

Chapter 4

Assessing competition in the Australian banking market

Overview

4.1 The Committee agrees with Treasury that:

Competition is the cornerstone of efficiency and productivity in any market. It promotes fair prices, enhances living standards and ensures that scarce resources are allocated to their highest value uses.¹

4.2 The extent of competition in the Australian banking industry has been examined in two recent reports by the Senate Economics References Committee. Some observations from these reports are:

The Australian banking market is dominated by four large banks, now accounting for around $\frac{3}{4}$ of the market. This has resulted from a series of mergers going back more than a century.²

A consequence of these mergers has been a long-run tendency towards increased concentration within the Australian banking industry. There was a temporary reduction in concentration with the deregulation of the 1980s, mostly reflecting the entry of foreign banks and conversion of the larger building societies, but this has now been overwhelmed by the ongoing mergers. As a result the Australian banking market is now, by some criteria, the most concentrated it has been for more than a century...The Australian banking market is now quite concentrated by international standards. This is likely to be one reason it is more profitable, and has wider interest margins, than banks in most comparable countries...³

4.3 There are a number of metrics by which the state of competition can be assessed. As Treasury and NAB explained:

These include market share, pricing, profitability, market contestability and product innovation. An assessment of the state of competition in banking requires consideration of all these indicators, and none of these indicators should be used individually as an exclusive and definitive indicator of the state of competition in the banking sector.⁴

1 Treasury, *Submission 102*, p 1.

2 Senate Economics References Committee, *Access of Small Business to Finance*, June 2010, p 47.

3 Senate Economics References Committee, *Report on Bank Mergers*, September 2009, pp 5-6.

4 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury, *Committee Hansard*, 13 December 2010, p 25.

...two critical measures, and this is how our investors look at it: what is the return on the equity that our shareholders have put into the business and what is the return on assets?⁵

4.4 These and other indicators are assessed in this chapter.

Number of products available and competitors

4.5 The banks often defend the state of competition by pointing to the number of players and products.⁶ It is true that there are a large number of lenders and deposit-takers in Australia:

Australian banking customers are currently served by a wide range of providers. These include 12 Australian-owned banks; 9 foreign-owned bank subsidiaries; 35 foreign bank branches; 11 building societies and more than 100 credit unions. Further, there are currently around 111 providers of over 2,200 mortgage products; 66 providers of over 420 different credit cards; and 114 providers of over 992 different types of deposit account.⁷

4.6 This indicator, however, also shows a sharp decline in the number of providers and products available in recent years:

In October 2007, the Australian mortgage market was serviced by over 150 financial institutions offering over 2,117 home loan products. In November 2010, this had fallen to 100 financial institutions offering 1,600 products.⁸

4.7 The more important point is that the number of competitors is not a good indicator of competition:

...an industry with four participants...can be either a tightly organised cartel gouging customers or highly competitive; the number of participants in the industry is not the important thing.⁹

4.8 There are hundreds of corner stores competing with Coles and Woolworths but this does not mean that these two stores do not dominate grocery retailing. In the same way, the four major banks dominate the banking market, notwithstanding a long tail of small financial organisations.

5 Mr Cameron Clyne, Chief Executive Officer, National Australia Bank, *Committee Hansard*, 13 December 2010, p 58.

6 See, for example, the Australian Bankers' Association, *Submission 76*, p 5.

7 Treasury, *Submission 102*, p 22.

8 NSW Business Chamber, *Submission 84*, p 5.

9 Professor Tom Valentine, *Committee Hansard*, 25 January 2011, p 61. See also National Australia Bank, *Submission 91*, p 3.

Intensity of competition

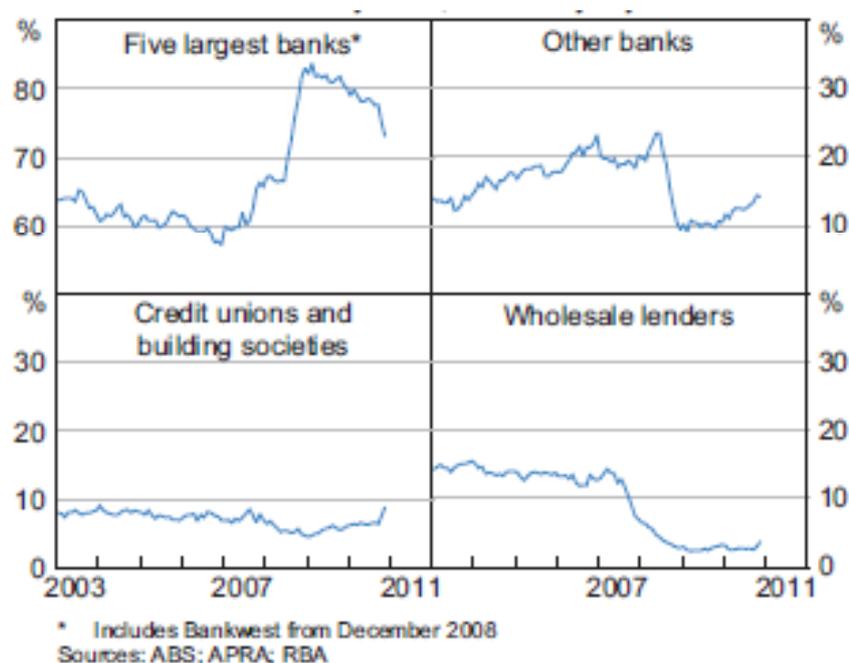
4.9 More relevant, but harder to quantify, is the intensity of competition between banks. As noted in earlier chapters, National Australia Bank has recently adopted a more competitive stance but only on certain products and it is unclear how long it will be sustained. Occasional bouts of heavily advertised 'competition' are not sufficient to demonstrate a truly deep-seated competitive ethos.

Measures of concentration in the Australian banking market

4.10 There are two common measures of market concentration. The first is simple; the market share of the largest three, four or five firms.

4.11 In Australia, the four major banks now dominate the Australian banking market, accounting for around three-quarters of deposits and assets and a larger share of home loans (Table 4.1, last row and Chart 4.1). One witness referred to the market as 'almost a quadropoly'.¹⁰

Chart 4.1: Share of owner-occupier housing loan approvals



Source: Reserve Bank of Australia, *Statement on Monetary Policy*, February 2011, p 49; update of chart in their *Submission 41*, p. 5.

10 Mr Peter Strong, Executive Director, Council of Small Business Organisations of Australia, *Committee Hansard*, 15 December 2010, p 12.

4.12 The weakness of this measure is that it is rather arbitrary how many firms are included, and it can make a difference to the results. For example, Westpac's takeover of St George (then the fifth largest bank) added significantly to the market share of the 'four largest' banks, but had little effect on the share of the 'five largest'.

4.13 A preferable measure of concentration is the Herfindahl-Hirschman concentration Index (HHI). This is calculated by summing the squares of the market shares (expressed as proportions). This means the measure can vary from 0 representing perfect competition to 1 representing monopoly.¹¹ A market with X equally-sized competitors will have an index of $1/X$.

4.14 Professor Sathye suggested 0.18 represents a 'red light', over which the index is indicating a worrying degree of concentration.¹² The ACCC uses 0.2 as a guide.¹³

Table 4.1: Measures of concentration in Australian banking market

	Assets		Deposits		Home loans	
	Share of 4 largest banks	HHI	Share of 4 largest banks	HHI	Share of 4 largest banks	HHI
1890	0.34	.06				
1913	0.38	.10				
1950	0.63	.14	0.64	.15		
1970	0.68	.16	0.68	.16	0.77 ¹	.21 ¹
1990	0.66	.12	0.65	.12	0.65	.13
Oct 2008 (pre-mergers)	0.65	.11	0.65	.12	0.74	.15
Oct 2008 (post-mergers ²)	0.73	.14	0.75	.15	0.86	.20
February 2011 ²	0.77 ³	.16 ³	0.78	.16	0.87	.21

¹ Assuming all owner-occupier housing loans were made by savings banks and accounted for all their loans.

² Counting BankWest and St George as parts of Commonwealth and Westpac respectively. ³ Not consistent with previous statistics due to reclassification by ANZ and Commonwealth.

Source: Secretariat, calculated from data in APRA, *Monthly Banking Statistics*, October 2008, February 2011; *RBA Bulletin*, June 1990; Butlin et al (1971), White (1973).

11 The measure is sometimes calculated using *percentages* rather than *proportions*, in which case possible values range from 0 to 10,000. Professor Sathye's *Submission 28* is an example.

12 Professor Milind Sathye, *Committee Hansard*, 15 December 2010, p 33. See also his *Submission 28*, pp 7 and 17.

13 Mr Brian Cassidy, Chief Executive Officer, ACCC, *Committee Hansard*, 25 January 2011, p 51.

4.15 The extent of concentration is attested to by some witnesses representing small business:

Currently, the major banks are providing two thirds of business credit. SEN research shows that 90 per cent of WA small businesses have applied for finance from the big four banks.¹⁴

4.16 As illustrated by Charts 2.1 to 2.5, the major banks have essentially grown their market share over the past century by successively taking over the various banks and building societies established in the previous century.¹⁵ This is reflected in a long-run tendency towards increased concentration (Table 4.1), only temporarily interrupted in the 1980s by the entry of foreign banks and conversion of the larger building societies. Australia's banking market is now, by some criteria, the most concentrated it has been for more than a century.

