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31 March 2014

Mr David Murray
Chairman
Financial System Inquiry
GPO Box 89
Sydney NSW 2001
Email: fsi@fsi.gov.au

Dear Sir,

Submission to Financial System Inquiry

Coles welcomes the opportunity to provide a submission to the Government's Financial System Inquiry (Inquiry) announced by the Prime Minster on 20 November 2013.

Coles is a leading food, liquor and convenience retailer, with a presence in every Australian state and territory. The business operates more than 2,300 retail outlets across Coles and BiLo supermarkets, First Choice Liquor, Liquorland, Vintage Cellars and Coles Express. With around 100,000 team members and almost 20 million customer transactions a week, Coles is an integral part of the Australian retail sector.

From a financial services perspective, Coles has offered a range of financial services products since the introduction of a closed loop store card. In 1995 Coles Myer entered into an agreement with General Electric to offer a broader range of credit products, including the Coles MasterCard which was launched in early 2012.

In 2010, Coles began offering simple Motor and Home Insurance products underwritten by Wesfarmers General Insurance. Growth has exceeded expectations and Coles Insurance is one of Australia's fastest-growing insurers.

From a payments perspective, in 1994 Coles was the first Australian retailer to establish its own payment switch. Through the development and operation of the payment switch, Coles has played a leadership role in the payments industry for many years including setting the first industry wide electronic payment standards, the creation of EFTPOS as a national payment platform and more recently being the first national supermarket business to implement contactless payments across all stores.

Whilst the provision of financial services by retailers in Australia has grown over recent years it remains relatively limited in comparison to offshore markets such as the UK, Canada and France.

While the overall market share of retailers in financial services has remained relatively small in these markets, we believe that their contribution to the sector as a whole has been important, driving innovation, competition and greater consumer choice.

Experience in offshore markets suggests that there are opportunities for Australian retailers to extend their financial service offerings for the benefit of consumers. The extension of this offering will need to be supported by a regulatory framework that remains open to competition and avoids unnecessary barriers to entry that discourages new participants, or acts as an impediment to innovation.

The key challenge for policy makers is to ensure that the regulatory environment allows competing business models to flourish and fosters innovation without jeopardising the stability of the financial system.

Our submission to the Inquiry provides a brief overview of the types of financial products and services offered by retailers both in Australia and offshore and the regulatory regimes that apply in these markets. Coles' has sought advice on the international regulatory approach from Promontory, an adviser on regulatory matters with an international network. Our submission also sets out our views on the key regulatory issues in Australia worth further consideration by the Inquiry to ensure adequate competition in personal financial services.

In addition Coles has commissioned Deloitte Access Economics to prepare a report on competition and innovation in the Australia financial system which we have provided as an attachment to our submission.

Fundamentally we believe that a vibrant financial system requires competition. This, in turn, requires that new entrants are able to compete in segments of the system without being subjected to regulatory burdens beyond those needed to establish fundamental safety and soundness as well as proper conduct.

We would be happy to discuss our views further, and may provide further comments on the Inquiry's proposed interim report after its scheduled release later this year.

Yours sincerely,

Rob Scott
Finance Director
Coles

COLES SUPERMARKETS AUSTRALIA PTY LTD

SUBMISSION TO THE FINANCIAL SYSTEM INQUIRY

31 MARCH 2014

Contents

Abbreviations

ACCC	Australian Competition and Consumer Commission
ACL	Australian Credit Licence
ACPR	Autorité de contrôle prudentiel et de resolution
ADI	Authorised Deposit-taking Institution
AFSL	Australian Financial Services Licence
AML/CTF	Anti-money laundering/ Counter-terrorism financing
APP	Australian Privacy Principle
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
AUSTRAC	Australian Transaction Reports and Analysis Centre
CA	Corporations Act 2001
CCA	Competition and Consumer Act 2010
CIBC	Canadian Imperial Bank of Commerce
CTFS	Canadian Tire Financial Services
EDR	External dispute resolution
GFC	Global financial crisis
IT	Information technology
OSFI	Office of the Superintendent of Financial Institutions
NCC	National Credit Code
NCP	Non-cash payment
PPF	Purchased payment facility
PRA	Prudential Regulation Authority (UK)
PSRA	Payment Systems (Regulation) Act 1998
RBA	Reserve Bank of Australia
RBS	Royal Bank of Scotland
RRP	Recovery and Resolution Plan
SCCI	Specialist Credit Card Institution

1. Executive Summary

A vibrant financial system requires competition. This, in turn, requires that new entrants are able to compete in segments of the system without being subjected to regulatory burdens beyond those needed to establish fundamental safety and soundness as well as proper conduct. The Wallis Report highlighted these characteristics and sought to establish a regulatory framework in which new entrants could compete off the back of new technologies and non-financial customer relationships such as those found in retailing.

This same objective has been pursued in other developed financial systems such as the UK, Canada and France, in which large retail groups have expanded their financial services businesses to cater for a greater range of financial products that have traditionally been provided only by licensed banks.

While the provision of financial services by retailers in Australia has grown over recent years, it remains less well developed than in other markets. Experience from these markets suggests that there are opportunities for Australian retailers to pursue further growth in their financial service offerings. This growth will, however, need to be supported by a regulatory framework that remains open to competition and avoids unnecessary barriers to entry.

In our view the current regulatory framework in Australia is broadly appropriate. There are certain specific aspects of the regulatory framework that we believe require attention to address unintended barriers that impede innovation or new entrants. However, at the broad systemic level, we observe that Australia weathered the global financial crisis (GFC) better than most countries, which we consider to be an endorsement of the existing regulatory regime.

In supporting new entrants, the existing regulatory framework incorporates an appropriate 'tiering' of regulations that sees the intensity of regulation increase progressively as the nature, scale and complexity of financial products offered to consumers expands.

