

---

# **FUTURE TRENDS IN THE BANKING INDUSTRY**

## **Impact on Banking Practitioners**

**Robert Paterson**

**General Counsel, ANZ Bank, Melbourne**

### **INTRODUCTION**

The banking industry in Australia is undergoing massive change and this will affect every aspect of a bank's business. Suppliers to the bank will not be immune from change. Where the goods or services supplied form part of the bank's offering of products to its customers the need for change will be greatest.

I will deal with the topic under a number of main headings:

- A. Forces producing change in the banking industry.
- B. The trends, particularly those relevant to banking law practitioners.
- C. What types of legal work does a bank require?
- D. What should the law firms be doing?
- E. Why is a bank an attractive client for a law firm?
- F. Some predictions.

### **A. FORCES PRODUCING CHANGE IN THE BANKING INDUSTRY**

Forces producing change in the banking industry at present can be classified under three headings:

1. Forces which are general throughout the rest of the business world (Australia and worldwide).
2. Forces affecting banking worldwide.
3. Forces peculiar to banking in Australia.

It is also interesting to consider the forces which might be expected to have an effect but have not yet done so.

In common with the rest of business worldwide, banks in Australia have been through a severe recession which has led them to reductions in staff, cutting of costs and better purchasing, re-engineering of processes and outsourcing for goods and services which can be supplied better by other organisations.

While banking used to be a labour intensive service industry it is moving to one which is making great use of rapidly changing technology. Examples for banks are the introduction of automatic telling machines, the introduction and massive increases in use of EFTPOS, much greater use of computers for things such as mobile home loan officers and interactive computer support for motor car dealers to enable them to produce contracts for financed vehicles on their premises. In addition smart cards and telephone banking where most of the conversation is with a voice activated computer will shortly be with us, following their introduction in other countries.

In common with banking worldwide the Australian banks are now suffering from excess capital and excess distribution capacity. There is a proliferation of new entrants, both former building societies and branches of foreign banks and in addition there is a new breed of competitor attacking particularly attractive niches of banking business. There is continuing substitution, such as the move from investment in banking products to investment with other financial institutions either by way of equity (or other) funds or by way of superannuation. Major corporate customers are borrowing in the capital markets directly rather than relying on the intermediaries in the banking industry and card issue by non banks is likely to follow American trends. Customers are becoming more sophisticated and seeking to understand their banking products in detail. There is a transition from less qualified staff to increasingly higher qualifications for permanent bank officers. The banks are hiring from outside at senior levels, often on short, fixed term, contracts.

In banking in Australia the two major banks which suffered most from the recession have recovered and so there are again four very strong competitors. The new banks, being former building societies and branches of foreign banks, are also significant as competitors. With some support, reconstruction and new ownership, the former State banks are also adding to the competition after some of them encountered difficulties during the recession. There is a media spotlight on banking nearly every day. Legal challenges, class actions and larger awards by credit tribunals are making it very hazardous for a bank to have any defects in its documentation or procedures. The credit legislation is being extended in scope so that it will shortly cover housing loans as well. There is great pressure for bank documentation to be in plain English so that customers understand it completely. Customer pressure on fees is intense. The investment analysts are concentrating on bank expenses to income ratios as a measure of bank efficiency.

## **B. THE TRENDS, PARTICULARLY THOSE RELEVANT TO BANKING LAW PRACTITIONERS**

At this stage I should say that the views I express are my own and are not necessarily shared by ANZ Bank. There is an element of prediction and precision is not possible.

There will be severe competition between the banks not only as to interest rates but also as to other features of their offerings including fees on security documentation, which are likely to be standardised and at a very low level.

Banking products are likely to be standardised for the vast majority of customers so that there cannot be any mistakes which might lead to challenges before credit tribunals and courts. Interactive software will be produced for creation of documents relating to the banking products and securities. While the software will require great skills in its preparation and testing, after it has been produced it will enable persons with relatively low levels of legal skills to produce quite sophisticated documentation. Of course setting up the software will require very high legal skills and the consequences of error will be enormous.

