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STANDING COMMITTEE ON ECONOMICS

Reference: Aspects of bank mergers

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SENATE STANDING COMMITTEE ON

ECONOMICS

Thursday, 12 March 2009

Members: Senator Hurley *(Chair)*, Senator Eggleston *(Deputy Chair)*, Senators Bushby, Cameron, Furner, Joyce, Pratt and Xenophon

Participating members: Senators Abetz, Adams, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Farrell, Feeney, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Kroger, Ludlam, Lundy, Ian Macdonald, McEwen, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Stephens, Sterle, Troeth, Trood, Williams and Wortley

Senators in attendance: Senators Bushby, Cameron, Eggleston, Furner, Hurley and Pratt

Terms of reference for the inquiry:

To inquire into and report on:

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

(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;

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

(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;

(e) the impact of mergers on consumer choice;

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

(g) the impact 'off-shoring' has on employment for Australians; and

(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.

WITNESSES

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HOSSACK, Mr Nicholas, Director, Prudential, Payments and Competition Policy, Australian Bankers Association

CHAIR (Senator Hurley)—I declare open this first hearing of the Senate Standing Committee on Economics inquiry into aspects of bank mergers. On 24 November 2008 the Senate referred to us a range of matters relating to bank mergers and to the practice of offshoring jobs. The committee is due to report by 17 September 2009. This inquiry will investigate the economic, social and employment impacts of the recent mergers among Australian banks, including the impact on consumer choice with a particular focus on the Westpac-St George merger.

The inquiry will also investigate the sufficiency of the measures available to enforce any conditions placed on merger parties by the Treasurer, the ACCC's power to force divestiture and its methods for measuring competition, and the adequacy of section 50 of the Trade Practice Act in preventing further concentration in the banking sector, with particular reference to the merits of a public benefits test. The inquiry also will investigate the extent to which Australian banks have offshored bank office services and the impact of this practice on employment for Australians.

These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind all witnesses that in giving evidence to the committee, they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as contempt. It is also contempt to give false or misleading evidence to a committee.

If a witness objects to answering a question, the witness should state the ground upon which the objection is taken, and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request of course may be made at any other time also. A witness called to answer a question for the first time should state their full name, the capacity in which they appear, and witnesses should speak clearly and into the microphones to assist Hansard to record proceedings. Mobile phones should be switched off. I welcome Mr Nick Hossack from the Australian Bankers Association. Mr Hossack, would you like to make an opening statement?

Mr Hossack—Yes, I would, Senator. Thank you very much for inviting the ABA to provide evidence before the committee. As you know we have provided a submission on behalf of our member banks, but we note also that a number of our banks have made submissions. I will summarise our submission. We believe that the regulatory arrangements for the assessment and clearance of bank mergers are essentially successfully. We see little evidence that any substantive changes are needed. In our submission we argue that Australia has a competitive banking system. This has emerged since deregulations in the early 1980s and continues today.

Even though the financial crisis is impacting banking systems, our banks are continuing to operate competitively by offering good value products to customers. Indeed, independent assessments also have found there is competition operating effectively. The ACCC recently cleared two bank merger proposals. In its public competition assessments, the ACCC noted that even after the proposed mergers went ahead, there would still exist sufficient market participants to provide effective competition. In evidence to a recent House of Representatives committee inquiry into banking and non-banking competition the Reserve Bank concluded that its assessment of the evidence indicated that the financial system was competitive. To the same inquiry the Federal Treasury noted in its submission that significant changes over the last two decades had resulted in greater competition in Australia's banking sector.

Another important point we make in our submission is that Australia has a history of a very sound and resilient banking system. This stands in contrast to many other countries. For example, since the 1890s depression, which is well over 100 years, there is only one example of bank depositors losing money in an Australian bank, and that was a small rural bank in the 1930s when the depositors lost one cent in the dollar. In our research we have found no example of when taxpayers' money has been used to bail out any Australian private bank.

Even in the midst of the current financial crisis, Australian banks are doing comparatively well. I would like to detail some of that evidence. One useful indicator of banking system performance is to examine the relative valuation of companies through their share prices. In December 2007 the market capitalisation of Australia's seven larges retail banks was in the order of $164 billion in US dollars. Since then, as at the end of February this year, it has dropped by about 36 per cent to $105 billion, again in US dollars. That is an unfortunate decline. It reflects uncertainty in the economic outlook, but this result compares very favourably to a number of other countries and regions.

For example, banks in the European Union are down 67 per cent; in Canada, 52 per cent; Japan, 62 per cent; and in the USA, a worrying 67 per cent. Indeed, the US banking system is struggling to stabilise because of uncertainty over the valuation of many bank assets held on the balance sheet of large institutions. Without confidence in the valuations, providing the appropriate support to these banks is a very problematic policy task. Further, the valuations of these assets will be dependent in large part on the US economy's performance, which as we are all aware is going through a deep downturn.

However, it is not all doom and gloom. Just yesterday Citibank recorded a profit result, and that was against market expectations. We are hopeful that the chairman of the federal reserve's prediction of a recovery in the latter part of this year comes to fruition. Critically the federal chairman notes that this recovery will be dependent upon the banking system stabilising. Another broad indicator of relative bank strength is revealed through the credit rankings of banking institutions. Of the 12 listed banks in the world today that have AA credit ratings, Australia has four of them, or 25 per cent. This is a remarkable statistic given our relative standing in population and other measures in the world.

But what is often overlooked is the importance of these strong ratings in protecting Australia's long-term future because Australia is heavily dependent upon capital in-flows to fund investments. Having well-rated banks means the banks firstly can adequately access funding and secondly access the funding at reasonable prices, which means reasonable interest rates. Another indicator of relative strength is demonstrated through impaired asset ratios. While Australia's own economic downturn is increasing these ratios, they are still reasonably low, certainly when compared to historic peaks. Total bank asset impairment, as judged by statistics produced by the Reserve Bank and which also include housing and business loans, is still below one per cent, although this is up reasonably sharply since mid-2007.

This increase in overall asset impairment mainly reflects some large problem loans, most of which have featured prominently in the news media and with which you would be familiar. The housing loan book is still looking good, with impaired assets running at around 0.4 per cent to 0.5 per cent, and for some banks may be slightly higher. That is still below the long-term average. Small business loans, impaired loans, have ticked up to on average approximately 2.2 per cent, but this is still roughly consistent with average impairment rates over the last five years.

Of course the unknown factor is how these bank assets will perform in the future, and in turn this will depend largely on the performance of the economy. Even though higher lending risk implied by the economic downturn is making it harder for some home loan borrowers and businesses to obtain finance, the banks are certainly open for business and are lending more or less normally to customers who can demonstrate a capacity for loan repayment. Indeed there is evidence of strong competition currently in the business loan market with at least two major banks announcing recently that they are actively aiming to increase their market shares in this sector. This is a positive sign, especially given that many smaller financiers have withdrawn from the market due to the financial crisis making their models unviable.

An important contextual issue I want to address is the perception that the federal government or taxpayers are bailing out the local banking industry and, as such, the implicit view that the banks should be acting in non-commercial ways. The evidence used to support this claim is that the government has introduced guarantees for bank liabilities, namely deposits and wholesale funding. While this is true—the guarantees are now in place and they certainly did provide a level of confidence to depositors throughout the community—it is important to understand the arrangements for these guarantees.

Firstly, with respect to the deposit guarantees, for customers with deposits up to $1 million this guarantee is fully funded by the banking industry itself. There is no taxpayers' money at risk. Secondly, for guaranteed deposits above $1 million, the bank pays an insurance premium to the government based on the bank's credit rating. Lastly, the wholesale guarantee, which was brought in to ensure that Australia was not disadvantaged by similar schemes introduced by overseas governments, is also paid for by banks through insurance premiums. Indeed, so far these guarantees have been a good proposition for the Australian taxpayer. The government has earned approximately $500 million in insurance premiums.

In conclusion, I emphasise that Australia's banking system is working well within an extremely difficult international environment. While many reasons are put forward to explain this relatively good performance, at least in part it is due to a good regulatory system that creates incentives for banks to make good commercial decisions within sound risk frameworks. The ABA would encourage the policymakers to continue supporting a regulatory environment that has proven to be robust. Having said that, I am happy to take questions.

CHAIR—Thank you, Mr Hossack. Indeed the so-called four pillars policy and the stability of the banks have been supported by successive governments. As you point out, during this time of financial instability in world markets, that has given the Australian banking system some stability. Nevertheless, it could be argued that the strength of the banks lies in that lack of competition and that banks in Australia have a more or less captive market. Following deregulation in the 1980s to which you alluded, a number of small banks did start up and foreign banks came in, but gradually either disappeared or were swallowed up by the larger banks.

We have that tension between ensuring that the banks have a big enough base to remain stable and providing enough competition for people who choose to use the services. You said that the system is working well at the moment, but does the ABA have any view about increasing the number of banks and how that could be done, if you believe that an increase in competition is desirable?

Mr Hossack—The principle of encouraging competition is right at the core of ABA's views on policy. We believe in it: It goes right to the DNA of the organisation. We believe that competition is the best way to preserve and protect consumers. Over the years we have always supported policy initiatives which have encouraged competition. To the extent to which banks are wishing to come and operate in Australia, the ABA would welcome that, if for no other reason than that there would be more members for the ABA. But certainly competition goes right to the core of what the ABA believes in.

CHAIR—What do you see as the key policy settings that would allow that? Is there anything that government can do to encourage that?

Mr Hossack—If there were any restrictions or impediments on banks coming into the market, they really are the province of governments these days. There are no obvious things that the banks do to impede entry at all. It is the government which imposes, if you like, licensing on banks. To operate as a bank in Australia you need a licence; in fact, you need a few licenses. You need a licence from the prudential regulator and you also need one from ASIC. There is also legislation that needs to be met, such as anti-money laundering legislation which imposes additional costs. We see, if there are impediments to entry, they are really related to government policies rather than the banks in any way.

Traditionally there were some claims that without a big branch network, for example, it would be very difficult to get into the retail banking market in Australia, but we have seen evidence of smaller institutions, admittedly with large well-capitalised international parents, coming into the market without branch networks and really increasing deposit portfolios and indeed lending portfolios. Technology has really reduced the benefit of having a branch network. The payment system has been nominated as an area in which the banks have had an advantage before because they have tended to dominate that system, but these days there are access regimes that allow participants to participate in those payment systems as they wish.

Another area is that in the early nineties it was the view that in lending it would be hard to get into the retail market unless you had a big deposit customer base because an incumbent would have an advantage in assessing the credit standing of a customer based on the relationship it had with its depositor. But that advantage is more or less gone now because there are statistical techniques that now allow you to assess the credit standing of customers a lot more effectively without the need for long-term relationships. We think that some of the historical reasons why entry might have been difficult have pretty much been overcome. It is really now a regulatory issue, if anything.

