Parliament of Australia

Senate Economics Committee

Inquiry into competition within the Australian banking sector

Submission
by

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Strategies for promoting real competition within the Australian banking sector

There is no doubt that the ability of the Commonwealth Bank and Westpac to remove St George, BankWest, RAMS, Aussie Home Loans and Wizard as independent competitors has had a major detrimental impact on the level of real competition within the Australian banking sector, particularly during the past two years.

St George, BankWest, RAMS, Aussie Home Loans and Wizard were all fiercely independent competitors and that helped put considerable downward competitive pressure on the four major banks. The fierce independent competition provided by St George, BankWest, RAMS, Aussie Home Loans and Wizard and the intense competitive pressure they put on the four major banks reminds us that the intensity and strength of competition in a marketplace depends squarely on the intensity and strength of independent competitors in that marketplace. Remove those independent competitors or hamper their ability to compete vigorously and you remove or hamper competition to the considerable detriment of consumers.

Not surprisingly, the removal of St George, BankWest, RAMS, Aussie Home Loans and Wizard as independent competitors has enabled the four major banks to entrench their market dominance and has allowed the majors to act as cosy club where they are able to push up interest rates as much as they want and to impose fees in excess of the reasonable cost of carrying out the activities giving rise to the fees.

In short, consumers are currently, and will continue to, face higher interest rates and unfair contract terms and fees as a direct result of the substantial reduction in the independent competition previously provided by St George, BankWest, RAMS, Aussie Home Loans and Wizard.

Until independent competition and the conditions that allow independent competition to flourish are restored consumers will continue to be gouged by the four major banks. The restoration of independent competition and the conditions conducive to such independent competition requires a carefully coordinated and targeted approach. The recommendations made in this submission would, if implemented, provide such as coordinated and targeted approach.

List of recommendations

(1) **Place the four major banks under the competition spotlight by requiring the ACCC to formally monitor the four major banks;**

(2) **Implement a seamless switching package to enable customers to move easily and quickly between financial institutions;**

(3) **Amend the definition of unfair term under the Australian Consumer Law to deal expressly with issue of unfair fees;**

(4) **Explore opportunities for Australia Post to offer basic banking services. This could involve asking the Productivity Commission to (i) undertake a feasibility study into Australia Post offering basic banking services; and (ii) review the overseas experience with national postal services offering banking services;**

(5) **Extend indefinitely the retail deposits guarantee for APRA supervised non-major banks and financial institutions;**

(6) **Strong and ongoing backing to the RMBS market, including an assessment by the Productivity Commission of the feasibility of Australia adopting the Canadian Mortgage Backed Securities program operated by the Canada Mortgage and Housing Corporation (CMHC);**

(7) **Direct the Productivity Commission to assess the impact on competition within the Australian banking sector as a result of the removal of St George, BankWest, RAMS, Aussie Home Loans and Wizard as independent competitors;**

(8) **Direct the Productivity Commission to undertake a review of the ACCC's current approach to assessing mergers and acquisitions within the Australian banking sector;**

(9) **Amend the *Banking Act* to provide for an outright prohibition against any merger between the four major banks so as to ensure that the four pillar policy is given the force of law and can only be altered by Parliament;**

(10) **The Senate Economics Committee request within 3 months of the date of the request a report pursuant to s 29(3) of the Trade Practices Act as to circumstances under which the ACCC would apply for a divestiture order pursuant to s 81 of the Trade Practices Act;**

(11) Amend s 50 of the *Trade Practices Act* to provide an effective prohibition against (i) a merger or acquisition that "materially" lessens competition; and (ii) creeping acquisitions by a firm with substantial market share that would lessen competition in a market.

(12) Amend the *Trade Practices Act* to provide for a general divestiture power whereby a Court can, on the application of the ACCC, order the break-up of companies (i) having substantial market share; and (ii) where either the characteristics of the market prevent, restrict or distort competition; or the companies have engaged in patterns of conduct that are detrimental to competition and consumers.

Placing the four major banks under the competition spotlight

In view of the market dominance of the four major banks it is appropriate to place them under ongoing scrutiny from a competition and consumer perspective. This ongoing scrutiny can be performed by the ACCC and is expressly provided for under the *Trade Practices Act*.

Indeed, under the prices surveillance part of the *Trade Practices Act* the relevant Federal Minister is able to the direct the ACCC to "formally monitor" the prices, costs and profits of an industry or specified companies. Such a direction can, for example, be made under section 95ZF of the *Trade Practices Act*:

TRADE PRACTICES ACT 1974 - SECT 95ZF

Directions to monitor prices, costs and profits of a business

(1) The Minister may give the Commission a written direction:

(a) to monitor prices, costs and profits relating to the supply of goods or services by a specified person; and
(b) to give the Minister a report on the monitoring at a specified time or at specified intervals within a specified period.

