



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

**HOUSE OF
REPRESENTATIVES**

STANDING COMMITTEE ON ECONOMICS

Reference: Competition in the banking and non-banking sectors

FRIDAY, 19 SEPTEMBER 2008

SYDNEY

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HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON ECONOMICS

Friday, 19 September 2008

Members: Mr Craig Thomson (*Chair*), Mr Pearce (*Deputy Chair*), Mr Bradbury, Mr Ciobo, Mr Dutton, Ms Jackson, Mr Keenan, Mr Marles, Ms Owens and Mr Turnour

Members in attendance: Mr Bradbury, Mr Ciobo, Mr Dutton, Mr Keenan, Mr Pearce, Mr Craig Thomson and Mr Turnour

Terms of reference for the inquiry:

To inquire into and report on:

Competition in the retail banking and non-banking sectors in Australia. The inquiry will pay particular attention to home mortgage products and linked facilities frequently offered to consumers such as credit cards and savings accounts.

1. The Committee will undertake a stock take of the Australian retail banking and non-banking industries, focussing on:
 - a. Recent developments in relation to products, providers and distribution channels;
 - b. the current state of the retail banking and non-banking industries;
 - c. the likely drivers of future change and innovation in the retail banking and non-banking sectors including the continuing impact of technological developments; and
 - d. comparisons with relevant international jurisdictions.
2. The Committee will also identify any barriers that may impact on competition in the retail banking and non-banking sectors, and policies to enhance further competition and product choice for consumers.

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The committee met at 9.15 am

MUNCHENBERG, Mr Steven, Group Manager, Government Affairs and Public Policy, National Australia Bank

SHAW, Mr Steven, Group Manager, Mortgages and Consumer Insurance, National Australia Bank

WARD, Ms Sarah, Manager, Government and Regulatory Affairs, National Australia Bank

CHAIR (Mr Craig Thomson)—I declare open this public hearing of the House of Representatives Standing Committee on Economics into competition in the banking and non-banking sectors. To date the committee has received 44 submissions to this inquiry. Submissions have raised numerous issues, which the committee is considering carefully. The committee will investigate the extent to which competition in the financial sector has reduced and, in particular, examine proposals that would help to increase competition and reduce fees and charges for people struggling with their mortgages.

Today we will hear from the National Australia Bank, Members Equity Bank, the Australian Competition and Consumer Commission, the Australian Office of Financial Management, the Australian Securities and Investment Commission and the Financial Sector Union. I remind witnesses that, although the committee does not require you to give evidence under oath, this hearing is a legal proceeding of parliament and warrants the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will attract parliamentary privilege. I welcome representatives of the National Australia Bank to today's inquiry and thank you for attending. We have received your written submission. Are there any other written submissions that you would seek to table before we start?

Mr Shaw—We would like to table some supplementary information.

CHAIR—Thank you. We will mark that as submission 45 in terms of these proceedings. Would you like to start with an opening statement?

Mr Shaw—Yes, we would. Thank you again for the opportunity to appear here today. As I stated, I have responsibility for National Australia Bank's mortgage portfolio. My colleague, Mr Munchenberg, has responsibility for NAB's government and public policy area, and Ms Ward is the government and regulatory affairs manager. In my opening comments I would like to cover three areas which reflect some of the issues raised in our submission of 18 July, updated in light of recent developments. I would first like to cover competition in the retail banking and non-banking sector. Here I will cover recent development in the credit markets and how we see their impacts on NAB and its customers, as well as on the wider retail banking and non-banking sector.

Secondly, I would like to cover NAB's experience and views on the drivers of future change innovation, and, thirdly, our views on policies to enhance further competition and promote consumer choice. I will start with competition in the retail banking sector. It is worth covering what we have seen in credit markets in recent weeks and months and what this means for

competition in retail banking. For NAB it would be a similar picture as for other ADIs where loans are funded from three primary sources including short-term wholesale funding, medium and long-term wholesale funding and customer deposits. Before global credit markets tightened from around August 2007, liquidity in wholesale funding meant that banks and non-banks could rely to a greater extent on wholesale funds, sourced both domestically and globally. In fact, around 30 per cent of Australian banks' funding is sourced offshore. This increased reliance on wholesale funding has been necessary to meet increased demand for credit as consumer deposits have been dwindling as a source of bank funding since the introduction of compulsory superannuation in 1992.

The chart of the 90-day bank bill liquidity premium tabled provides a useful reference as to how our primary driver of funding costs has moved recently. Once the tightening of credit as a result of the US subprime crisis started, NAB's increased cost of funding has ranged from between 20 to 120 basis points above the cost of the cash rate. In short, under the heightened global events, the RBA cash rate has lost its direct influence on market interest rates. This increased cost of funds has roughly halved our gross mortgage margin. This comes at a time when, as other banks and the Treasury and Reserve Bank have explained to the committee, banks have seen their net interest margin fall by nearly 50 per cent over the last 15 years or so.

I draw the committee's attention to the funding issues facing banks and non-banks since August 2007 as it shows competition at work, that is, competing for customers effectively meant each of the banks were reluctant to pass on increased input costs to the customers and wore those increased costs for five months or risk losing customers to the other banks and non-banks. For the same reason, despite continued high average funding costs, we have seen the banks eager to pass on to their customers the recent cash rate reduction earlier this month. In fact, the NAB signalled its intention to pass on any cash rate reduction in advance of 2 September RBA decision. We think this shows competition has a healthy role in our industry, which delivers better outcomes for customers.

Moving to our second point, we see the future drivers of change and innovation as having one common theme: the customer. Since deregulation of the sector in the 1980s, banks and new entrants have had to vie for market share by continually delivering new technologies, improved service, and better value for customers. We see no let-up in this development. At NAB we have had to actively compete for both deposit and lending customers by offering new products, accounts, channels and services such as internet, SMS and interactive banking, debit cards and an increased number of ATMs. We have also aimed to address our customers' concerns around fees with a range of transaction accounts, our Smart Everyday banking accounts, that provide the choice to pay no fees or reduced fees, and, for example, the NAB Clear Banking account that is free of exception fees. Just recently we have added a Clear Banking home loan to the range, which is free of all early exit fees.

We also aim to be flexible to our customers' changing circumstances. This is why we have adapted how we help those customers in financial difficulty in the current climate of higher living costs. We have significantly increased the team dealing with customers in financial hardship and we have appointed a financial counsellor liaison officer to manage the relationship between NAB and financial counsellors. We are in the process of rolling out a dedicated email address and 1300 number for financial counsellors and have streamlined the process for customers applying for help in difficult circumstances. Our NAB customer advocate, responsible

for overseeing and escalating customer issues, works directly with our Australian region CEO. On the third and final area, policies to further promote competition and choice, I would like to point to a number of current initiatives where NAB is working with others in the industry and in government: the switching initiative facilitated by the Australian Payments Clearing Association; developing a national e-conveyancing system; developing an industry stream for EFTPOS; the RBA review of payment systems; and the transfer of credit regulation to the Commonwealth, including mortgage broker regulation. We believe that these policy initiatives will continue the impetus of a competitive retail banking sector and any future policies should be considered against this current activity, ensuring a well considered and proportional response to any issues identified. Thank you for the opportunity to present today. My colleagues and I are happy to answer any questions you may have.

CHAIR—Thank you. You spoke about competition leading to your making an early announcement about an interest rate cut if the RBA did cut rates. I am keen to give you that opportunity again today to discuss prospective cuts that may happen in October or November. What is NAB's position if the Reserve Bank does cut interest rates in terms of passing that on to the consumer?

Mr Shaw—If you look at the period of 2 September RBA announcement and the period leading up to that, we had a sustained period of two or three weeks where there was stability in funding markets. They had reduced and that stability gave us the confidence to be able to come forward and reassure the Australian community that we could pass on the 25 basis point reduction that we assumed was going to be happening through the announcement of the RBA. In the supplementary information I have tabled, you can see that there has been significant volatility since then. If you refer to the chart, in the last two weeks we have seen the greatest volatility in that eight-month period. On 3 September it was a 30 basis point premium that banks had to pay. As of yesterday it was a 78 basis point premium that banks had to pay. In this time of increased volatility it would be hard for us to make a commitment as to whether we would be able to pre-emptively pass on the 25 basis point cash reduction that some market commentators anticipate.

CHAIR—You have cut your fixed interest rates, so you are factoring in that there is going to be a reduction from the Reserve Bank in terms of the cash rate. Why should that not be passed on to the consumer?

Mr Shaw—Fixed interest rates are priced off a yield curve, depending on the term of the fixed interest loan that we would be offering. Our funding comes from three main sources, that is, deposits, short-term funding and wholesale funding. The supplementary information really indicates the level of volatility in both short-term funding and long-term funding. That makes up about 50 per cent of our funding mix. It is a difficult time to actually determine which way markets are going to go. As you know, there is a great deal of global turmoil. At the time of the RBA decision in October, I think we would be sitting there weighing up what has actually happened in terms of cost of funds and trying to balance the needs of both shareholders and customers at that time.

CHAIR—What was your bank's profit in the last year?

Mr Shaw—I cannot recall the exact number.

Mr Munchenberg—Approximately \$4 billion. I am not aware of the exact figure.

CHAIR—That was another record level of profits.

Mr Munchenberg—It was a high level of profits, yes.

CHAIR—You could understand that on the street corners of Wyong in my electorate, for example, people would find it a little difficult to understand. The bank is making that level of profit and the cash rate is being reduced by the RBA, so they would find it hard to reconcile those two things with a decision that does not pass on interest rate cuts.

Mr Munchenberg—We can certainly understand that, at a personal level, people would be concerned about that. I imagine most of them are aware of what is happening in international markets and what is happening in the US. Australia has the advantage of being one of the few countries in the world which has, at the moment, a very stable banking sector, and we are not seeing household institutions collapsing or having to be taken over to prevent them from collapsing. While, undoubtedly, people want to see those interest rates and we would like to see those interest rates passed on as quickly and as fully as possible, the reality of the situation is with the intense, unprecedented volatility in international markets we simply cannot this far out from an RBA decision give any indication of what we will be able to do. As we did last time, we will be making every endeavour to pass on as much, if not all, of any RBA cuts.

CHAIR—If one of the other big four was to pass on the full amount of an interest rate cut, would you follow in terms of that? You are virtually forced to do so.

Mr Shaw—That would certainly be one input that we would take into any decision-making process and it is a good example of competition at work.

CHAIR—It is and it is not. One of the things that the electors on the streets of Wyong find a little hard to reconcile when we are talking about competition in the banking industry is that, if interest rates go up, they go up almost uniformly from each bank as one moves, even if their interest rate rise is above and beyond the RBA increases, and if one goes down they all seem to go down at the same time. How does this show competition between the banks? Does it show that there is an unofficial cooperation? That is not quite the right word. There certainly seems, from a consumer point of view, to be an absolute lack of competition when you all move together.

Mr Shaw—If you look back pre-crisis you would see that probably the standard variable rates of most of the major banks were all largely the same and at this point the standard variable rates of the banks largely diverge so we are all at different rates, or at three different price points. We have all moved relatively independently on the way up.

CHAIR—Although very similarly.

Mr Shaw—There has actually been quite a bit of variability in how much different institutions have gone up at different times, and that is reflective of the individual circumstances of each and every organisation, but it does take into account the competitive environment, as

well. We do work in a highly competitive industry and we are trying to be proactive and appropriate in meeting the needs of our customers and also those of our shareholders.

Mr Munchenberg—A lot of focus is given to the standard variable rate, but when customers come in through the door we do not necessarily offer them that rate. We offer them better rates than that. We compete on rates on a daily basis through discounting on the standard variable rate as well. We also saw earlier in the year, when banks did start to move rates up outside of RBA movements, quite a lot of variation in both the amounts that banks moved and the timing of those moves, and on the way down none of the major banks certainly feel that they can afford to move outside of what the other majors are doing because we will simply lose customers. We do not want to do that. That is competition at work.

CHAIR—We can talk about competition, because that is what this inquiry is essentially about, so that consumers can get a better deal. I suggest that 10 or 15 years ago, when the non-banks entered the market, bank margins were roughly around four per cent in respect to home loans. With them coming into the market, through competition, margins dropped to just under two per cent or 1.8 per cent, which is the figure that is widely used. In the last 12 months, particularly the last six months, we have seen bank margins move up again as the non-banking sector has largely gone into hibernation or died, depending on your analysis of that, so is that an indication that we have a difficulty with competition at the moment?

Mr Shaw—I would firstly point out that our mortgage margin is significantly lower than 1.8 per cent. We work in a very vibrant and competitive market. There are a thousand different home loan options out there for customers. There are 130 different providers. The major banks account for about 50 per cent of the market, which is a large chunk of the market, but the other 50 per cent is served through a broad range of financial services providers.

CHAIR—You are over 90 per cent of the new loans that are being written at the moment.

Mr Munchenberg—The banks are.

CHAIR—Yes.

Mr Munchenberg—There are a lot of banks. The four majors are not the only banks in Australia.

CHAIR—Yes.

Mr Shaw—I make this point around NAB's market share. We have seen declining market share for ourselves over the last 12 months, and that is an example of us working in a competitive market. It is not easy for us to grow our share of the market. It is tough. The consumer is very demanding on their terms around price and the other conditions of the loan. We have got to compete on that basis, and as I said our own market share has declined over the last 12 months through either RBA or APRA measures.

CHAIR—In this inquiry we have been told two different stories from two different groups that have come here. One is that the liquidity shortage at the moment is a cyclical thing and it will right itself as the market recovers at some stage, and that non-bank players will come back

into the market and things will adjust. The other story we are getting is that, if the government does not do something about the liquidity crisis at the moment, those players who were previously in the market will never be able to get back because there will be structural changes. Given the events of the last couple of weeks, how do you see the cycle in terms of access to liquidity? Are we looking at a short turnaround in the cycle, or is it something that is longer term that may need the government to look at some sort of action to increase the availability of liquidity?

Mr Munchenberg—We do not see that there is a liquidity crisis in the Australian market.

CHAIR—I was characterising the submissions that we have had. I am not saying that is the case.

Mr Munchenberg—In response to those that have put forward that claim, first of all we would dismiss that there is a liquidity crisis in the Australian market. We note that it is the Reserve Bank and Treasury in Australia that have characterised this process as cyclical rather than structural and, if anyone should be aware of that, it would be them as well as ourselves. The short answer to your question is that none of us know when this current situation is going to end. The mere fact that none of us know when this situation is going to end is reflected in the nervousness of the markets, the high costs and the escalation, for example, of the 90-day bill rate, so we cannot give you a time frame. We know that it will come to an end. We know that things will return to a more normal state, if you like. We know that at that time, as the costs of funding comes down, and we must remember it is actually the lack of availability of cheap credit which has undermined the non-bank lenders, but as cheaper credit becomes available—and we cannot tell you where that is going to settle—we will expect to see those players continue to regain their market shares as they have previously.

Mr Shaw—It is the mispricing of risk that we have seen occur in overseas markets that was able to provide a lot of the cheap funding into the Australian market that is now causing some of the turmoil that we are seeing in the US and the UK. The one thing that we can have comfort in is the stability of the Australian financial services system where we have banks that are well regulated, well capitalised and relatively successful. That should afford some comfort to Australian consumers.

CHAIR—I have a question about what has been put to us regarding access to liquidity. We have had submissions to look at an ‘Aussie Mac’ style model. We have had the position put to us about the action of the Bank of England in terms of one to three year special liquidity fund advances or as simple as extending RBA repos agreements to a broader range. Do you have any view on those particular types of interventions as to whether they would be necessary or not, given some are very short term and some are structural and permanent changes that could be made?

Mr Munchenberg—We do not have a particular view. As I mentioned, we do not see that there is a liquidity crisis. We are aware of proposals for a so-called ‘Aussie Mac’ and the easiest and most direct answer to that is to look at Freddie Mac and Fannie Mae in the US and the amount of taxpayer money that they are sucking up.

CHAIR—To be fair, that is a slightly different model to what has been proposed here.

Mr Munchenberg—Yes. That is true, but it does highlight a more important point and that is that it is obviously ultimately for the government to decide these things, but there is danger in government intervention into markets unless there is a serious issue that needs to be solved. What we are seeing at the moment is not a serious structural problem. If the government wishes to enter into the bonds market—and the RBA has taken initiatives, which is to be applauded. The RBA has acted incredibly responsibly through this whole exercise and it is one of the reasons why Australia's system is so much more stable than systems overseas. They can choose to do that. We do not see a need. We see some potential dangers with certain models that are applied overseas, but if the government wishes to do that then that is the government's choice.

CHAIR—When he was a member of this committee, Mr Turnbull was very interested in the issue of covered bonds and their application in other jurisdictions. Do you have any comments to make about their applicability?

Mr Munchenberg—No. I am not aware that we have any particular view on that.

CHAIR—You have made some positive comments in relation to switching and the package that will formally come into operation from November. We have had submissions that have suggested that the switching package, whilst being positive, does not go far enough, and propositions have been put to us around the portability of accounts through to the Dutch model of a central agency. What are your views about where we are with switching and taking that to a further level, either through portability or through a central registry? Do you have a view at all at this stage?

Mr Munchenberg—Our view would be that it is a little premature to be talking about what needs to be done beyond the current system because we are still going through the process of implementing the current changes. The formal process, of course, is not taking effect until 1 November. We have put in places, as other banks have, interim measures to make it easier for people to move their accounts between banks. The short answer would be, let us allow the system to get in place before we talk about what else needs to be done. There is no doubt that it is a complicated thing to do because of our structures, particularly with direct debits and the arrangements that are made with merchants, rather than directly with banks, but to change that is also a major re-engineering exercise involving a lot of banks and a lot of merchants who provide the direct debit services. We would hesitate before rushing into making those very fundamental changes. Our view would be to wait and see how the current system works before we embark on something a bit more ambitious.

Mr PEARCE—Thank you very much for being here this morning. I was interested to hear the comments that the chair made about what his constituents are saying to him from Wyong. My constituents also talk to me about interest rates, and that is obviously a concern to all of us, but my constituents also talk to me about why the government is raising taxes when we have got a \$22 billion budget surplus, as well. I am very interested in what your view is on the outlook over the next six to 12 months, given what has been going on in the global financial crisis, and given that the terms of this reference is particularly around competition and choice of products for consumers? What do you see as the outlook?

Mr Shaw—In terms of interest rates, the times are changing very rapidly, but broadly we would say that we still expect interest rates to fall between one and 1.25 per cent over the next

12 to 18 months, which is obviously going to be of benefit to your constituents. As I said, there is a range of choice and there are a large number of home loan options that customers have. It is in excess of 1,000. There are 130 bank providers. We are forced to compete very aggressively down at the high street level to win every new customer that comes in the front door. I would not want anyone to have the impression that it is easy for big banks to gain new customers because it is not. We work in a retail industry and we have got to be innovative in terms of our products. We have to be very sharp with our rates and our fees because that is what consumers demand when they walk in the front door of what is a retail outlet.

Mr PEARCE—Mr Munchenberg mentioned earlier the fact that there is this presumption that sometimes the variable rate is the rate that all mortgages are written at, and of course that is not the case. As you rightly identified, you are in a competitive situation. How do you determine what rate you offer a client?

Mr Shaw—We definitely look at the underlying cost of funds, which depends on whether it is a variable rate loan or a fixed rate loan and the term of those loans. We definitely take into account the competitive environment. We look at our own business aspirations and we determine what is the appropriate rate at that particular time. We adjust fixed rates regularly. Variable rates, until this year, have largely been pegged to the cash rate, but we have seen a divergence if you like, between our underlying funding cost to the cash rate, and so this year has been a very dynamic and interesting year in determining variable rates. As I said, the underlying cost of funds changes dramatically, as you will have seen from the volatility in the supplementary information. There are a number of factors that go into it to determine those rates.

Mr PEARCE—In NAB's case where do you get the majority of liquidity to fund your mortgages? Can you tell us where that comes from?

Mr Shaw—Half of it would come from customer deposits, 25 per cent will come from short-term wholesale funding and another 25 per cent will come from long-term wholesale funding. Of the wholesale funding that we get, probably 30 per cent of that comes from offshore and the rest of it would be sourced domestically.

Mr PEARCE—Fifty per cent is coming from retail customer deposits?

Mr Shaw—That is right.

Mr PEARCE—How competitive is that side of the business?

Mr Shaw—That is an extremely competitive part of our business and, in the current funding scenario, you can imagine that banks have a very great focus on customer deposits, because the more we can raise through that source is beneficial to the very costly long-term funding that we would need to raise offshore. You will find banks competing very aggressively for customer deposits at the moment. We have institutions paying well in excess of the cash rate, and in some cases, in excess of the bill rate.

Mr PEARCE—What has been happening with customer deposits over the last six months in your business? Have they been increasing, steady, or have you been losing market share in that area?

Mr Shaw—I am not fully across exactly what those numbers are. As you know, I look after the mortgage portfolio. I would suggest our deposit base has been growing but it is, as I said, a very competitive and aggressive market to compete in.

Mr PEARCE—How many mortgage products do you offer?

Mr Shaw—It depends on how you count it. If you look at all the different variables there are about 97 different home loan options that a customer could take.

Mr PEARCE—Is that right? I am with the NAB. I must have a look at the other 96.

Mr Munchenberg—We would be happy to help you.

Mr PEARCE—The point I was getting to was: how do you go about researching new products or determining how to put in place a new product? Do you do consumer research? Do you get in focus groups and ask customers? How does a bank like the NAB go about producing a new product?