CHAIR—Are there regulations that the government should relax to encourage new bank entry?

Mr Hossack—I suppose the irony is that the regulations that are in place are all soundly placed. If you want to operate a bank or certainly a deposit-taking institution, there are very good reasons as to why you should be prudentially sound and meet APRA's prudential standards, which it requires. You need that that could be a difficult exercise for someone wanting to come into the market.

CHAIR—In your submission in section three, 'Bank mergers and concentration', you state:

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.

Could you expand on that? It seems a bit counter logical.

Mr Hossack—It is a good question. Traditionally, competition law has suggested that the more competitors you have in a market, the more competitive that market will be. But when academics have tested that proposition for banking, they found—and I have alluded to some of the research—is that for the banking industry, concentration does not have the same impact on competitive outcomes as it might on other industries. The academics I have looked at, and whom others have reviewed, have concluded that you can have a very competitive banking system with not that many competitors and reasonably concentrated. That is an important academic finding that I wanted to include in the submission. We do not make too much of it but I thought it would be a useful contribution to the debate.

CHAIR—And yet there has been some recent publicity, the Australian bank survey fee for 2009, which found that Australians are paying far more than British households and a lot more than American households in bank fees, for example.

Mr Hossack—Yes. I think what you are alluding to is the Fujitsu report.

CHAIR—Yes, that is one.

Mr Hossack—We have had a look at that. That is not an official report from any of our regulators. The bank fee data which is normally referred to in Australia comes from the Reserve Bank in its annual bank fee report. We have had a look at the Fujitsu report and, to be honest, we are scratching our heads a little bit. There is a conclusion there that households are paying $1,000 per year on bank fees. We just cannot see how they can derive that number. If you look at the Reserve Bank's figures, roughly $4 billion a year is paid by households in fees. According to the ABS, there are about eight million households. It is a crude measure, but that works out to be roughly $500 a year in fees, which is half of what Fujitsu is claiming. Just on a broad measure like that, it does not seem to stack up. That is on average.

In the past we have looked at household expenditure data and the results are very interesting in that the low income households pay proportionately, in absolute terms and in proportional terms, the lowest bank fees of any of the other income categories. In a sense, the bank fees are structured in a very progressive way in Australia. That makes intuitive sense because most of the banks offer products for low-income customers that allow them to do standard transaction banking at either zero cost or very low cost. There is competition in banks to provide those low-cost products. The data that we have seen is inconsistent with what Fujitsu has reported.

Senator EGGLESTON—We have this four pillars policy. In the past it was a six pillars policy. When Allan Fels was chair of the ACCC he had the idea of four plus a regional bank in every area. Can you give us some background to how the six pillars became four pillars and the comment you would make about the Fels concept of a regional bank in every area as well?

Mr Hossack—My understanding of it is that the six pillars policy originally was a policy announcement by the Treasurer at the time, Paul Keating, and it included two mutual funds, the AMP and MLC I think it was, as well as the four banks. None of those could merge. Then there was a review in 1996 established by Howard and Costello, which was the Wallis inquiry. It inquired into competition and efficiency aspects of the banking and financial system. That concluded that there was no strong rationale for having a six pillars policy at the time, or indeed any additional restrictions on competition.

But of all the recommendations that Wallis made, one was not accepted, and that was the recommendation to abandon the six pillars policy. However, it was converted into a four-pillar policy in that the restriction was then just imposed on the major four banks. That has existed since. It is fair to say that it often has been characterised as the banks hate it and that the banks do everything to get rid of it. There have been various views expressed from banks over the years. Some have supported it at times and others have vehemently opposed it. The ABA has a position on it. Our view is that we agree with the principle of Wallis and that is that banking mergers should be assessed on the basis of all other industries on a competition basis, and that is by the ACCC.

Senator EGGLESTON—Yes. That is where I am going—to the issue of competition. In Australia we already have, in the grocery industry for example, a huge centralisation with two major players. That has become a bit of a feature of Australia in various ways. I would have thought it is counter intuitive to think that fewer banks are better for competition. Even though Wallis argued that the ACCC assessment provides appropriate protection for consumers, I cannot help feeling that more banks must provide a better degree of competition and service to the consumer simply through that competition. I am just a little bit surprised that your association, perhaps by implication in accepting the recommendations of the Wallis report, accepts that the ACCC assessment provides sufficient and appropriate protection to consumers without there being any limitation on further mergers by the government.

Mr Hossack—As an association we have not taken a view on whether there should be a merger between the major four or fewer players. What we have simply said is a pure policy position, which is that we think that the best way to assess competition is to allow the regulator to assess it, as it does with all other industries, but we make no comment on whether a merger should or should not go ahead.

Senator EGGLESTON—And you do not have a bottom line floor threshold that puts a limitation on further mergers by reducing them by four to two or three?

Mr Hossack—No, we do not. We have confidence in them. We have expressed support in the submission, and certainly in other submissions, that the current Trade Practices Act is sufficiently developed and is consistent with international practice in this area. We are confident that there is a reasonable process to go through to assess these mergers. At the end of an assessment, if the ACCC concluded that a merger would substantially lessen competition, then that is the finding. I could not imagine the ABA normally taking a view on that.

Senator EGGLESTON—You do not think there is a public policy issue about a minimum level of banks being necessary to provide adequate competition. I am little surprised that you do not have a point of view along those lines, rather than simply accepting the ACCC's assessment.

Mr Hossack—The environment could change. There may be circumstances in the future where it is better to have less or better to have more. The important thing for us is that there is a good robust legal process to assess these sorts of propositions that are put forward. We have confidence in the Trade Practices Act in relation to the mergers provisions.

Senator EGGLESTON—Recently we have seen the disappearance, and the process of disappearance, of two smaller banks, St George and BankWest. BankWest of course was owned by a bank in the UK which had great financial problems, but what is your view? In terms of what you have said, it is fairly obvious, perhaps, that you would not be concerned about the issue of creeping acquisitions reducing the number of banks, if you thought that the ACCC approved of it; but I do feel that banks like BankWest provided a very good service in regional Western Australia. St George obviously provided a good service in their catchment area as well. I would have thought that that was an argument to support the proposition that the loss of these banks is a disadvantage to the consumers in their catchment areas.

Mr Hossack—As I said before, the ABA's position is that we have confidence in the Trade Practices Act and how it deals with these mergers. What we have seen in the example you have put forward is that the ACCC has assessed the proposal that has been put to it, and its conclusion is that there would not be a substantial lessening of competition if that transaction went through. They have pointed out some public benefits as well in that transaction. So from that point of view, given we have confidence in the legal process, we would support that finding.

Senator EGGLESTON—I suppose it all comes down to what you would view as the public good. The other thing you raised was the role of Internet banking. Because of the capacity of the Internet to enable a very large number of people to participate, I am very interested in what your view is of the future of Internet banking may be in terms of preservation of numbers of banks and competition, if you have any views on that as an association.

Mr Hossack—The Internet has assisted competition. At least in a couple of cases in Australia, I think it is quite obvious that the existence of the Internet has enabled a number of subsidiaries of overseas banks to get reasonable deposit bases and also loan books in Australia. From a competition point of view, being able to distribute and to manage accounts through the Internet is a pro-competitive feature of the market.

Senator EGGLESTON—Presumably you are referring to ING. Does the fact that foreign banks can operate in Australia through the Internet create any cause of concern to you and your association?

Mr Hossack—What this goes to is really prudential requirements. If a bank wants to come into Australia and to offer deposit services, as we were discussing earlier, they need to get a licence to do that and they must then meet the prudential standards which APRA publishes. It is not a question of some bank without the appropriate licensing regime being a legitimate player by taking deposits out of Australia through the Internet. While there may be some fraudulent cases where that tries to happen, the regulators would be onto that pretty quickly and they would be notified by the competitor banks if that started happening.

Senator EGGLESTON—The only other question I could put to you relates to offshoring. With the banks’ offshoring services for calling customers, is there any pooling of resources occurring in that arrangement so that one call centre might be serving more than one Australian bank?

Mr Hossack—My understanding in relation to call centres is that I do not think any of the Australian-owned banks have call centres located outside Australia and New Zealand. The offshoring we have seen has mainly been in back office, IT, computer software development, and essentially in Bangalore, India. I am not aware. The last time we checked, which was probably six months ago, no banks had their call centres that actually dealt with customer calls located outside Australia and New Zealand. I can double check that but I am pretty sure that is the case. I think there was one foreign-owned bank that has a call centre in Malaysia, but that was the only one I could identify, and it was not an Australian-owned bank.

Senator EGGLESTON—If you could provide us with some further details on that, I would be grateful.

Senator FURNER—Westpac has held a higher credit rating than has St George for some time and prior to the merger so naturally were able to raise cheaper funds. That did not necessarily translate into cheaper interest rates, particularly for home loan lenders. Why now should customers really expect that they would gain any benefit from the merger of Westpac as they become larger?

Mr Hossack—The proposal for the merger of Westpac and St George was put to the ACCC and the ACCC assessed that against its obligations under the Trade Practices Act. In the end it concluded that there would not be a substantial lessening of competition and approved it. The ACCC obviously thought that there were going to be benefits coming from that merger. As you alluded to, what we have seen is that the St George customers now have access to a bank which is in a stronger position than St George was, as recognised by the AA rating to which you have referred. Those customers will enjoy benefits over time: there is no question of that.

Senator FURNER—What are those other benefits?

Mr Hossack—The immediate benefits will be that they will have access to Westpac ATMs at no additional cost, for example. They are some of the immediate ones. In time they will benefit from a broader range of products. In time also the AA credit rating will serve to keep downward pressure on the interest rates they pay as opposed to being in St George, which had a low credit rating as you suggested.

Senator FURNER—The Treasury placed a number of conditions on both Westpac and the Commonwealth on their respective merger proposals. Three of those, as a result of the merger, will expire on 1 December 2011. Does the ABA feel that the conditions placed on these banks were reasonable?

Mr Hossack—We have not taken a formal view on whether they are reasonable or not. We obviously noted them. When we discussed it with Westpac, Westpac seemed very positive about the conditions. From what we understand, they mutually agreed with the Treasurer. The conditions go to ensuring that they treat their customers well and also their staff, and any staff affected by the merger. I think they were happy to give undertakings or obligations on those conditions.

Senator FURNER—Was the period of three years reasonable in your view?

Mr Hossack—I do not have a view on that, but it seems like that is a reasonable period of time.

Senator FURNER—In relation to offshoring, I note your comment that no Australian banks in your view have call centres overseas. For those that do, are you privy to what happens about customer detail and security of those people who are being contacted from offshore, whether that is by call centres or by other means of contact?

