COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS

Reference: Competition in the banking and non-banking sectors

THURSDAY, 25 SEPTEMBER 2008

CANBERRA

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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS

Thursday, 25 September 2008

Members: Mr Craig Thomson *(Chair)*, Mr Pearce *(Deputy Chair)*, Ms Julie Bishop, Mr Bradbury, Mr Ciobo, Ms Jackson, Mr Marles, Ms Owens, Mr Tony Smith and Mr Turnour

Members in attendance: Mr Bradbury, Ms Jackson, Ms Owens, 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.

WITNESSES

Committee met at 9.20 am

CHAIR (Mr Craig Thomson)—I declare open this public hearing of the House of Representatives Standing Committee on Economics. The committee is conducting an inquiry 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 could help to increase competition and reduce fees and charges for people struggling with their mortgages.

Today we will hear from the Commonwealth Bank and the Australian Bankers' Association. I remind witnesses that, although the committee does not require you to give evidence under oath, this hearing is a legal proceeding of the 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 be recorded by Hansard and will attract parliamentary privilege.

[9.21 am]

BELL, Mr David, Chief Executive Officer, Australian Bankers Association Inc.

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

SHEFFIELD, Mr James, General Manager, Mortgage Wealth, Commonwealth Bank of Australia

CHAIR—Do you have any comments to make on the capacity in which you appear?

Mr Sheffield—I am also a technical adviser on mortgages to the ABA.

CHAIR—Welcome to today's hearing and thank you for making yourselves available. It is a little unusual that we have two bodies being heard at the same time. We intend to ask questions of the Commonwealth Bank and then go to the ABA, or vice versa. We will make it clear to whom our questions are directed. Both organisations made submissions, so I will invite both to make opening statements. Mr Bell, do you want to kick off?

Mr Bell—The ABA welcomes the opportunity of providing input into the committee's inquiry into banking and non-banking competition. With me from the ABA is Nicholas Hossack, who is a policy director with responsibility for payments, prudential and competition policy. We also have James Sheffield, the General Manager of Mortgage Wealth from Commonwealth Bank, who can provide input on technical questions on mortgage lending. James is here to provide technical input into the issues as they arise as opposed to discuss Commonwealth Bank specific issues.

The first point I make is that it is a luxury of sorts to be in a position where we can discuss banking competition issues. In many other countries right now, competition is of minor significance and the focus is on stability and soundness. This is dramatically brought home with the UK government's recent competition law waiver to hasten the merger between two of the UK's five major banks, HBOS and Lloyds TSB, even though the new entity will now account for about one-third of all home loans in the UK.

The history of banking stability in Australia is also borne out in light of the recent US government proposal for a US$700 billion package to purchase impaired housing debt assets. As far as we can assess, not one dollar of taxpayers' money has been spent in supporting an Australian bank since the 1890s. Any policy discussion regarding banking in Australia must recognise the social value this extended period of stability has generated for the community, a fact often overlooked by bank critics.

In terms of competition, it is our view that Australian consumers have access to very competitive banking markets that deliver good value to bank customers. Ever since the credit crunch which commenced in August last year, Australian consumers have continued to have a choice of around 130 housing loan providers, and the prices they pay in terms of interest rate margins continue to be pressured downwards. This is an important point to emphasise. On our understanding of the market, even though variable housing interest rates have increased in absolute terms above Reserve Bank cash rate increases, the actual margin experienced by the banks has continued to decline. Indeed, at one point this year some banks reported they were losing money on broker originated housing loans.

In the last two weeks, the cost of short- and long-term wholesale funding, which accounts for about half of all bank funding, has spiked again. This will be putting margin pressures on the banks. Even though the credit crisis commenced in August 2007, it took banks nearly six months before they began passing on higher wholesale funding costs to housing borrowers. The first such increase occurred in January this year. This delay was recognition that the bank that moved first would likely lose customers.

