furthermore, the aggregate RWA per loan for Australia's major ADIs is approximately 60 per cent to 70 per cent rather than 50 per cent as used in the Box 7 example. Correcting for these two impacts approximately doubles the six basis point funding cost impact from the Box 7 example.

In summary, ANZ agrees that the Australian banking sector should be 'unquestionably strong'. This strength should be evaluated using all relevant factors and not just capital. The primary focus should remain on the appropriate capital levels for the system, with 'relative' capital levels only one of several factors to be considered. Australian banks must be compared to the appropriate group of global ADIs, and every attempt should be made to standardise for national differences in the measurement of capital.

***Recommendation 2:** Raise the average internal ratings-based (IRB) mortgage risk weight to narrow the difference between average mortgage risk weights for authorised deposit-taking institutions using IRB risk-weight models and those using standardised risk weights*

ANZ notes that the primary rationale for this recommendation to narrow the perceived gap between IRB and Standardised RWA on mortgages is for reasons of competition, although the recommendation appears in the Final Report's chapter on resilience. In ANZ's view, it is not appropriate to use capital settings to deal with a perceived competition issue. The Australian mortgage market is already intensely competitive, as noted by the Reserve Bank of Australia.

Applying a higher capital charge to an IRB bank for mortgages will not affect the competitive position of other ADIs. The inferior position of ADIs using standardised risk weights is driven by inefficiencies including higher cost to income ratios, a lack of business and geographic diversification and other factors associated with higher risk which impact on access to funding. This is in turn reflected in their lower ROE rather than an inability to compete for customer business. In fact, requiring the major ADIs to increase capital further will increase wholesale debt investors' preference to invest in the larger ADIs rather than smaller ADIs using standardised risk weights.

There is a cost to excessive regulation. This recommendation will increase the variance between the actual risk of the mortgage portfolios, and the amount of expensive capital that banks are required to hold against this risk. This inefficiency can result in a misallocation of capital resources, encourage lending to shift from the regulated to unregulated sectors and represents a real cost to the economy. An appropriate, and well-managed level of bank leverage has acted as a shock absorber for the economy in the past, however this mechanism is now more constrained. We need to be cautious in encouraging the transfer of risk from the banking market (which is designed and regulated to manage the associated credit and liquidity risk) to other markets (such as capital markets). The GFC highlighted the problems with certain jurisdictions that had a high dependence on capital markets to directly fund their mortgage portfolios.

In a similar approach to recommendation 1, the FSI Final Report does not attempt to determine the 'right' amount of the capital required for the mortgage portfolios (for example, acknowledging actual loss history in Australia, yet recognising the fact that the Australian market has not suffered a significant downturn in recent times). Rather, the report focuses on the relative amount of capital compared to standardised banks.

ANZ supports the principle that ADIs must have strong incentives to build and maintain risk management capabilities and infrastructure. This risk-based principle is the core of the Basel II regime and the internal ratings-based (IRB) approach and must be retained. The risks characteristics of different ADI mortgage portfolios are not the same. In addition to the greater geographic and demographic diversification that the IRB banks achieve, the investment in risk systems that the IRB approach promotes including the systems particularly at mortgage origination, also improves the credit quality of the portfolio.

Recent developments

Since the release of the Final Report, there has been further developments from the international regulatory bodies (ie the BCBS) on likely future changes to RWA for all aspects of an ADI's risk base, including the mortgage portfolios. This includes material revisions to the Standardised approach to credit risk and the proposed introduction of a capital floor for IRB banks.

These developments are likely to determine the future RWA for mortgages, superseding this FSI recommendation. There is significant debate underway, and quantification of the impact is still to be completed by global regulators, before the revised Standardised approach or the capital floors are finalised and calibrated.

Consequently, ANZ suggests it is not practical to proceed with this recommendation until global developments are significantly more advanced.

The D-SIB charge and 'gap' between Standardised and IRB Risk Weights

In ANZ's view, the Final Report's analysis of the apparent 'gap' between the RWA requirement of the Australian IRB banks and standardised banks, does not sufficiently take into account the cost of establishing and maintaining IRB status.

The effective differential between IRB and Standardised RWA is narrower that the raw percentages (as detailed in some of the industry responses to the Interim Report). The recent domestic systemically important bank (D-SIB) charge only applies to the major banks, and materially reduces the size of this 'gap'.

