Additional Comments by Senator Xenophon

1.1 With the four major banks holding around three quarters of Australia's deposits and assets, and 87 percent of home loans, the lack of choice between financial institutions for consumers effectively means that the "big four" have free reign to do as they please.

1.2 Over the years, Australia's banking sector has significantly shrunk.

> "In October 2007, the Australian mortgage market was serviced by over 150 financial institutions offering 2,117 home loan products. In November 2010, this had fallen to 100 financial institutions offering 1,600 products."[1]

1.3 In a survey conducted by the Chamber of Commerce and Industry Queensland, almost 90 percent of respondents agreed that there should be more competition in the banking industry.[2] A separate survey found 72 percent of Australians thought the big four banks in Australia have too much market power.[3]

Bank profits up, but so are interest rates

1.4 During the recent global financial crisis, Australian consumers had to reduce their spending, yet it seemed the profits of Australia's big four banks were as high as ever.

1.5 An online poll conducted by Fairfax newspapers in October 2010 asked:

> Do you think commercial banks would be justified in either moving early to raise rates or lifting them by more than the Reserve Bank when it moves?

Yes, banks are paying more for their money so borrowers should expect to pick up the tab	16%
No, banks are earning huge profits and can afford to absorb the extra costs	80%
Too hard to tell	4%

1.6 Then, on Melbourne Cup Day in November 2010, Australians were outraged when the Reserve Bank increased interest rates by 25 basis points but the big four banks increased their standard home loan rates, on average, by 40 basis points.

1.7 This followed the Commonwealth Bank posting a net profit for the full year ending 30 June 2009 of $4.7 billion, ANZ, $4.5 billion, National Australia Bank $3.8 billion, and Westpac, $4.6 billion.

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[1] Treasury, *Submission 102*, Pg 22

[2] Chamber of Commerce and Industry Queensland, *Submission 43*, Pgs 3 and 16

[3] Fear et all, 2010, Pg iv

1.8 (And, in the first week of May 2011, ANZ and Westpac announced record half-year profits – ANZ, $2.66 billion, up 38 percent and Westpac, almost $3.2 billion for the half-year, up 7 percent.)

1.9 During the Committee Inquiry, the CEOs of the major banks explained to the Committee that their cost of wholesale funds had increased, hence the rise in interest rates.

1.10 However this has been a bitter pill to swallow for Australian consumers who have only watched the banks celebrate record profits while they have had to tighten their belts.

1.11 Greater transparency by the banks around the decision making process for increasing interest rates would better inform consumers. Each month, banks should be required to publish on their websites specific reasons for increasing or decreasing their standard home loan rates, whether in line with, outside of or above, the RBA's cash rate.

1.12 Furthermore, any time delay between the RBA's decisions and the banks' change in rates should be explained, especially where the RBA has lowered the cash rate and the bank has not followed suit.

1.13 This additional information will enable consumers to better assess their banks and have greater awareness for their justification for increasing interest rates and will help consumer more easily identify, at least on this issue, which bank they prefer.

The need for a 'fifth pillar'

1.14 In 2008, Westpac acquired St George Bank, then Australia's fifth largest bank. The loss of competition by this move attracted a lot of commentary during the Inquiry.

> **Mr Carter—**We had very vigorous exchanges with the ACCC around that, particularly the St George merger. We made it crystal clear to everybody we spoke to and particularly the ACCC that if they green-lit that merger they would essentially end competition against the big four... We had a fifth pillar; it was called St George, and Westpac were allowed to purchase it. We think that the ACCC completely went missing at a time when they needed to stand up...A thousand people lost their jobs as a result of that merger, and there are probably 2,000 or 3,000 more people who are going to lose their jobs. With the fall of St George, we have lost the only genuine competitor to the big four...No-one has won out of that."[4]

> **Associate Professor Zumbo—**There is absolutely no doubt in my mind that the St George acquisition by Westpac was a huge mistake. It was the beginning of the end. It was the tipping point. St George was an intensive competitor, particularly in relation to small businesses.…the four big banks basically took out one significant threat to them overnight. [5]

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4 Mr Leon Carter, Finance Sector Union, *Proof Committee Hansard*, 14 December 2010, Pg 45

5 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 14 December 2010, Pgs 61-62

1.15 Indeed, it has become apparent that whenever a 'smaller' bank or lending institution has emerged as a potential competitor in the sector, it has promptly been acquired by one of the major four banks.

1.16 For example, the Commonwealth Bank acquired West Australian bank, Bankwest, in 2008 for $2.1 billion, making the Commonwealth Bank the clear market leader in that state.

