
COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

# SENATE

## ECONOMICS REFERENCES COMMITTEE

**Reference: Aspects of bank mergers**

MONDAY, 10 AUGUST 2009

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**SENATE STANDING COMMITTEE ON**

**ECONOMICS**

**Monday, 10 August 2009**

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

**Participating members:** Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Farrell, Feeney, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, 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 Eggleston, Hurley, Joyce, Pratt, Williams and Xenophon

**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**

**Committee met at 9.03 am**

**CHAIR (Senator Eggleston)**—I declare open this fifth hearing of the inquiry of the Senate Standing Committee on Economics into bank mergers. On 24 November 2008 the Senate referred to us a range of matters relating to bank mergers and the practice of offshoring jobs. The committee is due to report by 17 September 2009.

The inquiry is investigating the economic, social and employment impacts of the recent mergers among Australian banks, with a particular focus on the Westpac and St George merger. The inquiry is also investigating the sufficiency of measures available to enforce any conditions imposed 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 Practices Act in preventing further concentration of the banking sector, with particular reference to the merits of the public benefits test. The inquiry is also investigating the extent to which Australian banks have offshored back 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 may, of course, also be made at any other time.

[9.06 am]

**FREEMAN, Ms Elissa, Senior Policy Officer, CHOICE**

**CHAIR**—Welcome. Ms Freeman, would you like to make an opening statement?

**Ms Freeman**—Yes, I would.

**CHAIR**—Thank you.

**Ms Freeman**—First, let me thank you for the opportunity to both make a submission to the inquiry into aspects of bank mergers and also to appear at today's hearing. Last year two major bank mergers were approved by the Australian Competition and Consumer Commission. The combined impacts of both these mergers and the global financial crisis have greatly altered the structure of Australia's banking market. As a result of these mergers that were approved last year, the Westpac group and the Commonwealth bank group now enjoy a phenomenal 56 per cent share of the household bank deposit market. Together, they account for 56 per cent of owner occupied loans and 51 per cent of credit card debts held by all banks.

The two have emerged as behemoths of the bank market. We have also moved to a lending market which is completely dominated by the banks. Since the two mergers were approved, the global financial crisis has continued to strengthen the dominance of banks in the home lending market.

Banks now write 90 per cent of new home loans compared to around 70 per cent in the period immediately prior to the crisis. CHOICE was a focal opponent to the two mergers that took place in 2008. At the time we argued that the respective mergers would substantially reduce competition. In our submission to this inquiry we propose a number of law and policy reforms that we believe will ensure that future considerations of bank mergers are more robust, transparent and accountable to the users of banking services. Firstly, we believe the merger review process needs improving. We believe that the ACCC should do more to protect and promote the public interest in its informal authorisation process. Specifically, we believe that submissions made to the ACCC should be published subject to an appropriate request for confidentiality.

Senators, any members of the public may view the terms of reference for this committee on the website of the Parliament of Australia. There they can find 19 submissions were made to this very inquiry—none confidential—and presenting the views of diverse stakeholders. We believe that such information should be available to the public regarding the ACCC's merger reviews.

We also believe that any primary research undertaken by the ACCC during the course of its investigations and subsequently used to inform its decision to allow or reject a merger should also be available to the public. During the Westpac and St George merger, for example, the ACCC undertook a customer survey but to date has refused to publish the results of the survey, despite using the survey results to inform its decision to allow the merger to proceed.

Moving on, we also think that any conditions placed on mergers by the Treasurer should be better enforced. Our submission outlines some of the conditions that were placed on the Westpac merger, including one condition requiring Westpac to work with consumer advocates to minimise community concern and to address concerns as sensitively and as quickly as possible. We believe that the public is entitled to be assured that Westpac is in compliance with its approval conditions.

For this reason, we believe that investigations should be commenced and compliance with merger conditions be reported publicly throughout the period in which they apply. That would be three years in the case of the Westpac merger. We also believe that the penalties for non-compliance with merger conditions as they currently stand are too narrow. Currently, the penalty is limited to the complete revocation of the merger. It is questionable whether the revocation of a merger is an appropriate penalty for failing, for example, to adequately consult consumer advocates and the community.

We believe that the merger revocation penalty is too narrow and, as a consequence, we are not convinced that conditions that are placed on bank mergers are in fact operating to protect the public interest. We believe that a broader range of penalties is needed.

Lastly, the committee has been asked to consider the implications on the community of these recent bank mergers. Over the past year, the competitiveness of the retail banking and lending markets has altered dramatically. In order to transition back to a competitive environment, the sector is likely to require ongoing intervention. We believe it is critical that an annual review of competition in the retail banking and lending markets commence. Such a review would go beyond existing data to establish barriers to competition on the supply and demand sides of the market. It would be used to inform the ACCC should any further mergers arise that it is asked to consider and, should the government introduce new divestiture powers, which we would support—similar to those, for example, in the United States—the information gathered during this process would be critical in highlighting when such powers may in fact be put to use. Thank you. I am happy to take questions.

**CHAIR**—Thank you very much.

**Senator XENOPHON**—Are you saying that there ought to be a formal process and that the ACCC ought to look at bank mergers as a matter of course: that at the moment there is not enough rigour in the process?

**Ms Freeman**—I am saying two separate things, I guess. Firstly, as a matter of course, we should be investigating the level of competition in the banking sector as a whole. That should be taking place regularly. In our submission we outlined the sort of information that is needed in that process.

**Senator XENOPHON**—How regularly?

**Ms Freeman**—I suspect annually is required. The other side is that on occasions the ACCC is asked to consider informal authorisation for bank mergers, as took place in the case of the Westpac and St George and the Commonwealth Bank and Bankwest mergers. In those specific cases I think there is a need for greater scrutiny around the processes that the ACCC uses.

Bank mergers are probably unique in the mergers that the ACCC considers because they have such a direct impact on retail customers and they are a great cause of concern in the community. We would like to see more transparency around the information that is used throughout those merger processes.

**Senator XENOPHON**—You do not think there is that transparency right now?

**Ms Freeman**—At the moment there is no transparency. We are limited to a public competition assessment that may or may not be provided at the end of a merger review process. It is at the discretion of the ACCC whether that statement is released. But our problem is that even when that public competition is released—if it is released—it relies on information to which we do not have access.

For example, in the Westpac and St George merger there were two critical pieces of information that really should be on the public record. One is around the survey of customers that was undertaken, and the other relates to any advice that APRA provided to the ACCC. Both those appear to be critical in the decision that was made, and we see no reason why that information should not be on the public record.

**Senator XENOPHON**—What you are suggesting is that there ought to be, in a sense, a checklist of a greater degree of rigour on the part of the ACCC. That would mean almost a checklist of matters that ought to be gone through, and that there ought to be public input so that organisations such as yours could query or contest some of the submissions put by the bank seeking the merger before the ACCC.

**Ms Freeman**—That is precisely correct. Because none of the information is published prior to the decision being made, or even after the decision being made, there is no way to scrutinise the decision that the ACCC has come to.

**Senator XENOPHON**—And that is something that the ACCC could do, without any legislative change to the Trade Practices Act?

**Ms Freeman**—Correct.

**Senator XENOPHON**—Has the ACCC advised CHOICE as to why they have not gone down that path?

**Ms Freeman**—The ACCC is of the view that it requires this process to be confidential in order to gather the information that it requires to make its decision. We accept that there will be certain commercial-in-confidence information that parties and stakeholders choose to make available to the ACCC. Again, we see that as being dealt with by the ACCC by putting in place appropriate confidentiality measures. The only explanation we have had from the ACCC is that they need to maintain the utmost confidentiality in order to proceed with this process.

**Senator XENOPHON**—Could CHOICE provide a list? You have outlined what you think would be an optimal way of dealing with a bank merger through the role of the ACCC. Could you provide in due course details of the sorts of things and be more explicit about the sorts of

things that you think ought to happen as well as the safeguards relating to commercial in confidence.

**Ms Freeman**—Certainly. I am happy to do that, I guess mainly because the processes are very well established. I use this committee as an example. The Parliament of Australia, the ACCC and other processes use these sorts of processes to ensure that they can protect sensitive and commercial information and at the same time maximise public transparency. I am happy to take that question on notice and provide further information.

**Senator XENOPHON**—I would find that very useful. Do you think that the Trade Practices Act is strong enough in its current form? Do you think there is a case for strengthening parts of the Trade Practices Act, in particular, in relation to the merger provisions?

**Ms Freeman**—Yes.

**Senator XENOPHON**—Do you have any views on that? Does CHOICE have any particular views about whether the act in its current form is adequate, in particular, section 50?

**Ms Freeman**—I will answer that question in two ways—firstly, by reflecting on the process that we have been through with these two mergers, and then, secondly, through a more academic approach. Going through these two merger reviews, the law as it stands sounds very good but the usefulness of it comes down to the practical application of the law by the ACCC.

The ACCC holds very detailed guidelines about how it applies those laws. The problem is that we have moved away from a prescriptive approach to mergers to one that gives the ACCC a lot of scope to determine how it will approach mergers. It used to be the case that we had very clear-cut measures. For example, a 75 per cent market share was a particular trigger. We have now moved away from that. The boundaries are a lot more blurred. It is difficult to engage with the process where essentially the ACCC decides wholly the way that it will interpret the law and apply it. It makes it very difficult to engage when you do not have the information that the ACCC has and they are essentially deciding as they go how they will apply the law as it stands.

I think particularly in the Commonwealth Bank and Bankwest merger there were some big question marks about how the ACCC applied one particular aspect of the test which is a significant competitor—the idea that a significant competitor would be removed from the marketplace. We would have appreciated the opportunity, I think, to challenge the ACCC in the way that it was applying the law in that particular case. However, we were not given that opportunity.

As the law stands it is difficult to engage with. Could it be better? Yes, I think it could be better. Of course, this is much broader law reform that you are talking about. The Trade Practices Act, as it stands at the moment, is broadly in line with pretty much the rest of the world and how the rest of the world approaches these sorts of mergers. My concern is that, as I said, it is difficult to engage with. There are no concrete measures that can be relied on to know the point at which you substantially lessen competition.

Something like creeping acquisition laws will be very useful to accompany this law. We certainly are keen to have those come in. They provide a different approach to looking at a

merger. The substantially lessened competition test is a very steep test to meet. Things like creeping acquisition laws are needed to provide a solution where you are not necessarily substantially lessening competition but nevertheless are lessening competition in a particular market.

**Senator XENOPHON**—I have two more questions if I may. It is a case of the ACCC pushing the envelope to see what it can do. In the absence of the ACCC doing that, you say there may be a need for some law reform to require the ACCC to go through a process that is more transparent and robust from your point of view?

**Ms Freeman**—Yes that is correct.

**Senator XENOPHON**—Would you say that the ACCC, in the way it has approached bank mergers recently, has let down Australian consumers from the perspective of CHOICE?

**Ms Freeman**—Bank mergers were deeply unpopular in the community. A lot of people made their views known to the ACCC, but there was no response from the ACCC to those concerns. It is for that reason that I believe the ACCC has let down the Australian community.

**Senator XENOPHON**—Finally, referring to the bank guarantees and the deposit guarantees announced by the government in response to the global financial crisis at the end of last year, some commentators have suggested that it has consolidated the power of the big four banks, in particular, to the expense of the smaller regional banks and non-bank financial institutions. Do you see that as a factor in increasing the pressure for mergers? Will it mean that the big guys will get bigger at the expense of the smaller operators as a consequence of the way in which the bank deposit guarantee is played out?

**Ms Freeman**—Yes. I think there is no doubt that the bank deposit guarantee has significantly improved the position of the dominant players in the marketplace. That has come at a time when there have already been major mergers, and market conditions are aligning to benefit those very same players. There is no doubt in our view that the nature of competition in the banking market has changed substantially.

It is for that reason that we propose an annual review of competition. There will be further measures that will be required in this market in order to transition back to a competitive market. We will get there eventually. But one issue that will need to be looked at in the context of that transition is the revised bank guarantee as it stands after the current three-year period. We certainly hope that it will be restructured in a way that results in a more equal playing field among the banking community.

**Senator XENOPHON**—Thank you.

**CHAIR**—I will ask a question and then pass over to Senator Hurley or Senator Pratt. You have made quite a strong case for a different set of laws or practices under which the ACCC can operate. We have this concentration now of banks, which is certainly not good for consumers. But a question arises about how new banks could begin to develop in Australia.

We have seen building societies taken over by banks; we have seen various other kinds of credit unions taken over; and it now appears to be very difficult for me to hope for new banks to arise under the existing structure of competitive laws. What would be your comment on the prospect for the development of new banks in Australia under existing law?

**Ms Freeman**—One of the greatest challenges I see in the banking market is the structural barriers to the customers engaged in moving between banks. I know that this is something the parliament has considered in the past.

One of the concerns that we have relates to the ease with which customers can switch between banks. I see this as a structural barrier within the banking sector and a main reason why we may not see new banks coming into this market because there is such stickiness. At the moment it is far too difficult to move between banks, despite the fact that some limited practices have been put in place. So from the consumers' side that is certainly where I see a barrier to new entrants coming into the market.

All the policies, such as the bank guarantee—all these policies that really create a better environment for the biggest players—will always be problematic. I think with the Bankwest merger we also saw this idea that new competitors that are successful, that challenge the big end of town, end up becoming a target themselves. With such dominance concentrated at that level there is a very great risk that we will not see new players coming into that market.

This idea that we systematically review the structural barriers to banks coming in, and to existing banks even, and credit unions and building societies building up their customer base, it is important that we look at that level. Again, hopefully, this idea of an annual review of competition can tease out what those structural barriers are at both the supply and demand level.

**CHAIR**—Thank you very much. There are quite heavy penalties to be paid when people seek to shift banks. Obviously that is an area that needs to be addressed. Peter Costello used to tell people that if their bank manager would not give them a loan on reasonable terms to tell him that they were leaving the bank, and take their business elsewhere. But that was an expensive thing to do. But it certainly would enable or empower the customers of the banks if in fact there were no such heavy penalties.

**Senator HURLEY**—As Senator Eggleston said, and as you said earlier, the concentration of home loans towards the big four banks has increased. But that is not so much due to any government intervention or merger law as it is to the global economic circumstances. A lot of that has been due partly to the bank guarantee but also partly due to the fact that a lot of the smaller players are less viable and are not able to be competitive in the loan market.

You are suggesting a number of ways of dealing with mergers. I am wondering whether those are framed in light of a situation which hopefully is relatively short term. In fact we do not want to put so much regulation around the sector so that when banks are able to recover and new players could come in, they might be deterred.

**Ms Freeman**—The sorts of changes that I am talking about in the merger review process are really aimed at the ACCC and the processes of the ACCC, and they are about improving the transparency there. I do not think any excessive regulatory burden is placed on banks that are

considering mergers. It is a big process to go through, obviously, if you are undertaking a merger.

I think that the sorts of measures I am talking about are fairly marginal in the context of what banks go through when they are looking at mergers. In that area I am not too concerned about the excessive burden that may arise. I simply think it is about having a better process from the ACCC when it considers all mergers in fact, and not just bank mergers. When it comes to conditions that are placed on mergers, again I think a condition that is placed on a merger is a very serious matter. It does not need to be there but it is there in order to protect some aspect of the public interest.

If it is to be effective in any way we need to know that it is appropriately enforced. If there is no need for such conditions being placed, they will not be. Again, it relies on the particular environment of the merger that is being considered. Again, if there is a need to put such a condition on a merger, I do not see that as an excessive burden on the business that is facing the merger. Obviously the banks have their own commercial priorities in pursuing a merger. I think it is fair that the community has its interests protected as well.

Referring to ongoing monitoring, again I do not think that is any excessive your burden on banks. Banks are subject to a fair degree of information gathering from the Reserve Bank of Australia. I have some sympathy for them because of the amount of information they are required to deliver to the banks. But really, I think that making that information available to the public and analysing that is about getting better and more effective regulatory processes. Recently we have seen some great examples of how information in the public can drive more competitive market dynamics with recent moves by banks to get rid of penalty fees. I think that is largely aligned to the fact that this very committee recommended that the Reserve Bank of Australia collect information about the precise level of penalty fees. It was collected by the bank.

Information of itself can be very powerful—in fact, driving competition and levelling the playing field. I hear what you are saying in the sense that we want to ensure we are maximising competition, but I do not think that any of the measures that we propose will constrain competition.

**Senator HURLEY**—Referring to that annual review, it is not only the Reserve Bank that gets a lot of information from the banks; it is also APRA. To add another government body seeking out information annually about banks is quite a large step. You might have an annual review by the ACCC of competition in the banking sector, but what will you then do with that information?

**Ms Freeman**—We see two uses for that information. The first is to inform any decisions that the government may take about regulatory or non-market interventions to improve the competitiveness of the market. The sort of information that would be gathered would be very useful, for example, in highlighting potential flaws in the bank deposit guarantee.

**Senator HURLEY**—But what information would the ACCC gather that is not already available from APRA or the Reserve Bank?

**Ms Freeman**—One piece of information that is missing in Australia is the rates of switching between institutions. No-one gathers that information, so we rely on very outdated data. To be

honest, I do not accept the validity of the sorts of numbers that are thrown around. Switching data is simply not available in any precise measure. However, that sort of information is very useful in understanding the ability for new players to enter the market and the success of any measures that are put in place to remove barriers for customers to move between players.

I am also interested in looking at the concentration ratios as they change over time. I did not get to this in your previous question—and I want to come back to this—but the second reason that we see this information as being useful is that on the occasions when the ACCC is asked to consider mergers, there is a very short time frame in which it must gather all the relevant information. As I said, currently that information is not made available publicly. In any case, there is a very short period of time in which the ACCC is legally obliged to make its decision.

Our concern is that basically you have this entire information gathering and evaluation task concentrated down in to a very small period when really the task should be undertaken with a much greater period of time for consideration and more transparency again around that information. Having that information there also enables the ACCC to consider any future bank mergers with the benefit of a longitudinal analysis of competition in the banking sector, in a sense.

**Senator HURLEY**—I do not know whether I agree with that. However, let us go on to the more comprehensive range of divestiture powers to the ACCC. Given the current economic climate, is there a danger that once a merger is approved, and there are these caveats, there that may weaken the banks to the extent that they are less able to compete effectively or that companies will not consider the merger even when one of the parties may be failing or may be a bank in trouble? It is too dangerous for them to go in to a merger situation. It would be cheaper and easier for them to let that smaller bank fail or get in to more trouble, and just poach their customers at that stage.

**Ms Freeman**—Can I clarify whether you are talking about the divestiture powers that are attached to conditions that are placed on mergers?

**Senator HURLEY**—Yes.

**Ms Freeman**—Or general divestiture powers?

**Senator HURLEY**—Attached to the conditions.

**Ms Freeman**—In law, the revocation powers are already attached to the conditions that are applied. Any bank merger that is approved with conditions that are not complied with faces the risk of complete revocation of the merger. Our submission is in fact asking I think a very similar question to the question that you are asking—that is, whether that is an appropriate penalty—although we come at it from a slightly different perspective, which is that it is very unlikely for such a heavy penalty to be applied where the breach may not be a particular any major breach. In fact, we are arguing for a broader range of penalties so that revocation is not the only penalty that is available to the government, should a condition not be breached. Does that answer your question?

**Senator HURLEY**—Yes, except I am wondering what penalties could be applied. If you penalise the merged institutions, that would create market uncertainty and it would mean that the boards of the two companies would consider that too great a risk.

**Ms Freeman**—Sure. It applies only to conditions that are placed by the Treasurer on a merger because the Treasurer is the only person who is able to place such conditions on a bank merger. Of course, the ACCC may place conditions on mergers but we are not talking about those; we are talking about any conditions that the Treasurer may place. As long as the merging firms are compliant, it is a risk that they can manage because there is a great degree of transparency around the conditions that are placed on those mergers. I am not sure what else to add to that.

The sorts of penalties that we envisage would be broadly in line with the penalties that apply under the Trade Practices Act—so a range of civil penalties rather than just the divestiture, the complete revocation of the merger. Again, I think those are the steps that merging parties would probably prefer, in a sense, to complete revocation. We need an approach where the penalty fits the breach. Not all breaches will necessarily require complete revocation; nevertheless, it should carry some penalty if they are not compliant.

**Senator HURLEY**—The last topic refers to competition. I think that is something that we would all like to see, particularly as the economy recovers. I do not think there are huge barriers to new banks entering the market. We have seen a couple of international banks enter recently, occupying various niches and so on. The barrier to entry is not setting up. Referring to both government action and bank action, how could we encourage the increase of competition in the sector?

**Ms Freeman**—I tend to agree with you that the barriers are not necessarily coming into the market. However, once you are in the market you can establish a bank as a competitive and viable entity. I will paraphrase terribly a submission that was made by Bankwest to, I believe, a joint parliamentary committee two years ago.

At that time they said you can establish a competitive edge, a commercial dynamic, but the real challenge is getting customers to switch into your option. When there is a perception out there that all the banks are the same you may as well stick with the bank that you are with at the moment. It is all just too difficult any way.

I think that there are further opportunities for the government to pursue a simpler bank switching arrangement both on the banking side and on the lending side. On the lending side variable rate home loans, for example, still have quite excessive charges attached to switching between players. It makes it very difficult, I think, for a bank to offer better deals and attract customers to a better deal when customers are so heavily penalised for moving between players. In the retail banking side the switching arrangements that have been put in place to date are just far too cumbersome. They relate directly to the ease with which customers can move direct debits and direct credit arrangements from one bank to the next. We believe that this is a very substantial barrier.

Referring to the sorts of measures that could be put in place, the switching package that was put in place in December last year can and should be tweaked. It should be a much simpler process for customers to authorise the transfer of direct debit and credit arrangements. We would

like to see a single-step process, we would like to see a highly automated process, and neither of those have been put in place to date. Those are very simple measures about enhancing the switching package. Other measures that are being talked about are things like account number portability. This starts to get much more technical and much more costly at the same time. However, it is also very new from a customer perspective. I am not sure yet whether the maths stack up for that particular option, but certainly there are very simple measures that can be put in place to get simpler switching in place.