Mr Shaw—We have 550,000 home loan customers so they are a very invaluable source of feedback on how our products are going and performing. We have 1,600 retail bankers that are out on the ground connecting with customers every day to give us feedback. We definitely use market research. We subscribe to both domestic and overseas data providers that give us feedback as to what are the new and innovative products that are coming out of the US, UK, Spain and Finland. It is a global industry that we compete in and we source good ideas and innovation from around the globe.

Mr PEARCE—My final question is on that point. How do you think the Australian mortgage competitive product range compares to international?

Mr Shaw—The Australian mortgage industry has typically been an innovator and, in fact, we were the first in the world to offer things like 100 per cent offset. If you go to the UK they refer to that style of loan as an Australian type mortgage. We have a good history of being innovators in the global mortgage market. We have also got a good history of being stable and having a well managed mortgage industry which has not seen us experience some of the excesses that have occurred in the US and elsewhere. We are very much focused on underlying borrower ability to repay the loan and ensuring good credit quality.

Mr TURNOUR—Welcome and thank you for coming in today. Have you launched the Clear Banking home loan product?

Mr Shaw—Yes, we have.

Mr TURNOUR—How is that going? Is it correct that it has no exit fees?

Mr Shaw—That is correct. I do not have the exact number of customers or the outstandings. I know it is meeting our business expectations. It is an option that provides for customers, in some circumstances, who are looking for the choice of not paying an exit fee. That is an option for them.

Mr TURNOUR—Is that a variable rate home loan?

Mr Shaw—That is right.

Mr TURNOUR—What is the most common standard variable rate that you would have written before this product?

Mr Shaw—Our standard variable rate is 9.36. Our average variable rate is probably down in the range of 8.8 per cent. Our averaged fixed rate—and we are talking about our stock of customers—would be around 7.6. Our average home loan rate is around about 8.5 per cent.

Mr TURNOUR—What is the rate for the Clear Banking home loan?

Mr Shaw—Clear Banking is at the standard variable rate, which is 9.36.

Mr TURNOUR—So it is a bit above it.

Mr Shaw—That is right.

Mr TURNOUR—You are basically factoring those establishment costs into the rate?

Mr Shaw—Yes. It is targeted to customers with generally smaller borrowings where the amount of an exit fee can be excessive, and so they are weighing up the higher interest rate relative to having to pay an exit fee if they choose to switch. It is not an option for everyone and that is what we have positioned it as. It is providing choice to consumers.

Mr Munchenberg—I am sure you are aware that NAB has tended to be the one that has led with various fee-free options, particularly starting with our transaction accounts. Our experience has been that getting these products out there starts a competitive process over time. We were able to add to that so we initially started with exception fee-free accounts for concession cardholders and now they are more generally available. This is the first round, if you like, of exit fee-free mortgage products. As with the transaction accounts and exception fees, we would expect that other banks would start providing these over time as well. It needs to be seen as an early product out there, but as a sign that competition is driving towards meeting consumer demand for exit fee-free accounts to the extent that people want that.

Mr TURNOUR—Thank you for that. What would be a normal exit fee on a standard variable?

Mr Shaw—Our typical exit fee is \$900 payable within the first four-year period.

Mr TURNOUR—You would say \$900 is about the cost of administration in setting up a standard mortgage over three to four years?

Mr Shaw—We have an application fee and an early exit fee. The application fee is quite often discounted as further evidence of it being a competitive market. The fact that we use an early exit fee is effectively like a deferment of some of the upfront costs, which in some ways actually

makes the cost of borrowing cheaper, particularly for first home buyers where having an exit fee on loans is a way of reducing some of the upfront costs, if you like.

Mr Munchenberg—None of these exit fees apply to people after three or four years.

Ms Ward—Four years.

Mr TURNOUR—We have had submissions in relation to exit fees and you have talked a fair bit today about chasing customers and how difficult it is. Once you have customers, allowing them to move around is very much a part of competition. We had some evidence from the Australian Payments Clearing Association regarding the switching package and I know that the chair has already asked you some questions in relation to that. I am particularly interested in whether we have gone far enough with switching, but the evidence that you have given already suggests that you think we should bed down what we have done and then look at that into the future.

Mr Munchenberg—That is correct.

Mr TURNOUR—One of the concerns I had with the Australian Payments Clearing Association is that they seem to be very much bank focused—obviously you are their major customer—and whether they had much consultation with consumer or consumer advocates. They had done some. Do you have any comments in relation to further involvement with consumers, or how do you look at consumers? Of the major organisations that are really driving the ability for banks to switch, at the moment it seems to be a captive of the banking industry rather than a captive of the broader community, not that the banking industry is not important.

Mr Munchenberg—I would not characterise it as captive. The fact remains that we are the ones that are having to make the changes, so we are working through and the APCA process is a way of trying to work through the best way to deliver on the commitment to make switching easier. The industry consults regularly with consumer groups and consumer groups are not at all shy about expressing their views to the industry, to government and to alternative governments. Through the Australian Bankers Association, we also meet with consumer groups and it is an opportunity for them to give their perspectives and details. We are aware of some recent media from some consumer groups expressing concerns about whether the switching package goes far enough. That seems to be a recent development. I cannot be thoroughly sure that I am accurate in assessing what their views have been, but there seems to have been a shift in their views since that package was first announced. At this stage, we are yet to put in place the final process and we are putting in place an interim process at the moment that enables customers to switch more easily. Our own research and knowledge of our customers tells us that those periodic payments, the direct debits and credits, are the main reason that customers give for not switching. Naturally, we do all that we can to assist customers coming to the bank with that and we are now putting in place a process to make it easier even for those customers who regretfully have decided to go to a competitor.

Mr TURNOUR—We have mainly focused on mortgages and home loans and there are reasons for that, but obviously the credit card factor is something that is growing tremendously over a period of time with deregulation and other competitors coming into the banking system. Have you got any comments or views about the competitiveness of the credit card industry or the

regulation of the credit card industry, and also in relation to that, with the volatility in the financial markets, whether that is going to place some squeeze on people with credit card debt?

Mr Munchenberg—As a general point when the costs of money go up interest rates are going to be under pressure to go up as well. It is not just going to apply to the standard variable rates. It is going to apply to a whole range of products. That is offset at the moment by the cash rate coming down. We have discussed what that might mean in future. There is intense competition around credit cards. There is competition from debit cards that are increasingly being used. There is competition from non-bank providers of credit. For example, I saw recently that David Jones has started to provide some form of credit card or debit card, but I am not sure of the details. There are a lot of players out there in that space, so it would be seen as a competitive space as well. I do not know if Mr Shaw has anything to add to that.

Mr Shaw—I would agree. It is certainly a competitive market. The thing in the credit card industry at the moment is ensuring that you are passing credit to consumers appropriately, you are not putting them into a stress situation and that you have got the ability to handle customers that are in a stressed situation appropriately. Some of the initiatives that we have put in place include the connection that we are making with financial counsellors and the way in which we handle our collections process that we go through. Credit cards is a competitive market and it is one where we are also very cognisant of the impacts that rising interest rates have on customers and we need to handle that appropriately.

Ms Ward—I would like to comment on your point about regulation of credit, as well. We are seeing the agreement through COAG at the moment to regulate credit at a federal level. We are supportive of that move in that it will help us as a national business to have certainty across Australia. At the moment we have a system whereby there is an inconsistency with the regulation of credit, so that again will help to alleviate some of the issues, and we support, for example, the regulation of mortgage brokers through that proposal. There are a number of projects and initiatives out there that will look to support choice and competition, and that is one of them.

Mr KEENAN—How many shareholders does the bank have?

Mr Munchenberg—Off the top of my head I could not give you that figure. I apologise. We are more than happy to provide that. It is obviously a public figure.

Mr KEENAN—Do you know what the size of the average shareholding is?

Mr Munchenberg—Again, I would need to take that on notice.

Mr KEENAN—Mr Shaw, you were saying that NAB's market share has declined in the past 12 months. To whom have you lost that market share? Is it the other three major banks or to other players?

Mr Shaw—It is hard to tell exactly where you have lost the share to, but you would assume that we have lost it to some of the three majors. BankWest is a particularly vibrant player in the mortgage market. Some other regional banks are also playing aggressively in the mortgage space. If we have lost a little share, firstly we would say that it is not what we want to do so we

have to compete, innovate and be as aggressive as we can on price and service, but I would say the loss is broad across the entire range of mortgage providers.

Mr KEENAN—I wanted to turn to your submission where you talk about tax and regulation. I think they are both very fair points and it is easy for us to be distracted by contemporary events, but really the committee will probably ultimately end up looking at those things about how we might encourage the government to have the most competitive regime to allow you to actually compete against each other. You talk about the taxation treatment of deposits and relate that back to superannuation. I am just wondering how you see that working in practice because there is not a lot of detail about that?

Mr Munchenberg—At this point we are just making the observation, as we have done publicly, that because of the Australian banks' reliance on offshore funding we find ourselves in the current situation where we are having to offset those increased costs against the interest rates we can provide customers in Australia, and we note that over time, for a number of reasons, the amount of deposits relative to other savings or wealth vehicles has not grown anywhere near as rapidly, and we would merely ask that as part of the federal government's review of taxation under Ken Henry that that also be considered. We have not put forward any specific proposals. We will do so through the course of the Henry review. Our main concern, at this stage, is to make sure that the taxation treatment of deposits is seen as part of that review. I should point out that we are not calling for an unwinding of the tax treatment of superannuation—that has been very important—but to some extent deposits has been the neglected savings vehicle. Would you like to add anything on that?

Ms Ward—No. That is fine.

Mr KEENAN—If you are not in a position to do so that is fine, but if thought has been given within the bank as to what form this might take then we would certainly be interested.

Mr Munchenberg—Yes. I must confess our internal timeline has been more dictated by the Henry review. We were not aware that the committee would be interested, but we will endeavour to get whatever we can to the committee within its reporting timeline.

Mr KEENAN—Regulation is a reasonable point and it is something the committee should be looking at extensively. You really make the point that we need to consider future regulation very carefully. I am just wondering if you have any comment on the existing regime? Is there something the government could look at in terms of winding back regulation or possibly improving the way we do it that might enhance competitiveness?

Mr Munchenberg—The starting point should be to restate the fact that Australia's very strong and good regulatory system is one of the reasons why we are not seeing the large financial institutions falling over as in the US, but there is always room for improvement. My colleague, Ms Ward, has already pointed out that we are strong supporters of the agreement reached between the states and the Commonwealth government for credit regulation to be moved to the Commonwealth level. We think that would be a significant improvement to have consistency across the Australian states, which would mean greater efficiencies for us and therefore lower costs and, as a result, through competition, to provide lower priced products to consumers. At this point that is probably the main regulatory proposal, but there are others.

Ms Ward—Yes. To add to that, as in the point we made in the submission, it was really that there are quite a lot of initiatives. There is the switching initiative, consideration of a national e-conveyancing system, the regulation of credit, as well as other smaller initiatives through the Financial Services Working Group on disclosure. As you know, financial services are predicated on effective disclosure, which enables consumers to make effective choices. We are seeing quite a lot of activity at the moment, and our view would be to wait and see how that works through and we will take an active role in helping the government flesh out the detail of that. We would see all those initiatives together as being quite a lot of consideration to help the sector at the moment.

Mr Munchenberg—What we would not want to see, but we are seeing a little bit of, is state governments trying to rush through consumer credit changes, having agreed that the Commonwealth will take over continuing to pursue divergences from the Universal Consumer Credit Code.

Ms Ward—UCCC.

Mr Munchenberg—As opposed to the ACCC, which is waiting to come on after us. We are concerned about that and the states have agreed, in principle, that the Commonwealth is the appropriate body to regulate, but we are still seeing to some extent here and also in Victoria, moves still going to diverge and we do not see that as necessarily helpful.

Mr KEENAN—I am mindful of the time. I might put that another way. I know NAB operates in international markets so how does our regime here compare to international regimes in terms of its ability to encourage competitiveness?

Mr Munchenberg—To be honest, I am not aware of any particular concerns that we have in that regard. Obviously we are coming from the premise that we have a very competitive banking sector here in Australia. There is nothing I can think of internationally that we would want to necessarily import into Australia to improve that. If we become aware of something, we would be, again, happy to provide it to the committee.

Mr CIOBO—I just want to follow up on a couple of points. You made comments about the Henry review looking at deposits. Is that especially with respect to, for example, the relative attractiveness of, say, investing in shares, getting a franked dividend and the potential for capital growth and obviously the potential of capital loss, versus a straight-up deposit, which most Australians would be paying 30 per cent on? Is that effectively what you are talking about?

Mr Munchenberg—Effectively what we are saying is that there are a number of other savings or investment vehicles out there which have been given, for whatever reasons, and I am sure they are appropriate policy reasons, particular tax treatment. I am not aware of anything, in particular, that has been done for deposits.

Mr CIOBO—Whilst I am citing only one example, is that the kind of differential that you are talking about that you want examined?

Mr Munchenberg—There is a differential there. There is a differential with the treatment of superannuation. For tax reasons, it may be that people will want to put money in super rather

than into a term deposit account, for example. We are not saying that super should be made less tax attractive. We have a sizeable and successful business in that area, as well. We are just saying that, given the relative neglect of reviewing the tax treatment of deposits, that should also be considered and looked at to see whether there are tax effective changes that can be made that would make deposits more attractive. We are seeing an increase in deposits and we would be happy to provide more specific details, but nonetheless over time the reality is that the growth of deposits has lagged significantly behind, for example, superannuation assets.

Mr CIOBO—In your submission you talk about the increased competition from the entry of overseas non-bank lenders. Do they enjoy a competitive advantage or disadvantage in the marketplace based on any differences in the regulatory framework, or at retail level is it all the same?

Mr Shaw—To one extent if you are a lender here and you are not an ADI then there is a certain level of regulation that you do not have to comply with. In some respects you could say that is a competitor advantage. On the other side, in not being an ADI, they are not able to go and raise deposit funds in this market to help balance their cost of funds between wholesale funds and domestic deposit holders.

Mr CIOBO—The proportion of your lending is what?

Mr Shaw—Deposit holder funds is approximately 50 per cent and the remainder is short and long-term wholesale funding.

Ms Ward—In the payments system there are specific initiatives that have been introduced to help new entrants into the payments system and that has revolutionised that space, so I would point to competition working there as well.

Mr CIOBO—What proportion of your customers would enjoy differential rates on the same borrowing? What I mean is, Dr Smith walks in and wants to borrow against the equity in his home and then the same home someone else would seek to borrow against it. Are they getting differential interest rates? What I am asking is, how responsive are you to your customers' risk when it comes to your lending?

Mr Shaw—When we provide money, we very much take into account the individual circumstances of the borrower. We look at their past payment history.

Mr CIOBO—That is not reflected in the rate, though, is it? That is reflected in whether they obtain the loan.

Mr Shaw—That is correct.

Mr CIOBO—I am talking about the rate.

Mr Shaw—The rate will vary, in many cases, depending on the size of the loan. We do offer tiering. So, if a loan is above a certain amount it will attract a different rate to loans that are below a certain threshold.

Mr CIOBO—Is it a higher rate or a lower rate?

Mr Shaw—The higher your loan gets typically the lower the rate.

Mr CIOBO—A cynic could argue that you are encouraged to borrow more money.

Mr Shaw—As I said in the outset, we are only lending money to customers where we believe it is appropriate to lend it to them.

Mr CIOBO—Based on their risk?

Mr Shaw—Certainly based on their risk, yes.

Mr CIOBO—What I am hearing from you is the way that you seek to control your exposure to risk is by the size of the borrowing rather than through the rate.

Mr Shaw—We do not control our risk through the rate. We control our risk through a range of risk mitigants. The amount that we are willing to advance to a customer is one of those things.

Mr CIOBO—What are the other factors?

Mr Shaw—We certainly look at the value of the underlying security. We are very rigorous in credit assessment. We use our own internal models. We use credit bureaus. We look at their particular living circumstances.

Mr CIOBO—Ultimately, all that comes back down to the amount that you are prepared to lend. Is that right?

Mr Shaw—Yes.

Mr CIOBO—Why is that not reflected in the rate? Why is it that one customer cannot walk in and get a different rate to another customer? Why is it one-size-fits-all, largely?

Mr Shaw—It is not particularly one-size-fits-all.

Mr CIOBO—By and large it is, is it not?

Mr Shaw—There will be a range of rates depending on the amount that the customer is looking to borrow, and it is a competitive environment, so in a large number of cases we will have customers come in to us and they will have a competing offer from another bank or a number of banks and we will determine whether, in the competitive environment, we want to go and match that rate.

Mr CIOBO—Why is it such a stretch that the rate should reflect the risk? I know, for example, that if you are a member of the AMA—it may not be your bank, it might be other banks—that you will get a straight up 50 basis points reduction on your borrowing rate. Why is that not standard practice across a range of income levels, occupations and so forth?

Mr Shaw—Most customers do not pay the standard variable rate. By and large they are probably paying a 50 basis point discount to the standard variable rate.

Mr CIOBO—Why is it most customers?

Mr Shaw—It would depend on the individual circumstances, what their needs are at the time, the amount that they are looking to borrow, as I said. It is a highly competitive market. We are forced to compete on rate.

Mr CIOBO—I am having trouble accepting that, because I would have thought that there would be a much greater difference between various rates offered to different customers if it was truly going to be a very competitive environment. There is not a lot of advertising saying, ‘Come in and let us talk about what rate we can give you.’ It is rather, ‘This is our headline rate and now let us talk about how much money we can lend you.’

Mr Munchenberg—That is disturbing that our advertising has had such little impact on you. You will often see exactly that sort of advertising. I think Members Equity, who are appearing later today, have got Melbourne tram stops plastered with, ‘Come in and we will do you a great rate.’ You see that from a lot of other banks, as well.

Mr CIOBO—What is the percentage then of your customer base that would be on differential rates? That is what I am trying to ascertain.

Mr Munchenberg—What do you mean by differential rates? Do you mean not paying the standard variable rate?

Mr CIOBO—If you take a suburban household mortgage, and I know this is difficult to quantify because you have got lots of different packages available, but for the same asset that you are lending against, how many of your customers would be on different rates that is reflective of their risk to the bank? I am not talking about the size of the loan, which is the primary mechanism that is used to control risk, but through rates.

Mr Shaw—If you took two customers of similar profile, similar underlying security and a similar amount that they wanted to borrow, I cannot give you the exact number, but by and large they will roughly have around about the same rate. There might be some slight variance, where because of competitive variables where one customer has gone and got a cheaper rate, for example, from Members Equity, we may choose to match that rate in that particular local market in which we are competing. You are also suggesting that Australian banks could look more at risk-based pricing where the price reflects the underlying level of risk. A strength of the Australian system is that we have not necessarily gone down that path where, the riskier the customer, you potentially have a—

Mr CIOBO—Why do you think that is a strength?

Mr Shaw—At the moment there is a degree of equity, if you like, across the range of our customer base. If you go down a risk-based pricing, you would have some customers that would pay potentially a lot less and a lot of customers pay potentially a lot more.

Mr CIOBO—Why is that a bad outcome? It seems to work okay for the insurance industry?

Mr Shaw—It depends on what side of that spectrum you are on. Risk-based pricing is a very difficult thing to implement. It requires a more positive credit bureau environment. As you know, in Australia we rely on a negative bureau environment, which is another reform that we have participated in.

Mr CIOBO—This is what this committee is looking at, and what I am hearing from you is that you believe that would be an inferior model to adopt from a regulatory point of view than our current model. As I said, it seems to work okay for insurance.

Mr Shaw—I cannot make any direct comment on the insurance industry.

Mr CIOBO—From an NAB perspective you would rather stick with what we have got than change?

Mr Shaw—The model that we have in place now works well for all of our customers.

Mr CIOBO—There must be a fair degree of cross-subsidisation when that happens. You must have people who are relatively low risk paying a lot more than they should and, vice versa, you must have people that are higher risk paying less than they should.

Mr Shaw—There is an element of cross-subsidisation in our business. You are right.

Mr CIOBO—Who do you think is most adversely affected by that? Take me as an example. Actually, I am probably not a good example. Take someone in the Public Service who has perhaps got more security of tenure than I do. They walk in off the street. They are on \$100,000 a year. And then you have got a small businessperson whose business is turning over \$100,000 a year. What is the likely scenario there?

Mr Shaw—They are very different scenarios. If it is a businessperson who is a sole trader then we will look at that individual risk versus the public servant earning \$100,000.

Mr Munchenberg—You were focusing, if you like, almost internal competition. I mean what differential does NAB play. We look at the risk at the point at which we are looking to provide the money. If the small business owner, to us, appears too risky so that we are not prepared to provide the money at the price that we are prepared to provide that money at, then that small business owner will go to one of the other 130 mortgage providers in Australia and there will be someone who will provide, perhaps at a higher cost, that money available to that person. I do not think we have a pure one or the other approach to this question because it is not a single system. They have other opportunities outside of the bank, if for whatever reason, the bank makes a judgement.

Mr CIOBO—I put it to you that is exactly what has happened, because largely the banks have an effectively one-size-fits-all approach. That is what drove the growth of low-doc and no-doc lenders because there was a great swag of Australians who simply could not secure finance, especially if you are in small business, for example, where you had difficulty proving income. That is exactly what drove this growth of low-doc and no-doc lenders because they were happy

to pay more. Perhaps I should rephrase that. They were prepared to pay more in order to secure access to credit. Just to pick up on your point, Mr Munchenberg, I am not sure that interbank competition is that important relative to actually competing for customers. You might say, what is the difference there? The difference is that true competition in the banking sector would be for each and every customer irrespective of whether they are with your bank or not, rather than the actual headline offering that each bank makes to each other.