As a result of the banks' desires to reduce operating costs and rationalise or even re-engineer their operations, the back offices of banks will be centralised. Staff in remaining bank branches will concentrate on some transaction processing and more significantly, sales and service. Problems will be passed up the line to centralised problem solving areas. Similarly documentation will be centralised where it requires to be customised, or it will be decentralised and fool-proof where it is possible to produce it by computer on a basis which cannot go wrong.

In common with the rest of the business world banks' supplier numbers will be reduced considerably. There are dangers in this for the suppliers who survive, but is it better to be a surviving supplier with risks or an ex-supplier (with no risks and no work)?

Reciprocity with suppliers will be a thing of the past - no longer will banks "give" some legal work to a law firm as quid pro quo for its banking business, particularly its trust account.

There will be very serious examination of outsourcing and attention to what is a bank's core business and possibly its core competence. When external lawyers are engaged they can expect to be supervised by internal lawyers rather than bank officers without legal skills.

Finally there will be two further trends which will be a result of the greater competition which results from the excess capacity. In their efforts to gain business, banks and their advisers will start cutting corners. For example, in an attempt to save the customer stamp duty or other fees the banks will find advisers willing to devise a structure or a set of transactions which allegedly finds a loophole in the taxation legislation. Competitors who are not prepared to be so aggressive will probably miss out on the business and so will be inclined to be more aggressive next time. The other element of cutting corners in aggressive competition for lending will be lower credit standards or reduction in prices (ie. interest and fees) below the level which is appropriate for the risk concerned.

## **C. WHAT TYPES OF LEGAL WORK DOES A BANK REQUIRE?**

A list of the legal work required by a bank is not very enlightening until sorted, and so I will classify it as follows:

1. Legal work required by any major industrial company.
2. Advice specific to the banking industry (or a section of the finance industry in which a bank subsidiary operates).
3. Specialised lending or security preparation work.
4. Bulk, fairly standard, security preparation work.
5. Difficult or major litigation.
6. Bulk "collection" litigation.

Under each of these headings I set out a list of the types of work which I have encountered in the last 2½ years, since joining ANZ.

### **1. *Legal work required by any major industrial company***

Advice on accounts and reporting to members and stock exchanges, advice on Annual General Meeting, role and work of compliance committee, preparation of and advice on contracts including purchasing conditions, advice on corporate structure, advice on corporations law, advice on crisis management, advice on directors' duties and proceedings including "corporate governance" issues, intellectual property advice, international aspects of contracts and transactions, advice on

minuting proceedings, advice on names, advice on new laws or amendments to laws, advice on personnel matters including industrial law, self insurance, employment contracts and terminations, plain English drafting, powers of attorney, property advice and transactions (real property, shares, business), prospectuses and share and debt issues, prices surveillance, public affairs, shareholders, superannuation, taxation and trade practices.

## **2. *Industry specific advice***

Advice on *Banking Act*, *Banks (Shareholdings) Act*, banker - customer contract, confidentiality and privacy, cheques, credit legislation, letters of credit, guarantees, preparation of banking forms including standard form security documentation, taxation particularly relating to banking (BAD, FID).

## **3. *Specialised lending or security preparation work***

Leveraged leases, structured financing, tax effective financing.

## **4. *Bulk, fairly standard, security preparation work***

Cross deeds of covenant, guarantees, loan agreements, mortgage debentures and mortgages.

## **5. *Difficult or major litigation***

Non-lending losses, frauds and forgeries, third party cheques. Major corporate customer insolvency.