**Senator HURLEY**—Thank you.

**Senator PRATT**—I refer to your statement, Ms Freeman, where it refers to the kinds of rules that apply to bank mergers. You have indicated that the ACCC has too much discretion and that a more transparent set of rules so that everyone knew where they stood, would be better. You referred to four examples for the 75 per cent rule.

**Ms Freeman**—Yes.

**Senator PRATT**—Surely to some extent that is an arbitrary set of rules that will not necessarily suit consumer interests. How do you distinguish between a set of rules that are rules for the sake of having some rules to test against, and those that are in the public interest?

**Ms Freeman**—That is a good question and it really goes to the heart of what is a public interest in considering mergers. The point about the 75 per cent rule is that there was a great deal of transparency in that you knew when a merger reached a critical level, and therefore you knew at which point the ACCC would be looking very carefully and potentially looking to block a merger. At the moment, because of the way in which the rules stand, it is difficult to know when that point has been reached. As a person who is engaging with the process, you really do not know.

I guess there is a sense that the goal posts are constantly shifting. From one bank merger to the next you do not know what information you need to be providing, what evidence you need to be providing, in order to provide accurate and appropriate information to the ACCC. If there were more transparency around the process I do not think this would be such a problem. I think the ACCC is the right body to decide what the critical level is. If it is not prescribed in any definite way, I think there needs to be steps along the way in the ACCC's thinking and process, whereby they articulate for that particular merger how they will approach it and what particular concentration levels they are concerned about. Really that is what is missing at the moment.

Either we need a prescriptive approach—which we used to have—or we need an approach that gives the ACCC some degree of leniency. But even then we need to know how the ACCC is approaching it. I guess I am suggesting the 75 per cent rule—those kinds of prescriptive measures—as my preference because I believe that that establishes quite clearly and up front where all players in the market are coming from. However that is probably unlikely to get up in this point in time. I do not object to the ACCC having those sorts of discretionary powers but I would like to see more information in the public sphere as to how they apply those powers.

**Senator PRATT**—So it can be done less prescriptively in the public interest, provided there is some kind of available transparent process?

**Ms Freeman**—Absolutely. It can be done both ways in the public interest but it needs to be transparent.

**CHAIR**—Thank you to the representative from CHOICE; it is always good to hear from you.

**Ms Freeman**—Thank you, Chair.

[9.46 am]

**DEGOTARDI, Mr Mark, Head of Public Affairs, Abacus Australian Mutuals**

**LAWLER, Mr Luke, Senior Adviser, Policy and Public Affairs, Abacus Australian Mutuals**

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

**Mr Degotardi**—Yes, thank you, Chair. Thank you also for the opportunity to appear before you today. Abacus represents the mutual banking sector—that is, credit unions and mutual building societies. Credit unions and mutual building societies are authorised deposit-taking institutions, as are banks, and we are regulated under the Banking Act by the Australian Prudential Regulation Authority. Our sector holds around 12 per cent of the household deposits market, ranking with, or just ahead of ANZ, NAB and behind CBA, Bankwest, and Westpac and St George. Our sector's share of the home loan market is around 6.5 per cent to seven per cent.

The particular aspect of your inquiry with which we are most engaged is the impact of mergers on consumer choice. Our member ADIs are entirely consumer focused. Our member ADIs do not have external shareholders; their customers are their owners, so we do not seek to maximise our profits to push up the share price. Our undivided focus is on our members and it is reflected in customer satisfaction ratings for credit unions and building societies that are consistently well ahead of the ratings of major banks.

Recently we also instituted a new mutual banking code of practice. Some of the key parts of that mutual banking code of practice include fair and ethical dealings with our customers, a focus on our members, clear information about our products and services, responsible lending, and high customer service and standards. Credit unions and building societies strongly support competition and consumer choice in the market but there is no doubt that consumer choice is being squeezed.

Major banks have taken over two of the large regional banks and there is continuing speculation about the future of some other regional banks. Non-ADI lenders have exited the market due to a loss of access to whole sale funding and securitisation markets remain dislocated, to use the RBA's description. Only mutual ADIs and a few remaining regional banks compete with the major banks across the full range of consumer banking products and services, such as transaction accounts, deposits, home and personal loans, debit and credit cards, and branch and ATM networks.

We note in our submission to this inquiry that the House of Representatives Standing Committee on Economics commented in a report last year that the big four banks 'aggressively compete with other players in the market' but 'there is some uncertainty as to whether the big four are actively competing with each other'. Recently, the chairman of the Australian Competition and Consumer Commission, Mr Graeme Samuel, said that the ACCC is 'becoming increasingly concerned as the banking system is becoming less and less competitive and that will ultimately reflect itself in costs to consumers in terms of interest rates, marginal loans and deposits'. Indeed, last week, the former chief executive of Westpac, David Morgan, said in a

newspaper column that we have not yet seen the full impact of the new found pricing power of the major banks.

According to David Morgan, there has been a significant structural shift that augurs well for major bank profitability. In our view, competition and consumer choice in the banking market is under grave threat. Given this background we see an urgent need to reform the anti-competitive fee structure applying to the government's guarantee of large deposits and wholesale funding. To be clear, we support the government guarantee of deposits for up to $1 million. It is the fee structure on the wholesale side of funding that we think should be amended. Currently, our members face a fee of 150 basis points to access this guarantee while a major bank's fee is 70 basis points. This fee structure is punitive for smaller lenders such as us. Only one of our 126 members has raised government guaranteed wholesale funding, while each of the major banks has raised tens of billions of dollars in government guaranteed wholesale funding. When this legislation implementing the scheme was debated in Parliament, the government said, 'This is not a measure for the big end of town, for the big four banks; this is a measure for all banks, credit unions and building societies, and it is a measure for the Australian economy and society as a whole.' We support the government guarantee but this scheme was not meant to give a massive competition boost to the major four banks. KPMG, the accounting firm recently commented that the fee structure has 'clearly placed the building societies, credit unions and regions at a comparative disadvantage to the major four banks and that this is compounded by the higher credit spread demanded by the market for funding smaller institutions.' Abacus recommends consideration of policy measures to respond to the serious threat now posed to competition and choice. We recommend removing anti-competitive aspects of the government's fee arrangements for the guarantee of large deposits and wholesale funding and we also think that further action needs to be taken to revise securitisation markets and encourage investors back into the market for high-quality residential mortgage-backed securities. We would be very pleased to take the committee's questions.

**Senator XENOPHON**—Thank you for your submission. You are saying that the consequence of the bank deposit guarantee has been not only to consolidate the power of the big four. Has it made it easier for them to take over smaller banks, and has it ultimately led to less consumer choice as an unintended consequence of the guarantee?

**Mr Degotardi**—I think I would probably characterise that in a slightly different way. We certainly think that the government's action in implementing the guarantee at the time was a welcome measure for all ADIs and a sound one for our economy. There is no question about it from our point of view. I would not say that deposit guarantee itself has led to the consolidation by the major banks. It is clear that from the time of October last year to now, and as a result of the economic pressures, there has certainly been consolidation in the market.

We are saying that if you want true consumer choice more needs to be done to encourage competition. As this committee has heard previously, the major banks are writing the vast majority of the loans out there in the market. They have consolidated and grown their market share of deposits. We are saying that more needs to be done now to stimulate competition. As we have said in our submission, one of those things is to reduce the competitive barriers of the wholesale funding guarantee. But over and above that we think more needs to be done to stimulate competition. A question that has been asked previously is whether enough is being done to encourage new banks to enter into the market. I guess that my reply to that is I am not

sure whether we need a whole bunch of new institutions—there are 127 credit unions and mutual building societies out there, ready and willing to take on that competitive task.

**Senator XENOPHON**—On the issue of credit unions you may have heard evidence from Ms Freeman from CHOICE, who said that effectively there ought to be a requirement on the ACCC to have a checklist, if you like, of matters to consider before a merger and that there should be a more open and robust process with respect to the ACCC considering mergers. Do you support the general thrust of that approach?

**Mr Degotardi**—I think that is a sound idea. We would certainly like a road map so that people know what needs to take place before a merger occurs. Referring to the transparency of the decision making round that process, we would absolutely support that.

**Senator XENOPHON**—Further to that, do you think the government should be more careful when a proving mergers between credit unions? Do you think there is a risk that there will be less consumer choice if the level of mergers or the rate of mergers continues among credit unions?

**Mr Degotardi**—Senator, you are correct; there have been mergers between credit unions. Clearly, they are not quite of the scale of the merger between Westpac and St George, for the sake of the argument.

**Senator XENOPHON**—No.

**Mr Degotardi**—Our institutions range from $10 million in assets to about $7 billion in assets. We would be happy to subject ourselves to the same set of principles as would apply to other mergers—clearly, yes. When a merger between two credit unions affects consumers, we should be able to meet the same tests that others are prepared to meet.

**Senator HURLEY**—Continuing on those lines, the ACCC was also talking about doing an annual review of competition in the banking sector, which I take it includes your sector. Your submission talks about the level of regulation. Would you regard that as an unnecessary additional imposition, or do you see some benefits from having an annual review conducted by the ACCC?

**Mr Degotardi**—Thank you, Senator, for the question. I will not sit here and be an advocate for further regulation of the ADI sector. Before embarking on any sort of additional review process you have to ask yourself what you hope to get out of that process. Already, credit unions, building societies and banks provide an enormous range of information to our regulators—APRA and ASIC being the two main regulators and also the RBA.

I would have thought that much of the information that might be sought by such an annual review process is already available. If indeed the process is about an institution being responsible for considering the question of competition while using information that is already held by those regulators, that may well be a worthwhile process. Setting up individual recording and other inquiry processes, I think you would have to be clear about the outcomes that you were trying to achieve before you embark on something that on the face of it appears to be quite costly.

**Senator HURLEY**—Let us talk about the outcomes. I am interested in what any outcome would be in increasing competition. I am not sure that having an annual review would contribute to that in any great way. Let us talk about increasing competition. Your member organisation generally has lower fees than the big four banks anyway, so there is that incentive for customers to go. Do you think that the key is that switching? It is difficult to switch accounts.

**Mr Degotardi**—Referring to the switching, I think you need to break that down a bit. In some products there is enormous switching. Credit cards are an example of a product where consumers freely and happily switch all the time. There is more stickiness around some of the products that people use in financial institutions that are critical to their daily lives—transaction accounts with direct debits and credits, for instance, and home loans are also very sticky products in that sense.

One of the things that institutions do to make customers stick to their institutions around home loans is to have high exit fees. I am happy to say that our industry, on average, has the lowest exit fees for mortgages across the market. The account switching proposals that were put in last year were an interesting start. There is no question in my mind that if account switching were to be easier between financial institutions, we would be the major beneficiaries of that.

We have higher customer satisfaction ratings; we have lower fees on average, lower interest rates on our home loans; and we have higher deposit rates. The conditions are there for consumers to be able to see our institution and to make a better choice, obviously, in our view. When you go into the account switching world you see some of the things that have been put out there, such as account number portability. It sounds like a terrific idea but it is highly technical and highly expensive to implement. At the outset I am not sure whether we would be highly supportive of that.

There are some other things that apply to account switching, which is an automated process. We would be interested in pursuing consideration of that view, but I would have to say to you that banking systems in this country are not terribly adept necessarily at being identical. They are not necessarily talking to each other with the same set of information. It was categorised by the former witness as being a simple process. I think it is a little more than simple. That is not to say that it should not necessarily be considered, but we should bear in mind the costs associated with that. In some ways we are in the ironic situation of being quite supportive of moves to get customers to move institutions, but without being necessarily able to access the funding to make that happen.

**Senator HURLEY**—Funding in relation to what?

**Mr Degotardi**—The technological costs and the investment in making a switching back.

**Senator HURLEY**—That is a serious consideration, is it not?

**Mr Degotardi**—Yes.

**Senator HURLEY**—There is no doubt that money would have to be spent on probably both hardware and software to achieve that.

**Mr Degotardi**—Yes, that is absolutely correct.

**Senator HURLEY**—It is a difficult time to start requiring that. I refer again to competition. As I was saying earlier, the barriers to entry are not high. A large number of financial institutions out there of various sorts are operating. In a sense, the consumer does have quite substantial choice. What do you think is the main reason—for example, in the home loan market—that the big four banks now have such a high proportion of the home loan Is it primarily that people are concerned about safety and security, or is it just the visibility of the banks? What is your view on that?

**Mr Degotardi**—I guess I would characterise it as a number of those things. People make choices about their home loans for all sorts of reasons. Perhaps they go to the bank that their parents used, or perhaps they go to the bank that was favoured by the broker that they happened to use. There are a whole range of reasons to categorise that. The visibility of the major four banks is one category of that.

We believe that more can and should be done by our prudential regulator to promote the concept of ADIs and the way in which they are regulated. I think there is a disparity in the way in which even seasoned commentators talk about ADIs. I am sure you are aware that credit unions and building societies meet exactly the same regulatory standards as the banks. So the question of safety and security often bemuses us.

Our capital levels are higher; our liquidity levels are higher; our loan book is more conservative; our arrears are lower. All those things would suggest that when it comes to a measure of safety and security we are at least competitive, if not more than competitive. There is a perception within the market that the major four have an advantage over the other players. Ironically, in some respects, when you take a loan from someone, in fact it is the institution that bears the risk and not you. So safety and security should not play any part in it at all.

**Mr Lawler**—Could I just add the so-called flight to quality you might expect, as Mark alluded to, in the area of your savings and investments. It seems we need a flight to quality on the loan side. Part of that might have been driven by the fact that those lenders who were competing before the global financial crisis hit, and securitisation markets stopped functioning were funded off those markets. Suddenly they were unable to provide competitively priced loans.

Some borrowers were left a bit exposed if their loan was with a lender who could not lower the rate. That factor was also playing into the mix. There is no doubt that the major banks have such enormous brand power. The way the public debate has been characterised throughout this global financial crisis has really supported the position of the major banks. The story has been about the security of the major banks, their high credit ratings, which are among the top 10 banks in the world, et cetera, which is all true. However, all that drives part of this anti-competitive problem that we are grappling with at the moment.

**Senator HURLEY**—Is that not up to the market? Surely it is up to you and your members to advertise or market your quality better?

**Mr Degotardi**—We are certainly not suggesting that the government needs to do our branding or our advertising for us. One of the factors that goes behind that, as Luke mentioned, is that second tier of the market has changed quite substantially in home lending. The non-ADI lenders disappeared, as is well known. The problem for us is that we want to pursue a growth strategy. We want to be competitive and occupy that second tier of the market. But for us to do so our prudential regulator rightly says to us, 'If you want to pursue a growth strategy you need to show me how you are funding that growth strategy.'

At the moment, with the single source of funding being retail deposits, with no securitisation or no ongoing wholesale market that we can access on a competitive basis, we cannot show that prudential regulator that we have that alternative source of funding to the extent that it is required to fill that competitive space. We have always accessed retail deposits as a major source of our funding and we have used wholesale funding as a liquidity tool or a capital management tool. If we could again access those wholesale markets through RMBS, in a better or more dependable way, we would be a much more competitive force to fill that second tier space.

**Senator HURLEY**—One thing the government can do there is work on RMBS and improve the situation.

**Mr Degotardi**—RMBS is one option that we think should be on the table, but also other schemes that would allow better access to wholesale funding of any form. That is certainly something we would encourage the government to look at.

**Senator HURLEY**—How would the government improve your access to wholesale funding?

**Mr Degotardi**—One way would be to change the fee we pay for it to begin with.

**Mr Lawler**—As Mark said in his opening statement, only one of our members has accessed government guaranteed wholesale funding—only one of 126 or 127.

**Senator HURLEY**—Because of the higher fee rate. Should the government provide guaranteed funding at a lower rate? I think you said previously that the market requires a greater spread from your organisation. Should the government take greater risk than the market is prepared to take?

**Mr Degotardi**—In answer to that question we would say that the government is not taking greater risk. If you look at our balance sheets you will find that they are a much better bet than some of the major banks.

**Senator HURLEY**—So why does the market not recognise that?

**Mr Degotardi**—The market runs on a different set of principles. We are ADIs with an APRA regulator. We have strong capital, strong liquidity, and very low arrears rates. In our view, the risk to the government is virtually nil. The way it is reflected at the moment is that there is an 80 basis point differential between us and the major banks, particularly in an interest rate environment that has been going south, so it is very low.

When that interest rate differential was brought in, I think the prevailing market rate, the cash rate, was about seven per cent and now it is three per cent. Even in relative terms that differential has got higher and higher over time. Again, we think that there needs to be a serious look at changing that.

**Senator PRATT**—Following the same line of questioning, I refer to securities funding and the level of regulation to which you are subject. A diversity of voices are asking for changes to the banking guarantee, yet as institutional players you are in different positions. For example, you have your deposit-taking mortgage securities asking for changes but they are not subject to the same level of regulation that you are. How does that influence decisions about what kinds of changes should be made in relation to whether it is pulled back, withdrawn entirely, made equal for everybody? Do you have a position on that question?

**Mr Degotardi**—Yes. In part it goes back to the question that Senator Hurley asked a minute ago. There is a fundamental difference. Of course, we are aware of the different voices in the deposit guarantee and wholesale funding guarantee debate. But the government needs to assess its risk. It is right that the government considers what risk it is taking on when it provides a guarantee—absolutely no question about that.

The government is very fortunate in this regard to have a gatekeeper who is affectionately known as the Australian Prudential Regulation Authority, to which we are fully subject. We apply the same capital and liquidly standards, and the same corporate governance standards, the same risk management standards as the major banks. In that sense, that is the risk ameliorating device, if you want to call it that, on which the government can rely when it provides a guarantee to ADIs.

In relation to moving that guarantee elsewhere, there is probably some argument for other APRA regulator institutions, which currently are not covered by the guarantee, at least to be considered for some of that guarantee if the guarantee were to be broadened in any way. If you are talking about moving that guarantee into non-APRA regulated institutions, or completely unregulated institutions, it is a matter for government whether it wants to take on that risk. But as an institution representing lenders, I guess we probably would not.

**Senator PRATT**—This committee is inquiring into aspects of bank mergers. A lot of the discussion has been around the coalescence of the bank merger issue alongside other changes in the marketplace. How do we get the bank merger question to pay more attention to these other kinds of trends, some of which have been quite difficult to foresee because they have all happened at the same time—sometimes because we have had a global financial crisis? On one hand that has meant that there has been more competition and pressure on banks creating the mergers at the same time. We have therefore had to guarantee deposits. How do we unpack those issues and look at future trends with bank mergers so that we can take account of what has happened historically and take account of the impact of the deposit guarantee on competition so that we can start to integrate those problems into the questions before us?

**Mr Degotardi**—If you are looking at the impact of bank mergers and what you can do in response to that, there are two things that you need to look at. Obviously, the committee is looking at them. The first of those is the regulation of bank mergers themselves. Other much more venerable commentators than I will pass judgment on the efficacy of the law in that regard.

Once you get the regulation and the transparency of the bank merger legislation right, on the other side the best mechanism you have to combat consumer choice is to foster competition within that market.

If you want the major players in any market to behave in a consumer friendly way, then you make sure that consumers have other choices. That is the thrust of our argument here. There are many far more qualified people who will speak about the law, but we want to ensure it is clear to this committee and to others that fostering competition in that space is critical for consumers.

**Senator PRATT**—The question relates not just to bank mergers but also to the policy and legal framework to support competition as a whole. Is that strong enough? To some extent, the stronger that is, the less scrutiny you need of the mergers.

**Mr Degotardi**—I presume that there will clearly always be a scrutiny on mergers, and rightly so. If you have strong competition the impact of a merger, because of its nature, is lessened. At the moment it is well known to this committee that there are four dominant players in this market and some would argue two very dominant players among those four. Clearly, that is a challenge for consumers generally. At the outset, in October when the government made the decision to implement a guarantee, I do not think anyone could rightly criticise it for not for seeing what would happen in the competitive space, and certainly not from our point of view.

We did not see it and this is not an outcome that we would have predicted. However, now that it is here, it is time to say, 'Given that this have occurred, we have created stability, we have done the right thing for our economy and the banking system is looking in pretty good shape.' But what is the outcome for consumers that we want from here? What will we do to ensure that consumers continue to have choice in the environment that faces us now.

**Senator PRATT**—Thank you.

**CHAIR**—I would like to ask you the same question that I asked CHOICE—that is, about the prospect of other banks to develop in the current financial situation, given the power of the major banks and existing competition laws. In effect, are we stuck with the four banks or will we see how this develops from building societies and credit unions, of which you say there are 127?

**Mr Degotardi**—I guess our initial starting point is that our institutions are there, ready, established, and willing to take on that competitive role, but there are those barriers that we have already discussed. It is not easy to open an ADI in Australia, nor should it be. ADIs take people's money and need to protect it, and it is right that they are regulated appropriately.

As the current market stands, to begin a new institution in this country would be very difficult. Without an adequate source to wholesale funding you would have to rely on the deposit market, and the deposit market is very competitive indeed. I think the prospect of a new bank starting in the foreseeable future from scratch is unlikely.

Having said that, I would say that given that that is the structure, that is why we need to look more at the competition that exists. What can we do to ensure that there is a more even playing field in some respects. But also we need to create some opportunities for those existing players to take on those four major banks.

**CHAIR**—I think Bankwest told us that they retain an independent operating structure within their takeover. How long would you expect them to remain as a functionally independent unit running their own affairs? Could you comment on the implications of a bigger bank taking over a smaller institution and, to some degree, letting it have an independent role in an abstract sense?

**Mr Degotardi**—I guess you will forgive me for being a little loath to comment on the aspects of that particular arrangement, mostly because we do not have the information to adequately answer that. I think there are examples of previous mergers in the banking space where brands have disappeared. St George itself is an amalgam of many other institutions—the Advance Bank, and the United Permanent Building Society before that. None of those brands exists now. So I guess therein would be my answer.