Mr Hossack—The banks I have spoken to, which have some capacity overseas particularly in India—as I said, back office processing in some cases and software development—have said to me, when this was an issue a number of years ago, in Australia the privacy principles to which they all subscribe are pretty much replicated in any data that goes overseas. The restrictions on the use of data that is gathered and the impositions on people who have access to that is replicated in any contracts they have with Indian suppliers, or indeed any captive workers that they own there. The same obligations that apply here also apply there, albeit there is a different legal framework in India than there is in Australia.

Senator FURNER—That is right, so it could be different to the extent that there may be a possibility of someone having access to gaining information of a customer in Australia.

Mr Hossack—The banks would certainly make sure that their contracts were sufficiently tight to ensure that there would be repercussions if that happens, just as it happens in Australia.

Senator FURNER—That is right.

Mr Hossack—There is a question about the legal framework in some of these countries. That is a question that is being examined at the moment by the government, and there are some recommendations to firm up, if you like, the obligations on the bank when the legal framework is different from Australia’s. But what the banks tell me is that they take that issue very seriously and make sure that the data is protected to the same standard as it is in Australia.

Senator CAMERON—Thanks Mr Hossack. On page 14 of your submission, you state:

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.

Does that include executives?

Mr Hossack—Over the last couple of years when the banks have assessed their strategic plans—and I should stress not all the banks; the comments in the submission are derived mainly from those banks that currently have offshore operations, and not all of them do so—and when they have assessed their employment needs in the future—

Senator CAMERON—I am asking you specifically about executives. Is that an area where there is a lack of capacity to educate and train executives within Australia?

Mr Hossack—I think it is evident in that a lot of Australian CEOs have come from overseas and the extent to which that is an international market. If you look at the CEOs for the banks for the last decade, quite a few of them have been sourced from overseas.

Senator CAMERON—Does that explain executive salaries?

Mr Hossack—I think that is a separate issue.

Senator CAMERON—It is an issue that falls within the terms of reference and social implications. People are looking at the banks and seeing offshoring, redundancies, and huge executive salaries as well as huge golden parachutes. How can the ABA support that type of differential in terms of salaries in the banking industry?

Mr Hossack—The comment in the submission was not related to salaries. It was related to where employment was going to come from in the future.

Senator CAMERON—I am asking you.

Mr Hossack—In terms of executive salaries, we do not have a strong position on that except to note that the market for executives is an international market. The executives work extremely hard. That is where the market has ended up.

Senator CAMERON—That is where the market has ended up, eh?

Mr Hossack—Yes.

Senator CAMERON—That is not really the case. That is what the boards are offering executives, is it not? It is not just a matter of the salaries ending up there. It does not work like that, does it?

Mr Hossack—The board's responsibility is to choose a chief executive. That is true. It is also a responsibility that they take seriously, and the salaries that are paid are what they have paid to get the people they want.

Senator CAMERON—I think the public are very concerned that the boom in executive salaries, the outrageous executive salaries, commenced in the banking industry. What is the ABA and the banking industry doing to try to ensure that we have some talent in Australia who can actually run a bank instead of having to go overseas and bring in these massive salaries, constituting extra costs to the bank and extra costs to the public? What is happening there? What are you doing?

Mr Hossack—If you look at the history of the performance of Australian banks, some of which I mentioned in my introduction, the history is one of good performance and stability. They have provided very good products for the community and stability. There have been no depositors who have lost money.

Senator CAMERON—The regulation is part of the stability. You are heavily regulated.

Mr Hossack—Those invested with the banks have received good returns, including those superannuation funds and those retirees who depend on money that comes from the banks through dividends.

Senator CAMERON—Does that justify the scale of executive salaries?

Mr Hossack—What it shows is that the remuneration packages, not just for the executives but within the banks themselves, have not at least detracted from the performance of the Australian banks because the Australian banks have performed very well.

Senator CAMERON—They would perform even better and you would be able to put more back to consumers if you were not paying outrageous executive salaries. What justifies tens of billions of dollars for an executive?

Mr Hossack—Tens of billions?

Senator CAMERON—Yes.

Mr Hossack—I am not aware of any; millions, perhaps.

Senator CAMERON—I am sorry, tens of millions, yes.

Mr Hossack—As I said before, all I can say is that there is an international market for CEOs, and the boards have to make those decisions. That is up to the boards.

Senator CAMERON—So you are not doing anything about trying to make sure there is an Australian market and that there is some hierarchy within the bank that can take over? We are still going to just look overseas and bring in these overpaid executives to Australia?

Mr Hossack—This is not really a role for the ABA. The appointment and remuneration of a chief executive is the role of a board.

Senator CAMERON—You said one of the reasons for offshoring is constraints on the banking industry. I assume from reading your submission that that means skills constraints. What is the banking industry doing in terms of skill development and working with training providers to provide more Australian jobs and more skills within Australia?

Mr Hossack—From my understanding, the banks do a lot of retraining of their staff. They all have very substantial programs to train their staff in all sorts of areas. There are good career developments.

Senator CAMERON—I am not talking internally. I am talking about what you are doing externally to overcome this problem. You are saying that the education institutions cannot provide the skilled labour. What is being done about that—just offshoring? India: Is that the answer?

Mr Hossack—What we have seen is that some banks have chosen to utilise offshoring services and some banks have not. There is a market dynamic going on here.

Senator CAMERON—Should the banks be forced to disclose the location of any offshoring, such as happens in France where it is legislated that if you offshore, the location of the offshoring has to be made known publicly?

Mr Hossack—I have not specifically considered the issue whether it is practical or not. I do not know. I would have to get back to you on that question.

Senator CAMERON—Could you provide the committee with some kind of analysis of the growth in salaries for Australian workers against executive salaries in the banking area?

Mr Hossack—I could have a go at that, assuming the data is available. Some points that are worth making are that the salaries in the banks and financial services are way above the average of salaries in general throughout industry. Also their redundancy packages are very generous where they have been utilised.

Senator CAMERON—Certainly for chief executives they are.

Mr Hossack—The unemployment rate in the financial services sector has been the lowest of private sector industries for almost as long as the data goes back. There is a very, very high proportion of women who work in the banking sector because of the extremely favourable working conditions that banks offer, including extremely good training. So I think that it is well recognised that the banks are good employers and provide real opportunities for people.

Senator CAMERON—Are there customer satisfaction surveys that have been done by the ABA after mergers? Are people satisfied with the services? Can you point to any of that evidence for us?

Mr Hossack—In terms of customer satisfaction surveys, the ABA does not undertake those. They are probably more appropriately undertaken by the banks that have the customers, I think. You see some of them reported every now and again. My understanding is that the satisfaction levels in banking have gone up markedly since, say, the mid-nineties and that banks are now providing to customers services which are much more valued.

Senator BUSHBY—Thank you, Chair, and thank you, Mr Hossack. You mentioned earlier that foreign banks are free to set up here, and since that policy has been in place, some have. But none of them seem to have made much of an impact on the market share of the big four. Why do you think that is?

Mr Hossack—I think that some have certainly made an impact. I do not want to name names, but we have seen some very aggressive pricing, and even market share growth rates, among some of the new banks that have come in. They have provided real pressure on the banks, which is a great thing because we welcome competition.

Senator BUSHBY—Are you aware of the market shares of foreign banks even in the Australian market?

Mr Hossack—I am not currently aware of it because the data is a little bit outdated.

Senator BUSHBY—What about the most recent data you have available to you?

Mr Hossack—I could come back to you on that, but I would make the point that up until the financial crisis, the major banks were losing market share at a reasonable rate.

Senator BUSHBY—To the foreign banks?

Mr Hossack—Between foreign banks and other banks and credit unions as well. Between about the late nineties and up until about 2007, at one stage only two in three housing loans were being made by the major banks. That shows the penetration they have had.

Senator BUSHBY—What you are saying is that up until things started to deteriorate internationally in the financial markets, the major banks were losing market share to competitors: the competitive market was working?

Mr Hossack—On most indicators, yes. Other banks, such as foreign banks and such as regional banks and credit unions, were increasing their market share relative to the majors on most indicators. That is not to suggest that the majors still were not doing well; they were, but that is what the market share data was showing us.

Senator BUSHBY—Obviously things changed late last year or maybe a bit earlier when the true size of the global financial crisis became apparent. That would have had an impact on foreign banks and their activity in Australia?

Mr Hossack—It is an interesting question. It is still an open question. There is a concern that with some of the parents of subsidiaries here, the trouble that the parents are in, with the bad loans they have taken out, may affect the business strategies of the local banks here. But I think it is still an open question as to the extent to which that is going to happen. We hear mixed reports. You would be aware that the government and the major banks have established a business partnership, if you like, to potentially fill some of the gaps which may emerge from foreign banks pulling back their activities in Australia. But there is no real evidence of it yet. I think we have just got to wait and see how the structure settles in the long term.

Senator BUSHBY—I do not know the answer to this question, which is why I am asking, but all foreign banks that were operating in Australia at, say, the beginning of last year are still operating?

Mr Hossack—My understanding is that that is right, yes.

Senator BUSHBY—Okay. The jury is still out on what impact it will have on foreign banks' participation in the Australian banking sector.

Mr Hossack—At the very least there will be participation. It is just the extent of it.

Senator BUSHBY—Yes, that is right.

Mr Hossack—We are just not sure.

Senator BUSHBY—It is not clear yet how that will pan out. You referred to the smaller financial institutions that were also taking market share over the last 15 or so years, such as credit unions, building societies and second-tier banks. What effect has the global financial crisis had on them in the last six to nine months?

Mr Hossack—I think at the smaller end, credit unions and building societies seem to have held their ground fine. That is my reading of the data. They seem to be doing quite well.

Senator BUSHBY—Are they having any issues in accessing funds to continue the activities that they were engaged in?

Mr Hossack—Not to the same extent as some of the other banks because typically they have a much higher proportion of funding coming from retail deposits. If you look at the major banks and look at their funding profile, it varies between banks but roughly half of their funding requirements come from retail deposits whereas if you look at an average credit union, it would probably be more like 95 per cent. It was those international money markets which were really affected by the financial crisis. In some ways the smaller end of the market has not been impacted to the same extent as have some of the other players.

Senator BUSHBY—I am not casting aspersions here, but just for the record: Does the ABA represent the smaller institutions?

Mr Hossack—We do not represent what are collectively known as the mutuals—the mutual organisations—where the customers are also the owners, such as the credit unions and the building societies, although we are representatives of Members Equity Bank, which is owned I think by a superannuation network.

Senator BUSHBY—Yes. I have heard anecdotal evidence that a lot of the smaller financial institutions are having problems in terms of being able to access funds as they need to, and that small businesses have had issues when they have come to roll over their debt or they are looking at their overdraft in the context of the current economic climate. Some of those small businesses have then turned to the banks and have found difficulties there because they have different lending criteria. The information you have does not suggest that that is the case?