4.17 The Australian banking market is also now quite concentrated by international standards (Table 4.2, Chart 4.2).¹⁶

Table 4.2: Measures of concentration, 2008

	Concentration measures (based on assets) ¹	
	% share of 4 largest banks	HH index
Australia	84	.19
Canada	76	.17
France	82	.21
Germany	47	.10
Japan	57	.10
Netherlands	97	.33
Sweden	99	.30
Switzerland	82	.32
UK	84	.21
United States	<59	<.10

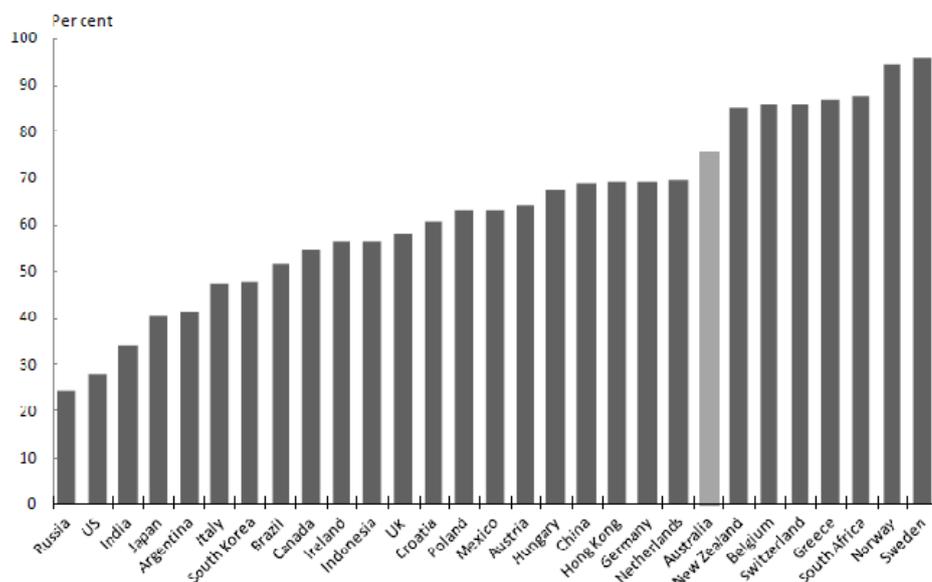
¹Only includes domestically-headquartered banks which rank in the world's top 1000. In Australia this includes nine banks accounting for 80 per cent of the market.

Sources: Secretariat, calculated from data in *The Banker*, July 2009; Bank for International Settlements (2009, p 39). (Comparisons in 1980 and 1990 can be found in Senate Economics References Committee, *Report on bank mergers*, September 2009, p 7.)

14 Mr Andrew Canon, Manager, Western Australian Small Enterprises Network, *Committee Hansard*, 21 January 2011, p 110.

15 With the exception of the Commonwealth Bank (only established in 1912), the increases in their market share are more than accounted for by their acquisitions; Senate Economics References Committee, *Report on bank mergers*, September 2009, p 5.

16 This conclusion is also reached by House of Representatives Standing Committee on Economics (2008, p 26).

Chart 4.2: Share of assets held by three largest banks (average 2000-2008)

Source: Treasury, *Submission 102*, p 13.

4.18 This is likely to be one reason the Australian banks are more profitable, and have wider interest margins, than banks in most comparable countries (Table 4.3), although this also partly reflects that it has fewer non-performing loans. Australian banks' operating costs are not especially low.¹⁷

4.19 The Australian banking market is commonly regarded as an oligopoly:

The banking sector, like a number of other sectors in Australia—maybe because of size and population—have those tendencies of oligopolistic markets...we should continually keep such markets under surveillance or oversight to ensure that consumers get the best results or outcomes from those markets.¹⁸

17 Senate Economics References Committee, *Report on Bank Mergers*, September 2009, p 7. There are challenges in comparing the profitability of Australian banks with those overseas. As Martin and Hawkins (1991, p 3) comment; 'the structure of banking, economic conditions, the extent of off-balance sheet activity, the tax system, the importance of international operations, the regulatory regime and the mix of household and corporate lending varies greatly, as do accounting practices'.

18 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury, *Committee Hansard*, 13 December 2010, pp 26-27.

Table 4.3: Profitability of banks (% to assets, 2009)

	Pre-tax profits	Net interest margin	Net gains from trading	Net fee income
Australia	0.9	1.9	0.1	0.5
Canada	0.7	1.7	0.1	0.9
France	0.2	1.1	0.3	0.4
Germany	-0.0	0.8	0.2	0.4
Japan	0.3	1.0	0.1	0.3
Netherlands	-0.1	1.2	0.0	0.4
Sweden	0.3	1.0	0.3	0.4
Switzerland	0.2	0.6	0.6	0.9
UK	-0.1	0.9	0.5	0.5
United States	0.4	2.7	0.3	0.7

Source: Bank for International Settlements (2010, p 29).

4.20 An oligopoly does not necessarily prevent strong competition but it does make it less likely:

You could have one of the big banks providing intensive competition if they so chose, and to some degree NAB is providing some level of tension. However, in an oligopoly structure, there is little incentive for one of the players to be aggressive because, all that does is cut their profit margins over time. They simply fall into a cosy club arrangement. So what you need is those independent competitors who, for lack of a better word, disrupt the oligopoly... Even within an oligopoly structure, one of the oligopolists may engage in periodic bouts of competition or, as I describe it, the odd angry shot... but will that continue over time?¹⁹

Competition can be strong in quite concentrated markets and weak in markets that are not highly concentrated. There is nevertheless a tendency, all else equal, for markets to be less competitive when more concentrated.²⁰

Economies of scale in banking

4.21 Economies of scale can be a force promoting concentration in banking, and hence reducing competition. The Reserve Bank comment that:

While a larger bank can, in principle, spread fixed costs across a greater range of activities, thereby taking advantage of economies of scale, larger

19 Associate Professor Frank Zumbo, *Committee Hansard*, 14 December 2010, p 60.

20 United Kingdom Independent Commission on Banking, *Issues Paper: Call for Evidence*, September 2010, p 22; cited by Abacus, *Submission 53*, p 7.

institutions also suffer some diseconomies of scale (e.g. difficulties associated with governance).²¹

4.22 Some submitters stressed the importance of economies of scale to differing extents:

In order to survive in the long term, banks need a certain scale to dilute their fixed costs and they need effective diversification both of assets and liabilities to ride out the peaks and troughs of the business cycle. This becomes a virtuous circle, with large and diversified banks rewarded by better credit ratings that more enable them to expand further. A viable bank is naturally a big bank. As a result, banking is a natural oligopoly. Given the size of the Australian economy, four banks seems about right. It would not be wise to tinker with the current situation.²²

Economies of scale in retail banking are significant and constitute a substantial barrier to competition. Scale influences the underlying cost of a banking business in various ways including, but not limited to, its influence on an ADI's credit rating...the ability to spread the cost of complying with regulation...[and] funding infrastructure investment in branch networks and payments systems, purchasing/cross-selling power, IT synergies.²³

Scale lowers the cost of capital because of increased diversification (e.g. most smaller players operate in just a few asset classes with real estate security concentrated geographically)...economies of scale in retail banking derive from IT capabilities, branch network presence, discretionary overheads (risk, marketing, finance, etc) and the spreading of risk. But these are small proportion of cost base and are being attacked by falling IT costs/ new technology and shift in consumer towards internet vs branch. More important is cost of funding which ultimately depends on credit rating/quality of lending book.²⁴

4.23 Empirical studies of economies of scale in banking were surveyed by the Reserve Bank. They summarise the results as:

Studies of economies of scale in banking tend to be inconclusive. One study, which is now quite dated – Berger et al. (1999) – summarises that most estimates of maximum efficient size lie in the range of \$100 million to \$25 billion of assets. However, Wheelock and Wilson (2001) note that firm conclusions on economies of scale for larger banks are difficult as there are few institutions, and a recent review by the Committee on the Global Financial System (2010) of the empirical literature suggests that there is

21 Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 1.

22 Mr Nicholas Palmer, *Submission 22*, p 4.

23 Mr Mike Hirst, Managing Director, Bendigo and Adelaide Bank, *Responses to questions on notice*, no 7, 20 January 2011, p 1.

24 National Australia Bank, *Responses to questions on notice*, no 11, 31 January 2011, p 1.

little evidence for the existence of scale or scope economies in international banking.²⁵

4.24 The ANZ Bank's reading of the literature is even more agnostic:

The literature on economies of scale in retail banking is inconclusive, reflecting conjecture about the point at which diseconomies occur and the diversity and uniqueness of the cases examined and the considerable variation in regulatory and operating environments across countries.²⁶

4.25 A UK parliamentary committee recently examined the arguments on economies of scale, and were sceptical about claims that there were significant advantages to consumers from banks with significant market shares merging:

The large banks have told us that ultimately consumers will benefit from lower prices resulting from the economies of scale and synergies provided by larger more diversified banks. We agree that there are economies of scale/minimum efficient scale in retail banking which will ultimately limit the total number of firms in the market. However, we question whether the need for economies of scale justifies banks having a 30% share of the market or whether such benefits, if they exist, will be passed onto consumers in a market where competition is deficient. Indeed, such economies of scale benefits are likely to be outweighed by the negative impact on competition by those providers who are perceived to be 'too big to fail'.²⁷

The profitability of banks in Australia

4.26 Profitability is another measure of competition:

The best test of competitiveness...is to look at the outcomes—that is, are the banks making an excessive profit?²⁸

4.27 Notwithstanding some increase in bad debts, the Australian banks' profitability held up during the global financial crisis and reached record levels in 2010 (Chart 4.3).

4.28 One component of this profits growth arising from banks persuading Australian households to take on more debt. Some of this has been of benefit to those households, allowing them to improve their education or their health. But much of it seems to have been spent on conspicuous consumption or in bidding up housing prices.

