

Chapter 1

Introduction

1.1 As the Senate's specialist committee for economic matters, issues related to the global financial crisis have been a focus of the committee's work in recent years. This inquiry continues the committee's examination of the impact of the crisis on the Australian financial sector and its implications for how the sector will function in the future. The committee has now produced a series of reports on the subject. The previous report, *Competition within the Australian banking sector* (hereafter referred to as the Competition Inquiry) concluded a comprehensive investigation by the committee into the state of competition in the sector following the crisis. The committee presented its report on that inquiry to the Senate in May 2011, but it considers that much of its analysis remains relevant. While this inquiry also touches on competition issues, readers interested in a detailed discussion of competition in the banking sector should refer to that report.

1.2 Other relevant inquiries conducted by this committee in recent years include:

- *Access of small business to finance* (reported 30 June 2010);
- *Aspects of bank mergers* (reported 17 September 2009); and
- *Bank funding guarantees* (reported 17 September 2009).

Terms of reference

1.3 On 14 March 2012, the Senate agreed to refer to this committee a further inquiry related to the global financial crisis and the Australian banking sector. The terms of reference are as follows:

An examination of recent developments in the banking sector arising out of the impact of the global financial crisis and subsequent events, including:

- (a) the impact of international regulatory changes on the Australian banking sector, particularly including changes to liquidity and capital holding requirements;
- (b) the impact on relative shares of specific banking markets;
- (c) the current cost of funds for lending purposes;
- (d) the impact on borrowing and lending practices in the banking sector both during and since the global financial crisis;
- (e) the need for further consideration of the state of the broader finance and banking sector; and
- (f) any other relevant matters.¹

1 *Journals of the Senate*, 2010–12, no. 81 (14 March 2012), p. 2238.

1.4 A number of distinct and complex issues are included in the terms of reference. One matter is Basel III—the internationally-agreed regulatory changes intended to address the identified weaknesses contained in the previous capital regulation and supervision arrangements. The current cost of funds for banks is also included; this is a controversial issue as the rising costs of funds is regularly cited by the major banks as the reason why their lending rates are not moving in step with the changes made by the Reserve Bank of Australia to the official cash rate, yet recently the major banks have been announcing record profits raising questions about their cost claims. Another significant and complicated issue is the impact of the crisis on lending practices. On this front, the evidence received was primarily focused on the allegations that, following the acquisition of Bankwest by the Commonwealth Bank of Australia in 2008, Bankwest's business loan portfolio was reviewed and in order to clear the books a number of existing small business clients of Bankwest were mistreated and deliberately made to default on their loans.

Conduct of the inquiry

1.5 The committee advertised the inquiry in *The Australian* and on its website. It also wrote to financial institutions, industry groups, government departments and agencies, consumer and small business groups, academics and other interested parties to inform them of the inquiry and to invite submissions. During the course of the inquiry, updates about its progress were also publicised through the Senate's Twitter account.²

1.6 In total, the committee received 158 submissions. Details about this material can be found in Appendix 1. The public submissions can be viewed on the committee's website.

1.7 The committee held five public hearings: 8 August 2012 (Canberra), 9 August 2012 (Sydney), 10 August 2012 (Sydney), 21 September 2012 (Canberra) and 10 October 2012 (Canberra). The committee took evidence from the Australian Treasury, the Reserve Bank of Australia, other relevant government agencies, the four major banks (including separate evidence from representatives of Bankwest, a subsidiary of one of the majors), a foreign subsidiary bank, representatives of credit unions, building societies and mutual banks, a professor of finance, representatives of credit advisers, an insolvency services firm and a number of former customers of Bankwest. The witnesses who appeared at these hearings are listed in Appendix 2.

1.8 The committee thanks all of the individuals and organisations that provided evidence for this inquiry.

Structure of the report

1.9 Reflecting the varied issues raised in the terms of reference, this report is divided into three parts.

Part I (chapters 2–5)

1.10 The first section of the report focuses on sector-wide issues that fundamentally impact the way financial institutions conduct their operations. Chapter 2 provides an overview of the post-global financial crisis banking sector; it discusses the state of competition in the sector, regulatory changes in other jurisdictions that are impacting Australian banks and various other developments that emerged this year such as the Libor manipulation scandal. Chapter 3 examines the changes to capital adequacy and liquidity requirements brought about in response to the global financial crisis and contained in Basel III; the chapter particularly focuses on the approach taken to implementing Basel III in Australia. Chapter 4 outlines the changes to the funding mix used by Australian banks and funding costs since the crisis. The final chapter in this part—chapter 5—examines proposals to help address funding challenges and competition concerns in the sector.

Part II (chapters 6–9)

1.11 Part II of the report focuses on the impact of the global financial crisis on borrowing and lending practices. Chapter 6 opens this section with an overview of the impact of the crisis on borrowing and lending preferences and supply and demand. This chapter also examines certain other borrowing and lending issues that arose during the inquiry, including allegations of predatory lending and fraud, and purported implications for the Australian Office of Financial Management's securitisation activities. Chapters 7, 8 and 9 examine the allegations related to Bankwest. Chapter 7 provides an overview of the evidence received on this issue, with a focus on the experiences that aggrieved borrowers appeared to share. Chapter 8 begins the committee's analysis of the evidence and the possible explanations as to why a significant number of small business borrowers and property developers had negative experiences with Bankwest. Chapter 9 contains the committee's findings and recommendations.

Part III (chapter 10)

1.12 The final part of the report is comprised of one chapter which focuses on paragraph (e) of the terms of reference—the need for further consideration of the state of the broader finance and banking sector. It outlines the evidence put forward as to why a widespread, independent root and branch inquiry into Australia's financial system is warranted and includes the committee's view on this proposal.

