

Chapter 11

The prudential supervision of financial intermediaries and their social obligations

11.1 There seems to be a broad consensus that good supervision played an important role in Australian financial intermediaries coming through the GFC without the need for the government bailouts and takeovers seen in many other countries. There are questions, however, about whether current or prospective supervisory rules could inhibit competition.

11.2 The Australian Prudential Regulation Authority (APRA) described its role in the financial system as follows:

Our mandate is to promote the sound and prudent management of the institutions we supervise so that, in the case of deposit taking, the institutions meet their promises to depositors under all reasonable circumstances.¹

11.3 Institutions wishing to raise deposits from the public require authorisation from APRA. They are hence known as 'authorised deposit-taking institutions' (ADIs). They comprise banks (domestic banks and subsidiaries and branches of foreign banks), building societies and credit unions.²

11.4 In general, the prudential framework does not raise issues of competitive neutrality between different types of ADIs:

...the prudential framework in Australia applies with few exceptions to banks, building societies and credit unions equally. Where it does not, there are prudential policy considerations—long-standing in one case—that justify a degree of differentiation. Overall, APRA does not consider that the prudential framework or its risk based approach to supervision acts as an impediment to a competitive banking system in Australia.³

In sum, APRA does not consider that its prudential framework for ADIs or its supervisory approach is a material factor in the competitive balance between different types of ADIs.⁴

1 Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 2.

2 There are a handful of 'other ADIs'; specialist credit card providers and purchased payment facilities providers.

3 Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 2.

4 Australian Prudential Regulation Authority, *Submission 57*, p 10.

Competition and stability

11.5 A claim frequently made during the inquiry was that the goals of stability and competition are conflicting. One stark example was the Westpac CEO's statement:

There is a trade-off between competition and stability, and getting that balance right is crucial.⁵

11.6 Yet not a minute before, she had claimed:

...the Australian banking sector is highly competitive. It is also strong and stable.⁶

11.7 Asked to elaborate, she postulated:

There are examples one can look at where a heightened competitive environment has led to some very poor practice and some very poor underpricing of risk, which has led to instability.⁷

11.8 A perhaps more nuanced version was offered by some prominent academic economists:

...in the US...that intensity of competition, together with some issues of regulation, could be argued as a major cause of the global financial crisis.⁸

...the whole point of financial regulation is to achieve an appropriate balance between competitive efficiency and system stability.⁹

Increased competition can also increase moral hazard incentives for banks to take on more risk. Declining profitability as a result of increased competition could tip the incentives of bankers towards assuming greater risk in an effort to maintain former profit levels.¹⁰

11.9 At one extreme, there is a trade-off between competition and stability:

5 Ms Gail Kelly, Chief Executive Officer, Westpac, *Committee Hansard*, 21 January 2011, p 65. This claim is also made repeatedly by the Australian Bankers' Association head in S Münchenberg, 'Balancing bank stability and competition', *The Australian*, 17 January 2011, p 32.

6 Ms Gail Kelly, Chief Executive Officer, Westpac, *Committee Hansard*, 21 January 2011, p 65.

7 Ms Gail Kelly, Chief Executive Officer, Westpac, *Committee Hansard*, 21 January 2011, p 97.

8 Professor Stephen King, *Committee Hansard*, 21 January 2011, p 108.

9 Professor Ian Harper, cited in 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 43.

10 Mishkin (2004, p 269), a well-known textbook by an economics professor formerly on the Federal Reserve Board.

...a monopoly bank would be very profitable, and therefore robust in a crisis, but would be unlikely to provide low-cost or innovative products to its customers.¹¹

11.10 Treasury warned that competition concerns need to be balanced with concerns about stability:

...there is going to be a trade-off there between ensuring a safe, secure and stable financial system versus competition.¹²

11.11 This seems somewhat at odds with their earlier view that:

Stability and confidence are important underpinnings for efficient, competitive markets.¹³

11.12 The competition authority's view is that:

It is the prudential requirements that bring about stability, not the adjusting up or down of the competition level.¹⁴

11.13 A British consultant not only claimed there was a trade-off between competition and stability but purported to quantify it (Chart 11.1):

Bain & Company calculates that the cost borne by taxpayers from an unstable banking industry is more than £1,000 per annum per head—mainly as a result of reduced output and higher unemployment. By contrast, regulators inclined to view the UK banking market as insufficiently competitive would be hard pressed to identify the cost of this to customers as more than £200 per annum per head. Those taxpayers and customers are, broadly speaking, one and the same.¹⁵

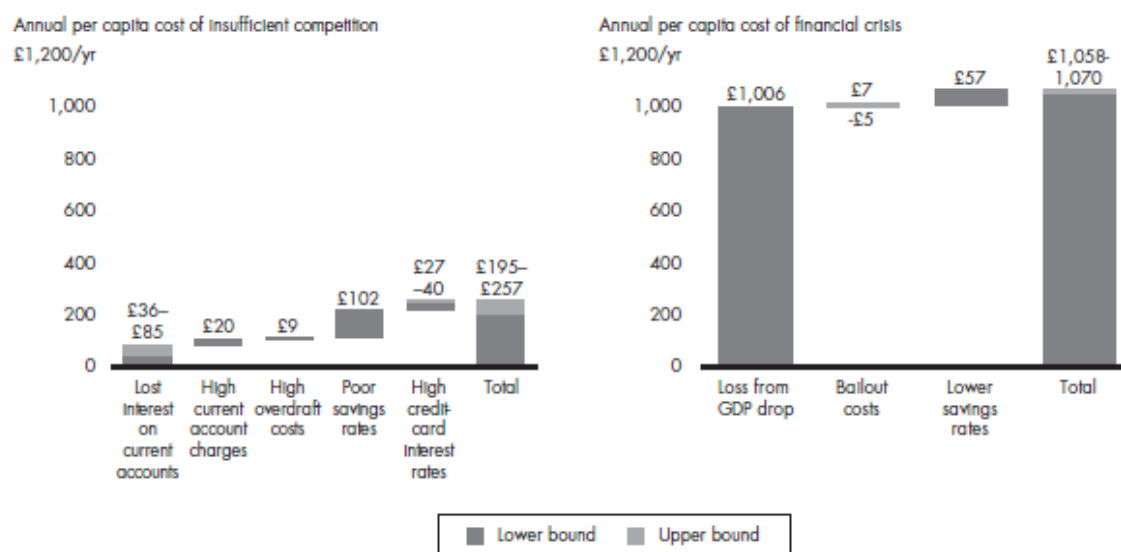
11 Senate Economics References Committee, *Government measures to address confidence concerns in the financial sector – The Financial Claims Scheme and the Guarantee Scheme for Large Deposits and Wholesale Funding*, September 2009, p 19.