25 Reserve Bank of Australia, *Responses to questions on notice, no 6*, 18 January 2011, p 1.

26 ANZ Bank, *Responses to questions on notice, no 11*, 31 January 2011, p 1.

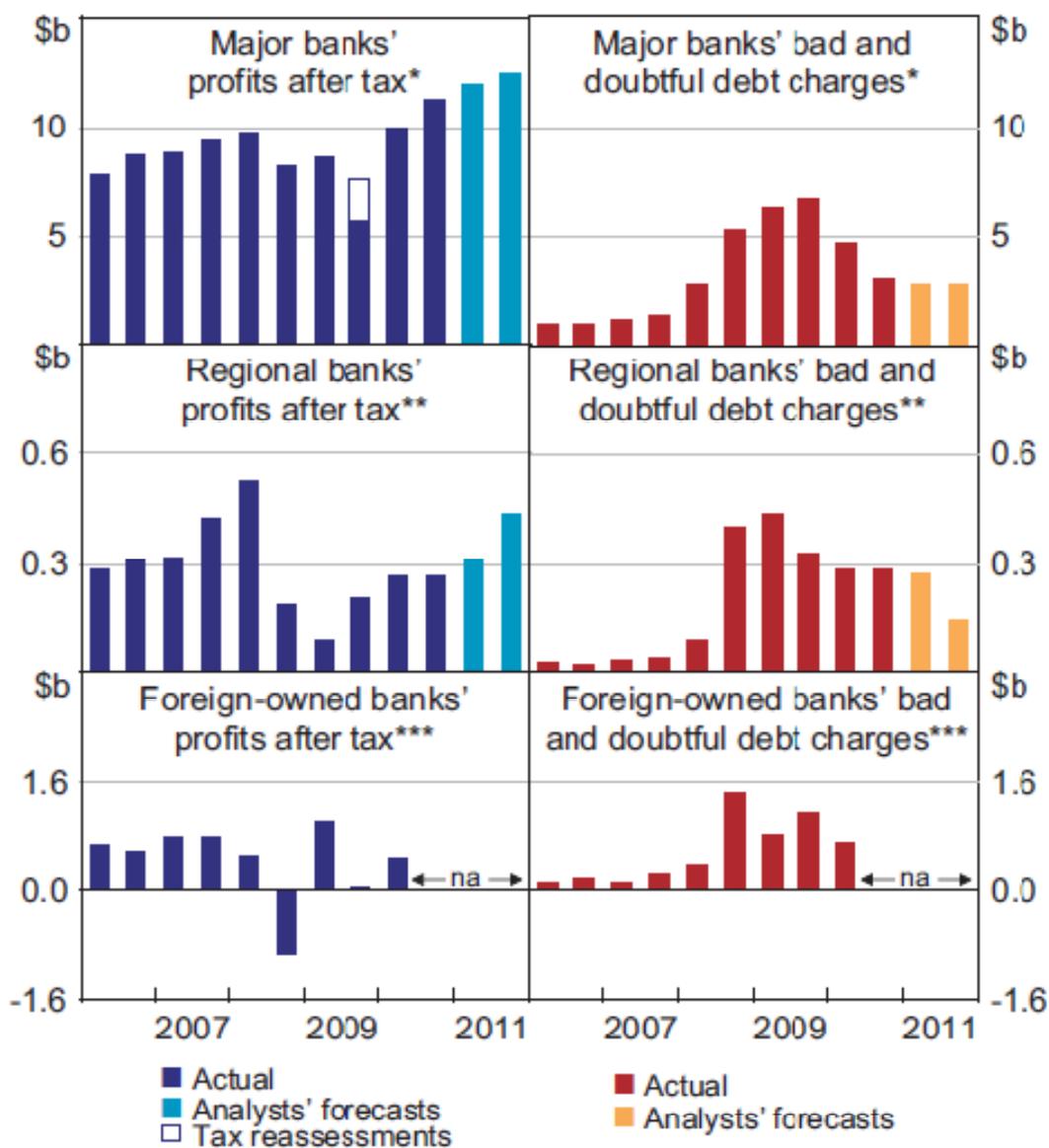
27 UK House of Commons Treasury Committee, *Competition and Choice in Retail Banking*, March 2011, p 23. The issue of banks being 'too big to fail' is discussed in Chapter 11.

28 Professor Tom Valentine, *Proof Committee Hansard*, 25 January 2011, p 60.

4.29 Professor Sathye's interpretation is that banks':

...profit margins have gone up significantly. These statistics, which are calculated from APRA's statistics, show that there is not enough competition in the market.²⁹

Chart 4.3: Profitability of banks operating in Australia



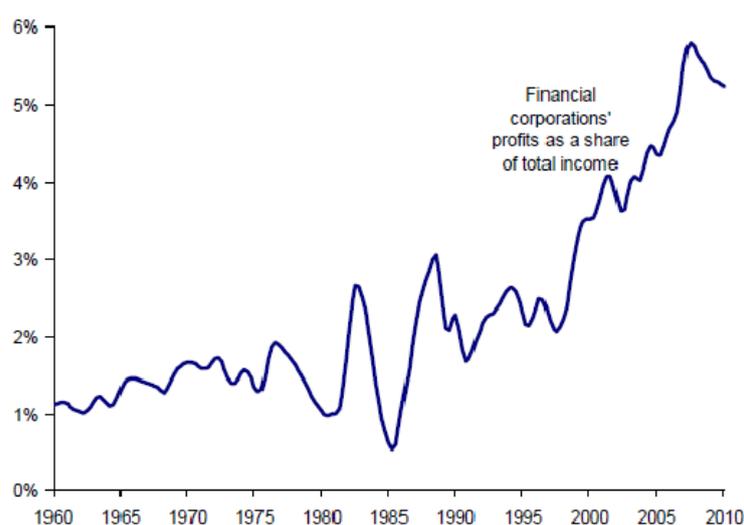
* ANZ, NAB and Westpac report half-yearly to March and September, while CBA reports to June and December
 ** Suncorp Bank, and Bendigo and Adelaide Bank report half-yearly to June and December, while Bank of Queensland reports to February and August
 *** All results are half year to June and December
 Sources: APRA; Citigroup; Deutsche Bank; Morgan Stanley; RBA; UBS Securities Australia; banks' annual and interim reports

Source: Reserve Bank of Australia, *Financial Stability Review*, February 2011, p. 22.

29 Professor Milind Sathye, *Committee Hansard*, 15 December 2010, p 33.

4.30 Over a longer period, it has been noted that the share of national income accounted for by financial institution profits has grown strongly (Chart 4.4).³⁰

Chart 4.4: Financial corporations' profit share



Source: Australian Council of Trade Unions, *Submission 89*, p 5.

4.31 A former Reserve Bank governor has mused:

I, like you, have often wondered why banks are so profitable—and they certainly have been extremely profitable in Australia... They always were very profitable, let's face it. They were very profitable in the regulated phase, and some of us thought that those profit rates would go down in the deregulated phase, as competition heated up. So you can understand why people are very interested in profits and very surprised that profits or rates of return on equity have remained so high.³¹

4.32 Other submitters put the view probably held by a significant share of the public:

And the only reason our banks are making such huge profits is because they are simply ripping us all off.³²

One does not have to be a rocket scientist to understand that in spite of banking costs rising (a little) for them to borrow, the banks are making Super profits at the expense of their customers.³³

30 The Bank for International Settlements (2010, p 77) show that the financial sector's share of total value added has also increased in other advanced economies but the increase in Australia has been unusually large.

31 Mr Ian Macfarlane, then Governor of the Reserve Bank, *House of Representatives Standing Committee on Economics, Finance and Public Administration Hansard*, 17 June 1999, p 77.

32 Mr Peter Higgins, *Submission 17*, p 4.

33 Mr Michael O'Connor, *Submission 125*, p 1.

4.33 Such comments struck Professor Valentine as unfair:

...bank bashing had little justification...the media and politicians, from both parties I might say, have adopted the approach of the Queen of Hearts in *Alice*—first the verdict, then the trial. In other words, there is no proof to justify the abuse which has been heaped on the heads of bankers. I have said on a number of occasions in a light-hearted way that there seems to be an argument for antivilification laws to protect bankers.³⁴

4.34 The banks justify high profits as necessary to maintain high credit ratings and thereby lower funding costs which they could pass on as lower loan interest rates:

Bank performance measures are critical for a bank to retain a high credit rating – without a high credit rating, the cost to access money and capital markets is higher. If banks have to pay higher rates for money, then individuals and businesses will also pay higher rates to borrow from banks.³⁵

4.35 Professor Sathye is not convinced:

I do not agree with that analysis that more profits mean a better rating or that the credit rating of the banks will be affected if their profits are lower. As a matter of fact, the Canadian banks have lower profits than the Australian banks, but their rating is not affected; their rating is similar to that of Australian banks...a credit rating does not depend exclusively on the profits that the banks make. A credit rating takes into account a number of factors, and those factors are basically the prudential standards in Australia and the asset qualities of banks.³⁶

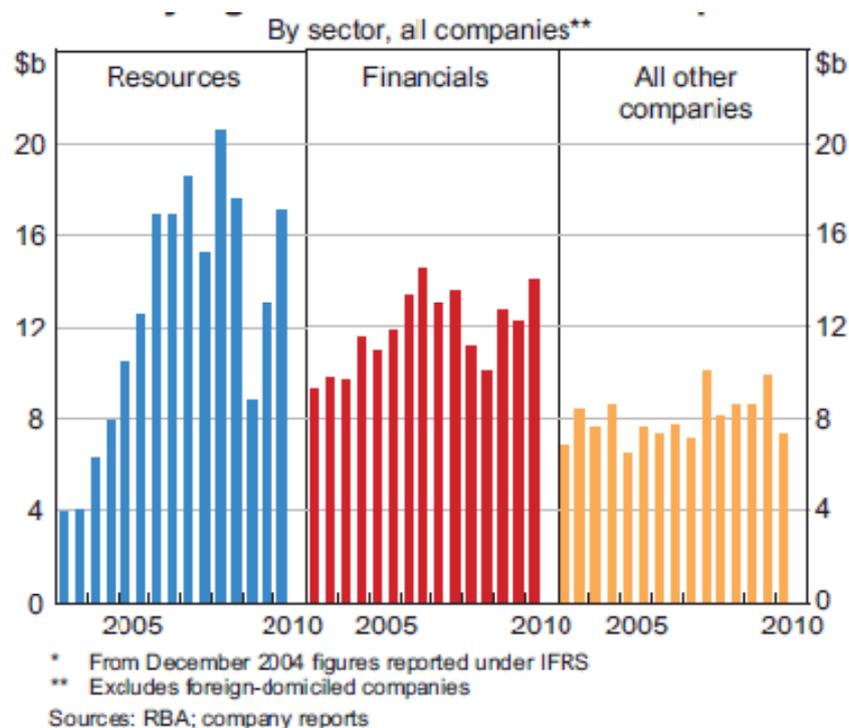
4.36 Another perspective comes from comparing profits in the financial, resources and other sectors. Around 2005 these were broadly the same in aggregate. Now the resources and financial sectors' profits are well above the other sector (Chart 4.5).³⁷

34 Professor Tom Valentine, *Committee Hansard*, 25 January 2011, p 60.

35 Australian Bankers' Association, *Submission 76*, p 21.

36 Professor Milind Sathye, *Committee Hansard*, 15 December 2010, p 39.

37 The Committee's attention was drawn to this chart by Mr Nick Behrens, General Manager, Policy, Chamber of Commerce and Industry Queensland, *Proof Committee Hansard*, 4 March 2011, p 61.

