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Regulatory creep will drive talent from the banks

THE AFR VIEW

The aim of Australia's prudential standards and supervision regime is to prevent systemic risks in the nation's financial institutions. By conventional measures, both the regulators and banks have performed well, enabling Australia's financial system to weather the global financial crisis and its aftermath without the need for taxpayer-funded bailouts. Today, despite the recent spate of scandals, the banks remain financially sound. But they also face new commercial challenges. The golden era of bank profits is also over. The core mortgage lending business that has underpinned bank profits is under pressure from heavily indebted households repaying loans earlier, and from the record low interest rates that have squeezed loan margins. Traditional banks, including the powerhouse big four – ANZ, NAB, CBA and Westpac – also face greater competition as digital and online platforms enter the market.

Banks, like many other institutions, will spend the 2020s dealing with the consequences of the disruptions that hit the economy, politics, and society in the 2010s. The danger is that the banks will be distracted from tackling these issues as the post-Hayne royal commission's regulatory overreach continues.

What operational expertise does APRA have to dictate to banks?

According to the head of the Australian Prudential Regulation Authority, Wayne Byres, the regulator's deep dive into the internal systems of the banks has only just begun. The billion-dollar capital penalties imposed on CBA and Westpac for their money-laundering failures could be just the start. So, too, might be the extra half a billion the ANZ and NAB have been forced to stump up as penance for the shortcomings self-exposed by APRA-initiated self-assessments. Mr Byres, in his exclusive new year's interview with *The Australian Financial Review*, has now warned that following the regulator's on-site reviews of governance, culture, risk and accountability, all banks and financial institutions that fail to upgrade their compliance will pay the price. In addition to capital penalties, licence conditions, infringement notices, and even disqualifications of individuals may all be imposed on institutions whose systems are deemed not up to scratch.

No one doubts the seriousness of the bad behaviour and systemic failures exposed by the financial advice and money-laundering scandals. But APRA's appropriate role is to set the prudential rules of the game, and not to try to social engineer and micromanage how institutions play the game. What operational expertise does APRA have to oversee and dictate governance, accountability and culture? And what does this say about the increasingly onerous non-financial risk obligations already imposed on all company directors, if APRA now has to come over the top with its own tick boxes?

Surely the reputational damage caused by lax internal processes and flawed systems has already focused the minds of bank boards and senior managers on fixing these problems. So must have the heavy financial costs of repaying customers charged fees for no service, and the heavy fines AUSTRAC imposed on CBA and will impose on Westpac and NAB for their money-laundering breaches. So why are additional capital penalties needed to incentivise banks to change, as Mr Byres claims. The regulatory overkill could also be counterproductive. The money-laundering scandals have been caused in part by technology failures. Paying dividends to demanding institutional superannuation and retiree shareholders have taken priority over reinvestment of profits in necessary upgrades. Levying capital penalties could in practice make closing the tech gap harder.

Now, more than ever, banks also need to be market- and customer-focused to stay relevant and drive innovation. But having to look over their shoulders, and wait for the regulator's other shoe to drop, doesn't only threaten to distract the banks from their core business focus. Australia's banks must not only be well supervised but also well managed. The regulatory overkill threatens to deter the best people from working in the financial sector. Regulation that stops banks from recruiting the talent needed not only to fix complex systems but also to develop the strategy to compete with disruptive rivals is hardly prudent.

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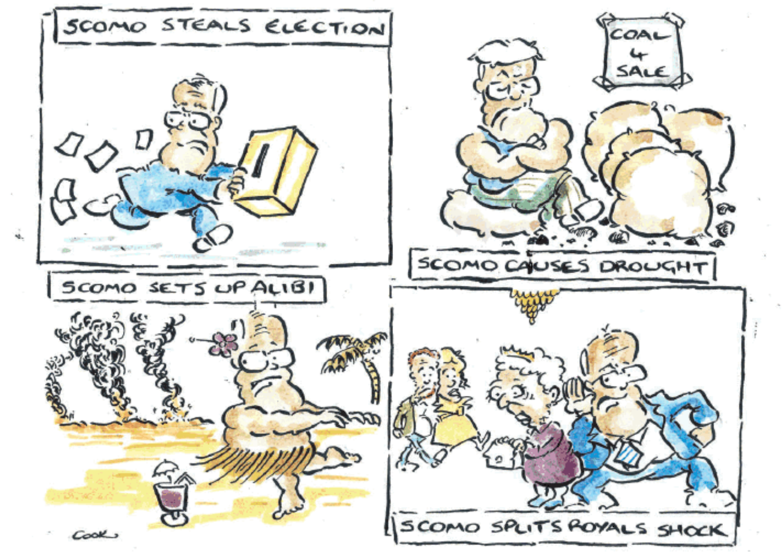
From the Gallery **Patrick Cook**



David Rowe is on leave

Case for the digital Aussie dollar

Currency wars

Digital currencies are coming, and the Reserve Bank is at risk of losing control of monetary policy if it does not act.