The SIB framework is based on a series of systemically important indicators. Two out of five of these indicator categories are materially influenced by the size of the mortgage portfolios for the Australian major ADIs. Specifically:

- **Size Category**: is a measure of the 'total exposure' of an ADI. For ANZ (and the other major ADIs), the mortgage portfolio is by far the largest asset on the balance sheet. Approximately 50 per cent of all ANZ loans (including ANZs offshore operations) are residential mortgages in our home markets of Australia and New Zealand.

- **Interconnectedness Category**: this includes 'Intra Financial System Liabilities' and 'Securities Outstanding'. ANZ's 'funding gap' is required to be funded with wholesale funding (the vast majority of which is sourced from other financial institutions, insurance companies, fund managers, superannuation funds etc). The household customer segment in Australia drives the majority of this 'funding gap'. Consequently, the size of term wholesale funding issued by Australian banks exists almost entirely due to the size of banks' mortgage portfolios.

In aggregate these two categories are material for the major Australian ADIs, due to the size of their mortgage portfolios. Without these very large portfolios, the systemically important indicators would be significantly lower.

Consequently, it can be argued that without these large mortgage portfolios, the major ADIs may not be designated as D-SIBs and subject to an additional 1 per cent Capital Conservation Buffer.

It is reasonable therefore, for major ADIs to consider the impost of the D-SIB charge as really applying only to the mortgage portfolio.

ANZ is targeting a CET1 ratio of approximately nine per cent inclusive of the D-SIB charge. If ANZ were not a D-SIB, the target CET1 would be closer to eight per cent. ANZ's current average RWA for IRB mortgages is approximately 17 per cent. At a nine per cent CET1 ratio target, the additional capital required to meet the D-SIB impost is currently approximately AUD3.6 billion. Allocation of this additional CET1 to the mortgage portfolio increases the effective RWA for mortgages from 17 per cent to 29 per cent. This compares to the Final Report's recommendation of 25 per cent to 30 per cent. Consequently, after consideration of the impact of the D-SIB capital impost, the effective average RWA for mortgages is already at the top of the FSI's recommended range.

> ***Recommendation 3:*** *Implement a framework for minimum loss absorbing and recapitalisation capacity in line with emerging international practice, sufficient to facilitate the orderly resolution of Australian authorised deposit-taking institutions and minimize taxpayer support*

ANZ agrees with the Final Report's recommendation that Australia should not move ahead of global developments regarding additional loss absorbing capacity (TLAC).

ANZ supports the Final Report's caution (expressed also by the RBA) with respect to TLAC. Given TLAC is a complex issue with potentially negative implications on credit ratings and system stability in a stress event, it needs to be carefully considered. ANZ has reservations that a TLAC regime could be implemented without increasing contagion risk across what is a relatively concentrated and homogeneous banking system. Therefore, any potential advantages of a TLAC regime over current resolution powers (already in place via the Business Transfer and Group Restructuring Act) must be further explored.

The Final Report notes that internationally a TLAC range of 16 per cent to 20 per cent has been suggested for Global Systemically Important Banks (G-SIBs) and that this may be appropriate for the Australian system. ANZ notes however that the 16 per cent to 20 per cent range is prior to the application of the Capital Conservation Buffer and additional management stress buffers. As a result, the actual range an ADI would need to operate at is more likely to be approximately 21 per cent to 25 per cent. The required TLAC for the Australian system must also take into account differences in the capital and RWA calculations between Australian and global competitors (ie it must be calibrated for the outcome of Recommendation 4).

It is important that in considering the implications of TLAC, funding availability impacts as well as funding cost impacts are taken into account. As noted in ANZ's submission following the FSI Interim Report, depending of the size of the TLAC requirement, Australian banks may not have access to the volume of additional loss absorbing instruments required. At a minimum, a longer transition period may be required. For example, certain investors have mandated restrictions on the type of instruments that can be held; it is not just a function of price.

ANZ recommends that any future implementation of TLAC in Australia fully recognise the resolution regimes that already exist in other jurisdictions where Australian banks have a material presence. This relates particularly to New Zealand and the existing Open Bank Resolution (OBR) policy. That is, no additional TLAC should be required for subsidiaries to the extent that an efficient resolution regime applies in that jurisdiction. Furthermore, if TLAC is introduced at some future point, ADIs should continue to be allowed to issue debt that is senior to TLAC and other subordinated liabilities. Careful management would be required to ensure the Government is seen to be supportive of the system. These measures should assist in keeping the senior debt rating as high as AA-.

