AUSTRALIAN BANKERS' ASSOCIATION INC.

Inquiry into aspects of bank mergers

Australian Bankers' Association

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Introduction and context

The Australian Bankers' Association (ABA) welcomes the opportunity to make a submission to the Senate Standing Committee on Economics in relation to its inquiry into aspects of bank mergers. The Committee is schedule to report on 26 February 2009.

The ABA's submission starts with a contextual section and then directly addresses the inquiry's terms-of-reference. This submission primarily deals with banking mergers from the perspective of retail banking rather than that of institutional banking, wealth management or insurance services.

1. Banking stability

The ABA's starting point is the fact that Australia's banking system is stable and competitive. Our system has demonstrated its durability through the 1997 Asian financial crisis, the tech bubble of 2000 and the latest financial crisis stemming from US sub-prime loans. Unlike many comparable countries, no direct taxpayers' money is being used to support Australian banks.[1]

Since the 1890's depression, there has been only one small example of depositors having lost money. In 1930, a small rural bank became insolvent and after the institution's wind-up, depositors lost one cent in the dollar. Apart from this, no depositor has lost money in an Australian bank for more than one hundred years.[2]

This history of stability is a critical social and economic benefit for the Australian community.

2. Brief history of competition in retail banking in Australia

The history of retail banking is a story of rising competitive tension.

Throughout much of the second half of last century, banking was a highly regulated business with regulations effectively controlling retail prices for deposits and loans. During this period, competition between banks focussed on the rollout of branches rather than on price or other aspects of service.

Deregulation in the 1980s, following the Campbell Inquiry, commenced a process of price competition in both loans and deposits, particularly

[1] The deposit and wholesale funding guarantees established in 2007 were not designed to 'bail out' or support the solvency of Australia's banks. The wholesale guarantee was a necessary response to similar guarantees established by other governments that threatened to impair the ability of Australian banks to successfully compete for international funding, of which Australia is heavily dependent. This wholesale guarantee is not free, it is paid for by the banks in the form of Government levies. The guarantee for deposits under $1million does not expose Australian taxpayers; the guarantee is underwritten by the banking industry. The guarantee for deposits over $1 million is paid by banks through Government levies.

[2] In the early 1990s, there were two significant bank failures, both of which were government-owned banks: (a) the State Bank of Victoria and (b) the State Bank of South Australia. Depositors did not lose money in these failed banks because they were guaranteed by their respective Government owners.

the former in the initial years. This competition is reflected in constant margin declines since the early 1990s.

In terms of housing lending, the following factors contributed to the rising competitive tension:

- Deregulation of interest rates and loan volumes in the 1980s;
- High default rates in corporate lending in the late 1980s and early 1990s which caused banks to increase focus on retail lending;
- The emergence of non-bank lenders like Aussie Home Loans in the early 1990s that offered lower interest rate on home loans (in part because they did not have expensive branch networks and full-service banking services to maintain). They ultimately funded their loans through securitisation markets;
- Product innovations by non-banks in the first half of this decade in areas such as low-doc loans and 100% loan-to-value (LVR) loans;
- The development of a large loan broking industry which resulted in, at one point, about 40% of all housing loans being originated through brokers and one in three loans being issued outside the major four banks; and
- More recently, direct Commonwealth Government subsidies through support for the Residential Mortgage Backed Securities (RMBS) issued by competitors to the major banks.

In terms of deposits, serious competition emerged in the market in about 1999 when a number of internationally-owned banks operating in Australia began targeting the deposit market with very high deposit interest rates, particularly for deposit accounts confined to management through the Internet.

Competition for deposits was given a fresh boost with the onset of the 2007 financial crisis which resulted in a world-wide liquidity crisis that threatened to limit the amount of funding Australian banks could source from overseas. With funding harder and more costly to source overseas, banks began fiercely competing for local deposits with aggressive pricing.

An important contextual point for this competition was that since the 1992 compulsory superannuation legislation and tax incentives for salary sacrificing into superannuation, Australian banks began seeing a gradual but pervasive decline in the proportion of deposits making up their funding base. This resulted in the Australian banks becoming more dependent upon non-deposit funding sources, such as overseas investors. About 25 per cent of bank funding now comes from offshore sources.