Richard Holden

One of the more intriguing ideas of 2019 was Facebook's proposal for a digital currency called Libra.

Facebook didn't have a great public relations year in 2019. And there is enough concern about Mark Zuckerberg's existing influence that plenty of people have rung alarm bells at the idea of putting him in charge of a global currency to rival the US dollar.

But make no mistake, in the early 2020s there will be a global digital currency. It could be launched by Facebook, or one of the other leading platform companies such as Amazon, Google, or Apple.

And while the US dollar may remain intact as the global reserve currency, in non-digital form, countries such as Australia will be forced to consider moving to a fully digital currency sooner rather than later.

As *The Australian Financial Review* reported, the Reserve Bank of Australia, in a submission to the Senate Select Committee on Financial Technology and Regulatory Technology, expressed scepticism about both the likelihood of a global stable coin such as Libra and even its usefulness given existing payment technologies in Australia.

That's the sort of thing they need to say. But it's wrong – and fundamentally misunderstand the power of what economists call "network externalities".

The idea behind Libra is to establish a digital currency backed by real assets. When up and running you would transfer, say, Australian dollars and receive Libra at a given exchange rate into your digital wallet called Calibra. With this you could buy and sell goods and services by tapping your phone or watch, just like using Apple Pay or Google Pay.

It would run on decentralised blockchain technology which would provide effectively impenetrable security, extremely low operating costs, and the ability to scale and adapt to new technological developments.

A crucial difference between Libra and a cryptocurrency such as Bitcoin is that Libra would be backed by a reserve of real assets. Every dollar – not just a portion – converted into Libra would be used to purchase government securities in a basket of different currencies.

The intrinsic value of the reserve is designed to create stable expectations of the future value of Libra. If people believe that Libra will be a stable store of value, then there is no reason to speculate on it. The Libra reserve would operate much like deposit insurance or government backing of banks – there's no point trying to trigger a bank run if other people rationally believe there is not going to be a bank run.

We cannot resist the irrepressible tide of technology.

Importantly, the Libra Association that governs the reserve and the currency more generally would not be controlled by Facebook, but by a group of non-profits (e.g. Kiva, Women's World Banking), technology and marketplace companies (e.g. Uber, Lyft), venture capitalists, blockchain firms, and telecommunications companies.

Why, you might ask, would anyone move from their existing mode of payment to a new digital currency?

For starters, there are an estimated 1.7 billion adults around the world who are unbanked, even though 1 billion of those have a mobile phone and therefore could use Libra. Others pay high fees to transfer money internationally. Still others are fed up with their existing financial institution.

But most of all, a digital currency backed by a platform such as Facebook, Google, Amazon, or Apple would be easy to use and instantly have hundreds of millions of users. If it's easy and cheap to use a digital currency on Amazon and you already purchase frequently on the platform, why not use it? If it's easy to transfer $20 from splitting a restaurant bill using Facebook Messenger or WhatsApp, then why use existing bank transfers?

This is the power of "network externalities" – when more people use a product or platform, it increases the value to other consumers. It's the central force which underpins the digital economy. And it's the key advantage which the big tech companies have in what will likely become the "currency wars" of the 2020s.

If this plays out, and one of the big tech companies establishes a global currency that is adopted by a meaningful number of Australians, then the RBA will essentially lose control of monetary policy. The supply of money used in Australia would be determined not by the RBA through setting the cash rate, but by the Libra Association, or the equivalent, if another tech company wins the battle for digital currency supremacy.

The US Federal Reserve may be able to withstand this threat – some global fiat currency will surely survive. Indeed, some will be needed to provide the asset backing for the digital currency.

But the current, fiat, the Australian dollar, might not survive.

A digital Australian dollar, by contrast, could survive. It would provide some of the benefits of Libra to an already financially sophisticated and digitally literate Australian public.

That prospect would be boosted by Australia pre-emptively adopting a digital Australian dollar. Doing so would lend support to the inevitable march towards digital currencies, but be more on the RBA's terms than completely losing control of monetary policy.

A digital Aussie dollar would be controlled by the RBA, useful in the basket of currencies used by Libra, and have many of the day-to-day benefits of a cashless society.

Like it or not, a global digital currency is coming. Like globalisation and automation, we cannot resist the irrepressible tide of technology. But we can pre-empt it to a degree, and do so on our own terms.

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