Chapter 3

Past reviews and calls for a new review

Introduction

3.1 This chapter both looks back to previous inquiries into the banking system and forward to calls for a new inquiry.

3.2 Five main inquiries into the Australian banking system, mostly following crises, have been identified by Associate Professor Selwyn Cornish.[1] These are the 1937 Royal Commission, the Campbell Committee, the Vic Martin Review Group, the Stephen Martin Report and the Wallis Report. After briefly discussing some earlier inquiries, this chapter examines each of these in turn, and then some recent parliamentary inquiries.

3.3 Drawing on Sir Harold Knight's[2] comments on the Campbell Committee, Mr Cornish described the role of the inquiries as being:

> …*an* agent of change rather than being *the* agent of change. It hastened the process of change and it did so by refocusing a hitherto inchoate or rather amorphous debate much more sharply on the key issues. It provided coherence and authority. An impressive report was produced, which set out the issues systematically. It argued judiciously and it concluded succinctly.[3]

3.4 The Committee hopes that future historians will make the same judgement about this inquiry.

3.5 But a difference between this inquiry and earlier inquiries is that this inquiry is more tightly focused, examining in particular *competition* in the banking system. By contrast, the earlier inquiries:

> …have not focused on what might be considered micro-economic issues; they were focused more on macro issues.[4]

> …have focused on bank stability, APRA regulation issues, bank accounting procedures and generally structural issues concerning bank operations. The

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1 Associate Professor Selwyn Cornish, *Submission 9*; *Committee Hansard*, 13 December 2010, p 112. Mr Cornish has written extensively on the development of economic policy in Australia and is currently working for the Reserve Bank on its official history from 1975 to 2000. He has written a shorter history of the Bank in Cornish (2010).

2 Sir Harold served as Governor of the Reserve Bank from 1975 to 1982.

3 Associate Professor Selwyn Cornish, *Committee Hansard*, 13 December 2010, p 112.

4 Associate Professor Selwyn Cornish, *Committee Hansard*, 13 December 2010, p 114.

> issue of competitive environment was not generally addressed, nor do the banks encourage it to be addressed.[5]

3.6 One difference between the various inquiries was the extent to which they were independent of government. The 1937 inquiry was a Royal Commission and the Stephen Martin inquiry, like this one, was by a parliamentary committee. Of the others, Professor Valentine's view is that:

> The Campbell inquiry was completely independent. In fact, I can tell you now, many years after the event, there were some rather furious confrontations with the then secretary of the Treasury, John Stone…He, for example, did not want the committee to recommend a floating exchange rate. The Wallis committee was half and half. It had an independent committee but the secretariat was...basically a Treasury secretariat.[6]

3.7 A common feature is that they were initiated by governments in response to public concerns. It has been noted that governments have reflected concerns about banks in their rhetoric for a long time:

> Looking at it over the last 20 years, every Treasurer, Prime Minister and minister has attacked the banks, verballed them, said awful things, threatened them, wept and cried…but nothing has changed.[7]

3.8 One submitter traced these concerns much further back:

> "The issue which has swept down the centuries and which will have to be fought sooner or later is the people versus the banks"; Lord Acton (1875)[8]

Early reviews of banking competition

3.9 Before the 1937 Royal Commission, there were at least three parliamentary committees which inquired into the banking system. As one witness observed:

> All the inquiries we have had, going back to the New South Wales upper house inquiry into monetary confusion in the 1840s, have talked about introducing new players and stimulating competition—and so did the Campbell and Wallis inquiries.[9]

3.10 The Tasmanian Parliament appointed a select committee in 1934 to review the financial system in that state. Influenced by the theories of the Douglas Social Credit

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5 Mr Mervin Reed, *Submission 5*, p 14.

6 Professor Tom Valentine, *Committee Hansard*, 25 January 2011, p 66.

7 Mr Peter Strong, Executive Officer, Council of Small Business Organisations of Australia, *Committee Hansard*, 15 December 2010, p 10.

8 Cited by Mrs Barbara and Mr Richard Wright, *Submission 18*, p 1. Lord Acton is probably best known for his dictum that 'power corrupts and absolute power corrupts absolutely'.

9 Mr David Richardson, Australia Institute, *Committee Hansard*, 15 December 2010, p 32.

movement it was critical of the 'monopoly of finance as represented by the private banks and their subsidiaries'.[10]

The 1937 Royal Commission

3.11 The Royal Commission into the Monetary and Banking Systems in Australia[11] (1935-1937) arose from concerns that the banking system had exacerbated the depressions of the 1890s and early 1930s. At the 1935 election the Country Party (and the Labor Party) had promised an inquiry and when the conservative government led by Joseph Lyons was forced to form a coalition with the Country Party, he agreed to establish an inquiry.[12]

3.12 The Commission was chaired by Justice John Napier and among its members was future treasurer and prime minister Ben Chifley.[13] The Commission held 105 public sessions and heard from 200 witnesses.[14]

3.13 The Royal Commission concluded the best system would be one:

> …in which trading banks and other financial institutions are integral parts of the system, with a central bank which regulates the volume of credit and currency.[15]

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10 Parliament of Tasmania, *Monetary System: Report of Select Committee*, 1935.