One indicator of competition is that of profitability. We note that Australian banks have generated good profits since the recession of the early 1990s and this profit performance has yielded real benefits to the Australian community in the form of banks' strong credit ratings. We agree with the Treasury submission to this inquiry, which says that profits in the banking sector have been sustained by growth in business activities, low levels of problem loans and reductions in operating costs. We also note their observation that net interest margins have fallen, particularly reflecting increased competition in lending and deposit markets. At the same time our banks have been able to offer a greater choice and new and innovative products, including basic bank accounts, for example the $5 all-you-can-eat accounts, and exception fee free accounts for low income customers. In practical terms all of these factors have enabled Australian banks to better weather the credit crisis than countries with weaker banks. Supply of housing and business loans continues to be available to eligible customers. We note also the Reserve Bank analysis that Australian banks generate profits at the high end of international experience, but this is accounted for by comparatively low bad debt performances resulting from their generally conservative lending practices.

There has been a degree of media discussion about barriers to switching housing loans. We see no evidence that Australia has a housing mortgage switching problem. Around 30 per cent of housing loan applications each year relate to customers refinancing. APRA has even commented on the degree of refinancing in this market. On the issue of fees, a recent report by ASIC produced data showing that refinancing a housing loan was cheaper in Australia than in the UK. The same report noted that the highest refinancing costs in Australia were charged by non-bank housing lenders, and by a considerable margin.

Our submission also touches on some topical policy issues which I would like to add some comments on now. On the issue of whether the government should establish a housing mortgage finance business, we noted in our submission that there are differing views amongst our member banks. We also noted that establishing the right governance arrangements for such a scheme would be problematic. Our submission also said that the industry is implementing a switching package which we negotiated with the federal Treasurer earlier this year. This commences formally on 1 November 2008, with interim arrangements already in place.

In terms of improving competition, we believe there is scope to improve the regulation of credit through a national approach, which we note the government supports, and also to improve the efficiency of conveyancing through a national regulatory framework for the introduction of electronic conveyancing. The payment system is also an area where there is scope to increase competitive tension. One initiative to this end is the proposed establishment of a scheme to operate the EFTPOS system. With these short introductory remarks we are very happy to answer any questions.

CHAIR—Mr Sheffield, do you have any opening comments separate to that?

Mr Sheffield—No.

CHAIR—Okay. My first lot of questions is to you, Mr Sheffield, and the Commonwealth Bank. What was the profit that the Commonwealth Bank made in the last year?

Mr Sheffield—From memory, I think it was $4.9 billion.

CHAIR—And dividends that were paid on the shares increased by around four per cent?

Mr Sheffield—I am sorry, I am not aware of that. I run home loans; I am not in the investment side of the business.

CHAIR—They did, which is a good return and shows that the Commonwealth Bank is on a solid footing. You would agree with that?

Mr Sheffield—I think we offer strength and stability in uncertain times.

CHAIR—Which is one of the strengths of the Australian banking system, isn't it, that we have very stable, strong banks.

Mr Sheffield—As the IMF noted, yes, that is one of our benefits. Banking is a long-term business, not a short-term business, so you have to make sure you are around for the long term.

CHAIR—In terms of the international credit crisis at the moment, how is your bank exposed or not exposed to that? What position do you see your bank in?

Mr Sheffield—These are very difficult times, especially for funding. Obviously a lot of the major banks go overseas to supplement their deposit funding to be able to lend money to customers. About 40 per cent of our funds are in short- or long-term funding from wholesale markets overseas. To give you a scale of the impact, which is pretty severe in the markets, the short-term funding was around 15 base points, 0.15 per cent, above the cash rate a year ago. Yesterday on the spot market it was 0.8 per cent—more than five times the amount. On long-term funding, because the maturity of our loans is about 4½ years, we cannot borrow money short term—you saw what happened to RAMS when they did that—because obviously it is a long-term funding game. We have a lot of long-term funding of three- and five-year terms. It is called maturity of your debts, to make sure that your deposits and your borrowings are the same. It is a bit like, at the moment, a home loan customer coming off a three-year loan or a five-year loan and going for the high rates. The bank's funding is coming off rates of three and five years ago, which, about a year ago, were 0.2 above the cash rate. They are now 1.8 per cent to two per cent more. This is derived from markets being very skittish about housing debt. The hardest thing is securing the funding, because a lot of American investors and European investors—

people who lend money in these spaces—have been very much cautioned by the economic environment from the US subprime meltdown. They are worried about paper backed by housing loans and, as a result, they are very cautious to lend. So, in many ways at the moment, we are trying to make sure we are securing funding to be able to continue to lend at the levels at which we are lending. I am happy to note that, as the Commonwealth Bank, we are able to do that because of our strong credit rating.

