How Will The Royal Commission Affect You?

HOW THE FALL OUT FROM THE ROYAL COMMISSION WILL AFFECT YOU.

I got it wrong when I predicted the Royal Commission (RC) wouldn't amount to much. As a hardened 25 year career banker even I've been dismayed by the revelations. There will be more to come later next month when the RC turns its attention to SMEs, but the ramifications from the RC will be far reaching so its timely to turn pose the question "what will this mean to me?"

The good news is the RC affords the opportunity to rebuild our broken banking system. The bad news is that in the meantime all stakeholders are going to be impacted, some much more than others. This is how I see it panning out:

Bank Customers
It will become harder to get credit as banks become even more risk averse. And it is difficult to imagine that things will get done any quicker. In addition, the cost of accessing banking services will come under pressure as banks seek to maintain earnings whilst their businesses shrink.

As new players evolve, banks will become less relevant but we need to better understand who and what will replace them. Whatever you think of banks, it may be that the grass is no greener on the other side.

Bank Shareholders
Bank profits and therefore dividends and share prices will come under pressure due to:

- Loss of revenue due to exiting of non-core businesses.
- Drop in revenue as customers vote with their feet and move to alternative suppliers.
- Further compliance and regulation imposts as well as fines.

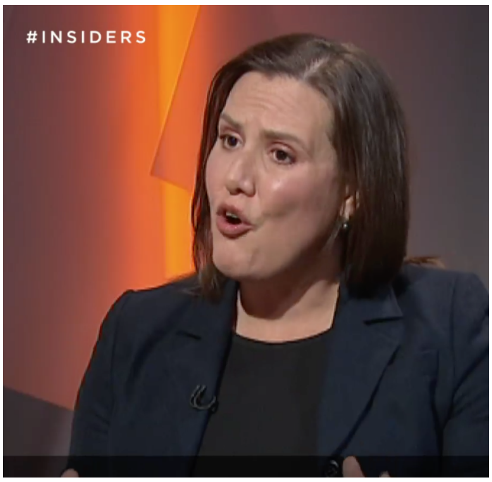
Every time banks have stepped outside their core business they have failed – stock broking, insurance, private equity and now wealth management. The same applies to expansion in Asia, the UK and the USA.

Banks are going to get smaller by their own volition, imposition from on high and market forces. The only foreseeable way the banks could grow in the short term is if the four pillars policy was removed which is unlikely as neither this government or the next would trust banks with increased market power.

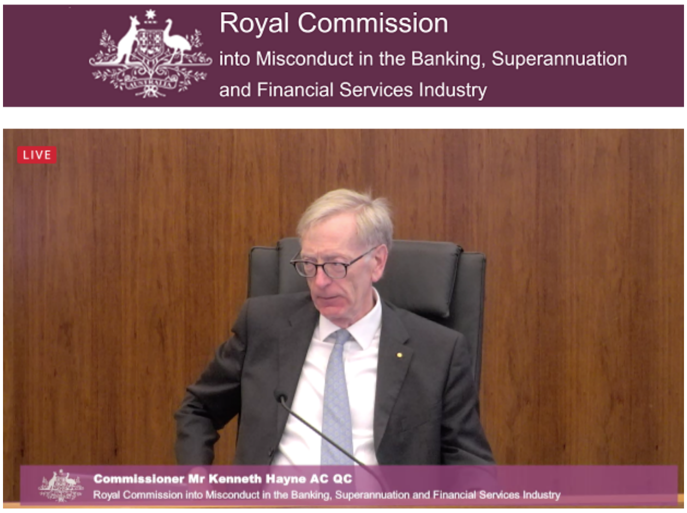
Bank Staff
99.9 per cent of the 250,000 Australians who work in banking and finance are decent people who want to do right by the customers. I know from conversations with bankers how badly they feel about the RC revelations and how they feel let down by their leaders. Ban bosses have just as a big a task in regaining trust of their employees as they do with their customers.

Anecdotally I hear of unprecedented numbers of staff are experiencing mental health issues. For many, the pride and enjoyment of working in a bank has disappeared. Disengaged staff are less productive and more inclined to leave and whilst this might assist in meeting planned head count reduction targets, some will still need to be replaced. Where will theses replacements come from? Younger people are less inclined to seek employment in an industry that is on the nose.