While we believe the current regulatory framework is broadly appropriate, it is important that it remains so in the face of the growing international trend to increase regulatory conservatism. Of particular relevance in this respect is APRA's newly introduced 'Level 3' framework for conglomerate regulation. This framework imposes requirements for prescribed conglomerates in relation to group governance, risk exposures, risk management and capital adequacy from 2015. These are not unreasonable for financial conglomerates but, if imposed on non-financial conglomerates, would involve material costs that would severely restrict retail groups' ability to expand their financial services offerings. While it is not APRA's current stated intention to extend the Level 3 framework beyond financial conglomerates, we would be concerned if future changes in APRA's Level 3 framework were to see APRA directly applying prudential requirements to non-regulated parts of a group such as a retailer.

With respect to specific regulations that may act as unintended barriers to innovation or new entrants, we note two examples that we believe require review. These are:

- Regulations associated with non-cash payments (NCPs) and other types of 'stored value' payment facilities. The current regulatory framework in this area is complex, and may inadvertently be preventing further innovation and competition in payment methods due to a lack of clarity in the regulations and how they apply to various types of payment facilities. This situation may be aggravated as new technologies emerge that do not clearly fit the regulatory framework – as it is, many now-common products are regulated as exemptions within the regime.

- Regulations associated with the promotion of financial products. We support the position that purchasers should be aware of what they are buying and should be able to understand the key features of the products involved. However, as new marketing channels develop, regulators will need to ensure that existing regulations are fit for purpose, and that they do not restrict the ability of participants to promote their products and compete in new markets effectively.

Further efforts to reduce unnecessary compliance costs associated with the multiple regulatory regimes that govern different types of financial services in Australia should also assist new entrants to compete more efficiently in financial services. In particular, we believe that opportunities exist to further streamline or harmonise requirements between ASIC's credit and financial services regimes.

2. Financial Services offered by Retailers

Over the past decade, large retailers in Australia have increasingly sought to expand their financial service offerings by leveraging their existing customer base and extensive distribution networks. In many cases, the financial services offered have aimed to complement retailers own core services, through the provision of financial services that support payments for retail goods and services. As a result of the complex authorisations required before an entity can provide financial services, retailers in Australia have generally offered their financial services through arrangements with third party providers in the financial services industry that are already licensed.

Table 1 below provides an overview of examples of financial products currently offered by

Australian retailers, and the typical arrangements in place with third party providers.

Table 1 - Provision of Financial Services by Australian Retailers

Product Type	Retailers offering Product	Description and arrangements with other providers
Credit Cards	Coles, Woolworths, Myer and David Jones.	These cards are branded under the retailer's name and can be used widely. The cards are issued in conjunction with a holder of an Australian Credit Licence (ACL). Credit cards that are part of the MasterCard and Visa schemes must also be issued (or sponsored) by an Authorised Deposit-taking Institution (ADI) (although reforms to the Reserve Bank of Australia's (RBA's) credit card access regime will remove this requirement).
In-store Finance	Extensive range of retailers across a range of industries including auto, fashion, health/wellbeing, home and office, photography, electrical, travel and outdoor. Over 100 participating retailers including Apple, Freedom, Camera House, JB Hi-Fi, Miele, Retravision, Dare Gallery, Forty Winks, Super A-Mart, Stratco, Kitchen Connection, Doors Plus, Starshots, BP, Rebel Sport, Harvey Norman, The Good Guys, Autobarn, Bob Jane, Michael Hill, Greencross Vet.	In-store finance (including interest-free deals) are typically offered through a credit card that can be used at participating retailers (e.g. Gem Visa/Go MasterCard). Cards are issued in conjunction with a holder of an Australian Credit Licence (ACL) and issued (or sponsored) by an Authorised Deposit-taking Institution (ADI) for MasterCard and Visa schemes.
Gift Cards (not reloadable, limited payment options)	Coles Group (Coles, Kmart, Target, 1st Choice, Officeworks etc), Myer, Woolworths Group (Woolworths, Big W, Masters, Dick Smith, BWS, Dan Murphys etc), David Jones, Westfield, as well as hundreds of individual retailers across a wide range of industries.	Gift cards are generally issued directly by retailers (relief provided by ASIC excludes such products from being subject to the full set of conduct obligations). They can either be used at one specific store or at a range of stores within the group (e.g. Coles Group) or location (e.g. Westfield shopping centre). Cards can be purchased from the store, via a mobile phone or online via dedicated gift-

Product Type	Retailers offering Product	Description and arrangements with other providers
		card websites.
Other stored value cards (including travel money)	Woolworths, Australia Post, Qantas, Virgin, Jetstar, 7 Eleven, Vodafone, Caltex, Newsagents, BP, Universal Visa Giftcard.	These are cards that hold 'stored-value' (e.g. pre-paid cards). Many of them allow funds to be re-loaded and allow cash to be withdrawn. Some also provide a travel card option, which allows the card to be used for offshore purchases and transactions. Stored value cards with such features are issued in conjunction with an ADI and and with an Australian Financial Services Licence (AFSL) holder (as distributor).
Retail leasing	Harvey Norman, Domayne, Apple, Joyce Mayne, Officeworks, DickSmith, Harris Technology (brands include Flexirent and RentSmart), car dealers	Consumer leases must be issued in conjunction with an ACL holder.
Short-term or payday loans	Cash Converters, car dealers	A retailer offering consumer loans must either be an ACL holder or issue such loans in conjunction with an ACL holder.
General insurance	Coles, Woolworths, car dealers, travel agents	A retailer offering or advising on insurance products must be an AFSL holder (or representative of an AFSL holder). Policies must be underwritten by a licensed insurer regulated by APRA.
Life insurance	Woolworths	A retailer offering or advising on insurance products must be an AFSL holder (or representative of an AFSL holder). Policies must be underwritten by a licensed insurer regulated by APRA.

The provision of financial services offered by retailers in Australia has grown over recent years but remains relatively limited in comparison to offshore markets. In jurisdictions such as the UK, Canada and France, large retail conglomerates have expanded their financial services business to cater for a greater range of financial products that have traditionally only been served by licensed banks.

