Banking Executive Accountability Regime

Response to Consultation Paper July 2017

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My background;

1. Commenced a banking career with Bankwest in 1964.
2. Involved in bank lending since 1969.
3. Held many senior positions which covered almost every aspect of banking, including lending, both from an administrative and a practitioner's point of view.
4. Studied banking academically and for a period lectured and tutored in banking and finance at an Australian university
5. Have worked mainly as a salaried bank official but also worked for some years on a consultancy/contract basis; span of career 47 years.
6. Most recently worked in a loan recovery role, 2009 to 2011.

Preamble

My interest in this paper stems from:

1. I worked in the banking industry for 47 years and while I have a firm belief in the importance of the Australian banking system I feel that the time has come to introduce a system of accountability which will ensure that banks operate in a manner which regains the trust of the community.

2. In 2012 I made a submission to the Senate Inquiry into the post-GFC banking sector. My submission included detailed recommendations for the introduction of enforceable professional standards for bank employees in the area of lending. That submission is self explanatory and is attached; my reason for doing so being that individual standards better match those applied to other professions and do not rely on systemic failure to alert regulators to problems.

Chapter 1- Introduction.

The quotation which makes up the third paragraph suggests that there would be numerous examples of a "poor compliance culture" in ADIs. It makes that assertion without presenting evidence, which seems at odds with the intent of the paper. Generalisations are not helpful in resolving specific problems and can lead to solutions which fail to address actual circumstances and are therefore ultimately ineffective.

In the next para the phrase, "..balance risk and reward" appears. Again, these words are essentially qualitative and open to interpretation depending on many variables which are obviously well beyond the scope of this paper. In addition, what does the average bank customer know about balancing risk and reward, a subject that is constantly under review in academia and keeps many bankers awake at night.

The next quotation uses the phrases "appropriate risk taking" and "fair treatment" but again, one is left with the task of an individual interpretation of the meaning. In general, I am suggestion that relative, subjective terms and amorphous aspirations generate strong emotional responses without pointing to remedies.

Chapter 3 - Institutions to be covered by the BEAR.

I agree that all entities within a group should be covered. In addition to the good reasons stated in the paper, not to do so would enable an ADI to place functions (within the scope of regulations) in non-BEAR entities to avoid the regime As it is, some ADIs may want to rid themselves of entities where they consider implementation of BEAR would be too onerous to retain the subsidiary. I strongly believe that all broking firms submitting loan applications to ADI should be subject to BEAR.

Chapter 4 – Individuals to be covered by the BEAR.

Table 1 lists 12 positions proposed for accountable functions. If my understanding is correct, in the case of Westpac (for example) out of a total group staff of approximately 35,000 only 12 would hold positions accountable under BEAR. The third paragraph mentions casting the net too wide but I suggest that the risk here is that the net is so small that many of the predators which it intends to catch will simply swim around it. I believe that the weighting of accountability should reflect the risk in the balance sheets and profit and loss statements of ADIs, i.e. lending, in terms of assets and the critical importance of interest margins to gross income. The risk area should be expanded to encompass those operating nearer to those dealing with customers. In large ADIs (CBA, Westpac, NAB and ANZ) there are many individuals operating with considerable autonomy, including policy making, who need to be aware that they will be held accountable for their actions by regulators. In the area of lending the list should include all Heads of Credit and Heads of Recovery, (in all aspects of lending including: consumer, business, corporate, agriculture, broking, leasing, property, trade finance, institutional, infrastructure, mining and oil and gas, syndications and exposures to other financial institutions and foreign exchange exposures) and which are mainly, but not all, senior executive positions reporting to Chief Risk. Not to expand the list in the (very large) area of credit would mean that Chief Risk would be solely and directly accountable for actions of thousands of staff, many of whom would be regarded as executives themselves. The alternative to this would mean that ultimately no one is accountable as reprehensible actions of individuals below the level of

Chief Risk could be deflected with the excuse that Chief Risk knew nothing of the occurrence nor endorsed it and it was ultimately carried out with “best intentions”. In addition to the above to avoid individuals “slipping through” the broad intent of BEAR accountability net I would strongly recommend that where the Financial Ombudsman Service reviewed a case and found that actions of an individual, or individuals (not an individual performing a function prescribed by BEAR) were grossly negligent, then subject to a review by BEAR that individual would be recorded on the BEAR register and the relevant ADI given notice of actions required by the relative Accountable Person to address shortcomings, including, if necessary, dismissal and other legal remedies.

