

30 November 2010

Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir/Madam,

Submission to the Senate inquiry into competition in the Australian Banking Sector

ING Bank (Australia) Limited trading as ING DIRECT commends the Federal Government for instigating an inquiry into the level of competition in the Australian banking sector to critically determine how the level of competition within this sector can be increased.

ING DIRECT strongly believes that healthy competition is the only means by which we will see the customer driving the market, interest rates, products on offer and fees. Over-regulating the banking sector will not achieve this and will see an increase in costs which will ultimately not be of any benefit to the consumer.

ING DIRECT has been an authorised deposit-taking institution since 1994 and is the 5th largest retail bank in Australia. We are part of the global ING Group, one of the world's largest financial institutions offering banking, insurance and asset management to more than 60 million clients in over 50 countries. Along with high interest, fee-free savings products - the ING DIRECT Savings Maximiser and Business Optimiser, ING DIRECT also offers a range of mortgage products.

ING DIRECT employs over 900 staff and has won a range of awards for its mortgage lending products and services.

Our aim is to continue making available high interest paying online deposit products with no ongoing account keeping fees. ING DIRECT was one of the first banks to offer very attractive deposit interest rates with no fees attached and no minimum deposit amount required. As you would be aware, it is these initiatives by ING DIRECT that drove other banks to compete with our products and offer consumers a range of competitive deposit products to select from.

With our mortgage products ING DIRECT is committed to providing Australians with an alternative to the big four in the mortgage market. We will continue to strive to develop products that include features that consumers have said they want and provide these products at very competitive interest rates with no hidden costs. For our mortgages we are primarily a broker bank, thus supporting the non-bank sector and will seek to increase mortgage production in 2011. While we have a direct channel available for our mortgage customers, ING DIRECT has never encouraged a two tiered interest rate structure. We have and will continue to be transparent in the channels of choice available to customers and our service and treatment of our customers will always be of the same superior quality. There will be no division to the customer irrespective of the customer coming directly to ING DIRECT or through our broker network.

We share the Government's concerns relating to the decline in competition among the smaller banks and the non-banking sector. It is only customer choice that will continue to drive the future of retail banking in Australia. For these to be delivered we need a dynamic and responsive market.

We see four substantial barriers to entry that puts ING DIRECT among other smaller banks at a competitive disadvantage. In order to generate real competition in the banking sector which would see the consumer leading the market, we urge the Government to consider the following barriers that currently impede real competition.



1. The Cost of Funding.

The availability of different means of raising capital is a key factor that drives interest rate and is vital to promote competition in the financial services sector and reduce the cost of raising capital.

In this area ING DIRECT recommends the Government to focus primarily on

- A Securitisation
- B Residential Mortgage Backed Securities
- C Permitting Covered Bonds in Australia.

A Securitisation

A key factor that drives interest rates is a bank's ability to raise funds. A functioning and growing securitisation market is vital to support competition in Australia's financial markets. As a result of the financial crisis there has been a further consolidation among Australia's banks, withdrawal of a number of internal banks and financiers and withdrawal or sale of a number of non-bank financial institutions.

The Government, regulators and the major banks have appropriately focused on financial stability as the overwhelming priority during the financial crisis but with an economic recovery underway attention should be directed to the structure and sustainability of the post-crisis financial system.

The role and importance of securitisation in financial systems has been recently recognised by the International Monetary Fund (IMF) and is also privately acknowledged by the Australian Government and regulators. Securitisation has an important role to play to augment the flow of funds within the Australian market and provide an element of competition in terms of product innovation, price and service to both Australians seeking home loans and businesses looking to fund income producing commercial property, new equipment and motor vehicle purchases.

Australia's securitisation market has stood the test of the financial crisis in terms of the transaction structures used in Australian securitisations and the credit performance of underlying asset pools, not only prime residential mortgages but also non-conforming residential mortgages. This reflects not only rigour in securitisation practices in Australia but also the prudent standards that operate in Australia's home loan and consumer finance markets.

B Residential Mortgage Backed Securities ("RMBS")

We urge the Government to continue its support in the area of the RMBS market either through the investment program of the Australian Office of Financial Management ("AOFM") or some other mechanism. The actions taken by the AOFM over the past two years to support the RMBS market have enabled smaller lenders to access funding in volumes and at prices that were otherwise unavailable. The funding from this program has assisted smaller lenders to continue providing competition in the mortgage market.