3. International experience

As noted above, several offshore markets have seen retail groups expand their offering of personal financial services beyond those currently seen in Australia. While in nearly all these cases the relative size of the financial services business written by retail groups' financial services arms represents a small proportion of the broader group operations, their contribution to the sector as a whole has been important, driving innovation, competition and greater consumer choice. Table 2 illustrates some of the products offered by large retail groups in offshore markets.

Table 2 - Provision of Financial Services by Retailers Offshore

Product Type	Offshore Retailers offering Product
Credit Cards	• UK – Tesco, Sainsbury, Marks & Spencer, Co-op Bank • Canada – Loblaw (President's Choice), Canadian Tire, Walmart • France – Carrefour, Auchan (Accord)
Personal deposits	• UK – Tesco, Sainsbury, Marks & Spencer, Co-op Bank • Canada – Loblaw (President's Choice), Canadian Tire • France – Carrefour
Personal loans	• UK – Tesco, Sainsbury, Marks & Spencer, Co-op Bank • Canada – Loblaw (President's Choice) • France – Carrefour, Auchan (Accord)
Mortgages	• UK – Tesco, Co-op Bank • Canada – Loblaw (President's Choice)
Insurance	• UK – Tesco, Sainsbury, Marks & Spencer, Co-op Bank • France – Carrefour, Auchan (Accord)

The experience in offshore markets suggests that there are opportunities for Australian retailers to pursue further growth in their financial service offerings, should the economics support expansion. Allowing retailers to expand and compete with financial institutions in personal financial services brings several potential benefits to consumers, including:

- Increased choice: which leads to cost savings for consumers as new entrants compete with incumbents and new technologies result in more efficient means of delivering financial services;

- Increased customer convenience and reduced search costs: for example, by allowing customers the ability to obtain multiple products and services at the one convenient location; and

- Further developments in innovation: which broaden the range of products as participants seek to identify new avenues and technologies that can provide them with a competitive advantage in delivering services more efficiently than their market competitors.

In order to realise these benefits, however, retailers need to be able to enter and compete in financial services markets without unnecessary barriers to entry. In this regard, the regulatory framework for the provision of personal financial services in Australia is critical, given the costs that regulations impose on business.

While we believe that regulation is critical in protecting consumers from market failure, it is important that regulations appropriately balance the benefits that new entrants bring against the potential costs and risks.

3.1 United Kingdom

The UK has a long history of retailers providing some financial services. The Co-operative Wholesale Society (a co-operative with a parallel Retail Society) opened a 'Loan & Deposit Department' as early as 1872. This became the CWS Bank in 1876 (also known as the 'Co-op Bank').

In 1975, CWS Bank became the first new member of the Committee of London Clearing Banks for 40 years, which enabled it to issue cheques in its own name. The bank has also sold personal insurance for many years.

More recently, the UK has had two major food retailers (Tesco and Sainsbury's), and other retailers – notably Marks & Spencer – set up personal finance arms or banks. These retailer banks[1], while still small in national banking terms, have extended their market shares and range of banking products in recent years. While their offerings are more limited than the full banking services offered by major clearing banks, their offerings are nonetheless more extensive than those currently offered by Australian retailers. Tesco, for example, has now commenced offering mortgages after gaining regulatory approval from the UK Prudential

[1] We use the term 'retailer banks' in this Submission to refer to the licensed banking subsidiaries of retail groups.

Regulatory Authority (PRA)[2] (refer Table 3).

Table 3: Financial products and services offered by UK retailers

Retailer	Financial products and services offered
Tesco	• Credit cards • Personal loans • Deposits • Mortgages • Insurance (car, home, pet, travel and life) – underwritten by several licensed insurers. Tesco Bank arranges and administers most insurance products.
Sainsbury's	• Credit cards • Personal loans • Deposits • Travel money – in conjunction with Travelex. • Insurance (car, home, pet, travel and life) – insurance is underwritten by several licensed insurers. Sainsbury Bank arranges and administers most insurance products.
Marks & Spencer	• Credit cards • Personal loans • Deposits • Travel money – through its arrangement with HSBC. • Investments • Insurance (car, home, pet, travel) – insurance is underwritten by several licensed insurers. M&S Bank arranges and administers most insurance products.
Co-op Bank	• Full range of personal and business banking services • Insurance – underwritten by a related entity, CIS General Insurance Limited.

The paths that UK retailers have taken to expand their financial service businesses have differed. In the case of Tesco, it obtained a banking licence from the regulator in 1997 to provide some financial services under its own name, but ran the operation as a joint venture with National Westminster Bank (and then with the Royal Bank of Scotland (RBS) when it took over Nat West). Only in 2008 did Tesco Bank take over the RBS share and provide financial

[2] In the UK, the PRA grants a banking licensee with certain 'permissions' to undertake certain banking business activities. A separate permission is required for mortgage lending. This framework does not apply in Australia's prudential regime.

services on a stand-alone basis, although migration of systems was not completed until 2012.

Sainsbury's followed a similar path to Tesco, having first received its banking licence in 1997 and entering into a joint-venture with Lloyds. It was only in early 2014 that Sainsbury's became a fully stand-alone bank.

Marks & Spencer followed a different path. Marks & Spencer started out by establishing a stand-alone bank in 2001. It then sold the bank to HSBC in 2004 subject to a 50:50 profit-sharing agreement with HSBC.

The growth of UK retailers banking business has been modest and all three banks are very small in comparison to the major UK clearing banks[3]. Statistics for them on a comparable basis over time cannot readily be found, especially for Marks & Spencer. However, some broad comparisons of size (and importance to the group) are shown in Table 4.

