After another disastrous year, 2020 looms as a watershed year for the big banks.

2020 LOOMS AS A WATERSHED YEAR FOR THE BIG BANKS

My last newsletter of 2018 was a wrap up of the Royal Commission and I concluded with the comment “2018 has been an “annus horribilus” for the big banks and 2019 is shaping up as being at least as challenging”.

It certainly has been a challenging year, probably even more so than most of us anticipated. And notwithstanding Westpac’s recently disclosed indiscretions, there could be more pain for it as well as ANZ and NAB over the next two weeks as shareholders vote on remuneration reports. A second vote of 25 per cent or more against the remuneration reports will trigger a spill of the board of these banks. This possibility begs a number of questions:

- Who in their right mind would put their hand up to replace the current bank directors?
- What would it mean if there are no suitable alternatives?
- Would these banks actually be better off with new boards?

The banks are struggling under a relentless double barrelled onslaught from a baying media constantly seeking to identify and expose the next episode of bank misconduct and politicians who, perhaps to their own surprise, have finally hit upon a profession which is even less trusted than themselves.

This newsletter explains why difficult times lie ahead for the banks and why 2020 looms as a watershed year for the banks.

TEN REASONS WHY DIFFICULT TIMES LIE AHEAD FOR THE BANKS.

25 years. We have flat wages growth, subdued consumer and business confidence and spending, soft demand for credit and historic low interest rates. Not great conditions for a trading bank!

2. Downside on profitability.
The golden years for the banks are well and truly gone. Further margin compression and higher costs especially in compliance and remediation weigh against bank profitability and dividends. Once the darlings of the ASX, the banks are now friendless laggards.

The low interest rate regime is seeing depositors looking elsewhere for better returns and this will continue to impact on bank liquidity and cost of funds. Negative interest rates would be uncharted waters but if this were to happen depositors might well prefer to hide their savings under the mattress rather than pay a bank to safeguard their money.

3. Emergence of genuine competition.
New competitors are popping up like mushrooms, picking the eyes out of business that was once bread and butter for banks such as home loans, SME banking, FX, deposits, and payments systems. And increasingly the younger generations seem to prefer buy now pay later offerings to credit cards.

4. Shrinking to greatness.
Banks are shrinking from non-core areas like insurance and wealth management and are looking to go back to the basics of retail and commercial banking. Some years back, former NAB CEO Don Argus spoke of the banks “becoming like giant building societies”. Over the journey, mortgage lending has proven to generate the best ROE for banks but their dominance of this market is at serious risk from smaller, friendlier and cheaper players.

Why as a loyal customer would you pay up to 0.75 per cent per annum more on a home loan than your bank is offering to entice new customers? And why would you take a home loan from a big bank when other bank and non-bank lenders offer exactly the same product for up to one per cent per annum less?

If the banks cannot demonstrate a competitive advantage in home loans, what will be their strong suite?

5. Cost of compliance and remediation.
Compliance and fear of more public scrutiny continues to hamper bank productivity. This burden is unlikely to ease as politicians, regulators and bureaucrats, chastened by the Royal Commission, come down hard on banks.

More and more resources are required to endeavour to satisfy compliance expectations and demands. Bankers are so hamstrung by compliance they only have limited time to devote to the customer. You wont lose your job if you fail to meet profit targets but you will if you continue to fail your compliance gates.

6. Lost connection with the customer.

connection is “up for grabs” although to a significant extent it has already been ceded to brokers who now account for around half of the home loans written by the banks.

7. Broken systems.
Despite spending billions of dollars on IT, bank systems and procedures continue to be found wanting. Westpac said its 750 person anti money laundering team would be boosted by a further 250 employees begging the question “if 750 can’t identify and fix the problem, what is employing another 250 people going to do?”

One of the biggest advantages new players have is they can start from scratch with their IT systems. Banks are torn between patching up existing systems on the one hand and, on the other, throwing systems out and starting completely from scratch.

8. Finding new leaders.
Where are the banks going to find visionary, ethical, knowledgeable leaders at board and senior management level that are not tarnished and are up for the challenge? They may be paid a lot of money but the risks are huge and it may not be long before we see the first bank directors or leaders do jail time.