Mr Hossack—Your question is: Are businesses finding it difficult?

Senator BUSHBY—No. Coming back to the question I asked you before about the smaller financial institutions—

Mr Hossack—Yes.

Senator BUSHBY—Being able to find sufficient liquidity to be able to continue the activities at the same level they were prior to the economic situation becoming apparent in Australia, I have read anecdotal evidence or stories about small businesses having difficulties with such institutions in being able to roll over their loans because the banks or those smaller institutions are saying that they do not have the funds.

Mr Hossack—I was referring mainly to the credit unions and building societies, for which it is more or less business as usual for them. There is another segment of the market, the financiers if you like, and some of those who were very heavily dependent upon the capital markets for their funding who have pulled back their lending in Australia.

In some cases, they have just exited the market, so there has been a bit of a gap that has opened up for some businesses who are securing funding from these financiers who are now looking to the banking sector to see if they can replace those loans. This is a very difficult issue because some of these businesses who traditionally did not get bank loans because of credit or other issues went to this segment of the market. As that has shrunk, there is a gap opening up.

Senator BUSHBY—Absolutely. Some of those had very successful businesses that presumably gave a decent return to the financiers that actually gave them the money.

Mr Hossack—The good news is that where the businesses can demonstrate that they are viable and that they can repay loans, what we are seeing is that the major banks and other banks in the market are providing services to them.

Senator BUSHBY—But you also have to throw in the change in economic circumstances which no doubt the banks would look at when they are assessing these things as well.

Mr Hossack—Yes. There is no question their economic circumstances have tightened credit standards to a degree. That is true.

Senator BUSHBY—Absolutely, which then self-feeds in some respects with some of the small businesses, and that impacts on the economy. I have just one final question on all that: Do you think that the effect of the bank guarantee on those smaller institutions has made it harder for them to access funds as well by missing a capital shift from them to guaranteed institutions?

Mr Hossack—If we look at the housing lending market, that was a rigorous competitor for housing loans against the banks—there is no question about that—you know, Aussie home loans and Wizard and all those brands that you would have heard of. Their business model is now much tougher because they were so dependent upon foreign funding. The cost of that foreign funding has increased really markedly. The models are really stretched. To the extent to which they can offer the same competition, I think that is a really open question.

Senator PRATT—Mr Hossack, I wanted to ask you about competition in communities that do not have a lot of banking services, particularly in relation to the proposed merger, and the extent to which, when you have Westpac and St George as the only two players in a community. Even if they remain separate entities, it is not necessarily an issue of competition in terms of the ways those two banks provide services to any single community. I would like you to comment on that and also to comment on to what extent you see other players entering into those kinds of markets, such as your Bendigo Banks or even other four-pillar banks entering into those spaces.

Mr Hossack—My reading of the Westpac-St George merger and the proposal and where the conditions ended up is that they are extremely sensitive to impacts of the merger on those communities you refer to, which is why they have announced that they are not going to be closing branches. They are going to be staying in those communities and keeping separate brands and separate management to keep those brands and products going. My reading of it is that they have really taken measure to make sure that those effects are minimised.

Senator PRATT—To what extent does that change with a long-term plan as opposed to a medium-term reassurance that is abided by?

Mr Hossack—Ultimately that is a question for Westpac, I suppose, but my reading of it is that they are very serious about customer service and they do value these community customer bases that they have. I think you will find they have a very substantial long-term commitment to those communities.

Senator PRATT—In that sense they would not want to see their customer base in those communities eroded from whatever they occupied within, say, Westpac and St George—whatever their combined mass is. Clearly, they would not want to see themselves going backwards from there.

Mr Hossack—My understanding of banks is that they go to great lengths to keep their customers because obviously that is their business. I do not think you will see them taking steps to put their customers in those areas at disadvantages.

Senator PRATT—What has changed in the history of this issue? We have certainly seen banks withdraw from communities and that is where players such as Bendigo came into the mix. Has the attitude within the banking sector changed?

Mr Hossack—You are essentially referring to the branch closures that occurred in the 1990s. The history of that really is a story of competition. For most of the last century if you like, up until deregulation, because banks could not compete on price and could not compete even on the amount of money they lent because it was fully regulated by government, how they did compete with one another was by rolling out these very, very substantial branch networks.

When deregulation happened, initially the competition was in corporate lending, but that did not go too well. Then the banks started focusing on the household sector more as an area of business. But a very important event that happened in 1992-93 was the entry of non-bank housing lenders.

Banks had not had competition from non-deposit taking institutions before in housing lending. They used to pay for their branch networks by charging the customer where it was in the interest margin. In a sense, those who had a home loan were paying a higher interest rate to cover the costs of these extensive branch networks. When Aussie Home Loans and other non-bank lenders came into the market, they did not have massive branch networks that they had to support so they could offer lower interest rates. The banks found themselves in a situation where they had extremely large and costly branch networks, but they were now facing competition in the lending portfolio from these new players who could offer much lower rates.

We saw a dynamic situation in the 1990s which took a lot of adjustment in the community. The banks started reducing some of those costs, closing some of the branches, and introducing fees to compete, if you like, against the non-bank lenders. That process worked its way out. If you look at the statistics over the past three or four years you will find that branch numbers are starting to increase again, in some banks at reasonably fast rates. We have, if you like, a heightened recognition in the banks now that the branches are providing good services. That is also helped by the fact that there is more of an acceptance in the community that they can charge fees for those services. You can start paying for branches through the imposition of fees. It is getting more to a user pays and sustainable system.

CHAIR—Thank you, Mr Hossack, for coming in this evening.

Mr Hossack—Thank you very much to the committee.

[7.35 pm]

McLENAGHAN, Mr John, Head of Government and Industry Affairs, Commonwealth Bank of Australia

NAREV, Mr Ian Mark, Group Executive, Business and Private Banking, Commonwealth Bank of Australia

CHAIR—Welcome, gentlemen. Would you like to make an opening statement?

Mr Narev—I do not propose to say a great deal by way of an opening statement. I think it would be most helpful if we simply respond to questions. It might be helpful if I clarified my personal role and the reason why I am here representing the bank. Since January this year my accountability has been with business and private banking. From May 2007, when I joined the Commonwealth Bank, until January this year I held the position of the group head of strategy with accountability for mergers and acquisitions. As such, I was heavily involved in the acquisition by the Commonwealth Bank of BankWest and St Andrews. The areas in which I might be helpful to the committee principally concern the rationale for the deal and the execution of a deal itself. Once the legal agreement was signed in October, accountability for the ongoing integration of St Andrews and BankWest moved from my area to other areas of the bank.

CHAIR—Thank you, Mr Narev. We have already heard a little about maintaining different brands and branches. Your submission states:

> Moreover, the Group is committed to maintaining and growing BankWest brand and operating BankWest and Commonwealth Bank branches in Western Australia for the transition period, even where branch presence of the two banks overlap. These measures will support ongoing employment opportunities for BankWest staff.

Can you explain the strategy behind that? Does it really assist competition? Does it really assist clients to maintain two separate brands? How does that advance from a customer point of view?

Mr Narev—The important point to bear in mind—this will probably be a theme underlying a few things we will say this evening—is that the governance of BankWest remains under a board that is separate from the board of the Commonwealth Bank of Australia, and under a managing director who reports to that board. Decisions regarding the BankWest footprint, the BankWest strategy and the BankWest brand are all made by the managing director, John Sutton, his executive team, and approved by a separate board. From the point of view of the consumer in Western Australia, there is still a choice between two quite separate brands and two quite separate looks and feels that are not coordinated through common governance processes.

Prior to the Commonwealth Bank's acquisition of BankWest these separate decisions were made and that process is ongoing. In my current role as the head of business banking I have no discussions whatsoever with my colleagues, like my counterparts at BankWest, about where they will put their banking centres at the moment or what will be their pricing. We are running those totally separately under totally separate governance processes. From the consumers' point of view the choice that they had prior to the acquisition has remained.

CHAIR—BankWest is growing and it already has a branch in Adelaide in South Australia—my home state—so I have noticed it. From an employee's point of view will both entities continue to grow and provide opportunities for employees? Will there be any crossover for employees?

Mr Narev—Again, I cannot speak for the strategy that BankWest will follow. However, I can say that in Mr McLenaghan's summary of our position you will note that three bullet points on strategic rationale are drawn directly out of a paper that I co-authored for the Commonwealth Bank board. The third point states that this 'creates a wider pool of talented and experienced people to complement the Group's vision of excelling in customer service'. In the governance of BankWest we have already seen, to the detriment of my current team, that John Sutton, the previous head of agribusiness in the Commonwealth Bank, has now been moved to the position of managing director of BankWest.

In the development of bankers' executives we might be able to give BankWest people and Commonwealth bank people access to a bigger pool of development opportunities through being across both brands. I expect there to be some cooperation in developing and enhancing the talent that both organisations have. That should mean that it creates a wider pool of opportunities than people may have had prior to the acquisition.

CHAIR—What benefits will the merger bring to the organisations involved? Given that they are running such separate operations, why bring them together?

Mr Narev—The rationale for our acquisition of BankWest was primarily a value-efficient way of enhancing our footprint in a state where we felt, over time, it would continue to grow strongly and where we felt our footprint and representation were underweighted. What was the benefit for the Commonwealth Bank? While we could have achieved investment in Western Australia over a period, which would have enabled us to grow our footprint and our branch representation, this was a way of growing at a fairly fast pace and that was appealing to us.

I cannot speak too much from BankWest's point of view other than to say that our outside-in analysis, as we were looking at the deal, revealed that the local BankWest would be under increasing pressure as a result of the pressure that its parent company was under, which I think was well known. The ACCC's investigations through its discussions, which obviously we were not able to have, gave it a clear view that BankWest was unsustainable in the form in which it had been.

I believe it gave BankWest people an opportunity to maintain careers in banking. I am speaking anecdotally here through conversations that I have had but we found that, as a general rule, while in many cases with mergers and acquisitions there can be a bit of discomfort, in many cases with the BankWest people there was a sense that a difficult time, resulting from their association with a troubled parent, had ended at that point. They now felt that that they had an opportunity under a secure and sustainable employer.

Senator CAMERON—Did the acquisition mean that they lost their jobs?

Mr Narev—I cannot say what would have been the BankWest strategy. I am speculating here but I suspect that had the acquisition not occurred many of them would have lost their jobs.

Senator EGGLESTON—Coming back to the BankWest issue, you said it was unsustainable in the situation that it was in. I presume that is because its parent bank in the United Kingdom was in a lot of trouble. Does that imply in any way that in Australian circumstances BankWest was not a profitable bank?