Table 4: Relative size and importance of UK retailer banks to their group (latest year's figures)

Name	Regulatory capital (£ bn)	Bank revenue as % of Group Turnover	Bank profit as % of profit before tax (approx.)	Total Bank assets (£ bn) (approx.)
Tesco Bank	1.0	Less than 2%	5 ½%	8.4
Sainsbury Bank[4]	0.4	Less than 1%	5 ½%	5.0
Co-op Bank	2.6	n/a	n/a	49.6

3.2 Canada

There are three major retail groups that operate personal financial services arms in Canada:

- Loblaw – which operates and controls President's Choice Bank
- Canadian Tire – which operates and controls Canadian Tire Bank
- Walmart Canada – which operates and controls Walmart Canada Bank

[3] Barclays, for example, in June 2012 (a roughly comparable date to the ones used in the table) had bank assets nearly 200 times the assets held by Tesco Bank.

[4] In the latest year available, Sainsbury owned only 50% of the bank but the numbers have been calculated as though the group had owned it all (as it now does).

In all three cases, the ownership structure of the retailer banks is different to that of other regulated Canadian banks. In particular, each of the retailer banks has been allowed an exception to the usual share ownership restrictions applying to domestic banks. The share ownership restriction limits the percentage ownership by any one shareholder to 10% (it serves a similar purpose to the *Financial Sector (Shareholding) Act* in Australia where the limit is 15%). The exception in Canada for banks in retail groups is available to the extent the equity in each of the banks is less than C$12 billion.

Like in the UK, the financial services offering of each of the Canadian retailers is limited relative to the banking services offered by conventional banks. Nevertheless, at least two Canadian retailers have entered into the deposit-taking business (one directly and one through a strategic partnership with a major Canadian Bank) and each issues its own credit cards.

Table 5 provides an overview of the products currently provided by the three financial services arms of each retailer group.

Table 5: Canadian retailer offerings in financial services

Retailer	Financial products and services offered
Loblaw/President's Choice	• Credit cards – provided directly by President's Choice Bank • Deposits, personal loans, mortgages and investments – provided indirectly through the banking division of CIBC
Canadian Tire	• Credit cards • Deposits • Investments
Walmart Canada	• Credit cards

All three retailers have obtained banking licences to operate under the *Bank Act (Canada)* and are subject to prudential supervision by the Office of the Superintendent of Financial Institutions (OSFI).

In the case of President's Choice, its bank is primarily focused on the credit cards business, which it first launched in 2001. While President's Choice offers other personal banking products, these are provided through a strategic partnership with a major Canadian chartered bank (CIBC). The strategic partnership arrangement sees all deposits, investments and loans issued under the President's Choice brand recorded on CIBC's balance sheet.

Canadian Tire Bank obtained its banking licence in 2003. The bank is a wholly-owned subsidiary of Canadian Tire Financial Services (CTFS), which became the first non-deposit taking institution in the world to launch a MasterCard in 1995. CTFS's credit card portfolio was transferred to Canadian Tire Bank on the bank's establishment.

Walmart Canada Bank is domiciled in Canada and is licensed as a Schedule II (Foreign Owned) bank by OSFI. The bank received authorisation to commence and carry on banking business on June 1, 2010, and launched a MasterCard credit card in June 2010.

Table 6 provides a high-level overview of the relative importance of the financial arms of each Canadian retailer relative to the overall group[5]. Like the UK retailers, each Canadian retail group's financial services arm remains relatively small.

Table 6: Relative size and importance of Canadian retailer banks to their group (latest year's figures)

Name	Regulatory capital ($C bn)	Bank revenue as % of Group Turnover	Bank profit as % of profit before tax (approx.)	Total Bank assets ($C bn) (approx.)
President's Choice Bank	0.6	2.3%	11%	2.5
Canadian Tire Bank	0.65	8.7%	9%	4.5
Walmart Canada Bank	0.1	n/a	n/a	1.0

3.3 France

There are several non-bank providers of financial services in France, including Carrefour, Auchan, Casino, Leclerc, Intermarché, Cora, But, Décathlon, Darty, Lapeyre, and Conformara. Some of these retail groups, such as Carrefour and Auchan, have been offering financial services for over 20 years.

Table 7 provides an overview of the key products and services offered by two of the largest retailers in France – Carrefour and Auchan.

[5] Given Walmart Canada's status as a foreign-owned bank, comparable statistics on the contribution of the Canadian banking arm to the overall Canadian group could not be found.

Table 7: French retailer offerings in financial services

Retailer	Financial products and services offered
Carrefour	• Credit and payment cards • Savings and investment products including life insurance, savings account and term deposits • Personal loans, consolidated loans and revolving credit • Insurance (car, home, health, school and life) – underwritten by a subsidiary of Carrefour Banque
Auchan	• Credit and payment cards • Savings and investment products including life insurance, savings account and mutual fund investments (investments in mutual funds are managed by Amundi) • Personal loans, consolidated loans and revolving credit • Insurance (car, home, health, borrower) – underwritten by Nexx Assurance SA

Carrefour offers its financial products through its banking entity, Carrefour Banque. The Banque is jointly owned by Carrefour (60%) and BNP Paribas Personal Finance (40%). The Banque has offered financial services for over 20 years and conducts banking activities in Italy, Belgium and Spain (in addition to France).

Auchan Group offers its financial services products through its banking entity, Oney Banque Accord (Accord Banque). Accord Banque was established in 1983 and operates across 11 countries. Its structure is relatively unique in that it is the only retail group in France that has established a banking subsidiary without partnering with another bank[6].

Both Carrefour Banque and Accord Banque are regulated by the French prudential supervisor – the Autorité de contrôle prudentiel et de resolution (ACPR). The relative size of each French retailer's bank to the group is set out in Table 8. As in Canada and the UK, the size of these retail group's financial arms remain a relatively small portion of the overall group.

[6] In France, the most common structure for retailers that offer banking-related services is to establish a joint venture/banking subsidiary arrangement with another bank (e.g. Carrefour and BNP Paribas, and Casino Bank and Crédit Mutuel).