> ***Recommendation 4:*** *Develop a reporting template for Australian authorised deposit-taking institutions capital ratios that is transparent against the minimum Basel capital framework*

ANZ supports the development of a reporting template only to the extent that it can be applied in a manner which genuinely improves transparency and comparability of the Australian banks' capital positions for global debt and equity investors relative to a global peer group.

This objective will not be achieved if the template is based only on the Basel minimums, which are not applied in most other jurisdictions. Since release of the Final Report, ANZ has spoken with a range of global fixed income investors who have re-enforced this point.

To ensure effective comparability, the standardised disclosure must include both explicit differences (ie variations to Basel minimums) as well as practice and implementation differences (ie differences in the implementation of IRB requirements and model accreditation). The latter is not a judgement on how regulators have implemented Basel II, it is simply about improving transparency on the differences. The BCBS has recognised this variability issue (see Recommendation 2).

ANZ acknowledges that a like-for-like comparison is not straightforward. However, specific material impacts must not be excluded from future disclosures simply because they cannot be determined with absolute accuracy and are not an explicit variation from the Basel minimums. This particularly relates to exposure at default (EAD) and loss given default (LGD) models used in the Australian IRB banks corporate asset class.

ANZ notes that this disclosure is likely to be less beneficial in the future should the Basel proposals regarding standardised risk weights and capital floors be implemented (which will also include additional disclosures).

> ***Recommendation 5:*** *Complete the existing process for strengthening crisis management powers that have been on hold pending the outcome of the inquiry*

ANZ supports progressing with the package 'Strengthening APRA's crisis management powers' (2012). ANZ agrees with the Final Report as well as APRA and the RBA that there is not a sufficient case for introducing a ring-fencing requirement in Australia.

> ***Recommendation 6:*** *Maintain the ex post funding structure of the Financial Claims Scheme for authorised deposit-taking institutions*

ANZ agrees with maintaining the Financial Claims Scheme as an ex-post funding structure. FSI proposals to further strengthen the system reduce the need for an ex-ante funded scheme.

> ***Recommendation 7:*** *Introduce a leverage ratio that acts as a backstop to authorised deposit-taking institutions' risk-weighted capital positions*

Consistent with ANZ's submission to the Interim Report, ANZ sees limited benefit from the introduction of a leverage ratio. ANZ's position is that capital requirements must continue to be primarily based on risk-weighted models that appropriately recognise the different risk characteristics of different credit exposures. ANZ does, however, recognise there is global momentum towards introducing a leverage ratio, perhaps making it inevitable. ANZ agrees that a leverage ratio should be a backstop measure only.

> ***Recommendation 8:*** *Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds*

ANZ agrees with the recommendation of the FSI in regards to leverage in Self-Managed Superannuation Funds. ANZ has not pursued this activity as part of its mortgages strategy. ANZ believes that leverage should be limited in superannuation portfolios and we agree with the RBA and APRA that it is incompatible with the objectives of superannuation.

CHAPTER 2: SUPERANNUATION AND RETIREMENT INCOMES

Objectives of the superannuation system

ANZ supports this group of recommendations, which are focussed on improving the operation of the superannuation system for the benefit of retirees. Even though the *Stronger Super* and *Future of Financial Advice* reforms are still being implemented, ANZ considers the Report's recommendations could proceed in the near term.

> ***Recommendation 9****: Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.*

The Final Report recommends a political process to achieve a broad consensus on the role of compulsory superannuation. While this goal is desirable, it is likely to require a broader public discussion on superannuation and current issues. The extent to which Australians will have sufficient income to meet their retirement expectations is an important issue. Issues such as this need to be canvassed throughout the community.

Improving efficiency during accumulation

> ***Recommendation 10****: Introduce a formal competitive process to allocate new default fund members to MySuper products; unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.*

As noted below, ANZ supports an open, competitive market for default funds. ANZ believes that all MySuper compliant products should be listed in awards. Removing current obstacles to a competitive market and increasing choice in default superannuation in this way is the most important and easily implementable step to increase the efficiency of superannuation accumulation.

The retirement phase of superannuation

> ***Recommendation 11****: Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.*

ANZ supports the removal of regulatory impediments to the development of retirement products. We welcome recent Treasury consultation relating to the Review of Retirement Income Stream Regulation. ANZ will work with the Government and Treasury to ensure Australia's policy framework best meets the needs of retirees.

