AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY

ACCI SUBMISSION TO

SENATE ECONOMICS REFERENCES COMMITTEE

INQUIRY INTO COMPETITION WITHIN THE AUSTRALIAN BANKING SECTOR

NOVEMBER 2010

ABN 85 008 391 795

Canberra Office
COMMERCE HOUSE
24 Brisbane Avenue
Barton ACT 2600

PO BOX 6005 Kingston,
ACT 2604 AUSTRALIA

T: 02 6273 2311
F: 02 6273 3286
E: info@acci.asn.au

Melbourne Office
Level 3, 486 Albert Street
East Melbourne VIC 3002

PO BOX 18008 Collins Street
East Melbourne
VIC 8003 AUSTRALIA

T: 03 9668 9950
F: 03 9668 9958
E: melb@acci.asn.au

W: www.acci.asn.au

1. EXECUTIVE SUMMARY

The recent decision by the major banks to increase their variable mortgage rates by more than the Reserve Bank's official hike in cash rate in November has sparked a new round of public debate on competition within the Australian banking system.

The global financial crisis has left the structural legacies of tighter credit conditions, higher cost of funding and increased risk aversion amongst investors and lenders. The dislocation in the securitisation market has led to the exit of non-bank lenders, who rely on securitisation as their source of funding, and the problem with foreign banks' parents has contributed to less competition in the Australian banking system.

While the profitability of the Australian banking sector as a whole remains healthy compared to its foreign counterparts, it has also become apparent that major banks have clawed back their market share especially in the mortgage market.

The reduction in banking competition has enabled banks to increase their margins at the expense of both mortgage holders and business customers. While the current public debate has been skewed towards mortgage holders, it is important for policymakers and stakeholders to note that small and medium businesses are those that have experienced the toughest conditions in a less competitive environment.

Since the onset of the global financial crisis, access to affordable finance has been an issue of significant concern for many of small businesses as major banks have become more risk averse and overly conservative in their small business lending. Accordingly, banks have increased their risk margins for small business loans and tightened their standards and terms for new loans through lower loan-to-valuation ratios, stricter collateral requirements and higher interest coverage requirements.

Moreover, the decline in retail banking competition following more recent merger and acquisition activity and reduced lending by smaller banks and non-bank financial institutions has further limited the avenue for small business to access finance for working capital, investment and business expansion.

While some businesses are being denied credit due to unsatisfactory financial performance, ACCI is concerned that even businesses with strong trading records and solid lending proposals are finding credit restricted due to weakened balance sheets, reduced revenues or cash flows, and/or falling real estate collateral values. Furthermore tighter credit standards imposed by major lenders have required small business owners to adjust their business strategies by delaying plans for expansion, downsizing, or in some cases closing an otherwise viable business.

Loans to the small business sector are especially vital to the Australian economy as they employ nearly 50 per cent of Australia's private sector workforce and produce around 40 per cent of private sector industry value-added. Thus the small business sector plays a crucial role in ensuring the durability and sustainability of private sector-led growth, creating jobs and introducing innovation and productivity growth in the Australian economy.

ACCI makes the following recommendations both to promote greater competition in the banking system and to ensure that business borrowers have access to adequate and affordable finance:

1.1 Major Recommendations

Recommendation 1: Based on current levels of competition, the Government should rule out any significant future merger and acquisition activity in the Australian retail banking system and the wider financial services sector which would consolidate the dominance of any one of the four major banks. ACCI would encourage initiatives to assist in the development of a 'fifth' or additional pillar to provide effective competition to the existing large incumbents.

Recommendation 2: The Government should promote a level playing field between major banks, regional banks, foreign owned banks and non-bank lenders. For example, by phasing out the interest witholding tax (IWT) on most forms of offshore borrowing by financial institutions more quickly.

Recommendation 3: Consideration should be given to explore new measures to reduce the cost of funding for Australian financial institutions especially the regional banks including:

- Equalising the fee applicable to the Australian Government Wholesale Funding Guarantee Scheme between the major banks and smaller ADIs; and
- Improving market liquidity by allowing Australian banks the capacity to issue covered bonds.

Recommendation 4: The Government should improve liquidity of the securitisation market through the Australian Office of Financial Management (AOFM) until normality returns to the securitisation market.

Recommendation 5: The Government should explore the feasibility of a temporary small business loan guarantee scheme. Such schemes operate in several jurisdictions including the US, UK and Canada with varying levels of eligibility and coverage. Proper design would be essential to avoid unintended consequences and such a scheme if implemented should be considered a temporary measure prior to the return of greater competition in the market place.

Recommendation 6: In the face of anticipated regulatory changes by international banking supervision agencies, Australian policymakers need to be aware that supervision and examination policies may unintentially impede banking competition as well as limit lending to small businesses. Care needs to be taken to ensure that more onerous Basel III rules applying to foreign banks relative to our domestic institutions do not have the effect of reducing competition in our market.

1.2 Additional Recommendations

Recommendation 7: The Reserve Bank or other related government agencies should conduct a quarterly credit conditions survey on banks and non-banks to assess the trends and developments in credit conditions for households and businesses.

Recommendation 8: Lenders should only be allowed to charge loan exit fees on a cost recovery basis when borrowers choose to switch to other lenders during the term of the loan.

Recommendation 9: The Government should encourage clearer information on financial products and transparency in loan pricing to promote greater willingness of depositors or borrowers to switch between banks. Taxonomy on loan and other financial products should be standardised to enable easier comparison.

Recommendation 10: In addition to this Senate inquiry process, the Government should commission the Productivity Commission to conduct an inquiry into examining the degree of competition in the provision of business finance. The study should examine:

- The impact of an increasing/decreasing number of participants in lending markets;
- The implication of repricing of risk to businesses;
- The changes that have occurred in the cost and availability of finance to business, especially smaller enterprises, over time; and
- International experiences in encouraging banking competition and their advantages and disadvantages if applied in Australia.

2. ABOUT ACCI

2.1 Who We Are

The Australian Chamber of Commerce and Industry (ACCI) speaks on behalf of Australian business at a national and international level.

Australia's largest and most representative business advocate, ACCI develops and advocates policies that are in the best interests of Australian business, economy and community.

We achieve this through the collaborative action of our national member network which comprises:

- All state and territory chambers of commerce
- 27 national industry associations
- Bilateral and multilateral business organisations

In this way, ACCI provides leadership for more than 350,000 businesses which:

- Operate in all industry sectors
- Includes small, medium and large businesses
- Are located throughout metropolitan and regional Australia

2.2 What We Do

ACCI takes a leading role in advocating the views of Australian business to public policy decision makers and influencers including:

- Federal Government Ministers & Shadow Ministers
- Federal Parliamentarians
- Policy Advisors
- Commonwealth Public Servants
- Regulatory Authorities
- Federal Government Agencies

Our objective is to ensure that the voice of Australian businesses is heard, whether they are one of the top 100 Australian companies or a small sole trader.

Our specific activities include:

- Representation and advocacy to Governments, parliaments, tribunals and policy makers both domestically and internationally;
- Business representation on a range of statutory and business boards and committees;
- Representing business in national forums including Fair Work Australia, Safe Work Australia and many other bodies associated with economics, taxation, sustainability, small business, superannuation, employment, education and training, migration, trade, workplace relations and occupational health and safety;
- Representing business in international and global forums including the International Labour Organisation, International Organisation of Employers, International Chamber of Commerce, Business and Industry Advisory Committee to the Organisation for Economic Co-operation and Development, Confederation of Asia-Pacific Chambers of Commerce and Industry and Confederation of Asia-Pacific Employers;
- Research and policy development on issues concerning Australian business;
- The publication of leading business surveys and other information products; and
- Providing forums for collective discussion amongst businesses on matters of law and policy.

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3. BANKING COMPETITION

Since the onset of the global financial crisis (GFC) in mid-2007, competition in the Australian banking system has diminished significantly as most of the non-bank financial institutions that relied on the securitisation market and foreign banks have exited or reduced lending in domestic markets. There is also the impact of the more recent acquisition of the St. George Bank and Bankwest by the major banks.

Reflecting these developments, the major banks have increased their share of the mortgage market from 57 per cent in August 2007 to 74 per cent in August 2009; while the share of foreign banks fell from 8 per cent to 5 per cent and non-bank lenders' share fell from 15 per cent to 11 per cent[1].

Moreover, the major banks have increased their market share in business lending, accounting for around 75 per cent of lending to unincorporated businesses and around two-thirds of total business credit[2].

Richardson (2010) estimated that the largest four banks alone made an underlying profit of around $35 billion before tax in 2009, of which $20 billion per annum in his view is likely to reflect the banks' monopoly power over the Australian payments system[3].

Table 1: Big four banks profits in recent years

	Year to			
	Sep 2006	**Sep 2007**	**Sep 2008**	**Sep 2009**
Pre-tax profit ($m)	23,043	25,398	18,856	22,096
Bad and doubtful debt provisions ($m)	1,801	2,278	6,675	12,993
Underlying profit ($m)	24,844	27,676	25,531	35,089
Pre-tax profit (% of GDP)	2.38	2.43	1.67	1.84
Bad and doubtful debt (% of GDP)	0.19	0.22	0.59	1.08
Underlying profit (% of GDP)	2.57	2.65	2.26	2.91

Source: Richardson (2010), page 4.

[1] Australian Government 2009, *Australia as a financial centre: Building on our strengths*, Report by the Australian Financial Forum, November 2009.
[2] RBA 2010, *Submission to the Inquiry into Access of Small Business to Finance*, March 2010, page 5.
[3] Richardson, D. 2010, *A licence to print money: bank profits in Australia*, The Australian Institute Policy Brief No. 10, March 2010, page 1.

