Submission to the Senate Economics Committee

Competition within the Australian banking sector

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Hobart November 2010

My submission follows your terms of reference and is to be considered a private submission.

(a) the current level of competition between bank and non-bank providers:

The present level of competition between bank providers and non-bank providers is extremely limited due to the following factors:

1. Bank providers have a strategic competitive advantage with guarantees provided by the government, interbank borrowing endorsed by the Banking Act, and protection afforded to the banks by control of the settlement system.

   This means non-bank providers are effectively locked out of the electronic funds transmission system, and are unable to settle electronically, and have to deal with their competition being the banks when providing data for settlements.

2. Bank providers are able to access wholesale funds market and the securitisation market and AAA rated level of access and cost of funds, whereas the non-bank providers cannot compete, either on interest-rate margin or more flexible of types of loans, as they do not have access to the same level of funds provision.

   The morphing or generation of a non-bank provider into a bank provider is impossible without government intervention to support the emergence of the non-bank provider as an active competitor on a level playing field to the present larger bank providers.

3. Non-bank providers have an extreme disadvantage as they are not generally approved deposit institutions, and have no access to retail deposits.

   They rely almost completely on wholesale funds market where bank providers have the capacity to take up available funds ahead of the non-bank providers given their government protected and guaranteed credit position.

   Clearly the capital markets are much more prepared to provide support for major Australian banks with bond issues underpinned by a government guarantee, than they are for smaller banks and non-bank providers endeavouring to do the same thing.

4. Non-bank providers are also disadvantaged when it comes to basic competition in relation to bundled product offerings.

   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.

   Non-bank providers generally don't in the main have the capacity to bundle products.

5. Lastly non-bank providers in the commercial mortgage market have to some degree being effectively destroyed following the global financial crisis, by banks withdrawing credit support for their operations, effectively closing mortgage funds by the use of the loan covenants, and operating such covenants in a manner designed to cause long-term impediment to further competition.

   There are reported factual instances where banks have imposed such stringent repayment priorities on mortgage funds and property funds that elderly Australians needing redemption funds on a hardship basis have been denied, with the bank insisting on all funds being repaid to it ahead of all other investors, even after application to the regulator by trustees stating that the funds are fully solvent and in no danger of collapse. In a lot of cases the loans to these mortgage funds and property funds represented only around 15% of the fund capital.

   In summary most of these funds are operating still, with the Banks being paid first and the general public who invested in these funds being left out of the equation.

(b) the products available, and fees and charges payable on those products:

Competitive product in the Australian banking sector is essentially a non-event.

There are basically simple products such as housing loans for residential housing dressed up to appear complex with a number of variations to appear competitive.

Simply put residential housing loans which are full recourse, offer fixed interest, or variable rate interest. Very few housing loans are interest only, and all banks have the same product.

There may be proposed by the banks that there is something different such as an equity line of credit facility, but these are nothing more than interest only loans on residential real estate.

So in fact rather than an ever expanding differential between various banks for loan types and structures they have in fact over the past four or five years been more concentrated, and the product offerings reduced.

The same applies to fees and charges where the fees and charges have expanded to a point where the disclosure to clients on fees and charges amounts to 90% of the paperwork given to customers.

These disclosures on fees and charges provide for the maximum, and generally do not state the minimum. There is not readily clear concise and readable summary.

Equally fees and charges over the term of the loan can be altered by banks without reference to the customer, and not be explained in clear concise terms to the customer.

Advice to customers for periodic changes to personal loans and credit card terms and conditions can generally run to around 2000 to 4000 words. The regulator should be more pro-active in simplifying this in a non legalistic way so that people are able to be better informed as customers. This should be mandated.

The fees and charges on the products available of course vary from bank to bank, but such variations are essentially cosmetic as the proportion of fees and charges as a component of bank profit has been steadily rising over the past four years, and was the subject of much public criticism especially with ATM charges to pensioners and small account holders.

