

Banks escape a wider royal commission

Parameters

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The Greens are seeking to widen the terms of reference for the banking royal commission to ensure it can investigate whether government support for banks in a crisis is encouraging them to take excessive risks.

Greens leader Richard Di Natale and the party's Treasury spokesman Peter Whish-Wilson wrote to Treasurer Scott Morrison yesterday, suggesting the government's draft terms of reference will prevent an examination of whether explicit or implicit funding guarantees for the major banks are encouraging inappropriate risk taking. This is because "macro-prudential policy, regulation or oversight" has been carved out from the commission's remit.

The Greens had negotiated a clause into the rebel Nationals commission of inquiry bill to look at the operation of the government guarantee for banks but the government's draft terms of reference cut this out.

Major investors in the banks also questioned the prudence of limiting macroprudential policy from the royal commission's oversight given it is having a significant influence on how banks set interest rates, what lending criteria they apply, and on the respective role of Australia's financial regulators.

"It's a missed opportunity if we do a wholesale review of the banking system and we don't look at regulatory issues that need to be cleaned up," said Kate Howitt, a portfolio manager at Fidelity International. "It would be timely to revisit regulatory framework in a calm and measured way, to make sure regulators are keeping their eyes on emerging risks."

Ms Howitt said it would be dangerous for the royal commission to make recommendations that sought to restrict bank loan pricing without having a detailed understanding of the

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influence and operation of macroprudential policy.

Labor's terms of reference would have examined the "blurred lines of institutional accountability" between APRA, the Reserve Bank and ASIC. Opposition Leader Bill Shorten asked that Labor be formally consulted on the terms of reference and said yesterday that failure to consult "will raise serious concerns and doubts about the way in which the royal commission is con-

stituted". Even though the commission will not inquire into financial stability or the resilience of banks, the government said it will examine the "the effectiveness and ability of regulators of a financial services entity to identify and address misconduct", and should advise if any changes to the financial regulators "are necessary to minimise the likelihood of misconduct...".

The government's terms of reference introduce a moving and subjective test against which the banks will be judged: "community standards and expectations". These are changing for all service industries, including financial services, and Chris Whitehead, CEO of Finsia, said a recent focus by banks on sales and productivity will need to be replaced with a demonstration of "traditional, professional banking values of stewardship and prudence".

The draft terms of reference specifically point to remuneration settings as being part of the inquiry, after the former head of governance at APRA, Fahmi Hosain, argued earlier this week that long-term incentives that focus on financial return metrics, rather than risk settings, were "the root cause" of the issues facing the banks.

The government has also removed the need for the commission to look into the recent allegations by AUSTRAC that Commonwealth Bank breached its anti-money laundering obligations, currently before the Federal Court.