Chart 4.5: Underlying profits of ASX 200 Companies

Source: Reserve Bank of Australia, *Statement on Monetary Policy*, November 2010, p 49.

Measures of return on equity

4.37 A related measure is banks' return on equity. The Governor of the Reserve Bank remarked to the Committee:

I would assess the current state of profitability of the majors as good. They are earning quite a healthy rate of return on their equity...³⁸

4.38 The Bank commented more recently:

As the major banks' profits have recovered, their average return on equity has increased to near pre-crisis levels, at almost 15 per cent in 2010. Analysts are forecasting a further small rise in 2011.³⁹

4.39 The Governor mused that this issue could become more telling in the future:

There are arguments about whether in the fullness of time—in a new regulatory world where banks, particularly globally, hold a lot more capital and are inherently therefore less risky— equity holders ought to expect a

38 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Committee Hansard*, 13 December 2010, p 9.

39 Reserve Bank of Australia. *Financial Stability Review*, March 2011, p 22.

lower rate of return because of a lower risk profile. That is quite an interesting question...⁴⁰

4.40 A banking analyst pointed out that the Australian banks' return on equity in 2010, of 16 per cent, is the same as their average return on equity over the past thirty years, and lower than many other large Australian companies.⁴¹ National Australia Bank said that the GFC had reduced its return on equity from around 16 per cent to 13 per cent and:

...13 to 16 does not represent an excess by Australian return standards.⁴²

The returns on equity and returns on assets over the last 10 years of the "big 4" are substantially lower than, for example, those of Woolworths or Telstra. Yet, their businesses are much more risky and hence demand a higher level of return.⁴³

4.41 One response to this is that the largest Australian non-bank companies include Telstra, the supermarket duopoly and large mining companies, all of which could be argued to be themselves operating in uncompetitive industries where supernormal profits may be earned.

4.42 Another response is to question the claim that banking is a risky business.⁴⁴ One indicator that banking in Australia is a relatively low-risk industry is that the major banks' return on equity has only once turned negative in the past thirty years and only twice dropped below 10 per cent (Chart 4.6). The explicit guarantees that government have provided (see Chapter 12) and the view that governments regard them as too big or important to be allowed to fail (see Chapter 11) are other factors that should lead investors to regard bank shares as lower risk.

4.43 In turn this low risk should imply that banks do not need to earn as high a return on equity as other companies to attract capital:

Profit levels are very strong and have increased in the last year or so after benefiting from government support. The fact that the government reduces bank shareholder risk would suggest that earnings should be closer to say 10 per cent return on equity rather than the 15 to 20 per cent currently being achieved.⁴⁵

40 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Committee Hansard*, 13 December 2010, p 11.

41 Mr Jonathan Mott, Bank Analyst, UBS Securities Australia, *Committee Hansard*, 14 December 2010, p 144.

42 Mr Cameron Clyne, Chief Executive Officer, National Australia Bank, *Committee Hansard*, 13 December 2010, p 59.

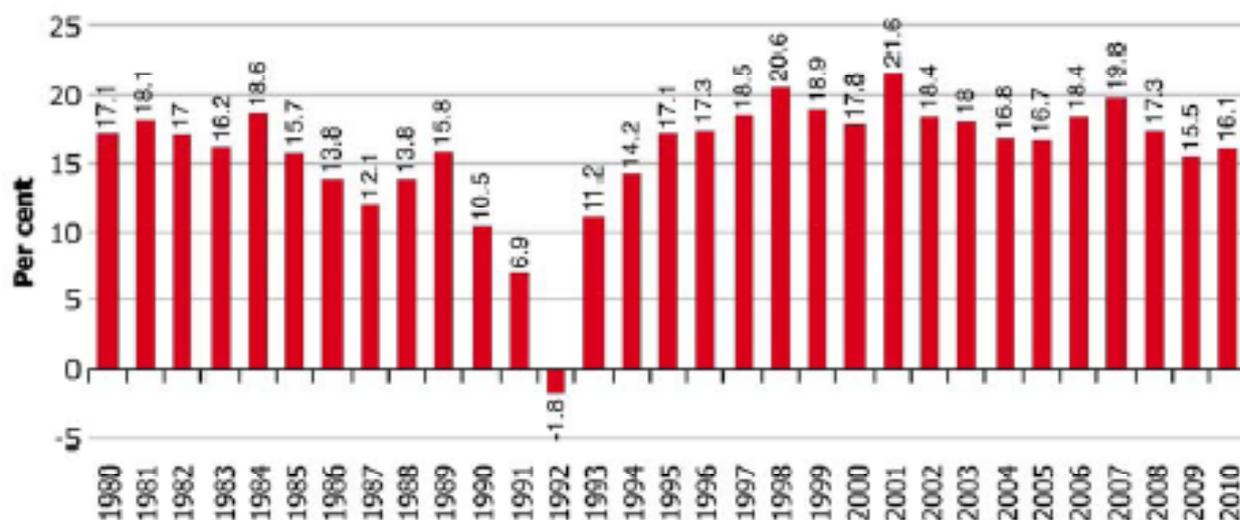
43 Mr George Ivanov, *Submission 124*, p 2.

44 ANZ Bank claims that banking is risky as banks are highly-geared organisations; *Responses to questions on notice, no 11*, 31 January 2011, p 2.

45 Master Builders' Australia, *Submission 38*, p 6.

Chart 4.6: Major Australian banks' return on equity

MAJOR AUSTRALIAN BANKS' RETURN ON EQUITY

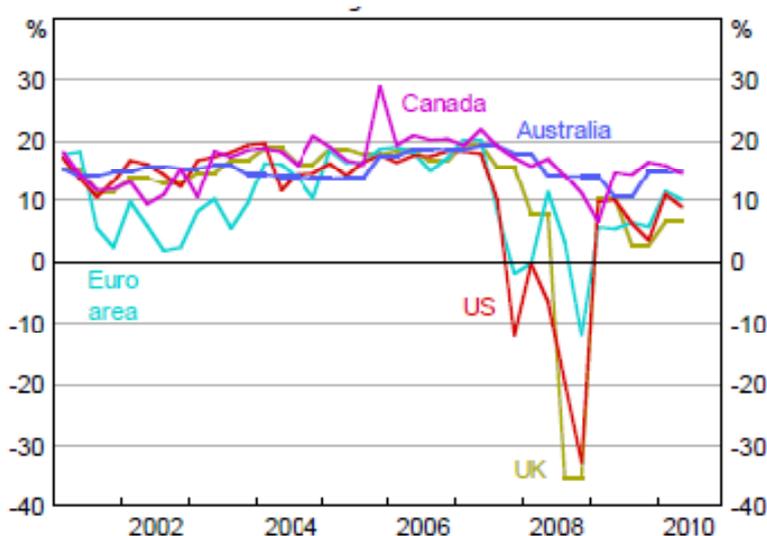


Source: Company data, UBS

Source: Westpac, *Submission 72*, p 27.

4.44 Australian banks' return on equity was similar to that in comparable countries in the years before the GFC. The difference since then has been that Australian (and Canadian) banks had only modest dips in returns, while European and US banks as a group incurred large losses (Chart 4.7).

Chart 4.7: Large banks' return on equity



* Six largest US banks, ten largest euro area banks (including Switzerland), five largest UK banks, four largest Australian banks and four largest Canadian banks.

Sources: Bloomberg; Banks' financial reports; RBA

Source: Reserve Bank of Australia, *Submission 41*, p 25.

4.45 Professor Sathye reports:

If you look at the profit data of the banks, the average return to shareholders in Australia over the last five years has been something like 9.5 per cent, which is probably the highest in the OECD countries...⁴⁶

4.46 Professor Valentine defended the returns earned by banks:

...nobody I have seen has presented evidence of excess returns over any reasonable period of time.⁴⁷

4.47 Treasury made a simple but telling observation on the adequacy of banks' returns:

I do not see anyone withdrawing from the market because of lack of profitability.⁴⁸

Interest margins

4.48 For a long time before the global financial crisis, banks' margins had been decreasing (Charts 4.8 to 4.11 and 5.1). The main forces driving down margins were the impact of deregulation and increasing competition from former building societies, foreign banks and non-bank mortgage lenders.