ANZ welcomes the Final Report's contribution to the debate in relation to retirement income. We look forward to the Government's response to this recommendation having considered the needs of retirees in the context of Australia's intergenerational trends and tax and transfer settings.

In this sense, the recent Intergenerational Report and the Tax White Paper process now underway must both play a critical role in the policy debate relating to the availability of appropriate superannuation and post retirement products.

Choice of fund

> ***Recommendation 12***: *Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.*

ANZ strongly supports freedom for employees in relation to choice of fund for their superannuation guarantee contributions. This would increase competition and encourage greater involvement by employees in their superannuation.

Governance of superannuation funds

> ***Recommendation 13***: *Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.*

ANZ supports the application of best practice governance principles to boards of corporate trustees of public offer superannuation funds. Aligning their governance arrangements with those of public companies, to the greatest extent possible, should improve performance and increase employee oversight.

CHAPTER 3: INNOVATION

ANZ supports the Final Report's findings that policy settings should support innovation and remove impediments to digital services. ANZ continues to invest heavily in new consumer and business applications and services that improve convenience, reduce costs and support better risk management. Innovation is key to ensuring that markets continue to develop for the benefit of consumers. However, it is important that innovation does not lead to unregulated areas of the market where consumers are exposed to greater risk of loss. Policies which seek to encourage innovation need to ensure that market integrity is maintained.

Collaboration to enable innovation

> ***Recommendation 14****: Establish a permanent public–private sector collaborative committee, the 'Innovation Collaboration', to facilitate financial system innovation and enable timely and coordinated policy and regulatory responses.*

Investment and competition in the market place is driving financial services innovation. Changes in services and the market are fast, typically disruptive and unpredictable as new, often unanticipated technologies become available. Financial institutions and indeed all technology-based businesses, regard technology and innovation as core to their strategy and often commercially sensitive.

In this context, the scope and structure of the proposed committee should be considered carefully with weight put on tangible outcomes. We suggest that the most useful focus could be on assessing developments in Australia and other jurisdictions, identifying regulatory and policy obstacles to innovation, and assessing progress in transition to a digital market. In our view, it is unlikely that a large committee would be effective. Accountability of the committee to a Government minister could assist in overcoming any unnecessary regulatory barriers to innovation.

Digital identity

> ***Recommendation 15****: Develop a national strategy for a federated-style model of trusted digital identities.*

ANZ supports the development of a national strategy for digital identities. Given the existing elements of a federated-style model, it would appear that the next step would be for government, in consultation with the private sector, to bring forward a proposal for wider consideration.

Clearer graduated payments regulation

> ***Recommendation 16****: Enhance graduation of retail payments regulation by clarifying thresholds for regulation by the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority.*
>
> *Strengthen consumer protection by mandating the ePayments Code. Introduce a separate prudential regime with two tiers for purchased payment facilities.*

ANZ supports further work to make the payments regulatory framework simpler, clearer and more transparent. Rules for connecting to and using a particular payment system should continue to be determined and controlled by the operator or owner of the system in line with the regulatory framework. A consistent approach to consumer protection is important. We support the ePayments Code being extended to all consumers.

Interchange fees and customer surcharging

> ***Recommendation 17**: Improve interchange fee regulation by clarifying thresholds for when they apply, broadening the range of fees and payments they apply to, and lowering interchange fees.*
>
> *Improve surcharging regulation by expanding its application and ensuring customers using lower-cost payment methods cannot be over-surcharged by allowing more prescriptive limits on surcharging.*

As the Final Report notes, the Australian payments system is undergoing rapid innovation and providing consumers access to an increasing array of online and mobile payments options. These options include competing debit and credit card systems, the new payments platform funded by the industry, bill payment and direct debit systems, proprietary mobile and internet systems, as well as traditional cheque and cash systems.

Because of the level of innovation, competition and investment taking place, ANZ believes that regulation of the payments system needs to be crafted in a way that does not inhibit competition and innovation. Previous regulatory interventions have had wide-ranging impacts, leading to some of the issues now highlighted.

ANZ understands many consumers raised issues of surcharging with the FSI. Excessive surcharging by a small number of merchants should be distinguished from a broad review of interchange.