Commercial confidentiality

(2) The Commission must, in preparing such a report, have regard to the need for commercial confidentiality.

Commission to send person a copy of the report

(3) The Commission must send the person a copy of the report on the day it gives the Minister the report.

Public inspection

(4) The Commission must also make copies of the report available for public inspection as soon as practicable after the person has received a copy of the report.

A direction under the prices surveillance part of the *Trade Practices Act* has previously been made in relation to unleaded petrol and can quite easily be given in relation to the four major banks. This would represent an important competition and consumer safeguard

RECOMMENDATION

For the relevant Minister to give a direction that the ACCC formally monitor the four major banks under the prices surveillance part of the *Trade Practices Act*.

Implementing a seamless switching package

A key ongoing obstacle to the promotion of a competitive Australian banking sector relates to the practical difficulties associated with a customer switching from their existing financial institution to another financial institution. With media reports regarding the minimal take up of the Federal Government's switching package announced back in October 2008, it is clear that the Federal Government needs to move quickly to make it much easier for customers to switch banks.

In particular, it would be submitted that for the sake of competition and consumers the Federal Government needs to make switching banks as easy and as seamless as possible. Within this context, the best outcome for bank customers would be to have an ability to simply go the new bank, sign an authority to allow the new bank to move the customer's dealings over to the new bank and have the new bank do all the work with the old bank. Such a process would be comparable to the situation with respect to switching phone or electricity providers.

RECOMMENDATION

For the Federal Treasurer to facilitate the implementation of a seamless banking switching package whereby a customer can simply authorise a new bank to undertake the switching on the customer's behalf.

Amend the definition of unfair term under the Australian Consumer Law to deal expressly with issue of unfair fees

The imposition of unfair fees by financial institutions is a clear obstacle to a fully competitive banking sector. Such an unfair fee arises where the fee payable materially exceeds the reasonable cost to the financial institution of undertaking the activity to which the fee relates.

Unfair fees represent a market failure in that there is generally a lack of competition between financial institutions regarding fees payable in connection with a financial product. This lack of competition will in practice mean that a fee payable may far exceed the reasonable cost to the financial institution of undertaking the activity to which the fee relates.

Within this context, it is appropriate to provide clear guidance to the courts when applying the unfair contract term provisions of the *Australian Consumer Law* in relation to fees payable in connection with a financial product. Such guidance could easily be provided through the insertion of the following new paragraph (c) to subsection (2) of s 24 of the *Australian Consumer Law*:

24 Meaning of *unfair*

(1) A term of a consumer contract is ***unfair*** if:
(a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
(b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
(c) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

(2) In determining whether a term of a consumer contract is unfair under subsection (1), a court may take into account such matters as it thinks relevant, but must take into account the following:
(a) the extent to which the term is transparent;
(b) the contract as a whole**;**
(c) **in relation to a fee payable in connection with a financial product, whether the fee materially exceeds the reasonable cost to the financial institution of undertaking the activity to which the fee relates.**

A new paragraph (c) to s 24(2) would simply be an additional matter the Court must have regard to when considering a fee payable in connection with a financial product within the context of the new unfair contract term provisions.

RECOMMENDATION

Amend the definition of unfair term under the Australian Consumer Law to deal expressly with issue of unfair fees.

Explore opportunities for Australia Post to offer basic banking services

With the removal of St George, BankWest, RAMS, Aussie Home Loans and Wizard as independent competitors it is imperative to inject new independent competition into the Australian banking sector. This can be done by encouraging new entrants into the sector and, in particular, by exploring opportunities for Australia Post to offer basic banking services either in its own right by seeking a banking licence, or through a joint venture or distribution arrangement with a non-major financial institution.

In this regard, basic banking services would involve offering a basic deposit account, credit card and mortgage facility. Such basic banking services would not only inject new independent competition into the Australian banking sector, but would also be a big plus for rural and regional customers given Australia Post's extensive branch network.

Australia Post offering basic banking services would be totally consistent with overseas experience where national postal services already offer banking services.

RECOMMENDATION

Explore opportunities for Australia Post to offer basic banking services. This could involve asking the Productivity Commission to (i) undertake a feasibility study into Australia Post offering basic banking services; and (ii) review the overseas experience with national postal services offering banking services.