1.17 The BankWest deal gave the Commonwealth Bank $55 billion in loans, $37 billion in customer deposits and 148 branches.[6]

1.18 Although these banks continue to have their own branding and operate individually at a retail front, there is a false sense of there being more competition than really exists at a consumer level, given that the umbrella owners are in fact one and the same.

1.19 The ability for banks to acquire emerging threats to their dominance should therefore be prohibited through legislative amendment to Competition and Consumer Act 2010. Similarly, Australia's 'four pillar' policy should never be reduced.

1.20 Unfortunately, mutuals, credit unions and smaller banks have struggled to effectively compete against the major four banks, and the global financial crisis and the Government's Wholesale Funding Guarantee Scheme, while necessary and beneficial in some regards, only compounded the market domination of the big four banks.

1.21 During the global financial crisis, the Australian Government guaranteed Australian Deposit-Taking Institutions (ADIs) with credit ratings of AAA to AA- at 70 basis points per annum, while those with credit ratings of A+ to A- were charged 100 basis points and others 150 basis points.

1.22 The double cost of this to smaller financial institutions compared to the major banks made it relatively onerous for them to access the guarantee and therefore more and more customers flocked to the major banks rather than supporting smaller lenders.

> **Mr Degotardi—**…during the GFC the largest banks accessed a wholesale government guarantee that we were not able to access because of the differential pricing on that guarantee. The cost for us therefore was too expensive. And that did put us at a disadvantage.[7]
>
> **Mr Lloyd—**There are differences of guarantee and differences in the price of guarantee, which has disproportionately benefited the major banks.[8]
>
> **Mr Minz—**Entities in the Australian marketplace which are regulated by the one entity, APRA, are subject to the same prudential standards…I do not believe the 150 basis points that we were charged was reasonable.[9]

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[6] Commonwealth steals BankWest, http://www.intelligentinvestor.com.au/articles/Commonwealth-Bank-CBA/Commonwealth-steals-BankWest.cfm?articleID=817412, 9 October 2008

[7] Mr Mark Degotardi, Head of Public Affairs, Abacus, *Proof Committee Hansard*, 13 December 2010, Pg 93

[8] Mr Richard Lloyd, International Policy Adviser, Choice, *Proof Committee Hansard*, 14 December 2010, Pg 31

[9] Mr John Minz, Chief Executive Officer, Heritage Building Society, *Proof Committee Hansard*, 4 March 2011, Pg 13. See also Mr James McPhee, Chief Executive Officer, Members Equity Bank, *Proof Committee Hansard*, 25 January 2011, Pg 11

> **Mr Anderson—**…if you equalise the cost arrangements in respect of the wholesale funding guarantee, that is going to be a direct advantage to those second-tier institutions, and they would have the capacity to flow that through…it certainly would allow them to compete more actively on price.[10]

1.23 The Committee's recommendation to reduce the guarantee permia to 70 basis points for all ADIs (Recommendation 12.1) is a positive measure and will work to even out the imbalance that currently exists.

1.24 It is crucial that financial institutions which could be potential fifth pillars in the banking sector be able to thrive and by making the guarantee more affordable for smaller ADIs, they will be able to compete against the big four and offer alternative banking choices to Australian consumers.

1.25 The Committee also heard that it was difficult for some of the smaller banks and credit unions to attract small and medium business loan customers due to the dominance of the major four banks.

1.26 CPA Australia told the Committee:

> Second tier lenders (smaller banks and credit unions) …without larger distribution networks and larger back office support…[are] unlikely…[to] become a major source of competition in small business lending.[11]

1.27 These second tier lenders should be better supported by the Government to enable them to provide alternative choice for consumers and increase competition in the small business market.

1.28 The Australian Office of Financial Management currently offers Residential Mortgage-Backed Securities and a similar scheme to support small business lending should be considered for second tier lenders only.

1.29 It was also put to the Committee that a distribution channel for smaller lenders should be established (such as through Australia Post) which would alleviate significant costs and provide better access to consumers across Australia.

1.30 A survey of Queensland businesses found that 45 per cent supported this proposal[12] and this was also encouraged by CHOICE.