11 Its full name was *Royal Commission appointed to inquire into the Monetary and Banking Systems at present in operation in Australia, and to report whether any, and if so what, alterations are desirable in the interests of the people of Australia as a whole, and the manner in which any such alterations should be effected*.

12 Chapter One of Sutherlin (1980) discusses this in more detail.

13 The other members were Edwin Nixon, an accountant who had also served on the Royal Commission on Taxation; Richard Mills, Professor of Economics at the University of Sydney (who according to Groenewegen (1986) and Sutherlin (1980, p 47) was responsible for much of the drafting); Henry Pitt, Director of Finance at the Victorian Treasury; and Joseph Abbott, president of the Graziers' Association of New South Wales. The secretary was W Harris, a Treasury accountant, and the staff economist was John Phillips, a student of Mills then with the Retail Traders Association who went on to become the Reserve Bank's second governor. The Government sounded out some overseas experts about being on the commission but could not find someone they regarded as suitable who was willing to participate; Sutherlin (1980, pp 32-35). Phillips reflected much later that 'the Royal Commission's major impact was the education of Ben Chifley'; Sutherlin (1980, p 278).

14 Hearings were advertised and 'all who intimated their desire to appear before the Commission were given an opportunity to appear'; Royal Commission into Monetary and Banking Systems, *Report*, p 5.

15 Royal Commission into Monetary and Banking Systems, *Report*, p 201. Mr Chifley dissented, preferring a 'system from which the profit motive is absent'; p 263.

3.14 It recommended stricter controls – both of a direct and indirect nature – over the monetary and banking systems of Australia. Many such controls were introduced as temporary wartime measures, and then made permanent by Mr Chifley in the *Banking Act 1945*.

3.15 The Commission also suggested that banking licences be issued and only those organisations possessing one should be able to style themselves as 'banks'.[16]

3.16 The Commission remarked on the essential role played by banks and the subsequent obligations this involved:

> Under modern industrial conditions practically no branch of industry can be carried on without adequate supplies of bank credit…therefore, these banks should be regarded as enjoying a privileged position which closely resembles that of a public utility.[17]

3.17 The Commission noted the lack of adequate disclosure of profits and the lack of comparability in reported results, and made recommendations to address this.[18] The lack of good information impeded the Commission in reaching conclusions about bank profitability but it opined that the banks:

> …are entitled to a fair return for the services which they render…If these [profits] are found to exceed what may be regarded as a fair return for the services rendered, the Government should consider whether the profits of the trading banks should be regulated or limited as in the case of some public utilities.[19]

3.18 Perhaps because at the time there were ten major banks rather than four, competition was not a major focus:

> So far as they have gone, amalgamations do not appear to have lessened the competition between trading banks, which, as we have already pointed out, is in some measure restricted.[20]

3.19 The Commission supported the Commonwealth Bank continuing as a competitor with the trading banks.[21]

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16 Royal Commission into Monetary and Banking Systems, *Report*, pp 248-251. State banks and savings banks established under state law could also call themselves 'banks'.

17 Royal Commission into Monetary and Banking Systems, *Report*, p 247.

18 Royal Commission into Monetary and Banking Systems, *Report*, pp 238-246.

19 Royal Commission into Monetary and Banking Systems, *Report*, p 247. Mr Chifley recommended legislation limiting bank profits to the lower of 5 per cent on shareholders' funds or 8 per cent on paid capital; p 268.

20 Royal Commission into Monetary and Banking Systems, *Report*, p 238.

21 Royal Commission into Monetary and Banking Systems, *Report*, p 224.

3.20 The Commission's report was initially well–received, with *The Economist* comparing it favourably to similar investigations in Britain, Canada and New Zealand.[22] But growing opposition from the private banks prevented the Lyons Government implementing its recommendations.[23]

3.21 For those nostalgic for a more regulated financial system, the Commission was:

> The last inquiry to offer decent insight into the financial sector in Australia…[24]

Campbell Committee

3.22 A broad-ranging inquiry into the Australian economy in 1965 recommended a review of the credit system noting the marked changes in the monetary field since the Royal Commission, but as with most recommendations in the *Vernon Report*, no action was taken.[25] It was not until 1979 that there was another comprehensive review.

3.23 The Committee of Inquiry into the Australian Financial System (1979-1981) arose from a government promise to hold an inquiry into capital markets, which was widened to cover the whole financial system.

3.24 Associate Professor Cornish summarised the Campbell Committee report as seeking to:

> …explain how the regulatory system had broken down. The world had changed. If the monetary authorities were to succeed in combating current problems of which inflation was the major one then new systems of operation had to be implemented. The report's principal recommendation included the deregulation of bank interest rates; the introduction of tender systems for the marketing of government debt; and a managed float of the Australian dollar, not a free float. Some of these reforms were underway before the Campbell Committee reported.[26]

3.25 The reforms arising from the Campbell Committee allowed the Reserve Bank to formulate the cash rate system, which is now the major operational instrument for conducting monetary policy in Australia.