Mr Narev—No. One of the attractive aspects of BankWest was that we felt it was a good bank hampered by a troubled owner. Any growth in banking requires supplies of capital and funding. It had a dependence on a parent for capital and funding that was beginning to dry up. Over a period—and I am purely speculating—I expect that would have caused difficulty for BankWest in being able to meet its customers' needs. Anecdotally, we also know that the bank was beginning to suffer brand concern locally as a result of its association with a parent that was increasingly in the news, probably heightened at the point of the Lloyd acquisition of HBOS. Prior to that point we believed that the local BankWest and St Andrews businesses were good businesses.

Senator EGGLESTON—Your agreement is that you will maintain that brand for three years?

Mr Narev—For at least three years.

Senator EGGLESTON—At least three years. That puts it in a different context. Nevertheless, it still reduces the number of banks available to customers in Western Australia. In effect, it is now down one, whereas before people had a choice between the Commonwealth, BankWest and the other three. How would a reduction in the number of banks improve competition and promote better service to the Western Australian public?

Mr Narev—I wish to say a couple of things, Senator. I guess we could get into a bit of an academic debate about whether a bank is still a bank if it is owned by another bank. We have a commitment to maintain and grow the BankWest brand—a commitment that the Treasurer has asked for in the context of approving the acquisition. I guess that the best thing I can do is give a personal view. I believe that customers banking with BankWest in Western Australia will have a different experience to customers banking with the Commonwealth Bank of Australia in Western Australia. Although ultimately they have the same shareholders from a consumer point of view, I think it is at least arguable that a choice among the majors, plus BankWest, as major brands in Western Australia remains.

Senator EGGLESTON—That is an interesting remark. I suppose we will have to wait and see whether those differences are maintained. If you had an opportunity to acquire the ANZ or Westpac, would you do it?

Mr Narev—I am not authorised to give the Commonwealth Bank's official view on that subject, but I can tell you that in my time as head of strategy I spent a lot of time looking at many good opportunities and that was not one of them.

Senator EGGLESTON—Nevertheless, we are seeing a progressive reduction in the number of banks in Australia. How does the Australian banking scene compare with comparable countries such as Canada? What happens there?

Mr Narev—I do not have the details. From memory I suspect that I would not be qualified to tell you anything about the actual concentration. The Canadian banking system has done relatively well in this environment. I think it has three strong banks. I would have to check and come back to you as I am going from memory. The two banking systems are compared relatively frequently.

Senator EGGLESTON—Recently, in the context of the global financial crisis, banks in Australia and Canada are not closing.

Mr Narev—Yes.

Senator EGGLESTON—Please continue, Mr McLenaghan.

Mr McLenaghan—I was going to say that some years ago I looked at the comparisons when the Manly report was being prepared in Canada because there was a similar issue about concentration. They tried to identify what they thought was an optimum number of major banks. I do not think that they ever reached a conclusion. However, the structure and the nature of the banks were quite similar. As you have said, it is interesting that in the current economic climate both Canada and Australia are ranked right at the top of the international banking systems. Maybe it has something to do with the structure.

Senator EGGLESTON—How many banks would there be in Canada? I am interested in this competition issue. Are there state or province-based banks in Canada? We have had Westpac, St George and various other banks in Western Australia that have been swallowed up by bigger banks. Has that phenomenon occurred in Canada?

Mr Narev—I recall from my sketchy memory that there are regional banks in Canada but, unfortunately, I cannot give you a lot of good information on that.

Senator CAMERON—Mr Narev, I noticed you sitting in the back of the room when I was asking the previous witness questions, so these questions will not come as a surprise to you. Was there any increase in executive salaries, either at the Commonwealth Bank or at BankWest as a result of the merger?

Mr Narev—I cannot comment on the executives at BankWest simply because they are from a separate governance process. I have had no discussions about that. I am not appropriately qualified to answer on behalf of the Commonwealth Bank. However, in discussions that I have been part of—which I can comment on—there have been no discussions about any additional remuneration going to any Commonwealth Bank executives as a result of the BankWest merger. As the head of strategy at the time—I am thinking about this now to make sure that I answer this question correctly—I did not have a single performance indicator or financial incentive directly related to the BankWest merger.

Senator CAMERON—I asked the previous witness questions about off-shoring. I do not know what the Commonwealth bank's off-shoring activities have been over the past few years as I have not been looking at them too closely. What is the situation?

Mr Narev—In anticipation of this question, I did obtain some information. I am not the best person to speak on behalf of the bank but I can tell you that we do not have any call centres offshore and we do not have any processing offshore. Currently, we do not have any plans to do any of those things offshore.

Some of the external providers with whom we work on aspects of IT applications have connections with IT developers in India, but they are not Commonwealth Bank employees, so we really have no off-shoring activities in those areas and no current plans.

Senator CAMERON—The ABA gave evidence to the effect that there were major skills constraints because of limitations by external education providers. Is that the experience of the Commonwealth Bank?

Mr Narev—My understanding of the ABA's papers is that they were looking at that and projecting outwards, which I have not done. In any industry good people are scarce. As a result of discussions that I have been part of relating to the talent that we need, I know that we draw substantially on a good, vibrant and valuable talent pool in Australia to fill our business positions. If the market and the banks continue to grow, et cetera, how that might look in four or five years time I think is another matter.

Senator CAMERON—When you referred to the business position is that across the board?

Mr Narev—Across the board.

Senator CAMERON—Thank you.

CHAIR—I have one last question relating to the corporate area. When mergers take place, share prices commonly fall because of the cost of dealing with the merger. What happened with the Commonwealth Bank's share price?

Mr Narev—That is a good question, but I cannot recall. In the current share price environment I think it would be extremely difficult to tie anything relating to our share price to the specifics of the BankWest merger. During that period, which was closely adjacent to the Lehman Brothers events in the United States of America in September this year, all the major banks' share prices between that time and the end of last year went significantly southwards. I do not recall any sustained movements in our share price that we would have considered to be relative to the BankWest acquisition at the time. However, I would have to go back and check that.

CHAIR—In general terms would you imagine that shareholders would be keen on mergers, based on past history?

Mr Narev—There is a lot of debate about this because some commentators cite a statistic that shows that about 70 per cent of mergers and acquisitions fail. The last time I looked at this—and

I will not have the numbers correct—I found that a lot of that is done on the data of the share price the day before the acquisition and the share price 10 days after, or something like that. From our point of view, the strategic rationale of BankWest was a long-term investment in Western Australia. We would expect the benefits of the merger to be apparent to our shareholders two, three, four or five years down the line. The rationale for the merger never was to have an immediate impact on our share price.

Often capital raisings are associated with the acquisitions and we therefore need to be cognisant of what the capital will cost. However, in relation to the value it really goes over time. Everyone in the market—our investors and our analysts—all have their own view of what constitutes a successful merger, when it pays for itself, et cetera. Everybody you ask will have a different point of view on that issue. Our point of view is the ability to create sustainable long-term value.

Senator PRATT—You probably heard me ask the Bankers Association questions about communities that have access to one or two banks when mergers such as this take place. You mentioned in your opening statement that you were after a greater penetration of the Commonwealth brand within Western Australia. I would have thought that the Commonwealth already had a pretty significant penetration there, as it seems to have a branch on every other street corner in communities in that area. Ultimately, at the end of the three-year period, you might think that you have a double up, but some of those services might drop off. What sort of analysis have you done in that area?

Mr Narev—The decision on where the branch is located will be made separately by the Commonwealth Bank and BankWest boards. I really cannot comment on that. Looking forward, I can state that in the strategic rationale for the acquisition, which I helped to prepare, we placed little, if any, value on synergies from closing branches. The plans that determined whether or not it would make sense for us to buy BankWest—with the business case different from many mergers in many industries that are very much cost-synergy based—were not based on cost synergies at all.

Senator PRATT—So the justification for the merger can be a separate thing? I appreciate that the justification for a merger is separate to that. In effect what might that mean? Does it mean that that issue has not been fully considered because it was not important to the merger question?

Mr Narev—In the Treasurer’s approval we had to give a commitment that no Commonwealth Bank or BankWest business banking centres or branches would be closed.

Senator PRATT—Within what time period?

Mr Narev—The Treasurer’s approval refers to the period of the integration. I have been party to no discussions at all about the closure of any branches in Western Australia. Since we purchased BankWest that topic has not come up.

Senator PRATT—Sometimes banks located their branches 50 metres down the street from one another. It does not appear to me as though that would be a long-term proposition and you might not necessarily have the same staffing numbers when two banks, owned by the same company, are located on the same street.

Mr McLenaghan—But we have an undertaking with the Treasurer to maintain and grow the brand for at least three years, so there will be no moves to change the branches in that time.

Senator PRATT—My question goes beyond that three-year period. I appreciate that it is difficult to comment on that issue. However, when I have talked to organisations such as the Financial Sector Union I have been reassured that they are looking at long-term employment prospects. To what extent are positions in front-line banking services being rationalised by new technology and the like?

Mr Narev—I do not have the numbers on that. However, I can tell you that in my time at the bank and from Ralph Norris's time as the chief executive officer, our number one commitment was excelling in customer service. That led to significant additions of people in the frontline, in particular, in the area for which I now have accountability. Over the past few years the business banking growth strategy has recognised underinvestment and people in the frontline have tried to rectify that.

Senator PRATT—Is that is the key driver for growth in employment in the banking sector?

Mr Narev—It is a driver of growth, yes.

Senator PRATT—What are the other drivers?

Mr Narev—For us the growth depends, to a large extent, on the demand for banking services in Australia related to the economy, and on what plans the Commonwealth Bank and other banks have for growth, both within and outside Australia. Obviously we are consistently looking to improve the service for customers and to deliver good returns to our shareholders. In the immediate and foreseeable future we do not concede at any time that people will not be at the centre of that. People are at the centre of interaction between the banks and the customers.

Senator BUSHBY—I thank representatives from the Commonwealth Bank for appearing tonight. Mr Narev, you said that the rationale for the merger with BankWest was not the immediate effect on share prices. From the perspective of the Commonwealth Bank what is the rationale for a merger with an entity such as BankWest?

Mr Narev—In the board paper that I co-wrote for the board's approval the key points were those outlined in Mr McLenaghan's letter. We have an aspiration to be Australia's leading financial services organisation. As we looked at that we felt that, notwithstanding any temporary effects of the economy, in the long term Western Australia appeared to be a major part of Australia's growth. We felt that we were underpenetrated in Western Australia. For us the greatest value of the acquisition was accelerating our penetration in Western Australia. There are opportunities to do that by building more branches ourselves organically, but that takes a much more significant period and this was a way to do that quickly and to become the leading bank in an important part of Australia's long-term growth story.

Senator BUSHBY—What percentage of the Western Australian market would you have had before on the commonly used criteria?

