Brian Hartzer, CEO Westpac Group

The Changing Landscape of Banking in Australia

2018 AFR Banking & Wealth Summit – 5 April 2018

****Check against delivery****

Good morning everyone. It's great to be here.

As I was thinking about what I'd like to say today, I was reminded of a dinner in London around six weeks ago with Ross McEwan, the Chief Executive of the Royal Bank of Scotland.

By coincidence it was the night before RBS announced their annual results. And although Ross was very discreet, I had a pretty good guess as to why he and his team were in such good spirits.

Sure enough, the next morning RBS posted its first annual profit in ten years, after a spectacular fall from grace at the start of the global financial crisis.

I remember back in 2008, we used to talk about how long the crisis would last. Most people thought it would be a few years, and only a few thought it would last longer than five.

It's safe to say not many would have believed it would be ten years before one of the world's biggest banks was able to finally emerge from the GFC and earn a profit.

So today I'd like to reflect on how far the banking industry has come since 2008, and what we've learned. I'll then make a couple of observations about what the next ten years might hold, and how Westpac is changing in response. And I'll finish with a few observations on the elephant in the room – the Royal Commission.

First, what's changed since the GFC.

The crisis was a turning point – the catalyst for a decade of change in how banks are run, regulated, and viewed by the communities they serve.

Some countries came through the crisis better than others.

But no major financial services company escaped the fallout. The way banks are managed has fundamentally changed.

As an industry, we're now more focused on the strength of our balance sheet than its rate of growth.

Deposits, not loans, are the first priority and play a more important role in our funding. At the same time we have substantially lengthened the term of the wholesale funding that we raise.

In Westpac's case, we have more than doubled our holdings of liquid assets to over $130 billion, which gives us much greater scope to ride out market disruption.

Similarly, the amount of capital we're now holding has increased by almost 300 per cent – that's an increase in Common Equity Tier 1 capital of more than $27 billion since the crisis. To put that number in perspective, that's roughly equivalent to the annual GDP of Tasmania.

The flow on effect has been around a 40 per cent reduction in our return on equity – from 22 per cent in 2008, down to 13.8 per cent last year.

At the same time we've implemented a 'three lines of defense' model for risk management, and invested many hundreds of millions of dollars in new systems, policies, and staffing to improve compliance, data disclosure, and governance.

Our regulators have also increased their focus on financial stability and building a stronger, more resilient banking system.

This has meant new rules on balance sheet management and conduct; macro-prudential rules on mortgage lending; tighter reporting standards; detailed enquiries into bank pricing strategies, sales standards, remuneration, and culture; and the new Bank Executive Accountability Regime – just to name a few.

These changes reflect the importance of maintaining confidence in our financial system, and also the erosion of trust in banking around the world.

In Australia this erosion of trust in our banks was compounded by too many ‘own goals’ that should *never* have happened, and collectively pushed the sector into the political cross-hairs.

But I would like to observe that Australian banks – both individually and collectively – have made a lot of progress towards earning back customers’ trust, despite what you might read.

Two years ago the Australian Banking Association announced the six-point “Better Banking” plan to address issues around sales remuneration, complaints handling, whistleblower support, removing individuals from the industry for poor conduct, and supporting ASIC as a stronger regulator.

Today, those initiatives are nearly complete, and the industry has announced a re-written *Banking Code of Practice* that will be mandatory for all members of the ABA.

At Westpac, we’ve reviewed 320 products and made over 150 changes, including reducing the number of consumer products on offer by more than 50 per cent, cutting transaction fees for 1.3 million customers, launching a “lite” credit card, removing ATM fees, and eliminating all sales incentives for tellers – who are now rewarded solely for providing great service.

We’ve set a new, higher bar for our conduct and actions. My instructions to our team are simple: we need to “Get it Right” and when where we find issues, we fix them. And if we find an unacceptable impact on customers, we “Put it Right”.

I should note that while all this has been going on, we've continued to support our customers and the Australian economy to grow – and are well prepared to keep doing this in bad times as well as good.

So we've come a long way, and yes there's more to be done – but for now I'll turn to where the industry's going.

If we look forward ten years, there's no doubt the banking industry will be very different from what it is today.

Customers expect more. Not just of banks, but in all areas of their lives. Our experience with Amazon, AirBnB, Netflix, or Uber means that, as *customers*, we expect better, simpler, and more efficient service, where and when we want it. Plus, the standards we expect from businesses are higher: We want more transparency; we want things to work – consistently; and we want to be in control.

This is changing the way nearly every industry works, and banking is no exception.

Let's take cash for example. It's starting to disappear. And I think this may happen faster than any of us anticipated.