When these overseas funds became more uncertain starting in August 2007, the banks prudently attempted to increase the weighting of Australian deposits in their liability profile.

3. Bank mergers and concentration

It is sometimes alleged that the stability of Australia's banks is a by-product of a system that is concentrated and uncompetitive. It is true banking is reasonably concentrated in Australia, like many comparable countries, but concentration should not be automatically assumed to produce uncompetitive outcomes.

Indeed, the academic literature on banking concentration finds there is no obvious link between concentration and inadequate competition. Strong competition can and does exist, despite high levels of concentration.

Using an analytical technique known as the "H-Statistic"[3] developed by Panzar-Ross (1987), a number of academic researchers[4] have found no evidence of a link between concentration and competition.

- Casu and Girardone (2006) examined banking markets for 15 European countries over the period 1997 to 2003 and found no evidence of a link between concentration and competition (as revealed by H-Statistics).
- Claessens and Laeven (2004) undertook a study of 50 countries over the period from 1994 to 2001. Similarly, no link between concentration and competition was found.
- Yildren and Philippatos (2007) studied 11 Latin American countries for the period 1993 to 2000 and found no significant link between concentration and competition, although they did find a link between competition and the country's openness to foreign bank entry.

4. Contestability of banking

Modern economics places considerable importance on encouraging competition by reducing the barriers to market entry. While banking has long been viewed as an industry characterised by high barriers to entry, evidence now shows that these barriers have fallen considerably.

Indeed, probably the most significant barriers are now imposed by Government through prudential and consumer protection measures such as APRA capital rules and ASIC's licensing regime, and also anti-money laundering and counter terrorism financing obligations

[3] The H-Statistic is an estimate of the responsiveness of firm revenue to changes in factor inputs. For example, if wages increase, how does this impact bank revenue? The degree of response to these changes gives an insight to the competitive workings in the banking system.

[4] See Davis (2007)

concerning the monitoring of unusual account activity and customers that exhibit high risk characteristics.

Apart from Government obligations, banking is now a much more contestable market. In the past, banks derived considerable advantage from having extensive branch networks that made it expensive for new entrants to duplicate. The emergence of the Internet, electronic banking and emergence of the loan and equipment finance broking industry has eroded this advantage.

There is clear evidence in the banking market that some foreign-owned subsidiaries with a retail presence have managed to build large deposit and lending books without extensive branch networks.

Another historic source of advantage was that banks had superior information to new entrants in assessing credit risk because they retained considerable information from their overall relationship with those customers. However, credit scoring techniques have also eroded the advantage as new entrants can purchase off-the-shelf credit scoring software that will enable them to accurately assess credit risk without needing extensive historical information.

A further historic advantage for incumbent banks was dominance over the payments system. These days there are essentially only prudential standard impediments to participation in the payments system, indeed under Reserve Bank rules, businesses seeking direct participation into the EFTPOS system have connection costs partly subsidised by incumbent banks.

Committee's Terms of Reference

(a) the economic, social and employment impacts of the recent mergers among Australian banks;

The Australian Competition and Consumer Commission (ACCC) has given its approval to both the mergers of Westpac and St. George and also to Commonwealth Bank's acquisition of BankWest/St Andrew's.

The reason mergers are subject to assessment by the ACCC under the Trade Practices Act (TPA) is that while a merger is assumed to offer benefits in terms of economic scale efficiency (i.e. production with fewer resources) there is a potential community cost if the merged entity materially gains or increases market power from the transaction.

Market power may result in the business charging the consumer a materially higher price for a product (despite no change in input costs), or being able to reduce service quality without risking a reduction in market share.

These possible outcomes can arise if there is ineffective competitive constraint on the merged entity. Competition can come from existing players or the new entrants.

Given the recent merger and the acquisition have both been cleared under the TPA, it is evident the ACCC considers these new entities will not result in a substantial lessening of competition in the relevant markets.

In its conclusion to the Westpac/St. George merger, the ACCC noted that post-merger, it believed there would be significant effective remaining competitors in all the markets it examined.

In relation to the Commonwealth Bank acquisition of BankWest, the ACCC noted that while BankWest was historically a vigorous competitor, the global financial crisis had impacted its parent bank, casting doubt on the competitive role it was likely to pursue going forward. In this context, the ACCC concluded the acquisition would not substantially lessen competition.