4.49 There were also some other forces at play:

A large and efficient mortgage broker network had established itself. By the middle of the [1990s] decade, 30% of all housing loans were being originated through brokers. The second factor contributing to competition was the enhanced use of the Internet. The Internet reduced search costs for prospective housing loan borrowers, enabling them to more easily compare loan products online, including fees and charges...The third factor was greater focus by foreign-owned subsidiaries on Australia's retail banking markets.⁴⁹

The sustained downward pressure on the net interest margin is one of the clearest, long-term economy-wide benefits of the deregulation of the Australian financial system...Competitive pressures from non-prudentially regulated lenders and new bank entrants in the period since 1995 also played a role in the fall in the net interest margin. New technologies that permitted a lowering of the industry's operational costs would also have played a part.⁵⁰

46 Professor Milind Sathye, *Committee Hansard*, 15 December 2010, p 34.

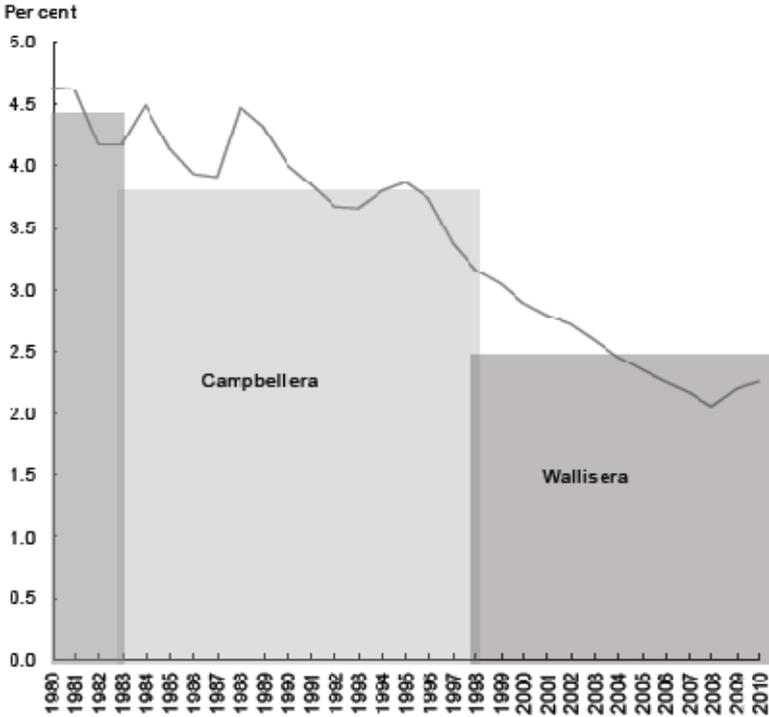
47 Professor Tom Valentine, *Committee Hansard*, 25 January 2011, p 61.

48 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury, *Proof Committee Hansard*, 9 March 2011, p 11.

49 Australian Bankers' Association, *Submission 76*, p 26.

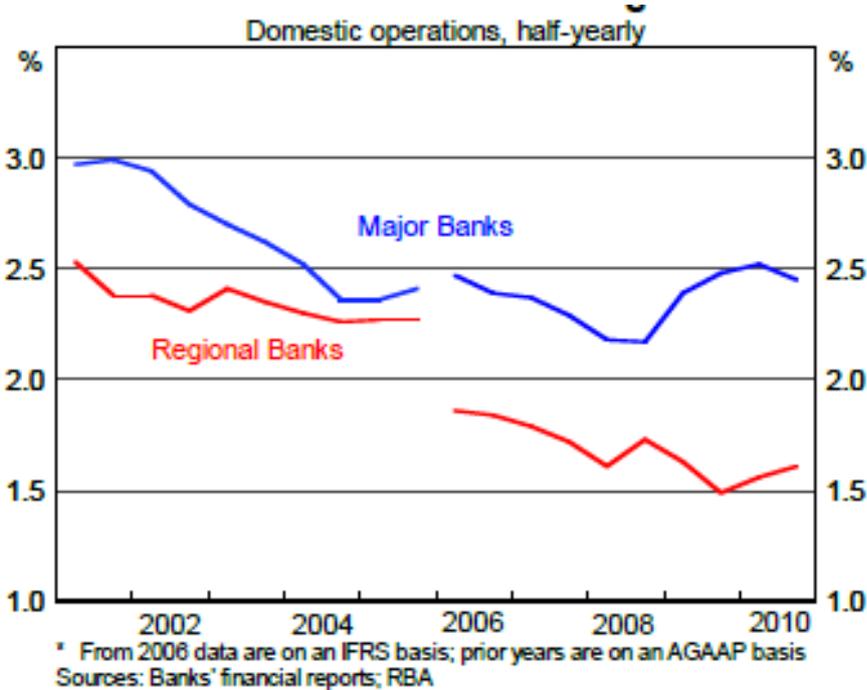
50 Then Treasury Secretary Dr Ken Henry (2011, p 21).

Chart 4.8: Bank net interest margins



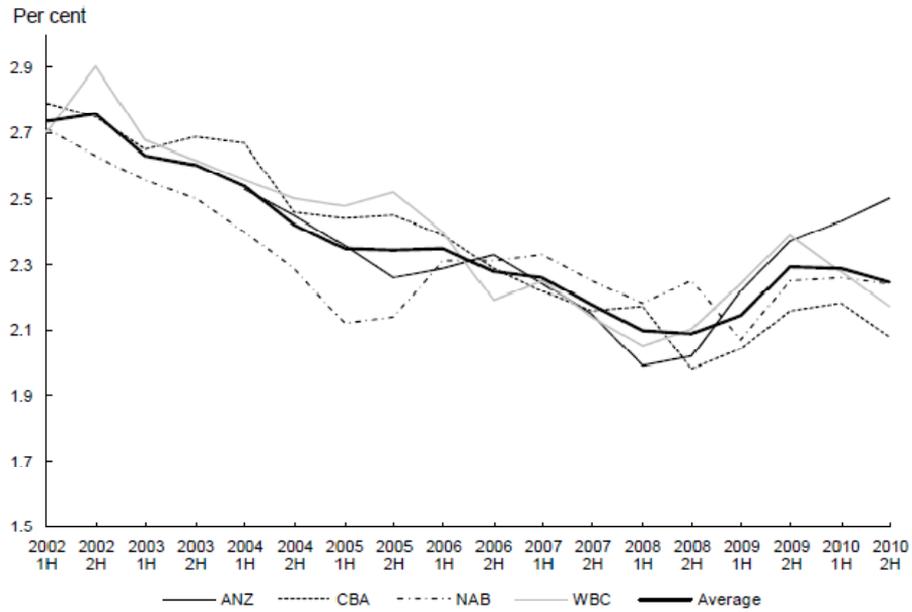
Source: Department of the Treasury, *Submission 102*, p 15.

Chart 4.9: Banks' net interest margin



Source: Reserve Bank of Australia, *Submission 41*, p 20.

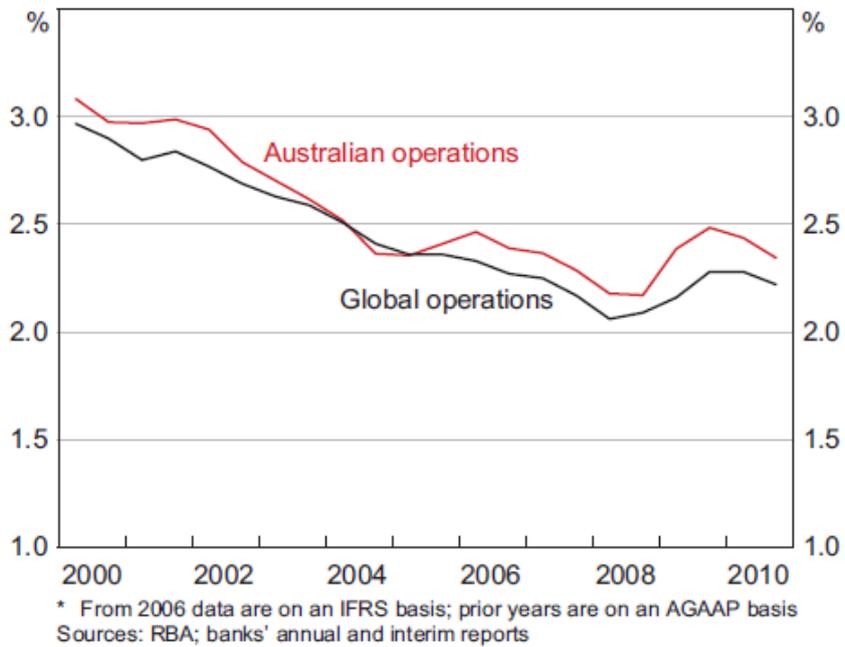
Chart 4.10: Net interest margins – four major banks



Source: Major banks' financial disclosure documents. Notes: Data is half yearly. Calculated as net interest income to average total interest earning assets on a group basis. ANZ data unavailable prior to 2004.

Source: Treasury, *Submission 102*, p 16.

Chart 4.11: Major banks' net interest margin



Source: Reserve Bank of Australia, *Financial Stability Review*, March 2011, p 23.

4.50 A recent econometric study by Kirkwood (2010) attempted to quantify the contributions to the reduction in margins, finding that about two-fifths was due to a decline in operating costs and one-fifth due to competition from mortgage originators.

4.51 Since the global financial crisis, however, the interest margins of the major banks in Australia have widened (Charts 4.9, 4.10 and 4.11). This broad pattern was common to all four major banks (Chart 4.10) and to both their domestic and foreign operations (Chart 4.11).