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22 *The Economist*, 16 October 1937, cited in Sutherlin (1980, pp 3, 177). See the fifth chapter of her thesis for more deatil on the reaction from the media, the banks and acdemics.

23 Sutherlin (1980, pp 237-256).

24 Dr Evan Jones, *Submission 81*, p 15.

25 *Report of the Committee of Economic Inquiry*, Volume 1, p 272.

26 Associate Professor Selwyn Cornish, *Committee Hansard*, 13 December 2010, p 113.

3.26 For Mr Cornish, the Campbell Committee report is the most impressive of the five. A contrary view was presented by Dr Evan Jones:

> … the stellar reputation of the Campbell Report is undeserved.[27]

3.27 Dr Jones argues that the inquiry started from a view that deregulation was desirable and interpreted all evidence in this light. Dr Jones claims this led to undesirable recommendations:

> The Campbell report bequeathed us abolition of specialist (including government-owned) institutions, market-based banking regulation (generally confined to hands-off prudential regulation), and market-based monetary policy (generally confined to manipulation of the cash rate). The abolition of specialist institutions has been a significant mistake…The over-dependence on prudential regulation has produced failings – lack of control over credit excesses (indeed contributing to it by the discounting of capital requirements on residential mortgage lending), lack of control over bank tendencies to illiquidity; lack of control over off-balance sheet manoeuvrings – but the attraction to the system (not least because of Basel-based global legitimation) remains undiminished. The ludicrous overdependence on the single short term cash rate instrument has produced manifest failings – a fundamental enhancing of boom and bust…[28]

3.28 The Campbell Committee emphasised free entry (or 'contestability' in the jargon) as the key to competition :

> As argued throughout this Report, any competitive deficiencies will generally be short-lived so long as there is effective freedom of entry…the mere *threat* of new entry will act as a strong incentive for established firms to remain efficient and competitive.[29]

3.29 It did, however, call for the Reserve Bank to be accorded a watchdog role:

> …the committee recommends that the Reserve Bank should undertake regular reviews of the overall functioning of the financial system, in the context of which it should diagnose and report on any structural problems that appear to exist and any barriers to effective competition, especially government-induced barriers.[30]

3.30 The Campbell Committee noted concerns about concentration in the banking industry and observed:

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27 Dr Evan Jones, *Submission 81*, p 15.

28 Dr Evan Jones, *Submission 81*, p 15.

29 *Committee of Inquiry into the Australian Financial System*, pp 531 and 538.

30 C*ommittee of Inquiry into the Australian Financial System*, p 533.

> While exactly comparable figures from other countries are not available, levels of concentration in Australia appear to be at the upper end of the spectrum by world standards – at least in respect of banking.[31]

3.31 The only response it regarded as appropriate, however, was:

> …the use of the *Trade Practices Act* to prevent an individual institution from acquiring a dominant position in the market and, in the process, substantially lessening competition.[32]

Vic Martin Review Group

3.32 The Australian Financial System Review Group (1983-1984) was commissioned by the Hawke Government soon after its election, essentially to review the Campbell Committee's recommendations in light of the incoming government's economic and social priorities. The Group was chaired by Vic Martin, the chair of the MLC insurance group, and also included Treasury and Reserve Bank officials and an academic.[33] Given the extensive recent consultation by the Campbell Committee, and its short timeframe, the Group decided against inviting public submissions or holding hearings.

3.33 The Group concluded:

> Market-oriented policy…is seen as having considerable advantages for monetary policy purposes…the Group does not consider controls over bank interest rates as appropriate for either monetary policy or prudential purposes.[34]

3.34 It supported competition in banking:

> Competition provides incentives for firms to produce at minimum cost, to price in accordance with the cost of production, and to respond to changing community needs by innovating in product design, extending product variety and so on.[35]

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31 *Committee of Inquiry into the Australian Financial System*, p 537.

32 *Committee of Inquiry into the Australian Financial System*, p 540.

33 Mr Richard Beetham from Treasury, Mr Des Cleary from the Reserve Bank and Professor Keith Hancock from Flinders University.