It is appropriate that a further, detailed review of the payments system issues be undertaken (noting the recent Issues Paper released by the RBA to review the regulatory framework for card payments). This review should closely identify specific problems to be resolved, options for addressing these issues and uncertainties associated with options. It is highly likely that each option will have a range of downstream impacts that should be considered. For example, regulating payments according to acceptance cost level would create considerable new complexity for merchants and the industry.

Crowd funding

> ***Recommendation 18**: Graduate fundraising regulation to facilitate crowd-funding for both debt and equity and, over time, other forms of financing.*

ANZ supports diversification of funding sources for small and medium enterprises provided that appropriate safeguards for non-sophisticated investors are in place. Consumer disclosure is particularly important. As highlighted by recent parliamentary inquiries, there are considerable difficulties associated with disclosure and understanding risk.

Data access and use

> ***Recommendation 19**: Review the costs and benefits of increasing access to and improving the use of data, taking into account community concerns about appropriate privacy protections.*

ANZ supports a Productivity Commission review of improved access to public sector data. Consultation with the private sector and consumer groups should take place during such a review.

Data held by businesses is an important commercial asset in a digital economy and is subject to strong privacy and customer obligations. ANZ does not support changes that reduce businesses' ability to manage data on behalf of customers and shareholders.

Comprehensive credit reporting

> ***Recommendation 20**: Support industry efforts to expand credit data sharing under the new voluntary comprehensive credit reporting regime. If, over time, participation is inadequate, Government should consider legislating mandatory participation.*

ANZ agrees with the recommendations that the new comprehensive credit reporting (CCR) regime should be implemented on a voluntary basis. CCR will take time to implement given major changes to business processes, information technology to exchange information, and the high sensitivity of dealing with customers' credit history. ANZ is making major investments in the CCR capabilities and anticipates it will be able to 'use' or 'provide' CCR data by 2016-17.

ANZ would expect the market to trend inevitably towards greater inclusion of SME lending in CCR. To some extent, CCR is now available on a reciprocal basis with some credit bureaus for SME lending. For example, Veda offers a trade payment service in which information is available on creditors and the aged trial balance for a customer.

CHAPTER 4: CONSUMER OUTCOMES

Strengthen product issuer and distributor accountability

> ***Recommendation 21:*** *Introduce a targeted and principles-based product design and distribution obligation.*

ANZ supports this new approach based on identification of the target market and a linked distribution strategy. It is a significant step in the regulatory regime, altering the responsibilities of product issuers, distributors and sales agents. ANZ notes the Final Report says that this new obligation should be principles-based and applied on a scaled basis allowing for firms to adapt their existing practices. While supportive of the recommendation, ANZ sees considerable difficulties in implementing the recommendation in a workable fashion. A thorough consultation process with consumers and industry should be undertaken given the significance of the proposed change.

The Final Report recommended the introduction of a concept of fairness to be at the centre of the relationship between institutions and consumers. ANZ believes that improvements to disclosure drawing on information on consumer behaviour can help simplify transactions and contracts, contributing to understanding and fairness. Care will be needed to ensure a concept of fairness can be made to operate consistently with disclosure and contractual law.

Product intervention power

> ***Recommendation 22:*** *Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.*

ANZ supports the new power being provided to the Australian Securities and Investment Commission (ASIC). For the power to be effective and not interfere with normal market fluctuations, this power should be targeted at cases of fraudulent, reckless, or negligent sale of products or services.

Facilitate innovative disclosure

> ***Recommendation 23****: Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.*

ANZ supports the removal of regulatory impediments to improve product disclosure and communication with consumers and welcomes work ASIC is undertaking to give effect to this recommendation.

Given the reliance on digital and different modes for communication, regulation and regulators need to ensure that new and better ways of informing consumers are allowed to proceed. We note that the Final Report finds that outcomes would be improved in this area where consideration is given to consumers' preferred communication channels.

ANZ notes the Final Report's conclusion that the industry should continue to improve fees and risk disclosure. ANZ supports the Final Report's finding that a self-regulatory, flexible approach to improving communication of risk and fees is the desired approach. This would allow the tailoring of disclosures for different classes of product and would avoid prescriptive regulation thereby reducing compliance costs.

Align interest of financial firms and consumers

> ***Recommendation 24**: Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.*

ANZ supports these recommendations and believes a national examination for licensing financial advisors would be an important step towards this goal.