Mr Narev—I will refer to the ACCC’s response on this, because I am pretty sure that it has good common criteria, which are the branch numbers. We had 11.9 per cent of the branches in Western Australia and BankWest had 13.5 per cent of the branches, giving the merged entity roughly 25. The other majors, Westpac and St George, had roughly 18 per cent, ANZ had roughly 13 per cent and NAB had roughly 11 per cent. By one commonly held measure, which is branches, it increased us from being almost the third player to being the number one player.

Senator BUSHBY—By quite a large margin. What criteria did the Commonwealth Bank use for judging the success of the merger? Obviously, in the short term you say that the rationale was to increase your penetration into the Western Australian market. Clearly, you did that immediately by acquiring BankWest. Are there other criteria? You talked about the share price in four or five years. What other factors did the Commonwealth Bank look at in deciding whether this was a good thing?

Mr Narev—For us there were probably two primary criteria. The long-term performance of our share price for our investors was one criterion. At last count I think 58 per cent of them were Australian households. The other criterion is that we have made a commitment that the board will ask for updates on our customer service performance each time we meet. Throughout the Commonwealth Bank group and all parts of the business, including the Commonwealth Bank and BankWest, we need to see significant and ongoing improvements in customer service, as measured by combinations of Roy Morgan surveys, TNS surveys, and other different external providers.

Senator BUSHBY—I might leave it at that, thank you.

Mr Narev—Thank you.

Senator FURNER—I refer to the comments in the Roy Morgan surveys. I understand that BankWest received a hit of 78.1 per cent of the market and the larger banks, which would have been the Commonwealth, Westpac, NAB and ANZ, received 66 per cent to 74 per cent. What is the merged bank doing now to maintain its 78.1 per cent customer satisfaction rating through Roy Morgan?

Mr Narev—Because I am not part of the governance of BankWest I suspect you will find that some of the key criteria by which BankWest staff are measured will be on improvements and customer satisfaction, which is consistent across the whole group.

Senator FURNER—Consistent with BankWest?

Mr Narev—Yes, against a baseline. I am purely speculating on that because I am not involved in those decisions, but the customer service aspiration crosses the whole of the Commonwealth Bank group. I suspect that a severe downturn in that, or an inability to sustain and approve that customer service satisfaction performance, would be considered a poor performance from BankWest.

Senator FURNER—Thank you.

CHAIR—Thank you, gentlemen, for coming in.

Mr Narev—Thank you.

[8.04 pm]

MARTINE, Mr David, General Manager, Financial System Division, Department of the Treasury

MURPHY, Mr James Andrew, Executive Director, Markets Group, Department of the Treasury

ROGERS, Mr Scott, Acting Manager, Competition Policy Framework Unit, Department of the Treasury

WIJEYEWARDENE, Ms Kerstin, Manager, Banking Unit, Department of the Treasury

CHAIR—I remind members of the committee that the Senate has resolved that departmental officers shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions to a superior officer or to a minister. This resolution only prohibits asking for opinions on matters of policy and does not preclude questions asking for explanations of policy, or factual questions about when and how policies were adopted. Do you want to make an opening statement?

Mr Murphy—I want to make a few quick points to give you some insight into Treasury's thinking about policy development in this area and the way we approach banking and financial services. I will make only some quick points. The goal of policy in this area and the goal of this government and the previous government are, in effect, to have a well-functioning financial services market. You might ask, 'How would you define that?' and we would say, 'It is vibrant, it is dynamic, it is competitive, and it has been diverse.' We would say that it incorporates a risk spectrum so that various individuals and businesses, of whatever size or ilk, would seek funding in the area of lending.

There is a risk spectrum for lending and, as is seen vividly at the moment with overseas markets, managers within financial institutions can manage risk competently, which is important. At the moment one key thing is coming out as a matter of policy for us. If we had a well-functioning financial system and that system had to be a financial system, stability would probably be the key thing that would be coming out of all policy considerations. Referring to the competitive financial system in Australia, there are over 150 approved deposit-taking institutions. We have laws about collusion and whatever, so there would seem to be the basis for competition. We could discuss that, but that is important. Mergers, in which you are particularly interested, are subject to the Trade Practices Act—economy-wide rules relating to competition.

We know that the ACCC rigorously upholds issues relating to competition and it runs a ruler over. We have seen some of its analyses relating to proposed mergers. In addition, because of the national interest, especially in the banking services sector, the treasurer has the power to make conditions. We have always worked closely with the ACCC. It is an independent statutory body but it makes the decision on market share and how those things will operate. The treasurer could then seek to impose certain conditions to ensure that competition continues, not only now but also into the future. As a matter of policy, in Treasury we are continually monitoring the delivery of financial services to the community. My colleagues can talk to you and explain to you how we do that.

Recently, in the life of this government, there have been issues relating to switching that has enabled individuals to switch from one bank account to another. The government has been strong in trying to ensure that the majors fully pass on interest rate cuts or to the greatest extent possible. The government is also is engaged in moral suasion and putting forward into the marketplace issues relating especially to bank fees. What is the future of competition? From our point of view, as a matter of policy, we are pleased with the way in which the Australian banking system and the financial services market have stood up to the shock of the global financial crisis. We are in such a good position compared to our overseas counterparts.

Senator Eggleston referred earlier to Canada. The two key countries that have been able to cope best with the stresses of the financial system crisis have been Canada and Australia. At the moment we are monitoring competition. Changes are evolving in the international banking services market. At this stage it is difficult to predict where that will end up. Our goal is to have a well-functioning and competitive system, and we will not digress from that. Where will the Australian market for financial services develop? There could be significant changes or minimal changes, taking account of the global financial crisis. That concludes my opening statement. We are happy to answer questions.

CHAIR—You said that we had around 150 ADIs. Some of them would be specialist organisations and some of them might be relatively inactive. We also have the four pillars policy. Is there any view about the optimum number of banks to support competition?

Mr Murphy—When I gave that figure of 150 it included 11 domestic banks, 11 building societies, 120 credit unions and nine foreign bank subsidiaries. Over the years we have found that the credit unions grow to a certain size and then they have mergers to make them more competitive and to reduce back-office costs. Over the years we went through this phenomenon where there were state banks and now, after the Wallis report, the banking system has come under federal regulation. It is difficult to say whether we have optimised the size. On the one hand we could say that our four majors are now within the top 20 banks in the world, or even within the top 15 in the AA ratings.

That might be apt for a country the size of Australia. We may have optimised; I am not sure. The United States has a big proliferation of savings and loans institutions, which are similar to our credit unions. It is difficult to say. Referring to whether there would be a concentration of mergers, Mr Samuels said that he doubts whether there could be a reduction in the number of majors in Australia. I think the Government would have to be strongly persuaded, or good arguments would have to be put to it, for it to see a benefit in reducing from four to two. Stability goes hand in hand with competition now and in the future. What is important is what is coming out of things.

There have been arguments as to whether, if an institution fails, the Government has to bail it out; whether you need pillars for your financial system or a platform on which you can build; or whether other smaller enterprises want to operate in financial services. Over the past few years we have found that marginal players have been the competitive stimulus to the majors to improve their customer services. When I refer to competition stimulus, I include credit unions and even the non-bank lenders who have put competitive pressure on major players to improve their services and their costs to consumers.

I do not say that what we have at the moment is the right size, but I would have to say that, looking at it in relation to other countries, our system has weathered the storm pretty well. The services to the community are not poor services. We always want improvements, lower fees and fewer costs imposed on consumers. All things said and done, there can be improvements, but they seem reasonable.

CHAIR—In earlier evidence the ABA placed the onus on the government to create more competition. Although they did not criticise the regulation they said that they believed the regulation was inhibiting competition. I think you alluded to that. It is a balance between getting stability right and increasing competition. Our vision has narrowed a lot from the 1980s when deregulation occurred and it was hoped that there would be new entrants into the banking sector that would simulate competition. That did happen but then most of them dropped off.

Mr Murphy—That is right. To elaborate on the 150 ADI point. For instance, 125 mortgage providers are providing over 2,000 mortgage products in Australia and 78 card providers provide over 330 types of credit cards. We have 114 providers of deposit accounts and there are 900 or more types of accounts. There are 32 providers of 39 different small business commercial loans, which represent a lot of different products. One person might argue that that is too many products for people to be able to make good judgments.

Underlying the whole of the financial services area there is a lack of financial interest—an issue about which we have talked previously to this committee. There is a lot of choice. On the competition side it is hard to mobilise people. However, because times have been so good up to now you wonder whether people have made an effort to shop around to try to get a better deal—a bargain on mortgages, or a bargain on credit-providing costs.

CHAIR—That deals with household-type consumers. You mentioned interest rate cuts, for example. I think that banks in that housing area, probably because of the competition, have passed on quite a lot of the Reserve Bank rate cuts. A number of people have complained to me that the interest rate for businesses is still quite high, if people can get finance. The interest rate is still quite high and the cuts have not been passed on. Is that due to a lack of competition in that business area?

Mr Murphy—I think we can give you some statistics on that.

Mr Martine—I was going to mention, Senator, that when you look at the data it is difficult to unpick the cause and effects. Referring to the current easing of monetary policy, which has been around 400 basis points, it is correct to say that the majority of that—not all of it but most of it—has been passed on to householder mortgages, and less so to businesses. However, other factors that are also at play do not necessarily lead one to the conclusion that a lack of competition has led to it. There is no doubt that one of the issues leading to the global financial crisis has been the pricing of risk. At the moment a lot of financial institutions are re-pricing their risk. The cost of funds has risen as well for a lot of financial institutions that are raising the capital to provide loans.

Senator CAMERON—Is that the global effect of what has happened? What you are describing is not the cause; it is the effect.

Mr Martine—The effect is the re-pricing of risk. But the cause of the global financial crisis is an under-pricing of risk.

Mr Murphy—Yes, but the Senator is correct. That is why the government brought in guarantees to enable banks to raise funds on a competitive basis. But the cost of those funds has gone up so it flows through the system. The banks will get their margin and the cost to business will be increased. The government would still like it if the banks could have less costly lending and it cost less for business, as long as it was done prudently. That is what the government wants. We want business to be able to continue at present. As a matter of policy that is a big issue.

CHAIR—Mr Martine, you referred to the number of people lending for home mortgage, but what number of people are lending for business?

Mr Martine—In effect, going back to some of Mr Murphy's earlier numbers and referring to the ADIs, you have 11 domestic banks and, in particular, many of the large corporate foreign banks are involved in business lending. The numbers are not as high as you would expect, compared to mortgages. Coming back to my earlier point, it is difficult when you are looking at aggregate data, in particular, in the current environment with the turmoil in financial markets, to try to unpick the demand and supply effects, whether something was caused by a lack of competition, a liquidity issue or a re-pricing of risk. You always spend a bit of time looking at the data. We have looked at spreads and at the extent to which banks have passed on the easing of 400 basis points. It is difficult to then start drawing conclusions on that.