9. Staff engagement.
Bank staff have been badly let down by their boards and senior management and feel they have been made the scapegoat for poor leadership. It is becoming harder and harder to retain and recruit people who are qualified and motivated to keep doing the right thing. Westpac’s decision to cancel staff Christmas parties is a small but telling example of employees paying a price for the sins of their leaders.

10. Loss of Trust.
But by far the biggest challenge facing the banks is **loss of trust**. A recent IPSOS poll identified the three least trusted professions in Australia as politicians, advertising executives and bankers in that order.

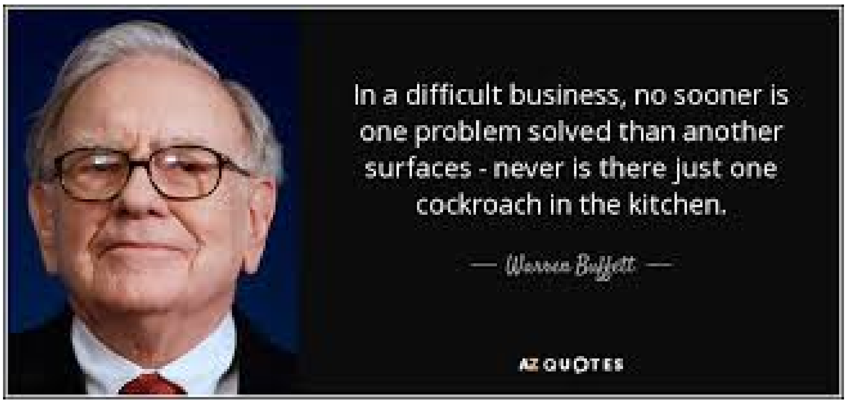
It is hard to argue that the banks don't deserve the bollocking they continue to receive. In recent months, both NAB and Westpac leaders have been stubbornly resolute in the face of widespread calls for their removal only to roll over when it finally dawned on them that the shareholders and the broader community would no longer tolerate them continuing in their roles. Their inability to “get it” only supports the view that many bank bosses have been living in a self-absorbed parallel universe.

At last week’s prestigious advertising industry B&T Awards, Westpac’s head of brand and in which it spent an estimated $40m trying to convince everyone that they were different to the other big banks. The advertising and media executives won awards and received bonuses but surprise surprise, the NAB brand remains indecipherable from its cohort.

For too long bank bosses, politicians and advertising executives have prioritised their own interests ahead of their customers and have taken the people for mugs. That's why they rate the lowest on trust. They continue to make this mistake at their peril.

WHAT WILL 2020 BRING?

It would be unwise to suggest that it can't get any worse for the banks. One thing we've come to learn is that if one bank has a problem, there's a fair chance the others will have similar problems. Warren Buffett's cockroach analogy rings true:



Banks will continue to proclaim with some justification that "compliance is killing us" but there will be no let up until such time as they demonstrate they have learned the lessons of the past.

They will continue the process of simplification which implies more divestments. Impetus for this will come from within the banks as well as external influence from markets, government and regulators. Shedding of staff will continue although the reliance on consultants will be unabated.

Investment in technology will increase and we are likely to see more partnering with innovators who leverage technology to improve customer outcomes and compliance. Offshoots like NAB Labs and Westpac's Reinventure will play an increasingly significant role in strategy and development.

The banks will remain the whipping boy for the politicians on all sides because there are votes in it. Scott Morrison wants to be seen as hard on both rogue banks and rogue unions and recently warned bankers that "crooked bankers will face tougher sanctions than union thugs".

At a more meaningful policy level there needs to be further discussion about the dismantling of the four pillars policy, not to allow mergers amongst the banks but rather to encourage a change in direction of one or more of them.

The removal of the government guarantee on deposits held with ADI's is something which

It has taken some years, but finally it seems that politicians and bureaucrats have come to the realisation that the best way to increase competition is not by trying to get the banks to change but by making it easier for new competitors to take them on. There is now more happening on this front but even more can be done.

The banks shouldn’t be written off just yet, they still have much going for them including a massive customer base and big and reasonably strong balance sheets. But time is no longer on their side as incumbency and inertia are finite advantages. One way or another, 2020 could herald the beginning of the dismantling of this long standing homogeneous oligopoly.

As this will be our last newsletter for 2019, theBankDoctor extends “Seasons Greetings” to all.

Neil Slonim
theBankDoctor