Raise the competency of advisers

> ***Recommendation 25**: Raise the competency of financial advice providers and introduce an enhanced register of advisers.*

ANZ supports the introduction of an enhanced register of financial advisers and enhanced professional and educational standards. The industry is committed to working with Government to bring about these improvements.

Improve guidance and disclosure in general insurance

> ***Recommendation 26**: Improve guidance (including tools and calculators) and disclosure for general insurance, especially in relation to home insurance.*

We agree that issuers should provide better information on replacement values to consumers to lessen the risk of underinsurance to consumers.

CHAPTER 5: REGULATORY SYSTEM

Regulator accountability

> ***Recommendation 27****: Create a new Financial Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates.*
>
> *Provide clearer guidance to regulators in Statements of Expectation and increase the use of performance indicators for regulator performance.*

We are pleased that the Final Report endorses the current regulatory framework with regulators largely having a functional approach.

In terms of improvements in regulator accountability, the proposal for an annual ex-post review of the regulators' performance could be useful. However, this needs to take account of the existing accountability mechanisms to the Parliament through annual reports and oversight by parliamentary committees.

Noting the efforts of the Government to reduce the number of government bodies, ANZ does not favour the establishment of a new organisation to oversee financial sector regulators. The establishment of a new oversight organisation may also reduce the clarity of accountability associated with the present regulatory structure and the flexibility of the CFR.

An alternative approach would be for APRA and ASIC to report annually as to the conduct of their operations through these existing accountability mechanisms. In particular, the regulators should report on whether they consider that current regulation is working effectively in balancing market integrity with facilitating and not impeding commercial activity. To be useful, annual reviews should be conducted efficiently to ensure that the burden on the regulator is contained. They should possibly be conducted on a confidential basis. Given commerciality and privacy issues, such an approach could improve the effectiveness of the regulator in the short term. A more elaborate process could prove costly and counterproductive.

Statements of expectations are useful tools for setting out high-level guidance to regulators from Government. The use of performance indicators could be further refined and could prove useful to the regulators in guiding their application of resources.

Execution of mandate

> ***Recommendation 28****: Provide regulators with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake periodic capability reviews.*

ANZ supports regulators undertaking capacity reviews. ANZ suggests that any increases in funding should always be accompanied by efficiency reviews of the organisation. Regulators should be encouraged through incentives to adopt technological solutions and improvements to effective supervision and surveillance.

Strengthening ASIC funding and powers

> ***Recommendation 29:*** *Introduce an industry-funding model for the Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.*

ANZ suggests a specific proposal for a new funding model for ASIC should be developed and implemented. There is considerable benefit in having the Government set the budget guidelines for regulators to ensure that regulation of the financial sector is not overly burdensome.

Proposals to give greater powers to ASIC for supervision and enforcement of the licensing regime for credit providers and financial advisers should be coordinated with the financial industry initiatives to improve the conduct and operation of the sector.

We note that the FSI recommendations to increase innovation and encouraging increased use of markets for risk transfer and funding (resulting from Recommendation 2), will require significantly greater funding and expertise in ASIC as supervision for risk shifts from the RBA and APRA to ASIC.

Strengthening focus on competition

> ***Recommendation 30****: Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of financial services and include consideration of competition in the Australian Securities and Investments Commission's mandate.*

ANZ considers that an open market within a transparent regulatory framework with appropriate consumer protections is the best means to promote competition and deliver better outcomes to consumers and business. This model has been the policy foundation for regulation of financial services in Australia in recent decades.

A periodic stocktake of outcomes and the performance of the financial services sector would be useful. ANZ believes that the primary focus should be on outcomes for businesses and consumers, with competition a means of delivering better outcomes. Assessment of outcomes and performance should take into account factors such as the range and uptake of services, prices, innovation, customer experience and investment.

ANZ suggests that such a stocktake should be undertaken every five years. Consideration should be given to the relationship between this process and the reporting and accountability of regulators. The Australian Competition and Consumer Commission (ACCC) should, as a matter of course, keep financial sector competition under review in all sectors of the economy. Where there is anti-competitive behaviour, the ACCC should have the tools to ensure that these matters are rectified.