CHAIR—There is no risk, though, in terms of your situation—the bank’s situation—because of what is happening internationally. What you have just answered is that there is an effect in terms of the cost of credit through what is happening but it is—

Mr Sheffield—There is a funding risk but it is more about the cost of funding, which has ballooned out.

CHAIR—Ordinary punters on the street corners of Wyong—I have used this question before in terms of my electorate—are going to find it a little difficult to equate, on one hand, the $4.8 billion, $4.9 billion profits, the big returns that are coming to shareholders in dividends and the cost of interest rates where you have put them up above and beyond the Reserve Bank. If you did not pass on any cuts, as you did on the last occasion, can you understand the anger of people out there who are facing weekly or fortnightly considerations of whether they can continue to pay their mortgages when they see those levels of profits?

Mr Sheffield—I can comment only about the financial stress. Obviously we are very sympathetic to people who you are undergoing financial duress at the moment. I think it is worth saying, though, that there is a lot of talk about that, but if you actually look at the statistics we are at the lowest level of arrears and defaults historically at the moment. About 70 per cent of our customers—and I cannot comment for other banks—are ahead in their repayments and home loans, so there is quite a strong consumer response to the credit market. A lot of customers are actually increasing their payments at the moment because of this. It is difficult for people. I cannot comment on the profits of the bank. We are a large, diverse organisation and, as the IMF report says, the growth in volume has actually driven a lot of the profitability. All our margins are going down. The margins we are making on home loans now—the home loan line of business—are less than they were a year ago by nearly 10 per cent, and, if you look at the long-term funding impacts as money rolls off, you will see that it will continue to decline over the next year because of the funding issue we have got. Obviously we take great care to consider what we do in terms of the customers. It is really important for us. We have also got to look at other stakeholders as well and make decisions. So we have absorbed some of those losses in the home loan book, hence the margin decline. Obviously we have also rearranged broker commissions and obviously we have had to pass some of the rates up but we have not passed on the full effect of the funding changes to customers. You will see that we are the lowest of all the major banks.

Mr Bell—I think that, if you were asked that question by a punter in the street, you could probably add two other things. One is that strong returns by banks, strong profitabilities, mean that they can retain their strong credit ratings. If they have strong credit ratings, it means they can source their finance more cheaply in the overseas markets. From memory, half of our funding comes from the wholesale markets, both domestic and overseas. I think that is a positive thing to mention. The other thing is that most punters, through their superannuation funds and other investments, particularly superannuation, would almost certainly have bank stocks in their portfolio. So I guess it is also in their interests that banks perform well and contribute to their superannuation portfolios.

CHAIR—I think it is the comparative issue that is the concern for people out there, when you are cutting back on essentials and kids' trips and all of those sorts of things because of the level of interest rates and the worry about that and then you see reports of banks making very large profits and shareholders doing very well in terms of the dividends that are being paid at the same time. The comparison is the thing. There are many businesses where passing on the costs to the consumer is not an option at all because of the level of competition that is out there. You do part of that, and that is why the question is there, and I think the questions will continue to be there from ordinary Australians with mortgages.

Mr Bell—It is a fair question and it is our job to explain the current situation. The strength we have in our banking sector actually does benefit people in Australia.

Mr Hossack—I think it is a really important point that David made, to stress that Australia is reliant upon overseas funds for housing borrowers and small businesses wanting loans to invest in assets. That money has to come from somewhere and we have got a relatively low deposit base in Australia. So the question is where does the money come from. About a quarter of it comes from overseas, and those overseas investors want to give their money to institutions which are strong and profitable and which they are confident will repay it. So the profit levels of the banks, the strong credit rating of the banks, has a social benefit as well.

CHAIR—I do not think anyone on this committee is at all unhappy with the regulation and the strength of the Australian banking system. But in terms of where sympathy would lie, I think you will find it a pretty tough argument to say that we should be showing some sympathy for banks relative to mum and dad and the kids who are doing it tough in mortgage land. So it is the comparative issue that I was going to in terms of those questions. But I will move on—

Mr Bell—I can add another point in terms of the way the banks lend versus non-bank lenders. There is roughly a 70:30 rule that applies here. That is, we are responsible for roughly 70 to 80 per cent of the loans here in Australia. Nonbanks are responsible for the others. If you look at where the problems lie, they typically lie in the inverse proportion with non-bank lenders. So we must be doing something right: when we are lending to people not only are we lending in a sensible, conservative fashion, we are also treating them correctly if they do get into trouble. Our banks have a number of measures in place to help people if they do have problems with their lending.