34 Australian Financial System Review Group, *Report*, pp 361-362.

35 Australian Financial System Review Group, *Report*, p 53.

3.35 The Group noted that mergers had led to the creation of four large banks, although at this time there were also a number of state-owned and regional banks.[36] Nonetheless the Group opined:

> …the oligopolistic structure of the industry and its regulated nature suggest that policies to enhance competition would benefit the Australian community.[37]

3.36 As well as regulatory barriers the Group identified as a barrier to increased competition:

> …the perceived difficulty of competing with the established banks, which have a substantial (albeit declining) base of non-interest-bearing deposits and strong ties with established customers.[38]

3.37 It supported the entry of foreign banks (with some limitations) but wanted to keep banks distinct from other intermediaries:

> The Group supports, as a general principle, the continuation of a basic distinction between banks and non-bank financial institutions…It reflects the view that undoubted confidence in banks is crucial to a well-functioning and stable financial system.[39]

3.38 Mr Cornish characterised the Group as:

> …a follow-up to the Campbell committee…Prime Minister Hawke and Treasurer Keating commissioned a small group…to investigate the Campbell Committee's recommendation in the light of the new government's social and political priorities. The Martin Group gave the major Campbell Committee recommendations a big tick,..[40]

3.39 Dr Jones regards it as having:

> …effectively facilitated the Hawke Labor Government 'taking ownership' of the Campbell report agenda.[41]

Stephen Martin Committee

3.40 The House of Representatives Standing Committee on Finance and Public Administration was referred an inquiry into banking and deregulation (1990-1991).

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36 As the Group puts it, 'The perception of the banking industry as oligopolistic must be modified, to some degree, by acknowledging the competition provided by State banks'; *Report*, p 53.

37 Australian Financial System Review Group, *Report*, p 54.

38 Australian Financial System Review Group, *Report*, p 51.

39 Australian Financial System Review Group, *Report*, pp 52-53.

40 Associate Professor Selwyn Cornish, *Committee Hansard*, 13 December 2010, p 113.

41 Dr Evan Jones, *Submission 81*, p 15.

The inquiry was established to assess the consequences of the financial deregulation that had ensued after the Campbell Committee's report. Its report, *A Pocketful of Change*: *Banking and Deregulation,* found that Australian banks were highly profitable by international standards. Deregulation had led to narrower interest margins overall but it appeared business was gaining more benefit than were consumers.[42] Cross-subsidies were being unwound as 'user pays' became more prevalent.

3.41 The Committee concluded concerning the impact of deregulation on competition that:

> …the four major banks have retained their market share and, accordingly, their dominant position in the industry; at the regional level, vigorous competition for market share is provided by locally based State banks, regionally operating banks and non-bank financial intermediaries; and foreign banks have had limited impact…[43]

3.42 The Committee warned that:

> The concerns which exist among various sections of the community about the trend towards increased concentration in the banking industry are shared by the Committee. There are dangers that increased concentration, by reducing the number and influence of competitors, ultimately could affect the level of industry efficiency, as the incumbent banks would be under less pressure to generate improved performances. Equally, there is greater likelihood of collusive or anti-competitive practices emerging, with consumers having less opportunity to move their business to alternative institutions. Clearly, such outcomes would be counter to the aims of financial deregulation.[44]

3.43 Accordingly, the Committee recommended:

> …the Treasurer, in considering proposals for mergers or acquisitions in the banking industry, refer to the Trade Practices Commission[45] for determination the question of whether the proposed merger or acquisition would substantially lessen competition in a substantial market, and whether there are any public benefits which would outweigh the detriment from the substantial lessening of competition.[46]

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42 A summary of the report's conclusions on banking and deregulation is given in Martin and Hawkins (1992).

43 House of Representatives Standing Committee on Finance and Public Administration (1991, p 117).

44 House of Representatives Standing Committee on Finance and Public Administration (1991, p 127).

45 The Trade Practices Commission was the forerunner to the Australian Competition and Consumer Commission.

46 House of Representatives Standing Committee on Finance and Public Administration (1991, p 128).

3.44 While the Committee was broadly supportive of the impetus to competition from deregulation, it acknowledged that banks had made some mistakes in handling the transition to a deregulated market. Access to the payments system was identified as a remaining barrier to competition.[47] The long-standing reputations and extensive branch networks of the four major banks were seen as a barrier to entry for potential competitors in the retail banking market.

3.45 Dr Jones gives the report mixed reviews:

> The [Stephen] Martin report did desirably concern itself with banking concentration (Ch.6), noting that the deregulation years had brought the Big 4 to market dominance. The Committee declined to succumb to the industry's siren song that competition was raging; indeed, it presciently raised the concern that things might be getting worse, with the threat of 'group dominance' of the entire finance system because of the latter day appearance of 'financial conglomerates'…Concerns for increasing concentration and lessening competition apart, the weighty Martin report was a fizzer.[48]

3.46 The Committee itself assessed how its recommendations had progressed a year after the report in a review called *Checking the Changes* (illustrating an advantage of an inquiry being done by a body with an ongoing existence.) This noted that the government had 'responded quickly' with some of the recommendations on foreign bank entry, supervisory arrangements and payments system matters implemented within three months.[49] A few months later the government agreed to the recommendation that a 'substantial lessening of competition' test be applied to mergers.[50] The Committee was given a continuing role in reviewing the banking industry.

3.47 The review itself concentrated on those recommendations directed to the banks, concluding:

> …most banks have made genuine efforts to implement specific recommendations and to respond to the general tenor of the Banking Report.[51]

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47 House of Representatives Standing Committee on Finance and Public Administration (1991, pp 136-142).