Compliance costs and policy process

> ***Recommendation 31****: Increase the time available for industry to implement complex regulatory change. Conduct post-implementation reviews of major regulatory changes more frequently.*

ANZ agrees with the Final Report that a reasonable period of time must be set for implementation of regulatory changes. This will allow more thought to be given to implementation and costly IT changes to systems to ensure change is managed efficiently. Post implementation reviews of major regulatory changes should, as a matter of good practice, be part of the regulators' work plans and their findings shared with the industry.

APPENDIX 1: SIGNIFICANT MATTERS

Recommendation	ANZ response
32. Explore ways to facilitate development of the **impact investment** market and encourage innovation in funding social service delivery. Provide guidance to superannuation trustees on the appropriateness of impact investment. Support law reform to classify a private ancillary fund as a 'sophisticated' or 'professional' investor, where the founder of the fund meets those definitions.	• ANZ supports these recommendations to promoted opportunities that provide both social and financial returns provided disclosure and consumer protections are maintained.
33. Reduce disclosure requirements for large listed corporates issuing **'simple' bonds** and encourage industry to develop standard terms for 'simple' bonds.	• ANZ supports this recommendation.
34. Support Government's process to extend **unfair contract term protections to small businesses**. Encourage industry to develop standards on the use of non-monetary default covenants.	• ANZ continues to seek to understand the detail of issues to be addressed by proposed legislation and believes that existing practice, regulation and law provide extensive protections. If further protections are required, an enforceable industry standard should be developed to ensure that contracts with small business are fair and appropriately balance the contractual rights and obligations of the parties.
35. Clearly **differentiate the investment products** that finance companies and similar entities offer retail consumers from authorised deposit-taking institution deposits.	• ANZ supports this recommendation.
36. Consult on possible **amendments to the external administration regime** to provide additional flexibility for businesses in financial difficulty.	• ANZ supports this recommendation.

Recommendation	ANZ response
37. Publish **retirement income projections** on member statements from defined contribution superannuation schemes using Australian Securities and Investments Commission (ASIC) regulatory guidance. Facilitate access to consolidated superannuation information from the Australian Taxation Office to use with ASIC's and superannuation funds' retirement income projection calculators.	• ANZ supports ASIC's Regulatory Guide 229 relating to "Superannuation forecasts", we welcome further consultation to amend the requirements where appropriate."
38. Update the **2009 Cyber Security Strategy** to reflect changes in the threat environment, improve cohesion in policy implementation, and progress public–private sector and cross-industry collaboration. Establish a formal framework for cyber security information sharing and response to cyber threats.	• ANZ supports this recommendation. It is important that there is a coordinated plan for public and private sectors in a cyber-crisis and to ensure threats can be dealt with effectively.
39. Identify, in consultation with the financial sector, and amend priority areas of **regulation to be technology neutral**. Embed consideration of the principle of technology neutrality into development processes for future regulation. Ensure regulation allows individuals to select alternative methods to access services to maintain fair treatment for all consumer segments.	• ANZ supports this recommendation. There will be significant efficiencies for business and consumers through the adoption of more technology neutral regulation.
40. **Rename 'general advice'** and require advisers and mortgage brokers to disclose ownership structures.	• ANZ supports this recommendation. The term 'General Advice' should be replaced by a term better understood by consumers and developed following appropriate consumer testing. Transparency of ownership will assist consumers to make informed decisions.
41. Define bank accounts and life insurance policies as **unclaimed monies only** if they are inactive for seven years.	• ANZ supports the Government's implementation of this recommendation.

Recommendation	ANZ response
42. Support Government's review of the Corporations and Markets Advisory Committee's recommendations on **managed investment schemes**, giving priority to matters relating to: • Consumer detriment, including illiquid schemes and freezing of funds. • Regulatory architecture impeding cross-border transactions and mutual recognition arrangements.	• ANZ supports this recommendation.
43. Introduce a mechanism to facilitate the **rationalisation of legacy products** in the life insurance and managed investments sectors.	• ANZ supports this recommendation and is of the view that rationalisation should include super fund structures as well as products. ANZ notes the Final Report's comment that there should be a 'no disadvantage test' for relevant consumers and suggests that this would need careful design. As the report notes, it is appropriate that there is tax relief to ensure consumers were not disadvantaged as a result of triggering an early capital gains tax event.
44. **Remove market ownership restrictions from the Corporations Act** 2001 once the current reforms to cross- border regulation of financial market infrastructure are complete.	• ANZ supports reviewing market restrictions on ownership contained in the Corporations Act following reforms to cross-border regulation of financial market infrastructure.