CHAIR—We did hear some evidence from Members Equity in relation to people's reactions, positive or negative, to banks and you came out very much in the negative, which is why there probably is the public sport of bank bashing. So it is an issue for you.

I want to turn to competition. The credit crisis has in some ways had a benefit for the established banks in that effectively the non-banking sector provided competition but with securitisation drying up you are, relative to your competitors, in a better position than you were 12 months ago.

Mr Bell—It is certainly the case, if you look at the figures, that the relative share of business has increased towards banks. That is a simple factor because non-bank lenders had a business model where they sought these funds from overseas and other places in the wholesale markets and they simply cannot get access to that. On the other hand, there is clear evidence also that margins are continuing to compress. So it is not the case that margins have increased; it is the case that margins continue to compress. It is business as usual for banks. We are lending money and lending in a sensible way and we are continuing to innovate and provide products for people. For example, in recent times a number of our banks have provided updates to their basic bank accounts. They have also provided accounts which are exception fee free. So for us it is business as usual. Yes, we acknowledge that the market share has increased, but you can view that in the most positive way, saying isn’t it good that there are banks out there which can lend in these times—

CHAIR—This inquiry is about competition, and I think everyone acknowledges that competition over the past decade has seen a better deal for consumers. It has seen a reduction in margins from four per cent to under two per cent.

Mr Bell—Yes.

CHAIR—largely driven by that level of competition. What we have seen in the last 12 months with the credit crisis is a reduction in competition.

Mr Bell—I would not agree with that.

CHAIR—You just did a few minutes ago by saying that there has been a move in the loans. Your banks are now writing upwards of 90 per cent of all new loans.

Mr Bell—But that does not mean that competition has decreased. The best test for competition is whether margins are increasing or decreasing. Margins are continuing to decrease. Is there product innovation? Yes. Are there are additional barriers to entry for new players coming into the market? You might argue that there are because of the problems with funding. But, if you look at those two measures, particularly margins, they are continuing to come down; therefore, competition continues.

CHAIR—Let us come at this from a slightly different angle then. Securitisation provided the bulk of funding for the non-banking sector or the non-ADIs. That is where they got their money from. That market has literally dried up. You would agree with that.

Mr Bell—Correct. There has been a drying up of the market.

CHAIR—That has seen those nonbanks either go into a holding pattern or fold—move out of the area. So, effectively, the active players that consumers can go to, can choose from, in the market have reduced.

Mr Bell—But does that mean that competition has decreased?

CHAIR—By definition, if there are fewer competitors there for a consumer to choose from, there is less competition. I am not talking about your margins; I am just talking about the numbers that are there.

Mr Bell—Again, I think it is important to be focused on—

CHAIR—Everyone else has actually agreed with his point. This is not the point I am really trying to get to. I am trying to build to a point.

Mr Bell—Sure. I have had my say; maybe my colleagues might want to have their say.

Mr Hossack—I think that, when we are looking at the numbers in the market, if you go to the publicly available websites that show you those that are offering home loans, there are still 130 or 140 providers out there. We take your point that the securitisers are finding it a lot more difficult to get money and to offer competitive products, but there is still a lot of competition within the banking sector and of course within the mutual sector—the credit unions, the building societies—

CHAIR—I am going to come to where I want to get to. I am just trying to say that we agree on where we are at at the moment in terms of—

Mr Hossack—I think another pertinent point is that, in the last decade, wholesale funding has been incredibly cheap, and a lot of people were saying that it was way too cheap. Of course, who is that going to benefit? It is going to benefit those market participants which rely solely upon those funds. So, in a sense, the securitisers over the last decade had a real boost from the cheapness of wholesale funds.

CHAIR—As did consumers.

Mr Hossack—Maybe some would say that that was not typical or was not necessarily the model going forward.

CHAIR—Where I was getting to—now that we have had that discussion about the number of competitors that are there—is that an argument is put that this is because of the cycle we are in, in terms of the market, and that this will pass. As the cycle comes to a different phase, nonbanks will reappear in the market. Is that your view? There may be a different view from the Commonwealth Bank to that from the association—I am not sure—but is that the view? The follow-up question on that is: how long do you think that the cycle is going to take before that happens, if that is your view?