I agree that BEAR should cover every aspect of an ADI’s operations. Given the critical importance and significant risks associated with certain non customer facing areas, including Information Technology and Treasury operations where knowledge of their activities is highly specialised, great care needs to be taken with oversight functions. I recommend that Human Resources departments be included in the regime to ensure that matters like staff selection, training and professional development result in a high quality organisation capable of meeting community expectations.

Chapter 5 – Expectations of ADIs and Accountable persons under the BEAR

Under Policy Considerations it is suggested that BEAR will apply when poor conduct or behaviour is of a systemic or prudential nature. The Cambridge Dictionary tells us that the non-biological meaning of systemic is: “A systemic problem or change is a basic one, experienced by the whole of an organization”. In other words BEAR would not apply until the whole of an ADI was experiencing poor conduct. Would this not be an example of shutting the stable door after the horse has bolted?

Another key point here is that it is intended that BEAR would ensure that accountable persons meet the expectations of the community. However, the expectations of the community would not be met if action under BEAR were not to apply until *after* systemic problems occurred.

How does the BEAR proposal compare with accountability regimes in other professions? Do other professions wait until problems become systemic or do they look at individual problems to ensure they don’t become systemic?

The definition of “community expectations” presents some difficulties. A community can become outraged by grossly unfair treatment shown to just one individual, family or a group. Under BEAR that would not represent systemic failure despite the fact that the whole community would take the view that their expectations had not been met.

Under BEAR the expectations suggest that an ADI should conduct its business with integrity, skill, care and diligence. How is it to be judged that an ADI has not conducted its business according to these relative measures? Would it require community outrage and a parliamentary inquiry? When you use these words to what extent or measure would an employee of an ADI actually apply “care, skill and diligence” to individual tasks? Does it mean that it is sufficient to satisfy the requirements of an ADI and will the application of those qualities vary between ADIs?

Chapter 7 – Implementation and Transitional Issues

In terms of registration of an accountable person I would recommend that if APRA formed the view that an individual was entirely unsuited or unqualified for the position (as in say a blatant case of nepotism or where APRA was aware of other information which had a clear bearing on suitability) then APRA should have the power to formally notify the board of the ADI to that effect or apply to an adjudicating authority for a ruling before the appointment took place.

The process of Accountability mapping would indeed have to be thorough and comprehensive if it were to effectively include all aspects of an ADI's operations. If an Accountable Person was, by this process, ultimately responsible for every aspect of his or her area of operations, no matter how far removed they where from those activities, then it would surely provide the extra focus that individuals require to exercise effective oversight activities. As an example, the Chief Risk residing in Sydney would ultimately have to be concerned about the guidelines for the lodgement, processing and review of credit card applications in a small branch in country Western Australia, including the suitability of the individuals carrying out the tasks.

I have already stated above that I would consider it appropriate that should the Financial Ombudsman Service find in a review of a matter that poor conduct was apparent, then advice to that effect should be issued to APRA who in turn would contact the appropriate Accountable Person.

I consider the civil penalties appropriate provided that they were well publicised at the time. Whether a court would agree with a penalty is another matter, given what I consider are too many subjective measures and terms in this Consultation Paper. ADIs can bring considerable legal resources to fight such issues and would generally have the backing of the ABA.

In terms of implementation timing I consider that it is sensible to provide a 3 to 5 years' time frame for a comprehensive implementation with ADIs under no illusion that there would be no extension of the commencement date. Given that ADIs' should already have all processes mapped and positions filled with suitably qualified individuals the cost should not be a great burden. A problem would only arise if an ADI was not already managed in an appropriately prudential manner.

Submission to the Senate

Inquiry into the post-GFC banking sector

May 2012

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Terms of Reference

An examination of recent developments in the banking sector arising out of the impact of the global financial crisis and subsequent events, including:
(a) the impact of international regulatory changes on the Australian banking sector, particularly including changes to liquidity and capital holding requirements;
(b) the impact on relative shares of specific banking markets;
(c) the current cost of funds for lending purposes;
(d) the impact on borrowing and lending practices in the banking sector both during and since the global financial crisis;
(e) the need for further consideration of the state of the broader finance and banking sector; and
(f) any other relevant matters.

This submission addresses articles (d) and (e) of the Terms of Reference;

(d) the impact on borrowing and lending practices in the banking sector both during and since the global financial crisis;
(e) the need for further consideration of the state of the broader finance and banking sector;

My background;

1. Commenced a banking career with Bankwest in 1964.
2. Involved in bank lending since 1969.
3. Held many senior positions which covered almost every aspect of banking, including lending, both from an administrative and a practitioner's point of view.
4. Studied banking academically and for a period lectured and tutored in banking and finance at an Australian university
5. Have worked mainly as a salaried bank official but also worked for some years on a consultancy/contract basis; span of career 47 years.
6. Most recently worked in a loan recovery role, 2009 to 2011.