I agree with Sen Bob Brown, Tasmanian Senator for the Greens, who makes the point that bank charges for low income earners is nothing more than a tax on the poor, where the size of the account, and its activity levels, there is no resemblance to the charges applied to it by the bank.

In essence there is no competition on fees and charges between the banks as this is unnecessary in their view, and the disclosure regime for fees and charges on a comparative basis to other providers as required for formal advice under the Corporations Act, is not done and therefore the consumer has no reference point to understand whether the fees and charges represent good value.

There has been the occasional change put into the market place recently evidenced by the NAB, but the end outcome has been a change to the fee base and a reduction or offset in bank costs which even out the net effect for the bank, but not for the consumer.

This is one area of regulatory change that should be addressed so that objective advice is provided to bank customers, and that a comparison from the fees being proposed in the banks letter of offer to the customer, should be compared and contrasted against fees from a least two other competitors in order for the customer to determine fair value. This should be mandated.

(c) how competition impacts upon unfair terms that may be included in contracts:

There is very little chance of a consumer discovering that the terms that are included in the banking contracts are unfair.

There is no mechanism presently in place to regulate bank contracts, nor is there any process by where bank contracts for consumers of any banking product is able to be reviewed by a regulator.

If there are unfair terms included in contracts, then there is no real chance of any consumer action of any meaningful type, being applied against a bank, and generally it has been in the past only when the Federal and High Court has held that certain matters were unfair, that actions have proceeded to provide to the consumer the minimum possible level of correction to meet the requirement of the court. The example here was the proof of income or serviceability requirement from consumers.

A further example of this is the use of "all monies mortgages"by banks where consumers are not advised that the mortgage they sign is not confined to their housing loan debt, but covers all of the debts with a bank of an unsecured nature.

The bank charges more for these other loans, not telling the consumer that the principal debt being housing loan has a security, which allows the bank to recover all loans made to the consumer as well as the housing loan using such a mortgage.

The issue here is that the consumer is not told that the bank is fully secured on what they considered to be unsecured loans and therefore are charged unsecured loan rates and fees, against what is effectively and legally secured lending.

The use of all monies mortgages should be regulated so that if a bank seeks such a mortgage then all bank loans to the customer covered by the mortgage security are charged interest at the rate of the primary mortgage security loan. This should be mandated.

(d) the likely drivers of future change and innovation in the banking and non-banking sectors:

At the present time there is a very little justification for banks with solid balance sheets and large and increasing in profits to proceed with innovation or change that would reduce or mitigate against future profit growth.

The chances of banks for instance providing franchise banking outlets is extremely limited, likewise the chance of banks providing see-through credit lines divided into housing finance, consumer finance, and credit card finance, at the same interest rate as housing loans for a single customer using one account.

The drivers of future change will undoubtedly be competition for the market within Australia the banking.

Given the four pillars policy, essentially a “closed shop” policy endorsed, and supported by the present government, there is no driver for change, nor is there likely to be.

Recent comment by the former head of the ACCC Prof Allan Fels, for there to be changes to the Trade Practices Act to prevent price signaling between banks, is that there is ample of where there is likely to be little change driven by organic means from the banks themselves.

There has been little innovation rolled out to consumers by banks.

The only innovation has been driven largely by credit card companies of an international nature in relation to technology.

The banking sector in Australia has ATM technology years behind their overseas competitors; and is extremely limited in what customers can do with that technology.

No innovation with this technology is possible until fees between various banks ATM Systems are eliminated by legislation, as this fee charged to the customer is an anti-competitive measure used to retain the customer. It also is used to stymie change in the technological base of the electronic marketplace.

If for example the ATM owned by the bank for which to the customer is a client is unserviceable (this not being the fault of the customer) and the customer then uses a competitor bank ATM, a fee is charged. Why? Does not the primary bank of the customer have a fiduciary duty to the customer to provide services to the customer for banking for which they are contracted?