12 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury, *Committee Hansard*, 13 December 2010, p 27.

13 Department of the Treasury, cited in 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 37.

14 Mr Graeme Samuel, Chairman, ACCC, *Committee Hansard*, 25 January 2011, p 56.

15 Bain & Co, 'Getting bank competition right post-crisis', provided by the Commonwealth Bank of Australia, *Additional information no. 7*, 23 December 2010, pp 1-2.

Chart 11.1: Costs of instability versus suboptimal competition

Source: Bain & Co, 'Getting bank competition right post-crisis', provided by Commonwealth Bank of Australia, *Additional information no. 7*, 23 December 2010.

11.14 Choice opined:

... financial stability does not have to be pursued at the expense of competition or to the detriment of consumers.¹⁶

11.15 A new market entrant suggested:

... stability is fundamental to a properly functioning banking system, but that is not mutually exclusive with conditions which foster competition.¹⁷

11.16 APRA's perspective is that:

We are required under our legislation to balance this objective of financial safety with efficiency, competition, contestability and competitive neutrality. Beyond that, we do not have any specific responsibility for competition in the deposit-taking sector. Of course, having prudently managed and well capitalised deposit-taking institutions surely lays the foundations for sustainable competition. Unless APRA are overzealous—and I do not believe we have been—there need be no difficult trade-offs between financial safety and competition over the longer term.¹⁸

¹⁶ CHOICE, *Submission 70*, p 11.

¹⁷ Mr Matt Baxby, Managing Director, Virgin Money Australia, *Proof Committee Hansard*, 4 March 2011, p 29.

¹⁸ Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 2.

11.17 The reference APRA make to *sustainable* competition is important. The type of competition, such as lending on very thin margins, that occasionally arises and causes problems for stability is *unsustainable* competition. It is this unsustainable competition which regulators such as APRA seek to avoid occurring. As APRA remarked:

...in the period 2002-03 we did see quite strong competition in housing lending which took the form of a dilution of credit standards, and that was a form of competition which we were uncomfortable with... there was just a competitive pressure to meet the customer by finessing, overriding or changing strong credit standards in some cases and it was an issue that we were vocal about at the time. That is competition which does raise prudential concerns. And of course if you look at the subprime experience in United States, you will see that whole problem writ very large.¹⁹

Are the major banks 'too big to fail'?

11.18 There is a common view around the world that large banks are 'too big to fail'. Usually regulators avoid explicit statements to this effect, but in the US, following the insolvency of Continental Illinois in 1984, the Comptroller of the Currency testified to Congress that the 11 largest banks were 'too large to fail' and would be bailed out so that no depositor or creditor would face a loss.²⁰

11.19 In Australia the major banks appear to be regarded as 'too big to fail', or more accurately 'too big for the authorities to allow them to fail'.

I do believe that the four big banks are too big to fail. There is no government that I could ever anticipate letting one of those big major banks fail. The devastation to the economy would be so great that no government could tolerate that. So that does give those four big banks an implicit advantage—a considerable implicit advantage.²¹

...no big bank will ever be allowed to fail to meet any liability to its depositors or anyone else...²²

...whatever the government might say, financial markets perceive each of the Big Four to be too big to fail and so protected by an (implicit) government guarantee.²³

...they are systemically important and too big to fail.²⁴

19 Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 7.

20 Mishkin (2004, p 263).

21 Associate Professor Frank Zumbo, *Committee Hansard*, 14 December 2010, p 62.

22 Mr Peter Mair, *Submission 2*, p 4.

23 Dr Nicholas Gruen, *Submission 21*, p 1.

The big four banks are able to raise funds much more cheaply on international wholesale markets. This is, in large part, due to the perception that the banks are 'too big to fail' and therefore ultimately supported by the Commonwealth Government. This situation entrenches the market power of the dominant oligopolistic firms, and they are able to extract significant returns which are then largely distributed to shareholders and senior executives.²⁵

11.20 The recent report by the UK's Independent Commission on Banking highlighted the problems caused by banks too big to fail:

Banks ought to face market disciplines without any prospect of taxpayer support, but systemically important banks have had and still enjoy some degree of implicit government guarantee. This is the 'too big to fail' problem. Unless contained, it gives the banks concerned an unwarranted competitive advantage over other institutions, and will encourage too much risk taking once market conditions normalise. It also puts the UK's public finances at further risk, especially given the size of the banks in relation to the UK economy. On top of the taxpayer risk from bank bail-outs, banking crises damage the public finances because of their effects on output and employment. Indeed the problem could arise in future that the banks are 'too big to save'.²⁶

11.21 Similarly a UK parliamentary committee, inquiring concurrently into banking competition there, warned:

We believe effective competition cannot take place in an environment where firms which are perceived as 'too important to fail' are both protected from the discipline of the market place and derive tangible benefits from this status.²⁷

11.22 If banks are indeed too big to fail, this represents a, potentially very large, contingent liability for the budget and hence the taxpayer:

The pre-GFC thinking was that banks should consolidate and become big because there is an advantage in being big. But the GFC very well demonstrated that a larger size is no longer a desirable thing. As a matter of fact, larger sized banks can become a permanent headache for the taxpayer because we do not know when these guys are going to stuff it up and come back to the taxpayer. So I have some concerns about the size of Australian banks.²⁸

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

25 Australian Council of Trade Unions, *Submission 89*, p 3.

26 Independent Commission on Banking (2011, p 2).

27 UK House of Commons Treasury Committee, *Competition and Choice in Retail Banking*, March 2011, p 5.

28 Professor Milind Sathye, *Committee Hansard*, 15 December 2010, p 33.

11.23 The Commonwealth Bank rejected this argument:

...we are a bank that does not take that view. We are a bank that is run on the basis that we will not fail and the 'too big to fail' part does not come into it.²⁹

11.24 Of course, the large banks overseas that failed would have also said this could never happen.

11.25 There have also been references to banks being 'too interconnected to fail'³⁰:

...what led to the unravelling in the UK banking market was not initially a large bank. It was Northern Rock, which was a relatively small bank but had a significant systemic impact on the UK economy...The issue does not really come down to the size of the bank. I think any banking situation where a bank fails has the potential to have flow-on impacts.³¹

11.26 These implicit guarantees may even be stronger now than before the GFC:

Lehman Brothers—a small bank in the US—was allowed to fail, and I do not think there is any doubt that, with the benefit of hindsight, the US regulators and US government would have bailed out Lehman Brothers had they realised what a psychological impact it would have on the market for a relatively small bank to collapse.³²

11.27 Asked whether the major banks had become 'too big to fail', APRA responded:

We never ever confess that any institution is too large to fail. There is a marketplace at work there and we have seen institutions around the globe that were household names that have moved into government ownership in other markets. What we seek to do is to minimise the risk that that will happen with any institution of any size.³³

Capital requirements presently

11.28 APRA has broadly adopted the internationally agreed capital adequacy rules, under which ADIs must hold capital equivalent to at least eight per cent of risk-weighted assets. The rules are developed by the Basel Committee on Banking

29 Mr Ralph Norris, Chief Executive Officer, Commonwealth Bank of Australia, *Committee Hansard*, 15 December 2010, p 68.

