



## Submission to the Senate Economics Committee Inquiry: Competition within the Australian banking sector



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## Executive Summary

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Credit Union Australia (CUA) is Australia's largest customer-owned financial institution with over 400,000 customers. CUA has a national presence and is a proud member of an industry that offers Australian consumers a viable and competitive alternative to the publicly listed banking model.

Over recent years, the Australian banking sector has become increasingly concentrated to the point where today CUA is essentially operating in an oligopoly controlled by the nation's Big Four banks.

Earlier this year, Treasury Secretary Ken Henry advised that oligopolistic markets in key sectors such as ours should be "monitored to ensure that competition is robust and cost increases appropriate." CUA firmly believes this scenario is not being realised and that competition within the sector has clearly diminished.

CUA believes that various factors have led to the current situation and shall discuss these further within this submission. However, they broadly stem from the unprecedented market dominance of the major four banks and the restrictions on smaller ADIs to access reasonably priced funding. The Global Financial Crisis (GFC) has also been a compounding factor.

CUA has been proactively championing increased competition in the Australian banking sector over the past year with a particular focus on the following four areas:

1. Improved access to reasonably priced funding through the securitisation market;
2. Amendment of the *Banking Act 1959 (Cwth)* to change the classification of Authorised Deposit Taking Institutions (ADI) to Authorised Banking Institutions (ABI) to enable credit unions and building societies reassure consumers that we are regulated in the same way as banks, and to reinforce our core function: banking;
3. Management of the Government's Deposit Guarantee to ensure it is maintained at \$1million or at the very least is not withdrawn too quickly, and;
4. Greater market transparency in terms of multi-bank branding.

CUA strongly supports this Senate Economics Committee's inquiry into competition within the Australian banking system and welcomes the opportunity to make this submission.

While there is undoubtedly more work CUA and our industry as a whole can, and will, be doing to promote greater awareness among consumers that we offer a viable and competitive alternative banking option to the major players, we believe there is also a significant role for the Government to play, both in aiding competition in our sector and in helping to create a more level playing field between the mutual industry, smaller lenders and the major banks.

Within this submission, CUA will make response to specific terms of reference outlined by the Senate Economics Committee and comment on why greater levels of competition are urgently required within the Australian banking sector, present various proposals on how this could be achieved, and outline why greater support is required to enhance consumer awareness of the viable alternatives to the major banks.

## Recommendations

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### 1. Competition between bank and non-bank lenders

The heading within the terms of reference provided by the Senate Economics Committee – *‘Competition between bank and non-bank lenders’* – goes to the heart of one of the major issues restricting competition in this sector.

Currently, the market is divided into ‘bank’ and ‘non-bank’ lenders. Due to current regulatory restrictions, the mutual industry falls into the ‘non-bank’ lender category despite the fact that it is required to adhere to the same regulatory standards as ‘banks’ and its core function is banking.

This classification puts mutuals at significant disadvantage and compounds the misconception among consumers that credit unions and building societies are not as secure or stable as ‘banks’<sup>1</sup>. We will discuss this issue in further detail within this submission (see 1.1 Banking Act), and will refer to ourselves and other mutuals as ‘customer-owned financial institutions’ from hereon in as we believe this is a term which more clearly describes our structure.

Australia’s customer-owned financial services industry is significant in size. Collectively the industry services over 4.5 million members and holds the sixth largest market share of assets under management, sitting only behind the four major banks and Suncorp<sup>2</sup>.

As the largest organisation within this industry, CUA is committed to promoting awareness of its viability and to making customer-owned banking relevant to more Australians.

One of CUA’s key differentiators is its ability to invest 100 per cent of our profits back into the products and services we provide, rather than pay out dividends to a small number of shareholders. The result is more competitive products and services and lower fees.

However, the banking sector as a whole is currently in a state where further consolidation is likely and the already diminished level of competition will continue to decline unless regulatory change is progressed. Ultimately, consumers will be the losers as smaller lenders will be unable to compete on price in the long term.