Politicians
Banks have been used a political football by all sides of politics for years. The Turnbull government does itself no favours by failing to acknowledge its stance on resisting the RC was a mistake. Kelly O'Dwyer's dissembling on the ABC's Insiders yesterday was embarassing. If you have not seen its worth watching at .....
https://www.facebook.com/InsidersABC/videos/1562340840544085/



As an aside, watching this clip made me wonder how much better might Parliament work if Kenneth Hayne QC was the Speaker. Can you imagine the reaction to him saying to politicians of both sides "we will get along much better if you just answer the question" as he did with a CBA executive last week? This is another exchange worth viewing..... http://www.abc.net.au/news/2018-04-18/royal-commission-grills-commonwealth-bank-witnesses/9673150 commonwealth-bank-witnesses/9673150



People saving for retirement
Banks will unwind their wealth management businesses but who will take over this role? How can we be confident any new owners will be better? It is likely that a number of financial planners will become totally independent but again, how can a customer be assured this arrangement will overcome the inherent weaknesses in the current system? Further, at least the banks have the capacity to compensate clients for wrong doing, it is less likely small independent advisors would be able to do so.

It may become even harder for retirees and those saving for retirement to find qualified reputable advice. The implications of this are significant. Will people shift their funds into asset classes they understand better such as residential real estate? What might this mean for housing affordability, the share market and future tax policy?

Brokers
There have been plenty of broker horror stories from the RC but like bank employees, the vast majority of brokers are good people who want to do the right thing by their clients. However being paid by the lender and not their client creates the potential for conflict of interest. As with financial planners, the relationships between banks and brokers will change. Some brokers will leave the industry, some will retire whilst others will modify their business model perhaps on a fixed fee for service basis.

For the very small number of brokers who have and continue to do the wrong thing, the RC is a timely reminder that unless they clean up their act, sooner or later they will be exposed.

Non-bank financiers
The good news is for these parties is that governments will do the banks no favours and will look to boost competition by making it easier for new entrants like fintechs and challenger banks to get up and running.

It’s been fascinating observing the reaction of non-bank lenders to the RC. The glee displayed as the banks receive their comeuppance is perhaps understandable but it could also prove short sighted. Some non-bank financiers would fare no better if they faced the same level of scrutiny the banks are currently receiving. For example, lack of transparency in the unregulated non-bank SME lending sector makes the big banks look like the good guys.

The banks' self inflicted reputational damage affords non-bank lenders the opportunity to gain market share by taking the high moral ground but first they would be well advised to ensure their own houses are order.

Regulators.
The questions many people are understandably asking at this time is include:

- Has ASIC been asleep at the wheel?
- Are the regulators powers adequate or is the problem more a failure to enforce existing powers?
- Why haven't there been more criminal proceedings rather than just banning orders and enforceable undertakings.

The extent of misconduct and the absence of proportionate responses to date suggests ASIC will be taking a much stronger approach to bank misconduct in the future.

Bank Directors & Senior Executives.
The conduct and lack of accountability of bank boards and senior executives is the heart of the problem. It is not just a few bad apples in the field but an absence of ethical leadership at the top combined with inadequate and ineffective systems that has brought us to this point.

Senior executives are extremely well paid, arguably overpaid. Changing community perceptions of banks requires stakeholders especially customers and staff believing remuneration of bank bosses is fair, equitable and aligned to appropriate outcomes. You may or may not believe the "fish rots from the head" is an apt analogy but few would dispute the contention that the banks have looked after their shareholders and senior executives in priority to customers.

AMP has acted promptly by sacking its CEO Craig Meller and it will be telling whether he will be the only CEO casualty. But its not just the CEOs who need to be accountable, the chairmen and directors have to date been largely absent from the RC proceedings. Where were the boards when all these misdeeds were taking place? What were the Audit and Risk Committees doing? Will we see bank CEOs, chairmen and directors called before the RC to answer such questions?

It would not surprise if some form of legal action was taken against bank boards. Equally, it would not surprise if some directors decided now was a good time to move on. The fees they earn are significant (directors earn on average $300k pa whilst chairmen earn around $1m plus they have other positions as well) but would this compensate for the risk of being fined or even jailed under proposed new laws?

Following on from this, who would replace them? Potential candidates could be forgiven for concluding that no amount of money or indemnities would persuade them to take on such a role. So, as with the staff, where is the new talent going to come from and how do banks ensure they get it right next time?

After countless inquiries, it has taken the RC to get us to this turning point. We should all hope the banks grasp this opportunity. Failure to do so will see market forces and regulators rendering them extinct within a decade.

The RC has and will continue to be a learning experience for all. A wise banking mentor once told me “you can trust but you should also verify”. Blind trust in our institutions is unfortunately misplaced these days so the onus is on the individual to verify. This requires a certain degree of financial literacy and the keys here are access to quality advice and investing our own time and effort to really understand the issues.

Interested in your thoughts.

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