Table 8: Relative size and importance of French retailer banks to overall group (latest year's figures)

Name	Regulatory capital (EUR bn)	Bank revenue as % of Group Turnover	Bank profit as % of profit before tax (approx.)	Total Bank assets (EUR bn) (approx.)
Carrefour Banque[7]	0.6	Less than 1%	5%	5.3
Accord Banque	0.3	Less than 1%	7%	2.5

4. The Regulatory Regimes in Offshore Jurisdictions

4.1 Common Regulatory Features Offshore

Regulatory regimes in offshore markets share a number of common features in relation to retail groups providing banking services:

- First, in each jurisdiction, retailers that offer banking services (specifically, accepting deposits) must obtain a banking licence from the relevant regulatory authority and become subject to prudential supervision. While there are some differences in the types of banking activities that trigger prudential supervision (e.g. the issuance of credit cards alone does not trigger prudential supervision in the UK[8], but does so in France), the approach to licensing is generally motivated by the potential reputational concerns that regulators would have were they to allow less onerous standards to be applied to retail groups relative to other banks.
- Secondly, the focus of prudential supervision for banks that are part of retail groups remains very much on the *stand-alone licensed bank* in each of the offshore jurisdictions noted above. We are not aware of any offshore jurisdiction having applied a 'Level 3' framework to retail groups (refer to section 5.2 for further details of APRA's Level 3 framework applying to conglomerate groups). While this approach partly reflects the

[7] The percentages of bank turnover and profit relative to the group have been calculated as though Carrefour fully owned the banking subsidiary.

[8] On 7 March 2014, the RBA announced that it has decided in principle to vary the Visa and MasterCard access regimes and to seek removal of the SCCI framework. These proposals will effectively allow non-prudentially regulated entities to directly acquire and issue credit cards in Australia.

limited size of the retail groups' financial services arms, we are not aware of regulators offshore moving in a direction that would see greater regulatory intrusion over retailer's non-banking entities.

- Thirdly, the main concern that regulators have with retailers operating in banking are the potential 'contagion risks' between the group and the bank i.e. the risks to the bank generated by its relationship with the parent/group. In this regard, regulators have typically focussed on the inter-linkages between a retail group's banking and retailing arms. Regulators are keen to ensure that a bank can continue to operate its core banking functions even if the parent fails.
- Finally, regulators are keen to ensure that the Boards of retailer banks consist of directors with the appropriate financial services expertise, with at least some independent non-executive directors on the bank Board.

4.2 Observations on Specific Jurisdictions

4.2.1 United Kingdom

In the UK, the prudential regulator (in the second half of the 90s) was open to the arrival of new entrants into the personal banking sector – particularly those such as Tesco and Sainsbury's that already had nationwide chains of branches (their stores) that other new entrants would take years to build.

This positive approach to new entrants was influenced by the UK Government's own eagerness to promote competition in the banking sector, which was seen at the time as too concentrated (it has since become even more so, following the GFC and the exit of many foreign lenders from the UK).

In recent years, however, changes to senior management at the UK's PRA (formerly the Financial Services Authority) have seen the regulator become more cautious about new entrants in financial services in light of the collapse of several UK banks during the GFC. Notwithstanding the change in stance, the regulatory approach adopted in the UK has always been to treat the licenced bank within a retailer group like any other new and potentially expanding bank business. There have been issues requiring attention – such as limiting exposure to other parts of the group, having adequate expertise on the bank's Board, and maintaining data privacy – but these have not been substantially different in kind from issues raised with other banks.

4.2.2 Canada

The Canadian regime (like other jurisdictions) requires retailers that operate banking activities to be licensed as banks and subject to the full weight of Federal Banking Regulations. However, given the relatively limited lines of (financial services) business the Canadian retailer banks offer, as well as the significant outsourcing arrangements that some of these banks rely on (e.g. President's Choice and its arrangements with CIBC), we understand that OSFI generally applies a lower intensity of prudential supervision to these banks relative to others.

For example, we understand that OSFI may rely on the internal controls and risk management systems of a retailer bank's third party supplier, where the bank has outsourced certain controls and risk systems to the third party. This approach recognises that the limited services (and size) of retailer banks may justify a more measured approach to supervision than that applied to larger banks.

OSFI, nevertheless, remains concerned about the issues of resolvability and contagion risk. In these areas, the prudential framework that applies to traditional banks would apply equally to banks that are part of a retail group. Further, given that some retailer banks rely heavily on outsourcing arrangements, OSFI typically applies the same outsourcing standards to these banks that it does to other stand-alone banks (e.g. that the bank has clear processes for monitoring the performance of the third party provider, and that service level agreements are met).

4.2.3 France

For regulatory purposes, France has recently introduced a separate class of credit institutions that only deal in limited banking and payment services. In particular, entities that operate as "banking operation and payment services intermediaries" and whose activities are limited to "presenting, proposing or helping in the conclusion of banking operations or payment services" can obtain a specialist class of licence that subjects these entities to less stringent prudential regulations. Entities that obtain the specialist class of licence are not authorised to conduct the full range of banking services but remain under the supervision of the French prudential supervisor – the ACPR. The recognition of this separate class of credit institution offers a more flexible and less constraining framework for retailers to offer banking products without necessarily obtaining a full banking licence.

4.3 Key Lessons for Australia

The international experience in offshore jurisdictions provides several key lessons for Australia's policy settings:

- First, the regulatory regimes in offshore jurisdictions have appropriately allowed for non-financial conglomerate groups to expand into the banking market by largely relying on their existing licensing regimes. Importantly, the regulatory approach in other jurisdictions has been to treat the bank on a stand-alone basis**.** There is no international precedent that sees a prudential regulator extend its supervisory reach by applying banking prudential requirements to the non-banking entities of a retail group that holds a banking licence. While regulators offshore quite rightly hold concerns about potential contagion risks that may occur between a retailer and its banking subsidiary, these concerns have generally been managed through requirements imposed on the bank itself – not on the parent retailer or other non-regulated parts of the group.