Mr Bell—I guess it all hinges on their business models. If you assume that their business model is deriving their funds from the wholesale markets, it depends how long this credit crisis is going to go for. I have heard various reports saying that it is halfway through, that it is one-third of the way through or that we are at least two or three years away from full restoration of the market. Eventually, at some point in the future when the credit crisis resolves itself and these wholesale funds are available, those institutions with those business models that rely on wholesale funds will come back into the market, but it is hard for me to predict with any more certainty than that.

Mr Hossack—There was some interesting evidence just a couple of weeks ago, when there was evidence of an easing in the short-term costs of funds. A non-bank lender started advertising. In fact, I think there were a few front pages in the newspapers about how they were going to discount their loans, get back in and start getting market share from the banks. So that is an indication that they are there, ready to go, and they are waiting for this. As David said, they are waiting for the funding costs to come down after markets settle a bit before they can really start getting into the market again.

CHAIR—Isn’t that one of the key questions for us here in the committee for our recommendations—that if we accept that there has been a reduction in the number of competitors in the industry then we have to assess whether that is of a short-, medium- or long-term nature? If we decide that it is a good thing to have more competitors in the banking industry, which is really what the terms of reference of this inquiry are about, then the recommendations that this committee would make in some way depend upon whether we are in a short-, medium- or long-term cycle before competitors, because of market situations, come back into the field.

Mr Bell—That would certainly be a consideration. I think there is also another question: is it the case that, because some participants, albeit with small market shares, have exited the market because their business models cannot be sustained in the current environment, that has caused a reduction in competition? Again, we say to the committee that there is no evidence at this stage that it has caused a reduction in competition, based on margins.

Mr Hossack—From a competition point of view, what I think is definitely more important than the number of competitors is having these competitors who can jump in. If margins do start to increase, they are there, ready to go, and they can enter the market very quickly. I mentioned the example before about when we did see some easing in the short-term funding costs: there was advertising and there was a media release, I think, from a non-bank lender that said, ‘Right, we’re going to now discount and get in before the major banks and cut our rates.’ Having those competitors on the side, ready to go, provides a very strong market discipline upon the providers at the moment who have got deposits. I think from a competition point of view that is probably more important than there being some number of players out there.

CHAIR—So your advice to us would be that we do not need to do anything?

Mr Hossack—Our advice is that we support competition; we believe in a competitive system, and—

CHAIR—I know you support competition. You are saying that. But, in terms of recommendations that we may make about—

Mr Bell—No, we certainly think there are a number of recommendations that the committee can take up, and we suggest—

CHAIR—No, in terms of looking at issues. We have had proposals, from an ‘Aussie Mac’ through to the Canadian system through to a range of covered bonds—a range of other interventions that we could recommend that provide liquidity to the market. What is your view as to what we should do about that?

Mr Hossack—I think that the covered bond proposal you mentioned is a pretty innovative idea. That is certainly something that the ABA would support. We can see benefit in that for the market in terms of liquidity. There are some issues with that in our prudential framework and depositor priority, but maybe they can be overcome, particularly because we have a policy holder and a depositor protection scheme coming into place. Maybe that reduces the importance of depositor priority, so we could have another look at covered bonds.

In terms of the government agencies buying housing loans, as David mentioned, our banks have differing views on that. We noted in our submission that we see a liquidity benefit to it. It is really up to the government as to whether they want get involved in that business. I think there is mixed evidence from overseas. The US government were originally the owners of Fannie Mae and Freddie Mac, and they have obviously got into trouble. It is really a decision for government. We noted that the Treasurer has said that he is not going to get involved in that, so we have pretty much left it there.

CHAIR—Obviously, because there are mixed views, that is the position the association has taken. What about the Commonwealth Bank? What is its position in relation to those sorts of interventions?

Mr Sheffield—I think the only thing you have to be concerned about is moral hazard. It is very important, when you are lending, to have prudential lending standards and be very careful. That is why our arrears rates are low and defaults are low; whereas non-financial institutions have blown out. Going back to competition, it is about quality, not quantity. As I said, a home loan is about 25 years; it is not just about a short-term fix.

CHAIR—Surely it is about both?

Mr Sheffield—It is about 25 years of security for the person in their house. I would say with these schemes that you have to be careful in your recommendations to be aware of moral hazard. The lending standards might suffer, because they know they are backed by the government AAA rated securities.