30 Professor John Quiggin, *Proof Committee Hansard*, 4 March 2011, p 45.

31 Mr Ralph Norris, Commonwealth Bank, *Committee Hansard*, 15 December 2010, p 68.

32 Mr David Craig, Chief Financial Officer, Commonwealth Bank of Australia, *Committee Hansard*, 15 December 2010, p 68.

33 Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 12.

Supervision, at which APRA represents Australia. The current set of rules, known as Basel II, provide for capital requirements to be calculated using whichever is more appropriate of a default 'standardised' approach or a more complex, 'advanced' approach.³⁴

11.29 It is sometimes claimed that the capital requirements discriminate against smaller banks and mutual financial intermediaries because the large banks are able to use the 'advanced' approach rather than the 'standardised' approach to calculating required capital and so need to hold less capital against home loans:

...we have to hold twice as much capital to support a mortgage as what the major banks do because of the different approaches we have to measuring our capital adequacy.³⁵

Under Basel II the risk weighting given to mortgages held by small ADIs is around twice that of the big four banks...³⁶

11.30 APRA responded:

To be able to use the advanced status you need to have very sophisticated risk modelling, robust risk management and quite deep extensive databases and then you can manage housing-lending portfolios using a much more rigorous method. There is a complete overlay of governance and controls on top of that. You need to do that not just for your lending to housing but for how you manage operational risk and how you manage interest rate risk on the banking books. So to be called an advanced bank requires a very comprehensive set of requirements... when we look at how it all washes out, with all the various changes, it is not clear from our evidence that there is a major difference in the impact of Basel II between the advanced and standardised banks when you put it all together.³⁷

...approval is based on the ADI's capabilities rather than its size.³⁸

11.31 There are additional imposts involved with the advanced approach too, not just benefits:

...advanced ADIs are subject to other capital requirements that are not applied to ADIs adopting the standardised approaches. For example, APRA requires advanced ADIs to hold capital against interest rate risk in the

34 In Australia only the four major banks and Macquarie Bank currently have approval to use the advanced approaches.

35 Mr Mike Hirst, Managing Director, Bendigo and Adelaide Bank, *Committee Hansard*, 15 December 2010, p 86. Similar remarks were made by Mr David Liddy, Chief Executive Officer, Bank of Queensland, *Committee Hansard*, 9 February 2011, p 16. See also Members Equity Bank, *Submission 77*, p 4.

36 Heritage Building Society, *Submission 113*, p 7.

37 Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, pp 12-13.

38 Australian Prudential Regulation Authority, *Submission 57*, p 5.

banking book. APRA also currently requires advanced ADIs to hold at least 90 per cent of the amount of regulatory capital that was required under the original Basel regime; standardised ADIs are not subject to such a limitation.³⁹

11.32 In practice, the major banks as a group do not appear to have gained a significant competitive advantage from being able to use the advanced approach:

Broadly speaking, the implementation of Basel II resulted in reductions of capital for advanced ADIs of between zero and ten per cent, and averaged around five per cent for standardised ADIs.⁴⁰

11.33 Notwithstanding such assurances, Heritage, Australia's largest building society, would like the current arrangements changed:

Given that mutual building societies and credit unions typically have significantly lower arrears rates for their mortgages than those of the big banks, it is recommended that the risk weighting for mortgages held by mutual building societies and credit unions be aligned with that of the big four banks. This initiative levels the playing field for smaller ADIs. It also frees capital to allow mutual building societies and credit unions to grow their share of the retail mortgage market more aggressively in competition with the banks.⁴¹

11.34 There were also claims that the capital rules are unduly harsh on small business loans:

...the Australian Prudential Regulation Authority (APRA) should explore whether the risk-weightings on business loans secured by residential properties are punitive. Currently, APRA requires the banks to apply a risk weighting of 50-70 per cent for small business whereas regional banks have to apply a risk weighting of 100 per cent for small business.⁴²

11.35 As was noted in Chapter 6 (see Chart 6.4), small business lending incurs larger losses than do housing loans and so it is justified for there to be a correspondingly higher amount of capital held against small business loans than the concessional amount required for housing loans. The Reserve Bank provides some quantitative estimates:

...small business borrowers are more than twice as likely as standard mortgage customers to default...once a default has occurred, APRA statistics suggest that a lender is likely to lose close to 30 per cent of the small business loan's value, compared with 20 per cent for housing loans.⁴³

39 Australian Prudential Regulation Authority, *Submission 57*, p 7.

40 Australian Prudential Regulation Authority, *Submission 57*, p 6.

41 Heritage Building Society, *Submission 113*, p 7.

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

43 Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 8.

Other current prudential requirements

11.36 APRA also require ADIs to have an adequate liquidity management strategy. Some smaller ADIs are exempted from the more complex aspects of this.⁴⁴ The mutual ADIs benefit from this. If they regard the simpler rules are more costly, they can just not apply for the exemption.

11.37 APRA also have prudential requirements covering governance, risk management, fitness and propriety, large exposures, associations with related entities, outsourcing and business continuity management; all of which apply equally to banks and mutual ADIs.⁴⁵

The new Basel III capital and liquidity requirements

11.38 The international community has responded to the global financial crisis by tightening the global prudential standards governing capital and liquidity. The new measures are known as 'Basel III' and will be phased in from 2013.⁴⁶

11.39 APRA explained the benefits of these reforms:

Basel III is underpinning the capital of the banking system globally and it is also strengthening capital and liquidity buffers in the global system. We are participants in the global system.⁴⁷

11.40 APRA does not expect the rules to be unduly onerous for Australian intermediaries:

...APRA does not expect that the more stringent global capital regime will have significant implications for ADIs in Australia, which remained well-capitalised throughout the global financial crisis...the main impact of the Basel III capital reforms will fall on the larger ADIs due to (i) their higher usage of structured capital instruments that will no longer be eligible as regulatory capital, and (ii) a larger impact from the tighter definition of capital deductions. Overall, APRA does not anticipate standardised ADIs being materially affected by the capital reforms.⁴⁸

11.41 Westpac explain their concerns about the new Liquidity Coverage Rules (LCR) as follows:

44 Australian Prudential Regulation Authority, *Submission 57*, pp 7-8.

45 Australian Prudential Regulation Authority, *Submission 57*, p 8.

46 Further information about them can be found at Australian Prudential Regulation Authority, *Submission 57*, Attachment B.