- Second, some jurisdictions such as Canada (and more recently France) have appropriately applied a measured approach to prudential supervision for banks with limited offerings, i.e. by reducing the intensity of prudential supervision for banks that offer only one or two types of products. This approach has helped these banks compete more efficiently with traditional players, while ensuring that key regulatory concerns around contagion, resolvability and outsourcing remain addressed. We see no barriers to Australia implementing a similar approach given APRA's 'risk-based' prudential regime.

- Third, there has been a recent shift in the regulatory stance following the GFC that has seen financial resilience/stability prioritised over a more competitive environment supportive of new entrants. The UK PRA's more recent stance on new entrants in the banking market provides one example of this shift. While this shift is understandable given the crisis, and perhaps even appropriate to that jurisdiction, it is critical that regulators in Australia do not over-react to the extent that the outcome stifles choice and innovation for Australian consumers. Governments have a key role in ensuring this does not occur. Indeed it was the UK Government's promotion of greater competition in the banking sector over the past two decades that set the tone for the prudential regulator's positive stance on new participants, thus allowing the likes of Tesco, Sainsbury's and Marks & Spencer to enter the market.

5. Future Regulatory Policy Settings

The provision of personal financial services in Australia is governed by a wide-range of regulations that seek to address issues of market conduct, consumer protection, prudential safety, competition and financial stability. This framework, administered by numerous independent regulatory agencies, has generally served Australia well since the time of the last Financial System Inquiry and throughout the GFC.

Appropriately, and consistent with good international practice, the regulatory framework in Australia incorporates a 'tiering' of regulations that sees the intensity of regulation progressively increase as the nature, scale and complexity of financial products being offered to consumers expands. For example, financial service providers that offer only credit products are generally subject to more limited obligations focussing on business conduct (e.g. obligations under ASIC's ACL regime), while financial service providers offering products with more complex features and/or significant financial promises (e.g. deposits) are subject to a much higher degree of regulatory scrutiny by way of APRA's prudential regime.

This tiering of regulations in the current framework is, in our view, appropriate and should be maintained. It ensures that all providers of financial services meet at least minimum standards of business conduct, while allowing those that wish to provide only basic financial services to enter the market with relatively low barriers to entry.

The challenge, however, is to ensure that, going forward, the regulatory framework remains appropriate and allows new entrants to compete without unnecessary barriers to entry. Our main concern in this regard is the potential for Australia's current regulatory framework to incrementally move to a significantly more conservative stance over time – driven either by international developments or by the inherent conservatism of Australia's financial regulators. Greater levels of conservatism may add to financial stability, but at the costs of discouraging new participants from entering the market. Given the increase in concentration we have seen in the financial services sector following the GFC, we believe that it is critical that barriers to entry remain low so as to encourage new participants.

To foster greater competition we also believe that it is important that any existing regulations that may unintentionally impede new entrants or new innovations in financial services should be identified and removed. While we believe there are relatively few in the current framework, two areas that we believe are worth review relate to:

- Regulations associated with NCP facilities and other types of 'stored value' payment facilities – the regulatory framework in this area is complex and we suggest a review be undertaken to ensure the ongoing appropriateness and transparency of the regulations applying to the various types of payment facilities.

- Regulations associated with the promotion of financial products – where certain regulations in relation to marketing (particularly online advertising) may be restricting the ability of participants to promote their products and compete in new markets effectively.

Further efforts to reduce unnecessary compliance costs associated with the multiple regulatory regimes that govern financial services in Australia would also allow new entrants to compete more efficiently and would be welcome. In particular, we believe that opportunities exist to further streamline and harmonise requirements between ASIC's credit and financial services regimes (i.e. the ACL and AFSL regimes). While we recognise that efforts have been made to streamline requirements between these regimes already, there remain a number of differences between the two ASIC regimes that appear to have no strong basis for justification. Each of these issues is discussed in further detail below.

5.1 Maintaining Responsible Barriers to Entry

As noted above, we believe that Australia's current tiered approach to regulation of financial services is appropriate. Australia's current regulatory framework incorporates a level of conservatism which, in our view, helped Australia to weather the GFC better than most countries.

We hold some concerns, however, that the regulatory framework may incrementally shift to an unintended point where financially sound and otherwise well-regulated new entrants cannot compete in financial services in the future. These concerns arise mainly from the growing trend internationally for financial regulators to impose more costly and intrusive forms of financial regulation.

This growing international trend is most notable in prudential regulation, where banks are now subject to higher capital, liquidity and risk management requirements under the 'Basel III' reforms. While we recognise that these reforms form part of Australia's international commitments to improve the resilience of the financial system (and there are strong reasons for implementing them), these reforms also have the potential to adversely affect efficiency and competition in financial services.

The issue of regulatory conservatism is particularly important in the Australian context given APRA's approach to prudential supervision is already among one of the most conservative in the world[9]. While we believe APRA's approach to be appropriate, it must be recognised that prudential supervision by APRA involves significant financial cost (by way of higher capital, liquidity and related financial requirements) and higher compliance burdens (e.g. through more extensive reporting obligations and heightened risk management expectations). Given APRA's conservative starting point, we believe it is important that the prudential regime in Australia does not become unreasonably onerous.