> **Mr Stace—**Smaller banks need a hand up and that may also be through access to a branch network including, for example, working with Australia Post.[13]

1.31 Associate Professor Frank Zumbo suggested that the Productivity Commission undertake a feasibility study into this proposal, and Australia Post

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[10] Mr Peter Anderson, Chief Executive, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 15 December 2010, Pg 114. See also Chamber of Commerce and Industry Queensland, *Submission 43*, Pg 19

[11] CPA Australia, *Submission 82*, Pg 9

[12] Chamber of Commerce and Industry Queensland, *Submission 43*, Pg 16

[13] Mr Nick Stace, CHOICE, Proof Committee Hansard, 14 December 2010, Pg 28

offering basic banking services and to review the overseas experience with national postal services offering banking services.[14]

'At Treasury, we won't save you'

1.32 In March 2010, Aussie Home Loans received an in principle 'go ahead' from the Australian Office of Financial Management that it would be able to acquire Residential Mortgage-Backed Securities.

1.33 This would have enabled Aussie Home Loans to provide approximately $1 billion in mortgages to its customers at interest rates below that of the banks.

1.34 However, on 3 December 2010, just days before the Treasurer, the Hon Wayne Swan MP, was due to announce the Government's banking reform agenda, Aussie Home Loans received an email stating that:

> "…contrary to previous advice, the AOFM is not going to be in a position to support the transaction, based on CBA's ownership of AHL.

Specifically,

> the Treasurer has clarified his expectation that the RMBS program not support the major banks, or their subsidiaries (whether fully or partially owned); and
>
> in light of this clarification, the AOFM will not be in a position to support the AHL transaction at this time."[15]

1.35 As a result of this decision, Mr Symond told the Committee Aussie Home Loan customers could face a 0.1 per cent increase, which would add about $350 a year to a $500,000 home loan.[16]

1.36 However, Aussie Home Loans is not a subsidiary of the Commonwealth Bank. In universally-accepted business terms, a 'subsidiary' is understood to be an entity that is controlled by a higher entity or parent company which owns more than 50 percent of the company.

1.37 Only 33 percent of Aussie Home Loans' shares are owned by the Commonwealth Bank and although it holds 2 seats on the Board, Mr Symond has repeatedly stated that Aussie Home Loans maintains operational independence from CBA.

1.38 Ultimately, Australia's banking sector should comprise of as many players where possible, to provide consumers with greater choice and thereby creating more competition between the financial corporations.

1.39 Financial institutions which can be an effective alternative to the major four banks need to be supported and the Government has significantly erred in this area by

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[14] Associate Professor Frank Zumbo, *Submission 56*, Pg 8

[15] Document tabled by Mr John Symond at a public hearing in Sydney on 14 December 2010; email correspondence between Michael Bath and Ernest Baisi

[16] Daily Telegraph, Aussie John Symond slams Wayne Swan's bank reforms, http://www.dailytelegraph.com.au/news/national/aussie-john-symond-slams-wayne-swans-bank-reforms/story-e6freuzr-1225971171836, 15 December 2011

choosing not to support Aussie Home Loans which would have seen it provide competition to the mortgage sector.

1.40 Aussie Home Loans is 'market maker' in that it has been the impetus for competition in the home loan market ever since it was established in 1992, providing an alternative to the big four banks and spurring competition in the sector thereby saving Australian consumers hundreds of millions of dollars.

1.41 The Treasurer's decision not to provide Aussie Home Loans access to the RMBS program will have the paradoxical effect of reducing competition in the mortgage market with negative consequences for consumers, despite the fact that the Government's banking reform package is intended to "empower consumers to get a better deal in the banking system, to support our smaller lenders so they can put more competitive pressure on the big banks"[17].

1.42 The Committee’s recommendation that the Australian Office of Financial Management be able to exercise its discretion to purchase residential mortgage-backed securities issued by entities with a substantial bank shareholding where it judges this would promote a more competitive market (Recommendation 13.5) is logical and should have been applied by the AOFM and the Treasurer in the case of Aussie Home Loans. It was a missed opportunity.

Recommendations

Recommendation 1
That banks be required to publish on their websites specific reasons for increasing or decreasing their standard home loan rates each month, and any time delay between the RBA’s decisions and the banks’ change in rates be disclosed and explanation given, especially where the RBA has lowered the cash rate and the bank has not followed suit.

Recommendation 2
That the Competition and Consumer Act 2010 be amended so that the big four banks be prohibited from acquiring any further second tier financial institutions.

Recommendation 3
That the Productivity Commission conduct a feasibility study into Australia Post becoming a distribution channel for smaller banks, credit unions and mutuals.

Recommendation4
That the Government introduce a scheme through the AOFM to assist second tier lenders only to facilitate small and medium business loans.

[17] Competitive and Sustainable Banking, http://www.treasury.gov.au/banking/content/report/report_01.htm

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