ING DIRECT executed our inaugural market RMBS deal (IDOL Trust Series 2010-1) in October 2010 with the support of the AOFM. The continued support of the AOFM will underpin our own securitisation activities and in turn our ability to continue competing in the mortgage market and providing consumers with cost effective mortgage products.

C Covered Bonds

We urge the Government that is so committed to enhancing banking competition, to permit Authorised Deposit Taking Institutions ("ADIs") to issue Covered Bonds. We understand that the Australian Prudential Regulation Authority ("APRA") has a view that the introduction of covered bonds would require an amendment to the Banking Act 1959 and we recommend the Government to make the necessary amendments urgently.

Access to covered bonds would take some of the pressure off funding costs and enable ADIs to issue a security with a credit rating higher than the rating of the ADI itself. ING DIRECT, for example, has a long term rating of A+ from Standard and Poor's but could issue a covered bond with a AAA rating. The capability to issue covered bonds would allow ADIs to access a pool of investors who are



restricted to higher rated investments. This would offer a lower cost funding alternative than traditional unsecured term funding and securitisation. This combination of increased funding at a lower cost would definitely assist us to meet some of our funding costs.

Pressure on funding is not something unique to Australia. It has been felt globally and in June this year we saw the central bank of New Zealand endorsing the issue of covered bonds in New Zealand. We need the Government to take note that Canadian banks have started selling covered bonds to Australian investors which raises the fear that domestic banks are at a disadvantage as they cannot issue them, hence the added urgency to permit ADIs in Australia to issue covered bonds.

We also recommend the Government to consider the impact and role Superannuation plays in cost of funding in Australia. While saving for retirement is an absolute priority and supported strongly by ING DIRECT, the Government needs to clearly investigate if the funds invested in Superannuation can be diversified in such a way that it could assist with funding of the banking system.

Trustees of superannuation funds are legally obliged to have an investment strategy that takes into account diversification, liquidity and the balance of risk and return in the best interest of the members [Superannuation Industry (Supervision) Act 1993]. There is a need to bridge the gap between superannuation funds sending much of their funds offshore and the needs of the Australian community, which is made up of the members they serve. Legislation could easily be drafted to support this public interest in the same way it was used to establish the current super industry. Leaving the superannuation funds (and other institutional investors) to direct investment according to the market system contributed to the global financial crisis. We must be conscious of this and take measures to prevent an adverse situation to ourselves especially with the proposed increase in the superannuation guarantee from 9% to 12%.

2. Taxation.

A competitive taxation system is absolutely essential both for the international competitiveness of the financial services sector and to reduce the cost on raising funds. This will enable second tier banks in providing products that are competitively priced thereby encouraging customers to shop around - resulting in the consumer driving the price of mortgage products.

In this space ING DIRECT urges the Government to look at:-

- A. reducing the cost of Interest Withholding Tax ("IWT") that is charged to Australian banks
- B. provide consumers with a serious tax free threshold on interest income from savings

A. Interest Withholding Tax

The 10% IWT on the interest that Australian banks pay to their non-resident affiliated banks make such borrowings uneconomic which reduces the banks' ability to offer mortgage and credit products at competitive interest rates. ING DIRECT has several sister companies around the world that have surplus savings they wish to invest. The IWT prevents ING DIRECT from accessing these moneys to fund Australia's mortgages and small businesses.

The Henry Review recommended the abolition of IWT on interest paid to non-residents by financial institutions operating in Australia and consideration being given to negotiating in future tax treaties, a reduction in IWT to zero.

The Johnson report recommended abolishing IWT on interest paid by Australian banks on funds raised offshore. The Government acknowledged the above recommendation made in both reports and announced the phasing down of IWT incurred by foreign bank subsidiaries on interest paid on offshore borrowings in the 2010 Federal budget, commencing from 2013.

With the decline in competition in the Banking industry and in order to bridge the disparity between the 4 major banks and the rest of the banking sector, we urge the Government to consider bringing forward the implementation of the IWT reduction to 2011 for both branches of foreign financial



institutions and Australian subsidiaries. The Global Financial Crisis has not only reduced the supply of funds from 'widely held' securities, but it has also increased the cost of obtaining that inter-bank finance for the smaller banks.

B. Tax concessions on interest income on savings

The Government recognised the need to encourage and increase consumer savings and in the 2010 Federal budget announced the introduction of a 50% tax discount on up to \$1,000 of interest earned by individuals, including interest earned on deposits held in an authorised deposit-taking institutions, bonds, debentures and annuity products. This measure was to commence on 1 July 2011.