Mr Murphy—But that having been said, the government is apprised of lending issues to business.

CHAIR—It is a bit of a chicken and an egg situation. If businesses do not get capital at a reasonable rate they are more at risk of not succeeding, are they not? It is a difficult situation.

Mr Martine—Their costs go up.

Mr Murphy—At the moment it is an important issue.

Senator EGGLESTON—You have already answered many of the questions that I wanted to ask you. You mentioned earlier that there are 11 banks in Australia. I did not realise that there were that many. I mentioned earlier that there had been the loss of some regional banks such as BankWest and St George. Obviously the loss of regional banks results in a reduction in competition, but will the disappearance of these regional banks result in an adverse outcome for the people of Australia?

Mr Murphy—I do not think so, as long as other institutions emerge if there is a market gap. From a Treasury point of view it does not matter whether it is from a regional bank or it is from one of the big four, as long as the services are provided to all Australians who need them. In relation to that issue, there has been some consolidation of regional banks. Bendigo and Adelaide got together and they seem to be reasonably well placed. From our point of view it is okay as long as the services are provided to the community at a competitive rate.

The regional banks have an advantage in that they might be closer to the market and they will get support because people identify with them. More local people might be involved, and people identify with that. I think we have to look at the cold hard facts to establish whether there is any diminution in services. If there is a diminution in services the government will become concerned and possibly will not agree to a merger.

Senator EGGLESTON—Do you suppose that the local banks might have a better perception of local economic circumstances and be more prepared to consider propositions because they better understand the local economy?

Mr Murphy—Yes.

Senator EGGLESTON—The local economy being a state, I presume?

Mr Murphy—Yes.

Senator EGGLESTON—Another issue that interests me is the growth of internet and online banking. Are you concerned about any issues relating to the growth of online banking, for example, service and competition, and also the access online of international banks to the Australian market?

Mr Murphy—In the first case the ING is involved in online banking and that has added to the competitive stimulus, which is a good thing. I think you will find that, given the nature of members of the younger generation, they are more au fait with technology. To my way of thinking, that will be a benefit for anyone who provides online services. Providers are seeking to encourage community members to move more into online services. They provide them but they try to encourage us to do that, which I think is a good thing.

If you are an online banker you have to meet all the prudential regulatory requirements, and the disclosure requirements for consumers, which is good. Referring to overseas banking, consumers have to be careful about putting savings with overseas banks. You can see this played out with United Kingdom residents' investments in Icelandic banks. There are some dangers there. It might sound sexy in this day and age, but it can be dangerous.

Senator EGGLESTON—Coming back to online banking and to young people, the different generation is accustomed to using the internet as a matter of course. Are there implications there because of the fact that you might no longer need branches? In a sense, people will use their computers as a bank and that will result in the closure of local bank branches across the country. In the end, online banking might become anti-competitive in the sense that it will become a fairly comprehensive exercise.

Mr Murphy—We have seen some trends in this area. Previously the banks to which you referred said, 'We want to reduce the number of branches.' They saw that as a major cost-cutting exercise. The trend now is to go back to trying to open branches. I do not have the numbers but I think you will find that that is their policy now. Bank branches have gone back to providing

Saturday morning services. I think they feel from their point of view that in having an interface with the customer and not just an ATM they can provide better service and probably get more fees for different products.

That has been the trend. In all these things you have to look at the statistics. You would use online banking to do your day-to-day transactions. If you wanted to borrow a significant loan for a mortgage or for a small business I think the banks now think that there must be a presence. You need to have your brand up in lights to register with people that you are there.

Senator EGGLESTON—You can, of course, take out a personal loan online. I have done it. You can do that at 2 am on a Thursday morning, but we would have to do that on a Saturday morning.

Mr Murphy—That is a very good thing. I hope you are not engaging in margin lending.

Senator EGGLESTON—I assure you that I am not. I was just wondering whether or not online banking would substantially lessen competition?

Mr Murphy—I think you would look at it from the point of view of being an alternative. With online banking we cannot be Canute. That is a service that is provided. If people want to take up that facility that is what the community wants. I do not know whether it will lead to fewer branches. The counterpoint to that is that the banks themselves now feel that they must move away from the idea of closing branches. I remember that when there was any talk of mergers there used to be a big point of policy, 'Are you closing branches? Are you reducing services to the community?' Banks have come back to opening more branches. These issues have to be looked at.

Senator FURNER—Mr Murphy, you referred briefly to bank switching which I know is a major objective of the treasurer. It has been some time since I switched banks but I am just wondering what are the current fees associated with exit fees on switching from one bank to another?

Mr Murphy—I might ask my colleague to answer that question.

Ms Wijeyewardene—I do not have the fees. There are different fees. With a lot of products, especially on the mortgage side, this was a big issue when the switching package was being developed. There were concerns about product entry and exit fees, and there were concerns about moving a lot of the entry fees to exit fees, or deferred administration fees. I guess the idea there was that if you waived the upfront fees and back-ended them that would prevent people from switching. I do not have the figures in front of me.

Senator FURNER—Perhaps I can put that question on notice and you can provide those details to the committee?

Ms Wijeyewardene—Yes.

Senator FURNER—A household survey of customer satisfaction was conducted, I think by the ACCC, when the Westpac and St George merger was on a—survey of approximately 240 householders. Are you privy to that information at all? Is it possible to get your hands on that?

Mr Murphy—When was that? Was it just before the merger?

Senator FURNER—I imagine so. I imagine that it might have been around the time of the merger because I understand that Choice tried to access that information and it was denied it.

Mr Martine—Senator, was it an ACCC survey?

Senator FURNER—I am not certain whether it was conducted by the ACCC, but Choice sought that information from the ACCC and it was denied it.

Mr Murphy—They might have used that for their analysis.

Mr Rogers—We do not have that information.

Mr Martine—Maybe as part of their inquiry that is fed through to their analysis. We are not too sure.

Senator BUSHBY—Thank you for coming along tonight. Most of the questions that I was interested in asking have been addressed to some extent. I am interested in following up on something that was talked about earlier. Mr Murphy went through a list of statistics which was interesting because of the broad range of institutions in the market and the products that they offer. Has there been any change in the institutions in the past 12 months? Have they contracted at all as a result of the economic conditions?

Mr Murphy—Yes. One of the effects of the global financial crisis has been a lack of quality in some of the smaller institutions, but not as much as we thought could happen. Some of the small institutions have lost deposits to the majors.

Senator BUSHBY—Are these the ADIs?

Mr Murphy—Within the ADI sector and also within the non-bank lenders. As I said, some people argue that you have to have a financial system with banks. The government’s policy is that there should be a diversity of credit providers as long as they are prudently managed. There has been a competition impact from the global financial crisis, which means that some of the small institutions are probably lending less at the moment.

Senator BUSHBY—Does that threaten their viability at all?

Mr Murphy—No, I do not think so. Because of the differential rate in the guaranteed costs of borrowings, some of the regional banks made strong representations to the government that they would find the cost of the guarantee detrimental to their business. But deposits at some of the second tier banks have also gone up.

Senator BUSHBY—But they have a guarantee to buy it, do they not?

Mr Murphy—Yes, but they were paying more than they felt they should. I think the business of non-bank lenders has been constrained by the current economic circumstances. The government has sought, through the Australian Office of Financial Manager, AOFM, to purchase up to $8 billion of residential mortgage-backed securities to facilitate lending back into the market by entities such as the Members Equity Bank, Challenger, FirstMac and those sorts of non-bank lenders.

Senator BUSHBY—Has a large amount of that $8 billion already been purchased?

CHAIR—Not the whole amount.

Ms Wijeyewardene—About $2 billion has already been allocated and another $1.8 billion is in the process of being allocated.

Senator BUSHBY—Can you tell us whether the money that is out there has had any impact at this point?

Mr Murphy—I think the impact has been a decline in the value of business but, to put it bluntly, they are still in business.

Senator BUSHBY—You said earlier that some ADIs at the smaller end were lending less. Presumably, on the basis of what you said—and correct me if I am wrong—that is because the deposits they are taking have fallen, so in a sense they have less to lend?

Mr Martine—Just to clarify that, Senator, in the lead up to the guarantee we saw deposits moving from the second tiers to the majors. As a depositor you might be a bit concerned about what was happening so you might park your deposits in the major banks. But with a deposit guarantee, deposits up to $1 million are for free—there is no fee. More recently we have been seeing deposit growth back in the smaller ADIs. In some of the regional banks the deposits have increased over the past few months. The fee differential relates to the wholesale funding.

Senator BUSHBY—All I am trying to establish is the effect on competition, which then flows into the viability of mergers or otherwise. I was interested in and encouraged to hear Mr Murphy’s opening comments about the degree of existing competition. However, I am concerned about the impact of the economic crisis on restricting the number of organisations that might be out there competing for business in the sector. I was going to ask next about the number of products or services that they offer.

I wanted to know whether or not that has also contracted and what effect it might have had on overall competition, particularly with those outside the majors that were offering a lot of innovative products. If that is contracting does it mean that the majors can relax a little in what they are doing and it might have a negative impact or effect on the overall economy?

Mr Murphy—As Mr Martine said, you cannot move away from the fact that the global financial crisis has been a re-pricing risk. To some extent there has been a tightening of lending criteria. That will possibly lead to some of the smaller players being more selective and more careful in their lending practices, which might be a good thing. However, at the same time it might reduce the amount of lending in the community. We are looking at that; Treasury is monitoring it. We do not think it is at a stage where it might be detrimental in the long term to the Australian financial services sector. You have to get through this financial crisis, especially overseas.

If overseas markets stabilise and the banking system in the United States of America and the United Kingdom return to normality to some extent, you might find that the cost of funds will reduce and more confidence will be brought back into the system worldwide. To some extent the government will be looking harder at these issues to ensure that we have a competitive system. We cannot escape the fact that there has been some impact from the GFC on the non-bank lending sector.

Senator BUSHBY—I find that very interesting and we could go off and explore it, but we would probably be way outside our terms of reference. Coming back to the terms of reference, when the government looks at potential mergers—whether it is between a major and a non-major, or whether it is between other non-ADIs—would the lessening of available products or credit, or what we have just discussed, impact on the government's decision-making process when considering mergers?

Mr Murphy—The ACCC divides up the market and looks at the products that are being provided. For instance, BankWest may be much stronger in a certain product line. When they look at BankWest and at the Commonwealth Bank they would look at the product lines to establish whether that gave that entity dominance in that particular product line. When they look at an institution they break down that institution into certain things that it does. That is what they do when they put through a merger. If they complement each other it is very much by chance.

Senator BUSHBY—Are you losing diversity?

Mr Murphy—Yes. It puts the merged institution in a dominant position in relation to that product.