Mergers often create employment redundancies

The Committee's terms of reference asks specifically about the employment impacts of recent mergers. The ABA is essentially confining its comments to general issue.[5]

It is true that one of the unfortunate aspects of mergers is that they often result in employment redundancies. For individuals that do not want to

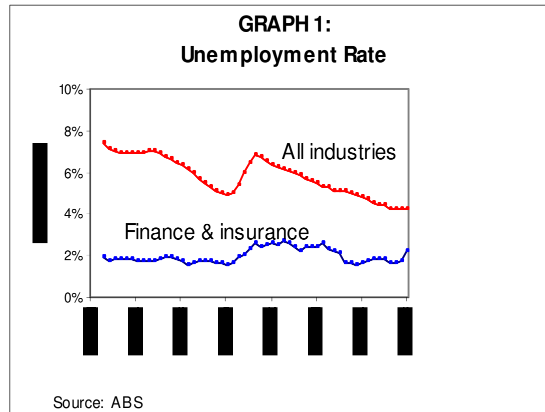
[5] The ABA notes that in the two recent experiences, both the Commonwealth Bank and Westpac/St. George have given the Treasurer extensive undertakings to deal with redundancies appropriately by ensuring that affected individuals are given assistance to the greatest extent possible to find new work within or outside the acquiring bank.

be made redundant or are concerned they will not find equivalent employment in a timely fashion, the impact is clearly traumatic.

In banking, two features of the employment market have historically assisted in reducing the difficulties caused by redundancies. Firstly, banks pay above average redundancy benefits which – all other things being equal - afford redundant staff a longer period to find alternative employment.

Secondly, unemployment in financial services is low compared to other industries, although there has been a narrowing recently due to the general contraction in financial services stemming from the global financial crisis.

Graph 1 shows the financial services unemployment rate versus the unemployment rate of all industries since November 1994. This low unemployment rate suggests that, in the past, any staff made redundant were likely to more easily find another job than if working in other private sector industries.



(b) the measures available to enforce the conditions on the Westpac Banking Corporation/St George Bank Limited merger and any conditions placed on future bank mergers;

In both the Westpac/St. George merger and the Commonwealth Bank acquisition of BankWest and St. Andrew's, approval for the transactions was required by the Commonwealth Treasurer acting under the *Financial Sector (Shareholdings) Act 1998*.[6]

As part of the authorisations, the Treasurer stipulated conditions the entities had to meet and of which formed part of his authorisation. These conditions were not required by the ACCC as part of its authorisation.

[6] The Treasurer, acting under the *Banking Act 1959*, also authorised St. George to enter into an arrangement for the disposal of its business to Westpac.

Appendix 1 details these conditions as they appeared publicly in the Treasurer's respective media releases announcing his clearance of the proposed transactions.

It is important to recognise that the conditions were not forced upon the two banks against their advice. The ABA understands that in respect of both the Westpac merger and the Commonwealth Bank acquisition, the conditions were either offered or mutually agreed.

Given the conditions formed part of the Treasurer's approvals, the conditions are publicly documented, and the banks themselves have committed to then, there is, in the ABA's view, no realistic scenario in which the conditions will not be fully met.

Furthermore, the conditions documented in the Treasurer's media are worded specifically enough to easily evaluate whether or not they have been achieved, particularly those relating to ATM and branch numbers[7], maintenance of brands, and availability of ATM networks to customers of the acquired entity.

Where the conditions relate to human resource management, there is less specificity but the role of the Financial Sector Union (FSU), media and bank reputations will ensure staffing changes, redeployment, retraining and general assistance to affected staff will be managed appropriately, meeting the Treasurer's obligations and the intent of those obligations.

The ABA understands both the Commonwealth Bank and Westpac have established internal controls and reporting arrangements with the Government to ensure the conditions are met in the same way as legal obligations are met.

(c) the capacity for the Australian Competition and Consumer Commission to enforce divestiture in the banking sector if it finds insufficient competition;

There is no general divestiture power incorporated into the TPA, but the ACCC has the legal authority to apply for the divestiture of any merger or acquisition transactions that it deems to have breached Section 50 of the TPA – the section that prohibits mergers or acquisitions that have the likely effect of substantially lessening competition.