In February I visited Denmark, where cash usage is clearly on the decline. I had assumed this was driven by banks trying to migrate transactions to cards, when in fact it's being driven by customers.

Five years ago Danske Bank launched MobilePay – a mobile to mobile payment service that consumers can use to pay each other or businesses. It's available to everyone, regardless of who they bank with, and all the banks can participate.

Today, more than 80 per cent of Danish people use MobilePay, and acceptance is so widespread many churches now collect their offerings this way.

Similar trends are happening in Sweden and the Netherlands. I understand the issue is also getting a lot more attention within the British government, so stay tuned.

In Australia, digital payments have overtaken cash as the most frequent means of payment, and ATM withdrawals have dropped to their lowest levels in 15 years.

Around half of our customers now bank primarily online, and in the past ten years branch transactions have almost halved. In the next decade, I wouldn’t be surprised if as many as 95 per cent of customer transactions are online or mobile.

The big driver of cash and cheques continues to be business customers. But based on some of the developments with mobile, contactless, and point-of-sale integration, I predict this is going to start to change very rapidly.

And that’s a good thing. The benefits of a cashless society are real.

There’s a major efficiency gain for banks and businesses alike by no longer handling cash, and the potential impact on the black economy would be good for governments as well.

And this is just one of the ways banking is being reshaped.

Data is flowing more freely, and is set to accelerate with “open banking”. Much of the discussion on open banking has focused on the ability to switch banks, and no doubt this will be one benefit. But I think a more interesting aspect is how competitors will be able to use data to offer better service and insights to customers on how to manage their money – and the race is on to figure out how best to do that.

The global payments landscape is also being transformed, with distributed ledgers, a plethora of new payment apps in both the physical and digital worlds, and – in Australia – the recently launched New Payments Platform.

And finally we're seeing the rise of new competitors who are fragmenting and disrupting the models of long-established businesses, as well as whole new classes of risk in cyber-security, privacy, and systems resilience.

In short, we're in the middle of the most dramatic period of change we've seen in banking since deregulation in the 1980s.
So, what does all this mean?

As an industry, we're dealing with the tail end of a decade-long set of legacy issues, in a tough regulatory and political environment, with the urgent need to earn back our customers' trust – while at the same time confronting a rapidly changing and increasingly competitive operating environment.

Not a small challenge.

But we think the answer is pretty straightforward. It involves staying true to our core purpose of helping the Australian economy to prosper, while having the courage to adapt our business model to the changing reality.

To recognise that we're a service business not a product business. That our job at Westpac – and all banks' job, for that matter – is to help customers with their money – not just to sell them another product.

And that no business has a God given right to make money using a particular business model. You have to be willing to adapt.

For us at Westpac this doesn't mean changing our strategy, but it has meant lifting our intensity of change.

We remain focused on growing in our core markets of Australia and New Zealand, and we are committed to the portfolio of businesses that we're in. Our multiple brands give us a competitive advantage in growing and serving our customer base, and we're staying in wealth management because we believe providing customers with the tools for wealth creation and protection is part of building lifelong relationships.

What we're doing *differently* is using the combination of great people and great technology to make banking easier and add value in ways that encourage customers to consolidate their business with us – to build a snowball of relationships on one of the most efficient platforms in banking.

As part of this, we're continuing to restructure our branch network, and have largely completed the redesign of our branches to improve service, capability, and efficiency.

We're continuing to invest in our customer-facing systems. For example, over the past two and a half years we've introduced over 400 enhancements and new features to our online and mobile platforms, launched wearable debit cards into the market, and this week launched Presto – a market-leading, integrated point-of-sale system for small businesses.

We're also investing $1.3 billion per year in core systems upgrades, including Panorama for wealth and a suite of systems we call our Customer Service Hub.

When this goes live for the Westpac brand at the end of this year, it will mean home loan offer documents will be delivered to customers in just minutes rather than days, while reducing the cost of mortgage origination by around 25 per cent. It will also significantly reduce paperwork for our bankers, while strengthening compliance.

Behind the scenes we've also strengthened our underlying technology infrastructure, which has reduced outages and improved cyber security.

We're also spending a lot of time on the people and culture side of great service – who we hire, how we train, and how we reward people for managing risk and building relationships that last.

The good news is that it's working. Over the past three years customer complaints have dropped by almost 60 per cent, and across the Group our staff engagement score is best in class at 79 per cent.

We're also looking outside our traditional walls to find and turbo-charge businesses that are using data to rethink customer service.

We recently ran Australia's first data-focused accelerator program, where we invited data start-ups in and gave them free access to anonymous, aggregated transaction-level data, investment support, and professional mentoring to help them develop their ideas.

One of these companies is now helping small hospitality businesses to predict how many customers will walk through their doors down to the hour; and even how much they're likely to eat and drink.