Table 1 shows that 2009 was a record year for major banks with an underlying profit of $35.1billion. This translates to a 26.4 per cent return on the banks' shareholder equity of $133.1billion. According to Richardson:

> "The rates of return earned by the banks (26.4 per cent using pre-tax underlying profit) can be compared with the rates of return earned elsewhere in the economy, which are estimated at approximately six to seven per cent. The average increase in the ASX accumulation index since December 1979 gives a figure of 12.3 per cent for big companies in general. However, as these figures include the banks' results, they are higher than they might otherwise be.
>
> "A second interesting comparison can be made with the alternative uses of their capital that other investors have to consider. The risk-free alternative use of capital can be taken to be represented by the 10-year government bond rate, which was 5.56 per cent in January 2010 and has averaged 5.65 per cent since January 2000. Adding a reasonable margin for risk implies a target rate of return at around the eight to nine per cent level.
>
> "These figures suggest that the underlying rate of return on equity in banks is at least 15 per cent higher than it might be in a truly competitive market, from which it can be inferred that the monopoly profits of the big four banks are around $20 billion, close to half the Commonwealth Government's total GST collections in 2008–09 and well over the $15.8 billion collected in fuel excise."[4]

Other studies on bank competition in Australia also found that Australia's bank revenues appeared to be earned under monopoly or conjectural short run oligopoly conditions for the period between 1998 and 2005, as the Australian banking sector is dominated by a small number of large banks[5].

According to the Boston Consulting Group (BCG) report, Australia's banking industries achieved an above-average total shareholder return (TSR) of 61.5 per cent in 2009. Australia had the highest average annual TSR of 9.2 per cent from 2005 to 2009[6].

For the first time, each of the largest four banks in Australia ranked among the 30 largest banks in the world[7].

For a third consecutive year, Australia together with Canada and Spain had the most profitable banking sector among the ten major markets in the world. In 2009, the Commonwealth Bank of Australia (CBA) was among the top ten large-caps banks with an estimated alpha of 33.9 per cent, the second best

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[4] Ibid., page 6-7.
[5] Chan et al., 2007, *Bank competition in New Zealand and Australia,* Paper presented at the 12th FINSIA-Melbourne Centre for Financial Studies Banking and Finance Conference, 24-25 September 2007.
[6] Boston Consulting Group (BSG) 2010, *After the Storm: Creating Value in Banking 2010*, February 2010, Massachusetts, USA, page 14.
[7] Ibid., page 19.

performer after Goldman Sachs. This estimate indicates that CBA had a 33.9 per cent risk-adjusted excess return on investment above market prediction[8].

ACCI fully supports and acknowledges the requirement for a strong and profitable banking sector. Indeed the stability of the sector relative to international developments helped secure our response to the global financial crisis and allowed us to emerge more quickly and less affected than all other advanced economies. Nevertheless, we are concerned about diminishing competition in retail banking and the likely detrimental impact on business borrowers.

3.1 Decline in the Securitisation Market

Before the GFC, the growth in Australian asset-backed securities (ABS), most of which was residential mortgage-backed securities (RMBS), was particularly strong (see Table 2).

Table 2: Australian asset-backed securities

	Outstanding ($bn)		**Share (per cent)**		**Annual growth (per cent)**	
	Jun 2007	Oct 2009	Jun 2007	Oct 2009	Jun 2007	Oct 2009
RMBS	176	102	63	66	27	-21
CMBS	12	7	4	4	78	-23
CDOs	18	10	6	6	44	-22
ABCP	68	30[a]	24	19	91	-29
of which: residential mortgages[b]	42	22				
Other ABS[c]	9	8	3	5	17	-3
Total	**283**	**157**	**100**	**100**	**29**	**-22**

Source: Debelle, G. 2009, *Wither securitisation?*, Address to the Australian Securitisation Conference 2009, Sydney, !8 November 2009.

Notes: RMBS – Residential mortgage-backed securities; CMBS – Commercial mortgage-backed securities; CDOs – Collaterised debt obligations; ABCP – asset-backed commercial paper.
(a) Latest value is for August 2009, corresponding share and growth rate are calculated using these data.
(b) Includes RMBS.
(c) Mainly bonds backed by leases, receivables and motor vehicle loans.

The rapid growth in securitisation as indicated in Table 2 before the GFC was mainly due to[9]:

[8] Ibid., page 20-21.
[9] Black, S., Brassil, A. and Hack, M. 2010, *The impact of the financial crisis on the bond market*, RBA Bulletin, June quarter 2010, page 56.

- Strong demand for housing finance;
- Increased competition from mortgage originators, which typically relied on securitisation for funding;
- The desire by banks to diversify their funding; and
- Investor demand or appetite for high-yielding AAA-rated securities, making this a cost-effective way of raising funds for many borrowers.

By mid-2007, asset-backed securities had grown to 30 per cent of the stock of Australian non-government bonds outstanding, bonds issued by Australian financial institutions were 40 per cent, bonds issued by Australian non-financial corporates were 18 per cent, and Kangaroo bonds[10] were 13 per cent.

However the onset of the GFC has led to a sharp fall in the issuance of asset-backed securities. Since mid-2007, quarterly issuance of RMBS has averaged $3 billion compared with average quarterly issuance of $15 billion in the two years prior to the GFC. The dislocation of the securitisation market in the aftermath of the GFC has forced non-bank lenders such as mortgage originators, which relied entirely on the securitisation market for funding, to reduce their lending to households.

As a result, the major banks have increased their market presence and shares of the mortgage market. The major banks have increased their share of the mortgage market from 57 per cent in mid-2007 to 74 per cent in August 2009. In contrast, the share of housing loans funded by securitisation fell from almost 25 per cent in mid-2007 to around 10 per cent in early 2010[11].

Moreover, the global increase in risk and risk aversion has also caused the cost of lower-rated corporate bond issuance to increase sharply and for a period some corporates had difficulty accessing the offshore bond market. As a result, many corporates turned to banks for funding, which has crowded out bank funding for small and medium sized enterprises (SMEs).

Therefore, the return of a well-functioning securitised debt market is important to ensure competition in the mortgage market, which in turn provides more incentive for banks to increase their business lending to SMEs.

[10] Kangaroo bonds are Australian dollar bonds issued in Australia by non-residents.
[11] Ibid., page 57.

3.2 Bank Funding Costs and Net Interest Margins

The decision of the major banks to increase their standard variable mortgage rates[12] by more than the 25 basis points cash rate hike by the Reserve Bank in November 2010 has re-ignited public debate on banking competition. In their press statements, the major banks have argued that the recent increase in bank funding costs has prompted them to increase their mortgage rates.

However, in the most recent September 2010 *Financial Stability Review*, the Reserve Bank noted that interest receipts from the core lending business of the major banks have been sufficient over the past two years to fully recoup higher funding costs and partly offset the rise in loan losses. Therefore, the net interest income which represents the major banks' main source of revenue has continued to underpin the profitability of the major banks, unlike for many of the largest global banks which have branched out into relying more heavily on trading and investment income[13].

In the November 2010 *Statement of Monetary Policy*, the Reserve Bank also noted that on aggregate the major banks' funding costs have been little changed over recent months, though trends differ for individual banks depending on their mix of funding. This finding is inconsistent with the recent public commentary of the major banks.

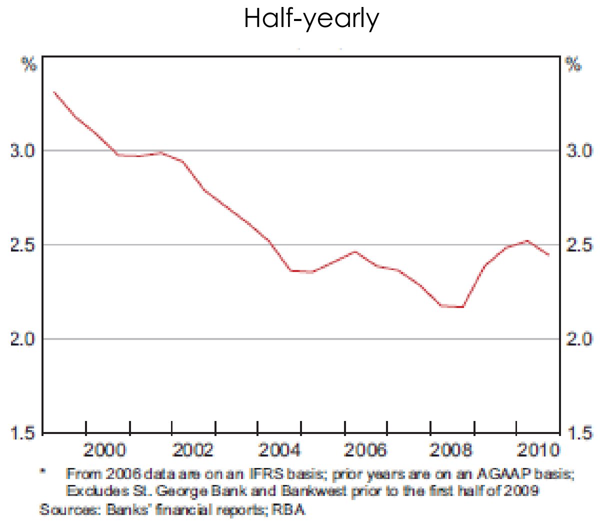
Moreover, the net interest margins (NIMs) – the margins between the average interest rate on bank loans and the average cost of funding – of the major banks have increased to about 20-25 basis points above the pre-GFC levels in late 2009, despite the NIMs levelling off in recent months (see Figure 1). The major banks' higher NIMs have supported their return on equity, partly offsetting the negative effects of the cyclical increase in their bad debts expense and the additional equity that they raised during the downturn[14].

According to a recent KPMG survey, Australia's major banks have posted record profits of $28.5 billion for the 2009-10 full year, an increase of 26 per

[12] As at 11 November 2010, the CBA and the ANZ have increased their standard variable mortgage rates by 45 and 39 basis points respectively.
[13] RBA 2010, *Financial Stability Review*, September, page 20.
[14] Brown, A., Davies, M., Fabbro, D., and Hanrick, T., 2010, *Recent developments in banks' funding costs and lending rates,* RBA Bulletin, March Quarter, page 35-44.

cent on 2008-09 results. The major banks' return on equity also increased from 13.7 per cent in 2008-09 to 15.9 per cent in 2009-10[15].