A particular concern in this regard is APRA's proposed 'Level 3' framework, which will require prescribed conglomerate groups to satisfy additional requirements in relation to group governance, risk exposures, risk management and capital adequacy from 2015. While we understand that Level 3 supervision is to apply to only a small number of financial conglomerates initially, as a retail group potentially seeking to expand its financial services offerings, Coles would wish to ensure that APRA's Level 3 framework does not introduce additional barriers that would restrict its ability to compete efficiently going forward. In particular, Coles would be concerned if changes to APRA's Level 3 framework saw APRA applying prudential requirements directly to the non-regulated entities of the group (such as its retail operations). Such an approach, while not currently proposed by APRA[10], would

[9] For example, APRA applied the Basel III reforms conservatively by adopting the higher minimum regulatory capital requirements under Basel III more quickly than other advanced economies such as the US and EU. APRA has also recently noted that, *"because of APRA's conservative approach, an internationally active ADI in Australia can face a capital requirement that is at least 100 basis points higher than that facing any other international bank subject to the minimum requirements of the Basel Framework"*. Refer to the Basel Committee on Banking Supervision's report on the *Assessment of Basel III regulations – Australia*, March 2014 (http://www.bis.org/bcbs/implementation/l2_au.pdf).
[10] APRA has instead indicated that its supervision of Level 3 groups will remain focused on the risks to the regulated entities within the group.

severely limit the ability of new entrants such as Coles to expand its financial services offerings (notwithstanding the potential synergies between retailing and financial services). We highlight that in offshore markets where non-financial conglomerates have been allowed to conduct financial services – such as the UK and Canada – a Level 3 framework has not been applied to retail groups. This approach has supported retail groups in expanding their financial services offering in these markets – adding further choice and innovation to consumers.

Beyond the prudential requirements, we would also caution against imposing additional regulatory burdens in the areas of market conduct, consumer protection and anti-money laundering. As we indicated earlier, we believe that the framework in place currently sets appropriate minimum standards of conduct while allowing new participants to enter with relatively low barriers. While we recognise that developments internationally have seen an increased focus on regulations dealing with consumer protection (such as regulations to address the wide-spread mis-selling of certain financial products in the UK and US that was exposed by the GFC), we strongly caution against Australia taking a 'highest common denominator' approach to regulations being applied globally. The issues that regulators are addressing in certain offshore jurisdiction are generally not material in Australia.

5.2 Removing Unintended Barriers to Innovation and New Entrants

5.2.1 Regulation of NCP facilities and other stored value payment facilities

Ongoing innovations in payment methods around the world (such as the use of mobile technology, online payment facilities, travel cards, e-wallets and other forms of 'stored value' facilities) are likely to continue to grow in light of advances in technology. These innovations present numerous opportunities for alternative providers of financial services, such as retailers, to offer payment service facilities that naturally complement their existing businesses.

While retailers in the past have largely limited their offerings in this space to low-value, single-load gift cards, opportunities exist to expand offerings in a broader array of innovative payment products given new technologies.

The existing regulations affecting non-cash payments and other forms of payment facilities (such as Purchased Payments Facilities (PPFs)) in Australia, however, are complex – layered by multiple requirements that are administered by ASIC, RBA and APRA[11]. For example:

- Under the Corporations Act (CA), the definition of an NCP facility is broad, with specific examples including cheque accounts, stored value cards, electronic cash, direct debit services, payroll cards, funds transfer services and electronic bill payment services. The

[11] AUSTRAC is also relevant in the case of anti-money laundering obligations.

broad definition of an NCP captures a potentially wide range of arrangements that are not intended to be regulated as NCP facilities, and has required ASIC to issue numerous class orders identifying products which are not subject to the full set of AFSL obligations (e.g. gift cards and loyalty schemes).

- PPFs, while sharing many of the same economic characteristics as certain NCPs, are defined under the Payments System Regulation Act (PSRA). Under the PSRA, PPFs capture a broad range of payments facilities that are not intended to be regulated as PPFs and have required the RBA to make declarations about facilities which are not deemed to be PPFs (many of which align with ASIC's class orders). The PSRA requires a holder of stored value under a PPF to be an ADI, unless subject to exemption or authority from the RBA.
- PPFs that feature 'deposit-like' characteristics are subject to prudential regulation by APRA, and require the provider of the PPF to obtain an ADI licence. The key features of a PPF that trigger prudential supervision are where: i) the product is widely available for purchase and used as a means of payment; and ii) the stored value is redeemable by the user on demand in Australian currency.

Table 9 provides a broad overview of the regulations applying to NCP facilities.

Table 9: Regulation of NCP facilities

Regulator	Facility	Regulatory objectives and mandate	Products/facilities where exemptions or relief have been provided
ASIC	NCP	Promote market integrity and consumer protection. Requires persons dealing or advising on NCPs to be subject to AFSL requirements.	• Credit facilities • Payments only to one person or to issuer • Low-value NCP facilities where amount is less than $1,000 and $10 million in total (conditional relief) • Gift cards/vouchers • Prepaid mobile phones, loyalty schemes, electronic road tolls
RBA	PPF	Promote public confidence, efficiency and competitiveness in payment systems.	• Gift cards, prepaid mobile phones, loyalty schemes, electronic road tolls • Facilities with limited value (< $10

Regulator	Facility	Regulatory objectives and mandate	Products/facilities where exemptions or relief have been provided
		Declares whether a payment facility is to be regulated as a PPF and whether the provider of the facility requires supervision by APRA as an ADI.	million) or a limited number of participants (<50) • Facilities guaranteed by an ADI or government authority
APRA	PPF	Protect beneficiaries of PPFs against loss. Determines whether a PPF constitutes 'banking business' and whether the provider of the facility requires an ADI licence.	• Facilities that are exempted by the RBA • Facilities that are not cash withdrawable and not available on a wide basis (for purchase and payment)
AUSTRAC	Stored-value card	Prevent money-laundering and terrorism financing. Requires entities providing stored-value cards to adopt appropriate AML/CTF controls.	• Cards with value less than $5,000 (not cash withdrawable) • Cards with value less than $1,000 (cash withdrawable)

While we believe there is merit in having NCP and related payment facilities subject to various forms of regulation (including conduct, payment system stability and, in some cases, prudential supervision), we believe that the current regulatory framework in this area is unnecessarily complex. For example, it is necessary to refer to at least 14 sources of legislation or relief instruments to determine the extent of regulations that apply to an NCP facility or PPF, and different terms are often used to classify what are economically very similar products.