**CHAIR**—That is a trend of history, yes. We thank you for appearing.

**Mr Degotardi**—Thank you for inviting us.

[10.19 am]

**BRODY, Mr Gerard Gavan, Senior Manager, Financial Inclusion, Brotherhood of St Laurence**

**CHAIR**—Welcome, Mr Brody. I invite you to make an opening statement.

**Mr Brody**—The Brotherhood of St Laurence welcomes the opportunity to make a submission to this inquiry and to appear at the hearing. Let me give you a bit of background about us. As a part of our wider efforts to promote social inclusion, the Brotherhood develops and demonstrates financial literacy and asset-building programs for disadvantaged people to address financial exclusion. In partnership with the ANZ bank we have developed Saver Plus, a matched savings and financial education program for people on low incomes, as well as progress loans—an affordable low rate, low repayment small loan program. While these programs have provided access to financial services for many people on low incomes, they are limited in scale. As such, we believe more must be done to ensure that all Australians, in particular, those on low incomes, have access to mainstream, affordable and appropriate financial services.

This inquiry was initiated in late 2008 after public concern over a number of bank mergers, in particular, the merger between the Commonwealth Bank of Australia and Bankwest, and Westpac and St George. There has also been recent speculation about further mergers which suggests that the issue is still alive. The Brotherhood's concern in relation to uncontrolled mergers is primarily that they have the potential to exacerbate financial exclusion through reduced choice and access to banking products and services, in particular, appropriate and fair bank accounts and affordable and safe credit.

Research on financial literacy has shown that six per cent of adults—about 900,000 people—are financially excluded based on product holdings. in addition, over 3 million people—those people in the bottom quintile of income—have an annual income, which means that they are automatically declined for a loan from mainstream lenders. With further concentration of the sector we are concerned that banks increasingly focus on wealthier, more profitable customers and more people will become financially excluded.

Since this inquiry was initiated some areas of the banking industry have taken steps to better service customers. In particular, the NAB has abolished bank penalty fees on all its transactions and savings accounts. As you know, penalty fees are incurred where people over draw their accounts and they are often imposed in relation to periodical direct debits which are encouraged by essential service providers such as energy providers, telcos, and insurers. People on low incomes are more vulnerable to such fees as they tend to have lower balances in their accounts. When an amount is direct debited unexpectedly, that can cause difficulties with fees of $40 or even $50 imposed.

It is not uncommon for our workers to deal with clients who have been charged with many such fees over the period of a month. Westpac and CBA have since followed NAB's lead, reducing penalty fees in a range of their accounts. We strongly welcome these moves and call on other banks and credit unions to follow suit. We also strongly welcome the government's

introduction of legislation to prohibit unfair contract terms. It appears that this legislation, at least in part, has contributed to the banks' decision to remove or reduce penalty fees.

Despite these welcome developments, more needs to be done to ensure that all Australians have access to affordable and appropriate financial services. Many banks have developed basic bank accounts—that is, accounts specifically designed for people with a health care card or pensioner concession card. These accounts are generally fee-free or low in fees, including penalty fees. However, many of our clients are not accessing such accounts. This is because people do not change accounts often and generally remain using a transaction account that they have always had. The banking code of practice requires banks to inform customers about such accounts where they become aware that the customer is receiving Centrelink benefits. Despite this, there is limited data on how many people are accessing such appropriate accounts. I want to touch on three matters on which the committee has called for input.

Firstly, measures to enforce conditions placed on bank mergers. In our submission, we welcome the conditions placed by the Treasurer on the Westpac and St George merger, particularly that which requires the merged entity to continue to provide a comprehensive range of affordable banking products to low-income consumers and to also work with consumer advocates and consumer stakeholders to minimise community concerns about the merger and its impacts on consumers in the community. We are not aware, however, of any measures to monitor and enforce these conditions, at least not in any public way.

We have also not been contacted by Westpac which is concerning, considering it is a condition of the merger for them to consult with the community. As I mention further later, we believe that there should be better and more regular monitoring and public reporting of banks provisions of services, in particular, to people on low incomes.

Secondly, there is the adequacy of section 50 of the Trade Practices Act in preventing further concentration in the banking sector. We believe that there needs to be further segmentation of the market in any assessment of competition. The ACCC only segments the market in to retail banking and business banking in its determinations of competition without considering how the banks are servicing people on low incomes. Being a group that is less profitable, banks are far less likely to compete in an area such as basic low-fee bank accounts or in the availability of fair, safe and affordable credit products. It is necessary for the ACCC to segment the market further in its assessments of competition.

Thirdly, there are the alternative approaches to assessing future mergers. We echo CHOICE's call for an annual report of the retail banking sector which would analyse competition in the sector. We think that any such analysis must consider how the banking sector is servicing people on low incomes. In particular, it could determine the numbers and percentage of eligible consumers accessing basic bank accounts, the availability of fair, appropriate credit for people on low incomes, and the geographic areas in which banks maintain a physical presence. This analysis would tell us whether banks are living up to the promise of appropriately servicing everyone in the community.

I want to mention in particular the availability of credit for people on low incomes because I know that is a contentious issue. It is important that any lending is undertaken responsibly and for that reason we strongly welcome the introduction of new legislation that imposes responsible

lending obligations. We would not want to see more credit being made available where there is an incapacity to pay back the loan. However, people on low incomes can and do pay back credit when it is lent responsibly. Our progress loans program, which provides between $500 and $3,000 to people to purchase essential items, has a defaults rate of less than one per cent, and 90 per cent of our clients have a sole income of Centrelink benefits. Nevertheless, access to this program and other appropriate small lending is limited.

People on low incomes are often forced to access payday loans, store credit cards or lease arrangements which cause and exacerbate financial hardship due to their high costs. A recent inquiry found that payday lending in Victoria is worth between $50 million and $100 million a year—amounts that essentially are being stolen from people who are unable to access more affordable mainstream credit. This demand suggests that people do need access to credit. Low levels of income support mean that people on benefits generally do not have sufficient savings to purchase a new refrigerator if it breaks down, or buy a car to access employment opportunities or take the children to school. The denial of credit can cause hardship, as can its excessive use. It is important for credit to be advanced responsibly, appropriately and affordably.

In conclusion, the Brotherhood has been pleased that the federal government has taken real and active steps to develop a social inclusion agenda in Australia. A social inclusion agenda is about the building of personal capabilities and material resources in order to maximise people's choices of participating in the economic and social mainstream so that they can enjoy a life of dignity. Social inclusion is about the prevention of problems as much as it is about providing crisis and emergency services. A social inclusion agenda is starting to intersect with important policy areas such as education, training and health, but it is missing in the area of financial and consumer policy. What we need is a national financial inclusion strategy that would complement the social inclusion agenda.

Such a strategy would develop policy settings and programs that ensure that all Australians on low incomes have effective access to financial services, including affordable credit insurance; that Australians on low incomes have the opportunity to save and build assets; that through appropriate regulation the financial services sector is required to serve the needs of the whole community, including those regarded as less profitable such as low-income earners; and that vulnerable Australians are given the opportunity to become financially literate—that is, be able to manage their money, make financial decisions, obtain all their rights and entitlements, and access support.

When it comes to banking, financial inclusion is about the banks ensuring that people are accessing basic bank accounts where they are entitled to them. It is about the banks providing appropriate, responsible and affordable small amounts of credit for people on low incomes. It is also about the banks having accessible services to the whole community, including those living in remote and disadvantaged areas. Thank you.

**CHAIR**—Thank you very much.

**Senator XENOPHON**—Mr Brody, thank you for your submission. You mention in your submission an arrangement that you have with the ANZ to provide low interest loans to the disadvantaged. Can you tell the committee a bit more about how it works? What outcomes have

there been in getting people out of the poverty trap, for instance? Do you think there is scope for other banks and financial institutions to offer a similar service?

**Mr Brody**—Sure. The ANZ-Brotherhood program, known as Progress Loans, began in 2006 and it followed a similar pilot that we ran with the Bendigo Bank. The community set the banking part of the Bendigo Bank. The program allows loans for the purchase of essential items but we consider that quite broadly—from household white goods up to vehicles, but it could include travel to visit families or anything a person deems is essential—from $500 to $3,000. The loans have a commercial interest rate; it is not a low interest rate. It is the same rate as a standard ANZ personal loan which is about 13 per cent. But, of course, that is a lot lower than the payday lenders and other options available out there in the market.

The interest rate is fixed to the term of the loan, so the person has an understanding about the amount that will be repaid at each period across the term of the loan, so it is fixed repayments. We time those repayments so that we make sure they come up when the Centrelink benefits go in. So there is an assurance that they will not be subject to penalty fees or things like that. As I said, that program has a defaults rate of less than one per cent. The way it works is that the client contacts the Brotherhood where loans officers work with them to fill in the application form, ensure that the thing they want to purchase is suitable to the loan program, and then the application goes to ANZ, which does a further credit assessment before a loan is drawn down. Probably only fewer than 20 per cent of people who apply through us are able to get a loan. We have assessments such as whether they are in stable housing, whether their bills and rent are up to date and there is also a checking of credit defaults on their credit history. Because of those checks a lower percentage go through for a loan, but by working with our loans officer we are able to help them address financial issues that they are having and perhaps guide them on the right path as to how they can apply and succeed in the future. We have just undertaken an evaluation of the program which is coming out in the next couple of months. That evaluation shows that the program has been effective in helping people on low incomes obtain basic items. There was a high degree of satisfaction with the program.

**Senator XENOPHON**—Do you think that other institutions could do the same?

**Mr Brody**—Yes. I should say that the National Australia Bank has a similar program that operates with the Good Shepherd Youth and Family Service known as Step Up. We would argue that all the banks should have similar programs to ensure that this sort of credit, which we see as appropriate and suitable for people with low incomes, is available more widely. At the moment our program is available only in metropolitan Melbourne, and we have the capacity to do only about 300 loans a year.

**Senator XENOPHON**—Thank you.

**Senator HURLEY**—Talking about those credit loans to low-income earners, you mentioned the ANZ and NAB, which are two of the big four banks. Do you have any view about whether smaller banks do a better job of servicing low-income earners? You also mentioned the Bendigo Bank I think.

**Mr Brody**—We have some experience of some of the small credit unions which have as their mission to serve people on low incomes. They provide appropriate credit to people on low

incomes—but not on a very wide scale—although the other smaller institutions are increasingly having to compete with banks and focus on the more profitable customers. We think that providers across the spectrum of services, from the large institutions to the smaller banks to credit unions, could do a better job in providing these sorts of loans.

**Senator HURLEY**—If there is more competition then financial institutions compete even for lower income earners. That might be a key. On the face of it, it does not seem as if the level of bank mergers has much impact on whether or not low-income earners are serviced well.

**Mr Brody**—We see that some of the institutions are doing some sort of innovative things, such as Bankwest. They are out there in the market offering new sorts of bank accounts that have lower fees. We are concerned that when those sorts of institutions that are willing to take innovative approaches to new products are susceptible to bank mergers, the capacity for them to do that is lessened.

**Senator HURLEY**—I was concerned to hear you talk about low-income customers not taking advantage of those accounts that cater for them with lower fees or no fees. The committee touched on this in an earlier inquiry. I think I am right in saying that at that time the ABA said that the banks were addressing that more and more. It is a serious worry if people are able to access those accounts and they are not. Obviously the banks have to give that advice to customers. Are there any other ways that customers could be encourage to take on those accounts, perhaps through Centrelink advising them when they go on to benefits? Does Centrelink do that?

**Mr Brody**—Our understanding is that they do not do that currently. We think that the banks could take a more active responsibility in migrating eligible customers across to those appropriate accounts. To their credit, currently, if you went into most bank branches and said that you were a person receiving Centrelink benefits, they would advise you about the availability of those products. We have done a bit of work to assess that, and that is the case. But as I said, our concern is that people generally do not go in and ask about basic transaction accounts. They set up a transaction account when they first receive income and it is the same one that they stay with most of their lives.

The banks obviously have data about who in their customer base is receiving Centrelink income. Their income generally is put straight into that bank account and the banks know that. We think that the banks, with that information, could do more active marketing campaigns to those eligible customers to ensure that they are transferred across to appropriate accounts.

**Senator HURLEY**—I want to explore that a bit more. A lot of people get Centrelink payments, and they are not necessarily very low income and not necessarily eligible for those accounts. Would banks be able to identify which of those Centrelink payments are going into customers accounts?

**Mr Brody**—My understanding is that they can. It might depend upon each individual bank and its systems, but the couple to whom I have spoken have identified that they can identify which sorts of Centrelink payments go into accounts, which would help them address that issue.

**Senator HURLEY**—When someone goes in to Centrelink, let us say that he or she has lost his or her job, and he or she goes onto some sort of Newstart benefit or whatever. In those cases Centrelink does not advise them when they are asked which account they want it paid into. Have you thought about that?

**Mr Brody**—Currently they do not, no. And probably more could be done to investigate whether Centrelink could provide more assistance in that way. Centrelink has the financial information service which is available for people, but I think that service is not used as much as it could be by many people, and full advice is not received by everyone about those sorts of accounts. Behavioural studies have shown us that people generally are lazy. It is difficult to change accounts, especially when you have direct debits lined up with different entity providers or telcos.

**Senator HURLEY**—But many people on low incomes do ensure that those things get paid.

**Mr Brody**—That is right. There are a number of steps that someone must take in order to transfer an account. It is not necessarily an easy or simple process.

**Senator HURLEY**—I want to explore your statement about the ACCC segmenting the market a little more when considering mergers. I am not exactly sure how you thought that might work. Could you just go through that again?

**Mr Brody**—Sure. As I explained, in the last couple of assessments that the ACCC has undertaken, they segmented the market into retail banking and business banking and they then undertook various surveys and other sorts of investigations to determine the level of competition. We believe that they could investigate further and look at particular indicators of competition that are particular to people on low incomes, such as the number and percentage of eligible consumers accessing basic bank accounts, and establishing whether the mainstream banks are providing appropriate, fair and affordable credit for people on low incomes.

Our experience is that most banks have a minimum personal loan these days of $5,000 or $7,000, which we would say is far beyond the needs of many people on low incomes. Instead they are told to access their credit card, and that might not be appropriate to their needs. We think that looking at those sorts of indicators, and also the geographic areas in which the banks maintain a physical presence, could provide a better understanding of the way in which those banks are servicing low-income people.

**Senator HURLEY**—I can understand the geographic spread but when assessing whether or not a financial institution should be allowed to merge, would it make a difference in how they dealt with low-income people? Would you not allow a merger if one did not and the other did?

**Mr Brody**—The way the ACCC undertake their assessments is to look at the whole market and to see whether, as a result of that particular merger, there will be a substantial lessening of competition. Our argument is that we should segment the market when determining whether that lessening of competition occurs. So it is not just at the high level of the whole market. People on low incomes, who are often paying a higher amount of their income in financial services costs, should not be disadvantaged by that merger. The competition should be servicing them as well.

**Senator HURLEY**—Thank you.

**Senator PRATT**—I refer to the question of accounts for low-income earners that are suitable, and other financial services, and I want also to refer to the question of competition. How important is the question of competition to whether those services are being provided? It seems to me that banks are avoiding providing many of those services, irrespective of how much or how little competition there is.

**Mr Brody**—We see it as a balance. Competition can play its role, and so can regulation. We should be setting up markets with regulation to ensure that competition has best outcomes for the whole community. You are right; if we left it just to competition, the banks probably might not even service low-income people at all if there were not some protections around the banking code of practice, et cetera. Both play a role.

**Senator PRATT**—You need regulation to create an obligation to provide services. Once that obligation exists then you will have different services available that people can access. In that sense, competition is important to ensure that there is some diversity.

**Mr Brody**—That is right.

**Senator PRATT**—With respect to banking fees and charges, you have explored options relating to Centrelink providing that information. Surely there could be some obligation on the banks to provide information to their customers to say, 'Did you know that you have recently been charged.' Sure, you get a statement to that effect but it is never added up for you and you are never offered an alternative service.

**Mr Brody**—That is right. As explained, the banking code of practice requires banks to inform customers about accounts that they have specifically for people on lower incomes when they become aware that a customer is receiving Centrelink benefits. They wait for the customer to come along and to tell them. We think that the banks should be providing a more wholesome service to encourage people to transfer accounts, recognising that that is a difficult and long-term process to do that.

**Senator PRATT**—If you have been charged an overdrawn fee on your account—I know about that because I got one the other day—I assume there is an obligation on the bank to write to a customer and to say—

**Mr Brody**—Most banks do write to a customer in those circumstances.

**Senator PRATT**—But perhaps in some circumstances they should also be informing them of accounts that might be available that cannot be overdrawn and they might not be subject to such fees.

**Mr Brody**—Yes. We think that that is right. They should probably do more than inform them; they should make the process very easy for them. As I explained, people have direct debit accounts and they have to go to each individual service provider to transfer money. If banks could work with people to make that a simple process to transfer accounts, perhaps competition would better service people in the market.

**Senator PRATT**—It is that complexity of changing everything that has been withdrawn from that specific account, and changing all the account numbers, et cetera, that makes it difficult, does it not?

**Mr Brody**—That is right.

**CHAIR**—Thank you.

**Proceedings suspended from 10.43 am to 11.00 am**

**BUTTSWORTH, Mr Andrew Mark, Head of Government and Industry Affairs, Westpac Banking Corporation**

**COOPER, Mr Bradley John, Group Chief Transformation Officer, Westpac Banking Corporation**

**CHAIR**—Welcome. I am sorry we changed the agenda around a little bit. I hope to accommodate you and get you on your plane. Would you like to make an opening statement?

**Mr Cooper**—I am the Group Chief Transformation Officer for Westpac. Among other things, I am responsible for the St George and Westpac merger and also the implementation of the bank's multi-branding strategy. I thank the committee for the opportunity to appear before you today. I propose to make a short statement covering some current issues and banking generally and then to address more specifically points from the committee's terms of reference. There is no need for me to restate the seismic shifts that have occurred in the global banking landscape in is recent times, particularly since the collapse of Lehman Brothers in September 2008. Suffice to say that in this climate more than ever, strong local banks are essential for a healthy Australian economy.

In this regard Australia has been well served. A glance at the statistics makes clear that at the same time as other advanced economies are suffering effects of financial systems in crisis, Australia has four of only eight AA rated banks remaining in the world. Despite unprecedented funding pressures in global capital markets, we have seen almost a complete pass through to customers of Reserve Bank interest rate cuts. That has resulted in mortgage lending rates that are the lowest in more than a generation.

On the other side of the equation, strong competition for deposits has provided significant savings benefits to customers. Finally, we have been well served by the exemplary performance of our central and prudential regulator. Despite these strengths and, indeed, because of them, there has been a renewed emphasis in the public debate on banking competition.

While I will leave the wider debate about the industry structure to this committee and others, I will highlight just a couple of points. If your measure of competition is prices to consumers then, as I have outlined, historically low mortgage rates, combined with a price war for customer deposits, would suggest that competition is alive and well. If the chosen metric is customer choice of institution then you would note that APRA is still supervising upward of 100 deposit-taking institutions in this country. If bank margins are your proxy for competition then I would point out that while margins have recovered to pre-crisis levels, they are still a long way below the mid-1990s levels. Overall, while it is true that concentration in the banking sector has increased slightly since the onset of the crisis, I would submit that there is no evidence that this has been a negative for Australian bank customers.

Despite all these strengths, it has nonetheless become apparent that we are moving towards a new equilibrium in banking. This new equilibrium is being driven by structural changes in the cost and availability of funding and a new attitude towards risk and reward. It will involve customers saving more and borrowing less. The cost of credit will increase both for individuals

and for businesses. All this raises the question of what the Westpac group is doing to help our customers, shareholders and employees manage this transition.

One of the key frameworks through which we are addressing these challenges is our merger with St George. I know that this is an important area of interest to the committee. It is to this subject that I would now like to turn.

Briefly, the strategic rationale behind the merger was founded on the fact that Westpac and St George had different but complementary business models. Accordingly, we have sought to retain the strengths, expertise and distinctive attributes of each institution. When added to our existing brands, like BT Financial Group and RAMS, this means we are able to present more offers to our customers. As part of the merger approval process, we were asked by the government to meet certain conditions.

I am pleased to say that we have recently reported to the Treasury that we are in full compliance with those conditions, which, among other things, included maintaining branch and ATM numbers, removing foreign ATM fees between entities, keeping separate management teams and retaining a corporate presence in St George's Kogarah location. I would also note in passing that the Westpac Group has recently made some of the most wide-ranging and substantial changes to our fee regime that the banking industry has seen in years, based principally on feedback from our customers. We have reduced exception fees across all consumer and business products to $9.

Importantly, the merger has meant that these new fees will also be available to St George and BankSA customers. Importantly, no customer-facing jobs have been lost through the merger process, employee engagement scores across the group have risen and we are on track to meet our objective of not losing any customers as a consequence of the merger. We also continue to consult widely with a range of stakeholders, including consumer groups, unions and the not-for-profit community sector with what has been generally a very positive response.

In short, while there is still some way to go to fully bed down the merger, we feel that we are making good progress. Importantly, along the way, the transaction has contributed to the safety and stability of the Australian banking sector that I outlined earlier. I would be happy to take your questions.

**Senator HURLEY**—Thank you. I would like, as you might expect, to examine the job aspect of it. One of the conditions was to maximise internal redeployment opportunities available for affected staff, to support external job placement where employee redundancies occur and to ensure that staff affected by the merger have timely access to their full entitlements and Westpac and St George retrenchment arrangements. Can you tell me how you have implemented that requirement?

**Mr Cooper**—Certainly, Senator. Thank you. We can start overall. Our staffing numbers as at 31 March, which was the last reporting, were 37,275 employees. That compares with 36,721 as at 1 December. So you can see what we have had since the merger is actually an increase in staffing numbers since the merger. Primarily, that has been around the increase in the number of customer-facing jobs. So we have actually increased the number of staff that we have in both our Westpac and St George branch networks.

It is true, though, that we have during the early period of the merger looked to consolidate some of our group functions, most notably around our financial, human resources and risk functions. People affected by those consolidations have been offered alternative employment. Where that has been able to be satisfied, we have been able to move those people into the roles; where not, then those people have been offered and received redundancy packages.

We also have quite a number of projects on the way at the moment—as you would imagine we would with the Basel II accreditation requirements that we have, the single ADI projects and so forth. Many of those people affected by the merger are now also working on those projects, too.

**Senator HURLEY**—Okay. Has there been any increase in functions that are performed offshore since the merger?

**Mr Cooper**—No, there has not. I think as the committee would note, we have recently suspended our offshoring program for banking functions. As a consequence of the merger we have not increased our offshoring activities.

