Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Estimates 22-23 October 2008

Question: sbt 19

Topic: **Bank Switching**

Hansard Page: **Written**

Senator Coonan asked:

1. What measures have the Government put in place to ensure that banks pass on official RBA rate cuts?
2. Is the Government moving to put in place a mechanism to stop rate rises independent and above that of the RBA?
3. What are the anticipated costs to banks for compliance with the Government's bank switching package?
4. Considering that a bank can offer a lower interest rate when there is an exit fee because the exit fee makes continued customer patronage more certain – what is the anticipated average rise in interest rates because of this regulation?
5. Has Treasury modelled these regulatory changes and their impact on bank product interest rates?
6. The Australian Payment Clearing Association has identified that the bank switching package is flawed because it relies on financial institutions providing exiting customers with account debits and credits for the last 13 months. In some cases financial institutions do not have these details. How will the Plan be implemented in the absence of records dating back 13 months?
7. Has the Dutch system of allowing bank account numbers to be transferred between banks been considered in formulation of the policy?
8. With the introduction of Government guarantees for deposit taking institutions, does the Government consider that banks should pass on the full 1% rate cut from the recent decision of the Reserve Bank?

Answer:

What measures have the Government put in place to ensure that banks pass on the official RBA rate cuts?

Australia has a market economy. This means the Government does not, as a normal course of action, regulate prices. The interest rates charged by banks are a commercial decision of each bank or lending institution and reflect a range of considerations, including the cost of funds, risk margins and competitive pressures in the market.

The banks have repeatedly stated that they have had difficulty in passing on in full the RBA's cut in official interest rates due to their higher funding costs. The cost of raising funds in domestic and international wholesale credit markets has risen relative to the RBA cash rate due to the repricing of risk and tightening of credit conditions since the start of the global financial crisis.

The Government has taken decisive action to ensure that Australia's financial institutions can continue to access funds by providing a guarantee on eligible deposits and wholesale funding of authorised deposit-taking institutions. The RBA has indicated in its *Statement on Monetary Policy* that it expects this initiative to lead to some reduction in bank lending rates.

The Government has also introduced a number of measures to support competition in mortgage lending. Competition will put downward pressure on the prices of banking services, and put pressure on providers of these services to improve their services in order to attract customers.

The Government has directed the Australian Office of Financial Management to invest up to $8 billion in Australian residential mortgage backed securities (RMBS), of which at least $4 billion must be invested in RMBS issued by mortgage lenders other than authorised deposit-taking institutions. This measure is designed to support competition from a diverse range of home loan lenders during the present market dislocation.

This initiative has provided greater competition in the mortgage market and downwards pressure on interest rates. Non-bank mortgage provider FirstMac, which was one of the first non-banks to access funding through the AOFM, announced on 21 November 2008 that it was offering an initial first year home loan rate of just 3.99 per cent. FirstMac indicated that this competitive interest rate was made possible as a result of the Government's RMBS investment.

More generally, the actions by the Government and the RBA have contributed to recent reductions in interest rates on a range of lending products. ANZ reduced its fixed rate home loans to as low as 5.99 per cent, the same as National Australia Bank's introductory fixed rate. Commonwealth Bank has also reduced its lowest fixed rates, to 5.99 per cent, while Westpac's one-year fixed rate remains at 6.99 per cent, including a reduction obtained when customers take out the bank's Premier Advantage Package. The Government expects further reductions in lenders' funding costs to be passed on in full to borrowers as quickly as possible.

Consumers who are not happy with the interest rate offered by their bank are now able to switch transaction accounts more easily than ever before, as a result of the Government's Account Switching Package. Since 1 November 2008, banks, building societies and credit unions have been obliged to help customers to switch to an alternative provider. Thus customers who are unhappy about high interest rates will be able to express their dissatisfaction, and exert competitive pressure on the market.

On 3 June 2008 the Government commissioned the House of Representatives Inquiry into competition in the banking and non-banking sectors and will give full consideration to its recommendations.

Is the Government moving to put in place a mechanism to stop rate rises independent and above that of the RBA?

As a general principle, the Government considers that promoting competition within the private sector is the best way to ensure that consumers get the services they want at the lowest possible price. The response to question 1 sets out the broad range of Government initiatives in place to support competition between providers of banking products.

In addition to this, the Treasurer requested the Australian Securities and Investment Commission (ASIC) to undertake a review of mortgage entry and exit fees. This review will help to maximise competition, by providing consumers with more information about products (including associated fees), and making it easier to compare those products. The report shows that there is substantial variation in fee structures across the mortgages provided to Australian consumers.

Since the Government announced the review, one major lender decided to offer a new mortgage product free from exit fees. This in turn should help to increase the amount of competition within the banking sector.