47 Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 8.

48 Australian Prudential Regulation Authority, *Submission 57*, p 9. See also Dr John Laker, Chairman, APRA, *Committee Hansard*, 14 December 2010, p 8.

Banks will also need to establish capacity to survive a “run” on deposits for a month, rather than a week which applied under the old standards. This will require them to hold more liquid assets, which may limit funds available for lending to customers and add to overall costs.⁴⁹

11.42 APRA comment about these new requirements:

There is no doubt that there are challenges for our banks in meeting that standard but also it is not as though our banks sailed through the crisis without any liquidity issues. We know they needed the wholesale guarantee for offshore funding and the deposit guarantee. There were various sorts of assistance that were given to the banking system to help it through the crisis and to help make sure that it was able to continue to operate in an orderly fashion during the crisis. What the Basel III liquidity requirements are about is trying to lessen the need for that public sector support next time around. So it is not as though our banks were as robust on the liquidity front as they might have been or could say, ‘We don’t need any reform whatsoever on that side of things.’⁵⁰

11.43 The Basel III rules are designed to restore confidence in global banking systems. In the longer term they should reduce the cost of funds for Australian banks from those prevailing since the GFC:

Over time when these new capital reforms are bedded down globally if that underpins more confidence in global banking systems you might like to think that some of those more extreme risk premiums can come down.⁵¹

The challenge posed by the shortage of government bonds

11.44 There is a problem that as Australian governments have been running surpluses and smaller deficits than most other economies represented on the Basel Committee, banks will struggle to find enough bonds to meet the liquidity requirements.

11.45 One response would be to allow highly rated RMBS to be counted as liquid assets. Unsurprisingly, this idea appealed to the Australian Securitisation Forum and the banks:

...we would put that if residential mortgage backed securities and certainly the higher rated tranches could be held as eligible assets under the liquidity tests that Basel III will introduce for Australian banks.⁵²

49 Westpac, *Submission 72*, p 30.

50 Mr Wayne Byres, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 8.

51 Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 8. The risk premia are unlikely to drop back to where they were immediately before the GFC as the risk premia then had been unrealistically low.

...by accepting third party AAA RMBS paper (currently eligible securities for repurchase transactions by the RBA) as an asset under the new liquidity rules, this reform would not only assist in rebuilding the primary and secondary securitisation markets in Australia, but would also assist banks to meet their obligations under the pending Basel III regulations...⁵³

11.46 The problem with this idea is that in the GFC the RMBS proved *not* to be liquid.⁵⁴ This was conceded by the Forum and a regional bank:

...there is good liquidity when market conditions are stable and favourable, and when markets become stressed and disrupted that liquidity vanishes.⁵⁵

Basel III has outlawed securitisation in terms of being available for liquidity but you can understand why that would be the case, because the performance of securitisation in offshore markets has been abysmal.⁵⁶

11.47 The best they could offer was the hope that by APRA:

...deeming them to be acceptable as eligible securities that then can create the liquidity perception that aids the market.⁵⁷

11.48 Another approach would be for the Reserve Bank to issue its own paper to create a riskless liquid security which banks could hold. Asked about this, the Reserve Bank responded:

Any debt issued by the RBA would be very similar to that issued by the Government. If the RBA were to issue its own paper to provide banks with additional liquid assets, the RBA would need to consider which assets to purchase with the proceeds of that debt issue. This would likely involve purchasing private securities on an outright basis, thereby permanently increasing the credit risk that the RBA it is facing. In contrast, accepting private securities (including RMBS), on a repo basis provides an extra degree of protection for the RBA. This is why counting RMBS as an eligible liquid asset in the commercial banks' portfolios is a less risky option than the RBA holding the paper outright.⁵⁸

52 Mr Chris Dalton, Chief Executive Officer, Australian Securitisation Forum, *Committee Hansard*, 14 December 2010, p 20. Members Equity Bank also argued for this; *Submission 77*, p 4, as did Aussie, *Submission 39*, p 5.

53 Australian Bankers' Association, *Submission 76*, p 57.

54 APRA, *Responses to questions on notice*, no 10, 31 January 2011, p 3.

55 Mr Chris Dalton, Chief Executive Officer, Australian Securitisation Forum, *Committee Hansard*, 14 December 2010, p 20.

56 Mr Mike Hirst, Managing Director, Bendigo and Adelaide Bank, *Committee Hansard*, 15 December 2010, p 87.

57 Mr Chris Dalton, Chief Executive Officer, Australian Securitisation Forum, *Committee Hansard*, 14 December 2010, p 20.

58 Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 1.

11.49 In the event, there has been an alternative arrangement put in place by APRA and the Reserve Bank to deal with the problem:

The Reserve Bank of Australia (RBA) and the Australian Prudential Regulation Authority (APRA) have agreed on an approach that will meet the global liquidity standard. Under this approach, an authorised deposit-taking institution (ADI) will be able to establish a committed secured liquidity facility with the RBA, sufficient in size to cover any shortfall between the ADI's holdings of high-quality liquid assets and the LCR requirement. Qualifying collateral for the facility will comprise all assets eligible for repurchase transactions with the RBA under normal market operations. In return for the committed facility, the RBA will charge a market-based commitment fee.⁵⁹

11.50 The size of the fee is yet to be determined, but the Reserve Bank have described the principles underlying it:

The fee is intended to leave participating ADIs with broadly the same set of incentives to prudently manage their liquidity as their counterparts in jurisdictions where there is an ample supply of high-quality liquid assets in their domestic currency. A single fee will apply to all institutions accessing the facility.⁶⁰

Banking 'licences'

11.51 Within ADIs only those with APRA's approval are allowed to have 'bank' in their name. The main impediment to building societies and credit unions being allowed to call themselves 'banks' is now the \$50 million minimum capital size that APRA requires before giving this approval. (Prior to 1998 they also had to relinquish their mutual status).⁶¹

11.52 There are currently 25 mutual ADIs—five building societies and twenty credit unions—that have sufficient capital to meet this requirement but have not applied to APRA for approval to style themselves as banks.⁶²

11.53 Abacus suggested there may be more applications:

I think now that some of our institutions will consider asking APRA to consider their application for a bank licence.⁶³

59 'Australian Implementation of Global Liquidity Standards', *Reserve Bank of Australia and APRA Joint Media Release*, 17 December 2010.