Figure 1: Major banks' net interest margins



4. COST OF FINANCE

4.1 Interest Rate Charges

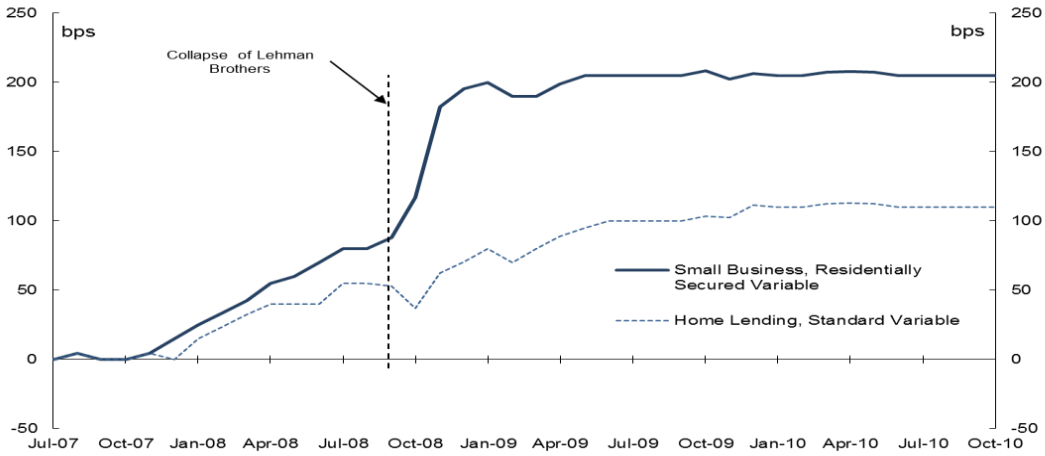
In the most recent 25 bps rate hike by the Reserve bank in November 2010, the major banks increased their standard variable mortgage rates by 35 to 45 bps, almost double the increase in cash rate. The major banks have argued that their funding costs have become more expensive which contradicts the Reserve Bank's findings that the major banks' funding costs have remained relatively stable in recent months. Therefore, the decline in banking competition has helped the banks to make rate adjustments in excess of official movements.

It is also evident from Figure 2 below that the increases in lending rates relative to the cash rate have been much larger for small business loans than housing loans since June 2007. Since mid-2007, the standard variable rate on home lending has increased by around 110 bps relative to cash rate, while

[15] KPMG survey of *Major Australian Banks Year End 2010* http://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/Press Releases/Pages/Record-profits-but-3-Nov-2010.aspx

the variable rate of small business residentially secured lending has increased by around 205 bps[16].

Figure 2: Cumulative change in lending spreads to the cash rate



Source: RBA Statistical Table F05.

Data from the Reserve Bank indicates that small businesses were paying a margin of 4.11 percentage points above the cash rate on average for bank finance, compared to a margin of 2.22 percentage points for large businesses and 2.32 percentage points for mortgage customers at the end of October 2010, despite most of these small business loans being residentially secured.

Between 2000 and 2007, the net interest margins (NIMs) on major banks' Australian operations fell by around 100 basis points driven mainly by increasing competition. Despite the fall in NIM, sizeable reductions in bank's operating expenses allowed the banks to continue operating profitably[17].

However since 2008, the NIM has widened again. According to RBA estimates, the major banks' net interest margins (NIMs) have increased by 20 to 25 bps above pre-crisis level. It is ironic that the impact of the global financial crisis has been to increase banks' NIMs.

According to the September 2010 *RBA Financial Stability Review,* the NIMs of the major banks' consolidated global operations have increased by around 20 bps since the trough in 2008 but have levelled off a little recently. Over the

[16] Note that this does not reflect the November rate hikes by the Reserve Bank and independent rate increases by the major banks.
[17] Battellino, R. 2009, *Some comments on bank funding,* Remarks to the 22nd Australasian Finance and Banking Conference, 16 December 2009.

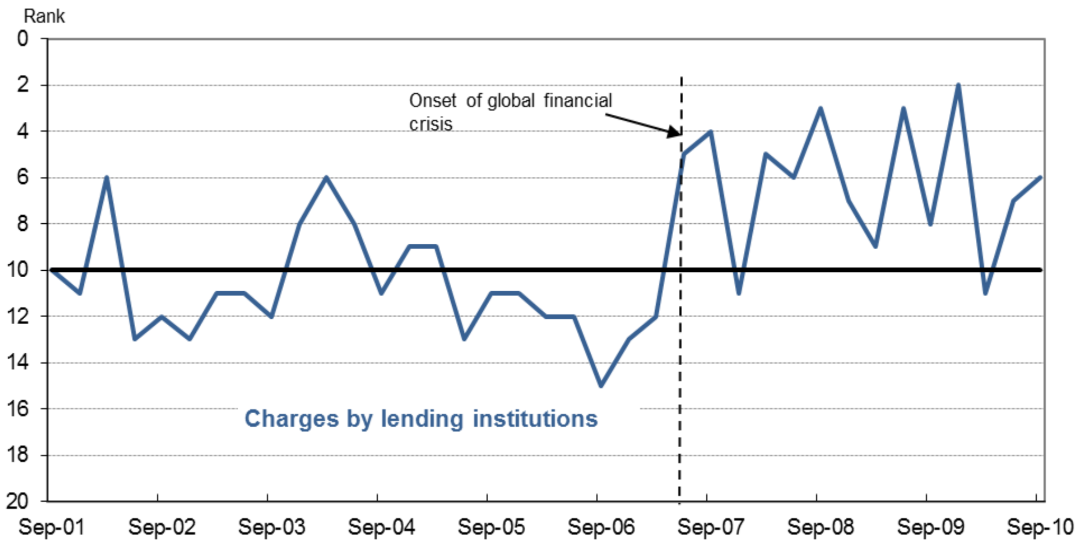
same period, the NIM for their Australian operations is around 35 bps higher. This divergence reflects that banks have been less successful in recovering increases in their funding costs in overseas markets than the domestic market, which could be partly attributed to the decline in competition in the Australian financial system.

4.2 Banking Fees

In addition to higher interest rate charges, business borrowers have also faced higher bank charges or fees since the onset of global financial crisis.

Since June 2007, the *ACCI Small Business Survey* found that *Charges by Lending Institutions* consistently ranked within the top ten constraints in small business investment in plant and equipment (see Figure 3.)

Figure 3: Selected constraint on small business investment



Source: ACCI Small Business Survey, November 2010.

These findings are further supported by the recent RBA's annual survey of banking fees[18]. In 2009, the RBA found that total domestic fee income grew by 9 per cent in 2009 to $12.7 billion, with fee income from businesses growing much faster than fee income from households (see Table 3 and Figure 4).

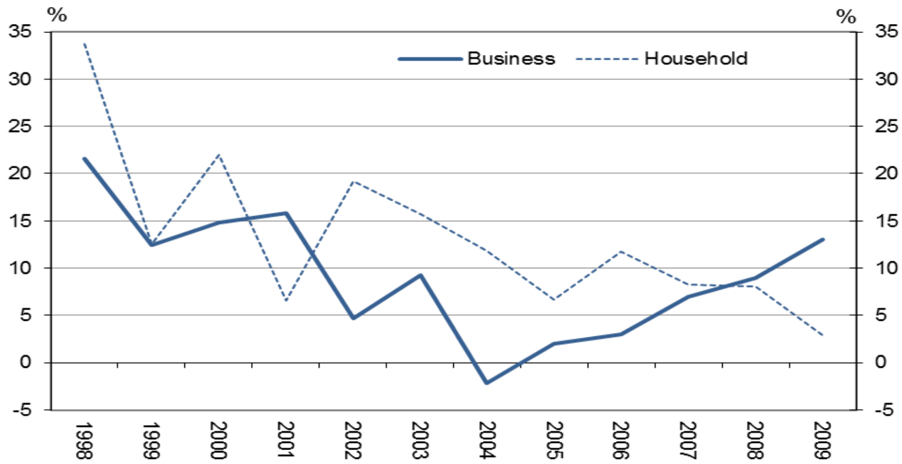
[18] RBA 2010, *Banking Fees in Australia*, RBA Bulletin, June quarter, page 31 to 35.

Table 3: Banks' fee income

	Households		Businesses		Total	
	$ bn	Growth (%)	$ bn	Growth (%)	$ bn	Growth (%)
2007	4.5	8	6.2	7	10.7	8
2008	4.9	8	6.8	9	11.6	9
2009	5.0	3	7.6	13	12.7	9

Source: RBA 2010, *Banking Fees in Australia*, RBA Bulletin, June quarter.

Figure 4: Growth in banks' fee income



Source: RBA Statistical Table F6.

In 2009, the banks' fee income from businesses increased by 13 per cent, much higher than its five year average growth of 4 per cent. As was the case in 2008, most of the growth in business fee income was from growth in fees from loans (up 20 per cent) and bank bill facilities (up 28 per cent). The RBA noted that the increase in fees on these facilities reflects the re-pricing of credit and liquidity risks; in particular, fees on undrawn loan facilities appear to have risen significantly.

Over the same period, the banks' fee income from households rose by 3 per cent, well below its five year average growth of 9 per cent and is the slowest rate of growth in household fees since the survey began in 1997. There has been strong growth in housing loan fee income (up 17 per cent) partially offset by a decline in deposit account fees (down 11 per cent), as banks compete heavily to attract retail deposits.