In addition, the Commonwealth and States have reached an historic agreement at the Council of Australian Governments to develop a national regulatory framework for mortgage lending, which is to be overseen by the Commonwealth. This framework will be informed by the recent ASIC report.

What are the anticipated costs to banks for compliance with the Government's bank switching package?

There was no estimate of costs made, as it was implemented voluntarily by industry.

Considering that a bank can offer a lower interest rate when there is an exit fee because the exit fee makes continued customer patronage more certain – what is the anticipated average rise in interest rates because of this regulation?

The Account Switching Package will not result in an increase in interest rate on mortgages. It will, however, make it easier to switch mortgages.

Many consumers 'bundle' their accounts (for example transaction accounts, credit card accounts, and home loans) with one provider. Transaction accounts have a particular significance for consumers. Research conducted by the UK Office of Fair Trading in 2008 shows transaction accounts to be at the core of a customer's relationship with a financial institution. Making it easier to switch that core component therefore makes it easier for the customer to switch the whole of their relationship, including their mortgage account.

Has Treasury modelled these regulatory changes and their impact on bank product interest rates?

The Government has not imposed legislation on industry. Consequently, no formal regulation impact statement was developed.

The only regulatory change made as a result of the Account Switching Package was a change to the industry codes – the Electronic Funds Transfer Code; and the Bulk Electronic Clearance Procedures. Industry agreed to the changes being incorporated in the industry codes when the Account Switching Package was first announced by the Treasurer on 9 February 2008.

Any pressure on interest rates of transaction accounts and mortgage accounts should be downwards pressure, as the changes will enhance competition. Estimation of the impact of the switching requirements on the size of any change in interest rates would require the isolation of the impact of the switching requirements from a range of other factors, such as the impact of global financial turmoil interest rates. There would also need to be an adjustment made for the impact of the turmoil on customer's inclination to switch accounts. These projections have not been made.

Prior to the financial turmoil it was estimated that the switching rate in Australia could increase from the currently reported rate of 3 per cent to 6 per cent, the rate of switching current in the United Kingdom, which has a comparable system, and has had switching support arrangements in place in relation to transaction accounts for a number of years.

The Government will monitor implementation of the new listing and switching requirements closely to determine whether further steps are required to assist people to exercise choice in the market.

The Australian Payment Clearing Association has identified that the bank switching package is flawed because it relies on financial institutions providing exiting customers with account debits and credits for the last 13 months. In some cases financial institutions do not have these details. How will the plan be implemented in the absence of records dating back 13 months?

In its final report on the completion of arrangements to support account switching for ADIs, APCA data indicated that its members were on track to implement the account switching package.

APCA noted that in the case of 2.8% of transactions, four small ADIs will initially be unable to provide full data on direct debits and credits for the past 13 months, although they would be able to provide full data in relation to transactions that have occurred in the past three months. By checking the customers accounts, these institutions will provide customers with sufficient information to enable receiving ADIs to identify the relevant recipients and payees for the direct debits and credits in question. This impact will reduce in size every month that the account switching arrangements are in place.

Has the Dutch system of allowing bank account numbers to be transferred between banks been considered in formulation of the policy?

The Government has considered the Netherlands approach to account switching arrangements. Due to substantial differences between Australia's and the Netherlands' clearing and settling arrangements for transactions, it would have been a very expensive option for Australia to take at the time. Netherlands' arrangement is a redirection service, not an account number portability system. Account number portability is not provided in any country.

A number of countries, including the Netherlands and the UK, do provide redirection services. This system is a good choice in these countries because they clear and settle transactions through a central switching arrangement, which makes redirection simpler. In addition, in the UK, the financial institution holds the customer's authority for direct debits and credits. Where the financial institution holds authority for the customer it can re-route direct credits and debits from the old institution to the new institution.

In Australia, as in Canada and Ireland, transactions are settled bilaterally between financial institutions, and this impacts on the switching solutions available. Also, in Australia, the DE User (or merchant) holds the authority for the direct debit or credit, and so the financial institution cannot legally redirect direct debits or credits on the customer's behalf as they do not have the authority to do so. Australia's account switching package will give Australian bank customers access to levels of service comparable to that offered in a number of overseas jurisdictions. The government is monitoring use of account switching arrangements to determine whether further measures are required to facilitate switching.

APCA is currently working with industry to explore options to replace the bilateral system with a more centralised approach, which would improve options available to support switching services, and could make switching arrangements more akin to the arrangements in the Netherlands possible. Treasury has written to APCA to request that it include switching options in its considerations on improvements to Australia's clearing and settling arrangements.

With the introduction of Government guarantees for deposit taking institutions does the Government consider that banks should pass on the full 1% rate cut from the recent decision of the Reserve Bank?

Treasury does not comment of the Government's view if a matter.