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<sup>1</sup> ‘The Changing Nature of Service’ research, conducted by CoreData brandmanagement on behalf of Abacus in September 2010.

<sup>2</sup> Abacus factsheet: data correct as at June 2010

Although research reveals that almost 90 per cent<sup>3</sup> of Australians believe the customer-owned business model provides better banking than the publicly listed model where profits go to shareholders not customers, regulatory and market limitations currently restrict the ability for customer-owned financial institutions to effectively compete with the major banks for market share.

### 1.1 Amendment of the Banking Act

All credit unions, building societies and banks are currently classified as Authorised Deposit-taking Institutions (ADIs) under the Banking Act. We are **all** subject to the same rigorous regulation and governance, are **all** closely supervised by the Australian Prudential Regulation Authority (APRA) and, are **all** required to comply with a range of requirements and prudential standards imposed by our regulator.

However, under the Banking Act, APRA does not endorse CUA and other customer-owned financial institutions referring to our core activity as 'banking', or to our products and services as 'banking' products and services, because we have chosen not to officially operate as a 'bank'. We are a credit union and proud of this.

The limitations of this are significant and directly impact our ability to compete on a level playing field with the 'banks'.

Despite the economic prudence of customer-owned financial institutions – in particular our stability and risk-averse economic strategy throughout the GFC – consumers have the misconception that we are not as secure as banks<sup>4</sup> in terms of managing capital and their deposits. This is compounded by our inability to overtly clarify that the core function of our business is to provide 'banking' products and services.

To this end, we offer our full support to our industry body, Abacus, in urging the Government to redress this issue by amending the Banking Act and changing the classification of all ADIs to Authorised Banking Institutions (ABI).

This would enable CUA to provide consumers some clarity around the fact that our core offer is 'banking' products and services. In addition, and more broadly, it would clarify that credit unions and building societies are regulated to the same standards as banks, while the term 'non-bank lender' would only apply to those institutions that operate to lower regulatory standards, such as mortgage brokers.

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<sup>3</sup> Independent research company Auspoll was commissioned by CUA to conduct a survey of Australians' attitudes towards customer-owned and publicly listed banking models. The research was conducted in May 2010 and based on a representative sample of 1,510 Australians.

<sup>4</sup> 'The Changing Nature of Service' research, conducted by CoreData brandmanagement on behalf of Abacus in September 2010.

## 1.2 Greater Market Transparency

The dominance of the four major banks in this market is unprecedented. While further consolidation across the sector is likely, CUA believes there is a real need for greater transparency and regulation in terms of multi-bank branding to ensure consumers are made explicitly aware of whom they are banking with.

CUA urges the Government to make it a requirement for institutions that are wholly owned subsidiaries of other financial institutions to clearly articulate that ownership within all signage, advertising and marketing material. This would avoid any misconception on behalf of the consumer as to whom they are ultimately banking with. It will also ensure institutions are not able to inadvertently mislead customers as to their size and status.

Increased transparency will not only enable consumers to make more informed decisions about who they bank with, it will also serve as another element to enhance competition.

## 1.3 Promoting Consumer Awareness

The customer-owned financial services industry is currently making considerable investment to promote greater awareness of itself. CUA has been a significant supporter of our industry body Abacus' most recent marketing campaign – '*back to you*'. In addition, we have increased our marketing spend for FY2011 by 50 per cent. However, our industry simply does not have the marketing budgets or power of the larger banks.

CUA is greatly encouraged by recent announcements from Treasurer Wayne Swan advocating a stronger role for credit unions and building societies in the banking system and we look forward to the release of details of the Government's reform package and to any support it may be considering to assist in raising awareness of our industry.

A Government-funded public education campaign could help to raise general consumer awareness of the alternatives to the major banks and to highlight the strength and security of customer-owned financial institutions.

## 1.4 Improved Access to Securitisation

Currently, one of the major factors restricting competition within the Australian banking sector is the difficulty CUA and other customer-owned financial institutions have in accessing reasonably priced funding from both domestic and overseas markets.