4.52 There are differing interpretations of this. One view is that there is just a bit of random variation in recent years and the underlying margins have been fairly steady for a number of years.⁵¹

4.53 An alternative interpretation is that margins have started to rise as competitive pressures have eased:

The reduction in banking competition has enabled banks to increase their margins at the expense of both mortgage holders and business customers.⁵²

...the period between 2000 and 2007 when we had very intensive competition as demonstrated by the reduction of net interest margins during that period. We had St George, BankWest, Aussie Home Loans, RAMS and Wizard and those players provided intense competition that did keep the big four banks honest. With the removal of those competitors...you saw the ability of the four big banks to start increasing their net interest margins...⁵³

4.54 A third interpretation, put by the banks themselves, is that:

From the beginning of 2007 we saw wholesale funding, particularly international funding and short-term funding, increase in price significantly. For the first six months of that the banks absorbed that cost and that will have had an impact on their margins, so we have had a bit of a dip, if you like. Banks then started to pass some of those costs on, but they also started to reprice for risk, which will cause an increase in the net interest margin.⁵⁴

4.55 APRA emphasised the latter factor:

...it is generally agreed that risk was not being adequately priced in the global banking system in the lead-up to the global financial crisis so some repricing of assets (and hence widening of margins) was to be expected and was prudent.⁵⁵

51 See Australian Bankers' Association, *Submission 76*, p 16 and ANZ Bank, *Submission 94*, p 15.

52 Australian Chamber of Commerce and Industry, *Submission 37*, p iii.

53 Associate Professor Frank Zumbo, *Committee Hansard*, 14 December 2010, p 52.

54 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 14 December 2010, p 94.

55 Australian Prudential Regulation Authority, *Responses to questions on notice*, no 6, 31 January 2011, p 1.

4.56 The Committee asked the Reserve Bank for their analysis. They replied that 'the early stages of the financial crisis saw funding costs rise more quickly than lending rates' and 'the small increase in margins following their trough in the financial crisis is likely partly to reflect the removal of those temporary factors'.⁵⁶

4.57 They add that margins can be also be affected by other factors such as:

- higher risk margins on lending, which have been encouraged by supervisors, will have boosted net interest margins (given these do not adjust for either expected or actual losses of principal);
- an increase in the amount of equity funding is likely to have boosted banks' margins (equity is a non-interest bearing liability that increases a bank's interest earnings);
- derivatives to hedge interest rate risk can have a substantial effect on banks' margins over short periods of time; and
- some institutions may have shifted the balance between fee and interest income.⁵⁷

4.58 The Treasury Secretary was more agnostic:

Over the last two years, the net interest margin has increased from 2¼ percentage points to 2½ percentage points – back to 2005 or 2006 levels. It is too early to judge whether this post-GFC widening can be explained fully by a lessening of competition, but it does provide a case for close examination of the factors affecting competition.⁵⁸

4.59 The interest margins are wider for the major banks than the regional banks (Chart 4.8). Asked about possible reasons for this, the Reserve Bank replied:

The higher credit ratings of the major banks allow them to raise wholesale debt on less expensive terms than the regional banks.

Differences in the composition of the different banking sectors' assets and funding liabilities.

- While deposit liabilities comprise a greater share of the major banks' funding liabilities than they do for regional banks, relatively expensive term deposits make up a considerably greater share of regional banks' funding liabilities (28 per cent) compared with the major banks' funding liabilities (20 per cent). This would be offset, somewhat, by the fact that the regional banks have a greater share of equity funding.
- Lower margin household lending makes up a greater share of the regional banks' assets than it does for the major banks' assets.

56 Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 1.

57 Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 2.

58 Then Treasury Secretary Dr Ken Henry (2011, pp 21-22).

Likewise, regional banks are relatively underweight in the credit card market, a relatively high-risk and high-margin product.

Moreover, different banks can offer customers different fee and interest rate combinations. Consequently, one institution might report a higher net interest margin but lower fee income than its competitors.⁵⁹

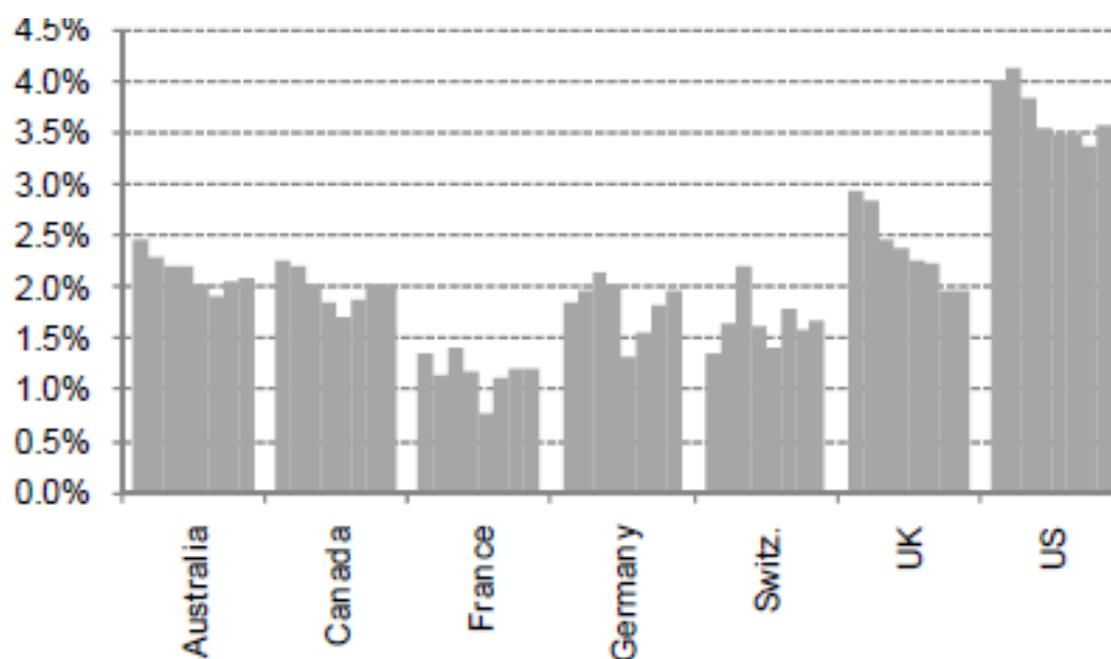
4.60 The ANZ's explanation was:

...the relative dominance of higher yielding (and higher risk) business segment on the books of the majors...[and] the higher credit ratings of the major banks which affords lower wholesale funding costs.⁶⁰

4.61 The Commonwealth Bank distinguished between margins on its household lending, which it claims have continued to shrink, and margins on business lending, which have expanded as risk is repriced.⁶¹

4.62 The net interest margins in Australia are within the range of comparable countries (Chart 4.12).

Chart 4.12: International bank net interest margins (2004-2010)



Source: Australian Bankers' Association, *Submission 76*, p 17.

59 Reserve Bank of Australia, *Responses to questions on notice, no 6*, 18 January 2011, p 2. See also Henry (2011, p 22).

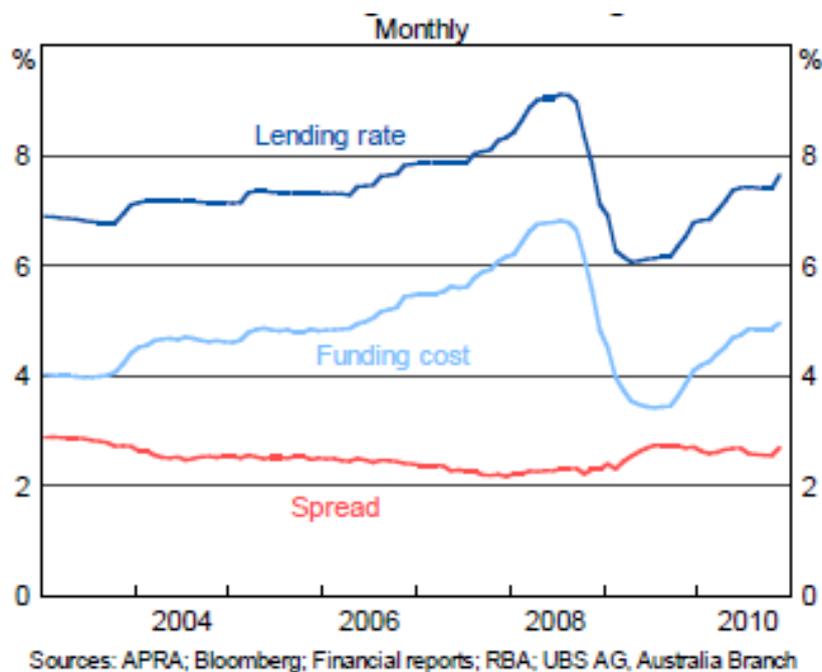
60 ANZ Bank, *Responses to questions on notice, no 11*, 31 January 2011, p 2.

61 Mr David Craig, Chief Financial Officer, Commonwealth Bank of Australia, *Committee Hansard*, 15 December 2010, p 55.

Interest spreads

4.63 Closely related to the interest margin is the interest spread; the difference between average lending rates and average funding costs (Chart 4.13). On the Reserve Bank's calculations, this has also widened somewhat since the GFC after a long period of narrowing.

Chart 4.13: Major banks' interest spread



Source: Reserve Bank of Australia, *Submission 41*, p 21.

4.64 The differences between the margin and the spread reflect an increased share of liquid assets and the fall in interest on them compared to loans, increases in arrears and bad debts, derivatives transactions and increases in equity.

Bank fees

4.65 As well as interest margins, banks make profits from fees and so the size of these fees is also pertinent to considerations of competition. Banks' fee income from households rose to \$5 billion in 2009, as higher fees on loan accounts more than offset a drop in fees on deposit accounts (partly reflecting the ATM fee reforms discussed in Chapter 14).

Table 4.4: Banks' fee income from households (\$ billion)

	<u>2007</u>	<u>2008</u>	<u>2009</u>
Housing loans	1.0	1.1	1.2
Personal loans	0.4	0.5	0.6
Credit cards	1.2	1.3	1.4
Deposits	1.8	1.9	1.7
Other fees	0.1	0.1	0.1
Total	4.5	4.9	5.0

Source: Reserve Bank of Australia, 'Banking fees in Australia', *Reserve Bank Bulletin*, June quarter 2010, p. 33.

