

A royal commission into banks would be overkill

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What will we learn this week that we didn't already know from the Big Four bank CEOs being questioned by Parliament's Economics Committee? In my view, very little. There were no surprises in any of the questions put to Commonwealth Bank's Ian Narev and ANZ's Shayne Elliott over the last two days, who handled them deftly.

The government is using the exercise as a classic case of retail political management, being seen to be keeping our major banks accountable while the Opposition calls for a royal commission into the banking industry. The Opposition's calls for a royal commission are also politically motivated and without empirical backing. One gets a sense that the political momentum for a royal commission could be starting to taper off.

A royal commission has to answer two considerations. Firstly, what, if anything, ails the banking sector? Secondly, is a royal commission the best mechanism to cure the ailment?

A royal commission might cost \$53 million and last two years. Furthermore, it would most likely cover the same ground as the Financial System Inquiry (FSI) of 2014, which was no doubt at least similarly expensive in only one year of operation. Perhaps more importantly, there needs to be a fair likelihood that a royal commission will boost confidence in the banking sector and not undermine it. I fear the latter might eventuate.

The provisions of the Royal Commissions Act 1902 allow for the set up of such commissions to "make inquiry and report upon any matter" that is relevant to the "good government of the Commonwealth". Significantly, in 2009, the Australian Law Reform Commission was tasked with reviewing the effectiveness of the royal commission mechanism in the context of matters of "substantial public importance". In my opinion, the test for whether any wrongdoing is "substantial" in nature is whether it is systemically entrenched within the system. I would argue that, based on the number of incidences of wrongdoing and the scale of losses relative to the total annual transactional values within the sector, a banking royal commission is not warranted.

A banking royal commission might be interpreted as a tacit acknowledgement by the federal government that there are serious and systemic shortcomings within the sector that the existing regulatory architecture is incapable of remedying. This could unsettle the financial markets, to the extent that it prompts an increase in the banks' wholesale borrowing costs. This would be detrimental to the banks' entire customer base. Although customers' deposits would remain safe, since they are protected by an implicit government guarantee, the added cost of funding would undoubtedly be passed on to customers.

Like any other sector, banking is not perfect. The overwhelming majority of banking-sector employees are diligent and honest. However, several incidents of bank behaviour that violate clients' best interests have prompted regulators, notably the Australian Securities and Investments Commission (ASIC), to call for a review of the employee reward systems and performance culture within the banking industry. ASIC's leadership in this regard is to be commended.

Moreover, there is already a monitoring mechanism in place, in the form of the Financial Ombudsman Service (FOS), to address customer complaints. Indeed, the FOS is one of the subjects (along with the Credit & Investments Ombudsman and Superannuation Complaints Tribunal) of a review into the financial system's external dispute resolution and complaints framework. Perhaps this review will recommend that trust issues and service performance in the banking system could focus more resources in remedies through a new national banking tribunal. In addition, the Future of Financial Advice (FOFA) reforms, are specifically designed to "improve the trust and confidence of Australian retail investors in the financial services sector".

In addition to the 2014 Murray Inquiry, the banking sector has been the subject of several reviews and inquiries over recent years. The 2015 Harper Review was also a contributor to competition policy in the financial system. The Cooper Review of 2010 had a big impact on superannuation.

Australia has financial regulators that are among the finest in the world. In addition to ASIC, the Commonwealth Treasury, the Reserve Bank of Australia (RBA) and the Australian Prudential Regulation Authority (APRA) are recognised as being world class in their respective fields. They have wide powers of investigation and enforcement, and they are staffed by highly educated, experienced and capable professionals. In addition, they are effectively coordinated in their supervision of the system, including through the Council of Financial Regulators.

Indeed the regulators themselves are subject to periodic performance reviews, in line with the recommendations of the Murray Inquiry. Among others, the inquiry recommended that financial regulators be subject to "periodic capability reviews" and an increased use of "performance indicators for regulator performance". This is a good outcome and one that reflects CIFR's approach in advocating the evaluation of operational effectiveness of evidence-based research.

To apply the full-scale resources of a royal commission to tackle issues that can readily be dealt with by the existing regulatory structure risks sending the wrong message and undermining confidence in the entire financial system.

Professor David R Gallagher is CEO of the Centre for International Finance and Regulation. These are his own views and not necessarily the views of the board of the CIFR.