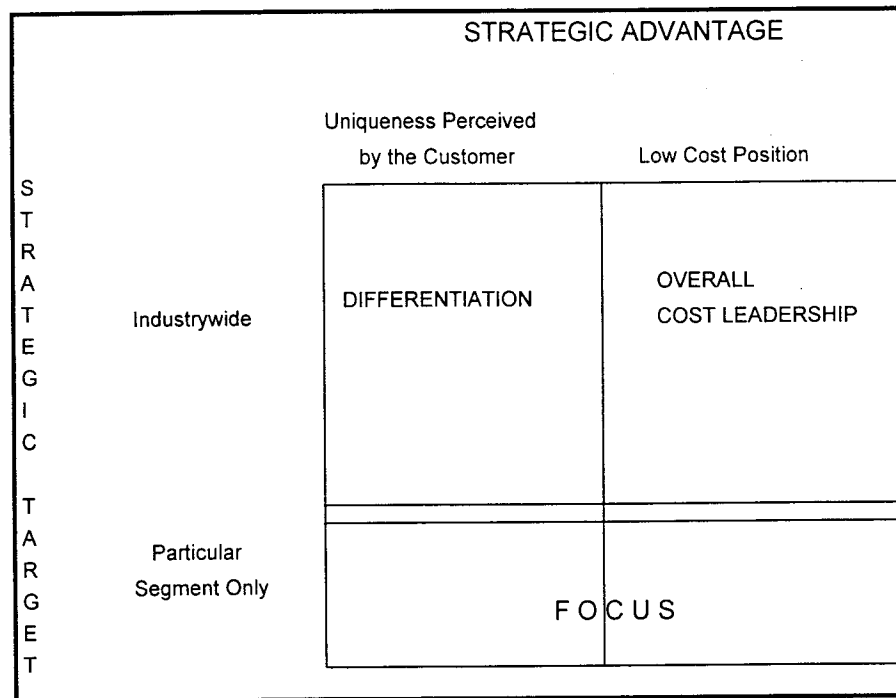
## **6. *Bulk "collection" litigation***

Enforcement actions relating to guarantees, mortgages and unsecured facilities. Bankruptcy and company winding-up proceedings.

## **D. WHAT SHOULD THE LAW FIRMS BE DOING?**

At this stage we will have a diversion to examine a framework for analysis of business strategy.

Michael Porter of Harvard University is well known for his books on business strategy, which were very popular during the 1980s and in my view remain very useful. The diagram below sets out the four potentially successful business strategies divided according to whether the product is "targeted" industry-wide or focussed on a particular segment only.

**DIAGRAM**

Adapted with the permission of The Free Press, a Division of Simon & Schuster Inc from *COMPETITIVE STRATEGY : Techniques for Analyzing Industries and Competitors* by Michael E Porter. Copyright © 1980 by The Free Press.

If one assumes that the bank will be best served in allocating its legal work to firms which have their strategy right then in my view most litigation aimed at collecting debt will be allocated to firms whose strategy is located in the top right-hand corner of the diagram being firms with skills across the range of litigation work but which are low cost producers. Put another way, it does not matter which firm's name is on a writ so long as it recovers the debt efficiently and at a fairly low cost. This type of work is unlikely to need any particularly specialised skills and a firm which practices litigation "industry wide" for a wide range of clients will be suitable for such work.

Securities preparation work is likely to be allocated to a firm whose strategy is located in the bottom right-hand corner. Preparation of security documentation requires specialised knowledge in a relatively limited area of banking law and is generally only useful to lenders. However what is sought is low cost production of the securities and again it matters very little which firm's name appears on the security documents so long as they are effective and are produced at a fairly low cost.

If a bank, or any other business for that matter, wishes to issue a prospectus it will engage a lawyer with specialist skills in that area. It is also likely to require that the firm have a particularly good reputation for work of this type, the reputation having been earned by credible and frequent prior performance. There are elements of prestige in prospectus documentation and the advisers' names on a prospectus send a message to the market. Usually large firms which are regarded as leading law firms are those engaged to do this work. The client is not particularly sensitive to the price and for most clients they need this type of work infrequently. Hence a premium price will be paid quite willingly. The firm selected for this work will probably have its strategy located in the bottom left-hand corner of the diagram.