Mr Munchenberg—I am sorry, I am not sure that I follow your last point.

Mr CIOBO—You said it is a domestic concern. By that I interpreted it as meaning an intrabank concern of your customer base and I am saying, from a regulatory point of view, you need to be competing for all of those customers. We can look at facilitating and swapping between banks absolutely, but should we be also trying to promote as much as possible an aggressive posture from customers as to the amount of money they can borrow off you if we are going to have a more efficient system?

Mr Munchenberg—We need to be a little bit careful with that. What I was suggesting was that, when you look across all available sources of funding for your small business owner, they will find, at some price, the money that they want if they are a reasonable risk proposition. If we push that argument too far, we are verging on the subprime issue that they had in the US where money was freely available to people who quite simply and ultimately were unable to repay that money. While there may be people frustrated because they are unable to access capital, it is a strength of our system that we do have such robust risk analysis and we are not prepared to offer money to people on a wing and a prayer, as in the situation in the US.

Mr CIOBO—It is a by-product of our pricing strategy rather than of regulatory oversight?

Mr Munchenberg—No. We have prudential regulation, which requires us to manage our risk very carefully, as well. I am not an expert in that area and if you have particular questions in that area we will need to come back to you, but my fundamental point is that there is a continuum between readily providing access to credit and managing our risk in a responsible way. If I understand the direction of your questioning, you are suggesting that we are perhaps a little too prudent or conservative in our lending, or at least that we should be offering higher risk loans at higher prices.

Mr CIOBO—No, that is not my point. My point is that the key reflection of risk should be driven by the rates that are offered. Yes, the amount of money is one way of doing it, but I think it is a very distant and poor way of doing it, rather than the rate reflecting the risk. That is essentially my point. I am mindful of the amount of time that I have taken, so I am happy to leave it at that.

CHAIR—I thank you for your attendance here today, particularly as you have gone well into overtime. We do appreciate your contribution. While we are still on the record, is it the wish of the committee that the additional submission by the NAB dated 19 September be accepted as evidence and authorised for publication? There being no objection, it is so ordered.

Proceedings suspended from 10.20 am to 10.29 am

PEARSON, Mr Mark John, Executive General Manager, Enforcement and Compliance Division, Australian Competition and Consumer Commission

THOMPSON, Mr Justin, Acting General Manager, Mergers and Asset Sales, Australian Competition and Consumer Commission

WOOD, Ms Danielle Ingrid, Director, Mergers and Asset Sales Branch, Australian Competition and Consumer Commission

CHAIR—I welcome representatives of the Australian Competition and Consumer Commission to today's hearing. Thank you for coming along today. Although the committee does not require you to give evidence on oath, I should advise you that these hearings are legal proceedings of the parliament and, therefore, have the same standing as proceedings of the respective houses. You did not make any written submissions. Are there any written submissions that you would like to table today, before we begin?

Mr Pearson—No, there are none.

CHAIR—I invite you to make an opening statement.

Mr Pearson—We do not believe that we need to make an opening statement. Most of our commentary about competition in the market is public in terms of our competition assessments and so on in recent mergers; therefore, we do not see any real benefit in making an opening statement, but we thank you for the opportunity.

CHAIR—We will go straight into questions. What is your view of the state of the banking and non-banking industry in terms of competition? Throughout this inquiry we have been presented with two very different views as to the level of competition. One is from the banks. I know that you were present during part of the NAB's submission, which, largely, was that it is a very competitive industry and that non-banks who may have faded from the forefront will re-emerge as the cycle changes. That contrasts with the position that we have heard from many of the non-banks, which effectively is that they are in hibernation if not moving out of the industry and are unlikely to come back, unless there is some government initiative to help them. What is your assessment of the level of competition at the moment?

Mr Pearson—The first statement that I would make about the level of competition is that a lot of our assessment of competition in the market is done in the context of particular transactions. We do not necessarily make a running assessment of markets over time. We almost take a view of a market at a point in time and then try to determine at that stage what we feel is going to happen in that market. The best assessment of that is probably the public competition notice we put out on St George-Westpac. That is a public notice, but it talks about what we saw as competitive constraints in the market and the developments with some of the changes over time regarding distribution channels and so forth.

In terms of problems with brokers and alternatives to the big banks, we would accept that there is doubt that there have been major problems with a lot of the mortgage brokers,

particularly with the so-called financial meltdown and its impact on financial markets overseas. We are not really in a position to make a judgement at this stage of whether we believe that those players will come back into the market as strong or weaker or will be completely forced out of it. We have a case that I will not say too much about, because my Chairman, our general counsel and the bank involved would not appreciate my doing so. My tenure as a public servant might be limited as well, if I say too much about it.

CHAIR—We do not want to put your tenure at risk here today.

Mr Pearson—But we do have a case in Brisbane, which is public and which involves one individual broker. We see that case as being important because we were concerned that big banks—one bank in particular—may have been exerting pressure on brokers or alternatives to banks in attempting to limit that competition and the development of those distribution channels. That case is in the court and it involves the ANZ Bank. I am not saying anything out of school, but I cannot comment on it too much because it is before the court. However, it demonstrates that we see those other channels as being very important to long-term competition in the market, particularly in those sort of mortgage broker and home loan markets.

My colleagues here from Mergers could probably add to this: I think it would be true to say that, in terms of some of the other markets—institutional banking that is relates to corporations and even some of the wealth management markets—there tend to be many options out there for people, which depend a little on the level of sophistication, if you like, of the individual consumer or customer concerned. Some issues there perhaps go more to the behavioural nature of consumers and financial literacy and so on.

CHAIR—I am particularly interested in what you have just said about bank behaviour, and you have talked about a particular example. Obviously, we cannot go into details about that particular example, but are you concerned that banks are using the current environment to gain a competitive advantage and reduce the level of competition that is there?

Mr Pearson—No. The case in question began before the recent financial problems. In a lot of ways, we saw it as being a rational reaction to competition in the market. In a lot of markets where there are new developments and new distribution channels, you will often see the incumbents attempting to restrict. We are fairly active in our assessment of that and in trying to go to bat to preserve emerging markets and development.

I do not have sufficient expertise or knowledge to judge exactly what is happening with the banks now. But I would say that a logical corollary to what is occurring in the markets is that, as alternative supplies become weaker with problems occurring in terms of people's ability to access capital and funds, obviously they will move towards banks. I think that would occur, whether banks were actively pursuing that to occur or not. As to whether there is a 'policy' of attempting to force some of the mortgage brokers out of the market—I have read a couple of the submissions in which I think there were claims that banks are trying to force some of the mortgage brokers out—I have seen no evidence of it. I run the Enforcement and Compliance Division and no one has brought in any complaints about it and I have not actually seen anything to support our saying that we have had—

CHAIR—No complaints at all about that have come to you. Is that right?

Mr Pearson—No. It goes back to the one that we have in court. Over the last six or seven months, we have had something like 260 or 270 complaints concerning banks. The vast majority of those I have referred on to ASIC. Some of the others are about more general things, such as basic interest rates and concerns about lack of competition. I do not have any knowledge of any coming in directly with any evidence about that from mortgage brokers or alternative distribution channels.

CHAIR—You have said that one of the things that the ACCC looks at doing is assisting or protecting emerging markets. Are you referring to markets that are under some stress through the usual cycle of the market and also those in areas where the ACCC feel they have a role to play in terms of preserving or protecting competition?

Mr Pearson—Only within the context of the Trade Practices Act. We always go back to that and now to the argument that is coming up in parliament about competition versus competitors—what is the role of sections of the act and who are we there to protect? In effect, our role is to try to protect competition but, in doing so, we have the constraints of the act. In a lot of ways, normal cyclical market events are how markets are disciplined in a capitalist society; market players are disciplined. That is not to say that, with the financial area, there are not some huge issues to do with prudential issues and systemic problems that are probably better looked at through agencies like APRA and ASIC rather than the ACCC. Our focus is not only on competition and structures but also on trying not to intervene or interfere by providing a back-up for people just because of the market's cyclical nature. Our focus is more on emerging markets or developments where it appears there has been a conscious decision, with others, to try to block or prevent—using market power and operating through Section 45, contract arrangements and understandings—the emergence of players who could bring competition to a market. It is more that aspect that we look at.

CHAIR—Would you agree with me though that, in terms of the consumer, the more competitors there are in the market and the easier it is to move between them, the greater the competitive pressures are, which ultimately will benefit the consumer?

Mr Pearson—Generally, we would agree with that, although there are markets, both here and around the world, where having more competitors does not necessarily mean having better service or lower prices for consumers.

CHAIR—I was coupling the two issues together.

Mr Pearson—I notice that you have discussed issues such as switching costs and so on, which have been brought up in some of the submissions. Our overall view is that, the better consumers are able to move, no matter what the market or the industry, the more likely it is that you will have some sort of competition for people to respond and react to. We would start from that premise. In terms of Australian markets, switching costs probably vary—and we all have personal anecdotal evidence as well as evidence that has come through. But, if you need to know a little more about how we look at switching costs, Ms Wood may have some commentary from the perspective of mergers.

CHAIR—I am going to ask questions about switching now. Clearly, exit fees and deferred establishment fees are barriers to switching. Do you agree with that proposition?

Ms Wood—Certainly, in the context of the Westpac-St George merger, we took that into account as barriers to switching between providers and also, potentially, as barriers to the entry of new home loan providers.

CHAIR—Obviously, there are costs in terms of switching and the banks and non-banks tell us that they factor such issues in. We have just heard from the National Australia Bank that the particular product they offer, which does not have an exit fee, has a higher rate of interest; so you are paying somewhere along the line in terms of that issue. Do you have a comment to make about that?

Ms Wood—We certainly did not do an in-depth analysis of switching fees and the extent to which the different structure of products might affect competition in the market. In terms of assessing that merger, we were essentially looking just at the impact on competition. I could not provide a broader comment on that.

Mr Thompson—It is probably useful for us to clarify that, in the context of a particular merger transaction, we do not look to assess whether switching costs and particular fees are fair, if you like, or are related to the costs to banks of providing that service. It is more directed at whether those switching costs would mean that, post a merger, customers would or would not move their business to a rival.

CHAIR—Barriers are there to stop that.

Mr Thompson—Exactly.

CHAIR—With respect to switching, if you attract more customers by virtue of your product and, therefore, get greater business, you will be able to make up the fee, which is there traditionally to stop people from moving, with the business that you get. Is that a fair proposition to put?

Mr Thompson—Yes. You would expect that the fees that are charged for a whole range of services would be informed by the competition that is occurring between the players in the market. Those players would seek to set their fees at levels that would mean attracting that business, which you have identified, to their advantage and at the expense of a rival.

CHAIR—Does that mean that effectively, where financial institutions are charging exit fees, or higher interest rates for products that do not have exit fees or deferred establishment fees, competition is not working in that area because, again, they are pricing the product so that it does not encourage someone to swap across or to use those sorts of products?

Mr Thompson—I think that is probably outside of our knowledge. It is not something that we have looked at in the context of particular transactions, including the latest St George-Westpac one.

Mr Pearson—One of the issues raised in our assessment knowledge of markets is that, when we look at a transaction or its base, we are looking at competition as it exists and making a judgement as to what will happen consequent on or subsequent to that merger, acquisition or joint venture going forward. Judgements will be made—and people can obviously read them—

about our interpretation of competition, but it is not necessarily a flat judgement on a scale of how competitive the market is vis-a-vis a perfectly competitive market, if that makes sense. It is almost a parallel process. We are not going out and saying what we would in a market report; for example—I promised my CEO that I would not mention these—both our grocery report and our petrol report went in to look at markets.

CHAIR—We are very happy with those—on this side of the table, anyway—if you want to keep mentioning them.

Mr Pearson—We looked at those in the sense of looking at a market. We do this really in terms of looking at a market. With mergers and most of our work internally, we look at that transaction and compare it with what exists now as opposed to what we think the overall state of a market is relative to a model of perfect competition, or whatever. It just makes it a little difficult sometimes to make bold statements such as, ‘This is extremely competitive,’ or, ‘This is very competitive,’ or whatever, unless you do a full-blown market report. As some of you would know, the OFT in the United Kingdom does a lot of those. They are probably the world’s leader in terms of market reports, and they are a different beast, if you like, than a lot of what we do.

Mr Thompson—Just as an extension of that, I guess we are saying that, when we look at a particular merger, which is the time when we come to assess most closely competition in banking, we do not look to see whether this could be a more competitive market, which perhaps is the committee’s domain; we just look to apply the test within the Trade Practices Act as to whether the particular transaction proposed would substantially lessen the existing competition.

CHAIR—I will not ask any more questions in the broad sense, but I have one or two questions specifically about the merger of St George and Westpac. In your view, how does the fifth largest bank merging with one of the big four not affect competition?

Ms Wood—Our view is that there were sufficient other constraints on the merged firm after the acquisition. So the three other major banks, regional banks, foreign owned banks and some of the non-bank lenders that are still in the market would be sufficient to constrain the merged entity such that the test we apply, which is a substantial lessening of competition, would not occur.

CHAIR—Is it true that competition in this sector is more between the banks and the non-banking sector than between the banks themselves?

Ms Wood—No. Certainly, the evidence that we saw suggests that there is quite strong competition between not only the major banks but also the regional banks, which are competing aggressively, and between the foreign banks.

CHAIR—How does a reduction of 20 per cent in terms of the big banks not affect competition substantially?

Ms Wood—I do not know what you mean by 20 per cent. My understanding is that St George has a market share of approximately eight per cent in most retail banking markets. If you add that to Westpac, you have a bank with an approximate 20 to 23 per cent share, depending on

which market you are talking about. That is a fairly small aggregation in the context of most mergers that we look at.

CHAIR—It is not, though, if you look at international comparisons in terms of other jurisdictions and the competition that exists there. It is a pretty sizeable entity that has over 20 per cent of market share.

Ms Wood—It is a sizeable entity, but the point we made is that there are quite a large number of other competitors out there in the market that will constrain that position.

Mr Pearson—When we look at a merger, there is a fairly simple question that we generally do not ask, because it does not sound fancy enough. We just want to know, ‘Are you going to charge more; are you going to have lousier service, or are you going to produce less?’ They are the three sorts of questions we want to ask. With the acquisition here, we thought it was highly unlikely that we would see an increase in price or a lowering of product or of service. That was partly because, in analysing and breaking down the four markets—personal banking, wealth management, businesses and SMEs, and corporate and institutional—and looking at the facts of the competition, the issue again would be, for example, whether St George was some sort of maverick in the sense of driving change and driving innovation. There is no doubt that it was a high-profile bank. But, from the evidence, it is not necessarily certain that they were driving pricing; rather, in some instances, they were perhaps following. They were very aggressive in terms of their service in other instances, but their pricing did not appear to be that different from the pricing of some of their competitors in the market. With respect to innovation, some of the local banks, such as the Bank of Queensland, BankWest and Bendigo, are moving out of their traditional local state base and are also preserving, maintaining and pushing some of their competition.

So, in the analysis of the acquisition and asking, ‘Is this going to substantially lessen competition?’ it seems that it is highly unlikely that it would. There is always a comment that comes back there: any acquisition is going to have an affect on competition, by the very fact that you are taking somebody out of a market. The test that we look at is the issue of ‘substantial lessening’. To some, it is a bit amorphous, but there is a lot of history and precedent behind it. It is a similar test around the world these days. Basically, even countries that have a dominance test look at ‘substantial lessening of competition’. So whether you believe that there will be an increase in price or a lowering of service is in the breaking down of those markets and then looking at the impact in the individual markets. It is our judgement that there would not be; and, of course, there are reasonable minds that would differ from that assessment.

Mr CIOBO—Picking up on a couple of things, I am interested in what the ACCC’s key findings were in regard to the government’s switching package and what your recommendations were that led to the announcement of that package.

Mr Pearson—I would have to say that we have not had any real comment on the switching package. In a lot of ways, it is really an issue for ASIC and for government policy. We have been following it, but we have not actually—

Mr CIOBO—Did you make recommendations to the government about the announcement of that package?

Mr Pearson—Not that I am aware of. I can double-check that for you but, as far as I am aware, we made no recommendations. I will take that on notice and make sure.

Mr CIOBO—You may or may not have been here while the previous witnesses gave their evidence. I questioned the banks about why it would appear that the pricing of risk is done not through interest rates but rather by the size of the loan. Does the ACCC have a view on how effective and efficient or inefficient is attempting to control risk by the size of the loan offered versus the rate offered? Do you think that is a good model or a poor model?

Mr Pearson—ASIC and APRA may have issues. The only thing I could say—and I was listening to that evidence—is that there may be some efficiency arguments. From the bank's point of view, there may be some efficiency arguments linked to doing that instead of having to deal with each customer on an individual basis. But that is almost a personal commentary.

Mr CIOBO—So the ACCC is not concerned about market efficiency.

Mr Pearson—Yes. But, in terms of the pricing, it is not something that we have looked at or considered. It is really an issue that sits more with some of our fellow regulators.

Mr CIOBO—So pricing in the retail banking market is not something that you have looked at.

Mr Pearson—We have looked at it in a more generic or general way. As with the transactions of St George and Westpac, we looked at what we thought was the effect on pricing vis-a-vis the other banks and compared the pricing before the merger with the pricing after the merger, but not to actually dig in and make some sort of call about whether that was the appropriate pricing. We would rarely do that in any industry.

Mr CIOBO—What is the ACCC's view of the role of an interest rate? What does an interest rate serve? What is its purpose?

Mr Pearson—I am not sure that we have a view. I am sure that our regulatory folk would have a strong view. In essence, it is a pricing mechanism or a mechanism to auction off limited resources or limited products.

Mr CIOBO—When you lend, wouldn't it be fair to assume that pricing should reflect the risk involved in the loan?

Mr Pearson—As far as I am aware, pricing and interest rates are reflective. We find that, for individuals, banks have different packages that depend on how much product or work those individuals put through that bank; they may have lesser fees and charges.

Mr CIOBO—That is an economy of scale argument, basically. I know your customer and economies of scale argument, but I make the point: shouldn't interest rates reflect risk? Is that a bridge too far?

Mr Pearson—A pretty strong general corporate finance view is that interest rates reflect risks. I would not be able to comment on whether the interest rate of banks reflects that.

Mr CIOBO—I am not asking you to comment on that. I am just observing that this committee's job is to look at the pricing model and forms of regulation for the Australian banking sector. It strikes me slightly strange that, by and large, the banks in Australia tend to offer most people similar kinds of interest rates. My entire point is: isn't that a little unusual? The bank, itself, conceded that a high degree of cross-subsidisation occurs across their customer base. Is that not of concern to the ACCC? Is that not something you have ever looked at? Now that you have heard that testimony, is it something that you might look at? What is your view?

Mr Pearson—It is not something that comes within our ambit, in terms of the Trade Practices Act.

Mr CIOBO—So who would that be? Would it be the Productivity Commission?

Mr Pearson—Yes. If you were going to do a review, you would probably have to have it done by something like the Productivity Commission. They probably will not thank me for putting their name up.

Mr CIOBO—I put their name up; you may have just agreed. It is my job to get people to agree with me, so do not worry.

Mr Pearson—Sometimes I get carried away with my own importance.

Mr CIOBO—That is an issue that others on this committee have too. I am sorry; please continue.

Mr Pearson—It is really not an issue that we would consider. We look at the area of interest and interest rates, in terms of capital asset pricing models and so on, very closely in regulating pricing pipelines and that sort of thing. But it is really not an aspect that we focus on in terms of our competition assessments, because we are not looking at the micro aspects of an individual firm. It is our view that we sit back and look at competition across the board; so we do not try to second-guess internal judgements of the proprietors, shareholders or whatever about how they should operate.

I have seen things happen where you work with businesses and you think, 'This is never going to work, because their cultures are different and wrong.' But it is not my job to stop something because I believe the culture is wrong. Quite often I am proved right, in that their mergers fail and problems are seen to occur in an industry; but those things are not connected with the aspects that we are responsible for under the Trade Practices Act, and the interest rate issue in terms of the banks would fit in there. I would agree that interest rates are a pricing mechanism, but how banks operate in that respect is really not an issue that we have any real responsibility for.

CHAIR—I would have the view—and I am more than happy to have people disagree with me, because this is just my personal observation—that, by and large, people who are a higher risk to lend to will not be able to find their needs met within the banking sector; therefore, typically they will turn to mezzanine finance or low-doc or no-doc lenders as a way of securing the funding that they are after and, albeit, at a higher risk premium—that is, a higher interest

rate. Is that the kind of market that you think we should be seeking to foster, or is that counter-intuitive?

Mr Pearson—No. There are some really important competition and consumer protection issues that arise out of that. For example, we can go all the way to the extreme of payday lenders. That is an issue of great concern to a lot of consumer groups and to government. The ministerial council and the Standing Committee of Officials of Consumer Affairs are looking at issues regarding payday lending and credit issues. But, again, with how the market develops, our philosophical basis, if you like, is a reluctance to intervene in markets as they are emerging, at the risk of doing more harm than good. I guess it is like doctors; we should be thinking first of not doing any harm.

Mr CIOBO—I am not sure whether you have answered my question though. Is it the ACCC's observation that people who are generally of a higher risk tend not to borrow from the banks?

Mr Pearson—We see a little bit of that in some of the work done through our consumer protection area. Again, I think ASIC has done a lot more work on that or their consumer protection area looks a lot more closely at those sorts of issues.

Mr KEENAN—From the evidence that you have given so far, it seems that, apart from mergers and acquisitions, you are not particularly interested in general competition in the banking industry.