My submission is structured as follows:

1. Opening comments
2. Causes of current bank lending environment
3. Lending practises and consequences
4. A roadmap for sustainable and safe bank lending

Opening comments.

The Terms of Reference (d) appear narrow in as much as if there was an "earthquake" in bank lending, during, and following the GFC, then the fault lines have been developing for over 20 years and have been well and truly apparent for at least 10 years. As a consequence, my comments, where they stray outside the confines of (d), should be considered as comments made under Term of Reference (e). My comments on the following pages consider the many changes in banking which have lead to the need for this inquiry.

For the avoidance of doubt this writer is **not** suggesting a return to the regulation of banks as existed up to the early 1980s.

My submission covers all types of lending including corporate lending. Lest there be the view that corporate lending is trouble free, it was reported in the last few days that Administrators of the Hastie Group have stated that; "I think there will be a substantial number of lenders who don't get their money back"..."Virtually every bank in Australia is involved." That statement suggests that not a single banker involved with the management of the risk with Hastie had any instinct or foresight that something might have been wrong. I find this astonishing to say the least and my final recommendations were always intended to include corporate lending.

Causes of current bank lending environment

Following deregulation of banking (early 1980s) bank lending was significantly liberalised leading to strong competition between institutions for market share. Unfortunately banks did not have time to fully understand and develop the risk management skills necessary to match the new market dynamic, thus deregulation proved to be a two edged sword. As a consequence, lending into rapidly inflating asset markets lead banks (and many borrowers) to varying degrees, to significant difficulties in the late 80s – early 90s.

From the early 90s on, banks, while much chagrined by their initial experience with deregulation, internally devoted much energy, (with encouragement from external consultants) in a very narrow manner, to developing strategies for the implementation of structures which revolved around;

1. Cost cutting

2. Restructuring for asset growth optimization

In terms of these strategies over time banks implemented the following:

1. Converted full service branch structures to deposit taking offices with some consumer lending functions attached. The consumer lending decision process is mainly system driven; i.e. computer lending programmes make the decisions unless the application falls outside certain criteria at which time it is referred to a higher authority in a central or head office.

2. Centralised banking processes and functions previously carried out within branch structures including lending functions such as loan approval letters, document preparation, follow up of arrears on loans, loan recoveries etc.

3. Outsourced other linked functions such as valuations and legal work, thus reducing the number of salaried professionals in those roles.

4. Withdrew business lending from the branch structure and consolidated in lending centres where lending managers and support staff worked in teams with most decisions being made by a head office credit decision team. As managers were no longer responsible for a branch operation (as Branch Managers) they were given larger portfolios and growth targets than previously managed under individual branch structures. Due to the centralised nature of the functions, rapid growth of portfolios could be accommodated by adding additional lending/relationship managers and splitting or resizing existing portfolio groups.

5. The withdrawal of all relationship banking from most personal clients (except those meeting wealthy client criteria) and smaller businesses; clients in these categories were pooled and managed by teams. The means of bank contact for these clients is via "help lines".

6. Offering redeployment or redundancy to former branch managers and middle management (often those involved with the administration of branch structures) whose services were no longer required under the new structures.

7. Significantly reduced training and professional development budgets in the area of lending with increased reliance on hiring staff where experienced replacements were required.

While business leaders would broadly support most of the above objectives, what was absent was an equal focus on developing and retaining a highly professional, ethical and stable workforce who could be relied on to use their banking experience and expertise to make fair and balanced judgements at all times.

Undoubtedly the strategies discussed above have positively impacted bank profits and shareholder dividends. On the other hand it is all too frequently reported in the media that the activities of banks, especially in the area of lending, are at times highly questionable. The negative impacts of the cost cutting strategies have been;

1. The former full service branch structures were a natural (and taxing) training ground for young bankers who, as they occupied various positions within those structures, were given the opportunity to develop leadership, lending skills and judgement under the critical eye of respected branch managers who in turn had to prove themselves to attain the respected senior status they held. In turn branch managers, who had proven themselves as sound operators over a number of years at different locations, provided the resource from which middle management positions, and eventually higher, were filled.

2. Individuals within that structure who were deemed unsuited for a banking career due to lack of judgement or other character flaws, were proactively counselled but the absence of improvement usually resulted in a stalled career so that branch manager or higher status was unlikely. No structure is perfect, but this environment created a more reliable and sustainable system of status within the organisation where, to the best of everyone's judgement and intentions, the most deserving, balanced, honest, reasonable, knowledgeable and experienced individuals held positions of influence. Contemporary banking structures provided rewards for short term performance regardless of how cavalier or toxic the individual.