This power contrasts to a general divestiture power. A general divestiture power (i.e. the power to force a business to divest assets regardless of whether those assets were accumulated through an acquisition or not) would represent a very significant increase in the ACCC's powers to intervene in economic markets.

[7] With respect to the commitments around ATM and branch numbers, this data is collected and published by the Australian Prudential Regulation Authority (APRA) on an annual basis as part of its Points-of-Presence (POP) survey. Pricing of ATM services is subject to disclosure obligations under the Code of Banking Practice and product transaction price changes are subject to regular media attention.

There may be circumstances that arise in which a business accumulates so much market power that, it may be argued; a divestiture of some nature is in the public interest.[8] In such as scenario, in the ABA's view, the only decision making body qualified to properly consider all the implications for shareholders, employees and the wider public is the Federal Government through a specific legislation. Of course, the parliamentary process is designed to encompass a wide range of stakeholder views, including that of bureaucratic agencies such as the ACCC.

(d) the adequacy of section 50 of the Trade Practices Act 1974 in preventing further concentration of the Australian banking sector, with specific reference to the merits of a 'public benefit' assessment for mergers;

The ABA is assuming this question is seeking views on whether merger applications to the ACCC, specifically banking mergers, should be subjected to an additional clearance test - a public benefit test on top of the current substantial lessening of competition test.

In respect of banking mergers, such an amendment is redundant because banking mergers are already subject to an additional clearance step that can be characterised as a public benefit test.

All banking mergers must be given clearance by the Commonwealth Treasurer acting under both the Financial Sector (Shareholders) Act 1998 and the Banking Act 1959. The Treasurer must be satisfied that the merger is in the national interest.

The Treasurer's responsibility in taking public interest consideration into his/her decision is reflected in the media release clearing the Westpac / St. George merger:

> *"After careful consideration, today I am announcing approval, with conditions, of the proposed acquisition of St .George Limited by the Westpac Banking Corporation…This decision follows a thorough assessment of its impact on the national interest, including factors such as competition, economic efficiency, prudential requirements, financial system stability, community banking needs and the impact on Westpac and St George customers and employees."*

This statement shows the breadth of advice and factors the Treasurer can use to inform and base his decision. The Treasurer's power to stop a merger is not in theory or practice simply a process formality (rubber stamp) – the power can and has been used to place real conditions on the merger parties.

In the Westpac/St. George merger, the Treasurer cleared the merger but the clearance specified 10 conditions that the merged entity had to meet. Similarly in the case of the Commonwealth Bank acquisition of

[8] Such a debate is currently underway regarding Telstra's vertical integration.

BankWest and St. Andrew's, the Treasurer's media release stipulated seven conditions. (See Appendix 1).

While these conditions are best characterised as offered by and/or mutually agreed with the relevant banks and the Treasurer, there is no legislative barrier to the Treasurer imposing additional conditions, even if they are opposed by the affected parties. Of course, the Treasurer and Government are ultimately responsible to the electorate which is an incentive to ensure any obligations agreed or imposed meet the public interest test.

Four Pillars Policy

The banking industry is effectively subject to a tougher competition test than other industries (perhaps with the exception of media).

While all other industries are only subject to Section 50 of the Trade Practices Act as a competition constraint on mergers, banks are subject to the Treasurer's approval and, indeed, mergers between the major four banks have been ruled out by both the current ALP Government as they were under the previous Coalition Government. The stated rational for the Four Pillars policy is that it protects competition.

The formal ABA Council position on the Four Pillars policy is that banking mergers should be subject to the TPA consistent with mergers in other industries. By having an outright ban on such mergers, the political system is potentially denying the community mergers which may benefit the public interest.

(e) the impact of mergers on consumer choice;

The ABA agrees that incentives to improve consumer choice stem from competition between participants for customers. Ensuring continual product innovation is one reason – along with pricing – that competition law seeks to preserve competitive tensions in markets.

In respect of recent mergers and acquisitions, the mergers are not likely to substantially lessen competition, so the incentives to innovate products and service will be retained.