4.66 The Reserve Bank explained:

One of the forces influencing the structure of bank fees was the increased competition from mortgage originators in the mid 1990s. As interest margins came under downward pressure, banks began to unwind the cross-subsidies that had existed between mortgage and deposit accounts. One specific outcome of this was that banks introduced periodic mortgage and account servicing fees. While, in aggregate, consumers of banking services benefited from this process, the consumers of the financial services that had previously been heavily subsidised were worse off...More recently, the financial crisis has had two opposing effects on bank fee income. First, more aggressive competition for deposit funding saw banks reduce and remove exception fees on deposit and transaction accounts for both business and personal customers. Second, there was a repricing of credit and liquidity risks on loans and bank bill facilities, which led to increased fees, particularly on undrawn loan facilities held by businesses. In particular, the total banking fee income reported by the major banks in their 2010 financial results indicated a 4 per cent decline in fee income.⁶²

4.67 A widely cited estimate by Fujitsu Consulting is that:

Australian households are likely to be paying close to \$1,000 for their banking services, assuming they have a full range of products and services and typical transaction patterns, compared with \$749 in the UK and \$850 in the USA.⁶³

4.68 The assumption that all households pay for a full range of services, however, is not realistic. The Reserve Bank data suggests that the average household pays about \$500 -- half Fujitsu's estimate -- for bank fees (the \$5 billion in Table 4.4 divided by

62 Reserve Bank of Australia, *Submission 41*, p 22.

63 Fujitsu Consulting, *Australian Bank Fee Survey 2009*, p. 6.

around 10 million households). Given this, not too much weight should be placed on Fujitsu's comparison between fees in Australia and overseas.

4.69 Bank fees may fall disproportionately on the poor:

Wealthy consumers (people with mortgages, people with term deposits or other investments, and members of professional associations) all receive generous fee exemptions and no attempt is made to recover the costs of individual transactions from such customers. This means that poorer customers who do pay fees subsidise their wealthier counterparts on a per transaction basis, although the banks would argue that they still make more income from their wealthy customers through their other business with the bank, despite the lost fee revenue.⁶⁴

Table 4.5: Unit fees on credit cards (\$)

	<u>2007</u>	<u>2008</u>	<u>2009</u>
Annual fees for no-frills cards	48	49	52
Cash advance fee at own bank's ATM	1.4	1.4	1.2
Cash advance fee at other banks' ATM	1.6	1.6	1.4
Late payment fee	31	31	31
Over limit fee	30	30	30

Source: Reserve Bank of Australia, 'Banking fees in Australia', *Reserve Bank Bulletin*, June quarter 2010, p. 34.

4.70 National Australia Bank took a strategic decision to cut fees which were damaging its reputation:

We were the first and only bank to completely abolish exception fees, which drove 50 per cent of complaints into the bank. We were the first and only bank to abolish account-keeping fees, which drove significant complaints into the bank. We have abolished mortgage exit fees.⁶⁵

4.71 There are reasons to think that there will be insufficient competition leading to excessive charging of some kinds of fees.

This is because consumers do not expect to pay penalty fees at the time they open an account or take out a loan or credit card, thus they do not negotiate over these terms (even if they are aware of them). Nor, for similar reasons,

64 Chris Connolly, Director, Financial Services Policy Centre, University of New South Wales, 'Do the Poor Pay More?', 2005.

65 Mr Cameron Clyne, Chief Executive Officer, National Australia Bank, *Proof Committee Hansard*, 13 December 2010, p 56.

do they choose one financial product over another based on the amount of penalty fees.⁶⁶

4.72 ASIC has indicated it is considering issuing a regulatory guide on unfair fees in general.⁶⁷ This is discussed further in Chapter 10.

Barriers to entry

Another indicator of the competitiveness of markets is whether there are significant barriers to entry. A number of factors have been suggested as impeding new entrants to the banking markets. From the 1940s to the 1980s there was a simple and decisive one; the government discouraged or would not allow it. But there remain other significant considerations.

Branch networks

4.73 Professor Sathye notes:

...it will be hard, well-nigh impossible, for the new entrant to create a vast network of branches like that of the Big Four. These banks have already developed long-term relationship with customers and it would be hard to make inroads into this strength of the banks. Online financial service provision is a possible alternative and it is being used effectively in the deposit market by some of the banks such as the ING Direct.⁶⁸

Low interest deposits

4.74 The existing banks, particularly the majors, have the advantage of a legacy of low or no interest deposits:

Those wondering about the absence of competition in retail banking might consider the impossibility of any new player building a substantial transaction deposit base on which no interest is paid: it is just not on...⁶⁹

4.75 The implicit bargain of low interest on deposits in exchange for free services has been very tax effective for banks and their customers (albeit paid for by taxpayers in general and by bank customers in the form of a less efficient banking system). One estimate puts the lost tax revenue at around \$3 billion a year.⁷⁰

66 Consumer Action Law Centre, *Submission 87*, p 22.

67 *ASIC Consultation Paper*, no 135. ASIC has already issued *Regulatory Guide 220* on mortgage exit fees, discussed further in Chapter 7.

68 Professor Milind Sathye, *Submission 28*, p 11.

69 Mr Peter Mair, *Submission 2*, p 8.

70 Mr Peter Mair, *Submission 2a*, p 2.

4.76 It has also made it harder for new entrants to compete. This may be gradually changing as banks have to compete more for deposits and electronic transactions erode the value of free services.

Financial planners

4.77 A submitter argued:

...the four major banks now control a significant share of the financial planning market. This market share is increasing through the banks offering consumers “free” financial plans. Over the years, I have seen a number of these plans prepared by various banks for my clients. They all have one feature in common: the products recommended are always those of the relevant bank or its associated insurance / managed funds arms.⁷¹

Bundling

4.78 Bundling of products may also be a problem:

Banks also make it almost impossible to get a loan unless you have all your banking with that bank, and this reduces competition. There should be no coercion or otherwise to get a loan other than on its merits, and not whether you bank with them.⁷²

Bank providers can bundle housing loans, with personal loans, with credit cards, and transaction accounts, in such a way as to provide a strategic commercial advantage, whilst at the same time leveraging potential clients in relation to wealth management and personal risk insurances, as well as general insurances.⁷³

...if one financial institution chooses to bundle their account services together and give you a special rate on your mortgage because you take other accounts with them, for example. I think it has been indicated to the committee already that that is the kind of thing that is a brake on moving.⁷⁴

There should be a possibility for a mono-line new market entrant to compete in one segment.⁷⁵

Bank bundling of products and stickiness of relationship result in customers being less price sensitive. Customers who choose to have several transaction accounts or products with an institution have a greater propensity to stay with that institution.⁷⁶

71 Mr Suryan Chandrasegaran, *Submission 4*, p 3.

72 Mr Murray Withers, *Submission 99*, p 1.

73 Mr Mervin Reed, *Submission 5*, p 3.

74 Mr Christopher Hamilton, Chief Executive Officer, APCA, *Committee Hansard*, 21 January 2011, p 33.

75 Mr Jost Stollmann, Chief Executive Officer, Tyro Payments, *Committee Hansard*, 21 January 2011, p 39.

76 Aussie, *Submission 39*, p 3.

4.79 Westpac's CEO referred to bundling as a factor further limiting competition between their Westpac and St George brands:

...typically, customers do not do that [bank with both Westpac and St George]...It may be that they have other products and services as well,... typically, people do not only move for price.⁷⁷

Advertising

4.80 The sheer size of the major banks allows them to spend enormous amounts on advertising which most new entrants could never match. The four major banks spend over \$1 billion a year on advertising.⁷⁸

Perceived safety and size

4.81 A survey showed that 19 per cent of customers believe a larger bank is safer.⁷⁹ This may partly explain why 43 per cent of the customers of the big four banks have never even considered switching to a smaller bank or credit union.⁸⁰

Attitude of ratings agencies

4.82 As discussed further in Chapter 9, the behaviour of ratings agencies, which exert an important influence on the cost of funds for financial intermediaries, may exacerbate the tendency for concentration by favouring larger entities.

Regulatory change

4.83 The major banks may be best placed to cope with regulatory change:

Australia's largest domestic banks once more have an advantage in their ability to find, in their domestic scale, immediate resources for the process changes, system changes, compliance and administration that new regulations may require. A recent example of legislation with the potential to inadvertently reduce competition in Australian financial services was the *National Consumer Credit Protection Act*, as it related to the provision of merchant point of sale credit. While fully supportive of the principles behind the reform, the burden of compliance requirements would have disproportionately disadvantaged HSBC and other affected credit card providers.⁸¹

...increased regulation of the banking sector may have the unintended consequence of placing a higher burden of compliance and increased costs on the smaller banks in comparison to the major banks. It is often

77 Ms Gail Kelly, Chief Executive Officer, Westpac, *Committee Hansard*, 21 January 2011, p 81.

78 Australia Institute, *Submission 46*, p 3.

79 Australia Institute, *Submission 46*, p 4.

80 Fear et al (2010, p 21).

81 HSBC, *Submission 107*, p 6.

fundamentally more expensive for smaller players to comply with new legislation, if that compliance relies on system based solutions. The fixed cost of developing these solutions does not vary greatly in relation to the size of an institution, therefore the unit cost of compliance falls as the scale of business increases.⁸²

Cross-subsidies

4.84 It has been suggested that the size and diversity of the four major banks allows them to cross-subsidise areas where competitive pressures arise to see off new entrants:

The major banks have a massive ability to cross-subsidise one area for another.⁸³

4.85 Cross-subsidising is undesirable on efficiency grounds as well as its implications for competition:

...one segment of customers subsidising another...if sustained for long periods of time, ... will impact on resource allocation in the different customer bases and therefore asset allocations in our economy.⁸⁴

Credit reporting

4.86 Limitation on credit reporting under the *Privacy Act 1988* has been mentioned as an impediment to new entrants:

Australia is one of only a handful of OECD countries restricting credit reports to negative information...Negative credit reporting gives established lenders a clear information advantage over new entrants when assessing lending risk. Their large existing customer base gives them broad insight into a consumer's ability to make repayments. In contrast a new lender, having to rely on the limited information available on credit reports, will have significantly less capacity to accurately differentiate high- and low-risk borrowers.⁸⁵

Perceptions of competition

4.87 The Chamber of Commerce and Industry Queensland surveyed its members and almost 90 per cent agreed that there should be more competition in the Australian banking industry. Asked about their biggest concern relating to the banking industry,

82 Bendigo and Adelaide Bank, *Submission 58*, p 2.

83 Mr David Liddy, Chief Executive Officer, Bank of Queensland, *Committee Hansard*, 9 February 2011, p 19.

84 Mr David Liddy, Bank of Queensland, *Committee Hansard*, 9 February 2011, p 15.

85 Veda Advantage, *Submission 50*, p 3. A similar argument is put by HSBC, *Submission 107*, p 5 and Abacus, *Submission 53*, p 31.