60 Reserve Bank of Australia, *Financial Stability Review*, March 2011, p 61.

61 Abacus, *Submission 53*, p 23.

62 Australian Prudential Regulation Authority, *Submission 57*, p 3.

63 Mr Mark Degotardi, Head of Public Affairs, Abacus, *Committee Hansard*, 13 December 2010, p 86.

11.54 APRA explained the policy rationale as:

...a test of substance, that the community has a view that banks are intended to be strong, durable financial institutions...The term does have a cachet of durability and strength.⁶⁴

11.55 The Government has asked APRA to review guidelines around use of the term 'bank', and report to the Government in March 2011.⁶⁵ APRA's chairman explained:

...we have said to the government that we will review the policy, and I will go into that review with an open mind and see what the issues are. There are a number of complex issues involved here, including, most importantly, financial stability impacts and customer understanding impacts. It will need careful consideration, and we will do that...The Productivity Commission also reviewed this issue this year when it was revisiting some of the regulatory impacts and its report argued, in a sense, for maintaining the status quo. It could not see a policy reason for changing that.⁶⁶

11.56 Asked about the value of their banking licence, the Commonwealth Bank initially replied:

Our business would have very little value if we did not have a licence. It is not valued in our books, though.⁶⁷

11.57 Perhaps sensing that the questioning was going towards a possible charge for the licence, the Commonwealth Bank then sought to downplay its importance:

Senator CORMANN—So, essentially, in a comprehensive sense, your Australian banking licence contributes to a lowering of, to a downward pressure on, your cost of funds?

Mr Norris—No, it is that the business is assessed by the rating agencies as to the strength of the business, and they have a number of criteria that they will look at. The fact that we operate in Australia is one part of that, from looking at the economic situation, but certainly the major issues around rating are the resilience of the organisation, its sustainability and its ability to continue to generate reasonable returns and profits; those are the factors that are most relevant.⁶⁸

64 Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 5.

65 Department of the Treasury, *Submission 102*, p 30.

66 Dr John Laker, Chairman, Australian Prudential Regulation Authority, *Committee Hansard*, 14 December 2010, p 5. See also *Competitive and Sustainable Banking System*, Australian Government, December 2010, p 17.

67 Mr Ralph Norris, Chief Executive Officer, Commonwealth Bank of Australia, *Committee Hansard*, 15 December 2010, p 66.

68 Mr Ralph Norris, Commonwealth Bank, *Committee Hansard*, 15 December 2010, p 67.

11.58 Credit Union Australia have enough capital that they could apply for a banking licence, but have chosen not to do so. Asked why, they responded:

...we would no longer be a credit union, which is also a protected term. We would then be a bank instead of being a credit union...we very much want to position ourselves as an alternative, so calling ourselves a bank we believe detracts from that as well as diminishes from our heritage as a credit union. Our desire is nonetheless to be able to very clearly represent that we are in the business of banking, and that is really what we are seeking.⁶⁹

11.59 A banking licence is related to having an exchange settlement account (ESA) with the Reserve Bank. Abacus comment:

...smaller banking institutions, such as credit unions and building societies, do not need to hold an ESA with the RBA because they can access settlement services and the payments system through central ADIs owned by the sector with specialist expertise such as Cuscal, Indue and ASL. However, a number of Abacus member banking institutions have exercised their option to become ESA holders.⁷⁰

Bank shareholding restrictions

11.60 One possible means of increasing the number of banks would be to ease the requirements in the *Bank Shareholders Act* limiting the stake of any single shareholder in a bank.

11.61 The Vic Martin report favoured retaining limits on bank shareholdings but put the arguments on both sides:

A wide dispersion of shareholders is regarded as offering the following advantages:

- avoids dominance of control of a bank by one or few interests;
- provides protection to depositors against a risk that a bank might be operated to serve the needs of shareholders;
- avoids the interdependence of a bank's viability with that of a dominant shareholder;
- ensures reasonable independence and continuity of management; and
- may enhance the bank's capacity to raise any additional capital required.

Against the above, the following points can be argued:

- a requirement limiting shareholdings inhibits entry and hence tends to increase concentration in the banking industry;

69 Mr Chris Whitehead, Chief Executive Officer, Credit Union Australia, *Committee Hansard*, 25 January 2011, p 84.

70 Abacus, *Submission 53*, p 21. The mutual ADIs with ESAs are Greater Building Society, Heritage Building Society, IMB Ltd, and Police Department Employees Credit Union.

- at least eleven unrelated shareholders (each of appropriate standing) are required in order to form a bank. This can be very difficult and a wasteful use of scarce, suitable domestic participants;
- a body interested in sponsoring a new bank is not able, under current administration of the *Banks (Shareholdings) Act*, to hold a substantial shareholding (ie 10 per cent or above) in a bank and this is a disincentive to sponsorship;
- a requirement for a wide dispersion of ownership effectively removes any likelihood of bank takeovers and may shift power too far in favour of management. The security of tenure for management may inhibit efficiency and innovation; and
- a few large shareholders may more readily be able to reach agreement on and to provide capital injections than a large number of shareholders.⁷¹

11.62 The Stephen Martin Committee cast the arguments as follows:

...a dominant shareholder poses the risk that a bank's deposits might be used for the benefit of such a shareholder, or that public confidence in the bank would be compromised by business problems experienced by the dominant shareholder...The main argument against the ownership rules is that they remove an important market discipline, by making it more difficult for an inefficient bank to be taken over...[and] reduce the capacity of banks to benefit from economies of scale. On the question of efficiency, it is important to note that while the ownership rules limit the potential for banks to be subject to takeover, they do not restrict more efficient banks from taking away an inefficient bank's market share.⁷²

Mutual ADIs and banks

11.63 Notwithstanding that APRA supervises mutual ADIs to the same standard as bank ADIs, this may not be the public perception. As one building society explained:

Research conducted by Heritage indicates that, irrespective of their dislike for the big banks, customers perceive them to be more secure than the alternatives. This belief relates both to the size of the banks and to a common belief that they have an explicit government guarantee that the building societies and credit unions do not.⁷³

11.64 Some mutual ADIs would prefer the term 'authorised deposit-taking institutions' be changed to 'authorised banking institutions':