CUA has a funding strategy based primarily on domestic retail deposits, however we also have elements of wholesale funding and securitisation. Securitisation is important because it provides an avenue whereby funding costs available to organisations like CUA are much closer to the levels at which the major banks can source funding.

The Australian Office of Financial Management (AOFM) has supported us in our endeavours to continue using securitisation as part of our funding strategy; however this support has been restricted due to the AOFM's current investment mandate that only allows it to invest in A rated notes.

While investors have been returning to the higher rated notes, lower rated notes in securitisation issues remain difficult to sell at reasonable margins and it would greatly assist if the investment mandate was expanded to provide the AOFM with the ability to invest in these notes. In addition, this would free up capital that CUA and other customer-owned financial institutions would have to hold against the securitised assets thus providing increased capacity to undertake greater levels of home lending.

Furthermore, the AOFM's current mandate is finite and its current commitment is approaching expiration. In order for smaller lenders to retain support in accessing securitisation markets, CUA urges the Government to introduce a new, wider mandate for the AOFM to enable it to provide continued support.

CUA has been a regular issuer into the Residential Mortgage Backed Securities (RMBS) market since 2002 and has established a reputation of providing mortgages that are amongst the best performing in Australia. Until the RMBS market returns to normal levels over the next few years, CUA's preferred approach is for the AOFM to continue its practice of investing in individual tranches offered by issuers, rather than see the implementation of a centralised program which would reduce flexibility for individual issuers and may not be as attractive to investors due to the aggregation of asset types and originators.

CUA believes these actions would significantly enhance the ability of customer-owned financial institutions to compete with the major banks and ultimately provide greater competition in terms of products and services for consumers.

### **1.5 Management of Market Pricing Strategies**

Australia has a highly concentrated banking industry, with recent evidence indicating that the 'Big Four' banks hold over 80 per cent of the banking market. Consequently, the major banks have unprecedented market power in terms of operations and price setting.

Through the implementation of pricing strategies that have had an overall predatory effect, the price of retail deposits (CUA's main funding source) has increased to such a point that the ability of small lenders to fairly compete is restricted.

The major banks appear to employ a range of other strategies to capture greater market share and exert more control over market pricing, including using multiple brands with different pricing strategies. Through their structures these banks are able to support loss leading products for extended periods of time to further enable their growth to the detriment of smaller lenders.

To cover the escalating cost of retail deposits, CUA, other customer-owned financial institutions and smaller lenders are forced to raise rates and suffer resulting downward pressure on margins. From the perspective of CUA, this also translates into us being unable to pass on more benefits in terms of even cheaper products and services to our members. Ultimately, competition across the sector is further diminished.

Longer term, should the major banks be allowed to continue this pricing activity, the margins of smaller lenders will be further squeezed to the point where some are likely to be pushed out of the market altogether – further reducing the already diminished competition within the sector.

Although Australia operates under a free economy, there are currently provisions in place under the *Trade Practices Act 1974 (Cwth)* aimed at deterring practices that restrict free competition. CUA proposes the Act is more proactively enforced to prevent the dominant players from misusing their market power and ensuring competition within the sector can be effectively revived.

## 2. The ease of moving between providers of banking services

### 2.1 Simplifying the switching process

Another major factor restricting competition within our market is the cumbersome, time-consuming and often costly process of switching accounts and mortgages between institutions. CUA believes this could be greatly enhanced to promote a more competitive environment and is broadly supportive of any move that makes switching institutions easier without further disadvantaging small lenders.

A reform package<sup>5</sup> aimed at making switching between financial institutions easier was introduced in September 2008 and within that, onus was imposed on the incumbent institution to assist if a retail customer wanted to move their business to another institution within a certain timeframe. However, consumer awareness of this is relatively low and CUA's experience has been that very few consumers have taken advantage of the legislation.