Case studies collected by ACCI members have also highlighted the issue of increasing bank fees:

- **Case study A:** One of the larger retail banks has increased the overdraft fees by 70 per cent without any prior discussion with small business owners. The fee will increase from $1,000 to $1,700 for an overdraft limit of $100,000 commencing from June 2010.

- **Case study B**: The annual fee for a business overdraft facility will increase from $1,250 per annum to $2,550 per annum, an increase of over 100 per cent.

In both of these cases, the reason given by the bank was that recent changes to regulatory requirements on the capital that banks need to put aside for lines of credit have increased the cost of providing banking services. These new regulatory changes require the banks to put aside additional capital on lines of credit even if they are not drawn by customers.

5. DIFFICULTIES IN ACCESSING FINANCE

While the cost of finance is an issue for business borrowers, an immediate and greater concern for small businesses is the availability of finance from major lenders. Since the crisis, banks have repriced risks for existing loan facilities and tightened the terms and conditions under which they are willing to extend credit to borrowers, in particular business borrowers.

Tough lending criteria have been imposed on business borrowers since 2008, including higher serviceability or interest coverage ratios and lower loan to value ratios. It was indicated that in the case of commercial property, banks may only lend up to 65 per cent of the value used to secure a loan, compared to 80 per cent in the past[19].

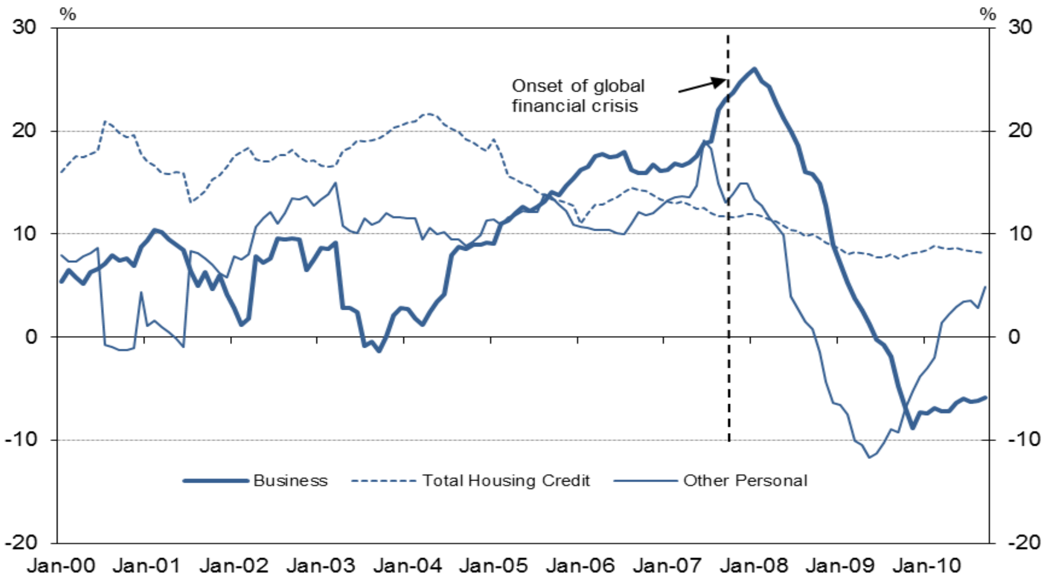
While housing credit continued to grow in the aftermath of the global financial crisis, credit flows to businesses have fallen significantly (see Figure 5). Over the year to September 2010, total housing credit (owner occupied and investor housing) has grown 8.2 per cent; while business credit fell by -5.9 per cent.

[19] Drummond, M. (19 October 2009), *Big banks put credit squeeze on small business borrowers,* the Australian Financial Review.

Bank business credit fell at an annualised rate of -4.9 per cent over the six months to September 2010, compared to -6.8 per cent over the six months to March 2010. In contrast to business credit, bank lending to households has remained resilient and grew at an annualised rate of 7.1 per cent over the six months to September 2010, compared to 9.3 per cent over the six months to March 2010.

Figure 5: Credit by sector

Year-ended percentage change



Source; RBA Statistical Table D2.

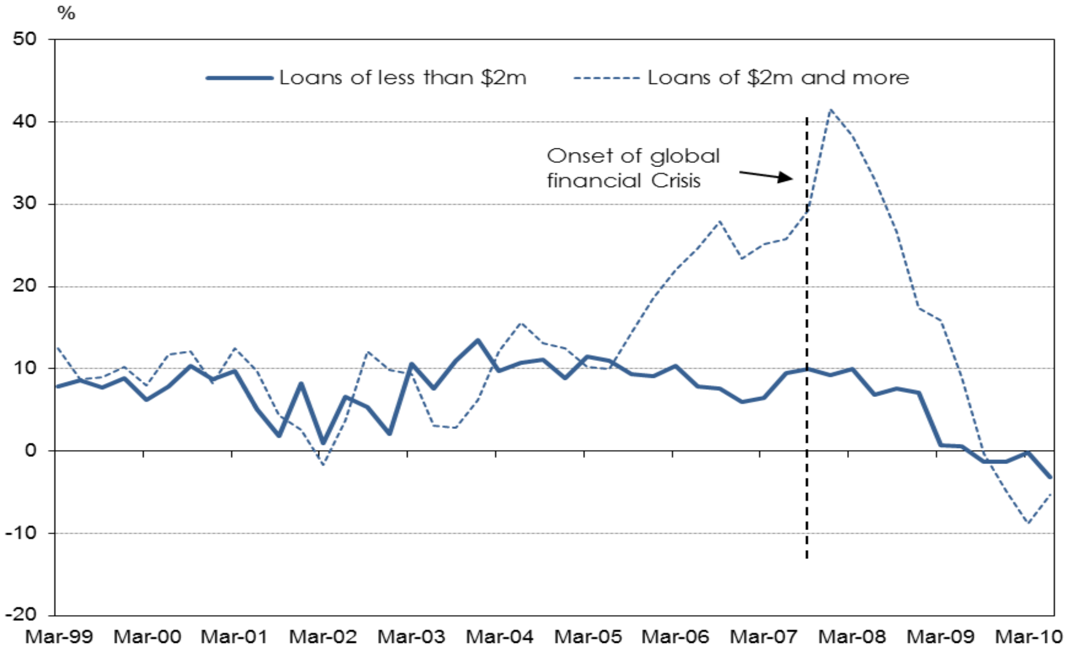
As the cost of intermediated finance has increased following the GFC, larger businesses have elected to diversify their funding by deleveraging their intermediated finance as indicated in Figure 6, whereby loans of $2 million and more have declined significantly since the crisis.

Large corporations re-adjust their balance sheet by relying on equity raisings and increasing their non-intermediated debt. As a source of external funds, the net amount of equity raising by large corporations amounted to 6 per cent of GDP in the six months to December 2009, up from an average of 2.5 per cent over the last decade[20].

[20] RBA 2010, *Financial Stability Review,* September 2010, page 44.

Figure 6: Total credit outstanding to large and small business

Year-ended percentage change



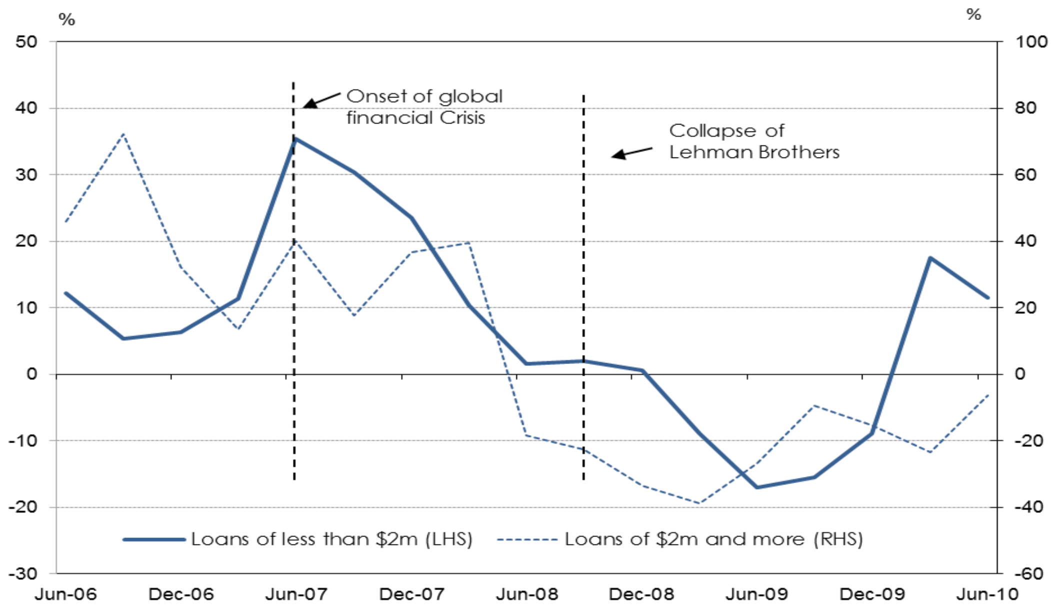
Source: RBA Statistical Table, D08.

However, it is concerning that credit flow to small business has also fallen significantly. Figure 6 shows that bank lending to small business (i.e. total credit outstanding for loans of less than $2 million) has recorded negative annual growth in the September quarter of 2009, the first time it has contracted over a 12 month period since the series began in 1994.

New credit approvals to small businesses have also fallen since the onset of the crisis. Figure 7 indicates that year-ended growth for new bank lending to small businesses has fallen from a peak of 35.3 per cent in the June quarter 2007 to 2.0 per cent in the September quarter 2008. After the collapse of Lehman Brothers in September 2008, new credit approvals fell to a trough of -17.0 per cent in the June quarter 2009 before recovering to a growth of 17.6 per cent in the March quarter 2010. New credit approvals for small business have fallen marginally over the recent months.