Mr Pearson—We are interested in it, but it is only of interest if it comes across our desk in terms of a merger, an acquisition, an enforcement issue or a compliance issue. For example, we have been working on the Code of Banking Practice. We provided some input into that because we are interested in it. Within my division, there is a group that tries to support industry and industry sectors that are looking at developing codes; sometimes it works and sometimes it does not. We have fairly strong views that we put forward to the parties. So we are interested in that respect, but it is not something where we would sit there and think, 'We're going to intervene', unless a cause comes across our desk or unless we look at developments, through our intelligence functions, where we see a range of concerns or issues coming up that we then believe we should address or do something about. In lots of respects, the issues that we see, particularly in terms of consumer protection, actually sit with other regulators. Generally, we would not see competition issues, unless they were to come up, for example, as with our banking case up in Brisbane or with a merger. So I guess the answer is yes.

Mr TURNOUR—We obviously think there are some competition issues; otherwise, we would not be having this inquiry. Clearly, the banking sector is a major area that everybody in the community needs to operate within, but obviously you have said no in relation to your looking at that overall. You have looked at the grocery and fuel areas and, just from your comments about the reports you have done on those areas, would say that you have a role to play in terms of competition in those areas. In a recent report that was handed down by Mr Samuels, I think you described competition in the fuel industry as being 'managed competition'.

Mr Pearson—We have an important role in competition across the economy. There is no way that we would turn a blind eye to competition issues, even within the banks. Internally, we regularly follow issues. We watch what comes out in reports, in the press and all those sorts of

things. We have a monthly meeting at staff level with our colleagues from ASIC, where we discuss common concerns and emerging issues. We see that as an important area and we are very interested in it. But, in terms of intervention, our role can be very limited.

With the grocery report, we identified a couple of areas, which we are following up and investigating. It is the same with the case that we are running up in Brisbane. With that case, we identified an area internally. We received some complaints about the development of distribution channels and brokers, so we followed those up. It is only an individual broker, but we see it as a bigger picture issue; we do look at that. But we cannot go intervening or pushing into markets just willy-nilly, particularly markets where there are other regulators. In a market like banking, for example, you have to be very careful about what you say and do, because you can really scare the horses, so to speak.

Mr TURNOUR—Let us look more broadly at some of the evidence that we have had in this inquiry and some of the competition issues that have been raised. Effectively, securitisation has disappeared as a way for non-bank lenders to raise funds. Would you agree with that, in terms of your understanding of the evidence or the industry?

Mr Pearson—To a large extent, yes.

Mr TURNOUR—Currently non-bank lenders in Australia effectively are left then to receive liquidity from the big banks, the ADIs. Is that correct? In effect, we have a section of the market that has provided a large amount of competition—and there would be very good arguments that they have driven down margins over the last 10 or 15 years—now in a situation where the only way they can get liquidity is to go to the big banks, their competitors.

Mr Pearson—There is no doubt that we are concerned about that; I am not saying that we are not concerned. But, again, the issue is: are there any breaches in there, or is that a matter more for government policy? It is not really for the ACCC to become involved in the policy side of that issue. There are some issues; I noticed, for example, that Joshua Gans and others made some suggestions.

Mr TURNOUR—I do not think it is a policy issue. In effect, you have the big four banks, and the non-bank sector has to go and raise funds from them. Wouldn't you be concerned that there might be some potential—I am not saying that it is happening—for collusion to occur over the sorts of levels of funding they might provide to those non-bank lenders, in terms of the margins and conditions they could put on those non-bank lenders regarding their mortgage sheets and those sorts of situations? I would have thought the ACCC would be interested in those sorts of issues.

Mr Pearson—Again, we would have great concern about that. There is no doubt that there are pressures in markets. As you know, without wishing to be quoted as representing the banking sector, we put a high priority on cartel type behaviour such as price fixing, collusion and so forth. Quite often you find that sort of behaviour in industries that are under stress, but we have to have evidence. It is well and good for us to say that we may have concerns about things that happen in an industry. We do not want to see competition lessened, and there is no doubt that a lot of the non-bank players in the market have driven change in the home-loan mortgage market. But we have no intervention strategy, if you like, for those sorts of markets, unless some sort of

reasons and evidence for believing that are put to us. That is the legal framework that we work under. Even if we have concerns about changes in the market, a lot of those changes have nothing to do with breaches of any act. There might be egregious behaviour somewhere, but—

Mr TURNOUR—The risk of that happening obviously could be considered to have increased though, in that non-bank lenders do not have other sectors where they can go to get money in order to compete with that. I am not saying that has happened, but the risk of that happening obviously would have gone up.

Mr Pearson—Without trying to pat our banking system on the back, our banks have very strong compliance programs. We work with the banks. For example, we work with the NAB—we also work with the other banks, but I will choose the NAB to speak about because they were on first—in terms of their internal compliance. We do this with a lot of businesses and we do it with the banks, so we have a fairly good sense of their compliance culture and of their respect for the law, the markets and so forth. Nobody can guarantee that something is not happening; but, again, with the notion that perhaps that is going on and we do not know about, that could happen in any industry. The fact is that, as far as we can see, there is a pretty strong compliance culture in those industries, and APRA and ASIC are very active in the industry as well.

Mr TURNOUR—But the role of those organisations is not to look at competition, is it? It is your role to look at competition.

Mr Pearson—Yes, our role is to look at that. But we are close enough to them that, if they come across issues, they would let us know. We have a pretty close relationship with them.

Mr TURNOUR—I was interested to hear you say that you really have not had a look at the switching package and you have no real view on it in terms of promoting competition.

Mr Pearson—No. I know there have been some issues about it. I have spoken about it with ASIC and with Peter Kell, our Deputy Chair. But, to my knowledge, the commission has no position on it, but I will double-check that to make sure that I have not missed something.

Mr Thompson—I will just clarify that we did mention it briefly in the Public Competition Assessment, which is a published document, in relation to that St George-Westpac transaction. We gave brief mention there that may give some help to switching costs.

Mr KEENAN—Mr Pearson, I want to ask you about your comments regarding mortgage brokers and their role in the market. You seem to think they have a detrimental role in our current climate. Is that right?

Mr Pearson—No, I did not mean to imply that at all. As any market develops, we like to see the development of alternatives. As those markets develop, it is up to consumers and the general public to support them or not support them. You may have misinterpreted something I said; but we do not see mortgage brokers as being evil at all, if that was the question.

Mr KEENAN—The RBA has a view that they have been responsible for some undisciplined lending, I suppose you could call it, within the Australian market. Do you think there is evidence to support that view?

Mr Pearson—I would not know. I would have to defer to the RBA, as they would be much closer to that than we would be. We would not have any real sense of what their actual loan package or loan portfolio looked like.

Mr KEENAN—We have heard evidence during the course of this inquiry that the role of intermediaries has been extraordinarily beneficial for consumers in the sense of driving down margins and increasing competition. Would that accord with the views of the ACCC?

Mr Pearson—Yes, it would.

CHAIR—Thank you for your attendance here today. You will be forwarded a copy of the transcript of today's proceedings. If you find any errors in that transcript, please get them back to us as quickly as possible so that they can be corrected. Once again, thank you for your contribution today.

Mr Pearson—Thank you. We will check that switching package for you.

CHAIR—Thank you. It would be most appreciated if you could get back to the secretary in relation to that.

[11.14 am]

BATH, Mr Michael Paul, Director, Financial Risk, Australian Office of Financial Management

HYDEN, Mr Neil Francis, Chief Executive Officer, Australian Office of Financial Management

CHAIR—I welcome representatives from the Australian Office of Financial Management to today's hearing. Although the committee does not require you to give evidence on oath, I should advise you that these hearings are legal proceedings of the parliament and, therefore, have the same standing as proceedings of the respective houses. We have not received a written submission from you. Do you have any written or oral submissions that you would like to make to us today before we commence questioning?

Mr Hyden—I have no written submissions, but I would like to make some opening comments.

CHAIR—Please proceed.

Mr Hyden—The Australian Office of Financial Management's functions are to issue government debt, manage the government's cash balances, undertake investments of financial assets and manage resulting asset and debt portfolios. Our responsibilities do not relate to competition in the retail banking and non-banking sectors; therefore, we have not made a submission to the inquiry. We understand that the committee has heard proposals that the government, acting through the AOFM, might invest in residential mortgage-backed securities to provide support for home mortgage lending. The demand for these securities has declined sharply over the last year and their yields have risen, making it less attractive to fund home mortgage lending in this way. This has reduced competition from these lenders or lenders who in the past have obtained their funding largely from the issue of these securities.

Any decision as to whether the AOFM should undertake investments in residential mortgage-backed securities to support competition in mortgage lending would be a matter for the government. We would not advise the government on the desirability of such an initiative or on what the likely impact such investments would have on competition in mortgage lending. However, for the information of the committee, I can describe our current investment powers. Under the Financial Management and Accountability Act, as amended earlier this year by the Commonwealth Securities and Investment Legislation Amendment Bill, the Treasurer may invest public money in authorised investments. Authorised investments include investments in debt instruments denominated in Australian currency with an investment-grade credit rating. This would potentially cover residential mortgage-backed securities with such a credit rating.

The Treasurer has delegated his investment powers to officers of the AOFM and has issued directions on the use of these powers. The directions are tabled in parliament but are not disallowable. The directions specify classes of authorised investments within the categories specified in the act. The list of investments authorised by the Treasurer includes debt

instruments, rated AAA or equivalent by one of the major credit rating agencies, issued by financial institutions in Australian currency. This is narrower than the provision in the act, but it would potentially cover a high proportion of residential mortgage-backed securities issued by Australian financial institutions. The Treasurer's directions provide for two types of investment. The first covers short-term investments of funds surplus to immediate financing needs that are used in managing the daily balances in the official public account. These investments are made in short-term instruments with a low credit risk. This excludes investment in residential mortgage-backed securities, which are medium- to long-term investments.

The other type of investment permitted under the Treasurer's directions relates to the investment of the proceeds of the issue of Treasury bonds to support the efficient operation of the market in Treasury bond futures contracts. The Treasurer announced in May this year that the government would increase issuance by up to \$5 billion this financial year—that is, the current financial year—and that the proceeds of this additional issuance will be invested by AOFM. Under the Treasurer's directions, these investments are to aim at providing returns that are commensurate with the debt-servicing costs of the additional bond issuance while adopting a prudent approach to credit and interest rate risks. Investing in residential mortgage-backed securities to support competition in housing lending would be a different policy objective to those set out in the current directions of the Treasurer. If the government were to decide that we would undertake such investment, the Treasurer would need to provide new or additional directions specifying the objectives and parameters of the investment.

CHAIR—We have been urged by some submissions to look to the United Kingdom, where your equivalent organisation has engaged in providing liquidity of one to three years. Have you had the opportunity to look at those submissions and, whether or you have or have not, can you make and comments in terms of that type of proposition?

Mr Hyden—I have not looked at those specific submissions. Basically it is a matter for the government rather than an operational question.

CHAIR—If the Treasurer were to give you different directions asking you to look at increasing competition in the residential mortgage area, would you see the risks in Australia as being relatively low if that direction were confined to AAA products?

Mr Hyden—AAA-rated products are of the highest quality. While there are variations even between different AAA instruments, they would rate very highly. So, in credit terms, they are highly attractive investments.

CHAIR—So, if the Treasurer were to go down that path, the risk to the taxpayer would not be high. Would that be your assessment?

Mr Hyden—The credit risk?

CHAIR—Yes.

Mr Hyden—There are other risks involved, such as interest rate risks. What the total risk to the taxpayer would be is a matter of how the portfolio of securities would fit into the overall risks carried on the government's balance sheet.

CHAIR—With the collapse of securitisation, one of the things that the government is being urged to do is to play some role in terms of looking at alternate ways of providing liquidity into the market. Clearly, one of the concerns has to be the risk that is there for the taxpayer. Would you like to expand a little on how you see the interest rate risk that is there?

Mr Hyden—Any investment is subject to interest rate risk. The residential mortgage-backed securities are a somewhat complex instrument. They depend basically on the package of mortgages that provide their asset backing. As those mortgages are paid off, the characteristics of the mortgage-backed securities will be changed in terms of the interest rate paid, the amount remaining and the length of term of the security, and they will vary. Mortgages and their valuation are affected also by movements in market interest rates. So we would be carrying some market risk realised and some risk in terms of what would happen over time to those mortgage-backed securities.

CHAIR—But surely the risk is in the amount that is there in terms of an intervention of that sort. It is no different to the directions that you operate under at the moment, in that those kinds of risks are there now. The risks that are there relate to how much you are exposed to in terms of that particular issue. Is that right?

Mr Hyden—Yes. That is something that the government would have to consider in terms to what it saw as the benefits coming from those interventions.

CHAIR—So it is conceivable that we have the opportunity of investing in AAA-rated mortgage products, which have low risk, and—I am trying to understand this correctly—the interest rate risk is probably better described as the level of exposure we have because of the size of the amount that we have invested. If we were to make any recommendations down that line, a recommendation that placed a cap on the amount of liquidity that your office invested in would go some way to restricting that risk.

Mr Hyden—The size of the investment is clearly a key parameter in determining not only the risk that would be covered for the government but also the effectiveness of the intervention or the impact it would have on the mortgage lending market.

CHAIR—If the government were to go down that path, would you have any comment to make about the relative size of the amount that should be capped in terms of exposure to risk?

Mr Hyden—The impact on the market goes to questions of competition and the operation of lending markets, which we do not have particular expertise in. How much risk the government should carry is a question of how long a piece of string is. I think that is something that the government would have to weigh up though—

CHAIR—You are going to leave that to us.

Mr Hyden—in terms of its assessment of the benefits that it would obtain from the intervention.

Mr PEARCE—Thank you very much for being here. You mentioned that you are not responsible for competition issues. With that in mind, I am struggling a bit to see how you fit

with our inquiry's terms of reference. In relation to the investments that you do make and that you are responsible for, how have they performed in the last couple of years and how do you think they will perform in the next couple of years?

Mr Hyden—Our investment mandate has changed considerably since the change in policy that the Treasurer announced in May. Up until then, our investments essentially were for managing the government's cash balances, and that was done to investments in term deposits with the Reserve Bank of Australia.

Mr PEARCE—How did they perform?

Mr Hyden—They are set at rates that are close to the cash rate. They have given us a margin over the rate that we would have got if it were just the cash rate, so it is a small positive margin. Since the change in approach announced by the Treasurer, we are starting to put a larger proportion of those funds into a wider range of instruments, particularly bank bills and negotiated certificates of deposit, on which there is a significant credit spread at the present time. So, currently, we are making a larger margin on those investments. The office also manages the investments of the Communications Fund in a similar range of instruments to those that have just been mentioned in our management of cash balances. On those, we have made a substantial margin for the government relative to the bank bills rate; that rate itself has been significantly above cash rates. Since July we have also been undertaking the additional issuance of Treasury bonds, as announced by the Treasurer, and investing the proceeds from that in a range of securities, particularly semi-government securities—they are bonds issued by state and territory governments—and some kangaroo bonds issued in Australia by overseas entities. We are quite happy with the way that has been going, but it is over a very short period.

Mr PEARCE—What do you see as the outlook?

Mr Hyden—At present—in one word—‘uncertainty’ in financial markets.

Mr PEARCE—How does your office prepare for that type of uncertainty or increased level of risk? What approach do you take?

Mr Hyden—The investments that we are undertaking with the proceeds of the additional issuance are closely matched to the cost and risk of that issuance. They are similarly rated high-quality bonds with a similar term. The maturity is closely matched to the issuance that we are undertaking. That means that the two sides of the account are closely matched, which protects us from the impact of market changes. For our shorter term investments, we are more at the mercy of market rates; but it is a matter there of getting the best result we can.

Mr Bath—In addition, we set pretty tight credit limits on individual issuers whose paper we can buy. We put a cap on how much of each issuer's paper we can purchase and invest in.

Mr TURNOUR—Do you issue liquidity to financial institutions?

Mr Hyden—No. We are not issuing liquidity; we are making investments but in instruments which are highly liquid in the market anyway. So our investment maybe adds to liquidity in the

sense that we are one more buyer in the market, but the investments that we make are instruments that already are highly liquid.

Mr TURNOUR—But can the banks or others go on and use that money in the market as a way of trading broadly?

Mr Hyden—Yes, in investing in, say, certificates of deposit. That is part of the funding of the people issuing those instruments, which include the banks.

Mr TURNOUR—Do you or non-bank organisations have the ability to invest in those sorts of instruments, whether that is through securitisation or whatever?

Mr Hyden—I think certificates of deposit and bank bills would not support housing lending by banks, but they would support other parts of their business. I guess that we are not lending directly to institutions other than to banks and financial institutions and to state and other governments.

Mr TURNOUR—So, effectively, one of the things that you are here to do is to comment on competition. I understand, from your evidence, that you are not going to comment on government policy—and large things are government policy. But I suppose that AAA-rated mortgages and their securitisation is one of the things that this committee is looking at—and I think the Chair has more than touched on that issue. Basically, you have said that, from your point of view, it is the interest rate and the size of and risks associated with those mortgages that would impact on investments in that area. But, just as a general comment, do you consider mortgages within Australia to be of a high or low quality in terms of risk?

Mr Hyden—Housing mortgages in Australia are generally regarded as being of high quality, when measured on an international scale or in comparison with elsewhere. Essentially, that reflects the prudent lending policies of the institutions involved and also the legal structure in Australia, which means that lenders have access to the full assets of the borrowing.

Mr TURNOUR—So the property rights and the financial regulations around mortgages and the like make them a secure asset in this country.

Mr Hyden—In relative terms.

Mr TURNOUR—So, in terms of risk, from a AAA-rating point of view, a bundle of those assets could be comparable with some of the other things that you may utilise in terms of investment, whether with state governments or banks.

Mr Hyden—Most of the investments we do with state and territory governments are AAA rated, and so they are comparable in that sense.

Mr TURNOUR—I think you said in earlier evidence that there were differences in AAA ratings. For somebody like me who has not worked in your area, would you like to explain a little more about the difference there?

Mr Hyden—Primarily, there is a difference in market perceptions. I guess that it is a question partly of the fineness of the gradations or distinctions one makes. Rating agencies obviously bundle a range of things together when they categorise instruments and lenders. State governments in Australia are basically rated AAA, but their bonds normally trade at a margin above the cost of the yields on Australian government debt. Those spreads have widened significantly over the last 12 months or so, in response to market pressures; so clearly some distinction is drawn by the market between different categories of AAA. In part, that may be because the Commonwealth is seen as a sovereign issuer, which is one with very wide taxation powers and an ultimate capacity to support its credit, whereas the states are seen as having not quite the same breadth of capacity to support their debt. From the point of view of Australians who know the constitutional system here, that might seem rather a fine distinction; but overseas investors, in particular, who may be less familiar with the details of our system, would perhaps attach a bit more difference to those sorts of gradations.

Mr CIOBO—Last night we saw central banks, in a coordinated effort, attempt to provide liquidity into the market through the injecting of capital. If the RBA were to do that, for example, would they do it through your office or do it directly themselves?

Mr Hyden—I am not sure whether I can comment on what was announced overnight; I was elsewhere when that announcement was made.

Mr CIOBO—With the credit crunch, there was a move by central banks to provide capital to markets. Is that something that your office would do, or would it be done directly?

Mr Hyden—It would be done directly by the central banks to the financial institutions that they deal with.

CHAIR—Thank you for your appearance here today. Your contribution is very valuable. Obviously, we will consider it in terms of the report that comes out of this inquiry.

[11.41 am]

BENNETT, Mr James, Senior Policy and Research Officer, Finance Sector Union

CARTER, Mr Leon, National Secretary, Finance Sector Union

CHAIR—I welcome representatives from the Finance Sector Union to today's hearing. Although the committee does not require you to give evidence on oath, I should advise you that these hearings are legal proceedings of the parliament and, therefore, have the same standing as proceedings of the respective houses. We have received a written submission from you. Are there any other written submissions you would like to table today?

Mr Bennett—No.

CHAIR—I invite you to make an opening comment.

Mr Bennett—We welcome the opportunity to appear today and thank the committee for its time. By way of background, the FSU represents approximately 50,000 members employed across Australia in the finance sector. In many ways, our members are on the front line of competition. They are often the first point of contact for customers and, unfortunately, they are sometimes what you might call casualties of competition and market forces. The FSU unashamedly represents the interests of its members; however, we would argue that these often go hand in hand with the interests of consumers and even finance companies; we would suggest they are not automatically mutually exclusive. We believe that banking is an essential service and that issues regarding competition and regulation of this sector should be seen in that context. In our opening statement, we would like to expand briefly on two issues: firstly, bank mergers; and, secondly, responsible lending.

In relation to bank mergers, I would say that we question the view that mergers automatically increase competition or benefit consumers. By way of example, we believe that the proposed Westpac-St George merger will result in less choice for Australian consumers, will remove an effective and vigorous competitor from the market and will result in large-scale job losses. Consequently, we do not believe that it will be good for competition. We acknowledge that the ACCC did not block the merger; however, we believe this reflects shortcomings with section 50 of the Trade Practices Act. Under the criteria in section 50, there is no requirement to demonstrate any public benefit from a proposed merger. As long as the merger does not result in a substantial lessening of competition, the ACCC is unlikely to raise concerns or oppose it. The FSU firmly believes that section 50 should include a public benefit analysis essentially when considering mergers of essential services providers, such as banks.