CUA proposes further investigation of the following measures:

1. A review of legislation introduced in 2008 to determine the reasons for the low adoption levels;
2. The introduction of a public education campaign to raise consumer awareness of the regulatory obligations incumbent financial institutions have in assisting in the switching process;
3. A streamlined switching administration process, with greater governance in terms of timeframes and procedures. CUA references the amended portability benefits provision in the *Superannuation Industry (Supervision) Act 1993 (Cwth)* regulations, effective from July 1 2005, which appears to have facilitated the switching process between funds, reducing the administration on behalf of consumers and re-enforced the onus on the incumbent provider to enable the switching process;
4. Improve the portability of Mortgage Lenders Insurance on an existing debt should a customer switch to another lender.

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<sup>5</sup> Financial Stability Review – September 2008: <http://www.rba.gov.au/publications/fsr/2008/sep/html/dev-sys-infra.html>

### **3. Regulation that has the impact of restricting or hindering competition within the banking sector, particularly regulation imposed during the GFC**

#### **3.1 Retention of the Government Deposit Guarantee**

When the Government's Deposit Guarantee is reviewed in October 2011, CUA strongly advocates that it remains at \$1million. While this may be high by world standards, we believe it is important that this guarantee is not reduced – or at the very least not reduced too far or too quickly – to prevent the further flow of deposits to the major banks based on a misconception that they are a more secure option.

Should the Government's Deposit Guarantee be removed, we have already advocated that this should be a transitional process. CUA proposes that transition should occur in a stepped process to alternative programs, such as deposit insurance, rather than one swift retraction thereby allowing depositors to see that nothing really changes through the transition.

#### **3.2 Franking Credits**

In regards to franking credits, CUA and other customer-owned financial institutions are currently disadvantaged by the very nature of our model.

Firstly, where shareholder-owned financial institutions are able to issue franking credits with dividends to shareholders, CUA, as a customer-owned financial institution, has no mechanism to return those credits to our owners. Secondly, in the case of a merger, the accumulated franking credits are simply lost from the merged entity's balance sheet.

To level the playing field on this issue, CUA proposes the following actions for consideration:

1. Enable customer-owned financial institutions to distribute their franking credits in the form of a 'tax credit' directly into member accounts;
2. Alternatively, lower the amount of tax customer-owned financial institutions are required to pay by the equivalent amount of the franking credit. CUA would then be able to invest this money into even more competitive products and services for our members;
3. Enable customer-owned financial institutions the ability to trade franking credits to offset against our tax bills.

## Summary

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As detailed within this submission, CUA broadly supports any moves which serve to enhance competition within the Australian banking sector and is very supportive of the focus of this Senate Inquiry.

We have provided a series of specific steps that we firmly believe will help to level the playing field between customer-owned financial institutions and the major banks.

Below is a summary of CUA's key recommendations to the Senate Economics Committee:

- Reclassify ADIs to ABIs to remove the division between 'banks' and 'non-banks' to provide greater clarity around the fact that credit unions and building societies are regulated in exactly the same way as 'banks' and, enable us to communicate and raise awareness of our core function: banking.
- Ensure greater market transparency in terms of multi-bank branding to ensure consumers are aware of exactly with whom they are banking.
- Ensure greater support from Government to promote viable banking alternatives in the form of a public education program.
- Provide improved access to securitisation markets to redress the funding cost differential between smaller and customer-owned financial institutions and the major banks.
- Introduce proactive management of the dominance of the major four banks to control their power over the market in terms of pricing and help revive competition within the sector.
- Simplifying the switching process between institutions through a review of existing legislation, the introduction of a public education campaign on the obligations incumbent financial institutions have under existing switching legislation, and improving the portability of Mortgage Lenders Insurance.
- Retain the existing Government Deposit Guarantee at \$1million.
- Reassess how franking credits may be utilised by customer-owned financial institutions.

CUA firmly believes that the customer-owned banking model has never been more relevant. We are committed to not only raising greater awareness of the benefits of banking with a customer-owned financial institution, but also to ensuring that the environment in which we operate facilitates competition and enables CUA to continue offering highly competitive products and services to our members.

Please feel free to contact me on 07 3365 0062 to discuss any items raised within this submission. I also welcome the opportunity to appear at the Senate Economics Committee's hearing to elaborate further on our recommendations.

Kind regards

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