Extend the retail deposits guarantee for APRA supervised non-major banks and financial institutions indefinitely

While Australia has one of the best prudential regulatory systems in the world which helps ensure that all our APRA supervised financial institutions are financially sound, there is a residual concern amongst consumers that non-bank financial institutions are perhaps not as “safe” as banks. Such a concern acts as a real impediment to a competitive Australian banking sector for the simple reason that it gives the four major banks a psychological and competitive advantage that is generally not totally deserved.

The reality is that APRA supervised financial institutions should never be allowed to fail. The Australian financial system as supervised by APRA is so interconnected that allowing even one APRA supervised financial institution to fail would have a disproportionately negative impact on the rest of the financial system and severely undermine the integrity and confidence in the system as a whole. The simple fact is that no Australian government should stand by and watch the collapse of an APRA supervised financial institution as the damage to Australia’s prudential and financial system would be considerable and irreparable.

It’s time to recognise that a strong prudential regulatory system is infinitely preferable to any misguided notion that banks should be allowed to fail. Within this context, the Federal Government could maintain consumer confidence in existing APRA supervised competitors to the four major banks by extending the retail guarantee for the non-major banks and financial institutions indefinitely. That would not only maintain confidence in the smaller banks and credit unions, but enable them to develop into effective independent competitors to the four major banks thereby boosting competition in the Australian banking sector.

RECOMMENDATION

Extend indefinitely the retail deposits guarantee for APRA supervised non-major banks and financial institutions.

Strong and ongoing backing to the RMBS market, including an assessment by the Productivity Commission of the feasibility of Australia adopting the Canadian Mortgage Backed Securities program operated by the Canada Mortgage and Housing Corporation (CMHC)

The Federal Government has already provided limited support to the RMBS (Residential Mortgage Backed Securities) on the basis that the support would assist non-major banks and financial institutions to raise funds. With the rationale for supporting the RMBS market a sound one, the Federal Government should not only continue that support, but expand it considerably.

The RMBS market represents a vital opportunity to promote a competitive Australian banking sector through offering non-major banks and financial institutions an ability to raise funds with both Federal Government and private investor support.

The potential of the RMBS market to promote competitive outcomes in Australia is such that consideration should be given by the Federal Government to adopting the Canadian Mortgage Backed Securities program operated by the Canada Mortgage and Housing Corporation (CMHC) (See: http://www.cmhc-schl.gc.ca/en/hoficlincl/mobase/mobase_001.cfm). Such a feasibility study could be quite easily be undertaken by the Productivity Commission.

RECOMMENDATION

Strong and ongoing backing to the RMBS market, including an assessment by the Productivity Commission of the feasibility of Australia adopting the Canadian Mortgage Backed Securities program operated by the Canada Mortgage and Housing Corporation (CMHC).

Directing the Productivity Commission to assess the impact on competition within the Australian banking sector as a result of the removal of St George, BankWest, RAMS, Aussie Home Loans and Wizard as independent competitors

Given that the removal of St George, BankWest, RAMS, Aussie Home Loans and Wizard as independent competitors has had a major detrimental impact on the level of real competition within the Australian banking sector, particularly during the past two years, it is appropriate to try and quantify the detriment to competition and consumers.

Such an exercise could be undertaken by the Productivity Commission and can serve as a very valuable guide to (i) how detrimental mergers and acquisitions can be to competition and consumers; and (ii) how such detriment can be avoided in the future.

Importantly, in such circumstances the Productivity Commission can make a timely and important arm's length assessment of the impact on competition as a result of past ACCC decisions not oppose the removal of St George, BankWest, RAMS, Aussie Home Loans and Wizard as independent competitors.

RECOMMENDATION

Directing the Productivity Commission to assess the impact on competition within the Australian banking sector as a result of the removal of St George, BankWest, RAMS, Aussie Home Loans and Wizard as independent competitors.

Directing the Productivity Commission to undertake a review of the ACCC's current approach to assessing mergers and acquisitions within the Australian Banking Sector

To ensure that there is no further reduction in independent competition it is appropriate to independently review the ACCC's direction and approach to assessing mergers and acquisitions within the Australian banking sector.

Such a review could be undertaken by the Productivity Commission and would ensure that the ACCC's mistakes of the past are not repeated and that any future merger or acquisition that entrenches or extends the market dominance by one of the four major banks is opposed in view of the significantly detrimental impact that the removal of St George, BankWest, RAMS, Aussie Home Loans and Wizard as independent competitors has had on the level of real competition within the Australian banking sector.