The concern with this complexity is that it may be inadvertently preventing new participants from developing new and innovative payment facilities for the benefit of consumers. For example, new participants wishing to enter the market with an innovative product offering may reassess their willingness to access the market due to the lack of clarity in regulations that apply, and the costs that may be involved if they were to become subject to prudential supervision.

New technologies that have been introduced in non-cash payments (including mobile and online technologies) and changes in consumer purchasing habits are also likely to further stress the appropriateness of the current regulatory environment (or give rise to potential unintended consequences).

The fact that many of the existing regulations applying to NCPs and PPFs have not been significantly reviewed for close to 10 years, and numerous relief orders/exemptions have had to be introduced in the interim, suggest that the current framework may already be failing to adequately keep pace with new technologies.

In light of ongoing technological developments and the complexity inherent in the existing regulatory framework, we suggest a review of the regulatory framework associated with NCP and related payment facilities is warranted. The objective of this review should be to ensure the ongoing appropriateness and transparency of the regulations that apply to various types of non-cash payment facilities. While we believe that such a review would benefit from a broad terms of reference that looks at the overall structure of regulations, two key areas that we believe merit closer attention are:

- The potential overlap in regulatory responsibilities between APRA and the RBA: the current framework appears to allocate responsibilities to both the RBA and APRA in determining whether a provider of a PPF is required to hold an ADI licence. In our view, there should be minimal regulatory overlap or duplication – with APRA having primary responsibility for determining whether a provider of a PPF needs an ADI licence (and supervising such entities), and the RBA having primary responsibility for setting any additional regulations that may be required to address payments system stability concerns.

- The criteria or thresholds that trigger the various types of regulation (conduct, prudential and payments system): currently, the criteria and thresholds that apply are covered under numerous pieces of legislation, regulations and other instruments e.g. class orders, declarations. While it would be useful to clarify the existing criteria and thresholds, it is even more important to ensure that the thresholds and criteria remain appropriate. For example, it is our view that the current $10m threshold that the RBA applies in determining whether a provider of a PPF is to be subject to payment systems regulation should be reviewed (in light of our comments above that the RBA's primary responsibilities should relate to payment system stability rather than the determination of ADI licensing needs). Similarly, the criteria applied by APRA to determine whether a PPF is 'banking business' (requiring the provider to be an ADI) should be reviewed. In our view, the trigger for prudential supervision to apply to providers of PPFs should be set relatively high.

5.2.2 Regulation of the promotion of financial products

The ability of new participants to effectively market their offerings in new markets provides a critical means to competing with traditional participants. While there is a need to ensure that participants do not provide false or misleading information to consumers when promoting their products, we believe that regulations on advertising – particularly digital and online advertising – need to keep up to date with developments in social media and upcoming digital delivery methods. Currently, guidance addressing online advertising (provided under ASIC's Regulatory Guide 234) contain some uncertainty about the types of messages that promoters of financial products must include in online ad placements with limited space (e.g. banners and social posts). For example, there is some uncertainty as to whether promoters must include the key terms, conditions and risks associated with a financial product in small ad placements such as tiles and social posts (or whether such information can be provided on a 'landing page' that interested customers refer to after clicking through).

We therefore suggest that regulations associated with the promotion of financial products continue to be updated to reflect ongoing developments in marketing channels and to ensure they do not inadvertently restrict the ability of participants to promote their products and compete in new markets effectively. While we recognise that ASIC has indicated that its online advertising guidelines may evolve over time, we support such revisions occurring sooner rather than later.

5.3 Further Harmonisation of ACL and AFSL Regimes

Obligations under the AFSL and ACL regimes are similar in many respects, even though they deal with different products and services. While many obligations between the two regimes are common, and efforts have been made to streamline requirements between the two regimes, there remain differences between the regimes that, in our opinion, have no strong basis for justification. These differences relate to both the approach taken in setting the obligations, as well as specific requirements that apply in a number of areas. In our view, these differences unnecessarily add to the compliance costs of market participants and discourage new entrants from entering the market.

In particular, certain requirements in relation to the provision of credit, which are contained in the *National Credit Act* (including the National Credit Code (NCC)) and supporting Regulations, do not appear to have kept pace with changes in the market or the use of modern delivery channels[12]. For example, the need to collect written consent to electronic communications which precludes verbal consent given over the phone. These provisions restrict the way in which credit providers can send certain information to consumers electronically, and do not align to the equivalent provisions in the CA that apply to other financial products. Unlike ASIC's ePayments Code and the CA, there is no capacity under the NCC to develop and distribute a

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[12] The NCC is largely based on the Uniform Consumer Credit Code that applied under the state-based regime prior to the introduction of the national credit regime. Many of these provisions have been in place for years – largely unchanged.

product that is serviced purely by electronic methods. There are significant cost savings and efficiencies in allowing products to be tailored for electronic channels that ultimately benefit the consumer in terms of costs (eg higher rates on your savings, lower costs on your credit), flexibility and innovation.

Other requirements in the NCC are also overly prescriptive and inconsistent with ASIC's view that general conduct obligations should be 'principles-based' and 'designed to apply in a flexible way'. For example, the provisions in the NCC and Regulations relating to comparison rates in credit advertising require licensees to use specific formula, rounding techniques and precise wording for warnings[13]. This contrasts with the generally principles-based regulations that apply to advertising for other financial services. The prescriptive requirements defining content and form of consumer credit contracts and pre-contractual statements have not been reviewed for some time. In our view they unnecessarily restrict financial service providers from communicating effectively with consumers.

These differences make it costly for new entrants to operate in financial services. We believe that there is merit in reviewing the ACL and AFSL regimes, with a view to ensuring greater harmonisation between the regimes. This would help reduce unnecessary compliance costs for participants and allow new entrants to compete more efficiently.

[13]Provisions in the NCC relating to the form of the credit contract also contain a long and unfriendly list of specific items that must be included in the contract

Appendix Deloitte Access Economics Report