'competition' was nominated by 12 per cent and 'difficulty in switching banks' by a further 5 per cent.⁸⁶ (This is not inconsistent with the earlier result; it just reflects many regarding competition as less of a concern than high interest rates and charges.)

4.88 Most Australians believe that the banking market is overly concentrated:

72 per cent of survey respondents said that the big four banks in Australia have too much market power.⁸⁷

4.89 There are also perceptions of collusion:

Additionally this style of advertising currently being deployed by the NAB Bank in saying they have broken up from the other Banks suggests historic collusion on how banks charge consumers fees and set interest rates.⁸⁸

4.90 In some cases, suspicions about banks leads submitters to suggest a return to a policy widely advocated in the past (see Chapter 3) and nationalise the banks:

Parliament could act upon this by nationalizing banks as they cannot be trusted.⁸⁹

Overview of competition

4.91 Witnesses differed on their views of the adequacy of competition. It was unsurprising that the major banks themselves argued there was sufficient competition. Among more independent witnesses, there were some who seemed comfortable:

I think there is a lot of competition in the market.⁹⁰

4.92 The Governor of the Reserve Bank distinguished between competition in deposit and loan markets:

Four years ago the competition was all in lending money. There was very intense competition to lend. But now there is very intense competition to raise money on the part of financial institutions.⁹¹ Other things have happened as well that affect the competitive landscape, but this is a very fundamental change in the state of the world. That said, the market, I think, remains more competitive than it was in the mid-nineties and borrowers have access to a larger range of products than they once did. The overall

86 Chamber of Commerce and Industry Queensland, *Submission 43*, pp 3 and 16.

87 Fear et al (2010, p iv).

88 Finance Brokers' Association of Australia, *Submission 133*, p 3.

89 Mrs Kay Robinson, *Submission 119*, p 3.

90 Associate Professor Selwyn Cornish, *Committee Hansard*, 13 December 2010, p 116.

91 The Governor later explained that the increase in competition for domestic deposits is related to the increased cost of raising wholesale funding offshore; *Committee Hansard*, 13 December 2010, p 10.

availability of finance to purchase housing, in particular, seems to be adequate.⁹²

4.93 A similar point was made by the CEO of ANZ Bank:

...the nature of competition has changed. Competition in the deposit market has never been so intense. Deposit rates have been bid up as financial institutions compete for stable sources of funds.⁹³

4.94 The Governor of the Reserve Bank referred to cycles in competition:

Competition is cyclical, to some extent. Competition is at its most intense usually around the peak of the business cycle when the risk that everybody is taking on is actually much greater than they think. Subsequently, the nature of those risks become clearer and people retreat from risk taking and the competition to lend...abates considerably and the competition to raise funds and shore up balance sheets gets much stronger.⁹⁴

Multi-brand banking

4.95 Perceptions of competition may be affected by multi-brand banking. Westpac explained their strategy:

...our strategy is one of offering customers choice through our multi-brand model, our key retail brands being Westpac, St George, Bank SA and RAMS. Each designs and implements their own customer strategies and plans. They have different marketing approaches, and it has become increasingly clear to us that they attract different types of customers.⁹⁵

4.96 At one point in her testimony, the Westpac CEO claimed the two brands are 'competing against each other for customers'.⁹⁶ But she had earlier conceded that the branches branded as St George do not compete with those branded as Westpac:

...customers who choose St George are not the customers who would choose Westpac. There is very little overlap there.⁹⁷

4.97 She claimed that St George caters for customers wanting a certain type of banking experience:

92 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Committee Hansard*, 13 December 2010, p 2.

93 Mr Michael Smith, Chief Executive Officer, ANZ Banking Group, *Committee Hansard*, 15 December 2010, p 117.

94 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Committee Hansard*, 13 December 2010, pp 9-10.

95 Ms Gail Kelly, Chief Executive Officer, Westpac, *Committee Hansard*, 21 January 2011, p 65.

96 Ms Gail Kelly, Westpac, *Committee Hansard*, 21 January 2011, p 81.

97 Ms Gail Kelly, Westpac, *Committee Hansard*, 21 January 2011, p 80.

...they see it as warm and friendly. It is down to earth. It is straightforward. It is community orientated. It is local. It is very grassroots. It is people based. It has a human-touch element to it.⁹⁸

4.98 This raises questions about what type of bank Westpac customers must be seeking.

4.99 Questioned about advantages to customers, the Westpac Group's CEO suggested:

...St George has the benefit of now being part of an AA-rated bank with a stronger capital base, which means that it can price products in an improved way...⁹⁹

4.100 Having a AA rating undoubtedly allows a bank to raise wholesale funds more cheaply. Whether this is passed on to customers is much less clear. Before the merger, home loan interest rates from the higher rated Westpac were not less than those from the lower rated St George. Currently, the Committee observed that lower rated entities such as Credit Union Australia are offering home loans at lower interest rates than the higher rated major banks.¹⁰⁰

4.101 It is important to note that among the conditions imposed by the Treasurer in approving Westpac's acquisition of St George in October 2008 was that Westpac would be required to retain all Westpac and St George retail banking brands including Bank SA, and maintain the existing number of Westpac and St George branches and ATMs, for a period of three years.¹⁰¹

4.102 A couple of months after her appearance before the Committee lauding the St George brand, Westpac's CEO announced that the St George branches in Victoria would be replaced by branches reviving the name of Bank of Melbourne.

4.103 Other submitters saw the multi-brand strategy as designed to 'create an illusion of more competition than actually exists'.¹⁰²

4.104 Some submitters felt it was potentially misleading for large banks to market themselves under multiple brands, and called for:

...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.¹⁰³

98 Ms Gail Kelly, Westpac, *Committee Hansard*, 21 January 2011, p 80.

99 Ms Gail Kelly, Westpac, *Committee Hansard*, 21 January 2011, p 86.

100 Credit Union Australia, *Tabled document, no. 8*, 25 January 2011.

101 The Hon. Wayne Swan MP, 'Proposed acquisition of St George Bank Limited by Westpac Banking Corporation', *Media release*, 23 October 2008. See also Senate Economics References Committee, *Report on Bank Mergers*, September 2009, pp 57-60.

102 Abacus, *Submission 53*, p 7.

Banking competition in regional areas

4.105 Banks may not be competing to provide a good service in remote areas. One bank admitted:

...the banks, 10 years ago, clearly broke a bond of trust with the community when they closed branches. There is no question about that; it was a mistake.¹⁰⁴

4.106 Bendigo and Adelaide Bank, the only bank with headquarters outside a capital city, related the decline in regional representation to the impact of greater competition:

...non-bank mortgage providers in the 1990s...entered the market because they identified that banks were subsidising their other activities by charging relatively higher rates on home loans. By competing on price in the home mortgage market alone, they were able to quickly gain material market share. The banks responded by competing with them on price. As a result...banks were forced to cut costs as revenue shrank. This resulted in bank job losses, branch closures and banking utility being withdrawn from individual communities—many of them based in rural Australia.¹⁰⁵

4.107 They warned of the deleterious effects:

Once a bank left town, people were forced to go to other places to do their banking and, pretty soon, they were doing their shopping in other towns as well. Before too long, most businesses in the towns that lost their banks closed...Some do not have banking services anymore and some do not have a meaningful business presence at all.¹⁰⁶

Committee view

4.108 The Committee note that even during the period of the GFC when the real economy slowed markedly, the profits of the major banks held up well. The returns they offer investors more than match those from other industries, despite the explicit and implicit support they received which makes banking a less risky activity.

4.109 While the Committee prefers banks to be profitable rather than unprofitable, their very high profits are ultimately paid for by households and small businesses. They are also a reflection that competition is not as keen as it should be.

103 Credit Union Australia, *Submission 85*, p 7.

104 Mr Cameron Clyne, Chief Executive Officer, National Australia Bank, *Committee Hansard*, 13 December 2010, p 56.

105 Mr Mike Hirst, Managing Director, Bendigo and Adelaide Bank, *Committee Hansard*, 15 December 2010, p 78.

106 Mr Mike Hirst, Managing Director, Bendigo and Adelaide Bank, *Proof Committee Hansard*, 15 December 2010, p 78.

4.110 The Committee commends the Reserve Bank for the information it publishes on bank profitability in its semi-annual *Financial Stability Review*. Further such information would help inform the public debate.

Recommendation 2

4.111 The Committee recommends that the Reserve Bank publish further regular information on banks' interest margins and returns on equity; and compare these to returns in other industries to allow an assessment of whether risk-adjusted returns in the banking sector are sufficiently high to suggest that competition is inadequate.