Figure 7: New loan approvals to large and small business

Year-ended percentage change



Source: RBA Statistical Table D08.

The RBA noted that while weak demand for credit has partly explained the low pace of growth in business credit outstanding since the GFC, it also reflects tighter financing conditions as banks' risk appetites decreased. However, in recent months, the RBA indicated that credit availability is improving and competition among lenders for some market segments is beginning to pick up[21].

Unlike larger business, small businesses rely on intermediated finance and their own retained earnings for working capital, investment and expansion. Credit rationing by the banks, through tighter lending criteria and repricing of existing and new loans, will constrain small business ability to invest, grow and employ.

This argument is further supported by the National Australia Bank's head of business banking Mr Joseph Healy's statement in an interview with the *Australian Financial Review* on 18 February 2010. He stated that:

> "[the] banking systems predilection for home loans was partly responsible for the lack of credit to small business and posed a long term risks for [the] economy.
>
> "A banking system which allocates capital away from the most productive areas of the economy – business – is ultimately bad for growth, bad for competition, bad for jobs, bad for business and in the end bad for Australia.

[21] Ibid., page 45.

> "…international banking rules, known as Basel II, contributed to banks' preference for lending for mortgages because they must hold five times more capital to support the same size of loan to a business."[22]

5.1 What Business Tell Us

Given the lack of publicly available information on the issue of difficulty in accessing finance, in particular for small business, this section attempts to use business surveys and case studies to highlight the issue.

In the March quarter of 2009 and 2010, ACCI polled businesses on how changes in bank lending criteria over the past six months have impacted on business capital expenditure (CAPEX) plans and working capital or ongoing operating expenses.

Table 4 shows that 25.4 per cent of respondents reported that changes in bank lending criteria negatively affected their capital expenditure plans in March 2010, an increase from 22.9 per cent reported a year earlier.

Table 4: ACCI survey responses – Impact on CAPEX

Per cent of Responses

	March 2009	**March 2010**
Major negative impact – greater than 10% reduction	10.2	11.2
Negative impact – up to 10% reduction	12.7	14.2
No impact	66.8	60.2
Positive impact – up to 10% increase	1.8	0.8
Major positive impact – greater than 10% increase	1.8	2.0
Not planning any investment	6.7	11.7

Note: March 2009 survey had 283 respondents while March 2010 survey had 394 respondents.

Moreover, Table 5 shows that the percentage of businesses reporting a negative impact of tightening in bank lending criteria on their working capital has increased from 20.1 per cent in March 2009 to 26.0 per cent in March 2010.

[22] Drummond, M. (18 February 2010), *Home loan bias bad for economy*, the Australian Financial Review.

Table 5: ACCI survey responses – Impact on working capital

Per cent of Responses

	March 2009	March 2010
Negative impact	20.1	26.0
No impact	78.1	71.1
Positive impact	1.8	2.9

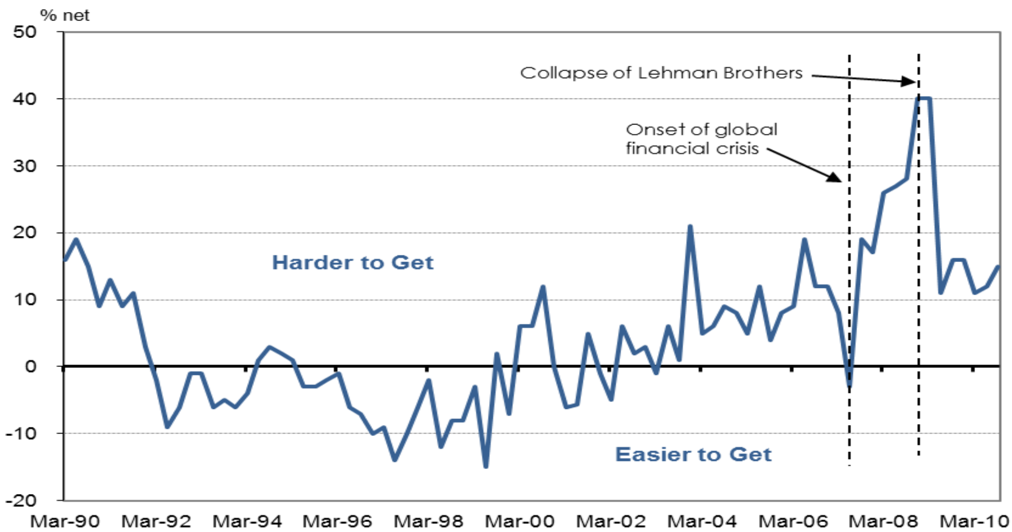
Note: See Table 4.

The above tables clearly demonstrate that while the economy begins to recover, more businesses are reporting the negative impact of difficulties in obtaining finance on their investment plans as well as their normal operating expenses.

The *ACCI – Westpac Survey of Industrial Trends* also found that more manufacturers are reporting that finance is harder to get since the onset of the global financial crisis. Figure 8 indicates that the net indicator of *Availability of Finance* reached a peak of +40 per cent in the December quarter 2008 and the March quarter 2009, significantly above its decade average of +10 per cent. In the December quarter of 2008, 45 per cent of manufacturers reported finance was harder to get compared to three months earlier while only 5 per cent of respondents indicated that finance was easier to obtain.

While conditions have improved since then, a net 15 per cent of manufactures continued to report finance harder to get over the September quarter of 2010.

Figure 8: ACCI survey - Availability of finance



Source: ACCI – Westpac Survey of Industrial Trends, September 2010.

According to the latest PricewaterhouseCoopers October 2010 *Private Business Barometer*, which surveyed 1,092 businesses with turnover of between $10 million and $100 million during August and September 2010, private business reported that interest rate increases (46 per cent), availability of credit (37 per cent), cost of funding (37 per cent) and terms and conditions of available credit (33 per cent) are amongst the top impediments to meet their business growth targets in 2011.

The 2010 CPA Australia *Asia-Pacific Small Business Survey*, which surveyed small business[23] owners from Australia, Singapore, Malaysia and Hong Kong in October 2010, found that Australian small business has the highest reliance on credit cards for finance, at 62.6 per cent, compared to less than 45 per cent for small businesses in Singapore, Malaysia and Hong Kong.

This finding highlights that many Australian small businesseses are of the view that credit card finance is more easily accessible than other forms of bank credits, even though other forms of finance may be more appropriate for the circumstances. Heavy reliance of credit card finance also means that small business owners are paying more than double the interest rate charges for credit card finance than a residential-secured business loan, which puts significant pressure on small business.

The recent VECCI – Victoria University survey on small business access to finance, which surveyed 284 businesses in Victoria during June and July 2010, found that:

- 16 per cent of respondents indicated that inadequate access to finance was a major obstabcle to growth, while a further 18 per cent identified it as a moderate obstacle;
- 30 per cent of respondents indicated that they had passed up attractive business opportunities in the previous two years because attempts to access external finance were unsuccessful; credit was not available in sufficient quantities; finance was too expensive; or lending conditions were too strict;
- businesses within the manufacturing industry and the construction sectors face larger obstacles in accessing finance than firms in the services sector. For example, 44 per cent of manufacturing firms (62 respondents) and 50 per cent of construction and utility-related

[23] In the CPA survey, small business is defined as business with less than 20 employees.

firms (18 respondents) reported that access to finance was a major or moderate obstacle, compared to 28 per cent of firms in the business and personal services sector;

- financial obstacles were greatest amongst firms with annual revenue between $0.5m and $1m (46 per cent of cohort). When considering firm size, those with 5 to 14 employees reported the highest level of financial obstacles (40 per cent of cohort); and

- of those reporting forgone investment due to inadequate access to finance, 39 per cent of businesses were 6 to 10 years old, 35 per cent were up to five years old, and 26 per cent were more than 10 years old. These findings suggested that it is not the new, micro businesses that have struggled most in terms of accessing finance, but SMEs that are in the early-mid expansion phase.

ACCI acknowledges that banks should be prudent when assessing business loan applications due to the underlying business risk. However, it is concerning that there are businesses with viable business plans that are unable to grow and expand due to inadequate access to finance as highlighted in the following case studies.

- **Case Study A**[24]: Business A is a SME incorporated in 1997 with three shareholders governed by a board of six. It provides engineering products and services. Sales and profits have increased over recent years including solid profit performance over the year to June 2009.

  It recently received a $2.8m order from a leading Australian engineering contractor for 3 treatment plants. The company is required to put up a bank guarantee (BG) of 10% for delivery and 12 months warranty in order to receive the 50% deposit with order. The company approached one of the major banks' (Bank Y) Business Bank Manager with its current financial position and forecast and requested Bank Y to cover the $160,000 for the BG for 7 days until the company received the $800,000 deposit. On receipt of the monies, Business A would then place the $160,000 on deposit at Bank Y to cover the contingent liability of the BG until they expired or returned.

  After discussing with Bank Y credit manager, the Business Bank Manager rejected the credit request. In response, Business A

[24] In order to protect the privacy of the business owners, the industry this business is in has been modified. However all the financial information has remained unchanged.

directors and shareholders were required to advance money to the company at 12% and the BG was issued and delivered to the customer. Currently, $160,000 is in a Bank Y deposit account earning about 4% interest.