In purely immediate and practical terms:

- The Bank West and St. George brands will be maintained such that it is largely 'business as usual' for customers, indeed with additional benefits.
- Foreign ATM fees for Westpac customers using St George ATMs and vice versa have been removed.
- Foreign ATM fees for CBA customers using BankWest ATMs and vice versa will be removed from 3 March 2009.

(See Appendix 1 for details of the conditions on the mergers agreed with the Treasurer. See Appendix 2 for the ACCC's conclusions to its

competition assessments for both the Westpac merger and Commonwealth Bank acquisition.)

(f) the extent to which Australian banks have 'offshored' services such as credit card and loan processing, information technology, finance and payroll functions;

Building comparative advantages to benefit Australian customers

A number of Australian banks have developed offshored capacity in order to remain competitive, drive innovation, improve service and manage costs. Australian banks conduct business globally and seek to establish services (including with partnering service providers) in the most appropriate locations where best-practice skills and capabilities can be sourced.

Efficiencies are derived from (i) access to a large local labour supply, (ii) time zones that extend the working day, (iii) managing costs and improving organisational efficiency and (iv) maximising economies of agglomeration.

Australian banks employ in-house, and/or have arrangements in place with specialist vendors in offshore locations, to provide a range of information technology development, back office and support roles to service the conduct of their Australian businesses.

Examples include credit assessment for mortgages, month-end reporting for Finance, credit analytical modelling for Risk and some HR functions. These centres of excellence, in some instances, also support operations elsewhere in the world, such as throughout Asia and the Pacific.

Approaches to offshoring

Australian banks have adopted different approaches to using offshored support services. A "captive" model is used by one major bank so that its offshored operation is fully owned by the bank, while also utilising some outsourced vendors who work onsite.

Other banks have used a fully outsourced model where trusted relationships are developed with offshored specialists to provide 'back office' operational support functions, particularly in IT roles. Banks may also use a hybrid version by combining aspects of these two models.

When offshoring/outsourcing, the major Australian banks have confirmed their commitment to (i) their focus on people management including early and transparent communication; (ii) redeployment and/or retraining, wherever possible, for affected staff; (iii) data security processes; and (iv) customer contact roles, such as call centres, remaining in Australia and New Zealand.

APRA prudential standard on outsourcing (APS 231)

The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the Australian financial services industry.

APRA has a prudential standard (APS 231) that aims to ensure that all outsourcing arrangements involving material business activities entered into by an authorised deposit-taking institution are subject to appropriate due diligence, approval and ongoing monitoring.

The Standard requires that all risks arising from outsourcing material business activities be appropriately managed to ensure that the authorised deposit-taking institution is able to meet both its financial and service obligations to its depositors.

The key requirements of this Prudential Standard include that an authorised deposit-taking institution must:

- have a policy relating to outsourcing of material business activities;
- have sufficient monitoring processes in place to manage the outsourcing of material business activities;
- for all outsourcing of material business activities with third parties, have a legally binding agreement in place, unless otherwise agreed by APRA;
- consult with APRA prior to entering into agreements to outsource material business activities to service providers who conduct their activities outside Australia; and
- notify APRA after entering into agreements to outsource material business activities.

(g) the impact 'offshoring' has on employment for Australians;

The ABA estimates that around 3,200 full-time employment positions have been impacted by services being sourced offshore over the past few years, equivalent to about 2.4% of the total workforce of ABA member banks. However, where services are outsourced to offshore providers it is not accurate to simply say this many 'jobs' have gone offshore – the intention is for the services to be done more efficiently including automating where possible. Further, as banks have been growing their workforces many impacted staff have had redeployment opportunities within the bank.

The full impact on Australian employment from offshoring must take into account a range of other factors.

In particular, offshoring can be positively related to the bank's growth and it is through growth that employment opportunities are created. Offshoring can reduce constraints on growth.

One obvious situation is where there is an insufficient supply of suitably qualified Australian-based workers to fill the demand by banks. In the absence of accessing offshore workers, the employment constraint will constrain growth. This was an emerging problem for the banking

industry throughout much of this decade as financial services companies competed for qualified staff against other sectors experiencing solid growth.

Another situation where offshoring is beneficial to company growth is where there is a shortage of Australian-based workers in a particular skill category. For example, it was estimated[9] that in 2007, the demand for ICT skills in Australia exceeded supply.