The fee is all out of proportion to the real cost of delivering that service.

It may be possible for this enquiry to seek an analysis by APRA as to the real costs of simple transactions between competing banks ATM’s. The APRA analysis should also review the nightly bank settlements bank to bank to see how the ATM transactions are handled.

Internationally there appears to be very little in the way of cross charging between banks for the use of a teller machine operated by an alternative bank.

Presently, therefore is little incentive for any future technology change from banks to drive down fees and charges to customers. The first step to open up competition would be to ban fee’s being charged for ATM transactions. This should be mandated.

(e) the ease of moving between providers of banking services:

The system of banking in Australia does not provide for this.

There is no system design nor is there any legislation that provides the consumer protection and rights when moving between providers of banking services.

Equally there is no encouragement by way of incentives from banks to attract customers from other banks.

For example there is no monetary incentive by way of interest holidays, free accounts, or permanent low rate credit cards offered. This occurs in other countries to attract customers from like institutions.

Specifically the process of moving from one bank to another is designed by banks to be as difficult as possible in relation to the exit policy for the customer, particularly with charges, fees, and delays.

This is systematically exploited by banks apparently unable to settle exiting customer properties with for example, housing loan transfers, sometimes for many weeks, leaving customers out-of-pocket, sometimes unable to move into properties, and all with a variety of excuses.

Banks are able to settle properties for purchase readily in normal commercial time, but when they are receiving the settlement from outgoing customer this becomes in the main a painful exercise for the customer.

It should be regulated that a bank is required to settle the transfer of a mortgage from one bank to another, within a maximum of 21 days of the date notified by the customer that they are transferring to another bank.

There is no system impediment to this occurring.

Mostly titles for properties exist both electronically and on paper and the exiting customer bank holding the title should be readily able to produce the physical title document, match it with the transfer signed by the customer, and transfer the title to the new lender within this period.

If the bank cannot produce the title within 21 days and affect the transfer for the customer a penalty of perhaps one month's interest expense for each day's delay by the bank be paid to the customer as compensation.

Until there are monetary penalties imposed by government upon banks for the lack of service to customers in regard to transfers between banks in a timely manner, there will be no increase in efficiency and thus ease of transfer.

The other method used by banks to limit competition between themselves is the archaic bank state branch identifying numbering system, which together with the account number, supposedly drives the payment system.

This antique framework was originally designed for the cheque clearance system specifically for Micra Ink readable cheques.

It is readily easily replaced by each customer having a bank account number that becomes the universal number for that person. In other words each Australian citizen can have a number of bank accounts, each with a separate and unique identifying number solely for that person.

The payments system for interbank clearances is readily adaptable to this identifier which would fully replace the bank state branch system of numbering, and thus make it very simple for a client to move banks whilst retaining their account numbers.

Of course the banks will oppose this and provide significant reasons why this can't be done, but it can simply be legislated for with 12 months notice of compliance.

(f) the impact of the large banks being considered “too big to fail”on profitability and competition:

The idea that large bank should be treated any differently to small banks is just a nonsense.

For example recently with a French bank and currency trading losses, the sample of Barings bank and derivative trading losses, the recent example of the Commonwealth Bank and losses by customers for poor advice, the failure of many banks in the United States in the past two years and their absorption by the Federal Banking authorities gives an idea that an impact upon the economy for a bank failure will be relatively minor. The signs of failure would be well identified by the regulator APRA prior to the event.

In any case the only way bank failures can occur is by lack of regulator supervision, and this is evidenced by the causes of the global financial crisis, and the increase of bank regulation by all governments around the world.

In relation to competition in the Australian banking sector and the impact of the four large banks which are undoubtedly large banks in world terms, is that to create a virtual monopoly especially with trading banks, creates an environment where competition is poor.

Further to this, the elimination of large-scale competition by the aggregation of smaller scale lenders and non-bank lenders, including mortgage broking dealers, has seen a concentration of distribution of banking services back to the four big banks and not much else.