48 Dr Evan Jones, *Submission 81*, p 16.

49 House of Representatives Standing Committee on Banking, Finance and Public Administration (1992, pp 1-2).

50 House of Representatives Standing Committee on Banking, Finance and Public Administration (1992, p 2).

51 House of Representatives Standing Committee on Banking, Finance and Public Administration (1992, p 116).

Wallis Committee

3.48 The Financial System Inquiry (1996-1997) was established soon after the Howard Government took office, fulfilling a promise to examine the consequences of financial deregulation.

3.49 It set out an underlying philosophy:

> Free and competitive markets can produce an efficient allocation of resources and provide a strong foundation for economic growth and development.[52]

3.50 These philosophical underpinnings for the Wallis Committee have been questioned:

> As Professor Harper, who was on the Wallis inquiry, has said, they were based on the assumption that the financial markets were efficient.[53]

3.51 The Wallis Committee commented on the role of competitors to the four major banks:

> Regional banks have been an increasingly important competitive force in recent years. In particular, along with credit unions and building societies, they have led the way on service, innovation and pricing on some products...However, there is nothing immutable about the present position of regional banks.[54]

3.52 Notwithstanding this recognition of both the positive role and vulnerability of these competitors, the Wallis Committee's recommendations envisaged a reduction in controls on mergers:

> The *Trade Practices Act* should provide the only competition regulation of financial system mergers...The 'six pillars' policy – which separately imposes a government prohibition on mergers among the largest four banks and the largest life companies – should be removed.[55]

3.53 As with earlier inquiries the payment system was identified as an area for reform:

> Access to clearing systems should be widened to include all institutions fulfilling objective criteria set by the regulator.[56]

3.54 The Wallis Committee recommended creation of a separate prudential regulator for all deposit-accepting institutions, including the insurance and

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52 *Financial System Inquiry Final Report*, p 177.

53 Professor Stephen King, *Committee Hansard*, 21 January 2011, p 105.

54 *Financial System Inquiry Final Report*, p 455.

55 *Financial System Inquiry Final Report*, pp 425 and 428.

56 *Financial System Inquiry Final Report*, p 401.

superannuation industries. These recommendations on supervision, realised in the creation of the Australian Prudential Regulation Authority, were lauded by some submitters:

> At least the Wallis Inquiry appears to have achieved something beneficial in the national interest. It is reported that the government of the day overwhelmingly adopted his report and established APRA…It is likely that without APRA and its regulatory framework the Australian economy may not have emerged as unscathed from the GFC.[57]

3.55 Again, Dr Jones is less enthusiastic about the report:

> …its untarnished reputation is undeserved. Its views on competition are insipid…It kowtows to the contemporary prestige of contestability notions…[58]

Recent parliamentary inquiries

3.56 There have been a number of inquiries by parliamentary committees into aspects of competition in banking in recent years. Disappointingly, there have been no formal government responses to them.

Home loan lending (2007)

3.57 A House of Representatives committee examined home loan lending practices. It noted how the entry of new players into the home loan market and an increased preference for residential lending among existing financial intermediaries had led to a reduction in interest margins but also a loosening in credit standards which had led to an increase in mortgage defaults. The committee recommended that:

> ..the Commonwealth Government regulate credit products and advice. This includes the regulation of mortgage brokers and non-bank lenders.[59]

Competition in banking and non-banking (2008)

3.58 Perhaps the inquiry most similar to this one is that by this committee's sister committee in the House. While the global financial crisis was still raging they reviewed the state of competition in the banking market and options to improve it. Their report observes:

> The non-banking sector, which has primarily relied on securitisation as a means of funding, has been the hardest hit and, as noted above, there has

57 Mr Lindsay Johnston, *Submission 97*, p 14.

58 Dr Evan Jones, *Submission 80*, p 17.

59 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Home Loan Lending*, September 2007, p 49.

definitely been a reduction in the amount of providers and products in the mortgage market.[60]

3.59 Looking forward, their prediction was that:

Increased levels of competition will return, but with the current financial climate groups are uncertain of how long it will take and whether it will be as effective as it was prior to 2007.[61]

3.60 A proposal to create a government-guaranteed 'AussieMac', based on the Canada Mortgage and Housing Corporation, to support the residential mortgage securitisation market was evaluated. The conclusion was that the:

…proposal is not a suitable model for the Australian context.[62]

3.61 On competition law, the conclusion was:

Both the ACCC and ASIC are constrained by their respective Acts which do not provide them with the power to independently investigate and report on issues of concern that relate to competition within the marketplace.[63]

3.62 Positive credit reporting was seen as helping smaller lenders compete with the major banks and the committee recommended:

The committee supports the findings of the Australian Law Reform Commission's report and urges the government to implement the report's recommendations on reforming Australia's credit reporting system.[64]

3.63 Account switching was another focus and the committee noted that the switching rate for transaction accounts in Australia was below that in Europe. The committee noted the switching package introduced by the Government in November 2008 and recommended that the Government consider including card schemes in the package.[65] They further recommended that:

…after 12 months in operation, the Treasury review the Account Switching Package with consideration being given to any areas in which it may be enhanced, including consideration of the costs and benefits of a more centralised account switching system, such as those in operation in the UK and the Netherlands.[66]

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60 House of Representatives Standing Committee on Economics, *Competition in the banking and non-banking sectors*, November 2008, p 21.