Looking ahead, and even factoring in the global financial crisis, Australian education institutions are not likely to be able to produce the deep pool of highly skilled labour, and in the numbers and specialties required, in order to run bank operations in the decades ahead.

Finally, company growth and long-term employment can be boosted if offshoring delivers cost and efficiency benefits. There are a number of aspects to this. At one level, offshoring can deliver direct cost savings for the Australian bank which improves performance and provides greater capital for expansion.

But there can also be more long-term, indirect benefits for companies and banks developing offshore operations or linking into centres of excellence.

Bangalore – centre of IT excellence

The Indian Government recognised twenty years ago that information technology could be an industry in which India developed comparative advantage.

The city of Bangalore developed as a global technology centre of excellence and attracted many of the world's largest companies, including IBM and Microsoft to locate key parts of their technology and operations support functions there, including their vendor laboratories that are critical for bank ITC operations.

Australian banks benefit by linking themselves into this centre of excellence or at least leave open the possibility of utilising the skills located there. To the extent that having links into Bangalore (or other centres of excellence) can connect banks to the latest developments and best skilled staff, then ultimately this will contribute to growth and greater employment overall.

Having links and operations in centres of excellence allows companies to tap what economists call 'economies of agglomeration'.[10] The fact that so many of the world's companies have sought to locate operations in Bangalore is evidence real benefits can be gained.

[9] Victorian Government 2007 ICT Skills Snapshot

[10] Economies of agglomeration describe the benefits that firms obtain when locating near each other. The more related firms that are clustered together, the lower the cost of production as firms have competing multiple suppliers, greater specialisation and division of labour. Cities form and grow to exploit economies of agglomeration.

Privacy and security

Australian banks recognise that data privacy and security are central to retaining the trust of their customers - it is a core banking principle and essential to on-going viability.

Banks that have offshored services have sought to maintain the high standards and privacy and confidentiality consistent with Australia's National Privacy Principles. Records for Australian bank customers are subject to Australian law and privacy standards. Through the contractual relationships banks have with either their employees working in offshored locations, or with specialist vendors, staff handling customer data are bound by bank information security policies.

For this reason, banks adopt comprehensive information security systems, staff training and compliance monitoring as well as arrangements with outsourced vendors to ensure privacy and confidentiality.

Banks have given assurances that should a customer breach or complaint emerge then it will be managed by banks in the same way as if it had occurred in Australia giving the customer recourse to the independent Financial Ombudsman Service.

Secondary benefits from offshoring

Offshoring can reduce the cost of providing goods and services resulting in benefits to customers (through containing product prices) and shareholders (through higher returns).

The latter is particularly important currently given the fragility of much of the world's banking system and the benefit Australia's stable banks have delivered to the community and taxpayers.

Although important not to overstate, there are also some potential risk reduction benefits accruing through offshoring. Having a portion of a bank's workforce operational in different time zones may assist in service delivery and fixing operational problems or upgrading systems at times when the systems are being used least. Further, business continuity planning can be made more resilient in the event of major incidents by having operations activities in multiple locations.

(h) alternative approaches to applying section 50 of the Trade Practices Act 1974 in respect of future mergers, with a focus on alternative approaches to measuring competition.

Section 50 of the TPA prohibits mergers or acquisitions that are likely to substantially lessen competition in a market. The competition test used in Australia is consistent with that used by Australia's major trading partners.

The conceptual framework for a merger assessment is based on a forward looking judgement as to how the merger will (a) impact

competition in the future, and (b) how competition will be impacted if the merger does not go ahead. There are, therefore, essentially two environmental states of competition that must be compared and assessed.

To form these judgements, there is a considerable data collection and analytical process. The typical starting point for a competition regulator, including the ACCC, in assessing these competitive states, is to define the product or service markets. This in turn commences with a review of the products or services offered by the merger applicants and then an assessment of how these products are distributed or delivered.

How the business delivers products essentially comes down to a geographical assessment of where the product or services are sold (e.g. at a local, state, national or global level). Other dimensions can also be relevant, such as the time of delivery.

Once the markets have been identified, the competition regulator must then assess whether a merger or acquisition is likely to substantially lessen competition in one of those identified markets, compared to the situation where there is no merger. In this step, there are a range of factors that can be examined to form this assessment. Many of these are actually specified in the TPA's Section 50 (3).