RECOMMENDATION

Directing the Productivity Commission to undertake a review of the ACCC's current approach to assessing mergers and acquisitions within the Australian Banking Sector

Amend the *Banking Act* to provide for an outright prohibition against any merger between the four major banks so as to give the four pillar policy the force of law

As with any Government policy, the four pillar policy can be varied or discarded at the whim of Government of the day. Unfortunately, this brings with it the very real risk that decisions regarding the four pillar policy may become politicised or be left to be dealt with under s 50(1) of the *Trade Practices Act* in circumstances where s 50(1) as currently drafted is failing to prevent anti-competitive mergers or acquisitions on the basis that the "substantial lessening of competition" test is far too high a threshold.

In short, s 50(1) of the *Trade Practices Act* as currently drafted would be grossly inadequate for dealing with any possible mergers between the 4 major banks. Given the increasing market share and power of the 4 major banks and how that market failure is leading to higher interest rates and fees, there are overwhelming national interest and competition grounds for ruling out through legislative means any merger between the 4 major banks unless approved by a further Act of Parliament. As Parliament is the ultimate guardian of the national interest it is more than appropriate that the *Banking Act* be amended to provide for the outright prohibition of any merger between the four major banks thereby giving the four pillar policy the force of law.

RECOMMENDATION

Amend the *Banking Act* to provide for an outright prohibition against any merger between the four major banks so as to ensure that the four pillar policy is given the force of law and can only be altered by Parliament.

The Senate Economics Committee request within 3 months of the date of the request a report pursuant to s 29(3) of the Trade Practices Act as to circumstances under which the ACCC would apply for a divestiture order pursuant to s 81 of the Trade Practices Act

Given that under s 81 of the *Trade Practices Act* the ACCC has 3 years in which to apply to the Federal Court for the divestiture of shares or assets acquired in breach of s 50 of the *Trade Practices Act*, the section of the Act that prohibits mergers that substantially lessen competition, the ACCC has an important, but very limited, window of opportunity to undo the destructive effects on competition flowing from a merger or acquisition that substantially lessens competition.

The power under s 81 is a significant, but under-utilised one and it is essential that businesses and consumers have a clear understanding as to the circumstances under which the ACCC would apply for a divestiture order under s 81.

In the absence of clear guidelines from the ACCC about the use of the power under s 81, the Senate Economics Committee is expressly empowered under s 29(3) of the *Trade Practices Act* to ask the ACCC to provide information regarding the ACCC's approach to applying for a divestiture order under s 81.

RECOMMENDATION

The Senate Economics Committee request within 3 months of the date of the request a report pursuant to s 29(3) of the Trade Practices Act as to circumstances under which the ACCC would apply for a divestiture order pursuant to s 81 of the Trade Practices Act.

Amend s 50 of the *Trade Practices Act* to provide an effective prohibition against (i) a merger or acquisition that "materially" lessens competition; and (ii) creeping acquisitions by a firm with substantial market share that would lessen competition in a market

Currently, s 50 of the *Trade Practices Act* only prohibits a merger or acquisition if it substantially lessens competition:

> (1) A corporation must not directly or indirectly:
>
> (a) acquire shares in the capital of a body corporate; or
>
> (b) acquire any assets of a person;
>
> if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

Unfortunately for consumers and competition the "substantial lessening of competition" test is far too high a threshold to meet and, accordingly, explains why the ACCC only opposes a relatively small number of mergers and acquisitions that it considers. The "substantial lessening of competition" test requires that in order for the merger or acquisition to be considered in breach of the test, the merged entity must have the ability to raise prices without losing business to rivals.

In this way, the "substantial lessening of competition" test has come to be equated with the "substantial market power" test under s 46 which also requires that it be established that the company have the ability to raise prices without losing business to rivals.

With the ACCC only stopping a very small number of mergers and acquisitions the current s 50(1) has resulted in Australia having some of the most highly concentrated markets in the world. This failure of s 50(1) to prevent mergers and acquisitions having a detrimental effect on consumers and competition can be directly attributed to the view that the present "substantial lessening of competition" test is simply too high a test to act as an appropriate filter to protect competition. In short, because the "substantial lessening of competition" test is set too high, s 50(1) as currently drafted is failing to prevent anti-competitive mergers and acquisitions.

Proposed amendment to s 50(1) of the *Trade Practices Act*

Within this context, it would be submitted that the "substantial lessening of competition" test under the current s 50(1) is in urgent need of change to a more balanced test of a "material lessening of competition." A "material lessening of competition" test would operate to lower the threshold for determining whether a merger or acquisition is anti-competitive in a manner

that would allow the merger or acquisition to be tested by reference to whether it has a pronounced or noticeably adverse affect on competition rather than on whether the merged entity would post merger be able to exercise substantial market power as is currently the case.