61 *Competition in the banking and non-banking sectors*, November 2008, p 24.

62 *Competition in the banking and non-banking sectors,* November 2008, p 39.

63 *Competition in the banking and non-banking sectors*, November 2008, p 52.

64 *Competition in the banking and non-banking sectors*, November 2008, p 56.

65 *Competition in the banking and non-banking sectors*, November 2008, p 56.

66 *Competition in the banking and non-banking sectors*, November 2008, p 74.

3.64 A lengthy discussion of the impact of exit fees on competition was somewhat inconclusive:

> The committee is uncertain whether there is a definite, across the board, negative impact on competition caused by the imposition of entry and exit fees on mortgage products…The Committee recommends that…the government consider mechanisms for making entry and exit fees more transparent and for addressing unfair entry and exit fees.[67]

3.65 The importance of improved financial literacy was recognised:

> The committee recommends that the Australian Securities and Investments Commission includes a glossary of standardised financial terms in simple language on its consumer website and also on the Financial Literacy Foundation's website.[68]

Bank mergers (2009)

3.66 This committee examined bank mergers in an earlier inquiry. A focus of the recommendations was improving the provision of information:

> The Committee recommends that the ACCC increase the transparency of their merger inquiries by publishing commissioned research and submissions unless the submitter explicitly asks that they be confidential…The Committee recommends that the Government request the ACCC, APRA and the Reserve Bank to provide a joint annual report to parliament on competition in the retail banking market in Australia, and the provision of affordable banking facilities to those on low incomes, but taking care not to increase unduly the reporting burden on financial institutions.[69]

3.67 It also was concerned about further increases in concentration in the banking industry:

> The Committee recommends that the Government retain the 'four pillars' policy of not allowing a merger between any of the four major banks…The Committee regards it as reasonable for the Treasurer to impose conditions on banks before approving a merger. Once conditions are imposed, there should be independent verification and appropriate penalties if the bank is not complying.[70]

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67 *Competition in the banking and non-banking sectors*, November 2008, p 86.

68 *Competition in the banking and non-banking sectors*, November 2008, p 98.

69 Senate Economics References Committee, *Report on Bank Mergers*, September 2009, pp 53-54.

70 Senate Economics References Committee, *Report on Bank Mergers*, pp 56 and 60.

Government funding guarantees (2009)

3.68 This committee examined the Government's two schemes to provide guarantees for bank deposits and other funding introduced in October 2008. (The schemes are discussed further in Chapter 12.) The Committee recommended changes to the premia charged for the scheme:

> The Committee recommends that, in view of the experience of markets not pricing all guaranteed debt identically, the Government review the need to apply differential premia for ADIs with different ratings for the wholesale funding guarantee (and hence also that applying to deposits over $1 million).[71]

3.69 Recognising the problems in the securitisation market, the Committee recommended that:

> …the Government introduce an appropriately designed guarantee scheme for residential mortgage-backed securities.[72]

3.70 Foreshadowing some of the issues faced in this inquiry, the Committee commented:

> During financial crises, the balance of concern tends to move from competition towards solvency. One manifestation of this is that the authorities tend to be more likely to allow mergers. The Committee regards it is appropriate for greater weight to be given to solvency concerns in a crisis. But a fine judgment is required as to how much the emphasis should shift, as it may be hard to revive competition once the crisis has passed.[73]

Bank accountability (2009)

3.71 The Senate Economics Legislation Committee examined a bill that would require a bank to explain to the Treasurer if it had moved interest rates contrary to movements in official interest rates and if the Treasurer regards the move as contrary to the public interest empower him to revoke the guarantee of the bank's deposits under the Financial Guarantee Scheme.

3.72 The Committee recommended against the bill as:

> … it is concerned that the bill may discourage banks from competing in reducing interest rates, could lead to higher bank fees and/or reduced lending to homebuyers, could raise doubts about the deposit guarantees and

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71 Senate Economics References Committee, *Government measures to address confidence concerns in the financial sector – The Financial Claims Scheme and the Guarantee Scheme for Large Deposits and Wholesale Funding*, September 2009, p 19.