There is no barrier specifically in the Trade Practices Legislation to prevent large banks from purchasing distribution systems of the non-banking sector in order to control market segments to a much larger degree, whilst limiting competition.

Such powers should be added to the Trade Practices Legislation in order to promote competition rather than concentration.

(g) regulation that has the impact of restricting or hindering competition within the banking sector, particularly regulation in place during the global financial crisis;

The biggest single regulatory mechanism used to hindering competition within the banking sector is the control by the four major banks of the payments system.

This needs to be deregulated as a matter of some priority to inject competition into the banking sector, to allow the banking sector to grow with smaller banks being able to compete fully, and credit unions and building societies being able to challenge the major banks on margin and thus grow their market share.

A further regulatory mechanism that hinders competition is the limitation on the approval of deposit taking institutions, and the way they can access the wholesale funds market with those deposits.

The regulatory changes introduced by way of government guarantees, during the global financial crisis has indeed entrenched much more deeply the lack of competitive banking operations within Australia. The withdrawal of some international banks operating within the Australian market due to operational priorities in their own home countries, has seen further narrowing of the commercial market.

The movement in the past two years by companies within Australia to raise their own corporate debt outside of the banking system by the issue of corporate bonds, and by companies also seeking equity from their shareholders to retire bank debt, indicates that banks have been less flexible and certainly not focused on business development for the long term.

As well the regulation movement by APRA to change the capital requirements for certain loan book structures of the major banks in Australia, has led to banks seeing commercial lending for buildings and infrastructure, as being of a lower level of importance than their lending book for housing and personal borrowing, which does not attract the same capital requirement.

Why put shareholders funds into quarantine to provide a capital adequacy outcome for a regulator when you don't have to!

Equally the regulator although doing their job, has caused a shift in the market and reduced competition for the acquisition of buildings, commercial infrastructure, and business finance, at a time when the economy other than the resources industry requires funding support.

At the present time funding for buildings and commercial infrastructure is falling.

(h) opportunities for, and obstacles to, the creation of new banking services and the entry of new banking service providers;

The committee in its deliberations will hear from a range of citizens indicating that new banking services are needed as well as new banking service providers.

The opportunity to this is deliberately remote with the present regulatory environment that specifically put in place obstacles such as access to source of funds in the wholesale market, approval of deposit taking institutions, and the provision of access to the payments system.

Unless these obstacles are removed there will be no opportunity for the creation of new banking services and banking service providers.

I will turn first in this section of my response to the committee's request for a submission to address the issue of opportunity.

The opportunity to create a bank in Australia exists on paper, but is prevented by the government embedded monopoly of the major banks with a few smaller banks seen as fringe dwellers and a little more than building societies on steroids.

The competitors to the major banks that presently exist, are seen not only as “set decoration” by the major banks, but in effect are left alone as they fully realise the smaller banks have nowhere to go and cannot challenge their predominance either in funding any sort of business expansion, nor can they challenge the major banks with bundled product.

The only way to engender further competition is to provide access to the securitisation market for these banks in order that they can access funds to provide competition.

With the present large banks owning 92% of the mortgages in Australia there is in effect no competition. Access to RMBS is vital for this competition by the smaller banks and indeed credit unions and building societies. It will be the credit unions and building societies that will be where the new banks will grow from.

It is simply a matter of access to funds and shareholder funds in particular.

If for example the Federal Government wished to engender competition, it could simply do so by purchasing a substantial shareholding in the smaller banks by way of a designed share issue, so as to increase their shareholder capital, and thus increase their capacity to lend into the market by way of credit creation using existing bank capital.

This could be done either by way of money is coming from the future funds or direct government resources with a legislative exit strategy using a sunset clause where the government shareholding using direct resources was on sold to the future fund for acquisition value at a future date.