**Senator HURLEY**—What is the reason for suspending the offshoring program?

**Mr Cooper**—The decision was taken by our group chief executive, Gail Kelly, and that was with the background of the impact on the Australian economy of increasing unemployment. We have taken a decision while that pressure was on the Australian economy to suspend the offshoring of those roles.

**Senator HURLEY**—Can you tell me a little bit more about what that means? What functions are done offshore?

**Mr Cooper**—We do not have any what we would call 'voice activities' conducted offshore. So we have no call centre activities conducted offshore. We do have some processing jobs conducted offshore; for example, mortgage processing applications and such things. We also have some reconciliation functions done, some back of office functions, and we have some IT programming work and so forth conducted offshore as well.

**Senator HURLEY**—Have you ever had the call centre done offshore?

**Mr Cooper**—No, as I say, call voice—that is, call centre activity—is done locally.

**Senator HURLEY**—So the suspension means that there is a halt on further activities being done offshore?

**Mr Cooper**—It is difficult to be black and white about exactly what is in and out of that. The suspension is that there would be no increase in the amount of offshoring that we are conducting now, particularly around the bank's operations role. Where we still need to do that because of skill shortages and so forth, particularly around our IT functions, then we are still looking to take advantage of that skills set offshore.

**Senator HURLEY**—One of the other conditions with regard to employment is working through the implications for employees as quickly and sensitively as possible in consultation

with employees. I think you have been through that. The Finance Sector Union and other affected stakeholders—have you been meeting with the Finance Sector Union?

**Mr Cooper**—We have had several meetings with the Finance Sector Union. We are currently in consultation with them again. I do not know when the next meeting is scheduled with them. But, certainly, we have enterprise agreements in place with St George and with Westpac. As we move together now into one ADI, we need to contemplate what we are doing with those enterprise agreements. In that respect we are in consultation with the FSU.

**Senator HURLEY**—When was your last meeting with the FSU?

**Mr Buttsworth**—I can speak to that in some detail in relation to meeting with the FSU. Generally, our employee relations area is meeting with them almost weekly, I think. We are about to enter into enterprise negotiations with them. The frequency of meetings has increased. In terms of a meeting specifically with them about the merger and their view of merger, the most recent round of consultation that we have conducted, in accordance with the Treasurer's approval conditions, was to write to a range of key stakeholders, including the FSU and the ACTU, seeking their particular feedback on the merger generally. We have not yet received a reply from the FSU on that, but it is part of an ongoing round of meetings with not just unions but also community groups, not-for-profit groups, government departments and other peak bodies.

**Senator HURLEY**—Speaking of that, the Brotherhood of St Laurence said here this morning that it had not been consulted. How have you chosen the community groups?

**Mr Cooper**—We currently have a community consultative committee that we work with. There are upwards of 20 members on that. It is made up of various consumer groups. As the senator would be aware, I was here during that testimony. I looked on our list and in fact the Brotherhood of St Laurence is not on that list. We have taken the opportunity to exchange contact details and we will be in contact with them after this meeting.

**Senator HURLEY**—One of the other conditions is to provide specialist resources to assist staff affected by the merger. Has that been accomplished?

**Mr Cooper**—Yes, again, we have internal resources. We also have external outplacement facilities where they are required for our staff as well and they are made available to our people.

**Senator HURLEY**—Okay. In terms of ongoing arrangements, apart from this period of transition, is the increase in employees the face-to-face type jobs in particular, is that responding to customer demand? Do you see the merger having savings in jobs in areas apart from that, more in HR and IT and that other areas?

**Mr Cooper**—We are very focused on our customer-facing roles. There would be opportunities within the branch network, but obviously within our call centres as well. I think it goes to the heart of the rationale for the merger with St George. For us it is very much a part of a growth strategy and it is built around continually satisfying our customer needs. We currently have in Australia customers on average with about eight products each. As well as what we are

doing with our customers, we have about two-and-a-half of those products held currently with Westpac.

Our strategy really resolves around building a bank that earns all of our customers' business. That means for us a matter of understanding why customers choose to have their banking among the institutions and how we overcome those objections. To do that we obviously need to increase the face time that we have with our customers. We have increased our branch numbers this year by about 20, we have increased our business centres by in the order of 50 and we have increased our staff numbers in customer-facing roles, as I mentioned earlier, by about 50-odd roles. We think that that will continue. It runs all of our customer-facing brand particularly—so BankSA, St George and for Westpac.

We are also looking for opportunities within the group functions to serve into those branches in a more efficient way. So we would not expect to be increasing staff numbers in finance functions or group HR functions like payroll and so forth. But HR functions devoted to supporting our customer-facing people, then as that staffing number increases you may expect a small increase there. Largely I think we would look to maintain or reduce the number of people in those group functions.

**Senator HURLEY**—You raised an interesting issue then about trying to decrease the spread of customers' accounts. There has been in fact some criticism that the big banks are putting undue pressure—not undue pressure, that is too harsh—they are encouraging customers, clients, who have, for example, home mortgages with them by bundling up a whole range of accounts. While this might have some advantages for the clients, and certainly for your bank, in the end it may not advantage clients. It is difficult for them understand it. It means that it is harder for them to transfer one account out because of exit fees and unbundling the whole product. How do you respond to those kinds of criticisms?

**Mr Cooper**—I think this is all about customer choice. We have selected the phrase 'earning all our customers' business' quite deliberately. That is, how do you create a bank that actually earns that business? For us it is a matter of understanding why customers choose alternative providers. Is it about the product, the price or the process? Are they risk averse and how do we overcome those objections so that customers make an active choice in choosing to move all their business to Westpac, St George or BankSA? So it is not a matter of coercion, it is none of these things. It is a matter of continuing to build our customer satisfaction levels and continuing to build our customer adequacy levels where our customers choose to bring more of their business to our group.

**Senator HURLEY**—Nevertheless, if we are talking about increasing competition and people having discussions about how to increase the ease of switching, then one obstacle in the way is if customers' accounts are encouraged by the bank to be interlinked in such a way that it is not only the fees and other things that makes it difficult to switch, it is the fact that accounts are linked. I do not suppose we can blame a bank for wanting to link customers. Can you comment on that whole issue of the ease of switching? No doubt it would benefit you, too, when the customers do want to switch to you that they can do it with relative ease.

**Mr Cooper**—Absolutely. We very much support competition; we support ability of customers to be able to move products between banks. We support that because, as you have pointed out,

Senator, it is a requirement of our strategy for success that our customers can move products between institutions. Then I think it is a matter of competing on which institution is best placed to serve all those customers' needs against a fairly broad set of services and products that customers are expecting today.

In terms of earning that business into our bank, it is not a matter of relying on some bundling and some pricing around that. We are seeing more and more today that consumers are availing themselves of things like internet banking by the extent to which now a Westpac or St George customer can go onto the internet and see their savings account, mortgage account, their credit card and in fact now their superannuation fund and its performance. It is something that our customers are particularly attracted to.

**Senator HURLEY**—But we are talking about encouraging or maybe legislating or regulating such as exit fees are not so high that you can transfer your automatic debits across more easily. I am asking how you feel about that sort of—

**Mr Cooper**—I think already we are in a position of providing statements to customers around how their direct debits are structured and customers can move those accounts between institutions today. In fact, there is no barrier to doing that. You would recognise that in some forms of accounts, and particularly fixed rate mortgages and so forth, there are appropriate costs to banks for breaking those types of offerings, and those costs are passed onto consumers.

**Mr Buttsworth**—Just one other point on that. The debate about switching tends to be divided into questions of the bank that people are switching to and the bank that they are switching from. So as a bank like Westpac seeks to earn our customer's business, we clearly, as my colleague said, want to make it as easy as possible for them to come to Westpac and set up their accounts. So we provide a whole range of services, as do our competitors, to help people make a transition as easy as possible. That includes form letters to help them re-establish direct debits and so forth.

The debate has been a little bit more around the institution losing customers, if you like. The government's intervention has been targeted around making it easy for someone to go to their bank and say, 'I want to leave the bank and go to Westpac.' What is about that switch that people say is difficult? So the switching package that was introduced by the government focused around giving customers lists of those direct debits, which as we point out, actually are arrangements largely between customers and merchants. They do not involve banks so it is not something we have control of, and that is something that gets missed. But we also do that as part of the government's package. So we operate both on the customers who wish to leave Westpac. We are offering a switching to and a switching from site. We actually see that that works quite well.

**Senator HURLEY**—I think that is what I am asking. We have had quite a bit of evidence that that needs to be made smoother and less complicated. But you do not believe that that is the case.

**Mr Buttsworth**—We see people opening and closing accounts every day. I personally have just closed an account at another institution. It was not as difficult as sometimes it is said to be. But it is the case that it is the direct debit area that people have identified as the most difficult and part of the intervention, about which we are now in compliance working, as are all the banks as a result of the government's policy. If you come in and say, 'I would like to move my

banking, give me a list', we will all produce you a list for the last 13 months of those direct debits. So I think that that was responding to customer pressure and government desires, and we have done that.

**Senator HURLEY**—Okay.

**CHAIR**—You talk about the separateness of St George and Westpac. In reality, how complete is that? Have you retained all Westpac branches that are opposed by a St George branch, for example, or do you propose to rationalise your branch structure? That is the first issue, I think?

**Mr Cooper**—Absolutely, we have retained the branch network. In fact, as I indicated earlier, we have increased our number of branch locations and we have a number of celebrated locations where in fact a St George branch is right next door—in fact, a couple of doors away from a Westpac branch. In those cases we have continued and will continue with locations. We continue to attract customers to both of those brands.

What we have also done now is allow customers from all of our brands to use the ATM networks right across the group. We have kept the management teams completely separate. We still have our managing director of our Bank of South Australia based in South Australia. We have a chief executive officer and a management team who run St George: similarly for Westpac. Behind that there are group functions that have been consolidated in terms of we have one product and operations area supporting each of those brands and one HR function.

**CHAIR**—You mentioned that. Although you have different brands, the central administration in effect has become in common. In Western Australia we used to have a bank called Town and Country Bank, which grew out of a building society that was taken over by ANZ. The Town and Country Bank customers were assured that nothing would change, but, of course, it did. In due course, Town and Country disappeared and their mortgages became ANZ mortgages with ANZ rules, which were very different to the kind of rules which had applied under the Town and Country Bank. You know, that is a precedent that I am personally aware of.

I suppose the drift when you look at the history of banking in Australia is towards acquisition and the eventual disappearance of the smaller party being subsumed in the larger one. What about the reality of borrowing? Are there any differences in terms of charges and availability of funding between Westpac and St George if a customer walks in? Are There differences? Is St George in a position to compete in effect with Westpac by offering better terms and conditions?

**Mr Cooper**—Thank you, Senator. I think there are a number of issues raised in your question there.

**CHAIR**—Sorry.

**Mr Cooper**—I think I would be first to acknowledge that this merger is very different to mergers that have gone on in the banking industry in the past. I note the example you provided for Western Australia. We have a similar example with the previous merger with the Bank of Melbourne. Of course, that brand does not exist anymore in Melbourne. This merger is all about a multi-branding strategy. It is a desire to be able to have and retain the distinctiveness of each of those brands. If you take, for example, RAMS versus St George versus Westpac scenario, each

of those has very different personalities and the brand appeals to very different customer groups. So it is incumbent on us to understand that distinctiveness, and in fact to accentuate it even more so that as a group we can appeal to more customers and attract more market share to ourselves.

This is a very different merger to what has gone on in the past, which has largely been about how do you acquire, and then simply eliminate the costs. To bring that to life, as the Senator points out, you need the ability for each of those brands to compete. Things that go to the heart of the value proposition, service proposition and, indeed, the employee proposition, belong to each of those managements team who run each of those brands. For example, the standard variable rate that is offered today in Westpac is different to St George and is indeed different to RAMS. The employment practices and policies between them have variants as well, depending on the types of people that the brands are seeking to attract.

Indeed, the service propositions, whether it is in call centres and so forth, are different as well. The number of staff per call in a St George call centre would be higher than, for example, in Westpac because the associates there would spend more time on the phone than Westpac. It is critical to retain the distinctiveness that the choices around those products and the service propositions are made by the management team running the brands and then the centralised product and operations teams need to be able to supply those services into the brands at the most efficient cost that they can.

**CHAIR**—Thank you. What about issues like the bank guarantee and the cost of money to St George, or a smaller bank versus a bigger bank? That is an issue that has been raised at this inquiry in a previous sitting. In fact, does it mean that the bank guarantee, because St George was a smaller bank and functionally still exists as an independent entity to some degree. They pay a higher price for obtaining money to on-lend to their customers?

**Mr Cooper**—No, internally there is not a price difference. Obviously, from 1 December, St George was AA rated in the same way that Westpac is. Internally we have one Treasury function that looks after our funding requirements and the cost passed through to each of the brands is based on the group's borrowing rather than borrowings for individual brands.

**CHAIR**—If St George is AA rated and you have one Treasury group managing their financial affairs, in effect, does that really mean it is the same bank but with a different label for the sort of commercial purposes being offered to the community? One might suggest it is like marketing of petrol. That all comes from the same refinery, but it is called Caltex, BP and Shell in different locations. It is not quite the same, but the central point I am making is that the product is the same. What you are offering is finance under this heading of Westpac and St George, but in fact it is the same organisation with the same credit rating setting up different shopfronts.

**Mr Cooper**—But of course, how the customer experiences that relationship is through the interaction with the staff and the nature of service and quality of service that is provided under each of those brands. So the brand personality and what they stand for is central to why people choose to do business with one bank versus the other. The distinction that you could draw there, even among the four majors is that you could argue that they are all AA rated and they all have mortgages and credit cards and personal loans. But they all have different strategies and different ways of executing those strategies that makes them different in the marketplace. It is very much the same with the banking brands that we have today.

**CHAIR**—I do not know whether you can answer this. In other major takeovers of smaller banks, are the credit ratings the same as the smaller banks post-takeover? Are the costs of money in terms of the bank guarantee the same or higher in these smaller banks once they are taken over by a bigger bank?

**Mr Cooper**—In terms of the bank guarantee as it stands today, our borrowings are obviously under the Westpac group, so we pay a premium for the entire borrowing as the Westpac group. So it does not go to each of the smaller subsidiaries of the bank as to what their rating would be on a standalone. They are part of the Westpac group and they are AA rated and we do the borrowing from our central group.

**CHAIR**—As a group, yes.

**Senator PRATT**—Thank you very much. I want to follow up from the chair's questioning. How will the separate branding be maintained? At this point you have indicated that it is a specific strategy to do that. Does that therefore mean it is indefinite? You cannot blame the Australian public for being suspicious when in the past commitments to keep separate branding, and therefore competition in the products that are offered, have eventually been phased out.

**Mr Cooper**—I understand some of that scepticism. As you say, because of the landscape that was there before us, this merger as I have indicated—at the heart of it is the multi-brand strategy. We are relying on our ability to maintain and in fact enhance the distinctiveness of those brands to again try to attract more and different types of customers into the group.

**Senator PRATT**—That might be true, but that is exactly what was said about the Challenge-Westpac merger in Western Australia. Ultimately those customer bases merged.

**Mr Cooper**—As I have indicated, I think that was said with the Bank of Melbourne and the same had occurred. I do not know what else I can say to overcome your concern about that, Senator. Suffice to say—

**Senator PRATT**—Give me a time line—guarantee it for, I do not know, five years or 10 years.

**Mr Cooper**—We have guaranteed it, I think as part of the Treasurer's conditions, for a minimum of three years. Certainly, we are not looking to the time line. In fact, the time line for us troubles us to the extent that it creates an artificial deadline. Rather what we have been talking to our people about is that it is a core part of our strategy. We are investing heavily in those brands, in the promotion of them, the employment of our people and the opening of locations.

Our people tell us internally that this feels very different to bank mergers of the past. Certainly, the customer satisfaction levels in St George since the merger have increased, as have the advocacy scores in both banks. The customer numbers have increased in St George since the merger as well. I think on those fronts this merger is very different to mergers that have been conducted in the past.

**Mr Buttsworth**—Just to add to that, any mergers and acquisitions process has a business case, if you like. Some mergers are very traditional about cost synergies. That is what is going to

make the business case stack up; that is how you sell it to the market—this will be accretive in earnings in per share terms for shareholders because we are going to cut out all of those costs.

In this case, this is very much about the revenue side of the equation. As my colleague has pointed out, we are investing in these brands, which is probably, you would argue, costing us more in some ways. But the reason it will still make the merger work is because we are actually going to keep those customers and in fact add to the customer base.

To answer your question, one of the defences might be that this is how the merger was built from the ground up. If we do what we are talking about and just try to carve all the costs of it out and shut down branches, then the whole business case will fall over.

**Senator PRATT**—Notwithstanding that, history has shown that things do change. One of the issues that the Trade Practice Commission looked at in the 1990s was bank mergers and retaining a regional bank presence and making sure that while the Trade Practice Commission approved a bunch of mergers they did so on the basis that the regional banking sector was still quite strong. However, the history of those mergers is that in fact has now changed in any case. Where do you think we will be in five to 10 years? Do you think it will still have distinct brands?

**Mr Cooper**—I think so, absolutely. My view is that there is a requirement. There are some customers who have a requirement for what you term as the regional bank. It is much more about this community-based close relationship that customers have with their local banking institution. You can see that in the case of the Bank of South Australia, which I think would be seen as a very strong local and regional bank, even though it has been part of the St George group for a while. And St George, particularly in New South Wales, has been viewed the same way. We certainly anticipate that in five years time they will still remain being strong regional banks in those heartland states.

I think what is more difficult is the extent to which those banks can maintain a regional footing in non-traditional states like St George in Western Australia, Queensland or Victoria. That is a little more difficult to get that. They seem to grow in strength in their home states, but it is more difficult I think to become a regional bank in non-homeland states.

**Senator HURLEY**—I want to explore the merger and the events around the merger. The now CEO of Westpac, Gail Kelly, resigned as chief executive officer of the St George Bank just before the merger. I am wondering what was put in place to ensure that there was no crossover of the information between the two and what role she played in encouraging any merger.

**Mr Cooper**—As I would imagine, we have continued to look at external opportunities for growth, and St George would have been on that list for quite some time—obviously well before Gail joined the Westpac group. Given the transition between her role and the time of the acquisition, she was kept completely separate to all the dealings around the acquisition. In fact, there was a subcommittee of the board, as you would expect, looking at it and a separate management team looking at that acquisition, and Gail had no role to play in that.

**Senator HURLEY**—So when Westpac took on Gail Kelly as the CEO the merger with St George was already under consideration?

**Mr Cooper**—It had been under consideration for quite some time. It had been contemplated well before Gail Kelly joined the Westpac group. The exact time lines of different events—I am probably not the best person to talk on that. We can furnish time lines for you after this meeting if you would like.

**Mr Buttsworth**—The thing to point out there is, of course, that all other banks have their own mergers and acquisition department and no doubt others were looking at St George as they look at all sorts of opportunities as well. So it is not simply that Westpac had a plan for St George. The valuation of the company forms part of the consideration for us as it does for others.

**Senator HURLEY**—But the other banks did not poach her as their chief executive officer before they went ahead with it. Did she still have any shareholding in St George at the time of the merger?

**Mr Cooper**—I could not talk to what shareholdings—

**Mr Buttsworth**—I cannot speak to her personal shareholding, except for—

**Senator HURLEY**—Is it not public?

**Mr Cooper**—It would be. I am just not aware of what they were and how many shareholdings—I would imagine it is in our and their public annual reports.

**Senator HURLEY**—The chief executive officer of St George at this time of the takeover, who took over from Gail Kelly, Mr Paul Fegan, was paid, I think, $2 million as termination payment when he resigned. Were any other St George senior executives or board members paid any kind of special termination or bonus payments?

**Mr Cooper**—I do not have any of that information, Senator, in terms of what remuneration arrangements were put in place for any of those executives, I am sorry.

**Senator HURLEY**—Would you be able to take that on notice?

**Mr Buttsworth**—We will have a look at it on notice and see if there is anything on the public record that we can provide.

**Senator HURLEY**—Okay.

**CHAIR**—I would like to ask couple of questions about the transitional conditions placed on Westpac by the Treasurer and the ACCC. One of the conditions was that Westpac would work with consumer advocates and community stakeholders to minimise concerns about the merger and its impact on customers and the community, and address any concerns as sensitively and as quickly as possible. What contact have you had with consumer advocates and community groups? Can you give us some details of that?

**Mr Cooper**—As I indicated, we do have a consumer consultative committee, which has a broad range of over 20 different groups as members of that. We have various, either meetings with individuals on that, meetings with them collectively and we also write to them and seek

their views on different matters. Each of the forums have occurred with different members of that committee in the last eight months since the merger commenced.

**CHAIR**—How are those people chosen?

**Mr Cooper**—We have had that consultative committee ongoing in Westpac for quite some time. We work with those groups as a way of understanding where priorities are in terms of the community's expectations of us as a bank and where we are best able to assist. That is the role that that committee has played for quite some time. For us it was a natural extension to continue to use that group as we started to think about the community impact of this merger. The construct of the group is very much around trying to select a representation from a broad set of stakeholders involved in the community. We think we achieved that with the group. Obviously you cannot involve everybody. But certainly such that a range of views would be included and considered would be our goal in the makeup of that committee.

**CHAIR**—What are you talking about in terms of a broad range—small business, housewives, single people, older people? What composition do you have? What are your headings?

**Mr Cooper**—I could furnish you with a list if you like are—

**CHAIR**—Yes, if you would on notice. I would be grateful.

**Mr Cooper**—Of who is on that committee.

**Mr Buttsworth**—The other thing I could point out is that we produce annually a publication we call the 'Stakeholder Impact Report'. That includes details on that committee and its role at Westpac, including feedback that they individually have given to us over the year. That is audited and we provide that as part of our annual submission to the Dow Jones Sustainability Index. That is all part of the fabric of consultation with the community that a bank like Westpac conducts all the time, merger or no merger. When the merger came along, it seemed like the obvious body, given that they were already engaged with us across the whole spectrum of our business—and that includes consultation with the board, by the way—and given that we continue to use them for this purpose.