Finally the top left corner of the diagram is likely to house firms which do work with a broad appeal, not particularly focussed or specialised but with the firm's product differentiated from that of other firms, probably because the firm is regarded as the best or equal to best in its market place. The

best example I have of a bank needing such a firm is where the bank starts an operation in a different country and wishes to send a message to the government officials who will be issuing it with licences, to other members of the business community and if applicable its local joint venture partners. It is likely to select the best local law firm, without regard to price even if the legal work involved is not particularly difficult and could be done properly by a range of law firms (including branch operations or associates of Australian law firms).

Returning to the topic of what should law firms be doing to ensure that they continue to do legal work for banks, I suggest that first they have to get their strategy right by working out carefully and detail what legal work they wish to do for the bank and how they will produce it.

Secondly the lawyers will have to refine their production systems. I know that there are some law firms which are very efficient producers of large volumes of legal work in areas such as industrial accident litigation and others in preparation of mortgages of land. However generally lawyers are not particularly efficient in their production of legal work. The typical law firm works on a production system which is described in the books on Operations Management as a "job shop". Most of the work which goes through a job shop spends far more time waiting for the next step in the production process than it does actually being worked upon. There are means of scheduling production to make a job shop efficient.

If one looks at the typical lawyer's programme for a day, or even better his time sheet or diary showing how he spent the day, you will find it broken up with a number of appointments. The lawyer's production method is to sit at his desk, to take telephone calls as they come, to work on a number of matters which are on his desk, and go to the various meetings. He is unlikely to adhere to a "to do" list nor is he likely to have the courage to set aside two or three hours to work upon one matter, during which time he declines to take telephone calls from clients. Accordingly his work on any particular matter is punctuated with many interruptions and it is most unlikely that any item of work will be produced with great efficiency.

It should be noted that the same lawyer who works in this manner during the week often goes into the office during the weekend and there we find an entirely different production method. He is keen not to spend the whole day in the office and he has a list of things which he wishes to do and he works through them in order of importance, one after another. He is not interrupted. He will tell you how much more he can do when he works in the office over the weekend. If the rest of his working week was arranged in a similar manner he would probably not have to visit his office during the weekend.

If a law firm gets its production system in order it is likely to produce a quality product on time. As an indication of the standards expected generally in industry, I give the example, which was cited in the Australian Financial Review newspaper on 8th August, 1991, of a company's plant in Melbourne which managed in May, 1991 for the first time to despatch orders from its distribution centre "100% in full and on time". The article went on to state that the warehouse, which distributes 42 million litres of paint nationally each year, achieved the 100% result on 8 days between 29th May and 8th August, 1991 and that the average daily score at August, 1991 was 99%. How many law firms achieve this level of performance, or even attempt to measure it?

The third thing the law firms should be doing to make their products relevant for banks particularly and as well other clients, is training, training and more training of the lawyers. They must know the law properly. By knowing the law I mean knowing the law generally and not just in a specialised area. They should be also trained to become practical, commercial and astute. One frequent complaint of bank officers is that the advice they get is too complex, that the lawyer is living in an ivory tower and does not understand the real world. ANZ's Retail Asset Management Unit has internal lawyers supervising matters where external solicitors are engaged. Those internal lawyers have noticed a lack of commercial nous in much of the advice and action taken by the external lawyers. If this cannot be provided by the external firms then the banks will have to build it for themselves and bring the legal work in-house.

The final thing the lawyer should be doing is persuading the bank that it should continue to outsource its legal services needs. One of my colleagues recently said to a Managing Partner of a large law firm "why should I buy from you at \$150 per hour when I can do the same work in-house for \$75 per hour". The external lawyer has to:

- (a) be better, more efficient, insured and require little supervision; and
- (b) have prices which are not significantly above the bank's cost of production for the same service;

if it is to be worthwhile for the bank to outsource its legal services needs.