The following draft illustrates how an amended s 50(1) would incorporate a new "material lessening of competition" test:

> *(1) A corporation must not directly or indirectly:*
>
> *(a) acquire shares in the capital of a body corporate; or*
>
> *(b) acquire any assets of a person;*
>
> *if the acquisition would have the effect, or be likely to have the effect, of materially lessening competition in a market.*

Dealing with creeping acquisitions: The importance of preventing the destruction of competition by stealth

Dealing effectively with the issue of creeping acquisitions is essential to protecting competition and consumers. The issue of creeping acquisitions arises because of the current drafting of s 50 of the *Trade Practices Act* which allows s 50 to be easily circumvented by undertaking piecemeal or small scale acquisitions which individually don't substantially lessen competition, but which over time lead to the increased dominance of the merged entities. This is clearly evident in the Australian banking sector where the series of acquisitions by the Commonwealth Bank and Westpac in recent years has led to the increased dominance of these two major banks in circumstances where s 50(1) as currently drafted has hitherto failed to prevent those piecemeal acquisitions.

Thus, while over time individual piecemeal acquisitions may, when taken together with previous acquisitions by the same entity, have the effect of collectively destroying competition, the current s 50(1) is powerless to stop the piecemeal acquisitions as can be so clearly seen in the Australian banking sector.

So under s 50(1) as currently drafted the creeping acquisitions of individual competitors will not be prevented because their small scale will not be considered to substantially lessen competition and, accordingly, not be seen to be in breach of s 50(1) of the *Trade Practices Act*. In this way creeping acquisitions lead to the destruction of competition over time in a manner that is not prevented by the current s 50(1) of the *Trade Practices Act*.

While, of course, those engaging in creeping acquisitions will justify the creeping acquisitions on efficiency grounds as possibly leading to greater economies of scale, it is essential to note that the removal of individual

efficient competitors over time means that there is a reduction in the very competition required to ensure that any savings from any economies of scale gained from acquisitions are passed onto consumers.

Thus, unless there is sufficient competition to force the merged entities to pass efficiency savings onto consumers, the benefits of any economies from mergers or acquisitions will simply be a windfall for the merged entity and not be passed onto consumers. More dangerously for consumer, the weakening of competition through merger activity, along with the increased dominance of the merged entities, allows the merged entities to raise prices to detriment of consumers. As noted above, we are now seeing a clear example of this in the Australian banking sector as direct a result of the acquisitions by the Commonwealth Bank and Westpac.

Proposed amendment to s 50 of the *Trade Practices Act*

Given that creeping acquisitions become a very real concern where they are being engaged in by companies already having a substantial market share it would be submitted that the focus of a prohibition on creeping acquisitions should be on those companies having a substantial share of the market. It is these companies with substantial market share that can engage in a destructive, but well organised, pattern of creeping acquisitions in order to increase their strength in the market through piecemeal acquisitions in circumstances where individually those acquisitions are not prevented by the current s 50(1).

The following new subsection of s 50 would be proposed to deal effectively with creeping acquisitions:

> *(1A) A corporation that has a substantial share of a market must not directly or indirectly:*
>
> > *(a) acquire shares in the capital of a body corporate; or*
> >
> > *(b) acquire any assets of a person;*
>
> *if the acquisition would have the effect, or be likely to have the effect, of lessening competition in a market.*

RECOMMENDATION:

Amend s 50 of the *Trade Practices Act* to provide an effective prohibition against (i) a merger or acquisition that "materially" lessens competition; and (ii) creeping acquisitions by a firm with substantial market share that would lessen competition in a market.

Amend the *Trade Practices Act* to provide for a general divestiture power whereby a Court can, on the application of the ACCC, order the break up of companies (i) having substantial market share; and (ii) where either the characteristics of the market prevent, restrict or distort competition; or the companies have engaged in patterns of conduct that are detrimental to competition and consumers.

Unlike the United Kingdom or the United States, Australia does not provide for a general divestiture power to deal with highly concentrated markets having characteristics that prevent, restrict or distort competition in those markets. In the United Kingdom a very sophisticated framework has been enacted to allow for highly concentrated markets to be reviewed with the purpose of assessing the level of competition in a market and for taking steps to remedy market distortions having a detrimental impact on competition and consumers.

RECOMMENDATION

Amend the *Trade Practices Act* to provide for a general divestiture power whereby a Court can, on the application of the ACCC, order the break up of companies (i) having substantial market share; and (ii) where either the characteristics of the market prevent, restrict or distort competition; or the companies have engaged in patterns of conduct that are detrimental to competition and consumers.