The other alternative is to engender competition by limiting the shareholding of the major banks in the minor banks to not greater than 3% on a group basis in order to prevent control of the minor banks by the major banks. The shareholding limitation should be permanent.

An opportunity also exists to create a major competitor to the four existing major banks by using The Future Fund and Australia Post to create the new “Postbank of Australia”.

Australia Post all ready has substantial and permanent distribution outlets that handle a wide variety of financial services transactions presently, and with little modification could handle banking business in open style shopfronts.

New banking technology allows this, with cash dispensing machines in place of bank teller draws which reduce the security problem to a very great degree.

New banks being presently opened almost are entirely open plan with no barrier security devices. The new cash dispensing and cash depositing machinery makes this possible.

It would be therefore quite feasible that with a substantial sum of around $20 billion Australian, injected into a new Postbank Australia, and with Postbank Australia operating as an approved deposit taking institution, the new bank would be created overnight, be profitable, and provide a rapid increase in competition to the existing for large major banks.

In all probability Postbank Australia would be a resounding success as it has been in Japan.

It will also be able to provide consumer banking and thus consumer banking loans at a substantial discount to margin that the present banks enjoy by way of monopoly.

It will put pressure on the margins of the existing banks which will not affect the smaller existing banks as they are very efficient in their own right but suffer from regular tree anti-competitive measures.

Postbank Australia on the other hand at start-up, would have the largest branch network distribution in Australia, and be able to offer services to pensioners and retirees at rates that would be attractive, with accessibility far greater than the present banking branch system. The Government could direct all of its business via Postbank to ensure its success.

In effect it would be instant competition of substantial kind.

(i) Assessment of claims by banks of cost of capital;

The claims by the banks of the cost of their capital, in other words the monies they borrow from others to on-lend to customers, has to a large degree been of their own making.

Some 15 years ago banks decided to increase their profits by reducing bank branches, and they began a process which accelerated from 1998 onwards, of closing banks in regional Australia, and closing branches in suburbs where transactions were slowly diminishing with demographic change.

This policy was one of cost control without a long-term strategic plan.

In all probability branch activity assessment was primarily driven on a transaction cost basis, rather than a long-term distribution of banking services basis.

This included deposits.

Subsequently banks are now finding it difficult to attract sufficient depositors who have some loyalty or affinity to the bank, as firstly, the bank is becoming harder to find and access, and secondly the range of deposit products has diminished substantially with rationalisation driven by cost accountants.

Equally depositors are able to go to managed funds platforms and invest in bank bills at a higher rate than is possible over the bank account and with virtually no fees. The average length of placement for fixed term deposits is trending down not up.

So the flow of funds that was predominantly hundred percent into the major banks is now moving at an increasing rate to other financial services components and permanently moving and not returning to the banks.

As well the banks have diminished (by the use of cost accountant bank rationalisation techniques), their national branch networks that transmitted deposit funds.

I can recall one bank branch in regional Tasmania that serviced the whole of the Huon Valley.

The bank involved decided that regional bank managers should not have account authority for trading accounts and overdrawing and as a result long-standing customers simply left.

Agriculture is a seasonal industry and weather dependent. When farmers could not get bank support for wages cheques they felt that the bank that they had supported for a long time did not care anymore about them.

When they left they also took all of the assets they had in the bank with them, as did all the people who knew the farmers, and as a result some hundreds of millions of dollars of deposits moved from one bank to another.

Subsequently the branch became unprofitable and was downgraded to an agency which it is today.

The people in the Huon Valley have long memories.

This I'm sure was repeated many many times around Australia, and is one of the fundamental reasons why the cost of bank capital in Australia is rising, as people choose not to deposit funds in banks but use alternative deposit opportunities which offer more defined and better deposit products.

This leaves the banks with a slowly shrinking deposit base when compared and contrasted against an expanding economy.

This is why the fundamental reasons why banks have spent billions of dollars of their shareholder capital purchasing wealth management distribution, in order to expand distribution and thus capital inflows especially superannuation.