- **Case Study B:** Business B took over a business in 2006 with a $500,000 turnover per annum and in 2009/10 the turnover is estimated to be $2.2m. Given the business is growing and expenses have increased due to expansion, Business B has applied for additional credit facility from Bank Z that it has been dealing with for the past 13 years. However Bank Z could not see Business B's growth prospect and has withheld from increasing its overdraft limit, line of credit and credit card limit to assist with paying the expenses. This has caused a significant cash flow problem for Business B.

The case studies above highlight examples where small business owners are facing significant difficulties in accessing finance from major banks for business expansion, investment and short-term cash flow assistance. These difficulties even occurred when the customer has had a long established relationship and a history of meeting commitments. Our business feedback indicates these are consistent problems amongst many small and medium sized enterprises.

ACCI is also concerned that difficulties in obtaining finance may have been worsened by the declining risk assessment skills within the banks. Small business lending is highly specialised and it is not generic like providing housing finance. Moreover it is often not assisted by the transparency and disclosure requirements which help risk assessment in lending to larger businesses. It relies on a skill set which has diminished in the Australian banking sector, including understanding cash flow and the impact of changing market and local conditions, but most importantly knowing and understanding the customer.

In a survey conducted by ACCI during March 2010, 34.0 per cent of the 215 business respondents reported that their business bankers do not have adequate understanding of their business' cash flows and its ability to service any current or prospective loan obligations.

The deterioration in business managers' risk assessment not only constrains the ability of banks to make the most out of small business lending, it also hinders the ability of small business to access required finance when business circumstances change, especially in the current environment where the risk appetite of banks remains subdued but small businesses see future growth prospect in their business.

Small business lending can be a profitable exercise for banks. However, failure to devote resources and skills in this area in favour of typical house lending has seen a foregone business opportunity.

6. POLICY OPTIONS TO IMPROVE BANKING COMPETITION

The exit of non-bank lenders and foreign banks following the GFC has increased the concentration of the Australian banking system. This section discusses some policy options that will promote banking competition, which in turn will improve small business access to finance and drive down the cost of finance for borrowers.

6.1 Improving the Liquidity of the Securitisation Market

The onset of the GFC has led to a sharp fall in the issuance of asset-backed securities, with the quarterly issuance of residential mortgage-backed securities (RMBS) averaging $3 billion since mid-2007, compared with average quarterly issuance of $15 billion in the two years prior to the GFC.

This dislocation of the securitisation market has forced non-bank lenders, which relied on the securitisation market for funding, to reduce their lending to households. The return of a well-functioning securitisation debt market is important to ensure competition in the mortgage market which will provide incentive for banks to increase their business lending to SMEs.

Therefore, the Government should improve liquidity of the securitisation market through the Australian Office of Financial Management (AOFM).

Over the year to September 2010, the AOFM has purchased around one quarter of the residential mortgage- backed securities (RMBS) issuance. While conditions in the securitisation market have improved, conditions remain challenging, with the market spreads on AAA-rated RMBS tranches at around

140 bps above bank bill rates[25]. According to bank sources, an increase in AOFM's holding of RMBS to $16 billion will reduce the market spreads to 80 bps.

6.2 Fees on Government Wholesale Funding Guarantee Scheme

The Australian Government Wholesale Funding Guarantee (hereafter the Guarantee Scheme) was announced in October 2008 in response to the extremely difficult conditions in the global financial system following the collapse of Lehman Brothers. The Guarantee Scheme ensured that Australian financial institutions were not placed at a disadvantage compared with their international competitors that could access similar government guarantees on bank debt.

Under the Guarantee Scheme, eligible authorised deposit-taking institutions (ADIs) have been able to offer government-guaranteed wholesale funding with maturity out to five years[26]. These arrangements became operational on 28 November 2008.

The Guarantee Scheme shared many features with wholesale guarantee arrangements announced in other countries, albeit on balance, it was more flexible and supportive:

- The Government did not set a fixed date for closure of the arrangements, announcing that the Guarantee Scheme would remain in place "until conditions normalise". On 7 February 2010, the Government announced that the Guarantee Scheme would close to new borrowing from 31 March 2010;
- The Guarantee Scheme has allowed guaranteed debt with a rolling maturity dates of five years, whereas most countries specified fixed maturity dates; and
- The fee applicable to AA-rated institutions (i.e. the major banks) under the Guarantee Scheme – 70 bps per annum, was at the low end of the international range for schemes with this structure. More

[25] RBA 2010, *Financial Stability Review,* September 2010, page 27.
[26] Foreign bank branches have had restricted access to the Guarantee Scheme including a shorter maturity limit. The differing treatment reflects that, unlike the foreign bank subsidiaries, foreign bank branches are not separate entities incorporated and independently capitalised in Australia, instead they are part of the foreign bank incorporated overseas.

> importantly, the fee differential between institutions with different credit ratings under the Australian Guarantee Scheme was relatively large by international standards, with the fee for A-rated institutions at 100 bps and 150 bps for BBB-rated and unrated institutions.

The average daily value of guaranteed short-term wholesale liabilities peaked at $22.4 billion in February 2009 and has fallen to average $17.1 billion in January 2010.

Higher rated institutions, i.e. the major banks, have significantly scaled back their usage of the Guarantee Scheme and have been able to issue unguaranteed bonds since around the middle of 2009. However for lower-rated ADIs, there continues to be little unguaranteed bond issuance[27].

The fee differential between higher and lower rated ADIs has caused unintended consequences to overall banking competition, as smaller banks have to incur a higher guarantee fee, 30 to 80 bps higher, than the major banks. As such the regional banks have not been able to compete effectively with the majors due to the higher funding costs.

The equalisation of the fee applicable to the Australian Government Wholesale Funding Guarantee Scheme between major banks and regional banks will reduce smaller banks' lending rates. According to industry sources, if the guarantee fee were equalised to 70 bps for all institutions, its standard variable rate would fall by 10 bps. However the impact will vary according to the amount of guaranteed bonds issued and credit rating of the ADIs.

6.3 Issuance of Covered Bonds

Covered bonds have been identified as additional sources of funding and liquidity to the ADIs. Similar to the RMBS, covered bonds enable the financial institutions to obtain a lower cost of funding. However covered bonds are considered to be less risky than the RMBS.

Covered bonds are issued directly by financial institutions and the bonds are covered by a pool of mortgage loans. If the issuing institution collapses, the bonds are 'covered' by the pool and are separated from the institution's other assets to pay back the bond holders. In other words, covered bonds

[27] Schwartz, C. 2010, *The Australian Government Guarantee Scheme*, RBA Bulletin March Quarter 2010, page 19-26.

provide investors with extra protection as they are secured against the financial institutions' loan book.

However, the Australian Prudential Regulation Authority (APRA) is of the view that covered bonds are not consistent with depositor preference provisions set out in the Banking Act and hence are prohibited. Section 13A(3) of the *Banking Act 1959* states that:

> "If an ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to meet that ADI's deposit liabilities in Australia in priority to all other liabilities of the ADI."

As such covered bonds are inconsistent with the Banking Act requirement that all assets must be available to meet deposit liabilities before all other liabilities, since covered bonds have priority over certain assets on the balance sheet in the pool.

While covered bonds would enable the banks to reduce their funding costs, a competitive market is still important to ensure that these savings are passed on to borrowers.

Therefore, it is important that extensive studies are undertaken to examine how covered bonds would benefit and enhance competition in the Australian financial system and how both investors who invest in covered bonds and depositors in the ADI would be protected.

6.4 Phasing out the IWT

Australia, unlike many other financial centres, levies interest withholding tax (IWT) on most forms of offshore borrowing by financial institutions.

Subject to any existing exemptions, IWT is levied on any interest paid by an Australian borrower to a non-resident lender. This includes interest paid overseas by Australian financial institutions when they borrow offshore or raise deposits directly from offshore customers.

IWT is imposed on non-residents at a rate of 10 per cent of gross interest, but is reduced to 5 per cent if the interest is paid by an Australian branch of a foreign bank to its parent. An Australian financial institution does not have to pay interest withholding tax if the interest is incurred in carrying on business outside Australia through a permanent establishment.

IWT has increased the cost of capital for Australian based banks borrowing offshore, especially for local subsidiaries of foreign banks and branches of foreign banks. Moreover, the application of withholding tax to some but not all offshore borrowings by Australian based banks for use in Australia has resulted in significant competitive distortions and inconsistencies. The *Australia as a Financial Centre* report (the Johnson Report) highlighted that:

> " … Australian banks have access to pools of overseas savings through their offshore banking operations. In a number of cases, these potential offshore savings pools are well beyond what they can use in the country of source, and hence could be used to support their lending and leasing arrangements conducted out of Australia. For Australian banks with a substantial presence in the region and a large number of retail deposit bases across a number of countries, this source of funds can be accessed and will avoid withholding tax due to the bank's ability to pool the funds. For other banks with a more limited network of retail depositors in the region, this may not be possible or, at best, the tax consequences may be ambiguous. In the Forum's view, these differences in tax treatment are arbitrary and undesirable…"[28]

In the 2010-2011 Federal Budget, the Government announced that:

- The rate of IWT will be reduced from 5 per cent to 2.5 per cent in 2013-14 and to zero in 2014-15 for Australian branches of overseas financial institutions with respect to borrowings from their parents; and

- The rate of IWT will be reduced from 10 per cent to 7.5 per cent in 2013-14, then to 5 per cent in 2014-15 for other offshore borrowings by financial institutions, including local subsidiaries of foreign banks.