Our experience of previous mergers, such as Westpac, Bank of Melbourne and Commonwealth Colonial, suggest that these mergers are often orientated towards short- or medium-term profit outcomes that can have long-term detrimental impacts on the interests of consumers, employees and communities. These mergers may reduce costs and increase efficiencies for the banks; however, we suspect that the average consumer has not received a corresponding benefit. We are on record as supporting the four pillars policy and welcome the

Treasurer's recent statements regarding this issue. We would also note that arguments for abolishing the four pillars seem to be consistently framed from an industry perspective, with little or no reference to any benefit to the public. The most common argument regarding the abolition of four pillars seems to be based on the questionable premise that Australian banks must be bigger to compete internationally. Regardless of whether that is true or not, the main benefactors and advocates for abolishing four pillars seem to be banking executives rather than the general public.

Secondly, we would like to comment on responsible lending. There is undoubtedly intense rivalry between providers to win consumers in the lending market, especially for mortgages. In many respects this is exactly what competition is all about and, theoretically, it should result in better outcomes for all consumers. However, we suggest that this may not automatically be the result. We note the increasing levels of 'mortgage stress' in Australia, which is a term that has become far more common in our present lexicon. A recent report by Fujitsu—which, I understand, has addressed the committee—predicted that the number of households experiencing mortgage stress in June 2008 was approximately 750,000, with over 300,000 of those experiencing what was termed severe mortgage stress. In Treasury's evidence to the Senate Inquiry into Housing Affordability earlier this year, it was stated that home repossessions have doubled in the past four years, rising to approximately 10,000 homes being repossessed in 2007.

We accept that a major aim of any business is to maximise profits; however, we would argue that the sale of any major credit product, such as a home loan, has much wider dimensions. If things go wrong, there can be devastating consequences for the consumer; and, if problems are widespread, there can be major implications for the financial system. The US subprime crisis is the obvious and unfortunate example of what can occur when inappropriate loans are sold on a large scale. Given the complexities and the importance of credit in our society, we believe that regulation of lending practices will always require balancing commercial activities for profit, on the one hand, with consumer protection and public policy priorities, on the other hand.

The increasing level of mortgage stress and foreclosures in Australia is obviously a disturbing trend with a mixture of causes. We believe that one part of this jigsaw is the increasing use of sales targets for finance sector workers. These sales targets are often applied to products such as home loans and personal loans, and increasingly these targets are used as the only way that staff can access any form of pay rise at all. Sales targets carry the implicit message that ever-increasing sales are automatically good and desirable. The FSU does not share this view. Credit products should be sold on the basis of the consumer's capacity to pay, not an employee's need to meet sales targets. Given the increase in people experiencing difficulties, we believe that any regulatory regime should contain some form of responsible lending practices. The FSU believes that this should include a genuine assessment of a customer's capacity to pay and the disclosure of any sales targets to the consumer. We submit that a legislative regime for responsible lending will help to ensure that consumers are better protected and that Australia can never go down the subprime path. The transfer of credit regulation to the Commonwealth provides the perfect opportunity to mandate this.

We note that other organisations have made similar representations to the committee and we also concur with sentiments expressed regarding prohibition on unsolicited pre-approved credit in the market. We thank the committee for the opportunity to appear and would welcome any questions.

CHAIR—In terms of its approach to lending, the financial sector in Australia is very different to that of the United States. I am aware that, on a number of occasions in your opening remarks, you compared us with the United States, but the US environment and its history of lending practices and regulation are very different.

Mr Bennett—It is, and I think we accept that. We are not trying to suggest that we are on the verge of a subprime crisis in any way. However, we would suggest that there are lessons to be learned from what has happened in America. Whilst we might have a very healthy, robust system here, we should always be looking at ways to improve it. We would point to the level of increasing mortgage stress and foreclosures as one of the issues, and perhaps mandating responsible lending would be a way of our beginning to address that issue.

Mr Carter—It is absolutely right to say that their financial institutions are completely different, let alone the environments that they have grown out of. But the other concern that we see is this move away from where, once upon a time, the Australian banking sector was in a position of being trusted. If you went into a bank, the advice you were provided and the discussion that you had with anybody in that branch or over the phone was on the basis of your needs. It was about, ‘How can we help you to buy your home, buy a car or go on a holiday?’—whatever the credit need was. Now, what we are clearly seeing, particularly within Australian banks, is a much more aggressive shift towards a sales culture. Now it is not about dealing with the customer as they come in and contact the bank; it is about, ‘How can we maximise our sales to every single person who walks through the door?’

A very common experience for a bank customer at the moment is to go into a bank branch to deposit or withdraw some money but not be allowed to leave until they have gone through 105 questions, such as, ‘Do you need a credit card? Do you need more money?’ We say that, if that is what competition is about in Australian banks, it creates an environment where you are not dealing with the genuine needs of the customer; it is about pushing and selling credit related products. That can be a very slippery road, if it is the mentality that the banks are going to operate under.

CHAIR—I will come back to that area. That is a large part of your submission and I am very interested in that. You have commented on repossessions. Repossessions in Australia are still very low by international comparisons. Would you agree with that?

Mr Carter—If the comparison is with where the line is in the US and other places, it is certainly lower, but they are going up. There is a combination of factors for that; we are not trying to say that it is just down to particular practices. But they are increasing. Particularly in pockets of New South Wales and Victoria, they are growing very quickly. We have talked to the banking sector about it and they say that the five big ones, including St George, have relatively good books. But, if you look outside of them at those sorts of non-ADI lenders, some of their loans are being foreclosed very quickly.

CHAIR—But they are lower for a reason, aren’t they? We do not have a financial sector where you would shut your door, give up your keys and walk away. Our financial sector always looks at ways in which loans can be managed and continue to be managed. That is a good thing, isn’t it?

Mr Carter—Absolutely. We absolutely support all lenders that have proper processes in place whereby, once a customer gets into trouble, they start talking to that customer early. That is something that should be applauded right across our banking sector. But we say that you cannot behave that way at one end of the spectrum while, at the other end, you send them credit cards that they have never asked for.

CHAIR—I am going to come to that because I think it is an important area.

Mr Carter—I just think that is a contradiction. They need to be good at both ends of the spectrum.

CHAIR—You spoke in your submission and in your opening statement about looking at lending practices based on a capacity to pay. That is not how it is assessed at the moment; it is assessed on risk, which is a different structure, because the risk looks at the value of the asset and those sorts of things.

Mr Carter—Absolutely.

CHAIR—But I do think that a lot of people who take out mortgages think that the bank has assessed their capacity to pay.

Mr Carter—Absolutely.

CHAIR—Is that where you are coming from in terms of the recommendations that are made there, so that the consumer perhaps would be restricted in the credit that is offered to them?

Mr Carter—It should at least be a factor that is considered. On many occasions when I have been sitting at home, I have received a letter in the mail from a bank saying either, ‘Congratulations; sign this form and we will double your credit card limit,’ or, ‘Here’s a new credit card.’ I think most consumers work under the assumption that the bank has gone through some sort of process to determine that they are able to repay that or deal with that level of credit. That process is done by them to some level, but that process is not as rigorous as it needs to be and the test is not about the capacity to pay.

If you look at a mortgage, of course, there is always some risk that a person could lose their job or their circumstances could change. We are not saying that you need to draw a line in the sand that says, ‘You can pay today but only this amount.’ There is always an element of risk. But I would agree absolutely with what you are saying—that there needs to be a much better balance between just assessing risk versus what is the capacity to pay.

CHAIR—I was not actually saying that; I was trying to take what you were saying and to characterise that.

Mr Carter—Yes, absolutely.

CHAIR—If this committee were to look at recommendations that outlawed or stopped the increasing of unsolicited credit or the number of credit cards you could get, wouldn’t that have an affect on competition, which ultimately would be to the detriment of the consumer?

Mr Carter—Certainly, you can run that argument and I think that is one of the factors that this committee and the parliament would need to consider. Whether there would be a charter of responsible lending or some sort of process of responsible lending, at the very least the institution should sign up to that in a voluntary way. We would argue that a legislative framework is important; but equally we would argue that, if there is a process of commitment to genuine self-regulation and they are prepared to stick to it, that is a significant step forward. However, we would argue that sending somebody an unsolicited letter about either expanding their credit card limit or a new credit card should not happen.

CHAIR—My final question goes to the pressure that staff are under in terms of selling products. What sort of effect do you think that has on the staff, who are obviously the members that you represent, but also on the consumer with their potential financial situation? Would you like to make some comments about that?

Mr Carter—Sure.

CHAIR—Also, in doing that, can you tell us just how widespread this practice is and of the pressure that is put on the staff in that respect?

Mr Carter—I will start with your last question. It is very widespread. The only real exceptions to this notion of very hard-core sales pressure and sales targets are some of the community banks. Bendigo Bank does not run such a regime. We have seen thousands of people leaving the big four or big five to go and work for Bendigo because that bank does not offer that culture. The other one that does not have a performance-pay regime is St George, which is potentially—and we hope it is not—being taken over by Westpac. They are the exceptions to that mentality.

The impact that it has for a person who works in a bank branch and has done so for a long time is at two levels. One is that they think it completely undermines their ability to provide the great customer service that they want to provide. They want to be known as a responsible bank officer who, in dealing with their customers, in many cases has known those customers for 10 or 20 years. They are humiliated by the fact that, when that customer comes in for the thousandth time, they have to ask them the same set of questions about whether they want a boat, whether they are going away on holidays or whether they have kids in school. It is just humiliating. They want to provide whatever service that person wants and get them out of the place so that they can serve the next person in the queue, rather than this mandated approach.

The other problem arising is that the pressure on those bank workers now is becoming much more intense. We are seeing a dramatic increase in the number of bullying cases that we run. You have the person in the bank branch who has a set of targets, but above that person is a series of targets as well. It is often the case in particular bank branches now that someone will stand behind the tellers. If one of those tellers does not go through the list of questions and does not try to up-sell credit, the person behind them will tap them on the shoulder and say, ‘What the hell are you doing? Why are you letting that person get out of the door without trying to sell them a new credit card?’ It goes beyond that intense pressure that comes from their knowing they are not providing the service that they want to provide, as now their remuneration is becoming more and more linked to whether they sell that credit. Around 50 per cent of those we represent in the

home loan business are now reporting back to us in the surveys we do that they feel that they are being pressured to sell credit related products regardless of the need of the consumer.

CHAIR—How is that bad for the consumer? If I go to any other retail outlet and I am offered a range of products, isn't that a good thing?

Mr Carter—It is a good thing if you can afford to pay for them. The classic example is that you might go into a branch to get a loan for \$100,000 and you walk out of there with a \$200,000 loan. You might go in there with a debit card and you get sold a credit card that has much higher interest rates. We should not underestimate the banks in Australia. They make billion dollar profits because they are very good at what they do. Their sales techniques and the pressures and processes they put in place are designed to make sure that those sales occur. It is more power to the consumer if they can go in there and say, 'No. actually I don't need that and I'm not going to take it up.' Banks only make that money because lots of people are taking up those products.

Mr PEARCE—Thank you for appearing here. Just on the issue of not soliciting, you have stated that you do not agree with the bank sending out unsolicited material. Do you think any organisation can send out unsolicited material, or is it just banks that you think should not send out such material?

Mr Carter—Our view would be that, of course, there are circumstances where you can send a consumer material offering to sell them something. But what the banks are sending out is literally a document that says, 'If you sign this, we will increase your credit card limit by \$10,000.' We say that that sort of unsolicited offer will only cause problems. If that person wants to increase their credit card limit by \$10,000, all they have to do is ring up the bank and that transaction will be handled within five minutes. They advertise the fact, 'If you need something done, ring us and we'll do it in five minutes.' We say that, of course, banks should be able to send advertising and sales material; we have no problem with that. But an actual letter that says, 'Here's a credit card; just sign it' or 'Here's an increase in your limit', we say, is not good for the consumer and, ultimately, not good for the economy.

Mr PEARCE—But how do you know that a particular consumer might not have indicated an interest in a particular product or service?

Mr Bennett—I guess we would argue that it then is not unsolicited.

Mr PEARCE—That is right, but it might appear to be unsolicited. They might have indicated an interest in the past. My question is: how does the FSU know that?

Mr Carter—Because we have members who work in the places where those letters are generated and sent out. We can tell you that they are sent out and they track the customer's credit card activity usually over a quarter.

Mr PEARCE—They do that from where they send the material out?

Mr Carter—Yes. The bank would generate a customer activity sheet, note that they are using a credit card and send them a letter about increasing their limit. Not the big five lenders but some of the other banks buy lists of names and shoot this stuff out. We have people, part of whose job

is to generate and send those letters, and they very clearly tell us that is not off the back of it being an approach. If there is an approach from the customer, as I said, that is all done over the phone and, in some cases, over the internet and they do it instantly. Literally, it would be a five-minute transaction to get your credit card limit increased, assuming that you are not in debt to the point where they would not allow that increase. But, as a margin for most of them, it is part of doing business. We have met with executives about it and have said to them, 'You should not be doing this; this is not responsible activity,' and they say, 'It's part of the process of growing our business.' I certainly would not put words in their mouth but, in the meetings we have had with them, they are not shy about admitting that is absolutely what they do.

Mr PEARCE—In relation to responsible lending and practices in and around that issue, all of the major financial institutions in Australia have responsible lending practices already. There is also the Financial Services Ombudsman that works with all of those institutions. What evidence can you give the committee to suggest that this concept of some sort of voluntary charter through legislation is actually necessary?

Mr Carter—The one that we would argue is missing from all of their credit assessment or responsible practices—because they all have some form of process—is the one about stating upfront, 'We lend based on consumer need.' We would say that, if we can get that motivation so that it is not just about a sales mentality, especially in relation to credit products, that will be a significant step forward to dealing with not only the unsolicited stuff but also some of the stresses that people are under and decoupling this notion that how much you sell equates to whether it is good performance or not. We would love to see performance pay in our industry based on great customer service rather than on sales. But we say that the thing missing from all of them is a genuine upfront statement that says, 'We lend based on consumer need.'

Mr PEARCE—You talked earlier about the experience of the teller being required to run through a 'sales pitch', for want of a better term. I have never had a sales pitch presented to me by a teller in my bank.

Mr Carter—Fantastic! Which bank is it?

Mr PEARCE—Can you provide evidence of the banks where this happens with their tellers?

Mr Carter—It is all of the four majors. As I said, St George and Bendigo have a different mentality. It often depends on how aggressive they are depending on what branch it is in. But I can tell you that every one of the big four has that process and all of our members have weekly target meetings about referrals for insurance, sales regarding mortgages—if that is what they do—and referrals to home loan lenders. As I said, sometimes it is more aggressive in certain branches than it is in others, but that mentality is within the big four.

Mr PEARCE—Are you suggesting today that that mentality is a bad thing for competition?

Mr Carter—No. It is a fair point to say that in some ways you can argue that the more stuff there is out there, the more choice somebody has and the better the competition is. One of the things that we would say that restricts that at the moment is the notion of switching. If you are locked within one institution and you cannot move, it is a bit harder to argue competition. However, we believe that it does not deliver real competition in the sense that there are no great

pricing differentials between the products that are on offer. There are margins sometimes with an interest rate; you may get a particular honeymoon rate or sometimes a sweetener rate in terms of deposit holding. But really it is about a sales mentality that I do not think equates to genuine choice and competition.

I am happy to agree absolutely that you could see it from the perspective of a consumer saying, 'I have this raft of choices and products being put in front of me.' We would say that is being put in front of them so that person sells it to meet their target. You could definitely argue that it is about choice, but we say that it is not a genuine choice and it is not genuine competition. If you are customer of Westpac and you cannot go into the Commonwealth Bank, it is not an easy thing to move all of your accounts and products from one to the other.

Mr PEARCE—I am trying to understand. Are you saying that people who work in banks, as part of the responsibilities of their position, have the need to sell and they have accepted that need to sell as part of the responsibilities of their job?

Mr Carter—When you talk about the bank worker coming into the industry, that process has probably become much more intense over the last five to 10 years. For example, the people banks are recruiting at the moment are generally from the retail sector, because banks want a sales culture. That is the sort of person that banks want to recruit, which is probably why the more experienced and mature bankers are going to other places like St George and Bendigo, where they are not about that sales culture.

Mr PEARCE—Are you suggesting that it is unethical?

Mr Carter—No.

Mr PEARCE—You obviously have the link that this activity is bad for consumers and, if it is unethical, of course it would be bad; I agree with that entirely. If it were immoral, it would be bad; I agree with that entirely. But you are not saying that. I am trying to understand your rationale for creating the link whereby you are suggesting to the committee that you think it is bad for competition.

Mr Carter—As I said, I think you can argue from the point of competition. We would say that it probably falls short of that unethical test, because at the end of the day they are meant to disclose and they have the UCCC and a whole range of other regulations to follow. It is not unethical behaviour; however, we say it is a set of behaviours that is pushing debt onto consumers. I would agree that that does not necessarily make it bad for competition, if that is one of the ways you want to come at it from; but, at a personal level and a household level, we are seeing the level of indebtedness going up. We say that those practices are not the best set of practices for a sector that should be responsible and sustainable.

Mr PEARCE—As an individual, let me ask you this. You say that there are two parties to this transaction; one is the entity putting forward this offer and the other is the person receiving it. You propose for one of those entities a responsible lending charter. What do you propose for the individual? What would you propose if it were for me?

Mr Carter—We would be saying—and have been arguing this for a long time—that there is a great need for this country, the banks in particular, to fund an increase in financial literacy education, as 90 per cent of the people in this country do not even understand what compound interest means. A number of people that we deal with and that we know financial counsellors deal with do not understand the consequences of what they are doing. So that would be one level.

Mr PEARCE—Does the union involve itself in this area at all?

Mr Carter—Absolutely. We promote a financial literacy program and provide it free of charge to anybody who wants it. We have been a long-term advocate for that being a very important thing that the industry can provide. The other side of that is that it must be about disclosure, about making it clear to the consumer what choices they have in front of them and about giving them the time to make their decision. At the end of the day, most people approach a financial institution knowing exactly what they want. They either need money to get a home, a car, a holiday, or whatever it is. They usually know what they want. What we see happening is that they will come in for what they want and that is then seen as an opportunity—‘How can we then on-sell or up-sell the products and the level of credit that is provided?’

Mr PEARCE—But that is not unique to the banking system.

Mr Carter—No.

Mr PEARCE—I have got to say to you that, every time I go into a shop or a restaurant, I quite often end up getting something that I did not quite have in mind. I do not think that is unique to banks. I understand the difference in the significance and I am not downplaying that. Let me be very clear: I do not condone any sort of unethical behaviour; but I just do not think that is unique to financial services.

Mr Carter—We are certainly not saying that it is unique; we are saying that the banking sector should be held to a higher standard than a McDonald’s franchise is.

Mr PEARCE—Mr Bennett, you said earlier that you agreed that Australia had a ‘healthy and robust’—I think were the words you used—financial services system. That is clearly proving to be the case at the moment, given what is happening in the world. In that sense, it is clearly not broke. Would you agree with that?

Mr Bennett—I would give a qualified yes. We have still obviously had major collapses in recent history—there was obviously HIH in the financial services sector. So, by way of contrast, I think it is much healthier than other jurisdictions. But obviously, through the work of this committee and many other forums, we want to make sure that we try to improve it wherever possible in an ongoing way.

Mr KEENAN—I want to take up the point that you make about financial literacy, because I think that is actually very important. If this committee were to make recommendations about enhancing people’s financial literacy, what would you like to see the government do?

Mr Carter—If it were possible that that be part of the wish list, I would think it should be mandated as part of education programs right through this country. Financial literacy should be included in the teaching of reading and writing at primary and secondary school level. I do not know whether it is a subject that goes with economics any more or what packet it would go into. But financial literacy should definitely be done very early and it should be right through the primary and secondary schooling system.

In general terms, Australia consumers are a little more educated than some others around the world. But, just in the last 10 years, I believe that certainly our innate level of financial literacy has declined. If you talk to the financial counsellors that are dealing with people, they believe the Harvey Norman stuff—‘Buy now, pay later’. They have no concept of what ‘pay later’ means. They buy a \$1,000 television, which in the end costs them \$3,000.

We would love to see the consumer being educated to the point where they make an informed choice. If someone can afford to pay \$3,000 in doing a loan, that is fine. Credit is a critical part of making the world go around, let alone this country, so we are not opposed to the lending of money. But we think that anything the banks and the government can do about financial literacy would be a great thing.

Mr KEENAN—There was the Financial Literacy Foundation but, unfortunately, that has been canned by the new government. To address some of the concerns that the union has, the committee may well look at recommending that the government reinstate what was a very good program.

Mr TURNOUR—I am sorry to interrupt but perhaps I can be of assistance. Mr Carter, you may not be aware that the former government introduced for grades or years—depending on which state you come from—3, 5, 7 and 9 mandatory financial literacy classes in concert with the states, and they have been introduced. Is that the sort of policy that you would want to endorse?

Mr Carter—Absolutely.

Mr KEENAN—I want to take up the issue of so-called irresponsible lending that the union has concerns about. With the present credit crunch and with households finding conditions much tougher in Australia than they did a year ago, I put to you that, in a sense, that seems to be something of a straw man, because we have found our systems in Australia to be incredibly robust. Evidence of irresponsible lending is pretty difficult to find, even with that figure of 10,000 foreclosures, which you spoke about. What sort of percentage of mortgages that are issued in Australia would that be?

Mr Bennett—Incredibly small, I am sure. The main point we argue is that it is increasing and, in our opinion, that can only be a bad thing.

Mr KEENAN—I suppose that the issue is why it is increasing. Is it increasing because there has been irresponsible lending, or is it increasing because the economic climate has deteriorated substantially?

Mr Bennett—I would argue that they potentially are linked. If we had upfront what are termed ‘a genuine capacity to pay’ and ‘responsible lending’, I believe there would be fewer foreclosures and less mortgage stress, because those conditions would have been factored into the initial assessment. I realise that is an ambiguous answer in some respects, but essentially I do not think it is one or the other.