3. The flattening of bank staff structures brought about by branch closures and centralisation has resulted in fewer opportunities for gradual and progressive promotion "through the ranks" of bank staff with its attendant testing of individuals along the way. As a consequence, promotion is often attained by moving to another bank. The corollary of that is that to a significant degree banks now rely on the hiring of "experienced" staff where a lending position (or for that matter many senior positions) needs to be filled; e.g. bank lender A resigns to join another bank in a more senior position (or higher paid) and is replaced by bank lender B who joins from another bank for the same reasons as the person he/she is replacing has left. Promotion by serial resignations does not imply that the individual has any particular merit. Mostly appointments are made on the basis of likely marketing skill of the individual; i.e. how quickly they can build the loan portfolio. Although off topic, one of the "big four" banks currently advertises roles in retail banking and makes the following statement; "Our Branch Managers come from many different backgrounds; you don’t need a financial background to have that special something that we’re looking for...." Note that the reference to Branch Managers refers to a retail banking (not business) structure involving deposit taking and automated consumer lending.

4. To varying degrees banks also hire university graduates with the idea of fast track training into positions which, under previous structures discussed above, would have taken many years for a bank officer to attain. Bankers developed by "shake and bake" processes have a thin crust of knowledge and little experience on which to base decisions which have the potential to significantly impact their clients. From experience I know that universities don’t teach lending

judgement, wisdom, experience, integrity and empathy, all character traits that take years of hard work on the job and for some, no matter what their education level, are forever beyond their grasp. I believe that in the finance industry there is a tendency to assume academic qualifications adequately replace these attributes. The fact is that a PhD in finance, on its own, would not qualify the holder of that award to take and approve a $5000 credit card application. At the time of its failure in the UK, HBOS (Halifax Bank of Scotland) CEO Andy Hornby, an Oxford graduate and Harvard MBA, (coming top out of 800 students) admitted to the UK Treasury Select Committee of the House of Commons that in fact his education had not given him any banking qualifications. The above statements should not be interpreted as being "anti intellectual". Academic qualifications, which do not signify intelligence or honesty, are but one spoke in the wheel, they are an addition, not a replacement, for the many other personal qualities required of a successful banker.

5. While outsourcing clearly has an appeal as a strategy for cost reduction and flexibility for growth, professional firms, such as valuers and legal firms external to the banks, do not necessarily view their work in the context of the wider functioning of the bank and relevance to the client. For example a salaried "in house" valuer is far more likely to have a greater understanding of the circumstances, complexity and variables of a loan application for which he or she has been called in to assist than an external valuer whose view of the process would be very narrow. The same applies to legal work and it needs to be mentioned that customer confidentiality has a part to play in this process. Collegiate interaction between bankers and supporting professionals is fundamental to good practice and outcomes.

6. Bank staff who previously worked and lived in the communities they served understood the impact of poor or unreasonable decisions on individuals and families who they knew personally. A bank manager needed to maintain a sound reputation and walk with honour in the community and this attitude became ingrained and served the banker and the general community well as more senior promotions were attained. Centralisation of lending functions often results in decision makers being remote from bank clients. This means that the relationship with the client tends to be more legalistic than personal. In that environment the consequences of bad decisions have little, if any, impact on bank staff, especially given the proclivity of people in the banking industry to seek employment with other banks.

7. Another negative element to the more recent structures is the "carrot and stick" approach of managing relationship managers, particularly those engaged in any form of business lending. With a heavy emphasis on growth, managers will not spend as much time as the previous generation of lending managers in developing close relationships with their existing customer base. Rather, the emphasis is on the "new deal", the new client deal which adds to the likelihood of a positive market share statement and bonuses at the end of the year. On the other hand, managers who for good reasons spend significant time developing an understanding of existing clients at the expense of writing sufficient new business, might find themselves downgraded for "lack of performance" and possibly be penalised in some other way.