**CHAIR**—If you could provide the secretariat with a copy of that—

**Mr Buttsworth**—We will do that.

**CHAIR**—That would be very helpful, and also of the kind of issues that consumers and communities raised with Westpac and how they were dealt with. We would be very interested in that.

**Mr Buttsworth**—On that, I might say that in the most recent round of correspondence, I think, there were more than 20 letters we sent out and we have only received a couple of replies, both of which were very positive. We can choose to try to communicate with people; they can then choose whether or not they want to come back and give us any feedback. To be honest, we have not been getting very much of that.

**CHAIR**—That is a fair point. Six of the conditions placed on Westpac by the Treasurer apply only for three years after the merger. I understand that they will expire on 1 December 2011. Do you feel that that three-year period is a reasonable one, or do you think it is too long?

**Mr Cooper**—I think that is the time frame that was agreed to with the Treasurer. I think it is where we have ended up in terms of the commitments that were asked for and that we have agreed to. It is difficult, I think, to understand why you would want to go out any further than that. I think we have to be particular to look at our business in terms of the current operating environment. You would recognise, particularly in recent times, that it changes fairly quickly. I think three years seems to me to strike the right balance in terms of the undertakings that we were asked to provide.

**CHAIR**—After 1 December 2011, for example, would Westpac be free to, say, reduce the number of St George branches?

**Mr Cooper**—That condition would no longer apply, but obviously that would go to the heart of our strategic intent in terms of maintaining and growing that distribution to attract more customers within the group. While it would no longer be a requirement under the condition, it would run completely counter to the strategy that we have employed and the rationale for the merger in the first place.

**CHAIR**—It is very important to establish, however, that behind your strategy there is also a condition laid down by the Treasurer over the merger, so that the removal of that condition does mean that you do not have that kind of pressure on you to continue with the strategy. It is a matter of choice then either to continue it or discontinue it.

**Mr Cooper**—That is factually true. I think the point I would point out, Senator, is that the strategic rationale was in place prior to the condition imposed by the Treasurer. In fact, it was at the heart of the reason for the merger in the first place.

**CHAIR**—I know you have said that and I am not questioning that. I am just observing that there is a legal obligation strengthening your resolve or requiring that this should be the approach taken. It looks as though Senator Xenophon is not going to be able to return in time. Perhaps he can put questions on notice for you.

**Mr Cooper**—Thank you.

**CHAIR**—With that, I think we will conclude this segment.

**Mr Cooper**—Thank you very much.

**Proceedings suspended from 11.49 am to 1.18 pm**

**PODDAR, Mr Dave, Chairman, Trade Practices Committee, Business Law Section, Law Council of Australia**

**ROSEMAN, Ms Justi, National Chair, Financial Services Committee, Business Law Section, Law Council of Australia**

**CHAIR**—Welcome. I invite you to make an opening statement.

**Mr Poddar**—The Trade Practices and Financial Services committees of the Business Law Section of the Law Council would like to thank the Senate economics committee for inviting us to attend to discuss this inquiry into aspects of bank mergers. We believe a properly functioning banking system is essential for the full and effective operation of Australia's economy. The importance of the banking system as a foundation for a successful economy has been reinforced by the current global financial crisis.

European and American banks, in particular, have failed or have been forced into public ownership over the last 18 months as a result of bad business decisions and the lack of available liquidity. To date, here in Australia our banking system has not faced such turmoil, largely as a result of the tighter regulatory framework which has limited Australian banks' exposure to toxic investment.

In spite of this, Australia's banks face difficult market conditions at this time. Bank mergers can play an important role in the creation and also maintenance of a stable financial system by allowing inefficient firms to exit the market while preserving customer choice and competition and encouraging product and service innovation. Bank mergers are subject to the current merger control regime, which applies equally to all sectors of the economy.

The regulatory framework is well understood by business and their advisers and is administered well in our view by the ACCC. Moreover, Australia's merger control regime is broadly consistent with international best practice and the regimes of our leading trading partners, including the United Kingdom, the European Union and the United States.

Any bank merger examined by the ACCC under section 50 of the Trade Practices Act will be approved or informally cleared only if it does not result in a substantial lessening of competition in a market in Australia. Additionally, participating mergers are subject to prudential and government controls and approvals which ensure that any such merger will be in the national interest. In reaching this decision, the Treasurer must determine whether a bank merger would support a strong and competitive Australian banking system taking into account issues such as prudential requirements, economic efficiency and community banking needs. In other words, bank mergers are already subject to a form of public benefit test.

Therefore, the committees believe that Australia's existing legislative regulatory framework for examining bank mergers provides the appropriate level of scrutiny to prevent any anticompetitive mergers from occurring. Bank mergers should not be subject to bespoke, legislative, or additional framework. They should continue to be subject to the same scrutiny as

all other sectors of the economy under section 50 of the Trade Practices Act and the prudential and government controls under the Banking Act and the Financial Sector Shareholdings Act.

In particular, the committee can see no legal or economic justification for the introduction of an alternative regime for assessing bank mergers or for the introduction of a different way of measuring competition in the banking sector. Rather, the committees support continued operation of the existing merger prudential and public benefit regulatory frameworks for the assessment of Australian bank mergers. The committees acknowledge that mergers of small sectors of the economy frequently result in a rationalisation as the parties seek to consolidate the merged businesses. In particular, staff retrenchments typically occur in the banking sector.

The committees understand that a number of banks have sought to send certain key services offshore, including to places such as India, which has resulted in the loss of jobs in Australia. While the committees wish to make clear to the Senate economics committee that we understand the human impact of the loss of employment resulting from mergers or offshoring of jobs and are sympathetic to those job losses, however, in the committees' view amending current legislative and regulatory frameworks to create an additional merger review or evaluation process for bank mergers may undermine the existing stability of Australia's banking system. Additionally, it may also result in real harm to consumers in the medium to long term by potentially enabling bank mergers to occur which would otherwise be subject to extensive scrutiny and even prohibition under the existing section 50 of the Trade Practices Act or the Banking and Financial Sector Shareholdings Act. Thank you. That is our opening statement.

**CHAIR**—Thank you very much indeed. I will go to Senator Xenophon, since this is his reference.

**Senator XENOPHON**—You basically say that things are working well enough as they are. Is that what you are essentially saying in terms of assessing bank mergers?

**Mr Poddar**—We are saying that, at this current time and having regard to the global financial crisis that we have or are just going through at the moment, the Australian merger control systems have worked very well in comparison to other jurisdictions and that in the short term, as the overall implications of the global financial crisis and financial stability issues have not fully been worked through, it is premature to see a need for changes to our existing merger control or other regulatory systems.

The various mergers which have been referred to, such as Commonwealth Bank and Bankwest or Westpac and St George, need to be considered in their particular factual circumstances. It is our view that neither of those particular mergers should be treated any differently now than when they were under the merger test when they were first assessed late last year or early this year.

**Senator XENOPHON**—Just go back a step then. In the absence of any changes to the Trade Practices Act, CHOICE—the consumer organisation—to fairly summarise their argument, are saying that currently there is a lack of transparency in the process with respect to the ACCC when they assess a merger. It is not required in terms of the extent and robustness of their process; it is not adequately transparent. There is no minimum requirement in terms of what things need to be looked at in terms of the potential impact of a bank merger on consumers, for instance.

Do you think that there is scope for a greater degree of transparency and openness in the process, a greater degree of robustness that groups such as CHOICE and, I think, Professor Frank Zumbo—who is here to give evidence today—say does not exist in the current approach taken by the ACCC in all cases?

**Mr Poddar**—We think the ACCC and the merger processes under the current ACCC administration are very transparent, that the informal merger reviews for both the CBA and Bankwest and Westpac and St George were very public. They are very transparent. They were more so than most other jurisdictions in terms of mergers that have occurred in recent years, in terms of bank mergers, or in terms of mergers that have occurred in the United Kingdom as a result of the global financial crisis.

The ACCC's public merger assessments were very transparent in terms of the Bankwest-Commonwealth Bank transaction. They were expressly clear that they were troubled by competition issues, but they made all the appropriate statements and language that, if you read through those public competition assessments carefully, referred to extensive advice from APRA, and I think the Reserve Bank, for example, to prudential issues which assisted and informed their decision not to oppose that transaction.

**CHAIR**—Can you just take us back to what you first said? Did you say you support or do not support the Bankwest acquisition?

**Mr Poddar**—We believe that the ACCC's analysis was sensible and appropriate, for example, in the Bankwest acquisition.

**Senator XENOPHON**—Further to that, I think the argument by CHOICE and others is that, for instance, with respect to the Westpac and St George merger, they said that there ought to be greater accountability and to dedicate greater resources to evaluating customer experience in relevant markets. I think one of the factors that was looked at by the ACCC was the issue of customer satisfaction surveys. Ms Roseman is nodding. I think I am right in relation to that.

But CHOICE said they never had an opportunity to independently assess that, or there was no opportunity to comment on that, to robustly assess the survey as to how accurate it could have been or the methodology of that survey, for instance. There is also a concern that what the ACCC does in terms of its checklist is entirely discretionary and that there is no template, in a sense, of what needs to be checked before a merger is assessed and a lack of community input. For instance, some of the things that are put to the ACCC, they stay confidential. CHOICE makes the point that if it is genuinely commercial-in-confidence, that is fair enough. But there seems to be a lack of transparency in the process with what the ACCC wants to do and consumer groups feel left out in the cold.

**Mr Poddar**—I think I am not across CHOICE's evidence from this morning. However, I did read some of their submission and the ACCC's submission. I think CHOICE, as with any interested stakeholder, is able to make submissions to a competition regulator such as the ACCC. It is up to the competition regulator entrusted by the government as an independent body to make its assessments as to what it believes and considers appropriate from a merger perspective, and what it takes into account, just as any other competition regulator of which I am aware.

There are very few and there are great dangers in having a checklist mentality in terms of any merger such that I must tick off a whole list of items. Each merger depends on its own facts.

**Senator XENOPHON**—Can we just pause there? There are two things in relation to that. Is it not reasonable that there will be some fundamental points that should be checked off by the ACCC and that thereby a degree of transparency in that so there is a base line, if you like, of basic things that ought to be considered?

**Mr Poddar**—To an extent parliament already has in section 50(3) where they have listed a range of competition factors which are relevant. But I am not sure whether CHOICE or any consumer organisation, as opposed to any industry association or any other party, whether there should be any other particular indicia factors that it should be mandated that a government regulator should consider. They should all turn on the particular facts. I am just trying to understand what CHOICE say in terms of the survey.

**Senator XENOPHON**—Perhaps so there is no misunderstanding or misrepresentation of their position, CHOICE in their submission says that in the recent mergers CHOICE called on the ACCC to undertake more thorough research into consumers' experiences of an attitudes towards competition in the retail banking sector. Despite such requests being made, the ACCC did not believe it was necessary or appropriate to conduct its own research into the market. My question to you is: do you think it is appropriate for the ACCC to conduct that sort of research independently of anything that is put to it by one of the parties that has a vested interested in getting a merger through?

**Mr Poddar**—I am not sure of the evidence that was put by the merger parties. That material is not public. I understood the ACCC did conduct their own surveys during the course of the Westpac and St George merger or least one of the mergers. I am not sure that any other parties should really seek to mould the way a competition regulator independently assesses a merger if the regulator is the best placed to make assessments. I understand parties making submissions, but CHOICE or any other organisation should not be placed in a better position.

**Senator XENOPHON**—No, not in a better position. The legislation already gives guidance as to the ACCC's powers are. It is not unnecessarily prescriptive, is it, to say that in relation to the issue of consumer attitudes towards banking services. The ACCC to undertake its own inquiries rather than to take on face value what one of the parties seeking the merger has provided or, alternatively, or in the absence of that to inquire to open up that survey to other parties such as CHOICE to be able to make submissions as to the robustness of that survey?

**Mr Poddar**—I think that is a question for the competition regulator, doing an appropriate task that it has been charged with, is to make an assessment as to whether its process of assessing customer satisfaction or services levels it considers appropriate.

**Senator XENOPHON**—I am not asking you—I know other Senators have questions. Do you think it is reasonable for the ACCC to conduct its own customer satisfaction surveys, for instance, or simply to rely on the customer satisfaction surveys of one of the parties in order to robustly assess whether consumers will be better or worse off with respect to a particular merger or not?

**Ms Roseman**—It may be quite difficult to conduct those kind of surveys once a merger is announced. Would it not be better to use existing backward-looking data gained from CANNEX or an independent house, which I understood definitely occurred in the St George-Westpac merger? But I suspect that, and I may misunderstand what CHOICE has put to you—so please correct me—that part of the disquiet for CHOICE and for some other organisations and also some of the customers of St George with the St George-Westpac merger was that on CANNEX data, St George comes out ahead of all the other banks in terms of customer satisfaction. But when the ACCC went through and looked at price pointing and whether customers objectively should be satisfied, their conclusion was that really customers' attachment to St George was emotive rather than based on any genuine competitiveness.

**Senator XENOPHON**—It was the vibe, was it?

**Ms Roseman**—That was how I interpreted it. Is that correct?

**Senator XENOPHON**—I will leave it there because it is a bit circular from my point as well. The Law Council has indicated for a more global consideration of the market. That is correct, is it not?

**Mr Poddar**—To take into account international factors. I am not suggesting that the ACCC does not take those things into account.

**Senator XENOPHON**—I do not mean as in 'international', but a broad approach.

**Mr Poddar**—A broader range of factors that they take into account?

**Senator XENOPHON**—Can I put it in context? Since the Westpac and St George merger, Westpac operates about one-third of all customer service points in South Australia—my home state—and one-quarter of ATMs in New South Wales and the ACT. These are well above the 15 per cent benchmark that the 1999 ACCC merger guidelines discussed. The question is: should the ACCC, for the purpose of assessing mergers, consider the proposal in on a more localised way as well? Should not the state or regional market also be a relevant market for retail banking, particularly in a smaller state such as South Australia?

**Mr Poddar**—Okay. My understanding is that, leaving aside that particular aspect of the bank merger—and I have a degree of knowledge of South Australia; it is also my home state—the ACCC typically does consider both regional, state-based and national markets. It is not obliged to take into account only a national market. It will cut and splice the market to look on a conservative basis what it considers is the appropriate geographic basis on which to make a competition assessment. I would be surprised that if you looked at individual issues, such as ATMs, the one that you have just raised, that it did not look at issues such as ATMs. But you think it would also be counterbalanced by the fact that there is an ability for other people to put in new ATMs.

I think the dynamics of the market are that there have been some recent announcements of new ATM-type structures and now people are doing alliances with ATMs. I do not think that the ACCC is any different than any other competition regulator in how it assesses, local, regional, state or national markets. I would be surprised if it took an overly national market in relation to a

bank merger where you did have very strong brands in South Australia, such as BankSA. I would be surprised if it did not look at that at quite a local level.

**Senator XENOPHON**—But we do not know whether they have though, do we? It has such a broad discretion that we as consumers do not know whether they have actually done that. We just do not know. They give us the tick of approval but we do not know what factors went into that in any great detail, do we?

**Mr Poddar**—The issue that you are touching on is something that, as a result of the Dawson inquiry in 2005, the Law Council and also, indeed, ACCC's Graeme Samuel have sought to increase transparency in public competition assessments that come out. I have not got the one, for example, for Westpac and St George in front of me, but the ACCC is actually much better than most other competition regulators around the world in terms of the transparency of the decisions that it makes. It does not always go into a huge amount of detail as to how it has cut local or state-based markets.

Those types of things are areas where I understand people can ask further questions of the commission if they want guidance. But from the work I have done overseas or with international bar associations, in addition to the Law Council role that Justi and I have, I do not concede criticism of this competition regulator for not taking into account proper international factors or not being transparent. The ACCC is one of the most transparent regulators in terms of your question. I think they do quite a good job. But I cannot recall on the particular facts whether they broke it down into a South Australian regional or even local markets.

**Senator XENOPHON**—In relation to the whole issue, the conditions that were attached to, for instance, the Westpac and St George merger—I think there were nine or 10 conditions attached to that—what happens now if there is a flagrant breach? They say, 'Oops! We have decided not to go down this path.' They are blatantly breaching the conditions set by the Treasurer. Are the sanctions adequate at the moment or not if a party breaches the conditions set by the Treasurer? It is technical in terms of the enforcement.

**Mr Poddar**—It is, and I think we dealt with that expressly in our submission. It is not a competition question that you are asking; these were not conditions imposed by the competition regulator in Westpac and St George. These were conditions imposed by the Treasurer, from my memory.

**Senator XENOPHON**—Yes, that is right.

**Mr Poddar**—I think we expressly dealt with some of the issues in our submission. I will find them and come back to you on those. But it seemed to me that the Treasurer has the ability, from my recollection of our submission—I remember there was a specific section on this—to seek to enforce those conditions if they so wish and also to bring proceedings if they think there was a contravention. If you have significant corporations such as Westpac doing transactions with the government, I would anticipate that those corporations take those things extremely seriously. From our experiences as lawyers we would believe that they would be complied with.

**Senator XENOPHON**—I was not clear with the question. You refer to 3.10 and 3.11.

**Mr Poddar**—And 3.12.

**Senator XENOPHON**—And 3.12 as well—3.10, 3.11 and 3.12. At the moment, are there significant financial penalties in place, or is it a case of saying that you have to do this, you have to undo what you have done? I am not sure. In other words, if they doing the wrong thing, are they fined or do they have to restore what happened? Do they have to re-open a few branches or rehire some staff?

**Ms Roseman**—My understanding is that you just have to take corrective action and that there are no financial penalties.

**Senator XENOPHON**—They have closed, say, 20 branches. They have flogged off the branches and they are now being used for some other purpose—they have been sold. How does corrective action work in those cases?

**Mr Poddar**—I think what we have explained in paragraph 3.12 of our submission on page six, revoking approval clearance or, alternatively, applying to the Federal Court for an injunction to prevent a breach, first off, a revocation of the approval of a clearance, are obviously significant and draconian. That is a very serious ramification if a corporation were to breach. Also, I would anticipate that if you start to see branches being closed in this financial environment, that would be very quickly notified or brought to the Treasurer's attention if there is a perceived breach of any of these conditions, which would give the government, the Treasurer, the ability to seek an injunction.

**Senator XENOPHON**—Finally, at the moment it is either revoke the merger—goodness knows how that will happen in a practical sense—or, secondly, get an injunction. Should there not be a third option of financial penalties as well as an alternative remedy? Would that not make sense as an extra tool in the toolbox to ensure compliance?

**Mr Poddar**—Can we take that and consider it a bit more as to whether that is appropriate? That is not a section of that particular legislation that I am fully familiar with. We may wish to consider that one a bit more before we respond to that.

**Senator XENOPHON**—Thank you.

**Senator HURLEY**—That is something I am interested in as well. Previous witnesses mentioned that they felt it was an all-or-nothing type route to either undo the merger or have the injunction. They were calling for intermediate measures that could be imposed on merged companies as a penalty. I canvassed the idea that if there were severe financial penalties or other unknowns to not complying with the merger conditions, then it may create risks for companies merging that they are unable to quantify, so it may make it extraordinarily difficult for them.

**Ms Roseman**—I am more across the banking as the financial service committee chair. I think it would be reasonable to impose those kind of intermediate penalties. It would also make the Banking Act then more consistent with other commonwealth statutes, like the Corporations Act, that has those kind of mid-range and tiered penalties as well.

**Senator HURLEY**—It has also been suggested that there needs to be changes to the Trade Practices Act, and section 50 in particular. You do address this in your submission, including some suggestion about creeping acquisition amendments. Can you just run through that? I do not really see how that applies in this. Financial institutions tend to just buy each other or not.

**Mr Poddar**—The Law Council Trade Practices Committee has just in fact put a further submission into Treasury in response to Treasury's discussion papers on creeping acquisitions. The way that we see so-called creeping acquisitions is very similar to the way that you have just expressed it. We talk about how creeping acquisitions are typically viewed in Australia, or in the past at least have been viewed in Australia, as a series of small acquisitions where the concern was that they may not each individually amount to a substantial lessening. We as a committee take the view that the existing substantial lessening of competition test would be sufficient to capture any participating merger, whether large or any particular smaller state or region or institution. That would almost certainly be captured by the existing section 50.

There is no need for an additional so-called creeping acquisition amendment in the case of the banking industry. Generally, some of the comments that we made in our opening statement are that we have significant concerns with continual tweaking of section 50 of the Trade Practices Act, which has worked very well. We believe that it has been well administered by the ACCC to date, that the ACCC has existing powers if they wish to take cases on. We think there would be great uncertainty created for the business community in Australia and internationally if the current section 50 were to continually be tweaked to take into account additional changes to deal with so-called creeping acquisitions. In particular, we have concerns with some of the suggestions about changing things to new tests dealing with market shares.

As a committee we believe that the tests with respect to some submissions, which suggest that new creeping acquisitions tests should be imposed on a corporation with substantial shares in a market—are not consistent with international best practice; they are not consistent with international considerations of mergers where market shares are only one indicia of the degree of power a corporation has. We believe that some of the suggestions for prohibiting parties that have a substantial share of a market from having any acquisitions would lessen competition, and we believe that they would be retrograde steps. They would be very uncertain to determine what would be lessening of competition.

We believe they do not relate back to the overall level of competition in the market and they would be retrograde steps for consumers because they would be effective caps on existing corporations' market positions. They would not be able to compete vigorously then by acquisition—any acquisitions, whether large or small. That would stultify competition, which would be to the detriment of the consumers. We would have grave concerns with some of the creeping acquisitions proposals that we have seen and that have been put forward in recent times.

We would make the very key point that the current merger test has not been shown not to work effectively across almost all industries. In fact, there is evidence that if we started to change our test we would be significantly different from different economies around the world. We saw recently that the Treasurer made some announcements in relation to changing the foreign investment threshold because of the global financial crisis having stopped the amounts of capital available for investment in Australia. We believe that changing the merger tests to put in

some form of creeping acquisitions-type tests would bring us out of line with other jurisdictions. We would create uncertainty in our merger and regulation test and it would stultify the investment of such capital in a capital starved world into places like Australia, which would not be good for jobs or consumers. Sorry, that is a very long answer to your question. I apologise if I have not dealt with it precisely.

