Submission to the Senate Committee on Bank Amendment (Keeping Banks Accountable) Bill 2009

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The views expressed in this submission are solely those of the author

Background
Keeping banks accountable is a policy outcome which in theory has beneficial consequences for the community. Banks and other Authorised Deposit taking Institutions (ADI's) provide the liquidity and credit essential for the working of any economy. The common perception about how ADIs raise and cost the funds to lend out has been tested in recent months.

As interest rates became the tool of choice to drive economic growth, customer expectations and perception were reinforced to such an extent that when the official RBA cash rates did change there was an expectation that this would be passed on regardless of the cost of funds to the ADI's.

The realities of the market and the dominance of the large four banks have put this myth to rest. The current Bill attempts to bring back a system of setting rates that were inefficient and do not reflect how funds are raised and costed today.

The Bill
The purpose of the Bill is to encourage all ADI's to link their mortgage interest rates to the RBA cash rate. The rationale for this approach, it would appear, is to provide a level of transparency and accountability in relation to the way interest rates are set by ADI's.

The Bill has a number of legal and technical difficulties to achieve these objectives. Currently ADIs are micromanaged to such an extent that it has caused additional administrative and cost pressure on smaller and regional ADI's. The Bill will only make the cost structure of the ADI more onerous. The Bill will not create a more accountable, more transparent or efficient market place. The big four ADI's will continue to dominate the market.

Micromanagement of ADIs
Currently the regulator (APRA) administers a regulatory regime which touches upon virtually every aspect of the ADIs operations and corporate structure, from the qualification of directors, to risk, to valuation, lending policies to corporate governance policies and procedures. Although APRA micromanages the "context" in which governance takes place there has not been any move to set prices. The Bill will add further cost to operating an ADI in addition to the costs of raising funds that could possible push such ADIs into becoming no longer viable. This would further erode choice and competition within the sector.

Keeping the Big four Accountable
The position of the four largest ADIs in the aftermath of the financial crisis will have a significant impact on the way credit is made available. The big four currently account for over 67% of all savings and in July 2009 100% of all new mortgages for that month. The big four raise their funds through a mixture of retail, wholesale and other financial instruments. The big four do not rely on the RBA cash rate; the international market governs the costs of funds. As the big four gain further momentum with the consolidation of the mutual ADI market, keeping the big four accountable as to the cost of mortgages is a task the Bill is unlikely to be effective.

Short of the Treasurer using powers provided under this Bill, the big four are unlikely to be kept accountable; rather, prices will be fixed. It is unlikely that the Bill will have any meaningful impact on the competitive nature of the four largest ADIs nor will there will be an enhancement of competition within the marketplace.

Interfering with Price
The Bill will interfere with the price setting mechanisms; it will not make ADIs accountable The workings of the free market have been distorted and favour the four largest banks; this Bill is unlikely to change this situation. Regardless of how prices are set, it's the lack of accountability and transparency of the mechanism which should be scrutinised rather than engaging in a price setting exercise.

Promoting an efficient market
The Bill will not promote an efficient market as prices will be set by other factors other than the cost of raising the funds in the first instance. The deposit and wholesale guarantees have to some extent injected a level of distortion which has favoured by the larger ADI's. The Bill will not address this structural distortion.

The fixing of prices tends not to be either efficient or an effective means to create the competitive transparent environment which will benefit the customers.

Nexus between Mortgages and RBA cash rate
In the post financial crisis period, there is virtually no nexus between the RBA cash rate and the mortgage / home loan interest rates. The cost of funds is determined predominantly by the lenders cost to raise the funds whether through securitisation, retail deposits, wholesale fund raising or a mixture of all.

As the financial crisis emphasised, investors are not concerned as to RBA cash rate they are more concern as to the security of their funds as much as the interest earned. The new re-valuation of risk in the current environment and the impact of the deposit guarantee have meant that there is little relevance of the RBA cash rate to mortgage / home loan interest rates.

In the event there is to be a legislated link between mortgage rates and the RBA cash rate many smaller ADI's are likely to formulate new strategies to administer a loan book that would be less competitive and prudent, thus forcing the smaller and regional ADI's to either restrict the supply of credit or not provide any credit at all.

Recommendation
The Committee should approach this issue of price accountability with great caution. The Bill is fraught with political and moral difficulties. From a benefit- detriment perspective the Bill should not be supported in its current form.

The writer is a lecturer in Banking and Finance Law, School of Business Law and Taxation Australian School of Business University of New South Wales and is a solicitor and barrister of the Supreme Court of New South Wales, High Court of Australia, is on the board of a mutual ADI, an author of a number of commercial law texts, chapters, articles, conference and discussion papers.

Yours sincerely,

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