## **E. WHY IS A BANK AN ATTRACTIVE CLIENT FOR A LAW FIRM?**

Banks have been attractive clients for law firms for the following reasons, some of which will not be applicable in future:-

1. Banks require a large volume of legal work, particularly at or about the peaks and troughs of economic activity.
2. The legal matters generated by a bank, especially for the bank's principal law firm, are of a quality and variety which is rarely matched by other clients.
3. Lawyers generally consider that it adds prestige to their marketing efforts if they can say that they have a major Australian trading bank in their client list.
4. A bank usually pays its legal bills promptly.
5. A bank rarely argues about the costs of legal work when it is bearing the cost itself. In respect of bills which are passed on to the customer, the amounts are usually fixed in advance and the customer has agreed to bear them. The bank usually pays the costs and debits the customer's account, which means there is no delay in payment.
6. Law firms regard it as attractive to charge knowing that it is the bank's customer rather than the bank which ultimately bears the costs. Often the bank will support the lawyer if the customer complains about the amount of the costs.
7. The bank will often be in a position where it can refer its customers to law firms in which it has confidence.
8. Acting for the bank quite often gives the lawyer a chance to show his "wares" to the bank's customer, while being paid to act for the bank (even if the customer is to reimburse the bank).
9. The lawyer may have an enhanced banking relationship with his bank if he is an esteemed supplier to the bank as well.

## **F. SOME PREDICTIONS**

Having reviewed the trends and the needs of banks I think I should commit myself with some predictions as to what will happen with each of the six categories of legal work which a bank requires. That type of work which is required by any major industrial company is likely to be outsourced except for matters where the lawyers working for the bank have particular expertise. Advice which is specific to the banking industry is in my opinion often better provided by in-house lawyers who are specialists in the particular areas although for major matters such as creation of standard forms for security documents, external lawyers will continue to be used. Specialised

lending or security preparation work will continue to be done by external lawyers but the standard security preparation work will probably be done in-house mainly by non lawyers using interactive computer software. Because the banking products will be standardised the volume of security preparation work which has to be outsourced will decline significantly. Difficult or major litigation will continue to be done by external lawyers, but with more in-house lawyer supervision. Bulk "collection" litigation will probably be split partly in-house and partly outsourced but in the latter case it will be vigorously supervised by in-house lawyers who will have very little sympathy for external lawyers who are not practical, commercial and astute, or who do not know all of the relevant law and practice.

## REFERENCES AND SOURCES

Audrey Duff, "One Thing General Motors Does Right" in *The American Lawyer*, April 1992.

John Durie, "Business Dices With Crime" in *Australian Financial Review*, 20 March 1987.

Roy Eccleston, "Lawyers' Brief to be Faster and Cheaper" in *The Weekend Australian*, 1-2 October 1994.

The Economist, "Survey - The Legal Profession" 18 July 1992.

Michael Hammer and James Champy, *Reengineering the Corporation - A Manifesto for Business Revolution*, 1993, Allen & Unwin, St Leonards NSW.

David H Maister, *Managing the Professional Service Firm*, 1993, The Free Press, New York.

Michael E Porter, *Competitive Strategy - Techniques for Analysing Industries and Competitors*, 1980, The Free Press, New York.

Michael E Porter, *Competitive Advantage - Creating and Sustaining Superior Performance*, 1985, The Free Press, New York.

C K Prahalad and Gary Hamel, "The Core Competence of the Corporation" in *Harvard Business Review*, Volume 68 Number 3, May-June 1990.

Peter Roberts, "'Customer First' has life looking rosy at Dulux" in *Australian Financial Review*, 8 August 1991.

Roger G Schroeder, *Operations Management - Decision Making in the Operations Function*, 3rd edn., 1989, McGraw-Hill Book Co, Singapore.

Andrew Stewart, "Quality Law comes from the Factory" in *Business Review Weekly*, 6 August 1993.

Michael Stutchbury, "A Shocking New Experience for Business Weaned on Cosy Pricing" in *Australian Financial Review*, 29 April 1993.