Senator BUSHBY—When banks go through that exercise, at the same time they look at those two institutions that are contemplating joining. At the same time products on offer from other competitors have contracted, whether it is because of the global situation or otherwise, and that will be fed into the decision-making process.

Mr Murphy—Yes. The same would apply to first home owners' mortgages. If they bank with the Commonwealth, for example, they would say, 'How much of the mortgage market in, say, Western Australia does BankWest have, and who are their competitors?' If BankWest had only 10 per cent of the market and the Commonwealth had 10 per cent, would they get 20 per cent of the market? That is okay because Westpac might have 20 per cent. But if BankWest had 90 per cent of the mortgage market they would not allow it; that would knock it out in that case.

Senator BUSHBY—Effectively, if the impact of the global financial crisis is to reduce the range of services offered by the range of players in the market, mergers may need a closer look, depending on the extent of the contraction of those services. It might be marginally harder to get through regulatory processes because—

Mr Murphy—Maybe. I would say they are not.

Mr Martine—It can vary, though, Senator. No doubt the ACCC can explain this much better than I can when they appear tomorrow. The important point that they look at is what would happen in the absence of the merger. What would the state of the market look like in the absence of a merger? It is not necessarily correct to say that you would have these two entities that had not merged operating as they do now, particularly in the current crisis. You might envisage situations where a smaller ADI is really struggling in the market and one of the majors comes along and a merger is proposed. But in the absence of that merger it may well be that that entity will not exist. In fact, you will lose that entity in the market.

Senator BUSHBY—Essentially, I am asking what impact the current financial international situation would have on the consideration of mergers.

Mr Murphy—Yes.

Senator BUSHBY—You just mentioned a completely different one where it might affect the viability of some of the smaller banks.

Mr Martine—That is right. In that situation—

Senator BUSHBY—It would not improve the prospects of a merger?

Mr Martine—That is right; it can work in the other direction.

Senator BUSHBY—Are there any other impacts that might flow from the global financial situation as it plays out in mergers in this area?

Mr Martine—Along with the competition aspects, the treasurer making the decision must take into account a whole range of other national interests and considerations. One of those is the stability of the financial system. In the current environment you can see that that would be an important consideration. Once again, it could be a decision either way, depending on the institution and what is occurring.

Mr Murphy—I think the key issue there is that you would be worried about a stable financial system. Up until this crisis you would have to say that the consumers of the world have largely benefited from the financial services industry. High salaries have been paid to some of these people, and we all have a judgment on that. But the proliferation of services and the ease with which we can now get mortgages compared to what our parents went through to get a mortgage are much better. It is a much better and a freer financial system. However, obviously there has been excessive risk taking.

Australia will not be out of kilter with the rest of the world. Major meetings have been occurring with officials to try to work out whether there is a need to tighten regulation and how that regulation should be tightened for financial services. At the same time I think everyone wants to retain the competitiveness of their own financial systems.

Senator BUSHBY—Earlier we heard evidence from the ABA that was not conflicting but that was probably more accurate than your opening statement. The ABA said that Australia's top four banks were in the top 12 by rating.

Mr Murphy—They are moving up.

Senator BUSHBY—Yes. They are all in the top 12.

Mr Murphy—I did not want to exaggerate.

Senator BUSHBY—It is not inconsistent but, as I said, that statement is probably more accurate.

Mr Murphy—I hope that they stay there.

Senator BUSHBY—Where are the other eight? Do you know? Is there a trend to show what other countries are doing fairly well?

Mr Murphy—In the last one I saw the HSBC was even. I am not sure where they are now. Wells Fargo, the Bank of America and one of the banks in the United Kingdom have done reasonably well.

Senator BUSHBY—I do not want you to name the banks; I am probably more interested in the nations.

Mr Murphy—The Spanish banks were doing very well supposedly because they did not get into some of these delivery products as much as banks in the other countries have done.

Senator BUSHBY—Are the Canadian banks in there?

Mr Murphy—The Canadians, yes. There would be a couple of Americans and I think there is one in the United Kingdom. There are also the Australians, the Canadians and the Spanish. The bad ones are those located in Iceland. They are a cot case, as you have seen with the United States. The interesting thing in the United States is that the investment banks have been the problem, but they are trying to turn them into retail banks. The theory is that having a regional deposit base provides some stability to a bank.

Senator BUSHBY—I have one final question. Tonight you clearly highlighted the fact that our financial system is working quite well relative to other nations?

Mr Murphy—It has weathered the storm so far.

Senator BUSHBY—It has weathered the storm well. That is one of the reasons why we have had contractions that impact on mergers. That is why we are not having a lot of banks or institutions falling over and requiring mergers. Why do you think our financial system has weathered the storm so well? What are the characteristics of the Australian financial system?

Mr Murphy—There are various views around, and everyone here would have a different view. As a matter of policy, both major parties have had a particular interest in ensuring that Australia has a well-regulated financial system—and that is what has occurred over 30 years. A lot of work has been put in by government to ensure that we have a competitive and stable financial system. It has not been an afterthought; it has been a direct policy thing. The regulator—

Senator BUSHBY—APRA?

Mr Murphy—APRA, which is responsible, has been vigilant and it has good dialogue with the business community. Some people disagree with this, but I think the leadership in Australian financial institutions has been prudent and sound. We can criticise various aspects and say that they should be more competitive, and we could get into the salary debate, but they seem to have made some sensible decisions. That has been publicly acknowledged. Only a few years ago David Morgan, as the chief executive officer of Westpac, came out publicly and said, ‘I will not get into certain risk avenues.’

There is a combination of factors. Maybe we have also benefited from our size. Ian McFarlane’s view was that it was a good thing that we borrowed so much from overseas because we had to be more upfront about the risks that an institution was taking, and there was more scrutiny of its own business before it could borrow overseas. Sometimes other people see that as vulnerability. You can look at these things differently. Overall, we have had a picture whereby governments have been pretty focused on the financial system for 20 to 30 years.

The regulators have been well-resourced by governments and they seem to be doing a good job. The business community seems to be sensible and seeking to make profits, as they should, but at the same time they are seeking to provide services to the community. That is a personal view but to some extent that is also the view of Treasury.

Senator CAMERON—Mr Murphy you referred a couple of times to executive salaries. You want to go there and then you do not want to go there.

Mr Murphy—Yes, I know.

Senator CAMERON—I am trying to bring you there.

Mr Murphy—These are executives.

Senator CAMERON—Bank executives. I thought you were approving of executive salaries, or were you a bit dismissive of them?

Mr Murphy—No, I am not approving. Executives’ salaries should be set for the job that is in hand. I suppose that the test should be what the community thinks of executive salaries.

Senator CAMERON—Treasury does a fair bit of analysis.

Mr Murphy—Yes, we have. You can look at executive salaries in the United States and in Australia. People have said that some of the salaries that are paid to the heads of United States financial institutions are obscene.

Senator CAMERON—I would say the same about those in Australia, but I suppose that is a matter of opinion. Referring to executives salaries, I assume they have an effect on the capacity of a bank to compete and to do a whole range of things if the salaries get out of kilter.

Mr Murphy—Yes.

Senator CAMERON—Over the years huge executive salaries have been paid in Australia and massive bonuses have been paid. We have had share options, golden handshakes and golden lures. This is fairly recent. In the history of the banking system in Australia I am wondering whether Treasury has done any analysis to establish whether all these massive payouts have improved productivity and driven growth. What is happening with these salaries? Are they driving consumption and creating wealth in the Australian community? To be honest, I think that is an issue for Treasury.

Mr Murphy—Over the past few years a fair bit of work has been done on executive salaries within Treasury. We introduced the non-binding resolution by the shareholders relating to executive salaries. Companies and institutions have to put forward their salary structure for their top 10 management people and they have to disclose that to the shareholders meeting. The shareholders can pass a—

Senator CAMERON—I am aware of all that stuff; I am asking about executive salaries. What influence do they have on productivity in the banking sector? What benefits does the community receive from the huge executive salaries that are paid to individuals? Over the years ordinary workers have been analysed upside down. Why does Treasury not analyse what benefits the community receives from these outrageous executive salaries?

Mr Murphy—We do look at them. Are you aware of the work that has been done by APRA in setting guidelines on remuneration for executives in financial institutions? They have done work that was commissioned by the Prime Minister. I understand that that work has been put to the G20 seeking it to adopt that worldwide. It is difficult to get into the quantum issue. We have a concern about executive salaries if they drive excessive risk taking and short term-ism. By that I mean your salary is pitched on an incentive plan, as most of these things are. There is a small base core and your remuneration works off achieving certain goals.

Does the drive to achieve those goals lead an individual to engage in excessive risk taking and making imprudent decisions? You could pretty well say that that was one of the root causes of the debacle that the United States and United Kingdom systems are in. I agree with you there. Referring to salaries, these things have to be disclosed.

CHAIR—Senator Cameron, I know that this is interesting, and you have made a connection with our terms of reference, but I think we have been wandering far and wide.

Senator CAMERON—I am happy to pursue another issue. In my opinion I only ask questions that are consistent with our terms of reference. You said that there were hundreds of products in the banking industry. I notice that some of those products have a little asterisk on them when they are advertised. Does Treasury believe that the product disclosure is sufficient to prevent information asymmetry for consumers in the banking industry?

Mr Murphy—Under the consumer protection provisions in the Corporations Act there are requirements as to appropriate disclosure. I think the issue is whether consumers take the time to understand the products and possibly the potential risks. I know that Minister Sherry is working to try to improve disclosure documents for financial products. Good work is going on in relation to financial literacy. Maybe in this current shock people are more concerned about what investments they are making and whether they are getting good returns for their money from where they put their banking services. This may lead people to be a bit more aware of these issues and a bit more careful about what product they choose. I think the information is there but I wonder whether people really get onto it.

Senator CAMERON—I have one last question relating to the global financial crisis and the implications it might have for competition or more mergers. Are there any lessons to be learned from Japan when de-leveraging took place over many years? What happened to competition? What happened to the number of banks in Japan? Are there any lessons to be learned from the Great Depression? You know where I am coming from. There are a lot of lessons to be learned.

Mr Murphy—A lot of lessons can be learned from the way in which Japan managed their financial services over the past 10 years. Sadly, those lessons are things that you do not want to do. They have had major problems. Referring to the Great Depression, that is what people look back to. Ben Bernanke made his reputation as an academic from his work on understanding the Great Depression. However, I do not think we have reached that stage. We are in a global financial crisis, which is nowhere near the depth or the severity of the Great Depression.

Senator CAMERON—I am not postulating; I am simply asking.

Mr Murphy—A lot of analyses have been done. Going back to Japan, they have had lots of problems with their financial services sector.

Senator CAMERON—Thank you.

CHAIR—I thank Treasury representatives for coming in this evening.

Committee adjourned at 8.59 pm