Financial System Inquiry 2014

This summary covers three areas of the inquiry focus, Consumer Outcomes, Innovation and Competition.

There is no argument that we need a strong and reliable financial system with integrity and the ability to support business and economic expansion for Australian interests locally and abroad.

I recall in the mid-nineties there was talk of Australia positioning itself as South Pacific financial centre along the lines of Switzerland and creating a bond market.

I think this opportunity has been missed and the current Australian Financial System is suffering as a consequence.

We need true money centre banking and retail banking as separate entities.

Banks should really be like providers of electricity for general lending activities and banking.

They can charge for skill and advisory but the velocity of money and general banking should be free other than the charge for use of funds.

We need a money centre bond market developed with our Asian focus in mind.

The growth of the Financial Services Industry in Australia has caused the size of our financial services giants to dominate a large percentage of the ASX values and at the same time the actual economic growth contribution has declined.

I would argue that growth is camouflage and that sheer size and volume of the big four and their associated entities including fund managers in turn leads to distortions in capital allocation and market pricing of securities.

Why do banks in Australia buy other banks or funds management companies? If the market was efficient then there would be arguably better capital allocation opportunities elsewhere.

My concerns for fair consumer outcomes are twofold in relation to our present financial services regime one is valuation & the other organised crime.

There have been many commentators local and overseas warning about the distorted Australian property sector and with good reason.

The first is banking dominance of property valuation portals Valex/RP data and the lack of enforceability or integrity of this system.

A bank can order a valuation or use a contract of sale in its lending process but the ultimate borrower being the only other risk taker cannot challenge in this area.

How can a vacant block of residential land be worth $60,000 more in 2011 then fall $70,000 in 2013 & then rise again by $70,000 in 2013 with no zoning or other changes.

Let me be very clear 2011 was post GFC and perhaps a low point of confidence so you would expect conservative values it was not so.

“There is no consumer protection for a borrower” this does not form part of the TOR for the financial Ombudsman’s Service.

The big four banks have access to more valuation data & contract information in real time than any valuation practice would ever gather yet a consumer can’t use this and has no protection.

The borrower the only other risk taker in the transaction has no redress if the bank and its internal valuation process get it wrong.

This unchecked lack of control in the banks valuation has been challenged in the courts by ASIC and they lost and now this distortion seems set to continue unchecked.

There needs to be a three way contractual linking between lender, borrower and Valuer.

That might make the valuation process realistic and robust with a better level of client protection.

Take the Bank West debacle as a recent example of bank methods.

To give the inquiry a valuation example of no confidence you need look no further than Commonwealth Banks financing of an OMC gang club house where the valuer describes the same as meeting rooms with no mention of the what the commercial property was being used for nor any necessary risk warnings.

The banks valuation process falls well short of good governance and undermines Australia’s credibility as an efficient property market.

What we have at present falls well short of Good Consumer outcomes.

The two remaining areas are competition and innovation and are interlinked.

There are two ways to improve competition one is by regulation and the other is by innovation that capitalises on regulation or applies a different thinking to the conventional approach to banking.

The banks need regulation in the area of client and entity identification that is linked to the ATO & other government reporting agencies.

They are not doing a good job of this at present and perhaps organised crime is impacting on economic growth in Australia.

The problem is that ID of clients is often left to the least experienced staff & bank tellers especially around company shareholder & trust situations.

So to improve competition a robust audit of the big fours SME entities trusts and companies in conjunction with the ATO would be a great place to clean up and get some treasury revenue.

The last area is innovation we have some great Australian examples I would encourage the inquiry team to examine the work of Josh Reich and his Simple Banking that was recently sold to a large Spanish Bank.

He has utilised technology as an enabler to make use of large data sets that banks have and lets the client slice and dice what they need out of it to make their lives simpler.

“The large banks make money more money by keeping customers confused” this statement by Josh in a recent BRW article by John Kehoe is really at the heart of competition and innovation banking should not be complicated yet Australia’s market place is littered with confusing products and falling competition.

We need two types of banks and the big four in particular need to split or demerge their retail from their wholesale activities and we need creation our own focussed bond market.

The simple banking mortgages and deposits needs to be charged at a fair rate by use like electricity or any other commodity product simple cheap & kept at low cost to produce vibrant activity based on reliable and connected valuations to keep all parties honest.

The only area where a bank should really be charging other than basic margin is for expertise and real complexity.

The financial services we have at present are distorting markets and blocking growth.

There seems to be very strong barriers to entry and vested interests that block proper reform.

John O’Brien