72 Senate Economics References Committee, *Government measures*, September 2009, p 34.

73 Senate Economics References Committee, *Government measures*, September 2009, p viii.

> so reduce confidence in the safety of bank deposits and could be perceived as politicising the setting of bank interest rates.[74]

3.73 Instead it argued for better disclosure of information around the cost of funds:

> The Committee recommends that the Reserve Bank and the Australian Prudential Regulation Authority regularly publish estimates of the costs of funds for the banking sector as a whole and bank interest margins.[75]

Access of Small Business to Finance (2010)

3.74 The Committee examined the availability of finance for small business. (This topic is discussed further in Chapter 6.) It reiterated earlier concerns about concentration in banking, recommending:

> …the Government retain the 'four pillars' policy of not allowing a merger between any of the four major banks…a moratorium be placed on approval of any further takeovers in the banking industry for one year, unless the bank being taken over is at imminent risk of failure…the *Trade Practices Act* be amended to inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (set based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.[76]

3.75 It viewed increasing competition as preferable to other suggestions for improving access by small business:

> The Committee notes the suggestion of a development bank but prefers to increase competition within the existing commercial banks…The Committee notes the suggestion of a guarantee for loans to small business but prefers to increase competition within the commercial banks rather than for a government entity to assume the risk.[77]

Access for Small and Medium Business to Finance (2011)

3.76 The Joint Committee on Corporations and Financial Services revisited the issue of the availability of finance in early 2011. Its main suggestion for improving competition was to strengthen the mutual sector and it recommended the government explore further means of doing this. It also recommended that minimum notice

74 Senate Economics Legislation Committee, *Banking Amendment (Keeping Banks Accountable) Bill 2009*, November 2009, p 17.

75 Senate Economics Legislation Committee, *Banking Amendment*, November 2009, p 10.

76 Senate Economics References Committee, *Access of Small Business to Finance*, June 2010, p 56.

77 Senate Economics References Committee, *Access of Small Business to Finance*, pp 60 and 68.

periods for adverse changes in terms and conditions of small business loans be added to the relevant codes of practice.

Calls for future banking inquiries

3.77 There have been some suggestions that in addition to this inquiry into *competition* in banking, there needs to be a broader inquiry into other aspects of the financial system. As Associate Professor Cornish notes, the five banking inquiries discussed above followed the depressions or recessions of the 1930s, 1970s, 1980s and 1990s, so:

> …it is not surprising that, following the Global Financial Crisis or Great Recession of 2007/09, calls have been made for a new inquiry; similar calls for inquiries have been made in other countries.[78]

3.78 A number of submitters and witnesses, particularly academics, made such a call:

> Following the lessons that have been learned during the global financial crisis, and the 12 years that have elapsed since the last such exercise, we believe that a broad-based inquiry into the integrity of Australia's financial system is now warranted.[79]
>
> …there are strong arguments for there to be regular inquiries into the financial system, similar to the Campbell, Martin and Wallis Committees.[80]
>
> Recommendation: Call a new enquiry to identify fundamental areas of concern in the wider banking industry – in particular, bank products and ways to regulate these products.[81]
>
> A complete and independent review of the Australian banking sector by the Productivity Commission is recommended.[82]
>
> A Royal Commission into the Banking sector is inevitable as there will be so many more vulnerable people losing their homes in the foreseeable future.[83]

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78 Associate Professor Selwyn Cornish, *Submission 9*, p 3.

79 Joshua Gans, Nicholas Gruen, Christopher Joye, Stephen King, John Quiggin and Sam Wylie, *Submission 103a*.

80 Dr Tom Valentine, *Submission 14*, p 5.

81 'Ren', *Submission 19*, p 1. Similar calls were made by Dr Brett Edgerton, *Submission 20*, p 2; Mr Terence Holmes, *Submission 3*, p 2; Mr Andrew Thomas, *Submission 73*, p 17; and Mr Lindsay Johnston, *Submission 97*, p 12.

82 WA Small Enterprise Network, *Submission 68*, p 3.

83 Banking and Finance Consumers Support Association, *Submission 112*, p 25.

> …what we probably need—looking at the terms of reference of your own committee—is a review that is broader than just thinking about competition. It is really thinking about our financial regulations…[84]

3.79 A survey of businesses in Queensland found that over 70 per cent supported a full review of the financial system.[85]

3.80 There were some in the banking community who supported a review but thought now was not the most propitious time:

> …although we support in principle the concept that regular reviews of the financial system are warranted, we believe that in all the circumstances currently before us, it would be appropriate to conduct such a wide-ranging inquiry when major international and domestic regulatory change has settled down over the next three to four years.[86]

3.81 Others thought it would be a mistake to wait for a 'more settled' time:

> I suspect it is going to be a long time before, for example, the sovereign debt crisis and the various adjustments in Europe play out. There is no guarantee that that resolution will come before the next financial crisis.…the likelihood is that we are not going to get a period of calm much better than the current one without running into the risk that we could see a severe financial shock. For example, a downturn in China, a collapse in the housing prices here or a number of factors could expose our system to severe stress.[87]

3.82 Some submitters saw an additional inquiry as unnecessary:

> …the FSU does not champion the notion that there is a need for a "son of Wallis" type inquiry…Rather, efforts ought to be made to implement the outcomes/recommendations from recent parliamentary reviews into the banking sector.[88]

3.83 Yet other witnesses were agnostic:

> I am not here to advocate another major inquiry into the Australian financial system at this time, nor am I saying that there should not be another inquiry.[89]

> Whether or not we require a further inquiry I think depends very much on the findings of this committee…[90]

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84 Professor Stephen King, *Committee Hansard*, 21 January 2011, p 103.