And then there's Reinventure, our $100 million venture capital fund, which to date has invested in 19 fintech start-ups, all of which are using technology to rethink some aspect of customer service.

And we're investing *directly* in fintech start-ups where we see an immediate opportunity to grow our business.

For example, Uno Home Loans – which is rethinking mortgage broking; and Zip Money – which is rethinking how people pay for their purchases.

It all adds up to a dynamic, future focused business that is true to the lessons of our 201 years of history – the importance of great people, long-term relationships, and a willingness to adapt.

Before I close I'd like to offer a few observations on the Royal Commission.

As the CEO of Westpac, the concerns, criticisms, and case studies being aired through the Commission process are very uncomfortable and confronting to hear. Many of these stories are terrible for the customers involved, and some of these issues took too long to fix.

It’s a tough process for the industry to go through but it’s one we must embrace. And I’m hopeful that the seriousness of this process can bring closure to the issues it has examined.

I won’t speculate on what the findings of the Commission will be. However, there are a couple of themes that are emerging from the hearings so far, which I expect the industry to pick up on, and will deliver better outcomes for customers.

The first is the need to increase transparency for customers and remove (or at least, reduce wherever possible) any remaining real or perceived conflicts of interest.

This is something we need to fix across the industry if we are to show customers that we have their best interests at heart. At a minimum, customers should understand what they’re signing up for and know how financial services providers–and their employees–are being paid for the services they’re delivering.

The second is to recognise that the customer issues that have been raised are broader than just the banks, and that a level playing field is needed. Mortgage brokers, auto dealers, non-bank financiers, financial planning firms, insurance companies, superannuation funds, and the regulators themselves all have a part to play – along with the banks – in delivering a financial system that is fair, resilient, and efficient.

At Westpac, we’ve started to consider how these principles would translate into further reforms.

For example, in auto finance. We’ve consistently supported the view that payments and commission arrangements for dealers in car financing need to change. We have advocated for the removal of flex-commissions, and introduced our own cap before this occurs.

In mortgage broking, increased transparency around broker commissions, fees and costs would help consumers to make more informed choices. One option that could be considered would be for brokers to charge customers directly for their services, although the consequences of such a change for all stakeholders would need to be considered carefully.

My third observation relates to the suggestion that it's not possible for banks to achieve good commercial outcomes while also delivering good customer outcomes – in other words, that banks need to tradeoff between making profits or doing the right thing for customers.

I think about it differently.

Yes, in the short term there are opportunities for banks to raise profit at the expense of customers. But that would be very short sighted, and experienced bankers know better.

If we take Westpac as an example, the next three years' dividends add up to about 20 per cent of the stock price. Said another way, 80 per cent of the value that you buy when you buy Westpac shares is in the future.

And that future value will be driven overwhelmingly by the growth and sustainability of our customer franchise, as well as the health of the Australian economy. Which means that in the long run, there *is no conflict* between doing the right thing by our customers, by our community, and by our shareholders.

We haven't got everything right yet, but we are absolutely motivated to run our business in a way that is fair to customers, fair to our shareholders, and supports the growth of our economy through its inevitable ups and downs.

And that's the lens that we'll continue to use as we engage with the Royal Commission and respond to its recommendations.

I thought I'd finish with a reflection on one of the most fundamental tenets of banking: the power of compound interest.

The consequences of the GFC have been devastating to the world economy; to individual customers and shareholders; and to the banking industry as a whole. It will take many years for the RBSs of the world to rebuild the value that has been lost over the past decade as a consequence of poor decisions or poor strategic choices.

Similarly, it will take many years to rebuild the trust that has been lost in our industry as a result of poor treatment of customers.

At Westpac we recognise that consistency – avoiding big mistakes – is critical to seeing value compound for both our customers and our shareholders.

And though the competitive landscape we face is increasingly complex, the fundamentals – of focusing on service and culture, maintaining a strong balance sheet, and having the courage to adapt our business to changing circumstances – are the best way to maintain that compounding effect.

Almost a year ago today, I shared a stage with all five of my living predecessors as CEO of Westpac – Bob White, Frank Conroy, Bob Joss, David Morgan and Gail Kelly – who led the company for a combined total of more than 30 years.

It was an amazing experience, and I think it's safe to say that not many companies could organise a meeting like that.

And despite the very different challenges that each of them faced, what was remarkable was the common thread that ran through all of their remarks: the importance of good people and a strong culture; a deep respect and focus on helping our customers; the value of good banking fundamentals; and the commitment of our company to advancing Australia's prosperity.

It's the same set of beliefs that have helped us last two hundred years, and which remain central to our strategy for the period ahead.

Thank you.