Lending practices and their consequences

The comments made in the preceding sections set the environment for current lending practices. It should not be assumed all bank lenders are negligent and only interested in their bonus, far from it. The problem is that the environment does not provide the appropriate development and training ground for long term safe and sustainable practices and decisions which are in the best interest of clients and banks. The existence of the Senate Inquiry supports this point. Lending practices which are not appropriate and their consequences are as follows:

1. Lenders relying on valuations of either property or other assets, without ever having set foot on, or viewed those assets. This can and does occur when the manager is lending to a client in a location far removed from his lending centre. Managers should have a sound knowledge of valuation procedure and a good knowledge of the market and local economy in which the property is situated. Armed with this information they should be able to carefully examine the asset in question and form an educated opinion about its worth, sustainability and usefulness to the loan application and customer in question. This is vital when the loan is for business related purposes. No lending should ever take place where this practice does not occur, yet the occurrence of lending without viewing the asset or its environment is widespread. The consequences of failure in this area are dramatic. Loans can be approved when the customer has made a very bad decision about the purchase or use of an asset which later becomes unsuitable and unsaleable

2. Lenders who do not have sufficient knowledge of the client (either an existing or new clients) to make a mature, objective assessment of the customer's background, past business experience, business acumen and hence likely success of the business venture which the bank lender has under consideration. Lenders need to know their clients and be sufficiently experienced in interviewing and assessing the character traits desirable for success. Importantly a lender needs to be able to say "no" when the evidence does not support the application. Problems occur when lenders do not have sufficient time to develop relationships with clients and are lending in situations where the loan has been introduced by a third party, e.g. a finance broker, and/or the loan applicant is situated in a location remote from the lender. The consequences of not knowing the client can include the eventual or rapid failure of a business with subsequent loss of assets, especially family homes, with attendant hardship for family members. "Know your client" used to be a golden rule in banking.

3. Lenders who do not understand the client's or applicant's business, industry and the context in which it sits in the wider economy and are thus unable to arrive at a balanced, educated and mature decision about the desirability of the loan application. This problem is particularly prevalent when lenders are dealing with locations remote from their operations centre. A lender cannot glean the economic prospects of a town, region or suburb by reading a few notes. These are complex issues and require sound knowledge and understanding of the variables, e.g. a client might want to establish a new business in location x; the lender needs to include in his considerations the demand for the services or products offered by that business, the risks inherent in the particular business, existing and potential competition, the prospects in the location as well as the issues raised in sections 1 and 2 above. These requirements of course apply regardless of distance of the business from the lender's location. Lenders who do not have sufficient knowledge and experience to make both quantitative and qualitative assessments will make poor decisions and clients will suffer accordingly.

4. When property markets becomes buoyant banks create a dangerous cycle by lending against assets whose valuations have become artificially inflated by earlier indiscriminate lending, stemming from the failure of financial institutions to question the reason for rapid increases and sustainability of valuations. In certain circumstances such cycles have the characteristics of "Ponzi" schemes. Banks need to carefully assess the sustainability of any property valuation and make deductions for bank lending purposes where the valuation trend clearly exceeds long term averages with a lack of economic fundamentals to support bloated price increases. This measure would slow down rapid valuation increases (which are simply a function of the lending itself) and deter buyers who would have to find more cash or equity to make a purchase. Banks should adopt prudent valuation procedures which assist to minimize speculative property rushes and their consequent losses.

5. Lenders who become involved in complex transactions and do not have the experience, time or resources to properly consider and manage the proposal. The drive to grow lending portfolios will tempt many lenders to bite off more than they can chew. Given the remarks contained earlier in this paper, it is not surprising that significant losses can occur when loans are approved in these circumstances. An example is property development which constantly claims its victims, largely because enthusiastic, but immature bankers fail to recognise the nuances of the complexities and difficulties in these dealings, especially when combined with issues around valuations and remote locations discussed in the preceding paragraph.

6. Lenders who do not have sufficient time to properly manage their existing client base and thus are not aware of the warning signs of a deterioration of a client's business. This problem can occur in combination with the banker not being close to the client, not understanding the business and its prospects and wrongly analysing financial data which in any case may be out of date. This of course frequently occurs when a lender takes over an existing loan portfolio and is under immediate pressure to get out and find new business. In reality it takes months for an experienced banker to come to grips with a loan portfolio. The above is further complicated if the banker does not have the time to carefully scrutinize data including cash flows, and in any event does not know what to look for. In this environment problems may not be uncovered before it is too late to avoid or minimize losses to the client and bank.

7. Lenders who do not have sufficient maturity and experience to negotiate effectively when the situation calls for control to be exercised. This often occurs in conjunction with 6 above but can also occur when a new application is being considered. If young managers are timid or are inappropriately influenced when dealing with an applicant or third party, e.g. a finance broker, then the scene is set for future problems.

8. Loans approved where the primary focus is the strength of the security offered; the ability to repay the loan being considered of secondary importance. Lending of this type is referred to as "security lending". Following significant losses by banks in the early 90s, when property values fell sharply, security lending was shown to be a poor practice and was frowned upon for a number of years. In more recent years I have seen evidence of this practice re-emerging with unfortunate consequences for borrowers and banks. It can take many forms, including loans to small businesses, (e.g. so called low doc loans) but it is particularly dangerous in bridging loans and loans involving third party guarantee securities, e.g. where parents provide a family home to secure loans for their children. If the borrower has difficulties servicing the debt then they and their guarantors are at risk of losing their assets. If property values are falling the consequences can be very serious. If such loans have other weaknesses (see 1 to 7 above) then the negatives can be significantly exacerbated.