While ACCI welcomes the budget measures, the Government should quicken the pace of phasing out the interest withholding tax as recommended in the Johnson Report (Recommendation 3.4). This is to ensure a level playing field between foreign banks and Australian owned banks, as the current IWT arrangements disadvantage Australian branches and subsidiaries of foreign financial institutions, as offshore borrowings from their parents are often a significant source of funding for the loans they make.

6.5 Entry and Exit Fees

Banks or lenders charge an entry fee[29] to set up a loan and an exit fee[30] if a loan is terminated or refinanced. Excessive entry and exit fees often create barriers to competition as they deter borrowers from switching to another

[28] Australian Financial Centre Forum 2009, *Australia as a Financial Centre: Building on Our Strengths*, Canberra November, page 67.

[29] Entry fees include application fees, establishment fees, valuation fees, legal fees and settlement fees.

[30] Exit fees include early termination fees – deferred establishment fees for variable rate loans, early termination fees – break costs for fixed rate loans, and termination fees or discharge fees.

credit provider during the life of the loan. In comparison to the UK and US, Australia has the lowest entry and discharge fees and highest early termination fees[31].

Some commentators have argued that to encourage further competition in the banking sector, exit fees should be banned. However, ACCI is concerned that there will be a trade-off between entry and exit fees, with lenders increasing the entry fees to recover the banned exit fees.

This trade-off will increase borrowing costs for the majority of borrowers while only benefiting the few who will switch to other credit providers as few borrowers are willing to change their existing banking relationship. The October 2010 PricewaterhouseCoopers *Private Business Barometer Survey* found that only 6 per cent of businesses changed their business banking relationship in the last six months and 16 per cent of businesses indicated that they are planning to change their banking relationship in the next six months.

Moreover, ACCI notes some of the concerns by smaller lenders that a blanket ban on early mortgage exit fees could have a negative impact on competition by restricting the ability of small lenders to offer competitive pricing to their borrowers. According to Mortgage and Finance Association chief executive Phil Naylor:

> "… confusion remained between mortgage exit fees and deferred establishment fees…Smaller, non-bank lenders typically allow customers to defer paying an upfront loan establishment charge, but slug customers with a higher fee if they decide to switch lenders after a few years. Exit fees are paid if you break a loan to recoup costs…Deferred establishment fees were an innovation by non-banks that enable people to get a lower ongoing interest rate with no establishment fees at the start… so deferred establishment fees are seen as competitive advantage by non-banks and you only pay them if you leave after 2 or 3 years…"[32]

ACCI advocates that exit fees should be cost reflective and should not include anti-competitive elements by charging a fee that deters borrowers, both consumers and business borrowers, from switching to other banks. Therefore, ACCI welcomes the new Australian Securities and Investment Commission (ASIC) regulation on early termination fees or exit fees for residential loans, which states that exit fees must be limited to the losses that occur at the time that the early termination takes place.

[31] Australian Parliament 2008, *Competition in the banking and non-banking sectors,* House of Representative Standing Committee on Economics Report, November 2008, Canberra, page 77.
[32] Searle, J. (2010, 9 November), *Smaller lenders could lose their edge*, The Australian Financial Review, page 48.

6.6 Improving Process and Transparency

Increased provision of easy-to-understand information about financial and product alternatives may promote greater willingness of borrowers to switch from one institution to another and increase competitiveness within the financial industry.

Borrowers are often not presented with a clear picture when assessing loan products. There are a wide range of fee and interest rate variations in the Australian market and borrowers need to make a trade-off between interest rates and fees, with a lower headline interest rate often attracting higher fees for application, valuation, legal, settlement and early termination fees.

Therefore, more transparency in the pricing of loan products such as fees and interest rates will promote greater borrower understanding and allow them to compare between loan products or financial institutions effectively.

Moreover, borrowers are faced with different loan products described in different terminologies which often create difficulty and confusion. Thus, standardised taxonomy on loan products especially on fees should be considered for easier comparison between products which enables borrowers to make fully informed decisions.

While the account switching package aimed at improving the efficiency and ease of changing or switching transaction accounts for financial consumers was announced in 2008, ACCI considers that a "switching package" that simplifies the administrative steps for switching loan products should also be promoted to encourage competition in the lending market.

7. OTHER POLICY OPTIONS

This section discusses other policy options which will have direct implications on small business access to finance.

7.1 Government Guarantee on Small Business Loans

Unlike other economies such as the US, Canada, Japan, Korea and Singapore, Australia currently does not have a public or private organisation(s) mandated to provide financial support or assistance to SMEs.

Many countries have extended and diversified their government guarantee loan schemes to alleviate small business credit constraints following the GFC, for example[33]:

- In the United States, the Small Business Administration (SBA), a US government agency that has provided support to small business since 1953, guarantees loans made to small businesses by financial institutions. Following the GFC, the SBA temporarily increased the maximum guarantee on its 7(a) Loan Program, which is designed to assist start-ups and existing small businesses, to 90 per cent;

- In the United Kingdom, the *Enterprise Finance Guarantee*, managed by the Department for Business Innovation and Skills, provides a loan guarantee scheme to facilitate business lending to SMEs; and

- In Canada, the Canadian government guarantees 85 per cent of loans made by eligible financial institutions to qualifying businesses under the *Canada Small Business Financing Program*.

While the coverage, eligibility and mechanism for these government guarantee schemes are different and have been structured to address specific difficulties faced by small businesses in each country, the governments recognise their role in increasing availability of credit to SMEs.

Given that Australian SMEs continue to face difficulties in accessing finance, ACCI considers that there is scope for the Australian government to explore the feasibility of establishing a similar small business loan guarantee scheme in Australia. Any small business loan guarantee programs should be temporary until normality returns to the credit market.

[33] For detailed discussion on international experienced in small business loan guarantee, please refer to the March 2010 ACCI submission to the Senate Inquiry into Access of Small Business to Finance.

7.2 Credit Conditions Survey

At presence, there is a lack of publicly available information on changes in the availability of mortgage and business finance in Australia.

ACCI considers that the Reserve Bank should conduct a quarterly credit conditions survey on bank and non-banks to highlight the trends and developments in credit conditions for households and businesses. Similar surveys have been conducted by central banks in developed countries, such as the *Senior Loan Officer Survey* conducted by the US Federal Reserve and the Bank of Canada and the *Credit Conditions Survey* conducted by the Bank of England.

The publicly available information on the availability of finance will help inform policymakers on the needs for additional efforts designed to help borrowers especially the SMEs during economic downturn.

8. ACCI RECOMMENDATIONS

Restoring competition in the Australian banking system is the key to improving small business access to affordable finance. Therefore, ACCI proposes that:

8.1 Major Recommendations

Recommendation 1: Based on current levels of competition, the Government should rule out any significant future merger and acquisition activity in the Australian retail banking system and the wider financial services sector which would consolidate the dominance of any one of the four major banks. ACCI would encourage initiatives to assist in the development of a 'fifth' or additional pillar to provide effective competition to the existing large incumbents.

Recommendation 2: The Government should promote a level playing field between major banks, regional banks, foreign owned banks and non-bank lenders. For example, by phasing out the interest witholding tax (IWT) on most forms of offshore borrowing by financial institutions more quickly.

Recommendation 3: Consideration should be given to explore new measures to reduce the cost of funding for Australian financial institutions especially the regional banks including:

- Equalising of the fee applicable to the Australian Government Wholesale Funding Guarantee Scheme between the major banks and smaller ADIs; and
- Improving market liquidity by allowing Australian banks the capacity to issue covered bonds.

Recommendation 4: The Government should improve liquidity of the securitisation market through the Australian Office of Financial Management (AOFM) until normality returns to the securitisation market.

Recommendation 5: The Government should explore the feasibility of a temporary small business loan guarantee scheme. Such schemes operate in several jurisdictions including the US, UK and Canada with varying levels of eligibility and coverage. Proper design would be essential to avoid unintended consequences and such a scheme if implemented should be considered a temporary measure prior to the return of greater competition in the market place.

Recommendation 6: In the face of anticipated regulatory changes by international banking supervision agencies, Australian policymakers need to be aware that supervision and examination policies may unintentially impede banking competition as well as limit lending to small businesses. Care needs to be taken to ensure that more onerous Basel III rules applying to foreign banks relative to our domestic institutions do not have the effect of reducing competition in our market.

8.2 Additional Recommendations

Recommendation 7: The Reserve Bank or other related government agencies should conduct a quarterly credit conditions survey on banks and non-banks to assess the trends and developments in credit conditions for households and businesses.

Recommendation 8: Lenders should only be allowed to charge loan exit fees on a cost recovery basis when borrowers choose to switch to other lenders during the term of the loan.

Recommendation 9: The Government should encourage clearer information on financial products and transparency in loan pricing to promote greater willingness of depositors or borrowers to switch between banks. Taxonomy on loan and other financial products should be standardised to enable easier comparison.

Recommendation 10: In addition to this Senate inquiry process, the Government should commission the Productivity Commission to conduct an inquiry into examining the degree of competition in the provision of business finance. The study should examine:

a. The impact of an increasing/decreasing number of participants in lending markets;

b. The implication of repricing of risk to businesses;

c. The changes that have occurred in the cost and availability of finance to business, especially smaller enterprises, over time; and

d. International experiences in encouraging banking competition and their advantages and disadvantages if applied in Australia.