71 Australian Financial System Review Group, *Report*, pp 56-57.

72 House of Representatives Standing Committee on Finance and Public Administration (1991, p 129).

73 Heritage Building Society, *Submission 113*, p 5.

...to reassure consumers that we are regulated in the same way as banks and to reinforce our core function, which is banking.⁷⁴

11.65 Rather than being referred to as 'non-banks', with a possible misinterpretation that they are not as secure or well-supervised as banks, some mutual ADIs would prefer to be known as 'customer-owned financial institutions'.⁷⁵

11.66 Their industry body argued:

APRA should allow all ADIs the non-compulsory option of marketing themselves as “banks”. This would enable Abacus members to exercise the option of marketing themselves as “mutual banks” to the market generally or to market segments where the terms “credit union” or “building society” are less effective.⁷⁶

11.67 The Productivity Commission concluded:

It would seem, *prima facie*, that there is little beyond the name ‘bank’ to distinguish some credit unions and building societies from banks. It would be useful to remove any unnecessary restrictions which limit the ability of building societies and credit unions to compete with banks on a level playing field. The current restrictions on the use of terms such as ‘bank’ by other ADIs could be reconsidered.⁷⁷

11.68 Mutual ADIs are also disadvantaged relative to banks by institutional investors being less familiar with them:

...the banking sector is a known quantity in the investment community as opposed to credit unions. A fund manager cannot invest in a credit union today, so they have not been examining them, whereas of course they have a very strong view on the banking sector.⁷⁸

11.69 Credit Union Australia has consistently charged less for home loans than the major banks. Asked how they can do this, they responded:

Firstly, we do not have to generate profit at the same levels. We need to generate sufficient profits to maintain strong reserves and to fund the growth and development of the organisation, but that is the limit of our profit requirements. Anything in excess of that is returned through better pricing. The fact that a shareholder based institution would be paying out

74 Mr Chris Whitehead, Chief Executive Officer, Credit Union Australia, *Committee Hansard*, 25 January 2011, p 82. See also their *Submission 84*, p 3. A similar view was put by Heritage Building Society, *Submission 113*, p 6 and Abacus, *Submission 53*, p 22.

75 Credit Union Australia, *Submission 85*, p 5.

76 Abacus, *Submission 53*, p 22.

77 Productivity Commission *Annual Review of Regulatory Burdens on Business: Business and Consumer Services*. August 2010 Research Report, cited in Abacus, *Submission 53*, p 23.

78 Mr John Brogden, Chief Executive Officer, Financial Services Council, *Committee Hansard*, 21 January 2011, p 21.

something like 60 per cent of its profits in dividends does give us a significant pricing advantage—or, looked at another way, we return dividends to our shareholders, who are our customers, through lower prices rather than in the form of a separate dividend. It does support that model. We are aided by the fact that we have a relatively simple business. It is a pure consumer business. It does not have the volatility of business and corporate banking, which obviously varies enormously with the economic cycle. Our intention is to keep it a simple and low-cost business as well.⁷⁹

Recent initiatives

11.70 The Treasurer's December 2010 package foreshadows the introduction of a 'government protected' logo for ADIs which is intended to build confidence in mutual ADIs and smaller banks.

11.71 Abacus, the peak body for building societies and credit unions, welcomed the recent announcements, although they do not go as far as Abacus hoped:

[based on] ...18 months worth of market research on the barriers that people have to switching to credit unions and building societies. We constantly find the view that the big banks are covered by a separate and better regulatory system, and that is a barrier to change. So we see the idea of the protected deposits seal and that link back to government regulation as a very pro-competitive reform.⁸⁰

...the government protected deposit seal, and that certainly will go some way to improving the awareness of consumers around regulated institutions.⁸¹

11.72 It also attracted praise in other circles:

So an education awareness program funded by government around the safety of mutuals is very welcome.⁸²

It will encourage competition coming through there, so I think that measure will be successful.⁸³

79 Mr Chris Whitehead, Chief Executive Officer, Credit Union Australia, *Committee Hansard*, 25 January 2011, p 86.

80 Ms Louise Petschler, Chief Executive Officer, Abacus, *Committee Hansard*, 13 December 2010, p 83.

81 Mr Mark Degotardi, Head of Public Affairs, Abacus, *Committee Hansard*, 13 December 2010, p 86.

82 Mr Mark Bouris, Executive Chairman, Yellow Brick Road Wealth Management, *Committee Hansard*, 13 December 2010, p 97.

83 Mr Jonathan Mott, Banking Analyst, UBS Securities Australia, *Committee Hansard*, 14 December 2010, p 146.

Recommendation 18

11.73 The Committee recommends that mutual financial intermediaries be allowed to refer to themselves as a 'mutual bank' or 'approved banking institution' and use terms such as 'credit union bank' in their name.

Other financial institutions

11.74 ASIC explained the difference between the prudential supervision by APRA of authorised deposit-taking institutions (ADIs) and those financial institutions which raise money in wholesale markets or by offering a stake more like equity than a deposit:

The issue about which institutions are subject to prudential regulation is a government decision, and the government has decided that the deposit-taking institutions should be prudentially regulated by APRA. All institutions, both the ones that are regulated by APRA and the ones that are not regulated by APRA, have to have a licence, and that is where we come in. One of the conditions of having a licence is certain issues which go to the financial management of the institution, so to that extent there is some form of monitoring of the financial situation of these institutions. The government has made a decision that there is greater prudential risk for institutions which accept deposits and lend money than there is with institutions which just borrow money on the wholesale market and lend the money.⁸⁴

11.75 Some non-ADIs felt they were subject to excessively harsh requirements. In particular there was concern expressed over ASIC's RG156 rule related to the issue of debentures:

This required that all the advertisements for debentures should include a prominent statement to the effect that investors 'risk losing some or all of their principal and interest'.⁸⁵

11.76 Some non-ADIs also objected to how they are required to characterise the bonds they issue:

The changing of the naming of the from 'debentures' to 'unsecured notes' will undoubtedly put further doubt in the investor's minds with respect to the level of risk...⁸⁶

11.77 The regulators have a delicate balancing act between avoiding terminology that may overstate the riskiness of investing with unsupervised financial intermediaries (and so reduce the competitive pressure they can exert on the ADIs)

84 Dr Peter Boxall, Commissioner, ASIC, *Committee Hansard*, 21 January 2011, p 13.

85 Provic Group, *Submission 123*, p 5.

86 Provic Group, *Submission 123*, p 6.

and ensuring that unsophisticated investors realise that the unsupervised entities are riskier than ADIs. The Government's introduction of a 'government protected' logo may give an opportunity to allow the non-ADIs to apply less critical language.