9. During times of growth where competition for loans is strong, banks can be tempted to take an ad hoc approach to lending beyond the constraints of their core policies. The danger of this practice is that if the market turns against "flavour of the month" industries, banks may want to exit those loans to avoid potential problems. Ad hoc approaches are the antithesis of carefully thought out philosophies and usually indicate a lack of in depth understanding of the risks of a particular market. Banks need to be consistent with treatment of clients in various industry segments and develop policies to ensure that they are not creating the very bubbles which they then try to escape from.

10. Under the now long replaced branch banking structures managers were given sensible loan approval delegations based on their experience and size of their individual branches. The benefit of this process was that managers learned to use their authority wisely and one of the key tests of a successful manager was to learn to say "no" and have the conviction to advise the client accordingly. In the current environment most managers must refer their loans to a regional or head office credit department for approval. The process of simply recommending a loan for approval does not carry the same weight as actually approving the loan. A banker will take far more care if the final decision rests on his table than at some remote office. The success or otherwise of managers via the use of their lending delegations was critical in determining suitability for promotions.

11. The centralisation of lending functions also involves, with most banks, placing loan recovery departments in a head office environment. At first sight this might seem like an efficient process but what it actually does is shield lending managers (and credit approval functions) from the

often awful consequences of their actions. A key area of learning for lending staff is understanding and dealing personally with loans that have gone wrong. This is often a time consuming, frustrating and sad process but is one which teaches the manager to take a great deal of care with new loans, to get to know their clients well and to be highly proactive should early warning signs of borrower difficulties emerge.

12. Recent reports suggest that when a customer experiences difficulties, some banks immediately take an unyielding and unsympathetic stance to protect the bank's interests. What I am suggesting in this submission is that the actions of banks in their lending processes are often the cause of the problem in the first place. Banks would have far fewer loan defaults if more care was taken with original applications and more time was allocated to relationship management and to proactively and progressively monitoring the financial health of borrowers during the term of the loan. Notwithstanding the above, there are times when, despite the most professional approach to lending, things go wrong. It is at these times that the bank, with wise, calm and experienced staff, can sit down with the client, who they know well, and discuss the range of options available. My experience is that the vast majority of people are reasonable and often well understand the banker's predicament, even when faced with serious difficulties, provided that the bank in turn is reasonable and has not contributed to the problem in the first place.

13. Banks' credit approval functions should be resourced by "old" and highly experienced staff who have witnessed multiple economic cycles and are deaf to the siren call of growth at any cost. Further, credit people should ignore the impassioned pleas of business development or lending centre managers who wish to see a certain loan approved when the credit approval department has serious doubts about the viability of the proposal. The consequences of credit staff not having the courage of their convictions and the support of the bank's senior executive team, has, in my experience, proved to be a significant source of poor lending.

14. When loans are approved for business or investment purposes, banks often do so on the basis of ongoing conditions for the life of the loan. These conditions will be written into the loan approval contracts and to give some very common examples, will relate to financial reporting, profit (e.g. EBITDA) targets, security values, capital expenditure and very many others depending on a significant number of variables. While loan conditions are a legitimate process in lending they do not replace all the due diligence issues discussed in the above sections. For example, if the bank wishes the customer to provide regular financial reports, e.g. quarterly financial statements, then it should first ascertain that the client has the means, resources and ability to produce such information. If the client's accountant is to produce the data, can the client provide the accountant with the raw data in a timely manner and will the cost be manageable. Further, will the accountant understand the bank's requirement and produce the right data on time to avoid a breach of the loan conditions. Does the client use an accounting package, e.g. MYOB, and does he have sufficient understanding of bookkeeping to produce data that is accurate and does not require time consuming and costly re-work by the accountant. It will be seen from the above that a simple statement in a loan approval letter regarding financials has a number of complex issues attached which could take some time to resolve. Another example is the EBITDA target clause. If the bank is satisfied beyond any reasonable doubt, after full and thorough analysis, that the client can easily maintain the required EBITDA, then it is unlikely to be a problem. If however the loan process is faulty for some or all of the reasons discussed above, then a breach of the clause could occur quickly with most unfortunate consequences for the borrower. If the clauses in a loan contract are numerous, the customer and bank, in their mutual haste to have the loan made available, may gloss over the fine detail, only to have it emerge later as a possible breach of the loan conditions.