**Senator HURLEY**—No, it was nicely comprehensive. I have no more questions.

**Mr Poddar**—Thank you.

**Senator XENOPHON**—You say that the current merger has not been shown not to work effectively and that, if we change it, it will be different from other major economies around the world. Can you take on notice a comparison and provide to the committee in due course details of that, such as in Europe and the US, for instance?

**Mr Poddar**—We can provide to you, if that addresses that, the submissions that we have made to Treasury on creeping acquisitions, which have expressly dealt with the creeping acquisitions issue and why it would be out of step. We are not aware of any jurisdiction which has imposed a creeping acquisitions test. In particular some of the harm that people have alluded to, we have pointed to the United Kingdom having exactly the same mergers test as we do. People in the United Kingdom are looking at grocery and other industries in relation to being able to enforce the United Kingdom test in relation to those types of industries and certainly in relation to banking. We would note, though, in relation to banking that the United Kingdom government has overridden some of the competition regulator's advice as a result of the financial crisis to allow the Lloyds-HBOS merger, for example, to proceed. We are happy to provide you with those submissions. We think they have largely already been made.

**CHAIR**—I notice in your submission in 5.12 you state that if Australia introduced creeping acquisitions legislation all merger activity, small sectors of the economy would be affected. Is that a bad thing, because we see a great concentration of ownership in many industries and especially retail sectors in Australia at the moment?

**Mr Poddar**—I think this comes back to Senator Xenophon's documents that he has requested or some of our comparisons. The issue that we have put forward in our submissions to Treasury on creeping acquisitions is that around the world most of the studies have indicated between five and seven per cent or 10 per cent of mergers are problematic and need to be assessed from a competition perspective. Australia for many years under the current administration by chairman Samuel and the previous administration was in the same bounds. We have expressed concerns with some of the proposals for creeping acquisitions that in the tests being put forward would mean that every merger in Australia would then become subject to new creeping acquisitions tests, which would create additional filing requirements.

For example, on the various types of submission that have been put forward, I see that Professor Zumbo has put forward a submission dealing with when you have a substantial share of a market. If there is any lessening of that, you would end up with many sectors in Australia with consolidated industries or entities being subject to additional mergers because of the small population, large distances and the need for economies of scale. You would have many of those entities being subject to additional merger filings where they would not contravene the mergers

test, and you would find if you have some of the other proposals that have been put forward, every corporation would have to satisfy both section 50 and the new creeping acquisitions test.

So for the approximately five per cent or seven per cent of merger filings that cause problematic competition assessments, you would vastly increase the amount of filings that the ACCC would have to deal with and that corporate Australia would have to deal with. What we have humbly requested of Treasury or of the ACCC is to put forward evidence of problematic industry sectors where the current test could not satisfy them. Even if we think in terms of most consolidated industries, we are a small, open economy. We have a large amount of imports coming in, and barriers to entry in many of our different sectors are quite low. But the current test, if administered and enforced strictly should satisfy that. Those are the concerns that we have if we were to impose across all industry sectors a new creeping acquisitions test.

**CHAIR**—Thank you. Nevertheless, it is still regarded as something of a social problem that we have such high concentration of ownership in various sectors like the grocery sector, the fuel sector and so on. In the United States they have antitrust legislation, whereas we do not seem to have that kind of consumer protection here which promotes competition.

**Mr Poddar**—It is a very strong point that I make. May I say two things and relate it back to this particular inquiry? To move slightly away from the creeping acquisitions one is that we believe that there are two things that are very important having regard to the global financial crisis in the short term circumstance. There has been a United Kingdom Office of Fair Trading study or report as a result of the global financial crisis released last week. I will send a reference for that to the committee. It referred to the importance at this early stage, particularly in banking, of seeking to address the terms of unfairness or fairness and equity in the credit industry or the provision of credit and consumers.

The Law Council Financial Services Committee and Trade Practices Committee are supportive of the government's changes on unfair contracts as a whole. We believe that some of the laws that the government is currently considering, and some of the approaches and responses that the financial institutions are currently considering, start to address some of those concentration issues that you have alluded to.

The second aspect is that we strongly believe, just as the United Kingdom Office of Fair Trading has indicated—and I apologise if I have not fully answered Senator Xenophon's question properly—that we have concerns that there should not be knee-jerk imposition of new competition merger regulation or extensive regulation where the effects of the global financial crisis have not been fully determined.

At this stage, the regulators in Australia, such as is ASIC, APRA and the ACCC, have done a very good job in terms of our financial system. We have not suffered as much as elsewhere. It could be premature to impose too much new regulation in some of those important sectors. We believe some of the better ways of promoting competition are some of the other things which I think your committee and some of the other committees are considering, whether they are able to increase funding and finances for the non-bank sector and the regional banks, such as some of the suggestions about guarantees of residential mortgage backed securities or whether there may be future changes for example of funds through covered bonds.

Some of the other committees may have heard things through the Australian Securitisation Forum that have sought to address competition issues. I also have seen some of the submissions that have been put in by some of the regional banks to this committee that have sought to address competition issues by dealing with funding.

If you want to increase competition you will need to increase cash flow and funds into some of those small regional banks and non-bank institutions. We believe the better course in terms of promoting competition for Australian consumers and providing choice is for those things to be dealt with continually rather than introducing competition regulation which may restrict the proper functioning of the market. That would be our response in relation to those things. We are very happy to provide you with some of those documents and references.

**CHAIR**—That would be very good. I am interested that the European Union does not have creeping acquisitions legislation. You write in your submission that they do have quite a lot of innovative legislation competition and unfair contract terms, things like that. I suppose what we are concerned about here is competition in the banking industry and the fact that it is very difficult for new banks or to see new banks growing in competition with the four majors. We are told there are 120 credit unions in Australia, for example, but how do they grow into being another bank? What are your comments about the possibility of foreign banks coming into Australia and setting up here in competition with the four big banks that we have at the moment? What difficulties might lie in the way of foreign banks doing that under the existing regimes?

**Ms Roseman**—I do not think the hurdles for the foreign banks are in the competition arena so much as more in the regulatory arena under the Corporations Act and the Banking Act. The hurdles you have to clear in order to set up a banking body in Australia—for example, the way it was with Citibank—are not insurmountable. You have to have a separate body in Australia. You cannot run your banking organisation from offshore. You have to have your own licences, your own AFSLs, and now your own Australian credit licence as well. The start-up costs, which are your barriers to entering the financial services market, are very, very high, so that stifles competition. I do not know that that is necessarily a bad thing. Going back to what David said earlier, it is those very higher barriers to entry and the very stringent regulations we have that afford protection. The financial services market has protected us as an economy from the kind of collapses that the US has suffered where they have not had those kind of barriers.

**CHAIR**—I accept that. But the same sort of requirement makes it difficult for small organisations such as credit unions, which are probably the only groups that might go on to become banks, as building societies have in the past. It is very hard for them to mature into banks in the current regulatory atmosphere in Australia.

**Ms Roseman**—I agree. The potentially new wave of reform that is coming through in terms of the national consumer credit protection bill that has come into parliament is a good thing, but it will make it harder for those smaller organisations because their compliance costs will be much higher and the compliance costs per unit will be much higher because they are much smaller organisations.

**CHAIR**—Okay. I think that concludes your time. Do you wish to ask any questions of the Law Council, Senator Joyce?

**Senator JOYCE**—I am actually having some time with the Law Council in a week or so. I will leave my questions until then.

**CHAIR**—Thank you for appearing.

[2.01 pm]

**FOSTER, Mr David, Group Executive, Suncorp Bank**

**CHAIR**—We welcome representatives of Suncorp to this hearing. Would you like to make an opening statement?

**Mr Foster**—Thank you, Senator. Firstly, thank you for the opportunity to appear before the committee. I would like to make a few opening remarks about Suncorp Bank and our experience as the largest remaining regional bank in Australia. The terms of reference for the inquiry are particularly pertinent for our bank due to the unique size and nature of our business in the Australian banking sector. Certainly over the past two years there has been a confluence of economic funding and environmental events that have fundamentally changed the operating environment for all banks, more significantly for non-majors. How these events evolve will determine the banking landscape and competition going forward.

It is no surprise that the biggest impact emanates from the credit squeeze which shut down access to the types of liquid international markets that existed prior to the global financial crisis. There has been significant flow-on effects, even for those banks that have not accessed wholesale markets traditionally. All banks have had to review their portfolios and the emphasis they are placing on lending in various segments. We have seen aggressive pricing competition for deposits as the alternative funding sources have dried up. Meanwhile, the economic downturn has seen an increase in bad debts, which has put pressure on earnings and capital.

Global debt markets have shown improving conditions over 2009. This has not been across all areas. Certainly, the short-term markets have functioned effectively for most of the year, while term markets have seen wide acceptance of the guaranteed debt with improvements in their spreads in recent months. The non-guaranteed market has seen some improvement but this is not yet broadly based or consistent. We have seen isolated small issuance on a non-guaranteed basis, but it is not sustainable for the banks, AA rated or otherwise. The securitisation market, particularly important for smaller banks and non-banks, has seen limited activity globally with the domestic market only supporting issues where the Australian Office of Financial Management is providing support. It is fair to say that there is some way to go before our banking sector is out of the woods.

Our sector hit a critical point at the time of the collapse of Lehman Brothers. This put a freeze on funding markets and created consumer confidence issues worldwide. Retail deposits started shifting and the major banks in Australia pressed their size advantage with media and advertising which focused on confidence issues.

The government deposit guarantee provided much needed reassurance to consumers and the wholesale funding guarantee once again allowed Australian banks to raise funds in international markets. The guarantee has been utilised extensively over the past 10 months, underpinning the ongoing ability of Australian banks to lend. The pricing approach taken by investors, however, has in our view not been in line with that initially intended, leading to a significant costs advantage for the AA rated banks over the smaller, lower rated banks.

Prior to the financial crisis, AA- and A-rated Australian banks accessed a range of funding markets to provide long and short term wholesale funding. The pre-crisis levels were on average five to 10 basis points higher for Suncorp over the majors for both short and term debt. As the crisis developed, the AA banks had significantly greater access to the market than the As and lower rated banks, with these banks effectively being squeezed out of the a market. Implementation of the guarantee scheme gave A-rated banks access to the markets again, but the cost differential of doing so was higher than initially anticipated. In practice, investors looked through the guarantee and applied near to a full differential between AA and A credit, in line with that being applied by the government for the provision of the guarantee Consequently, the total cost of funding for A-rated banks is approximately 55 to 65 points wider than that of AA banks.

That created a cost to funding differential between the majors and all other players that was virtually non-existent two years ago and for at least a decade prior to that. A protracted period of such disparity has the potential to significantly impact going forward. This signals the importance of the guarantee. Regional banks should expect to pay more given their lower credit ratings, and this is happening through natural market forces as investors price for risk. But regionals are paying twice, through the guarantee and market pricing. I do not believe that this was the government's intention and we cannot afford a double differential. The fees should be level for all banks at the rate paid by the AA rated banks.

Events over the past two years have certainly changed regional banks. As the largest regional bank, we occupy a unique space between the majors with their AA ratings and the rest of the regional banks, which have BBB ratings. We have a larger balance sheet than other regionals, but a lower credit rating than the majors. The shutdown of wholesale markets, on which Australia is heavily reliant, put the majors in a difficult position, but placed even further pressure on ourselves. It meant that we had to make some changes and we have had to adapt.

We have driven significant change in the shape and complexity of our bank. The bank we operate today is a far different organisation than it was two years or even 12 months ago. We have brought our retail and business banking together and moved out of finely priced funding and capital and intense business banking portfolios. These portfolios rely on access to wholesale funding markets, which are just not there for us, certainly not at the right price. We have had to rationalise and the result is a large regional bank no longer competing in the corporate and property banking space.

Funding as an environment is playing a critical role in competition. I believe time will tell whether the major mergers of the past couple of years will significantly impact competition. I do believe that it is in the best interests of Australian consumers and our economy for a robust, multi-tiered banking system to exist. The threat right now is that limited access to funding markets and securitisation will restrict the ability of the regional and non-banks to create the necessary competition and tension. There are plenty of participants in the market right now, but at question is their ability to offer a sustainable, competitive proposition. There are a number of options open to government to support initiatives which open up market and support competition. These include more funds from the AOFM, which would help non-bank lenders as well as the banks—and the Australian Securitisation Forum certainly has written a comprehensive paper on the various options. These have real merit.

Right now, access to funding and thus competition would be supported by the flattening of the fee on government guaranteed wholesale funding, and importantly would maintain the scheme for the security of the whole banking system. Neither major nor regional banks are currently accessing non-guaranteed funds on a sustainable basis. Investors take a holistic view of Australian financial services, and a deterioration in one sector of our banking system will have flow-on implications for all banks.

It is imperative that eventual removal of the guarantee is based on a view that takes into account all Australian deposit-taking institutions. It is important that no steps are made to remove the guarantee until the markets allow efficient issuance for all ADIs that utilise term funding.

The challenge for policymakers in Australia today is to look through all of the rhetoric and various agendas of the market movers and put in place a system that genuinely supports competition and a sustainable banking sector into the future. I am happy to take questions.

**Senator XENOPHON**—Thank you for your submission. You have said that now smaller banks, regional banks, are copping a double differential in a sense, are they not? You also talked about the need to have a robust, multi-tiered banking system. Are you saying that as a result of the unintended consequences of the deposit guarantee, the banking system is less robust and that there is in fact less competition or consumers partly as a consequence of the unintended consequence of that guarantee?

**Mr Foster**—Firstly, I would certainly make the point that the guarantee when it was put in place was absolutely the right thing to do to provide stability to the system, both from a wholesale guarantee and a deposit guarantee basis.

**Senator XENOPHON**—Sure.

**Mr Foster**—I have absolutely no argument with that. As I mentioned, I think the unintended consequence of it was that the investment markets have looked through the guarantee and differentially priced on different credit ratings for the various institutions. The challenge that that provides, if that type of position is sustained for a period of time, is that it constrains the ability of lower rated organisations, who have to raise their funds through more expensive wholesale debt, to be more competitive on a longer-term basis.

**Senator XENOPHON**—So, to put it bluntly, that hurts you commercially.

**Mr Foster**—Yes, absolutely.

**Senator XENOPHON**—This inquiry is principally about mergers. Suncorp and the Bank of Queensland are often cited as the most likely to be a target of a hostile takeover bid. Do you agree with that assertion—that you are a prime target for a takeover bid?

**Mr Foster**—We have obviously seen the landscape in the financial services sector change dramatically over the last couple of years with St George and Bankwest taken over with mergers. There are three reasonable size regional banks that remain in the marketplace. If majors want to pursue growth domestically then that would be one of the alternatives that they would look at.

**Senator XENOPHON**—As a result of the unintended consequences of the government's guarantees, in terms of wholesale guarantee funding and deposit, a regional bank such as yours is slightly more vulnerable to a takeover because you are not as competitive as a result of that double differential that you have referred to?

**Mr Foster**—I think the main focus that I would comment on initially is that the change in the landscape and funding is part of that as well as is the economic environment. That has caused us to make some fundamental decisions around reshaping and taking a strategic direction with our organisation. Certainly, the objective of that is to create a sustainable regional bank going forward. Notwithstanding any comments around or thoughts around inorganic activity, that strategy stands under whatever circumstances. Certainly, the effectiveness of that strategy is impacted by the longevity of the funding differential as it currently stands.

**Senator XENOPHON**—What do you think the impact would be on consumers if there was a merger, if Suncorp was swallowed up by one of the big four? What do you say in practical terms that would do for your customers?

**Mr Foster**—It is very difficult to speculate. I think we have not seen the full impacts of the two mergers that have already taken place over the last 12 months or 18 months. They have been undertaken under very different circumstances. So I think it would be very difficult to speculate what the impact would be. It would depend on the circumstances at the time.

**Senator XENOPHON**—I suppose one of the reasons cited for these mergers is the so-called back office efficiencies. Would Suncorp be vulnerable to that in the context of being a further subject of a merger? What would that do to jobs for Suncorp? Are you saying it is too hypothetical at this stage?

**Mr Foster**—It is a little too hypothetical. Certainly, the board has an obligation to look at and consider options as they are put in front of them. But traditionally Suncorp benefits from a broader group and the strength of our broader group in terms of synergies within the group. Beyond that it would be a bit hypothetical to comment.

**Senator XENOPHON**—In time, unless the double differential is sorted out sooner rather than later, it puts Suncorp, I would not say in a weak position, but not in as strong a position as it would have been otherwise, which in turn could have some impact if you are going to be the subject of a hostile takeover bid?

**Mr Foster**—Certainly, as I mentioned, I think our current strategy being executed puts us on a path to being a sustainable regional bank. The current double-dipping of the government guarantee does impact upon our commercial performance and, depending upon how long that differential exists, that has a more material impact over time.

**Senator XENOPHON**—And it just makes you that little bit more vulnerable to a hostile takeover bid?

**Mr Foster**—Probably more importantly in the short term, it does constrain our ability to perhaps be as aggressive from a competition point of view as we have been historically.

**Senator XENOPHON**—So the answer in short is yes?

**Mr Foster**—Again, it does certainly impact our commercial performance the longer it goes, depending on the broader circumstances, both relating to Suncorp and more broadly. It is probably a bit hard to speculate and to be categorical about that.

**Senator HURLEY**—Could I just follow on from that? Senator Xenophon has attributed a difficulty in competing solely to the difference in rate.

**Senator XENOPHON**—I did not say that solely; I would not say solely. I said it is a factor.

**Senator HURLEY**—That is what you were focusing on.

**CHAIR**—We have heard that elsewhere.

**Senator HURLEY**—All this ties into the fact that you are having trouble accessing funds, does it not? That is the only reason you would need the government guarantee. If funds were freed in other ways, then the smaller banks would not have this difficulty.

**Mr Foster**—I think part of the challenge which I talked about a little bit earlier is that the reorientation of our bank was driven by a number of things. We certainly focused on creating a sustainable bank. It is not so much an issue any longer of availability of funds; the government guarantee certainly has provided accessibility to funding. The challenge with the current differential that exists for us as well as smaller institutions and non-bank lenders is that, in their case, they may not be able to access funds because they are not an ADI and covered under the bank guarantee. In our case, and for the smaller regional banks, we access funds—certainly markets are reasonably liquid and accessible. But it is a significant cost disadvantage for us. As I mentioned, there is a number of alternatives that we would see.

**Senator HURLEY**—So you are accessing funds from your depositors or from wholesale sources overseas?

**Mr Foster**—Both.

**Senator HURLEY**—Funds you are accessing from your retail depositors, surely they are not affected? They are affected by the government guarantee in that it is an advantage for you?

**Mr Foster**—In one respect they are, certainly in terms of providing consumer confidence. The government guarantee around deposits has certainly provided that for the whole industry, absolutely. Again, the potentially unintended consequence of it is that it certainly heightened the competition for retail deposits because it tends to be in some cases, or certainly historically, cheaper to raise retail deposits than it is to access the funds from wholesale point of view, particularly with the cost differential. So that would be the difference from a retail deposit point of view. Certainly, we do raise funds from the wholesale markets.

Again, the differential tends to be around the 50 to 60 basis points difference between ourselves and the major banks. But in terms of other alternatives, which I know have been discussed through things like AOFM opening up securitisation markets, which certainly is a

source that all of the banks have used historically and certainly non-bank lenders to use to great advantage historically as well. But that market, unlike funding markets, actually has not opened up as broadly as the wholesale markets.

**Senator HURLEY**—So we are not just concentrating on the difference of fee for the bank guarantee; there are all sorts of others. Is that what you mean by double-dipping? I am sorry: you did not say that. I think it was—

**Mr Foster**—The double-dipping certainly relates to the fact that when the guarantee was put in place it was put in place with a different guarantee fee depending upon the credit rating of the organisation. So AA banks pay 70 basis points. We, as an A, pay 100 basis points and BBB pay 150. That was put in place under the assumption that the market would price equally because the paper issued by the government guarantee was all AAA rated and, therefore, the pricing would be equivalent.

But what we are seeing is between ours and the major bank the market, in addition to that 30 point differential, overlaying another 20 to 30 basis points on top of that, is taking into account our different credit rating anyway. That is what I mean by double-dipping. But in terms of the multiple options available, absolutely, the government guarantee flattening is certainly one of the steps that could be taken to equalise the competitive playing field and opening alternative sources of funding such as securitisation. That is certainly another important factor.

**Senator HURLEY**—There have been a number of complaints from non-AOFM institutions about the government guarantee. I think anything that makes it more generous would incite probably more claims of competitiveness and reducing competition in the sector.

**Mr Foster**—It depends. Certainly, the government guarantee is not applicable and relevant for some players that used to participate in the mortgage market. It certainly would make competition more valid for those that do, such as the regional banks and smaller institutions. ADIs opening up different options such as securitisation would then bring some of those non-ADI institutions and heighten it further.

**Senator HURLEY**—Okay. Just to get back to mergers, short of banning further mergers in the financial institutions, would you like to see the government ban further mergers? Would you like to see any government action in tightening up criteria for mergers?

**Mr Foster**—I think the last couple of years make that difficult to answer, particularly in the case of Bankwest was driven by extenuating circumstances. So I think it is hard to make that statement as a black and white statement. Likewise, the step before you can determine whether or not mergers and acquisitions take place is to make sure that we have a level and competitive playing field—that you can maximise opportunities to compete with the relevant players. That would be a step before considering implications for mergers and acquisitions.

It does depend a little bit on what the flow-on implication of the mergers that have taken place have occurred. As I said, there are plenty of potential providers for financial services in the market. But back to the competitive playing field—not everyone is operating on a level playing field to make those assessments valid at the moment.

**Senator HURLEY**—If I could paraphrase that answer, what you are saying is that at the current time we do not need any changes to the merger regulations, rules and regulations; that we need to be patient for a little while a see what works through the market.

**Mr Foster**—The two points I would make is to make sure that we do have a competitive playing field for the current players within that market, which provides a better place to start assessing that. The other one is that I think now is an opportune time for regulators and government to determine what type of financial services and banking marketplace that they want for the industry in Australia and use that as a backdrop for further assessment.

**Senator HURLEY**—Thank you.

**Senator JOYCE**—I declare my interest, I used to work for Suncorp. I declare that. Why are you paying 20 points in the marketplace when it is the same guarantee as everybody else?