Mr Carter—The other thing that we have seen is the banks now being much more prepared to lend closer to 100 per cent of the value of the home. One upon a time it was 80 and then it went to 90, but it is much closer to 100 now. As that shifts, I think that might have something to do with the capacity to repay into the future. The other thing is mortgage insurance. They now make sure that, if something goes wrong, they are covered at the mortgage insurance level. I think that also has had something to do with it.

You can still argue that mortgage lending in this country goes through a very vigorous test. We would say that there is still some pushing around of the envelope that they do around a sales culture that should be fixed. But, with the credit card end and the personal loan end, whilst they still go through a process, it is nowhere near as vigorous as the mortgage side. You might have a very responsibly loaned mortgage but, if you have also been able to get five credit cards, which you are maxing out in order to pay that mortgage, ultimately that will impact on your capacity to pay back your mortgage. You might have gone through a very proper assessment to get that mortgage and the loan was absolutely on the money, but we would say that one of the things at the moment is that it is just too disconnected. There should be much more transparency about what everyone’s personal rate of credit is.

At the moment, you can go from one shop to another shop to another shop, and I could walk out of there with five different credit cards based around that store, sometimes from exactly the same provider, without any of those providers ever looking at whether I am in default with the other credit cards. One of the things we would like to see is much more transparency and discourse right across the sector. If I do go into one of the big four where I have a credit card and then go to another bank to try to get another credit card, that second bank should be able to look up my records and say, ‘Well, that person already has five credit cards; we’re not going to give them another one.’ At the moment, I think that second bank would just say, ‘Thank God; another credit card sale.’

Mr KEENAN—I would assume that they would need to disclose that when they were applying for that card.

Mr Carter—Yes.

Mr KEENAN—There must be some onus on the consumer to take some responsibility also.

Mr Carter—Absolutely.

Mr KEENAN—Effectively, they would have to lie to the institution that they were getting that extra credit from.

Mr Carter—Absolutely, but we are in desperate times.

Mr KEENAN—You spoke of 100 per cent mortgages, and the RBA has made similar sorts of comments to this committee, not on this inquiry but on other inquiries. That, in itself, is not a problem. Surely, it is depends on your capacity to pay.

Mr Carter—You would hope so, yes. If that is what it is about and every single decision about pushing it closer to the envelope of 100 per cent is about genuine assessment of risk and the capacity to pay, in and of itself, that is not necessarily a problem. But I think it is no coincidence that, as those sorts of envelopes gets pushed, more troubles tend to arrive, because it is a bit more fragile now. Probably the value of some houses will come down now. But, looking at the ridiculous prices that exist at present and at all those sorts of factors that are being rolled into the issue and find you are still lending closer to that 100 per cent envelope, it does create a different set of stresses. In circumstances such as those, it is probably much easier for one little thing to happen in your life that will have a much more devastating impact on your capacity to pay.

Mr KEENAN—I still put the view that it is exceptional that, under these very difficult circumstances, we have had so few foreclosures in the Australian market. That is a great indication that lending practices have been very robust. I will put on the record that I bank with one of the majors and I have never had any of these check lists that you assert are given to customers. I do not go into branches very often but, when I have, it certainly has not happened to me.

Mr Carter—We would be more than happy next time, if we get the opportunity, to bring along a couple of the members who do that every single day; that is their life.

Mr BRADBURY—I apologise for coming a little late to the presentation; I had another commitment. I note in your submission your comment about responsible lending. Recently, the Assistant Governor of the Reserve Bank, Dr Lowe, made some statements in relation to remuneration structures generally throughout the finance sector. At what levels within financial institutions is the bulk of your members?

Mr Carter—The bulk of the membership would be tellers and employees in call centres, up to middle management, although we do have a number who are beyond that. Certainly the bulk would be those in retail banks at teller level and in call centres, who are on the phone selling products, dealing with recoveries and that sort of stuff.

Mr BRADBURY—The statements in your submission go very much to the issue of greater competition driving the need to be more aggressive in practices, if I can summarise it in that general sense. For the teller, that might mean suggesting that someone might want to upsize to a new product. But, clearly, a range of incentives are built within the overall remuneration system, and that goes from the bottom of the organisation right up to the very top.

Mr Carter—Absolutely, yes.

Mr BRADBURY—Do you have any views not so much about that segment of the market where your members principally are but about the higher echelons within financial institutions, regarding existing practices? Might there be alternative mechanisms through which remuneration packages can be developed in a way that does not necessarily require more

aggressive practices that potentially leave institutions and the system open to greater levels of risk?

Mr Carter—We would say that, of course, performance based incentives are needed at those levels. One of the things that we would like to see is the performance not just relating to quantum of sales; it needs to be about service—whether they are providing the sort of service needed and are meeting their regulatory requirements, and those sorts of things. The other major concern that we have had for a long time, particularly with executive remuneration in the sector, is that it is now completely linked to share price. One of our concerns now would be with the options and the shares that are provided to CEOs and below. I think that has skewed the focus of some of those institutions away from good-quality service, such as making sure they are meeting their customers' needs, to how they can maximise value for shareholders. Shareholders are a very important part of it and we are not saying they should not have maximised value in terms of the money that they put on the table. But, if you are running a banking institution, it has to be about more than just maximising the profit for the shareholder community; it has to be about what impact it makes on the community. We would say that, of course, if it going to make money, it has to be about how they sell, but it should be about responsible sales and customer service. We would love to see some of the people at that end of the spectrum having some of the targets that our people have in making sure that there is sufficient staff in branches and on phones to make sure that they can deal with the calls so that people do not have to wait for half an hour. We say is that there is a concern about it being completely a shareholder mentality. The other part that we would have a concern about is that there is a very narrow focus with what they are providing incentives for, and we think that should be expanded to include customer service and responsible lending.

Mr BRADBURY—Turning to the issue of consolidations, I note your comments in relation to the four-pillars policy. Obviously we are conducting this inquiry against a backdrop of the Treasurer having reaffirmed the government's commitment to the four-pillars policy. Given what we are observing internationally in very recent times from a consolidation perspective, to what extent are broader considerations of stability to be taken into account vis-a-vis competitive issues within any given marketplace? Do you have a view on that broader question that needs to be determined?

Mr Carter—It is a genuine debate, where you look at the notion of more competitiveness versus the stability of the system. At the end of the day, stability does matter. It needs integrity and it needs to be able to survive these sorts of shocks. I do not think you can say that, by having major consolidations and big institutions, survival is made easier. Just that, in the last 24 hours, we have seen HBOS in UK—which no one could argue is anything other than a mammoth institution in that part of the world—having to go to Lloyds. You have institutions in America, which are phenomenally sized mortgage lenders; but the size does not matter. We would argue that at the end of the day it has to come back to the practices, the regulation, the responsibility and the public policy that is in place.

It cannot just be a coincidence that we have a four-pillar policy that does not allow the big four to get together. In some ways it makes them a bit introverted in this country and it makes them look to themselves to make sure that their practices are in place. But I think that, if we come up with a good sustainable and responsible industry, it can have more bang or even a couple of gargantuan bangs. From a competition angle, it is obviously better if you have more

choice. The Treasurer has indicated that he wants the consumer to be able to say, 'If I'm not happy with that bank, I'm going somewhere else.' We would argue that the more that consolidates, obviously the less choice they have. It needs to be sustainable. We would argue that sustainability does not only come from size; it comes from practices, from the laws of the country and from the various regulations that the parliament have put in place.

Mr BRADBURY—I think it would be fair to say that some of the consolidation occurring at the moment would not have occurred had more robust prudential regulatory environments existed.

Mr Carter—Absolutely.

Mr CIOBO—Mr Carter, you would be familiar with the phrase, 'The grass is always greener.' Have you done any modelling on the impact on the economy of there not being enough credit?

Mr Carter—No. If you are asking whether the FSU has personally done some modelling about that, I would say no. But we have had a range of discussions and we ask other people to do those sorts of modellings. We look at that and we know what the impact will be in broad terms if credit is not available, which is why some of the central banks have tipped in billions of dollars in recent times to make sure that that money can flow.

Mr CIOBO—Haven't the bulk of the problems that we are witnessing globally now been as a consequence of there not being enough credit?

Mr Carter—You could argue that is the case in some areas. But I would agree with Mr Bradbury that it is also to do with the way some of those loans have been made.

Mr CIOBO—That is a good point to explore. Do you think that is what it is? What is the fundamental difference between the Australian housing sector and loans here and the US housing sector and loans there? If you had to distil it down to one key and fundamental difference between the two, what would you characterise that as being?

Mr Carter—I could pick a couple. One is the notion of the low-doc loans that are rife throughout America.

Mr CIOBO—They exist in both countries, don't they?

Mr Carter—They do; but in Australia it is a very small minority, even where the big institutions have gone. So it is a much more rigorous process and assessment in Australia.

Mr CIOBO—What else?

Mr Carter—I would say that the other thing is the regulation of the system in Australia; there are hands on the wheels to make sure that it does not run away from itself.

Mr CIOBO—I do not agree with you. I think the single biggest difference would be the inability to have recourse loans. Perhaps the problem with the United States is not that their lending practices were poor but rather that they do not have recourse loans. Perhaps that people

can just throw their keys at the bank, walk away and cause a glut of houses for sale has been the principal driver of the problems in the United States. Do you think that is a reasonable conclusion?

Mr Carter—No.

Mr CIOBO—Why is that?

Mr Carter—I do not think that you can just say that the whole meltdown in the US is driven by that one cause alone. Is it an issue? Absolutely.

Mr CIOBO—Why do you say that?

Mr Carter—We would say that, if you look at the regulation and the practices that exist within Australia, they show that, if a system is run with a different mentality, is subject to regulation and is subject to much more vigour around responsibility and those practices, that also contributes to sustainability.

Mr CIOBO—No, that is not what I said. What evidence do you have that that is not the root cause?

Mr Carter—I do not have any evidence.

Mr CIOBO—One of my primary concerns about Australian lending practices is that banks—and indeed, the NAB made this comment this morning—basically allow for cross-subsidisation because lending practices are not having their risks reflected in the interest premium but are attempting to control risks by the size of the loan. To me, that seems to be a poor way of operating; nonetheless, that is the system we operate under. There is a large appetite among people who may have a stronger risk profile, as in being more risky, to also have access to credit, which they cannot get from one of the banks or one of the ADIs. They are then forced to turn to non-bank lenders and to follow a low-doc or no-doc application process to give them a better chance, albeit at a higher premium. Do you think that might explain why you note in your submission that there tends to be a higher default rate et cetera, and problems with low-doc loans? Maybe the problem is not the low-doc loan. Maybe the problem is that the banks are not lending to people in a way that is appropriate and as a consequence they are going somewhere else?

Mr Carter—We have had those discussions with a range of the institutions, that is, that some of the attitudes that they take to those sorts of loans, their risk profiles and those sorts of issues need to be broadened out. I think you are right in the sense that, if the banks are turning them down, people will still go and find the money. I would agree that is one of the issues that the banks need to address.

Mr CIOBO—It is important to note that not enough credit is potentially as big a problem, if not more of a problem, than too much credit, but neither is desirable.

Mr Carter—Yes.

Mr CIOBO—You say that 52 per cent of workers felt obliged to try to sell debt products even when a customer did not need them. How do your members determine whether a customer needs them or not?

Mr Carter—Generally they come into the bank branch to conduct whatever business it is. A couple of members of the committee have been the exception to this and that is fantastic, but in a number of the bank branches they have a script that they run through, and they would describe that as unsolicited. They have not come into that branch to do that.

Mr CIOBO—That is not what I asked. I said: how do your members determine whether a customer needs them or not?

Mr Carter—Because they have not asked for it.

Mr CIOBO—That is the measure?

Mr Carter—If you are asking just as a point blank how do they know that it was not needed, if someone has come into the branch to do their weekly small business deposits and they end up having questions asked to them about a loan or a credit card product that they have not asked for, then our members would say that that is something they were not in need of and generally they walk out without the product.

Mr CIOBO—Finally, do you know the title of the person who stands behind the tellers across the banks?

Mr Carter—There is not a title. It can vary. It can be anything from your lead teller. It can be your bank manager. It can be a CSR.

Mr CIOBO—Does it vary from institution to institution?

Mr Carter—Yes. It is not a job title.

Mr CIOBO—Are they under an award?

Mr Carter—Yes.

Mr CIOBO—Which award is the person responsible for standing behind the tellers?

Mr Carter—I am sorry, I am not sure I understand. They are just part of the banking award.

Mr CIOBO—In all the banks you said there is someone who stands behind the tellers.

Mr Carter—That is right. They are just part of the bank officers award or, if they are an employee at NAB, it would be the NAB award. If it were the ANZ, it would be the ANZ award.

Mr CIOBO—It is not a classification?

Mr Carter—No. It is not a classification. It is part of their duties to ensure the sales are met.

CHAIR—Thank you for your time and contribution here today.

Mr Carter—Thank you for your time.

Mr Bennett—Thank you.

Proceedings suspended from 12.35 pm to 1.33 pm

WAMSTEKER, Mr Anthony Stewart, Chief Executive Officer, Members Equity Bank Pty Ltd

CHAIR—Welcome, Mr Wamsteker. Although the committee does not require you to give evidence on oath, I should advise you these hearings are legal proceedings of the parliament and therefore have the same standing as the proceedings of the respective houses. You did not make a submission. Is there a written submission that you would like to tender today or would you like to make some opening comments before we go to questions?

Mr Wamsteker—I would like to make some opening comments.

CHAIR—We are in your hands.

Mr Wamsteker—Thank you for your time today. I am pleased to be here in the capacity as the chief executive of Members Equity Bank. The very fact that you are holding this inquiry shows that people do not feel like there is enough competition in banking. Australia has a very safe banking system, but it does not provide the service standards demanded by customers. How can I say this? It is because the published measures of the commonly applied measure of customer advocacy, net promoter score, show an average score of minus-35 for the banks used by around 80 per cent of Australian consumers. Net promoter score simply takes a percentage difference between promoters and attractors, happy customers and unhappy customers, if you like. It is a reliable measure of whether competition is working to produce satisfied customers. It tells us whether people feel like there is competition. Whatever else we say about competition in banking it has not been felt yet by customers and they should be the final judge. Our industries do much better on this measure. Indeed, many banks do better on this measure as well, including our own bank, Members Equity Bank, which according to the independent research achieves the best result, a score of plus-49.

To allow competition to benefit customers they need to be able to switch between banks relatively easily when they are dissatisfied with the service they are getting. The government is uniquely placed to facilitate such an outcome with three simple changes. Firstly, make it easier for customers to switch banks. Secondly, provide statistics on customer satisfaction at all banks and, thirdly, provide a guarantee of liquidity for AAA rated mortgages, a housing competition guarantee, if you like. Each of these is straightforward to implement.

Firstly, I turn to easy switching. The UK government has introduced processes for customers to switch banks. The Australian government could mandate similar processes and set maximum exit penalties for those who wish to refinance their loans. There is no incentive for a bank unilaterally to make it easy for their customers to switch, so the government needs to provide the policy framework. Making it easy to switch will provide a strong incentive for all banks to lift their customer satisfaction on price and service.

The second point is customer satisfaction data. The government already produces a huge volume of statistics about banks. However, it does not produce any data on customer satisfaction levels. Since consumers are not feeling that they benefit from competition, why not add this key

missing piece of information so that they can see where they might be happier? Make the information well known and readily accessible to consumers.

The third point is the housing competition guarantee or a liquidity guarantee. The fact is that households in Australia only deposit \$4 for every \$10 that they borrow from banks. The other \$6 is obtained by banks from capital market investors. Most depositors and investors prefer short-term investors, whilst most borrowers want long-term loans, for example, 30 years for a home loan. Australian banks are very good at managing this liquidity mismatch, because home loans, as such, are a safe asset. It is in this area that scale is important and large banks have a fundamental advantage. In times of uncertainty investors are much more comfortable investing with the bigger banks, even if the underlying assets are the same as for small banks. This has led to the current global phenomenon of big banks taking over smaller competitors.

In Australia it is the smaller banks that have typically achieved better customer satisfaction ratings. Competition needs to be felt by consumers in the area where they have their greatest exposure to banks, that is, home loans. The provision of a liquidity guarantee for a commercial fee available to all banks, building societies and credit unions that meet minimum criteria on their home loan portfolio such as AAA rating would make a big difference. I understand the arguments of those who claim such a program is not appropriate for government. However, why would the government not ensure that Australians have guaranteed access to a competitive home loan market in all market scenarios, particularly when it would be profitable for the government to do so? The counterarguments usually apply to a far more complicated program than is needed in practice.

In conclusion, whatever people might say about competition in banking, it is simply not being felt by most Australians. Bank bashing remains a national pastime, but a simple three-pronged approach would ensure that customers feel the benefit of competition and that it does exist in practice.

CHAIR—The government's policy regarding switching officially comes into effect at the start of November. What are your views on those measures that have been announced in respect of the points that you made in your opening remarks?

Mr Wamsteker—I do not think that you can go too far on this. The fact of the matter is that we know currently only about five per cent of people switch banks. Minus-35 is what they think of their bank. Thirty-five per cent more people are unhappy than happy and yet five per cent a year are switching. I am happy to have the measures coming in. I encourage you to go as far as you think you can. I encourage you to look all over the world. We understand the UK has a very effective scheme. Once you make it easy for people to switch, you will stop getting feedback about how unhappy they are because they will be able to say, 'If I am unhappy I can go and find something better.'

CHAIR—Provided there are other institutions they can switch to, which goes to your third point. We have heard submissions so far in relation to switching about looking at portability of accounts, through to the Dutch model of there being a central registry that the customer only needs to notify that they have changed their banks and all their direct debits change from there. Do you have a view on either of those propositions?

Mr Wamsteker—I would go for the simplest approach first.

CHAIR—Which of those do you think is simpler?

Mr Wamsteker—The simplest method is to say that banks should be required, if asked, to hand over all of the data about debits and credits in an account from one bank to another. That would be simple. The government does not have to do too much. It is just a requirement.

CHAIR—That is the switching policy that we have announced.

Mr Wamsteker—Yes, that is right. To me, that is the simplest and most straightforward to start with. I think that will work in practice. It is very similar to being allowed to take your phone number when you change carriers. The banks have the data. You need to give them a bit of lead time for all of us to get it all together. We will, in the end, find a quick and convenient way to exchange it electronically and off you go.

CHAIR—Given that that is what we have said will be happening from November, your view is that we should see how that operates in the first instance?

Mr Wamsteker—You should see how that operates. The only other thing, as I said in my introductory comments, is that you are talking about a barrier to switching, basically a transaction account, but there are other accounts and the biggest exposure people have to their banks is their home loan. As I said, there is only \$4 of deposits for every \$10 in home loans and of those four there is only \$1 in transaction accounts. It is a very important account, but in terms of exposure, loans and home loans are much bigger. In addition, we could see a system where there are mandated maximum exit penalties for refinancing loans, which is the other side of the equation for consumers.

CHAIR—I have a couple of questions about your government guaranteed liquidity fund or however you termed that. One of the arguments against doing that is the risk to the taxpayer, and the recent history of Fannie and Freddie would not be great examples of the risk that is potentially there for a government. Do you have a view on that?

Mr Wamsteker—Yes. Most people would agree that governments are in the business of building nations. We hear about nation building and things like that.

CHAIR—We did not for a while, but we do now.

Mr Wamsteker—Governments are interested in nation building and what people are interested in is their house. If you talk about nation building, the first thing is why wouldn't the government, to the extent that people believe there might be a risk, say that they are prepared to say that they will use some of the risk capital that they have effectively got to help build what Australians really want, which is their house. Then you could ask: what is the risk? This is the risk. It is a liquidity risk. As I said, people want to borrow for 30 years to buy that house, but we have not been rushed off our feet with people walking in saying, 'I will give you a deposit for 30 years', and the wholesale markets do not have lots of investors queuing up to give you money for 30 years. So, the whole banking system is about saying, 'What do you do when depositors and investors want to have money at call virtually and borrowers want to have it for 30 years?'

If your 30-year asset is a highly risky asset, then you have a huge problem, but we are not talking about a highly risky asset. We are talking about the home loans of average Australians. It is about the safest asset you can get. The government does not need to complicate this. This is a facility that is commercially available in the market. If you have a 30-year asset and it is AAA rated, you can set whatever guidelines you want to stamp out anything that you think will be irresponsible lending and that will not be allowed in the pool. That is a 30-year asset, AAA rated, meeting all the standards of what the government says is a good policy in terms of non-excessive credit risk. Then the investors say, 'We will give you money but we will only give it for three months, overnight or whatever.' The banks facilitate the intermediation and take the difference. So, if the markets go into crisis mode and people want their money back and panic, then the government just says, 'We will invest until the market has resumed to normal. We will stand in until they resume to normal.' You do not outlay any money. You simply say, 'We are willing to stand in.' If the government should happen to decide to stand in, the government has unlimited access to money; the government can fund it and can make a huge margin on it until such time as the market investors come back and say, 'We will do it again.' The history of the markets is that when that is provided commercially it is almost never called. The liquidity providers almost never have to put the money in. They just keep rolling it over, because people know they are only investing for the short term that they prefer.

CHAIR—Are you looking at this as a short to medium term fix with respect to market failure as in the current credit crisis that we are in at the moment, or are you looking at this as a more fundamental long-term structure?

Mr Wamsteker—The fact with banking is that there will always be this mismatch forever.