A roadmap for sustainable and safe bank lending

The matters before the Senate Inquiry are, I believe, manifestations of the issues I have raised above. While it is easy to criticize banks, it is, I believe, far more useful to point the way forward so that banks and bankers can once again hold their heads up high and enjoy a reputation of professionalism and prudence.

We live in a world where most professionals are in one way or another controlled or constrained in their occupations by permits, licences or authorities to practice, together with requirements for continuous professional development, all, except bankers, that is. The fact is that it is much easier for a plumber to become a banker than for a banker to become a plumber. Reason? A plumber must be licensed, a banker doesn't, although issuers and advisers of margin lending facilities now have to be licensed by ASIC under an Australian Financial Services (AFS) licence.

The consequences of grossly unprofessional conduct of many individuals in financial institutions worldwide has devastated economies and left countless millions of individuals jobless and much poorer; many will never recover. Yet, how many of these bankers continue in their occupations relatively unscathed by their action?

Just as when you visit a doctor, a solicitor, fly with an airline or have a tap installed in your kitchen, you expect the person holding the stethoscope, law book, controls or wrench, to use all their skills and experience in an ethical and balanced manner to obtain the best outcome for you. Bank clients should expect no less from their bankers. And just as other professionals and those holding trade licences can lose the right to conduct their profession if they are negligent or careless in their dealings with you, so should individual bankers suffer the consequences of their careless and cavalier actions. Note that I deliberately use the term bankers here rather than bank. Banks are nothing more than a collection of individuals running the business of banks; it is individuals that must know they will be held accountable for their actions.

Regardless of the discussions that take place about governments guaranteeing bank deposits, it should be clear by now that the public becomes concerned about banks when the value of the bank's assets (loans) are questioned. If governments guarantee bank deposits, they are in effect underwriting bank lending and it therefore behoves all banks to lend in a highly professional manner at all times. In the medium term I do not see an easy resolution to the question of the implied government guarantee of banks, simply because no government under any circumstances could afford to see the banking system, and with it the payments system fail. Such an outcome would bring about instant destruction of the entire economy. This issue will continue to be a serious contingency for governments and the only obvious answer is that all bankers must commence to adhere to specific professional standards in their occupations, failing which they lose the right to practise.

My proposal is therefore that all individuals working in the finance industry, including all types of loan brokers, be required to be licensed under a new type of AFS multi-tiered licence system which would reflect each individual's experience, track record, knowledge, and education.

To expand the concept;

1) ASIC or APRA ,or a combination thereof, would consider the requirements for making sound bank lending decisions, with various types of loans, acknowledging the generic nature of many elements, e.g. know the client, know the business, know the industry, know the cash flow, know the asset etc.

2) To recognise that there are gradations in the complexity and difficulty of loans the licence system be multi tiered; e.g.

i) Tier 1 licence. Enables all lending of all types up to the institution's prudential limits. Would be expected to be required by Chief Risk Officers, Managing Directors and Heads of Credit.

ii) Tier 2 licence. Enables all lending of all types up to $A million and would be expected to be issued to Senior Credit Managers.

iii) Tier 3 licence. Enables all lending of all types up to $B million and would be expected to be required by middle ranking Credit Managers.

iv) Tier 4 licence. Enables lending for investment and business purposes up to $C million and would likely be required by Senior Relationship Managers.

v) Tier 5 licence. Enables lending for investment and business purposes up to $D million and would be required by Junior Relationship Managers and Relationship Assistants.

vi) Tier 6 licence. Enables consumer only lending up to $E millions.

vii) Tier 7 licence, Enables consumer only lending up to $F millions.

viii) Tier 8 licence issued to external professionals who advise the bank or provide services to the bank, e.g. Valuers, Solicitors and other Consultants.

3) Licences could be further qualified by adding or subtracting some loan types, e.g. a Tier 5,A licence could signify agricultural lending only while Tier 5,AB might signify business and agricultural lending.

4) Financial institutions be given 10 years to structure their organisations' training, professional development and career paths to best equip their people to obtain the licence required to carry out their role. A licence would be required of everyone involved with lending, including brokers, regardless of whether they approve or recommend a loan. The licence number would automatically attach to a loan approval and provide a link to the chain of command for that loan approval.

5) Licence holders to undertake set hours of ASIC/APRA approved professional development each year, failing which the license is withdrawn or downgraded.