Recommendation 19

11.78 The Committee recommends that financial intermediaries not supervised by the Australian Prudential Regulation Authority be required to state clearly that funds placed with them are 'not guaranteed by government' but otherwise should not be prohibited from applying familiar terms such as 'debenture' where this would not be misleading.

Bank holding companies and the 'narrow banking' model

11.79 Professor Davis noted:

...there may be some scope in a proposal that I have seen from the OECD that says you should get banks to change to a non-operating holding company structure where one part of it is sort of the standard banking—taking deposits; making simple loans—and the other subsidiary part of the nonoperating holding company is the investment bank.⁸⁷

11.80 Professor Valentine observed:

...as a matter of history, at the Campbell committee we looked closely at the holding company concept and, at that stage—and that was 30 years ago—it seemed to us that there was a lot in it.⁸⁸

11.81 Suncorp Group has recently adopted a holding company structure to separate its banking and insurance operations:

...it was about transparency and simplicity to be able to explain the operations of each of our businesses more clearly.⁸⁹

11.82 The separation of banking and other operations was also suggested:

...one could start with the divestment of insurance / wealth management from the Big 4, the fusion of which no defensible argument has ever been mounted. Share-broking subsidiaries could readily be hived off. And so on.⁹⁰

11.83 It is noted that in April 2011, the Independent Commission on Banking in the UK, in its interim report, recommended the ring fencing of banks' retail activities to

87 Professor Kevin Davis, *Committee Hansard*, 25 January 2011, p 77.

88 Professor Tom Valentine, *Committee Hansard*, 25 January 2011, p 77.

89 Mr Anthony Rose, Chief Financial Officer, Suncorp Bank, *Committee Hansard*, 9 February 2011, p 8.

90 Confidential, *Submission 81*, p 19.

minimise the possibility of losses from the riskier investment bank activities infecting a bank's retail business:

...a focus of the Commission's work is the question of whether there should be a form of separation between UK retail banking and wholesale and investment banking. Ring-fencing a bank's UK retail banking activities could have several advantages. It would make it easier and less costly to sort out banks if they got into trouble, by allowing different parts of the bank to be treated in different ways. Vital retail operations could be kept running while commercial solutions – reorganisation or wind-down – were found for other operations...The Commission is therefore considering forms of retail ring-fencing under which retail banking operations would be carried out by a separate subsidiary within a wider group.⁹¹

11.84 Some leading academic economists have become increasingly vocal supporters of such an approach since the GFC:

...a specific, but serious, problem arises from the ability of conglomerate financial institutions to use retail deposits which are implicitly or explicitly guaranteed by government as collateral for their other activities and particularly for proprietary trading. The use of the deposit base in this way encourages irresponsible risk-taking, creates major distortions of competition and imposes unacceptable burdens on taxpayers. Such activity can only be blocked by establishing a firewall between retail deposits and other liabilities of banks.⁹²

11.85 A harsher version of the approach of separating riskier activities into a distinct part of a banking group is banning banks from any involvement in riskier activities. Such an approach was considered (but not favoured) by the Independent Commission on Banking in the United Kingdom in its recent report:

Banks must have greater loss-absorbing capacity and/or simpler and safer structures. One policy approach would be structural radicalism – for example to require retail banking and wholesale and investment banking to be in wholly separate firms.⁹³

11.86 The ACTU supports 'narrow banking' as a response to the problem of banks being 'too big to fail':

A regulatory regime should be considered in which Australian banks are regulated as public utilities and forbidden from expanding into risky asset classes and/or jurisdictions while they enjoy a Government guarantee (explicit or implicit) of their liabilities...The Australian Government should make it clear that it will not act to ensure the continued viability of

91 Independent Commission on Banking (2011, pp 3-4).

92 Kay (2010, pp 225-226).

93 Independent Commission on Banking (2011, p 2).

non-deposit taking institutions that pursue excessively risky investments...⁹⁴

Committee view

11.87 The Committee believes that APRA effectively ensures that Australian banks do not pursue excessively risky investments. This is an area, however, that could be usefully addressed by the broader inquiry into the financial system for which the Committee has called.

Social obligations of banks

11.88 Banks have a special status. For businesses, 93 per cent of respondents to a recent survey indicated their banking relationship is important or critically important.⁹⁵ They provide what could nowadays be regarded as an essential service:

...when I first started my working life I received my wages in a little yellow envelope in cash and it was my choice if I placed some or all of that money into a bank account. Today Australian people are forced to accept their wages electronically into a bank account, we have no choice and are then charged a fee by the banks to access our own money.⁹⁶

Australians do not have the day to day capacity to simply opt out of the banking system. Banking is connected and integrated into our ability as citizens to function and exist in modern society.⁹⁷

A bank account is a necessity for effective participation in modern Australian economic life, and should therefore be regarded as an essential service.⁹⁸

Banks...do have a unique role in our community...Banks have a special place in our society. They are the lifeblood of liquidity... Technology and national security laws have ensured that participation in the banking system has become a mandatory feature of modern life. The banking system's crucial role in supplying the economy's financial arteries and transforming savings into investment makes it different from most other industries.⁹⁹

Everyone knows the financial system—and that is why the government is concerned—is such an important part of everyone's life. Post GFC, international debate has raged: are these just private sector profit-making

94 Australian Council of Trade Unions, *Submission 89*, p 3.

95 Chamber of Commerce and Industry Queensland, *Submission 43*, p 5.

96 Mr Peter Higgins, *Submission 17*, p 2.

97 Finance Sector Union, *Submission 80*, p 11.

98 Australian Council of Trade Unions, *Submission 89*, p 2.

99 The Hon. Joe Hockey MP, 'Address to the Australian Industry Group Annual National Forum, Canberra, 25 October 2010.

entities, as we view them in Australia, or are they a hybrid, providing an essential service to the community?¹⁰⁰

11.89 Many would regard banks as having social obligations in exchange for the privileges they enjoy:

Nevertheless banks protected by government insurance of small deposits have some responsibility to return to the community a level of service and a responsible level of profit-taking...Bank management, and most particularly local bank managers, have responsibilities to the community.¹⁰¹

Ultimately financial institutions must have a broader responsibility for economic development in Australia.¹⁰²

The Brotherhood [of St Laurence] believes that all Australians have a right to fair and affordable access to basic services, including banking services. Fair and affordable access to essential services helps disadvantaged and low-income people by enabling them to be part of Australia's mainstream society, and by ensuring corporate, government and community sectors all take responsibility for addressing social problems.¹⁰³