CHAIR—We had great competition five or 10 years ago without this. If the purpose of this is to increase competition are we looking at the short to medium term market failure situations before the cycle changes and comes around again?

Mr Wamsteker—My view is that it is an area where prevention is better than cure. If you say that the government has an agency and that is their job, then I do not think the markets will fail because people know it is there. Prevention is better than cure. If you come in at the last minute when the markets are in turmoil and say, 'Now we will provide it', and that is what is happening in the US really—

CHAIR—Part of the ASF's submission to us was to look at the Australian Office of Financial Management and give them the authority to look at one- to three-year issues in relation to AAA rated mortgages. Would that be the type of solution that you are advocating or an example of that?

Mr Wamsteker—I would not constrain it to a brief window of time. If you look at when the markets really got competitive for home loans, that was back in the early to mid-nineties and, to be honest, what really made it work for us and many other lenders who came in and provided the competition at that time was that you could obtain mortgage insurance from a government agency, HLIC, Home Loans Insurance Corporation, and so that provided a competitive environment where you could say that these are very safe assets. Everyone knows these are safe assets. This is what investors ultimately want to hold, but sometimes investors just need the reassurance of saying it is a 30-year asset but is it safe for 30 years?

There is nothing wrong with government saying, 'We are interested in nation building.' What the Australian public wants is to own their own home. Even with the massive growth in super, it is their biggest asset. There are lots of discussions about housing affordability and we are seeing that even though there is nothing wrong with the Australian financial system it is a very good, safe system. It is the safest system in the world potentially, but even with that we are seeing a reduction in competition. The question is whether it is for one year, three years or whether it is a permanent commitment of government. Does the government have a view since they are the ultimate liquidity maker in the economy that they should say that there is a particular type of asset that we know to be very safe and that is what we think the true value is of government liquidity, in making that market work efficiently?

In times where the market says, as we had leading up to this credit crisis, 'That liquidity is easy to provide. It is a no-brainer. We will just do it', the government agency steps back and says, 'We do not have to do as much', but it should always be there to provide that layer of reassurance. As I said, prevention is better than cure, so you do not ever get close to it. By the way, I do not think we are close to it now. There is not a real liquidity problem in Australia now, but it is just a safety net. If it is always there, then we are never going to have a financial market crisis that impacts on homeowners in Australia. Imagine if you could say that?

CHAIR—Before I go to Mr Pearce, I should put on record that I was a director on HESTA, which is one of the owners of Members Equity.

Mr PEARCE—Thank you very much for being here today. Members Equity Bank is a little bit different from the big four or five in Australia in a lot of ways. The four or five are public companies and ME is essentially a private company. Just from a competitive point of view, what do you consider to be the competitive advantages for a customer in joining your bank?

Mr Wamsteker—The real advantage is that we compete on the basis of high levels of customer service and customer satisfaction. As I said, there is independent data to say that we are No. 1 in the market. We have the lowest price that we can possibly get out there, and we achieve that by having a narrower product range. We have a very simple product range of basic banking services. We choose not to compete on an extensive product range in order to devote our resources to high levels of customer service and low price.

Mr PEARCE—How many customers do you have?

Mr Wamsteker—Over 200,000.

Mr PEARCE—I have often heard over the years from people in the banking and financial services area that are in public companies and are not constructed like you in the sense of being private entity and about the transparency of information. What I mean by that is that when you are a public company and you are listed, for example, you have obligations in relation to market disclosure, et cetera. You do not have those obligations because you are a private entity; is that right?

Mr Wamsteker—We have the disclosure obligations of a private company but not a stock exchange listed company. That is right.

Mr PEARCE—Do you think that raises any issues about transparency of information in the marketplace?

Mr Wamsteker—No, I do not, because the stock exchange itself is a private sector organisation and so the obligations they put on listed companies are another private sector company saying, ‘You should disclose this.’ There are two obligations that we have. One is the disclosure obligations under ASIC of a private company, which are very significant disclosure obligations. Secondly, we have the same disclosure obligations of every other bank that is regulated by APRA. To get a banking licence we have huge disclosure obligations to APRA, and we are very happy to subscribe to those.

Mr PEARCE—You mentioned before that one of your points of differentiation is that you have a thinner set of product ranges and you do not choose to operate in some other product areas. Why is that?

Mr Wamsteker—I will use credit cards as an example. We say in credit cards that our commitment is to as low a price as we can get out there and highest level of customer service; so we offer one credit card. From what I can gather and what I have heard anecdotally, some banks have 20 different credit cards. You might say, ‘What is the problem? They are giving a lot of choice.’ But the difficulty is that if somebody rings up and says, ‘I have got a credit card’, the customer service operator—once you finally get through—has to say, ‘What sort is it? Sorry, Sir, you have rung the gold credit card number but you have got a platinum credit card’ or whatever it happens to be. You have either to train call centre operators in 20 different credit cards or you need a phone system that diverts whichever way they happen to call up. I am using that simplistic example, but it highlights it. We talk about operational excellence. We will have a very narrow product range but will be excellent in how we operate those products. It is simpler for us to work that way. For most customers the one product we offer absolutely hits the mark and they are interested in the price and service and not the breadth of the offering.

Mr PEARCE—In a sense you are saying that in our marketplace there is quite a large range of products and services available in banking and financial institutions?

Mr Wamsteker—Yes.

Mr PEARCE—You do not see any issue there with the range of products and the choices that consumers have? There are multiple choices and multiple products.

Mr Wamsteker—I do not have a problem with it, but the issue that it creates is that it can be very confusing for consumers to identify what is the best product. One of the things that you can do to make customers feel like they are getting more competition in banking is to cut through the confusion and provide simple things for consumers to easily understand and where they will get what they are looking for.

Mr PEARCE—I am conscious of the time. Lastly, I notice that you did not make a submission to the inquiry. Was there a reason why you did not?

Mr Wamsteker—No, there was not any particular reason. What we say to the inquiry we say publicly. We are on the public record as saying: make it easy for people to switch banks. Make it

easy to find out where you are going to get good service. We think the best measure of that is where are people happy. We are already on the public record on these things. There has been a lot of debate about that. Having been invited to come here we are happy to say it to the committee as well, just as we are happy to say it publicly. We certainly appreciate the commitment to set up an inquiry into competition in banking, because that is what we want.

Mr TURNOUR—With reference to your balance sheet, do you raise your money from deposits? Where does the money come from in terms of securitisation?

Mr Wamsteker—We get most of our money from securitisation. We have a small and growing deposit portfolio, but we are one of the banks that rely heavily on that \$6 out of \$10 that comes out of the wholesale markets. When I say \$10 of lending to consumers, \$4 comes from deposits and \$6 from the wholesale markets. Of that \$6 usually about \$1 of the \$6 comes from securitisation and \$5 of the \$6 comes direct to the bank's balance sheets and they on-lend it. Our funding is heavily concentrated in the \$6 and we are heavily concentrated in the \$1 of the \$6 by securitising our home loans.

Mr TURNOUR—You are heavily concentrated in the \$1 of the \$6?

Mr Wamsteker—Yes.

Mr TURNOUR—My understanding is that market has pretty much dried up to a certain extent now, so that must be having impacts?

Mr Wamsteker—We went into the funding downturn with a long pipeline of supply already locked in. We were more than happy to pay liquidity fee lines to have funding locked in well in advance, and of the money that we have had to raise in the capital markets we have probably raised half of it in the last 12 months and chewed up some of our pipeline. What that means is our pipeline now is probably only about six months, whereas a year ago it was 12 months, so it is not as strong a position as we were 12 months ago. It is still a very strong position and we are comfortable with that, but we would prefer always to know there is no limit to how fast you should grow.

Mr TURNOUR—Thank you for that. I just wanted to clarify that for myself. I gather some of your owners are superannuation funds?

Mr Wamsteker—All of our owners, yes.

Mr TURNOUR—You talked about the mismatch between length of mortgage and short-term money market. I am not across all the regulations, but I understand that there would be some regulation that would prevent you from using superannuation to support mortgages. Is that something that would be worth looking at in terms of how superannuation investments could effectively feed into supporting a longer term investment, which was a mortgage, because similarly they are over long periods?

Mr Wamsteker—Yes. That is a good point. It is interesting if you look at the mass of super in Australia. Again, to do it out of 10, for every \$10 that Australians have borrowed from their bank coincidentally they have also got \$10 in super. That is the rough number. It is about equal. Their

borrowings are about equal to how much they have now got in super. But when they invest in super, because it is long term, the typical super fund has something like 70 per cent of that \$10, \$7 of that \$10, in things like shares, property and what they call growth assets. There is only \$2 or \$3 of the \$10 available for debt instruments. That is the first issue. Even the growing pot of super is not enough to fund the whole capital markets requirement of all banks in Australia, that is, the \$6 out of \$10 that needs to be raised to fund the borrowing patterns of Australians.

The second thing about it is that, despite the fact that it is long-term money, a large part of superannuation still has to be invested in relatively liquid assets. Super funds have some capacity, but they do not have unlimited capacity to invest all of their money in liquid assets. They are part of the system, too, where they invest and they want to know that they can get their money back. If we go to the super funds and ask them to invest in a 30-year mortgage, there is a limit to how much the super funds of Australia collectively would be able to put into that. It is one of the sources of capital markets funding that all banks access, but it is not meeting the whole thing. There is still a liquidity management exercise that is not fully solved by using superannuation money.

Mr TURNOUR—I think you said \$3 out of \$7 might go into that. The NAB was here this morning and suggested that we should change the taxation environment for deposits, because effectively super was a much more tax effective way to save money. In the end, one is suggesting we should make people more inclined to put their money in deposits so you can then access that to lend to housing loans. The other way is to give more incentive for superannuation and provide more liquidity to the mortgage market, given they are closer matched in terms of the length of the investments than maybe they are at the moment.

Mr Wamsteker—The whole question of giving tax advantages to deposits is a big area, but of course most deposits are short term in nature. The tax advantages that go to super help the government and all Australians in the long run, because it is reducing the pressure on the pension to provide a decent standard of living for people, whereas not many people are putting money into deposits for their old age retirement. I am not sure about it generally, but what I do say is that housing affordability is a big problem. Housing affordability is a big issue for all Australians and the move to say could we make it tax advantageous for people who are using their deposits specifically to save for a home is a good idea, because one of the largest causes of poverty in Australia is people who do not have their own home, and housing prices continuing to rise and then rents going up. It is good public policy to make it tax effective for people to put money into an account to save for their home. I think it is good public policy to make it tax effective for people to save for their retirement. I have not thought through whether it is good public policy to just make it tax effective to save full stop.

Mr TURNOUR—I am aware of the time. I have one last question that goes to the issue of Reserve Bank rate changes and your bank's decision-making process. If the RBA cuts another 25 bases points, do we assume that you would follow the RBA? What is your bank's view in relation to that?

Mr Wamsteker—I would like to answer that in the context of what has happened to date in 2008 and that is that we, along with most of the banks, have had an increase in our cost of funding over and above what has happened with the RBA decisions. Most banks have passed on something of the order of half a per cent in addition to RBA rates. What we do is every month

we consider what our margins should be and each time that coincides with the RBA having moved we are more focussed on whether we should move our rates as well. If the RBA were to cut at its next meeting, and based on what has happened with funding costs up until now, most likely we would be able to pass on the full cut because there has been some easing in funding margins. As you know, it is a very uncertain environment at the moment and so by the time that deliberation takes place things may have changed.

Mr KEENAN—You were saying that you have the one credit card product. What rate do you charge for that?

Mr Wamsteker—You have got me there. It is one of these low rate credit cards. It is about 10.5 per cent or around that ballpark. It is not 18 per cent or 20 per cent.

Mr KEENAN—You just missed an opportunity for a great advertisement. What sort of rate are you charging on your mortgages? I assume you have more than one product on the mortgage front?

Mr Wamsteker—Yes. Our mortgage is at 8.79 percent for our standard variable home loan rate.

Mr KEENAN—What would the comparison rate be?

Mr Wamsteker—It is 8.79 per cent. We have no fees or anything.

Mr KEENAN—Do you charge different rates for different consumers or does everyone get the same rate?

Mr Wamsteker—We have two different rates that we charge. We charge a higher rate for people who are not members of one of the superannuation funds who invest in the program, and we have a full transaction based home loan account where we charge a higher rate as well, but they can use it essentially as their bank account and so all the interest on that account is offset against the home loan balance, so it is a very effective cash management vehicle for people who have that account.

Mr KEENAN—Someone suggested that the current credit crunch—and you have suggested something similar—is somehow some market failure. Could you make the case that what markets are really doing is just repricing the risk of lending money and understanding that there is some greater risk in the environment that we are in now; the market is just reacting to that and making money more expensive?

Mr Wamsteker—There is no greater risk in home loans in Australia than there ever was when you look at it over the full economic cycle, and to say that markets are efficient and do not overreact says that Macquarie Bank has somehow or other lost half of its value over the last few months and even yesterday has lost 15 per cent or 20 per cent of its value and recaptured that and more today. I accept that markets occasionally overreact.

Mr KEENAN—I am not suggesting that. There can be an element of the madness of crowds, but ultimately markets are pretty good at identifying where risk is for things and that is

essentially what they are doing when they are repricing the risk associated with lending money. What I am getting at is that I would be concerned if we had a scheme that put risk on the taxpayers where we have a private sector that is perfectly prepared to accept that risk for a fee.

Mr Wamsteker—I do not think too many taxpayers would be concerned if they thought that the government was going out and saying, ‘We want competition in housing’, and there are certain market environments that sometimes favour the really big players and when those environments come along we, as the government, will say, ‘If the smaller players who often provide the competition at the really pointy end are being disadvantaged by market behaviour, we will be there providing some support’, because what that does is guarantee competition in the housing market, and that is the most important exposure that people have to their bank. I do not think too many taxpayers would think that is not a very good use of their taxpaying dollars.

Mr KEENAN—When you are talking about competition in the market, 30 years ago if I wanted to get a mortgage the big question would have been: can I get finance? What you would have to do is to really work hard to try to get someone to lend you money for a mortgage, for instance. Fifteen years ago you would probably be paying the bank a margin of about four per cent of the loan. If you go and get a mortgage today you would be paying a margin of 1.5 per cent. The history of the Australian credit market is one of increasing competition over time. That is the sense that I would get out of that.

Mr Wamsteker—The great catalyst to competition came in the early to mid-nineties and the really big catalyst in the early to mid-nineties was the involvement of a government owned entity, Housing Loans Insurance Corporation. I know, because we set it up. We wanted to compete. We saw four per cent and we said, ‘We think you could actually do this for two per cent because they are very safe assets’, but what you need is some assurance to the capital market investors that that loan is safe and the extra layer of assurance that was provided then was Home Loans Insurance Corporation, being a government owned entity. It was so profitable the government sold it off and it was owned for a while by GE, and now GE has spun it off into a separate flow.

You went through a period where markets are efficient and everyone realises now that loans are safe. But as I said, there is nothing wrong with reassuring the average Australian family that, if the market which funds \$6 out of \$10 of your home loan has any sort of breakdown at all, we are there forever. We are there providing a form of guarantee, because what we are doing is we are guaranteeing competition in the home loan market, and the evidence that that competition is welcomed is this net promoter score where it is minus-35 for banks, which cover 80 per cent of the public, but there is much higher satisfaction for smaller banks. Customers welcome competition in banking.

Mr KEENAN—I think that is right that customers welcome it. I do not know that the taxpayer would welcome accepting that risk from the private sector. The other thing I would say is if the government is going to be a guarantor of last resort, I wonder what that means for people’s behaviour or even corporate behaviour. I have a sense that it could affect corporate behaviour if you know ultimately that you have the taxpayer standing behind you. We have a policy of ambiguity that works reasonably well there. As I said, there is no guarantee that the government would necessarily back up a failed bank or anything along those lines. Anyway, I appreciate your point of view.

Mr BRADBURY—This committee has heard consistently through this review that the Australian residential mortgage-backed security market is of a much better quality than those similar markets overseas and that perhaps that market has suffered as a result of the adverse perceptions of it, perhaps unfairly. The advice that we have received through this committee is that reasonable returns are available in that market in the Australian context. One of the questions that has emerged is why superannuation funds have not sought to become more involved in that market. Given your associations with super funds, do you have any particular views on that point?

Mr Wamsteker—Yes. I am a chief executive of a bank that promotes our mortgage-backed securities to all investors in the market, including super funds. On the one hand, I am not the right person to ask, because I do not understand why you would not buy more and more of ours or other mortgage-backed securities. They are a very safe AAA rated asset. The mortgage-backed securities that we and other providers offer have a higher credit rating than the credit rating on even the biggest banks in Australia. That is how safe they are. They are very safe assets, and yet we have seen some market turmoil, which means that it is harder for us to place those securities in the market.

It comes down to a few things. One of the things that it comes down to is that only about 20 per cent or 30 per cent of the superannuation funds' money is invested in cash and fixed interest in the first place and not all of it. The second thing about it is, even though they have invested, the long-term super funds need to be focussed on liquidity and so they would ideally prefer for the same investment to know that they can get their money back in 90 days, rather than in 30 years or however long. That is the issue with super funds; like everyone else in saying 'What is the price of liquidity? How much are we prepared to give up liquidity for the sake of getting a higher return?' What is the price of that? That price does change over time and at the moment the price is very high. Everyone wants liquidity. Everyone wants to get a huge margin for being willing to invest in assets that might take 30 years to be fully repaid.

Mr BRADBURY—One of the recurring themes of this inquiry has been that some people have sought to characterise the equation facing policy makers as being one wherein sometimes increased competition might come at the expense of greater stability within the financial system. Do you see that to be the case, that there is, to some extent, a trade-off between stability and competition?

Mr Wamsteker—I would look at it like this. I would say there has to be a minimum level of safety and stability in the financial system. That has to be a given. You have to set up the system in such a way that it survives any environment and then, once you have got that right, you say, 'Within that system now we want as much competition as we can.' That is the trade-off that you are making. It is not a trade-off to say more competition produces less stability but you do have to say, 'There will be no deviation from the principle of the utmost stability in the Australian financial system, but within that foundation or building block we want a high level of competition.' I do not think competition destabilises that. If you think that the smaller banks are in some way less stable, it is true in the sense that they get lower credit ratings than the major banks, but they have the same asset. It just highlights the fact that banking is a scale business. Bigger banks have an advantage, but in Australia's experience small banks typically give better customer service. They have in no way destabilised the whole system. As I said, it is one of the

stronger banking systems in the world and all the banks in Australia are very safe and very stable.

Mr BRADBURY—In terms of that minimum level of stability that should be required, do you believe that our system currently achieves that or are there any particular areas where you believe there could be greater regulatory intervention?

Mr Wamsteker—We have that level of stability in Australia now. There is no doubt it is a very stable banking system and all the parties who have contributed to that need to be congratulated on what a great stable system we have in Australia. The real question for policy is no matter how safe you make the system the safest entity in the economy is always the government. The government is always the safest.

Mr TURNOUR—I am sure people feel you are in very safe hands with our government.

Mr Wamsteker—The government can print money like nobody else can. The question is whether there are occasions when the government should say, ‘The assets that are owned by the banking sector are safe. We know that, but we are the safest of all and we are prepared, on a commercial basis, to give our assurance that the system is completely stable and you should go where you get the best deal.’

Mr DUTTON—Thank you very much for your time and the evidence that you have given. We are up against the clock here, but I would like to ask you a couple of questions. The first key to your three points was to suggest that switching of products be made easier and so you agreed with the government’s current product proposal. What is the key element that you agree with? What is the most significant part of that policy to you?

Mr Wamsteker—I know I keep coming back to this fact, but if the average consumer in the Australian banking system is unhappy as publicly available data shows, but they are not switching, it must be too hard. If people are unhappy with their carrier in their mobile phone service they switch. Almost every other industry has higher satisfaction ratings and that is why we get this phenomenon called bank bashing. What I really support is policy intervention to make sure that it is easy for people to switch so that they can exercise the choice when they are dissatisfied.

Mr DUTTON—That is the basic philosophy, but what element of the government’s proposal strikes you as being the most remarkable?

Mr Wamsteker—No disrespect, but there is nothing remarkable about it. It is simple. You just say to banks, ‘If the barrier to switching is that consumers do not know where the debits and credits are going on their bank account, then just provide that.’ Just say, ‘This is all the debits and credits. Provide it to the new bank.’

Mr DUTTON—I would like to confine our thinking to the cost element, because obviously there is a cost recovery for establishment and then discharge of a particular home loan products. Do you charge a lower upfront fee than other banks or, if one of your customers is not satisfied or they want to refinance somewhere else, is your current fee comparable to that of the major banks?

Mr Wamsteker—We have a lower fee. We have no upfront fee and we have a very low exit fee. To get to your point, we do have an exit fee.

Mr DUTTON—How much would that be on an average mortgage?

Mr Wamsteker—It is either \$500 or \$750. I think it is \$750. We do say that if you were to leave before we recouped the cost of establishing the loan we reserve the right to recoup that and I am pretty sure that it is five years before we say it is waived permanently, because after five years we have recouped the cost. I have never said you cannot have exit fees. I think you should have exit fees if there are costs associated with providing that product that have not been recouped. I am not advocating that there be none, but I am advocating that there be no penalties that are designed to lock people in. I do not think that is going to help customer satisfaction. Consumers are not benefiting from being held to a product that they no longer want. That is going to decrease customer satisfaction and not increase it. We should not have it and we should not allow it.