6) Licences to be granted on the basis of experience in the level of the licence requested; that is length of service in that role, actual track record of success (or failure) professional development and training undertaken, actual demonstrated knowledge, and education. ASIC/APRA to set the standards for issue of licences and the comments in the preceding sections express my views on some of the knowledge that a banker requires. I would also include knowledge of accounting, economics, business types, legal matters, insolvency, loan recoveries, the operations of financial markets, derivatives and for people working in agricultural finance, specific knowledge relating to farm operations, incomes, viability, trends and markets.

7) From the time of issue of the licence, individual loans to show that it is demonstrated that the people involved conducted full and proper due diligence according to the standards set by ASIC/APRA and of course those of the institution.

8) Use of Rating Agency reports to be permitted as another opinion only and under no circumstances to take the place of full and independent analysis by bank lenders.

9) APRA/ASIC to instruct banks to develop their own prudential loan writing standards which must include APRA/ASIC standards but not simply default to those.

10) If loan defaults, the prudential reporting requirements would simply require the institution to have the system report individual license numbers involved with the loan. Depending on the

seriousness of the issue APRA/ASIC may ask for explanations and their inspectors could check files for compliance with standards. Breaches could be dealt with firstly by warnings for minor, and for more serious or repeat of minor breaches, demotion to a lower tier licence. This action of course would impact the licence holder's position in the bank, so there would be strong motivation to protect the licence. Further, if ASIC/APRA found a common link which indicated that the chain of command was implicated or contributed to the issue, holders of those licences would also suffer the same penalties, up to and including the head, e.g. Managing Director, if necessary. For more serious breaches, demotion to low tiers could be more severe and finally the licence could be withdrawn which could require the individual, or individuals, to seek employment that did not involve lending, or to leave the industry.

11) Breaches could also impact rights to bonuses and the legislation could stipulate that bonuses were tied to the duration of loans and cancelled or reduced if breaches occurred. On a macro basis Senior Executives could lose bonuses if breaches in a particular organisation exceeded certain levels.

12) Licences would be personal to individuals, not their positions, and thus be transferrable, should they change institutions. If an individual lost the license, he/she could not seek employment as a lender with another institution, or if they had already changed employment the licence would be lost with the obvious consequences. This process would continually weed out those who were unsuited, for whatever reason, to the finance industry.

13) External professionals advising in any way, including but not restricted to solicitors, valuers and other consultants would need to hold the licences now recommended which would require them to adhere to professional standards. This would be in addition to their own professional practice certificates etc. A breach of standards by an external professional could mean a loss of the licence and thus the inability to work which involved lending. This process would avoid fragmented control of professionals and would enable ASIC/APRA to take action quickly in need, even if the licence holder's own professional body did not consider the actions of the individual a breach of the body's standards.

14) When institutions advertised jobs they would need to show the level of license required to be held be applicants to be eligible for the position.

15) Over time ASIC/APRA would conduct reviews of their standards (see 1 above) and issue revised standards as required.

16) The licence attaching to automated lending decisions would be that of the person introducing the loan, i.e. Broker or Loan Officer, Senior Credit Manager through to the Managing Director, providing very strong motivation for senior executives to ensure that these systems were reliable.

17) The requirements for senior executives to be involved would avoid the danger of impressive and highly educated individuals running financial institutions when in fact they were not qualified to do so.

18) The legislation could introduce penalties for non licence holders who attempt to influence the outcome of loan applications.

19) The definition of loan would require some thought to avoid the obvious danger of organisations circumventing the legislation.

Some concluding remarks

The above observations and suggestions in no way try to limit bank lending, or change the way banks are structured. It simply says that standards will apply and be enforced on an individual basis. If the suggested environment were implemented, the eventual outcome would be:

1) The most experienced, and likely oldest, lenders would become a valuable commodity and during times of downturns would be the least likely people made redundant; I would suggest the opposite applies now.

2) During buoyant economic times banks couldn't simply employ inexperienced people to take advantage of lending opportunities. The licensing requirements would be such that it would take years for an individual to gain a Business Relationship Lending Manager Licence with no short cuts possible. This is the reason I have suggested a 10 year implementation period.

3) Senior executives would be far less likely to be flamboyant in their approach to growing their organisations.

4) Financial institution would compete on the basis of high levels of professionalism, not simply cutting standards to win business.

5) Individuals who were unsuited to the profession would be progressively weeded out, ensuring that standards remained high at all times.

6) The volume of poor lending would be dramatically reduced with the resulting reduction in bankruptcies and loss of family homes.

7) Property bubbles could still occur, but would be far more subdued and not as damaging to the economy.

8) The public's confidence in financial institutions would improve and make the likelihood of a run on banks only a very remote possibility. In turn the Federal Government could rest easier knowing that the financial system was more stable.

9) Australian banks would further improve their international standing.

Thank you for reading my submission.