The government has recognised the special place of banks, and it grants banks privileges and benefits that are not afforded to other sectors...The banks may occasionally chafe under the restrictions, but they must concede the system of prudential supervision imparts tremendous benefits to their operations...I want a Social Compact between our Taxpayer guaranteed banks, their shareholders and our Government and our Parliament. This must define the relationship and must include direction on competition, expansion, expectations of credit and savings, community service obligations, risks and rates.¹⁰⁴

The social contract should provide at a minimum, access to “fee free” credit accounts for wage earners and for people on regular low incomes, portability of credit accounts, exit fee free discharges from loans and cost free access to ADR for individuals and small businesses and a mediation process...¹⁰⁵

...our banking system has a social obligation to the Australian community in addition to their economic and commercial role...we need them to enter into a social and economic contract for the benefit of all

100 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury, *Proof Committee Hansard*, 9 March 2011, p 11.

101 Mr Andrew Oliver, *Submission 1*, pp 2-3.

102 Chamber of Commerce and Industry Queensland, *Submission 43*, p 3.

103 Brotherhood of St Laurence, *Submission 29*, p 3.

104 The Hon. Joe Hockey MP, 'Address to the Australian Industry Group Annual National Forum, Canberra, 25 October 2010.

105 Mr Lindsay Johnston, *Submission 97*, p 10.

Australians...Australia's financial service should function in an accessible, affordable and fair manner reflecting its status as an essential service.¹⁰⁶

11.90 Some suggested a competitive banking system may still not meet all social obligations:

...competition alone is not enough to address the significant problem of financial exclusion for low-income and vulnerable Australians.¹⁰⁷

11.91 Westpac considered banks were just like any other company, except for the fact their deposit taking function required regulation:

...a bank is a company like any other company... we are a regulated industry. We have depositors' funds and that is why we have the level of regulation that is required...¹⁰⁸

11.92 As noted in Chapter 14, concerns have been raised about changes to the products the banks offer more vulnerable individuals, such as bank customers being pushed into credit cards instead of being able to access small personal loans.¹⁰⁹

11.93 Other countries monitor banks' performance on these matters:

...in the United Kingdom and the United States, performance monitoring has become widespread in creating accountability among financial institutions to develop affordable, appropriate products to address financial exclusion. In the United Kingdom and elsewhere, competition regulators have powers to conduct market studies to determine whether competition is benefiting all consumers.¹¹⁰

11.94 A desire to find innovative means of competing with the major banks has led one smaller bank to offer a deposit account which pays only minimal interest but instead offers a prize draw of \$20,000 a month.¹¹¹ This has been criticised as encouraging savers to instead become gamblers.

11.95 The Brotherhood of St Laurence note:

106 Finance Sector Union, *Submission 80*, pp 1- 3.

107 Mr Gerard Brody, Senior Manager, Financial Inclusion, Brotherhood of St Laurence, *Committee Hansard*, 25 January 2011, p 2.

108 Ms Gail Kelly, Chief Executive Officer, Westpac, *Committee Hansard*, 21 January 2011, pp 78-79.

109 Mr Gerard Brody, Senior Manager, Financial Inclusion, Brotherhood of St Laurence, *Committee Hansard*, 25 January 2011, pp 2 and 5.

110 Mr Gerard Brody, Brotherhood of St Laurence, *Committee Hansard*, 25 January 2011, p 3.

111 Mr David Liddy, Chief Executive Officer, Bank of Queensland, *Committee Hansard*, 9 February 2011, p 21. Mr Liddy stated that while the lottery account was unique in Australia similar products were offered in New Zealand and the United Kingdom.

On community service obligations: further regulation can be used to ensure that financial institutions provide accessible basic services to all customers. This can be necessary in markets where policymakers recognise conflict between the profit motive of firms and the social policy goals of the industry. For example, in privatised telecommunications, gas or electricity markets, companies are not able to deny access to less profitable rural or low income customers.¹¹²

11.96 The banks reject the idea that they should be obliged to provide basic banking products:

...the proposal to mandate that banks, as distinct from other ADIs, offer a free transaction account to all account holders in Australia, whatever their legal and financial status, is anti-competitive, and therefore would distort the provision of retail banking services in Australia...no other business in Australia is required to provide its services free of charge.¹¹³

11.97 Even where banks provide a basic banking product, it may not be taken up by those customers who could most benefit:

Especially with our clients, it takes some time to work with them to ensure that they are thinking about their finances and their money management issues and to build their financial literacy so that they are making the decisions that are in their own best interests.¹¹⁴

We think that the banks could do more in promoting those products and identifying customers who would be eligible for such products—even make it a default option that they get put on those sorts of accounts...Generally, those accounts are available to those who have some form of Centrelink income or have access to a healthcare card or a pensioner concession card, for example. Banks generally know if that is the case with their clients, particularly around Centrelink income because it is deposited into their accounts.¹¹⁵

11.98 Bankers have played a trusted role as financial advisers in the community, but are increasingly in a conflict of interest:

When people are asked to make financial decisions that they do not fully understand, they often rely on other people for help, particularly people that they regard as better qualified or informed. In the case of bank products, people often rely on the advice they receive from bank workers. What is not well understood is that bank workers in Australia are often paid commissions to sell their bank's products. The more products they sell—in other words, the more debt they convince customers to take on—the more

112 Mr Gerard Brody, Senior Manager, Financial Inclusion, Brotherhood of St Laurence, *Committee Hansard*, 25 January 2011, pp 3-4.

113 Australian Bankers' Association, *Submission 76*, p 44.

114 Mr Gerard Brody, Brotherhood of St Laurence, *Committee Hansard*, 25 January 2011, p 11.

115 Mr Gerard Brody, Brotherhood of St Laurence, *Committee Hansard*, 25 January 2011, p 7.

money they make. In fact, encouraging bank tellers and call-centre workers to sell debt products is an integral part of a bank's marketing strategy. Consumers can no longer be confident that the advice they receive from bank workers is objective rather than conflicted.¹¹⁶

Committee view

11.99 The Committee recognises that banks are accorded a special status and given special privileges. In exchange they have social obligations to provide banking services to the broad community. These are obligations that the banks should meet voluntarily rather than compulsorily. In areas where there are unmet demands for basic banking services which the government believes on social grounds should be provided to disadvantaged members of the community, the government should invite banks to tender to provide the services and the government pay to ensure they are provided.

116 Australia Institute, *Submission 46*, p 3.