Mr DUTTON—I do not disagree with what you suggest, that we should make competition in the banking space to the benefit of customers wherever we can, but the problem that I have is trying to understand that, if a customer does have to pay the set-up or the discharge cost, which would seem reasonable—if it cost your bank \$5,000 to write a loan to set up the documentation—then it would not seem unreasonable for you to charge that amount of whatever it is if the customer decided to transfer to one of your competitors. The difficulty is if I am with the ANZ, Westpac or your bank, there is not such a differentiation in the Australian marketplace that makes it advantageous for me to switch. You would say that your product is superior and it may well be compared with that offered elsewhere, but it is not so substantially different, as I see it, in terms of the rates and the ongoing fees that would justify my paying to the bank if I am not happy after year one or year two, \$500, \$1,000 or \$5,000. I just wonder what end is achieved, if I can put it that way? I am not trying to be difficult or disrespectful to your submission, but it is like going from Pauls Milk to Pura Milk. Is there so much difference that I would want to change my variable home loan with ANZ to Westpac?

Mr Wamsteker—Firstly, I would say that you have an inquiry into competition in banking for a reason. There must be a lot of people out there who think there is not enough competition, and you have had a lot of submissions to say there is. I would say that you should see what the customers think. The customers are unhappy. You can get the data that says on balance customers are unhappy.

Mr DUTTON—I do not doubt that. I am not taking issue with you on that. The fact is the majority of people will still stay with one of the major banks. Many people have taken up your product, which is good and will continue to be the case, but you are a relatively small player in the market and you have access to relatively lower sums of capital to fund new business. Hopefully you will continue to grow and that will be a good thing in terms of competition. My point is, in my view, we do need to support more marketplace competition in the home loan space, but I think the products on offer are so homogenous that it is very difficult to see where customers will gain any benefit, even if it is cheaper to switch from one of the major banks to the others, or even to one of the securitisers that have fallen away a little bit. I am wondering whether there is something more substantive or more revolutionary that you could put to us that we could contemplate?

Mr Wamsteker—I often say to people that a home loan is a home loan is a home loan, because we want to get the message out there that you do not need to be confused about what a home loan is. It is a straightforward financial instrument and that is why we have only got one or two types and not 10 different types of home loan. They are not homogenous in two key respects. The first is that a lot of banks now compete on the basis that if you in as a customer they will give you 70 basis points off the standard rate. That is not homogenous with what the rest of their customers are paying. Seventy points is a very material difference. We are asked whether we would pass on a full 25 point rate cut, yet there is no question at all that it is appropriate for a bank to offer two customers 70 points difference on the same homogenous product.

The second way the products are not homogenous is that I would challenge anyone to go and ask what is the difference in a customer's level of satisfaction with a bank between a minus-35 and a plus-49. That cannot be homogenous. That is the difference between somebody driving a Rolls Royce and somebody else driving an old beat up car and asking them how happy they are.

Mr DUTTON—We could debate all of that. It could be that they are not happy with fees or because of the products that you do not offer and the banks do. We will accept that people are unhappy with banks, and on your evidence they are happy with your product. I know we are out of time, but I just wanted to ask another question about your proposal that the Australian government conducts some sort of underwriting business. HOIC, from my understanding—and pardon my ignorance—was a mortgage insurer offering the same product that GE does or another two or three in the space do; nonetheless, it is an insurance product offered by the government and now offered by the private sector. I do not understand, in your evidence, how the Australian government could carry on its balance sheet a contingent liability to the amount of the whole home loan insurance market in our country, which essentially from what I understand of your evidence, is what you want the government to do. Are you arguing that the Australian government would underwrite every dollar that is funded through a bank into a mortgage?

Mr Wamsteker—HLIC was available for anyone who wanted to provide home loans to customers and then wanted to on-sell those home loans. Not everyone wants to do that, but the fact that you could do it allowed a greater level of competition than you otherwise would have had and it was that competition that was instrumental in rates coming from a four per cent margin to under a two per cent margin. They provided the product, and as you say there were others providing the product, but the HLIC product was superior because it was AAA rated. The other mortgage insurers providing the product were not AAA rated.

This is a lot simpler than that. This is not guaranteeing the whole home loan. It is simply saying that, if there is any sort of difficulty in refinancing that portfolio of loans in the market, this liquidity facility is in place. Just like HLIC, the liquidity facilities are available in the market today. It is a commercial product available in the market today. It is just saying, 'We will make sure.' Why would we make sure? Why would we add a layer of competition to the market? It is because it is so important to Australians. Home loans are so important that you have competition for home loans, just like health insurance and a number of other areas are so important. That is all I am advocating. I am saying that most people would probably think that it is reasonable public policy to guarantee competition in the market for home loans and the fact of the matter is that when HLIC were in the business of doing it we saw the biggest change ever in the competitive landscape for home loans in Australia.

Mr DUTTON—I am sorry we do not have more time.

CHAIR—Thank you for your appearance here today. It is most appreciated.

Mr Wamsteker—Certainly.

CHAIR—Once again, thank you for your contribution.

Mr Wamsteker—Thank you.

[2.34 pm]

COOPER, Mr Jeremy, Deputy Chairman, Australian Securities and Investments Commission

KIRK, Mr Greg, Senior Executive Leader, Deposit Takers, Credit and Insurance Providers, Australian Securities and Investments Commission

CHAIR—I welcome representatives from the Australian Securities and Investments Commission to today's hearing. Although the committee does not require you to give evidence on oath, I should advise you these hearings are legal proceedings of the parliament and therefore have the same standing as proceedings of the respective houses. You did not make a formal written submission. Are there any submissions you would like to tender before we start or would you like to make an opening statement?

Mr Cooper—Neither, thank you.

CHAIR—Can you tell us a bit more about the findings of your review on mortgage entry and exit fees that was conducted earlier this year?

Mr Cooper—We issued a report back in April and it is fair to say that we found a number of different practices. For example, if you take entry fees, there were products that had no entry fees attaching to them and there were products that had quite substantial entry fees. Similarly, when it came to ongoing fees there were products in which there were no ongoing fees and others with relatively substantial ones. It was the same for fees for various types of services that you might ask for with respect to your account. Lastly, in relation to exit fees, being the main focus of the report, it is much the same thing. It seemed that each institution had at least one product on which there were no exit fees. We did see a trend where the major banks seemed to charge lower exit fees than some of the other lenders and then we saw a vast range of products, types of fees and honeymoon rates. It is fair to say that there is a great range of products for consumers to pick through and see which ones suit them.

CHAIR—What were the sorts of levels that were being charged in terms of the range of exit fees from that study?

Mr Cooper—The range was starting at zero and the maximums were up to very substantial amounts of \$6,000 to \$8,000 in the non-ADI area.

CHAIR—Those exit fees of \$6,000 to \$8,000 were clearly more than recovery of costs. They were there as a disincentive to leave that loan?

Mr Cooper—That is hard to say, because you need to look at the overall mix. You would need to look at whether there were other fees being charged and the interest rate being charged. You would have to drill down and see what the overall economic proposition was. In very crude terms, you might be right in saying that, but we do not have the data on each particular product to actually make that proposition. It would certainly suggest that that was the case.

Mr Kirk—With some providers the fee was a percentage of the total amount financed. To the extent that means the fee will go up with the amount financed, whereas a lot of the administrative costs are in setting up a loan, they would not be variable or not variable to that extent with the amount financed, and it would suggest that for some it is more than just cost recovery on their administrative costs.

CHAIR—The very nature of exit fees themselves are about trying to stop someone leaving your product. Would you say that is the nature of it?

Mr Cooper—Not really. It was interesting in this work that it was put to us that in fact it was an attractive way of doing away with an entry fee. This was when the market really opened up to competition via the likes of Aussie Home Loans and so on. The magic there was that they were able to offer a product that had no entry fee whatsoever, but you took the risk, if you like, that if you moved out of your product within a four- or five-year period you were going to have to pay an exit fee. If you did not, there was neither an entry fee nor an exit fee. In the first instance, it did not have that purpose. Of course it can be designed to achieve that purpose, but it was put to us that that was not the purpose for initially creating it.

CHAIR—Whether by design or not, clearly if you are looking at switching your loan and you are going to face a fee of \$6,000 to \$8,000, that is a disincentive to switch your loan.

Mr Cooper—All things being equal, yes, that is absolutely right.

Mr KEENAN—I want to ask you briefly about the Financial Literacy Foundation, because it came up in some of the evidence that we were hearing this morning. How is that going under ASIC's domain?

Mr Cooper—We assumed responsibility for the foundation as from 1 July and we are currently working on a more comprehensive plan with the minister as to how we are going to discharge that function going forward.

Mr KEENAN—When would you expect that we will see that plan?

Mr Cooper—That would really be up to the minister. The current situation is that we have assumed the Treasury staff that were with the foundation in particular working on the very important schools and education component of financial literacy, ensuring that financial literacy is embedded in the school curriculum. The other piece of work involves rolling the Understanding Money website either into existing ASIC websites or creating a new one. Those two pieces of work are being undertaken at the moment and then it is a matter of scoping the other parts of the plan.

Mr KEENAN—Do those Treasury officials now work for ASIC?

Mr Cooper—They do.

Mr KEENAN—What sort of extra level of resourcing did you get to run this?

Mr Cooper—We did not get any specific additional funding. We said we would fund it out of our existing budget for this year.

Mr KEENAN—Is there talk of extra resourcing once this plan has been finalised with the minister?

Mr Cooper—I would imagine that there will be that sort of discussion, yes, depending on the size of the business plan, of course.

Mr BRADBURY—In relation to the broader issue of stability in financial markets, obviously there has been a lot of discussion. I think we would all agree that we have a collective responsibility to ensure that there is a maximum level of confidence within our markets, but I would like to move to the issue of short selling. I know there has been a lot of discussion in that area. I wanted to ask whether you believe that ASIC has sufficient powers to deal adequately with matters relating to short selling and whether you are confident these are issues that are currently being dealt with adequately within the Australian context?

Mr Cooper—To the extent that that is not expressing a policy opinion, there is an existing short selling regime in Australia. There is a regime that prohibits making short sales unless they are on an approved list maintained by the ASX. The government has indicated that it is considering a new obligation of disclosure in relation to the covered short sales, and I understand a bill is being worked on, so if the government seeks to change that then that will be a matter for government. Obviously we will assist in the drafting and providing whatever advice we can. Really beyond that it gets into an expression of opinion as to whether you think short selling is a positive for the thing for the market or not and, depending on the answer to that question, whether you think it should be disclosed, and then the extent of what should be disclosed and should the actual price at which short sales have been made disclosed and so on. I suppose all the regulators in the major markets at the moment are asking themselves those questions.

Mr BRADBURY—We would clearly be aware of some of the steps that have been taken in the United States recently.

Mr Cooper—Indeed.

Mr BRADBURY—In the context of the different, albeit interconnected, set of circumstances that we find ourselves in here in Australia, the issue really goes to a question of whether you are confident that what is occurring within the marketplace here is not posing any significant risks to the stability of our markets in Australia. What is your view on that?

Mr Cooper—I am not sure what you are asking me there? Are you asking me whether I think that the existing short selling regime is adequate?

Mr BRADBURY—Is it adequate? You may choose not to answer that on the grounds of it being a policy question.

Mr Cooper—It is a policy question. There are two views. One is whether short selling should be allowed or not. In our regime it is allowed subject to specific restrictions and qualifications, but it then comes down to a disclosure question. As I said, this is entirely a matter of policy for

the government but all regulators are examining the sort of disclosure, how would it work, how would it inform various types of investors and would it provide any assistance to retail investors to know, for example, of net short positions in stocks. As I said, that is a policy question.

Mr DUTTON—Thank you for your evidence. I wanted to ask you a couple of questions following on from Mr Keenan’s questions on the Financial Literacy Foundation. Is the board still in its original structure or pre-July structure and who is the chair?

Mr Cooper—Yes, it is. It now lives within ASIC, where we are currently working out what to call and how to present it and so forth, but it has exactly the same people. Mr Paul Clitheroe is still the chair and so on. It meets now within ASIC much as it would have done previously. That aspect of it has not been changed.

Mr DUTTON—What activities have been curbed as a result of their coming across and the lack of funding that has come with that?

Mr Cooper—It is not so much a lack of funding in that we are committed to it.

Mr DUTTON—Have you been asked to absorb the costs?

Mr Cooper—Indeed.

Mr DUTTON—What functions have been cut?

Mr Cooper—There would have been—

Mr DUTTON—For argument’s sake, would the school education program have been cut?

Mr Cooper—That certainly has not been cut.

Mr DUTTON—What has been cut?

Mr Cooper—It is difficult to say because we are now resourcing activities using our resources. In answer to your question, as far as I am aware none of the activities has necessarily been cut, because we have absorbed the core personnel working on the education component and all of the existing board members have continued in office. The other activities that the foundation might have been working on were things such as research projects and so on. All of those things can be done within ASIC and will be.

Mr DUTTON—Some of the functions may have been taken away and performed by other ASIC officers as opposed to the board in their original form?

Mr Cooper—That is correct.

Mr DUTTON—I would like to ask you a question about the efficiency dividend and what that has meant in terms of your output. What difficulties have that presented to you?

Mr Cooper—I must admit I have not come prepared to answer questions about that. I will have to take that on notice.

CHAIR—I am not sure that is really to do with this committee.

Mr DUTTON—We are talking about the functions of ASIC in terms of education and its monitoring in this particular space that we are concentrating on. If they have had their money cut and they have had to cut functions, it is particularly relevant and so that is why I have asked. If you have not come prepared, perhaps you could take it on notice.

Mr Cooper—I have not, but I would correct the record; our money has not been cut.

Mr DUTTON—Were you subject to the efficiency dividend?

Mr Cooper—I would have to take that on notice. There were various negotiations.

Mr DUTTON—If you could, that would be great. I wanted to ask you a question following on from Mr Bradbury's comments about the current turmoil in the market. You would have seen some of the comments by the US Attorney-General and the chairman overnight about short selling and some of the warning, at the very least, that was given out to some operators in the US market. How do you respond to those comments?

Mr Cooper—There has been so much press and comment that I am not sure what in particular you are referring to. You will know that earlier in the year ASIC and the ASX made similar pronouncements to our market about short selling and making sure that the rules were being followed.

Mr DUTTON—If there was a request by the government for advice on how to deal with current market difficulties, an options paper as it were, in terms of regulation of market oversight, would you be involved in that process and in the preparation of that document?

Mr Cooper—We may be through the Council of Financial Management. That is a hypothetical question.

Mr DUTTON—My question is: would you be involved in it?

Mr Cooper—Would I personally?

Mr DUTTON—Yes, as the deputy?

Mr Cooper—Yes, I would be likely to.

Mr DUTTON—Do I take it by your answer that you have not been asked for any options paper?

Mr Cooper—No, I would not draw that inference at all.

Mr DUTTON—I would not seek to ask what was in the paper, but I am asking in relation to whether or not any advice has been provided to government in the last 24 or 48 hours or indeed in the last week?

CHAIR—Again, I am not quite sure this is relevant.

Mr DUTTON—It follows on from Mr Bradbury's line of questioning in relation to the current market. I am not sure why it is okay for Mr Bradbury to ask a question about short selling and the difficulty of the current markets but it is not okay for us.

CHAIR—It is not an issue of talking about short selling. There might be an issue about asking advice that has been requested or not requested.

Mr DUTTON—Mr Cooper goes before estimates.

CHAIR—This is not estimates today.

Mr DUTTON—I am sure that he has an understanding of how committees of the parliament work. I am asking him a question because it has direct impact on the way in which our housing market and liquidity is operating in this country and as we speak on our markets as they operate today.

CHAIR—I am suggesting that estimates may be the best forum for this type of question.

Mr DUTTON—Perhaps that is the case, but this is also a forum to ask questions about ASIC's view on the current market turmoil, which directly impacts on the housing market.

CHAIR—I have no problem with that type of questioning.

Mr DUTTON—That is why I asked him to answer the question.

Mr Cooper—I do not want to be tedious, but could you rephrase which question it is that you are asking me?

Mr DUTTON—Have you been involved in any advice going to the government in the last 24 to 48 hours, or indeed over the last seven days, in relation to options about extra regulation or ways in which the government could intervene in the current market turmoil domestically?

CHAIR—Again, this is a question that is best put at estimates. This is not a question that fits within the purview of this inquiry. I would say that the witness does not have to answer that type of question.

Mr DUTTON—Let me rephrase it. At this inquiry we have had terms of reference issued to us by the Treasurer on 3 June this year. It goes to doing stocktake of the Australian retail banking and non-banking industries focussing on a number of things, including developments in the current state of the banking and non-banking industries, and in light of that and the current difficulties that are being experienced by many of the major banks in our country, their raising of capital, the way in which they are conducting their businesses in the current market. Have you

provided any government advice over the last seven days in relation to regulatory action that could be taken by the government and options that may be available to the government in relation to the current market turmoil?

Mr Cooper—No.

Mr DUTTON—I would like to ask a question about switching fees. You were here for the evidence of the previous witness. I raised the point about the fact that financial institutions have a cost generated when they need to prepare documents, settle a loan, engage counsel and all of the costs that go with that. Do you believe that it is reasonable for the institutions to pass on that cost either in the form of an upfront fee or a discharge fee, or is there some other way? That seems to be a major inhibitor to switching products. How do we get around that difficulty?

Mr Cooper—I understand part of the equation is looking at some of those costs and perhaps using technology and different procedures to bring them down, and I think we will see that in the industry. For example, in our report we used the expression ‘termination fee’ really to mean just the pure discharge of the mortgage, the paperwork, the production of the title and that kind of machinery work. During the hearings and meetings that we conducted it was fairly widely acknowledged that there were some antiquated processes in that aspect of the market that could be fixed up and therefore the costs would be reduced. You see this in some of the online banking products. While they might not resolve those specific problems, they are able to offer both deposit and credit products at considerably cheaper prices than the traditional paper based product. I think that consumer demand for them will see some of those costs being reduced. But will they be able to be eliminated entirely? It is up to the bank, I would have thought, as to where they want to put those costs. In one sense they could gross them up into the interest rate if they wanted to, but that would not be an attractive thing. You are going to find those costs placed at various points, whether it is entry, exit, ongoing or what have you. There is a blend of ways that those costs can be passed on to the consumer.

Mr TURNOUR—Thank you coming in today. This is an inquiry into competition in the banking industry. Does ASIC see its role as assessing competition in the banking industry?

Mr Cooper—Not directly, no. Ours is a consumer protection role and in this particular context consumer protection would extend to making consumers aware of the different types of products and how they might work their way around overly high fees of one sort or another. We do that by giving them information. Actually becoming interested in creating competition or regulating in some way is quite beyond our jurisdiction. Certainly as a consumer protection regulator we would in part assist in creating competition by providing information that then leads to more confident and informed investors and consumers who then seek better rates in different products and query fees and so on. Information does create competition.

Mr TURNOUR—Do you see any other particular agency that might have a role in doing that?

Mr Cooper—The ACCC has a role in competition. Obviously mergers or anticompetitive practices of one sort or another in that sector, just like any other sector, would be within their purview, but the consumer protection aspect of financial services is with us.

Mr TURNOUR—I was interested in your comments on that. The ACCC gave evidence earlier and referred to other regulatory organisations similar to yourself in terms of that area. I was trying to get a snapshot of your views in relation to that. They talked about competition in terms of a merger, but in general they did not necessarily see themselves as having a great role, although their evidence did vary a little bit on that when we delved into it. I was just interested in that point of view. The other area that I am interested in is credit cards. We have looked at exit fees. There is a certain amount of evidence that the inquiry has received in relation to behaviours in terms of the encouragement or the providing of various credit card products to people. I am asking you specifically in relation to what your views are about whether there is not necessarily a lack of competition but whether there is a clarity of information when people make decisions and whether that is working effectively in the current market?

Mr Cooper—Mr Kirk might have something to say about this in a minute. We are certainly quite vigilant about advertising for credit card products. There have been some instances where we believe the line has been crossed and issuers are engaged in misleading inducements of particular types of advantages. They might be able to get discounts at a particular outlet or something like that. Typically these advertisements are aimed very much at household consumers and retail customers and the credit cards carry very high interest rates. We are quite vigorous in going after what we see as misleading advertising.

Mr TURNOUR—Would you like to add to that, Mr Kirk?

Mr Kirk—We should emphasise that we have not been, and are still not, the primary regulators of credit, including credit cards, in Australia. That has been a responsibility of the states, with the main legislation being the Uniform Consumer Credit Code. To the extent that there has been concern over those sorts of issues raised particularly by consumer groups with the way that credit cards are marketed in terms of promotion or responsible lending and the like, that has been an issue that they have taken up with the states and the states through the Ministerial Council on Consumer Affairs have been looking at that and have put out in relatively recent times a regulatory impact statement. That has all been work done at the state level and that is really where the responsibility has been.

Mr TURNOUR—With the agreements and that regulation at a Commonwealth level do you think there are some things that this inquiry could recommend in terms of strengthening information or the abilities of consumers to make more informed choices about credit cards, and then in that way strengthen competition from ASIC's point of view and in general?

Mr Cooper—Essentially the work that has been done on the issue has been done by the states, and the summary of that is in that regulatory impact statement. I think there are a lot of ideas there. Assuming credit is transferred to the Commonwealth government, whether some of those ideas are implemented and how they are implemented is really a policy question for the government in the process of that transfer.

CHAIR—Thank you for your attendance today. It has been a good contribution that we will obviously consider in the fullness of the report. There was also a question that you took on notice from Mr Dutton, and so if that material could be sent to the secretary that would be most appreciated. Thank you again for your contribution today.

Resolved (on motion of **Mr Keenan**):

That the committee authorise publication, including publication on the parliamentary database, of the proof of transcript of the evidence given before it at the public hearing today.

Committee adjourned at 3.02 pm