Unfortunately, on 9 November 2010 we were informed that the Government has delayed the tax discount for interest income by 12 months and lowered the cap on interest income to \$500 in 2012-13 and thereafter up to \$1000 of interest income earned.

From data released by APRA, it has been noted that household savings fund only approximately 19% of total resident assets. Asset growth has outstripped savings growth, increasing reliance on other funding sources. If the Government would like to see a significant increase in household savings, we recommend that the Government reconsider its decision to delay the implementation of this tax concession on savings.

Currently the tax regime favours superannuation and investment housing as savings/investment tools over bank deposits. While this is absolutely essential for the future of our country, we need to consider that much of the money invested in superannuation products is invested offshore and Australia does not receive the short term benefits of this funding.

3. Empowering the consumer to switch products and banks

We acknowledge the Government's initiative to enhance competition by introducing the account switching package in 2008. It is clear that direct debits and credits serve the purpose of tentacles for banks to hold onto customers by restricting them from moving to another provider. Unfortunately, for the Account Switching package to work effectively, changes are required under the Bulk Electronic Clearing System ("BECS") rules. Currently consumers do not find the package convenient or user friendly and are reluctant to initiate switching to other banks even when they are not happy with the service provided to them by their current bank.

Since the customer has to open a new account number and then take the responsibility to actually transfer the credits and debits over, there is reluctance on the part of consumers to initiate a change.

Portability of a single account number from one bank to another where all debits & credits already linked to that account are automatically transferred over to the new bank, is the ultimate goal the Government should aim at achieving.

However there are other short term options that are being trialled in other countries which Australia should also seriously consider. One such option is a change taking place in New Zealand. The media has announced that in New Zealand, a new company called 'Payments NZ' owned by ANZ, Westpac, ASB, BNZ, Kiwibank, HSBC TSB and Citibank, has been established. Our understanding is that Payments NZ, will be taking over the New Zealand Bankers' Association's Electronic Credit System Code and the Direct Debit Systems Code, which documents the operational agreements and arrangements among member banks for clearing electronic credits and direct debits. Under this proposed model, the customers will fill out a form authorising the incoming bank to get all the customer's information relating to direct debits & credits linked to their existing account from the outgoing bank and the incoming bank will organise the entire switching process and have the direct debits and credits linked to the new account number with the incoming bank. A structure such as this eases the burden on consumers when initiating a change in banks.

ING DIRECT commends the Government on the release of the Australian Securities and Investments Commission ("ASIC") guidance for mortgage lenders on mortgage early termination fees. ING DIRECT strongly discourages the introduction of further regulation on fees. Any further regulation will



add to the ever escalating compliance cost which will eventually flow through to costs to the consumer.

For account switching to work, customers will look for both the cheaper price and convenience of access. With today's technological advancements and lack of time, accessing accounts electronically is important to customers.

We applaud the Government on the release of the draft Bill which amends the Anti Money Laundering and Counter Terrorism Financing Act ("AML/CTF Act") and Privacy Act to enable regulated businesses to use credit reporting data held by credit reporting agencies to verify the identity of their customers for the purposes of the AML/CTF Act. ING DIRECT looks forward to the implementation of this legislation which will allow more customers to be verified electronically rather than making them go to an Australian Post branch to be verified manually. In addition to the high cost, this inconvenient process discourages prospective customers from taking the initiative to switch banks and from taking up our deposit products, thus putting ING DIRECT at a competitive disadvantage to those banks that have branches. The implementation of this legislative amendment will support smaller internet banks such as ING DIRECT to remain competitive in the banking sector by introducing cost effective mortgage products that will enhance consumer choice.

4. The future of the Government deposit guarantee cap

Another factor that we believe may be of importance for the Government to consider alongside increasing the level of competition within the financial sector is the future of the Government's deposit guarantee cap post October 2011, particularly in relation to retail term deposits. Any ambiguity or confusion around the deposit guarantee or the absence of a timely clarification from government could be detrimental to the confidence in the banking system, particularly for those banks outside of the four major banks, and have a flow on effect on banking competition. If the Government's decision is to continue providing a Government guarantee, we believe that the level of the Government guarantee cap must continue to be appropriate for the Australian banking industry and must continue to sustain competition within the Australian banking industry.

In conclusion we would like to thank the Federal Government once again for genuinely looking into the means of increasing the level of competition within the Australian banking sector and look forward to addressing any questions that you may have.

Please feel free to contact me on 02 9028 4544, to discuss any items raised in our submission.

Regards

Mark Mullington
Chief Financial Officer
ING Bank (Australia) Limited