In all probability the cost of capital for banks is probably rising, whilst at the same time their net interest margin has risen with the rising costs.

Even the Reserve Bank understands this very well and has stated this.

All that is presently occurring as the banks are maintaining their interest margin and thus their profit margin, without any market competition as to the rationality of this monopoly supported by government.

The lack of competition means that these margins are unchallenged in the marketplace.

Being unchallenged effectively means that the cost to the real economy rise at a rate that is unsustainable, and ultimately means that the economy will reach a crossover point were the cost of borrowing exceeds the capacity for business and indeed householders to pay for that borrowing.

There are signs presently in the economy of a substantial trend down in business banking volumes, and a further trend for small business to move out of business banking loans and refinance to a larger housing loan with a split for the business purposes, and a margin of usually some 150 basis points less in cost.

Indeed the recent NAB survey of business intentions notes a reduction in borrowing activity by small and medium business.

Any new entrant into the banking market should be encouraged to focus primarily on business banking by way of new personal mortgage business loan structures, so that the cost of business finance across Australia drops, and in this way competition between the banks will become fierce and unremitting.

This is the simplest way to drive down costs in the economy and increase the focus on funding business activities for the small medium enterprise.

(l) the role and impact of past enquiries into the banking sector in promoting reform and related matters.

Past enquiries into the banking sector resulted in regulation that entrenched the present non-competitive nature, engendered a scenario where extremely strong balance sheets for the four major banks were enhanced leading to increased acquisitions by the major banks of competitors without the application of the Trade Practices Legislation.

Recent rejection of the National Australia Bank acquisition proposals for AXA and its Australian and Asian operations by the ACCC was related to the wealth management competitive market where the Trade Practices Commission has jurisdiction by virtue of the Corporations Act having the Trade Practices Act implanted in it in so far as financial services or nonbanking nature are concerned.

The removal of the restriction in the ACCC legislation should be a primary goal of this enquiry.

Secondly, past enquiries have focused on bank stability, APRA regulation issues, bank accounting procedures and generally structural issues concerning bank operations.

The issue of competitive environment was not generally addressed, nor do the banks encourage it to be addressed.

This leads to the position where wealth management in Australia is being increasingly concentrated in controlled by the four major banks, where competition exists on a controlled basis, and where short-term decisions driven by share price considerations and bonuses paid to bank staff based on an annualised profit outcome, do more to drive non-competitive activities than anything else.

The Senate Economics Committee may well accept that the lack of competition is price that the Australian community has to pay for a strong banking system. This will be the position put by the banks to the enquiry, as absolutely it is in their interest to do so.

Alternatively the Senate Economics Committee may well consider that bank competition is now relatively benign, that the entrance of new banks to the market is effectively choked off by present government policy, and that government actions in relation to the guarantee put in place some years ago, although needed at the time, has had the effect of being a weapon used by the banks to remove competition for the future.

As well, you might consider creating a series of opportunities for the Australian community by way of opening up access to banking licenses and to creating competition.

The example I detailed earlier in my submission with the creation of Postbank Australia would be one way of rapidly dialing- in competition without any stress to the economy.

You may also care to consider ways of determining further access to the RMBS funding system, opening up and removing the monopoly for the payment system, and providing a universal bank account number that is able to be transferred from bank to bank without stress.

Equally you may well consider that given recent concerns of the government in terms of food security, that loans to farmers to produce food, be the first charge against any bank capital applied in the marketplace, and that legislation should enshrine this.

You may also consider that the government return to the marketplace by the future fund developing a new rural bank as part of the Postbank Australia structure, with such a rural bank to be known as Rural Postbank Australia.

Again further competition in this area would be in the interests of the people of Australia. It certainly would be in the interests of the people of Australia who grow our food and who are generally unrecognised in the competitive market.

I thank the Senate for the opportunity of providing a submission to the committee and I wish you well in your endeavors and look forward to reading your final report.

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