**Mr Foster**—I think when the government guarantee was put in place there was an assumption that because they are all AAA-rated paper that gets issued, that would not be an issue. Therefore, the differential that applied on the guarantee was fair and legitimate to reflect the differential credit risks and credit ratings that each of the institutions have. However, given the balance of supply and demand, the fact is that they can. Issuance institutions have provided uninflated differential in terms of debt issuance. As I said, prior to the financial crisis, that differential did exist, but it was more in the range of five to 10 basis points. But that has blown out to more like 20 to 30 basis points, which in the normal course of a guarantee paper is absolutely valid.

**Senator JOYCE**—They must think there is some difference in their security.

**Mr Foster**—But they have essentially chosen to ignore the guarantee provided by the government and differentially priced anyway.

**Senator JOYCE**—No doubt you have been in contact with them to explain that it is the same government underwriting the whole lot.

**Mr Foster**—Yes.

**Senator JOYCE**—What do they say back?

**Mr Foster**—It is a bit of a case of supply and demand. Certainly all banks, whether they are major banks or ourselves, need the funding to continue to operate and lend to customers. Whether or not it is the absolute quantum of the issue price, which has obviously been quite significant at times over the last 12 months, that certainly contracted over recent months to a more manageable level. However, differential has been maintained.

**Senator JOYCE**—How many of these major issuance organisations are there?

**Mr Foster**—I could not comment on the specific number.

**Senator JOYCE**—Do they all put a 20-point premium on the money they give you, or is it just some of them that do?

**Mr Foster**—No, it is a fairly consistent market practice across the board. It is a dynamic and competitively based market and, as I said, driven by supply and demand. They look at what different transactions are underway and also the stability of the financial markets. As I said, absolute prices have reduced over the last nine months or so. However, the differential between us and the AA rated has been maintained at that 20 to 30 basis points.

**Senator JOYCE**—Surely there is a big advantage for someone if they want to issue it without that 20 points. Is the market of such a form that they all know each other's actions? How do they all come up to this 20 to 30 point premium?

**Mr Foster**—It is quite a transparent financial market.

**Senator JOYCE**—Is there a multiplicity or organisations that you deal with or just a couple?

**Mr Foster**—It is quite a large number across the board. In our case we have tapped markets in the United Kingdom, Europe, Japan and the US. It is quite a abroad range and involves institutional placement as well as private placements.

**Senator JOYCE**—Just back into the aspect of mergers. What is your definition of a market? People always talk about a free market and not interfering in it. What is your definition of a market?

**Mr Foster**—I am not quite sure exactly where you are going.

**Senator JOYCE**—Does it have a multiplicity of players or can it have a few players or two or three players? When is a market no longer a market? I will cut to the point. How small can you make a market before it is no longer a market, it is an arrangement between major players?

**Mr Foster**—I think that depends, a little bit. The way I would look at it is more around different institutions have different segmentation strategies around different types of customers. Certainly what we have done over the last nine months is a good illustration of that. We have elected to no longer compete in certain parts of the market because of the different factors that have been brought to bear with the financial crisis. So some institutions can be very targeted and pick very niche segments, which in definition is a market in its own right, and they may in fact be only one of a very few competitors which may be a very small market, though—or more broadly to the mass market where you may have 30 or 40 people who provide mortgages to the mass market.

**Senator JOYCE**—I will cut to the chase. Can I set up a bank? Mr Foster, if I decided today that I am over the Senate, it is boring me a little bit and I think I might start a bank instead, how would I go?

**Mr Foster**—There are a number of regulatory hurdles to overcome. It does come back to the points about who you want to set up the bank for, what type of customers to target, and where you would go from there. We have seen a couple of offshore institutions come and set up very successful strategies.

**Senator JOYCE**—I want to grow it in Australia. Can I just go out and call it the 'Bank of Barnaby' and open for business?

**Mr Foster**—Assuming that you met all the regulatory hurdles and so forth.

**Senator JOYCE**—Give me an example of some of them. Once more, I will get to the point. It is a highly restrictive market. You have to have capital adequacy and capacity, and there is immense regulatory oversight. It is a market which is implicitly near impossible to get access to, unless, as you say, you have an overseas entity that already has that capacity to finance the overheads. You cannot just build up a bank in Australia. I do not know whether it has ever happened. There have been quasi institutions. There has been no build-up lately, or any new private bank, has there?

**Mr Foster**—Certainly, in a more level playing field we have seen strong groups among the regional bank sector prior to the financial crisis in terms of growth. While not strictly banks as such, certainly, we have seen significant competition and successful players grow in the mortgage space over recent years.

**Senator JOYCE**—I had the joy of going through the transformation process when they created Suncorp. I do not know whether you were with them at that stage.

**Mr Foster**—No.

**Senator JOYCE**—Was Metway a government bank or a private bank?

**Mr Foster**—At one stage it was but then it was obviously floated.

**Senator JOYCE**—But it was government based.

**Mr Foster**—Yes.

**Senator JOYCE**—How about Suncorp? Was that a government bank or a private bank?

**Mr Foster**—Again, regional. I think it was a government insurance agency.

**Senator JOYCE**—What about the Queensland Industry Development Corporation? Was that a government bank or a private bank?

**Mr Foster**—Again, originally I believe it was a government organisation.

**Senator JOYCE**—The only one that really had the capacity, of all those three banks, and became one bank. At the time they were trying drag in the Bank of Queensland, which luckily they did not drag. I think the Bank of Queensland has benefited somewhat from being outside that scope. From three, we got one. I do not know necessarily whether the one was better than the three we had.

**Mr Foster**—I have not got the history of the prior organisation, so I probably cannot answer that for you.

**Senator JOYCE**—Nonetheless, do you know of any private enterprise that has set up a bank in Australia and ever survived?

**Senator HURLEY**—Bendigo.

**Senator JOYCE**—Bendigo. Anyone else?

**Mr Foster**—Not that spring to mind. I am sure there are plenty of building societies and credit unions that are quite successful.

**Senator JOYCE**—The nature of banking is completely different to the nature of other markets—that is, the capacity to enter them is highly regulated, extremely difficult. Therefore, one would have to be inherently suspicious of bank mergers in what is ultimately an extremely difficult market to participate in any case.

**Mr Foster**—Certainly, the regulation is more significant for a full-service ADI, as I mentioned. I think there are a number of examples of niche players targeting particular products within the industry.

**Senator JOYCE**—One would suspect that, just at a very cursory level. It infuriates me every time I go to the bank and they charge me $2 to use their ATM. I know it does not cost them $2, but they charge me $2. They seem all miraculously to come up with the same charge.

**CHAIR**—It is a miracle.

**Senator JOYCE**—How does that come about? Is that just coincidence, or is it the fact that the market is so centralised that it does not take much? People do not have to vocalise their coordination; it just becomes implicit in how they act because the market is so centralised and so well understood?

**Mr Foster**—I think there is certainly a lot of transparency in the market, particularly around product pricing, and certainly competitive pressures in those respects do draw people to a reasonable common ground. However, I think certainly over the last nine months, and more recently with some of the fee changes announced in the last couple of weeks, different banks have opted for different paths in that respect. So I do not know that I could categorically say that everyone gravitates to the one outcome across the board.

**Senator JOYCE**—This will be interesting. The changes that have been made and some of the reductions in cost, would you put that down to market pressures or government pressures?

**Mr Foster**—I think that for most decisions that financial institutions make, they take into account all stakeholders in their decision making.

**Senator JOYCE**—So if they were reacting not to market pressures but more to government pressures, would it imply that the market as far as that is concerned is not really present and, therefore, to centralise the market further beyond what it is would be inherently dangerous? Do you think the markets could operate with two major banks? If NAB took over Westpac and ANZ

was taken over by the Commonwealth, and you disappeared into NAB, do you think that would be competitive? Would the market at that stage be more or less competitive than it is now?

**Mr Foster**—It would be pretty hard to speculate without knowing what the balance of the industry and sector looks like.

**Senator JOYCE**—Have a punt.

**Mr Foster**—I would not like to speculate.

**Senator JOYCE**—I would say that it would be far less competitive. Can we have a competitive environment with just one player?

**Mr Foster**—Again, that would be difficult—

**Senator JOYCE**—If we had just one it would be difficult to assess.

**Mr Foster**—Again, it is a bit speculative not knowing what the total sector and industry looks like and what other players, if any, there were.

**Senator JOYCE**—So in a town where there are two players and now there is one player, you would say that there would be the same competitive tensions as there were before?

**Mr Foster**—Again, it is hard to answer that without a complete backdrop of where the industry was.

**Senator JOYCE**—Do you believe there should be no restrictions on bank mergers?

**Mr Foster**—No, I think it is important for the ACCC to consider all the factors relevant at the time and balance those up against the backdrop of what the banking structure looks like and the pertinent environmental factors at the time.

**Senator JOYCE**—You have a lot of faith in the ACCC. Do you want to tell me the last time the ACCC actually rejected a merger?

**Mr Foster**—I could not recall.

**Senator JOYCE**—Do you know what powers the ACCC has? If a merger goes through and it is not working out—basically, it has just compromised the marketplace—what powers does the ACCC have to break an entity?

**Mr Foster**—I do not know that they have sufficient powers to do that. Looking at the mergers recently undertaken, we would want to see how they pan out over time.

**Senator JOYCE**—Have you heard of any new powers that the ACCC is going to get to bring about divestiture in organisations where it becomes quite apparent that there are not competitive stresses giving consumers the best deal in the marketplace?

**Mr Foster**—I am not aware of that.

**Senator JOYCE**—Because there are not. Why would we want to have more mergers in an already over-centralised market?

**Mr Foster**—Again, it is hard to speculate on that. But I would come back to the point that it is important that with the current players we have a competitive playing field for everybody to compete on an equal standing and with players not being disadvantaged. That would be the first point to come back to. The second would be that it is important for regulators and government to have a view around what the ideal structure of the financial system in Australia would be.

**Senator JOYCE**—Obviously some of the competitive stresses that you are dealing with in your bank are because of access to funds. When do you envisage that we could put aside the government guarantee? Are we moving to a position where we could scrap the government guarantee and move on?

**Mr Foster**—I think all players in the industry would like to see the industry move as quickly as possible to a point that the guarantees, both of wholesale funding and retail deposits, are no longer required. I think that is a given. We are certainly still seeing significant uncertainty globally in terms of financial markets. They are improving, but they are still quite fragile.

Back to a point I made—it is important that before any changes are made to either the wholesale or deposit guarantee that the ability of all players, all ADIs in the system, is taken into account both on a domestic and a global basis before any changes are made. But given that fragility that still exists in the system, I think that is still some time away.

**Senator JOYCE**—Thank you very much.

**CHAIR**—Thank you, Mr Foster. We have heard quite a lot of witnesses over the various hearings we have had who have said it is very difficult to expect new banks to emerge now that we have reached the point that we have with this concentration of four banks and just a few individual operators such as yourself. Many people think that is bad for competition within the Australian market—bad for the Australian public. What are your views about foreign banks coming into the Australian market with plenty of capital and resources to set up an extensive branch structure and to operate in competition with the four big banks in this country? Would you have any reservations about that happening?

**Mr Foster**—I would not have any reservation about that. I think certainly most of the global banks have pressures in their home markets and so forth that they are dealing with. So I would say that the likelihood of that in the short term is probably not significant, just given the home pressures that they are dealing with. I would come back to the point, though, that it would depend a little bit on what the playing field was like that they were entering. If it was a level playing field then there is no reason why that could not occur, provided that it did it within the framework that the regulators and government determine in terms of what a sustainable banking system looked like in the country.

**CHAIR**—Bankwest was bought by a Scottish bank and that was their entry into Australia because there was already an established branch network in Australia, in particular. Some people

do see competition as having a positive benefit for the Australian public. Do you agree that we have an over concentration, lack of competition and somehow or other we have to free up this situation so that there is competition to benefit the Australian consumer?

**Mr Foster**—A couple of points I would make are that it is premature to determine the impact of the recent mergers that have taken place. Certainly, in the case of Westpac and St George the ACCC found that they thought there would be sufficient competition at that point in time, albeit it was prior to the major financial crisis. Obviously Bankwest-CBA is under different circumstances. I think if I look at certain products within the banking system there are certainly plenty providers that exist to provide those services. But because we are competing on different levels on the playing field, the ability of all the players to compete equally is hindered currently.

**CHAIR**—In respect of the negative impacts on the smaller operators such as yourselves, with the higher charges for the bank guarantee and so on, in the last lot of hearings we heard from Aussie bank, who are operating as a sort of mortgage broker at the moment. That is a long way from what they were doing five years ago.

**Mr Foster**—Yes.

**CHAIR**—So across the whole scene there has been a contraction of service providers in the Australian market of various kinds. I would view that as a matter of some concern. How does that compare with countries like the US and the United Kingdom and our situation?

**Mr Foster**—I think the industry structures are quite different between geographies from my knowledge. Certainly, the closest parallel to an industry structure is probably ourselves and Canada, which has five major banks. They have a regional bank presence, although they tend to be smaller regional banks with lower credit ratings. The situation in the United Kingdom and the US, particularly the US, is far more fragmented. They have national banks and different regional structures as well as a lot of very small institutions that obviously have failed over the last 12 months or so: likewise in the United Kingdom. That tended to be a grouping of multinational banks with a different industry structure to Australia.

So the Australian structure in some ways is a little unique, and we are the only area that has an A-rated regional bank. Canada has tended to have BBB and lower-rated institutions and tends to be focused on more specific geographies whereas historically our regionals have had a broader focus and footprint. Certainly the regulatory frameworks have been quite different, particularly in the US and UK. I think we have seen borne out through the stability of the system here and in Canada that the strengths of the regulation have supported these systems well in comparison.

**CHAIR**—Is the Canadian regulatory system similar to ours? I have heard that Canada and Australia are two countries which do have very sound banks and have survived the global financial crisis better than other countries.

**Mr Foster**—I believe the regulatory frameworks are quite similar. A number of market facets are quite similar. As I mentioned, they have five major banks. They do have some regional banks which tend to be focused on provincial markets, particularly Quebec, given the European background. Most of the major banks there, unlike Australian banks, do tend to have a more

international flavour and are particularly focused into the US and in some offshore locations as well.

**CHAIR**—Thank you very much for appearing.

[2.44 pm]

**ZUMBO, Associate Professor Frank, Private capacity**

**CHAIR**—Welcome, Professor Zumbo. The secretary has just noted that you are a double feature today.

**Prof. Zumbo**—Yes, a double header.

**Senator JOYCE**—Where is the popcorn?

**Prof. Zumbo**—Exactly. Have an intermission.

**CHAIR**—I welcome you yet again to the economics committee and invite you to make an opening statement.

**Prof. Zumbo**—Thank you. As always, I appreciate the courtesies extended to me by the committee. I welcome the opportunity to make an opening statement and give evidence today. I have looked at this issue very closely over many, many years, but more specifically over the last couple of months. I have to say following that review I am very concerned about what I will describe as the competition vitals—the signs of the patient, the patient being the Australian banking sector. I am concerned there is some hardening of the arteries. I think there are some other issues that are going to cause problems.

The vital signs are concerning in the sense that we see that the four major banks have increased their market share in home lending and in deposits significantly—certainly in the previous 18 months. We have seen increases in fees over a period of time; we have seen an increase in interest margins over a period of time; we have seen an increase in net interest margins in recent times. That is very troubling because all of those are indicia of a competition that is weakening and perhaps failing. It is a bit like having a stress test for a heart condition. Signs are there and I think we have to look very carefully.

What is concerning is that in a very short period of time, in the space of 18 months, we have lost two vigorous competitors—the Commonwealth Bank has taken out Bankwest. Bankwest has been a significant, vigorous and independent player in the market. The Commonwealth Bank previously took ownership stakes in Aussie Home Loans and Wizard. Those two—Aussie Home Loans and Wizard—were significant non-bank mortgage providers. Westpac took out St George and previously RAMS Home Loans.

When you look at all that, firstly, a couple of things emerge. One is that CBA and Westpac have become very significant market players. As a result, that significantly increased their dominance and market power. From that scenario, what worries me the most is two possible scenarios. One is when you look at the market share figures of NAB and ANZ. If you were to add those two together, you would come to a market share that would be roughly equivalent to CBA's market share currently and Westpac's market share currently. My deepest concern is that there will be conversations or thought given to the possibility of NAB and ANZ merging.

Yes, there is a four-pillar policy. But I am concerned that that is only a policy. I think if the government is truly committed to the four-pillar policy, it should enact its regulatory framework and the four-pillar policy should be codified as a law to lock in those four banks, the major banks.

Another scenario is probably the more obvious one, where NAB will need to make some acquisitions. and ANZ will need to make acquisitions. I have to point the committee to a very open interview that the chief executive officer of ANZ gave on *Lateline* last week and other comments from the chief executive officer ANZ. It was very telling that the chief executive officer suggested that organic growth between the major banks is challenging and therefore growth comes through acquisitions. He is not saying anything revolutionary in that proposition. Yes, growth in the banking sector comes through acquisitions as has been dramatically shown in recent years.

Within that context I am concerned also about the operation of section 50 of the Trade Practices Act. It is deeply troubling that 97 per cent of mergers that the ACCC considers are approved by the ACCC. I have to say that, if all my students got 97 out of 100 in their exams, they would all be jumping for joy. I can imagine that the big end of town and others and their legal advisers who appeared previously today say there is nothing wrong with section 50. I say there is something wrong with section 50 because when 97 per cent of mergers are going through, it does not take long before you have a highly concentrated market.

I look at these issues from strictly a competition and consumer perspective. I am concerned about what is best for the consumer, what is best for competition. The banks will have their self-interested line. They have to show growth for all sorts of reasons. Those who advise the major banks will want all their mergers or as many of them to go through the ACCC as possible. But where I sit I am concerned that competition is shrinking dramatically and that is leading to higher fees, higher interest margins.

A lot has been made of reductions in fees of late. With all due respect, yes, it is great that we have reductions in fees, but there should be many more reductions. At the moment it is just tokenism. I compare it to Coles and Woolworths having the odd 50 cents off a litre of petrol, but the rest of the year they are gouging you on grocery prices. With banks, the interest rate margins are increasing and as a result they have the luxury of cutting back some fees here and there. They should be cutting back many more of those fees.

The reality is that the majors do act as a cosy club. With all due respect, they shadow one another. Some go up on interest rates, others follow. Some cut a fee and others follow. To me that is not the test of true, genuine competition. We need a diverse market that leads to diversity in the offering in terms of the key principle being competitive interest rates.

The reality is those non-bank mortgage providers having been knocked out has removed a great source of competitive tension. You can see that the net interest margins started to increase after Bankwest, St George and those non-bank providers were taken out of the picture.

In terms of creeping acquisitions, CBA took out a stake in Aussie Home Loans. That was a piecemeal acquisition in respect to earlier evidence. A creeping acquisition is any small-scale acquisition that happens over a period of time that collectively has an adverse impact on

competition but at the time it is considered because it is small scale and it does not fall foul of section 50.

The biggest problem with section 50 is that the substantial lessening of competition test is a very high threshold. It has been a equated to the ability of the merged party to raise prices without losing business. Very few corporations have that ability and as a result just like section 46 following the Boral case, just like the 97 per cent success rate of mergers, you can understand why we have a highly concentrated market. Thank you.

**CHAIR**—Thank you very much, Professor. We will go to Senator Xenophon because it is his referral.

**Senator XENOPHON**—The Law Council, in their evidence, effectively said there is no evidence that the current provisions do not work; that if you try to change them, particularly in the context of the global financial crisis, it would be absolutely the worst time to do that; that we have strong, stable financial institutions; and that we should leave things as they are, particularly in the context of the global financial crisis. What do you say to that argument?

**Prof. Zumbo**—I would say, with all due respect to my colleagues at the Law Council, that they would say that—most, if not the vast majority of members, being lawyers representing the big end of town, and they have a vested interest in getting as many of those mergers through as possible. I do not have that vested interest; my concern is consumers. Global financial crisis, yes, that is an issue. I understand that. But let us not overplay that. Certainly, there are signs that the economy is improving. The Australian economy is fairly resilient and has been. We have a strong banking regulatory framework. As a result, to say all is well is, I think, dismissive.

As I said, it is a bit like having that stress test. If you know anything about those stress tests or heart conditions, they are not that sensitive. They may give you a tick of good health, but you might fall over a few weeks later because the sensitivity of that analysis is not as you would expect. That is the point I am making. Following more sensitive analysis of these issues, I think not all is well when you look at all the vital signs—competition vital signs where fees have been increasing, where interest margins have been increasing, where 97 per cent of mergers considered by the ACCC are approved. I think it is very dismissive and I think it is dismissive to say there is no problem.

Having said that, I do believe in terms of the ACCC—one thing that the ACCC can do and has not been good at doing in the past is having post-merger reviews of particular mergers. They make a decision at any point in time and that decision needs to be tested subsequently. There is research in the United States that suggests that competition regulators in the United States should be looking at these post-mergers reviews to look back to see whether they made the right decision so they can then finetune their analysis. I have read comments on the record where the ACCC has expressed some concern and regret about Bankwest, for example.

**Senator XENOPHON**—Could you provide some further details of that in terms of the post-merger review?

**Prof. Zumbo**—Sure.

**Senator XENOPHON**—Ms Freeman from CHOICE said in her submission earlier today—I think a broad summary is that there ought to be a greater degree of specificity, not programmatic specificity in terms of merger proposals; in other words, the checklist and things like that. I think the Law Council said that that was not necessary. What is your view at least for there to be some guidelines and greater transparency and public consultation?

**Prof. Zumbo**—I am all for greater transparency. I think those public assessment documents—that is competition assessment documents—that the ACCC brings out are a step forward. I think they could be more comprehensive. I certainly believe that submissions, when they are not confidential, should be made available on the ACCC website. I believe transparency leads to a greater debate, and we need to have a greater debate. To some degree, the ACCC's hands are tied by substantial lessening of the competition test. I think it is a very high threshold.