The regulator will then estimate market shares in each identified market to assess the likely market dominance of the merged entity. The other typical assessment is to look at the number of suppliers left in the market after the merger and to assess their capacity to compete.

Once this is done, a second tier of factors come into play, essentially chosen on the grounds of relevance to the actual transaction being proposed. Some of these include: (a) barriers to entry, (b) counterveiling power, (c) extent of substitute products, (d) product dynamics.

The ABA does not have a strong view on whether there are better approaches than that current process described above. In relation to banking, the fact academic studies have shown that there is no correlation between bank concentration and competition suggests competition regulators should take care in weighting market shares too heavily in their assessments.

Creeping acquisition proposal

The Federal Government is currently consulting on the proposed creeping acquisition amendment. This proposed amendment to the TPA is aimed at giving the ACCC sufficient power to stop certain businesses from making small acquisitions which, in themselves do not pose competition concerns, but may do so after a string of acquisitions over time.

The ABA, along with other national industry associations, opposes this proposed amendment. There is little evidence such an amendment is needed and such a move would make Australia's mergers law an outlier

internationally. The business environment would become more uncertain and hardworking small business owners may be denied the full value of their life’s work because they cannot sell the asset to the buyer willing to pay most.

Conclusion

In conclusion, it is worthwhile to briefly describe the challenging environment that banks are facing. Much of the developed world is in recession and Australian economic growth has slowed dramatically. The link between bank performance and the economic growth is strong, so the deteriorating environment will create additional pressures on banks in the form of rising problem loans and slowing credit growth.

We have seen these pressures already reflected in bank share prices, with most banks experiencing share price reductions in excess of the share index overall.

Furthermore, with so many international banks struggling to rebuild capital levels (as evidenced by massive government stakes in many banks), 2009 is likely to see a significant change in the structure of business financing in Australia, with many large Australian corporates facing greater difficulty in securing loans from these international bank syndicates.

This all means the local Australian-owned banks will be looked upon to fill any significant gaps that arise.[11]

More generally, and in a practical sense, what this means is that the Australian banks need to maintain healthy balance sheets and credit ratings, continue to source funding from overseas at reasonable cost, and ensure they can appropriately price for risk.

The Westpac/St George merger and the Commonwealth Bank acquisition of Bank West and St Andrew's is consistent with the building of financial resilience[12] to meet these upcoming challenges and, as concluded by the ACCC and the Commonwealth Treasurer, will not be at a cost to competition or the national interest.

Finally, the actions of the Federal Government through its deposit and wholesale funding guarantees have assisted in retaining depositor and investor confidence and, therefore, help to keep the Australian banking system functioning well in challenging times.

[11] One such identified gap is that of commercial property finance of which there is a consensus that a significant exit of foreign bank funding to this sector will be difficult to replace. For this reason a Government / bank joint venture in the form of a special purpose vehicle (SPV) is being established, as a standby if needed, to provide liquidity until the private market can ultimately fill the financing gap.

[12] For example, by merging with Westpac, St. George's creditors obtain the benefit of Westpac's higher credit rating (AA) – an important benefit in the current financial environment. In respect of Bank West, the beneficiaries of that bank will receive the benefits of having a parent bank in a stronger financial position.

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Appendix 1: Treasurer conditions on Westpac merger and Commonwealth Bank acquisition

Commonwealth Bank acquisitions of Bank West/St.Andrew's [13]

The conditions to which this approval is subject are that:

For a period of at least three years after the date of acquisition:

1. CBA will maintain and grow the BankWest brand;
2. foreign ATM fees for CBA customers using BankWest ATMs and vice versa will be removed from 3 March 2009;

In addition, for the period of integration under the acquisition process:

3. CBA will maintain BankWest's head office, Managing Director and core functions in Western Australia and in accordance with the Bank of Western Australia Act 1995;
4. CBA and BankWest branches and business centres in Western Australia will not close as a consequence of the acquisition;
5. CBA will maximise internal redeployment opportunities available for affected staff, support external job placement where employee redundancies occur, and ensure that staff affected by the acquisition have timely access to their full entitlements under CBA or BankWest (as applicable) retrenchment arrangements;
6. CBA will work through the implications for employees as quickly and sensitively as possible, in consultation with employees, the Finance Sector Union and other affected stakeholders; and
7. CBA will provide specialist resources to assist staff affected by the acquisition.