85 Chamber of Commerce and Industry Queensland, *Submission 43*, p 16.

86 Westpac, *Submission 72*, p 39. See also Australian Bankers' Association, *Submission 76*, p 43.

87 Professor John Quiggin, *Proof Committee Hansard*, 4 March 2011, p 48.

88 Finance Sector Union, *Submission 80*, p 1.

89 Mr Selwyn Cornish, *Committee Hansard*, 13 December 2010, p 112.

3.84 The Committee heard calls for decennial reviews of the banking system:

> I also recommend, and have done ever since I worked with the Campbell committee in the early eighties, that there be regular and independent inquiries into the financial services industry. We had an understanding then, which was continued into the Wallis committee, that there would be a review every 10 years. It is now 14 years since the Wallis committee. Consequently, I think it is probably time for another such review.[91]

3.85 The Wallis Report titled its overview section "Towards 2010", suggesting another review is due by now to chart the future direction.

3.86 Regular inquiries are the pattern in some other countries:

> In Canada, for example, it is well established now that they have a comprehensive review of the financial system every 10 years.[92]

3.87 On the possible focus of such an inquiry, Associate Professor Cornish notes:

> New methods and techniques of operation in the financial services industry were introduced over the preceding twenty years and some of them contributed no doubt to the recent financial and economic collapses around the world. The financial crisis itself has revealed weaknesses in regulatory procedures in some of the world's preeminent financial centres, and there have been deficiencies in the way that some of these countries have conducted their monetary and financial policies.[93]

3.88 The Stephen Martin Committee identified a cyclical pattern in both bank behaviour and public inquiries:

> The people have also looked to governments to rein in the excesses of banks. Banks have been prone to overreact in both booms and busts. Imprudent lending fuelled the speculative mania of both the 1880s and the 1980s. Excessive contraction of credit worsened the slumps of the 1890s and 1930s. Many believe this pattern is repeating itself in the early 1990s. In many cases, changes in government controls over the financial system followed major public inquiries...Other steps include regulation. This has moved in a cycle.[94]

3.89 Some submitters requested further inquiries into specific aspects of competition in banking:

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90 Mr Michael Smith, Chief Executive Officer, ANZ Banking Group, *Committee Hansard*, 15 December 2010, p 133.

91 Professor Tom Valentine, *Committee Hansard*, 25 January 2011, p 62.

92 Associate Professor Selwyn Cornish, *Committee Hansard*, 13 December 2010, p 119.

93 Associate Professor Selwyn Cornish, *Submission 9*, p 3.

94 *A Pocket Full of Change: Banking and Deregulation*, p 35.

> 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:
>
> 1. The impact of an increasing/decreasing number of participants in lending markets;
> 2. The implication of repricing of risk to businesses;
> 3. The changes that have occurred in the cost and availability of finance to business, especially smaller enterprises, over time; and
> 4. International experiences in encouraging banking competition and their advantages and disadvantages if applied in Australia.[95]
>
> Master Builders recommends that the Productivity Commission conduct an independent inquiry into the banking system to improve competition within the Australian banking system.[96]
>
> At the risk of raising yet another inquiry, I think we need a far more fact based view on the sources of competitive advantage in banking. I think the merits of maintaining the current biases towards major bank regulations needs independent analysis.[97]

3.90 After the Committee had concluded its hearings, it emerged that Treasury was also an advocate of a broader inquiry into the financial system. In its 'Red Book' briefing to the re-elected government, released under Freedom of Information in March 2011, Treasury referred to:

> …initiating a comprehensive financial sector review in order to take stock of the lessons of the financial crisis and draw together the work currently being undertaken both here and internationally….Australia has not undertaken a comparable review since 1997 and we strongly urge you to make this a key priority in your second term… There is merit in establishing an inquiry that draws together the existing work streams and considers broader, more systemic issues. This includes considering the lessons from the GFC and the balance between the dual objects of stability and safety, and competition and efficiency. The best time for such an inquiry to commence is once markets have stabilised and G20 outcomes have become clear.[98]

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95 Australian Chamber of Commerce and Industry, *Submission 37*, pp v-vi.

96 Master Builders' Association, *Submission 38*, p 6.

97 Mr David Liddy, Chief Executive Officer, Bank of Queensland, *Committee Hansard*, 9 February 2011, p 15.

98 'Incoming Government Brief", pp 2-3 and 36. Available on Treasury website at http://www.treasury.gov.au/documents/1875/PDF/01_Overview.pdf.

Recommendation 1

3.91 The Committee recommends that a broad ranging inquiry into the Australian financial system be established, modelled on that conducted by the Campbell Committee. The terms of reference should be broad, covering the role of banks and other financial institutions in a post-GFC financial environment. The inquiry should be well resourced and have its own secretariat, independent of government departments.