

# **Chapter 1**

## **Introduction**

1.1 Competition in Australia's banking sector, or the (alleged) lack thereof, has attracted substantial attention in recent times, especially so far as it manifests in interest rates charged to home loan borrowers. This report aims to put forward the facts about the extent of competition in the sector and, where inadequacies are identified, to suggest remedies.

### **Referral of the Inquiry**

1.2 On 28 October 2010, on a motion by Senators Bushby, Williams and Xenophon, the Senate referred a number of matters relating to competition in the Australian banking market to the Senate Economics References Committee for inquiry and report by 31 March 2011. The terms of reference setting out the matters to be investigated during the inquiry were as follows:

Competition within the Australian banking sector, including:

- (a) the current level of competition between bank and non-bank providers;
- (b) the products available and fees and charges payable on those products;
- (c) how competition impacts on unfair terms that may be included in contracts;
- (d) the likely drivers of future change and innovation in the banking and non-banking sectors;
- (e) the ease of moving between providers of banking services;
- (f) the impact of the large banks being considered 'too big to fail' on profitability and competition;
- (g) regulation that has the impact of restricting or hindering competition within the banking sector, particularly regulation imposed during the global financial crisis;
- (h) opportunities for, and obstacles to, the creation of new banking services and the entry of new banking service providers;
- (i) assessment of claims by banks of cost of capital;
- (j) any other policies, practices and strategies that may enhance competition in banking, including legislative change;
- (k) comparisons with relevant international jurisdictions;
- (l) the role and impact of past inquiries into the banking sector in promoting reform; and
- (m) any other related matter.

## Conduct of the inquiry

1.3 The Committee advertised the inquiry in the national press on numerous occasions and on its website. It also wrote to relevant organisations and academics to inform them of the inquiry. After the Government announced a package of measures aimed at improving banking competition on 12 December 2010, the Committee extended the closing date for submissions to 14 January 2011. The Committee received over 130 submissions, which are listed in Appendix 1.

1.4 Reflecting the location of submitters, the Committee held public hearings in Canberra (15 December 2010 and 9 February 2011), Melbourne (25 January 2011), Sydney (13 and 14 December 2010, 21 January and 9 March 2011) and, after deferring it to allow witnesses to recover from the floods, Brisbane (4 March 2011). Teleconference facilities were used to hear witnesses from other locations such as Perth.

1.5 The witnesses included the CEOs of all four major banks and a number of smaller banks, the Governor of the Reserve Bank and senior government officials. The witnesses who appeared at these hearings are listed in Appendix 2. The Committee thanks those who contributed to the inquiry. It particularly thanks the Reserve Bank of Australia and the Australian Securitisation Forum for providing a briefing and useful materials.

1.6 In conducting this inquiry, the Committee was able to draw on its previous inquiries into bank mergers (September 2009), bank funding guarantee schemes (September 2009) and finance for small business (June 2010), as well as submissions to an inquiry by its sister committee on the Banking Amendment (Delivering Essential Financial Services for the Community) Bill 2010.<sup>1</sup>

1.7 It was noticeable that banking competition appeared to heat up during the inquiry, with one major bank announcing it was 'breaking up' with the others, and banks cutting fees and offering enticements to customers to move to them. The Committee agrees, however, with one witness who commented:

I would like to see an environment that ensures the competitiveness continues into the long term and not just for the duration of the Senate inquiry...<sup>2</sup>

1.8 There were other ways in which the world would not stay still while the Committee prepared its report. The Government, perhaps spurred by the attention the Committee's hearings were giving to the topic, announced a number of initiatives, referred to in the relevant chapters here.

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1 The Senate Economics Legislation Committee did not make a substantive report on the bill due to the calling of the 2010 federal election soon after the bill was referred.

2 Mr John Minz, Chief Executive Officer, Heritage Building Society, *Proof Committee Hansard*, 4 March 2011, p 15.

1.9 To enable the report to reflect fully the implications of these changes and the large volume of evidence compiled, the Committee viewed an extension of its reporting date as desirable and the Senate decided on 24 March 2011 to extend the reporting date to 27 April 2011.

## **Outline of the report**

1.10 The report is effectively divided into two parts. The first part provides context and identifies the problems. Background information on the Australian financial sector and developments in competition are provided in Chapter 2. The previous inquiries into bank competition are discussed in Chapter 3. This chapter also endorses calls for a new comprehensive inquiry into the operation of the financial system. The degree of competition in the Australian banking market is assessed in Chapter 4 and it is noted that Australian banks are very profitable, offering large returns to investors and relatively low risk. The contentious issue of the relationship between the interest rate charged by banks on variable rate home mortgage loans and the policy rate set by the Reserve Bank is covered in Chapter 5. The overall conclusion reached is that prior to the global financial crisis (GFC) there was vigorous competition in lending markets. International factors then created serious problems for smaller lenders and the big four banks increased their market share as there was a 'flight to quality' by nervous investors and depositors. The Australian Government, like those overseas, placed greater emphasis on stability than competition during this period. As the effects of the GFC pass, and regulators respond to the lessons learned from it, competition has heated up for deposits but not yet for loans. The Committee believes the time has come to again place more emphasis on boosting competition.

1.11 Having identified some inadequacies in competition, the following chapters seek remedies. There is no 'silver bullet'. No single recommendation will transform the banking sector into a paragon of competition. Rather, a number of smaller recommendations are made, each of which will improve the operation of the banking market. In addition some other possibilities are identified which warrant further investigation. Small businesses are important customers of banks and their situation is addressed in Chapter 6. The ease of moving between banks, and in particular the role of mortgage exit fees, forms the subject of Chapter 7. The report then turns to competition and consumer issues, with Chapter 8 reviewing proposals to ban 'price signalling', Chapter 9 discussing mergers and measures to increase the number of competitors and Chapter 10 concerned with unfair banking contracts. Prudential supervision, including the new Basel III rules, while generally welcomed on prudential grounds, was raised as a possible impediment to competition and this is examined in Chapter 11. The role of government guarantees in potentially either encouraging or impeding competition is discussed in Chapter 12. Markets for bank bonds are the focus of Chapter 13 and Chapter 14 looks at competition in the payments system. Chapter 15 looks at taxation and related matters.