9. ACCI MEMBERS

ACT AND REGION CHAMBER OF COMMERCE & INDUSTRY
12A THESIGER COURT
DEAKIN ACT 2600

T: 02 6283 5200
F: 02 6282 2439
E:chamber@actchamber.com.au
W: www.actchamber.com.au

AUSTRALIAN FEDERATION OF EMPLOYERS AND INDUSTRIES
PO BOX A233
SYDNEY SOUTH NSW 1235

T: 02 9264 2000
F: 02 9261 1968
E: afei@afei.org.au
W: www.afei.org.au

BUSINESS SA
ENTERPRISE HOUSE
136 GREENHILL ROAD
UNLEY SA 5061

T: 08 8300 0000
F: 08 8300 0001
E: enquiries@business-sa.com
W: www.business-sa.com

CHAMBER OF COMMERCE & INDUSTRY WESTERN AUSTRALIA
PO BOX 6209, HAY STREET EAST
EAST PERTH WA 6892

T: 08 9365 7555
F: 08 9365 7550
E: info@cciwa.com
W: www.cciwa.com

CHAMBER OF COMMERCE NORTHERN TERRITORY
CONFEDERATION HOUSE
SUITE 1, 2 SHEPHERD STREET
DARWIN NT 0800

T: 08 8982 8100
F: 08 8981 1405
E: darwin@chambernt.com.au
W: www.chambernt.com.au

NEW SOUTH WALES BUSINESS CHAMBER
LEVEL 15, 140 ARTHUR STREET
NORTH SYDNEY NSW 2060

T: 132696
F: 1300 655 277
W: www.nswbc.com.au

VICTORIAN EMPLOYERS' CHAMBER OF COMMERCE & INDUSTRY
GPO BOX 4352
MELBOURNE VIC 3001

T: 03 8662 5333
F: 03 8662 5462
E: vecci@vecci.org.au
W: www.vecci.org.au

ACCORD
SUITE 4.02, LEVEL 4, 22-36 MOUNTAIN STREET
ULTIMO NSW 2007

T: 02 9281 2322
F: 02 9281 0366
E: bcapanna@accord.asn.au
W: www.accord.asn.au

AGRIBUSINESS EMPLOYERS' FEDERATION
GPO BOX 2883
ADELAIDE SA 5001

T: 08 8212 0585
F: 08 8212 0311
E: aef@aef.net.au
W: www.aef.net.au

CHAMBER OF COMMERCE & INDUSTRY QUEENSLAND
INDUSTRY HOUSE
375 WICKHAM TERRACE
BRISBANE QLD 4000

T: 07 3842 2244
F: 07 3832 3195
E: info@cciq.com.au
W: www.cciq.com.au

TASMANIAN CHAMBER OF COMMERCE & INDUSTRY
GPO BOX 793
HOBART TAS 7001

T: 03 6236 3600
F: 03 6231 1278
E: admin@tcci.com.au
W: www.tcci.com.au

AIR CONDITIONING & MECHANICAL CONTRACTORS' ASSOCIATION
30 CROMWELL STREET
BURWOOD VIC 3125

T: 03 9888 8266
F: 03 9888 8459
E: deynon@amca.com.au
W: www.amca.com.au/vic

AUSTRALIAN BEVERAGES COUNCIL
SUITE 4, LEVEL 1
6-8 CREWE PLACE
ROSEBERRY NSW 2018

T: 02 9662 2844
F: 02 9662 2899
E: info@australianbeverages.org
W:www.australianbeverages.org

AUSTRALIAN MINES & METALS ASSOCIATION
LEVEL 10
607 BOURKE STREET
MELBOURNE VIC 3000

T: 03 9614 4777
F: 03 9614 3970
E: vicamma@amma.org.au
W:www.amma.org.au

CONSULT AUSTRALIA
LEVEL 6, 50 CLARENCE STREET
SYDNEY NSW 2000

T: 02 9922 4711
F: 02 9957 2484
E: acea@acea.com.au
W:www.consultaustralia.com.au

AUSTRALIAN FOOD & GROCERY COUNCIL
LEVEL 2
2 BRISBANE AVENUE
BARTON ACT 2600

T: 02 6273 1466
F: 02 6273 1477
E: info@afgc.org.au
W:www.afgc.org.au

AUSTRALIAN PAINT MANUFACTURERS' FEDERATION
SUITE 1201, LEVEL 12
275 ALFRED STREET
NORTH SYDNEY NSW 2060

T: 02 9922 3955
F: 02 9929 9743
E: office@apmf.asn.au
W:www.apmf.asn.au

LIVE PERFORMANCE AUSTRALIA
LEVEL 1
15-17 QUEEN STREET
MELBOURNE VIC 3000

T: 03 9614 1111
F: 03 9614 1166
E: info@liveperformance.com.au
W: www.liveperformance.com.au

AUSTRALIAN INTERNATIONAL AIRLINES OPERATIONS GROUP
C/- QANTAS AIRWAYS
QANTAS CENTRE
QCD1, 203 COWARD STREET
MASCOT NSW 2020

T: 02 9691 3636
F: 02 9691 2065

AUSTRALIAN RETAILERS' ASSOCIATION
LEVEL 10
136 EXHIBITION STREET
MELBOURNE VIC 3000

T: 1300 368 041
F: 03 8660 3399
E: info@retail.org.au
W:www.ara.com.au

MASTER BUILDERS AUSTRALIA
LEVEL 1, 16 BENTHAM STREET
YARRALUMLA ACT 2600

T: 02 6202 8888
F: 02 6202 8877
E: enquiries@masterbuilders.com.au
W:www.masterbuilders.com.au

AUSTRALIAN MADE, AUSTRALIAN GROWN CAMPAIGN
SUITE 105, 161 PARK STREET
SOUTH MELBOURNE VIC 3205

T: 03 9686 1500
F: 03 9686 1600
E:ausmade@australianmade.com.au
W:www.australianmade.com.au

BUS INDUSTRY CONFEDERATION
SUITE 6
6 LONSDALE STREET
BRADDON ACT 2612

T: 02 6247 5990
F: 02 6230 6898
E: isuru@bic.asn.au
W: www.bic.asn.au

MASTER PLUMBERS' & MECHANICAL SERVICES ASSOCIATION OF AUSTRALIA (THE)
525 KING STREET
WEST MELBOURNE VIC 3003

T: 03 9329 9622
F: 03 9329 5060
E: info@mpmsaa.org.au
W:www.plumber.com.au

NATIONAL BAKING INDUSTRY ASSOCIATION
BREAD HOUSE, 49 GREGORY TERRACE
SPRING HILL QLD 4000

T: 1300 557 022
E: nbia@nbia.org.au
W:www.nbia.org.au

OIL INDUSTRY INDUSTRIAL ASSOCIATION
C/- SHELL AUSTRALIA
GPO BOX 872K
MELBOURNE VIC 3001

T: 03 9666 5444
F: 03 9666 5008

RESTAURANT & CATERING AUSTRALIA
SUITE 17
401 PACIFIC HIGHWAY
ARTARMON NSW 2604

T: 02 9966 0055
F: 02 9966 9915
E:restncat@restaurantcater.asn.au
W:www.restaurantcater.asn.au

NATIONAL ELECTRICAL & COMMUNICATIONS ASSOCIATION
LEVEL 4
30 ATCHISON STREET
ST LEONARDS NSW 2065

T: 02 9439 8523
F: 02 9439 8525
E: necanat@neca.asn.au
W:www.neca.asn.au

NATIONAL FIRE INDUSTRY ASSOCIATION
PO BOX 6825
ST KILDA CENTRAL VIC 8008

T: 03 9865 8611
F: 03 9865 8615
W:www.nfia.com.au

NATIONAL RETAIL ASSOCIATION
PO BOX 91
FORTITUDE VALLEY QLD 4006

T: 07 3251 3000
F: 07 3251 3030
E:info@nationalretailassociation.com.au
W:www.nationalretailassociation.com.au

AUSTRALIAN HOTELS ASSOCIATION
24 BRISBANE AVENUE
BARTON ACT 2600

T: 02 6273 4007
F: 02 6273 4011
E: aha@aha.org.au
W: www.aha.org.au

PHARMACY GUILD OF AUSTRALIA
PO BOX 7036
CANBERRA BC ACT 2610

T: 02 6270 1888
F: 02 6270 1800
E: guild.nat@guild.org.au
W:www.guild.org.au

PLASTICS & CHEMICALS INDUSTRIES ASSOCIATION
LEVEL 1, 651 VICTORIA STREET
ABBOTSFORD VIC 3067

T: 03 9429 0670
F: 03 9429 0690
E: info@pacia.org.au
W:www.pacia.org.au

PRINTING INDUSTRIES ASSOCIATION OF AUSTRALIA
25 SOUTH PARADE
AUBURN NSW 2144

T: 02 8789 7300
F: 02 8789 7387
E: info@printnet.com.au
W:www.printnet.com.au

STANDARDS AUSTRALIA LIMITED
LEVEL 10
20 BRIDGE STREET
SYDNEY NSW 2000

T: 02 9237 6000
F: 02 9237 6010
E: mail@standards.org.au
W:www.standards.org.au

VICTORIAN AUTOMOBILE CHAMBER OF COMMERCE
7TH FLOOR
464 ST KILDA ROAD
MELBOURNE VIC 3004

T: 03 9829 1111
F: 03 9820 3401
E: vacc@vacc.asn.au
W:www.vacc.com.au

AUSTRALIAN DENTAL INDUSTRY ASSOCIATION
LEVEL 5, 757 ELIZABETH STREET
ZETLAND NSW 2017

T: 1300 943 094 OR 02 9319 5631
F: 02 9319 5381
E: adia@adia.org.au
W: www.adia.org.au