Westpac merger with St. George[14]

The conditions to which this approval is subject are that, for a period of three years after the implementation of the proposed merger, the merged entity is required to:

1. maintain (in net terms) branches and ATMs at the respective numbers existing as at the Share Scheme Implementation Date,

[13] See - Treasurer, the Hon. Wayne Swan MP, 'Proposed Acquisition of Bank of Western Australia and St Andrew's By The Commonwealth Bank of Australia', media release, 18/ 12 /2008.
[14] See – Treasurer, the Hon. Wayne Swan MP, 'Proposed Acquisition of St George Bank Limited By Westpac Banking Corporation', media release, 23/ 10/ 2008.

including by maintaining (in net terms) branch and ATM numbers in areas outside of major urban centres;

2. remove foreign ATM fees for Westpac customers using St George ATMs and vice-versa;
3. continue to provide a comprehensive range of affordable banking products to low-income consumers and other members of the community with special needs;
4. retain all Westpac and St George retail banking brands including Bank SA;
5. maintain dedicated management teams for St George and Westpac retail banking distribution; and
6. retain a corporate presence in Kogarah.

In addition, for the period of integration under the merger process (the period between the Share Scheme Implementation Date and the merger of the ADIs), the merged entity is required to:

7. maximise internal redeployment opportunities available for affected staff, support external job placement where employee redundancies occur, and ensure that staff affected by the merger have timely access to their full entitlements under Westpac and St George retrenchment arrangements;
8. work with consumer advocates and community stakeholders to minimise community concerns about the merger and its impact on customers and the community, and address any concerns as sensitively and quickly as possible;
9. work through the implications for employees as quickly and sensitively as possible, in consultation with employees, the Finance Sector Union and other affected stakeholders; and
10. provide specialist resources to assist staff affected by the merger.

Appendix 2: ACCC competition assessment conclusions to the Westpac merger and Commonwealth Bank acquisition

Westpac merger with St George[15]

ACCC: "94. The ACCC considers that the proposed acquisition would be unlikely to result in a substantial lessening of competition in the markets for the supply of retail platforms. There remain a number of strong competitors including other wrap platforms — such as Macquarie, Avanteos (CBA), and Oasis (ING/ANZ) — as well as a number of master trust platforms including CFS First Choice, MLC (NAB) and Navigator (Aviva). The ACCC further considers that the highly dynamic and technology driven nature of this market means that new competitive threats are likely to emerge in any case, as already evident in the availability of SMA products…

98. On the basis of the factors set out above, the ACCC formed the view that the proposed acquisition would be unlikely to result in a substantial lessening of competition in any of the relevant markets."

Commonwealth Bank acquisitions of Bank West / St. Andrew's[16]

ACCC: "96. The ACCC considers that BankWest has been a particularly vigorous and effective competitor in retail banking markets nationally, especially for transaction accounts, home loans and saving products. However, under the counterfactual it will not continue with its east coast expansion or continue to act as the aggressive competitor it was previously.

97. In the absence of the global financial crisis, and the funding difficulties faced by BankWest's parent company, the ACCC's conclusion may have been different. However, with BankWest no longer capable of competing as aggressively, the ACCC found that it is unlikely that the removal of BankWest as an independent competitor would result in a substantial lessening of competition, relative to the counterfactual.

98. In Western Australia, the proposed acquisition will significantly increase CBA's market share, particularly for transaction accounts, but a number of other significant competitors remain. It is likely that the key aspects of the transaction account offer (product manufacture, price, staffing levels and opening hours) will continue to be determined nationally and therefore must reflect national rather than state or local competitive conditions.

[15] ACCC (2008, August)
[16] ACCC (2008, December)

99. While the acquisition will result in less consumer or business choice in the local markets where the branch presence of the two banks overlaps, in almost every local area there remains several other competitors with a physical presence in the same suburb, or at least in a major suburb nearby.

100. On the basis of the factors set out above, the ACCC formed the view that the proposed acquisition would be unlikely to result in a substantial lessening of competition in any of the relevant markets."