Having said that, I think the ACCC could approach the issue with much more rigour in the sense of testing some of these propositions. We heard that basically the Bankwest acquisition had to be accepted because of financial conditions. When you dig down a little bit further, the reality is that the parent, HBOS, of Bankwest was bought out by Lloyd's and then Lloyd's was bought out by the government. So I think it was a bit premature to say that Bankwest would not have continued as an effective competitor because of the global financial crisis. So I think sometimes things are put in those assessments to justify a position, a decision at a point in time, without duly being tested either at the time or subsequently post-merger.

**Senator XENOPHON**—Chair, do I have time for one more and that is it?

**CHAIR**—Yes.

**Senator XENOPHON**—This is something that I put to the Law Council and they indicated support for a more global consideration of the market. However, since the Westpac and St George merger, Westpac operates about a third of all customer service points in South Australia and a quarter of ATMs in New South Wales and the ACT. These are well above the 15 per cent benchmark that the 1999 ACCC merger guidelines discuss. Should the ACCC, for the purpose of assessing mergers, consider the proposal on a more localised scale as well? Should the state or regional market not also be a relevant market for retail banking?

**Prof. Zumbo**—Step one, the paramount consideration of the ACCC should be the Australian consumer. It does not surprise me one little bit that the Law Council, with respect to them, would argue for a global market. It is a very simple proposition in competition law that the wider the market definition the less likely a merger is going to substantially lessen competition. Obviously the Law Council has a vested interest in defining market as broadly as it can.

If you define the banking market as global, you will never stop any merger in Australia on that basis. Obviously that is where they are headed with that proposition. The reality is that markets are localised and, as much as we talk about the global world, there are still national markets. We see foreign banks come into Australia. I can provide you with a long list from APRA of foreign banks, but they do not make headway. They do not because the incumbents—the four major bank—are so well entrenched. We see it with Coles and Woolworths. It is hard to get foreign competitors into the country because they need to get retail outlets and what have you. They are same problems with foreign banks trying to break into the Australian market.

I would argue that there is an Australian banking market. Sure, you have regard to international factors, but only at the margins for the simple reason that the four major banks are so dominant and that Australian consumers are finding that is detrimental to the consumer interest, to their interest.

**Senator XENOPHON**—It is not out of an abundance of caution that I declare that I regularly speak with Professor Zumbo. I cannot say that I have rehearsed any of these questions with him.

**CHAIR**—He did not provide them to you, either?

**Senator XENOPHON**—No, he did not provide them to me either. On two occasions Professor Zumbo has come to Adelaide and I have met his travel expenses to meet constituent groups to discuss competition issues. So I just wanted to make that clear. It was without remuneration.

**Senator JOYCE**—I think I should start by putting on the record that I, too, know Frank quite well. I recollect one night where we had far too much to drink—no! I know Professor Zumbo extremely well, so I will not go through the mistrust of pretending I do not. But, utilising his knowledge of trade practices law, let us wave a magic wand and say, you have clearly spelt out some problems, what are your solutions?

**Prof. Zumbo**—I have six recommendations in my submission. As I said, I think the four-pillar policy should be codified. I think we need to draw a line in the sand and that is one line in the sand. I do believe the ACCC should revisit the Bankwest and St George acquisitions. The ACCC does have a limited window of opportunity under section 81 of the Trade Practices Act to seek a divestiture of an acquisition in breach of section 50. Given the ACCC's public concerns—and I am simply quoting public reports.

**Senator JOYCE**—Have you ever seen one of those divestitures ever happen?

**Prof. Zumbo**—No. But that does not mean that it should not be tested. It does not mean that it is not there to be used. A divestiture power is a very important power because as markets become more concentrated the only order or remedy you have left is a divestiture to break it up. The Americans have done it for over 100 years and it has been very successful in a number of industries to inject competition. In Australia we have a very limited divesture power dealing with breaches of section 50. I do believe—

**Senator JOYCE**—What powers would be used if we were lifting powers from the United States act? How would they look? What are those powers we would lift? How would we bring them across and how would they work?

**Prof. Zumbo**—What we need ultimately is a general divesture power, which the United States does have and also the United Kingdom has.

**Senator JOYCE**—For the record, can you tell us where those powers are?

**Prof. Zumbo**—The United Kingdom arises out of the Enterprise Act. I can provide the secretary with the details. Divestiture emerges out of the Sherman act in the United States. They

are general divesture powers. The United Kingdom provides a sophisticated regulatory framework for dealing with divesture where the competition commission there can make an order where the market structure is such that it is detrimental to consumers and competition.

I favour the United Kingdom model because it sets out a nice registry framework, provides business certainty as to exactly when an order would be used, and there are quite a number of safeguards for the use of that order. A divestiture power is a last resort; it is when all else has failed the only way you can inject competition.

The reality is that in market economics, the so-called free market view of world, companies merge until you are left with one. Your point earlier is well made about in a monopoly; you do not have a market. But it is the tendency of a market economy to head that way. You need some vehicle. The Americans recognised over 100 years ago the necessity of breaking up that monopoly or breaking up those market structures that are detrimental to consumers.

**Senator JOYCE**—Why do you think we do not have those powers in Australia?

**Prof. Zumbo**—To be quite blunt, I think the big end of town has been very effective in opposing those powers.

**CHAIR**—Who has been very effective?

**Prof. Zumbo**—The big end of town. They and their legal advisers have been very effective in stopping any changes to the Trade Practices Act. We saw it with section 51AC, which is the unconscionable conduct provision. I was involved in the drafting and implementation of that. We had suggestions from the big end of town that it would be the end of western civilisation was we know it. Ten years later it has been neutralised to a point where it is ineffective. In 1974, the big end of town opposed the Trade Practices Act.

We were one of the last mainstream countries around the world to have these. We were very late in coming to the trade practices club, if I can put it that way. The Americans had them in the 1890s or early 1900s. There has been a very effective lobby in Australia by big business and their legal advisers against any change to the Trade Practices Act that may strengthen the act. That is another line that needs to be drawn in the sand, because our act is becoming weakened by court decisions, by inaction by governments of all persuasions, and the act needs to be strengthened.

**Senator JOYCE**—When you talk about inaction, can you give any examples of that?

**Prof. Zumbo**—It took a long time to strengthen section 46. There was a High Court decision in 2003—the Boral case—which rendered section 46 essentially useless. It took four, five or six years to get to a point where we had the Birdsville amendment, which the then opposition supported, but upon coming to government tried to repeal it. It was not repealed because the coalition and Senator Xenophon voted against its repeal. Every gain in strengthening the Trade Practices Act is hard fought. Then when ultimately you get that change, there is a rearguard action to undo that change.

**Senator HURLEY**—In your submission on page four on table two you show the major banks' net interest margin and Australian operation versus global operations. I take it that that is the global operations of Australian banks.

**Prof. Zumbo**—Yes.

**Senator HURLEY**—It shows that difference reducing quite markedly to be almost same. Then following the global financial crisis, and the conditions arising from that, it is spread out. You attribute that solely to the acquisitions that the big four banks have made. But it is really over a relatively short period, just over a year. Yet, on the basis of that and other things, you have made six quite drastic recommendations for changes in the law. Would you think that we should, given the volatility of the financial markets, operate just on the basis of the last year or so and make major changes like that?

**Prof. Zumbo**—The global financial crisis has been used in an opportunistic manner by the four major banks to strengthen their position. They have been very opportunistic, they have taken out the competition. You have to remember that the St George merger was sought pre-global financial crisis. That was waved through in circumstances where I believe it should not because St George was a vigorous competitor. Once those competitors are knocked out of the market, we see an upward trend in the net interest margin.

A trip has to start somewhere. Yes, maybe it is very early on, but we have had 18 months of it. It is clear that that trend is going upwards; those interest margins are getting better for the four major banks.

**Senator HURLEY**—But that is not an immutable trend, is it? If market improves—

**Prof. Zumbo**—It is not unusual when competition is knocked out.

**Senator HURLEY**—Are you claiming that competition is knocked out completely?

**Prof. Zumbo**—To a significant extent, yes. You have major competitors, Bankwest and St George, the major non-bank mortgage providers, and they have all been knocked out of the market.

**Senator HURLEY**—But they started up the mortgage providers, they only started up—

**Prof. Zumbo**—In the early part of that graph—early 2001.

**Senator HURLEY**—Why could not other mortgage providers start up again if market conditions improve?

**Prof. Zumbo**—They may, but the reality is that we are looking at the here and now and here, and now consumers are being gouged.

**Senator HURLEY**—You are looking at the here and now. I am saying—

**Prof. Zumbo**—I will look long term.

**Senator HURLEY**—In a year or two when the market improves, we may see competitors coming back into the market. We have made dramatic changes to the financial sector on your recommendations and maybe caused significant disruptions in order to satisfy a short-term need that you see.

**Prof. Zumbo**—I do not believe it is short term.

**Senator HURLEY**—The trend is not immutable.

**Prof. Zumbo**—We have believed that foreign banks would introduce competition all the way from the days that Prime Minister Keating allowed foreign banks in. They have not been the strong force that Prime Minister Paul Keating thought they were, and that is 30 years later.

**Senator HURLEY**—There have been other strong competitive forces.

**Prof. Zumbo**—Yes.

**Senator HURLEY**—As shown by that very graph.

**Prof. Zumbo**—And they have been taken out of the equation. It takes time to build up. Senator, these non-bank providers took a while to build up their presence. The thing is that, in relation to the barrier to entry, we have talked about regulation but also brand awareness. If you are a non-bank mortgage provider, you start afresh. You have to advertise and you have to build awareness. But for the foreseeable future, you need to get finance. It is going to be a struggle for these non-bank mortgage providers to get that finance at the right price. So I do not see in the foreseeable future that these non-bank mortgage providers will be coming back into the market.

**Senator HURLEY**—What is the foreseeable future?

**Prof. Zumbo**—I do not see it for at least five years.

**Senator HURLEY**—Because there has been no economic recovery in five years? What is the basis for that?

**Prof. Zumbo**—There comes a point where the market is so locked up that it is very hard for new entrants to penetrate. You have to look at the business reality. The business reality is that the four major banks have become so dominant—they have increased their dominance. That becomes itself a barrier to entry. We have it in other industries and we are seeing it now in the banking sector. So the dominance of the four a major banks will be such that it will be hard for any new entrant to come in without just going beyond the margins. We have a lot of foreign banks here already, and they are only—

**Senator HURLEY**—I do not know why you are talking about foreign banks; I am not. I am talking about mortgage providers and other entities, including foreign banks, I guess. But I am not saying that foreign bank are the ones that are necessarily going to provide the competition.

**Prof. Zumbo**—I am glad you agree that they may not, because, on the evidence, they have not. In terms of non-bank mortgage providers, as I said, in the foreseeable future, given the

restrictions—given dominance of the major banks—it is a bit like me trying to open up a corner store and trying to compete with Coles and Woolworths. These non-bank financial providers are going to struggle to get back into the market. That is not to say that they will not, and some will not come into the market and some of them may become successful over a period of time. When you look at the experience of RAMS, Aussie Home Loans and Wizard, it took them periods of five, eight, 10 years to have that sort of level of penetration, and that was after a lot of advertising and hard work.

**Senator HURLEY**—In order to address the situation, we may not get competition back for five years or so, and you want to pull apart a couple of mergers that have already taken place, including one that has been in operation for some time with the Commonwealth Bank and Westpac mergers.

**Prof. Zumbo**—That was last year.

**Senator HURLEY**—If that were pulled apart and the Commonwealth were made to divest itself of the Bankwest operation again, we have just heard Suncorp here and other people say that they are struggling in some respects in the market. Do you think that Bankwest would be successful then if you pulled apart the merger?

**Prof. Zumbo**—I believe it was a mistake to let that go through when it did.

**Senator HURLEY**—Yes. But now you are recommending that it be pulled apart.

**Prof. Zumbo**—Yes, and there would be an orderly framework for doing that. I am not suggesting a fire sale. I mean a divestiture order can be tailored. For example, Bankwest could be list as a separate entity. The CBA could pare back its share holding over a period of time. It is like an initial public offering. You put shares onto the market. If there was an interest, people would buy those shares.

**Senator HURLEY**—The Commonwealth would be made to hold an interest in an entity that they know in the future they are going to have to divest and will be a competitor. They will be major shareholder while other people slowly dribble in.

**Prof. Zumbo**—We can put it on the market now. But I want there to be an orderly transition if we go down that path. I have to be clear: a divestiture order would be premised on a finding by a court that there has been a substantial lessening of competition. A court may not find that and, therefore, there would not be a divestiture order if there was not that finding. I believe if there was a finding that the merger did not substantially lessen competition that would provide further evidence that the substantial lessening of competition test is too high a test. That is my very fundamental proposition in this submission.

**Senator HURLEY**—So your fundamental proposition is that the Commonwealth should divest Bankwest.

**Prof. Zumbo**—No, I have to correct that.

**Senator HURLEY**—No, you said that if the court did not find that that was the case, then the test was not good enough.

**Prof. Zumbo**—If there was a breach of section—

**Senator HURLEY**—The logical conclusion of that is that you think it should be divested.

**Prof. Zumbo**—If there was a breach of section 50, which only a court can find, the court then has the power under section 81 to order a divestiture, if it so chooses. No doubt the court can find that there is no substantial lessening of competition. But the impacts of that acquisition on the power of the CBA are that it has increased its pricing power, it has increased its market power, and it has increased its market share. When you take all those factors into account and the substantial lessening test allows that merger then I would be very nervous from a public policy point of view about a test that will allow a merger that leads to the destruction of competition in the way that that merger has.

**Senator HURLEY**—Let us talk about the divestiture provisions you were referring to in the United States, and so on. When you were talking about those, you were saying that they would be a last resort and you were talking about monopoly situations.

**Prof. Zumbo**—Not only—

**Senator HURLEY**—Where are we taking about a monopoly situation in the financial sector in Australia? Where in the United States has there been forced divesture in a non-monopoly situation?

**Prof. Zumbo**—When I said monopoly, that is one last resort. The reality is that you would never let it get to that point. The United Kingdom framework looks at market structure. I say monopoly as a shorthand to simplify the debate. But, lest that confuses, Senator, I will be very specific and say that you look at the market structure in the United Kingdom proposal. If that market structure is detrimental to consumers and a finding is made after a very transparent, very open and public process, then that is one of the orders that can be issued as a way of undoing the damage to competition and restoring competition. There have been small instances where divestiture power has been used the United States, for example. It has been a way of injecting competition into a market where competition has failed or is failing badly. So it is about resuscitating competition. You look at the market structure, if the market structure is failing—

**Senator HURLEY**—In what sense do you think the competition in the financial sector industry has failed badly? Is there not a range of products; is in there not a range of fees and charges?

**Prof. Zumbo**—Senator, you say a range of products from four major banks that shadow one another. Different products are called different names, but the infrastructure is very comparable, the fee structures are very comparable.

**Senator HURLEY**—You are talking as if we only have four banks. We do not have four banks in Australia; we have a range of regional banks and smaller banks, the Macquarie Bank,

and we have banks operating on the internet. Let us not accept that there are only four banks in Australia.

**Prof. Zumbo**—No, Senator. There are four major banks that have a stranglehold on the Australian banking sector.

**Senator HURLEY**—On the retail scene, are you saying?

**Prof. Zumbo**—Yes.

**Senator HURLEY**—On the entire banking sector?

**Prof. Zumbo**—Look at the numbers, Senator. The four major banks control 86.54 per cent of the bank home lending market.

**Senator HURLEY**—So we are just talking about the home lending market.

**Prof. Zumbo**—That is one measure.

**Senator HURLEY**—Okay. So those four have a majority share of the home lending market.

**Prof. Zumbo**—It is an overwhelming market.

**Senator HURLEY**—On the basis of that majority in that very important and very large but not the sole area, you are going to make those four banks in a volatile economic situation divest themselves of acquisitions?

**Prof. Zumbo**—If they are in breach of the Trade Practices Act then the remedies of the Trade Practices Act—

**Senator HURLEY**—Are they in breach of the Trade Practices Act?

**Prof. Zumbo**—I think there is a strong argument to be made for it.

**Senator HURLEY**—So you are arguing that they should be made to divest?

**Prof. Zumbo**—Yes. I am arguing that in breach—that those acquisitions were in breach of section 50. They at the very least should have been challenged more vigorously than they were by the ACCC.

**Senator HURLEY**—Why are they in breach of section 50?

**Prof. Zumbo**—Because I believe there is a strong argument to be made that they are in breach of section 50 on the basis of my analysis of the impact on competition.

**Senator HURLEY**—Yes, but can you be specific? Why are they in breach of section 50?

**Prof. Zumbo**—Because it has increased their dominance; it has increased their pricing power.

**Senator HURLEY**—That is one.

**Prof. Zumbo**—It has increased their market share. These all then become barriers to entry for new competitors. Statistics in terms of percentage of the home lending market, or bank deposits, are all significant percentages. That is the point I am making. The court may disagree with me.

**Senator HURLEY**—They are in breach of section 50 because they increase their market share?

**Prof. Zumbo**—Yes, pricing power—the ability to dictate terms. For example, there are instances where RBA has undertaken some practices with mortgage brokers about the number of mortgages they have to sell in order to be accredited. That is a unilateral application of market power. They have market force; they exercise that market power. That market power has been increased as a result of those acquisitions.

The alternative to a divestiture order is a penalty under the Trade Practices Act. I have to be clear lest I suggest to the committee that divestiture is the only order. If there is a breach of the Trade Practices Act, it should be prosecuted without fear or favour. If that means a financial penalty, good. If it means a divestiture, that is a matter for the court. I am just bringing those to the attention of the committee.

**Senator HURLEY**—Okay, I will leave it there.

**Prof. Zumbo**—Thank you, Senator.

**CHAIR**—We have heard that we have 120 credit unions in Australia. Do you see them being able to consolidate and set themselves up in due course as an alternative bank?

**Prof. Zumbo**—Yes, possibly. Obviously, as the CBA and Westpac have got bigger, that has had a domino effect. It has forced them all to become bigger. That is why it is imperative that the chief executive officer of the ANZ says he is looking for growth through acquisitions. Having let CBA take over Bankwest, having let Westpac take over St George, you have created this enormous pressure to require all the other institutions to consolidate. So, yes, you will end up with a more concentrated sector because the pressure will be on all these credit unions, regional banks.

An alternative scenario that I have suggested may have been that St George could have been the basis of a fifth bank. You could have had St George, Bankwest and Suncorp merging as a fifth major bank. Let us have a debate about protecting competition, about promoting consumer welfare rather than just hiding behind the global financial crisis. Yes, that is a big factor; I do not underestimate that. But our banking sector is resilient and I think we need to think more laterally to protect competition and consumers.

**CHAIR**—Of course, for those three banks to merge—it is a commercial situation that was open to them to do, one presumes, if they wish to, but they did not.

**Prof. Zumbo**—Of course. But the Treasurer does have a veto power. The Treasurer is using taxpayers' money to guarantee. The Treasurer would have an ability to indicate a view which may or may not be accepted by the market.

**CHAIR**—The Bankwest story, as I said earlier to other witnesses, is an interesting one because of course it was acquired by a Scottish bank, which gave it a lot more financial firepower. It was on the road to developing a national network when it was acquired. It was nipped in the bud, if you like, largely as a result of the global financial crisis affecting its parent bank. Do you see that as a model that might still occur, or is the Australian banking milieu with the four banks so well entrenched that foreign banks will look at this market and say 'too difficult' no a matter how much money they put into it?

**Prof. Zumbo**—Absolutely. As I said earlier to Senator Hurley, Prime Minister Keating had this faith in foreign banks. I think a lot of people had faith. As I said, there is a long list of foreign banks that have not been able to cut through it. I think the Bankwest model was the initial model.

To draw parallels with the grocery sector, you can have an Aldi turn up and you can have a Costco turn up to inject new competition. You may have another version of Bankwest, but the reality is those established players overseas will look at Australia and say that the four players are so dominant we are just banging our heads against a brick wall. That is what Tesco and Walmart have said about the Australian market. Why bang your heed against the wall when Coles and Woolworths are so dominant? It is the same view in relation to banks.

**CHAIR**—That is another issue, the concentration of power in the retail sector of Australia. So I presume you do, but do you believe that we need antitrust laws or something like that in Australia as they have in the United States?

**Prof. Zumbo**—I certainly believe we should be exploring a whole range of possible public policy approaches to the issue. Divestiture is a very important aspect of it.

**CHAIR**—You mentioned divestiture.

**Prof. Zumbo**—But also tweaking our competition laws to reflect Australian conditions and the fact that we have some of the most highly concentrated markets in the world, which is detrimental to consumers. Consumers are paying higher grocery prices, food inflation is running at over three times the rate of inflation. We are seeing bank interest margins growing, fees are growing and you get the odd token reduction of a fee. In response to Senator Hurley's earlier comments, these proposals are looking at market structure across a range of industries, all of which have the same problem of high concentration levels.

**CHAIR**—I will go back to Senator Xenophon, who has a question for you on foreign banks.

**Senator XENOPHON**—On mergers. I asked the Law Council as to whether the current penalties at the moment if you do not comply, if a bank or entity does not comply with merger provisions, the current remedies are you unravel the merger. I do not know how you do that.

**Prof. Zumbo**—In this case it is easy because Bankwest has operated separately and St George is operated separately. Ironically, in this case you could do it a lot easier.

**Senator XENOPHON**—But in terms of the options at the moment, you negate it and go back to square one.

**Prof. Zumbo**—Yes.

**Senator XENOPHON**—You have injunctions to stop it breaching any conditions. Do you think there also should be a third level or third option for remedies; namely, some significant financial penalties as part of the tool box of enforcement remedies?

**Prof. Zumbo**—Without a doubt, that should be explored. But I have to add one proviso: sometimes it might become a cost-benefit analysis for the big business to say, if I breach this and the financial penalty is X, maybe I can wear that. We just have to be mindful that they may undertake a cost-benefit analysis. Financial penalties have to be real and meaningful and would have to be comparable to the ones in the Trade Practices Act.

**Senator XENOPHON**—Unless, of course, the penalties were sufficient to be a real deterrent rather than just a balance sheet equation.

**Prof. Zumbo**—Yes. They have to be a real deterrent—10 per cent of turnover really focuses the mind.

**Senator XENOPHON**—Thank you.

**CHAIR**—Thank you, Professor Zumbo.

**Committee adjourned at 3.25 pm**