The difficulty with that, as you have seen, is that it might mean people can push the barrow a bit when they are considering customers' creditworthiness and then pass the burden over to government AAA ratings. You have seen that recently in America. So that is something you should be considering as part of your diligence around this.

CHAIR—This is a question I am sure you have anticipated before you came here today: if the Reserve Bank were to cut interest rates later this year, would the Commonwealth Bank pass those cuts on?

Mr Sheffield—I think my chief exec is on the record on this one—

CHAIR—Your chief executive has an interesting interpretation of our political system, I understand, as well. Putting that aside—

Mr Sheffield—We cannot be in a position to make any comment. The volatility of the market is huge at the moment. As I said, the spot price yesterday in short term was 80. It was not that a week ago. So I think you have to wait for the theoreticals to become real and make a decision, balance out the interests of our customers. Obviously we will pass on as much to the customers as we can afford, but you have also got to bear in mind that we are in very turbulent waters at the moment and all stakeholders have to be potentially considered as part of this, and that includes all people in Australia and the security of the lending system at the moment.

Mr Bell—Generally, when institutions make those decisions they have to look at both the level of the indicator rates which they borrow off in the wholesale markets, in other words the 90-day bank bill swap rate for short term and the AA bond rate for long term. We have to look at the volatility as well. So those are the things that they have to weigh up.

CHAIR—My colleague Mr Bradbury had a question relating to what you have probably seen in some of the previous hearings. The Reserve Bank has said in some of its minutes about decisions it has made in putting up rates that it has taken into account the behaviour of banks and what they will do with their rates. If that is the position they take, can you understand that not letting people know the intentions of the banks could have an effect on monetary policy? If the RBA do not know what you are going to do and take a decision that they are going to cut interest rates by 25 basis points because they believe that is required for the economy, and you do not pass that on, you are directly acting against the intention of the rate cut by the RBA. Isn’t it the responsible thing for the banks to be letting the RBA know what they will do, whether they will pass on these cuts to interest rates before they make these decisions?

Mr Bell—I think a number of us want to comment on that. The first thing to note is that what has happened as a result of the subprime crisis and the subsequent credit squeeze is that there is a new reality out there, that there is not necessarily a perfect correlation between the RBA cash rate and funding costs. The reality is that banks on average, depending on which bank you are talking about, get half their funds from the wholesale markets both overseas and internationally. It is hard to imagine a circumstance where the Reserve Bank can directly influence the price of money from overseas. That is reality which banks face in determining their business models and how they fund.

Mr Hossack—The Reserve Bank are very skilled at monetary policy and setting their rates, and of course they will identify where they want the retail rates to be and how they can influence that through the cash rate. They will take into consideration how they believe the banks will respond to that. They will look at the wholesale funding costs—

CHAIR—The Governor has said that, that he takes into account what the banks will do, but if we do not know what the banks are going to do because you are not going to let anyone know about it then surely the logical conclusion of that is that that affects the efficiency of the monetary policy decision that has been made.

Mr Bell—We are all in the same boat, you see, because, as we talked about before, the indicator rates on the wholesale markets which we price off have been extremely volatile. We can table information to you which shows that they have been going up and down. If they are volatile and that is the basis on which banks price their products then it is a difficult thing for banks to make decisions well in advance. Given the volatility, they have to take things as they come.

CHAIR—I think you have probably got the message pretty loud and clear from this government that we expect interest rate cuts to be passed on. That is the expectation that we certainly have, and I think that the punter on the streets of Wyong I was talking about would certainly have that expectation is well.

Mr PEARCE—Getting back to the topic of the inquiry, competition, why do you think that on the one hand most people seem to think that the banking sector in Australia is very competitive when it comes to deposits? For example, you can open up any newspaper each day and there are multiple ads trying to attract deposits to the banks, so people acknowledge it is very competitive in terms of deposits et cetera. But then when we talk about mortgages, on the other hand, people seem to paint an impression that it is not competitive. Why do you think that is?

Mr Bell—Are you talking about in recent times or prior to the credit crisis?

Mr PEARCE—Prior to.

Mr Hossack—It is a very good point that you make. You look at the deposit market now and it is very competitive. As you said, there is quite aggressive advertising on the television and in the newspapers. What is interesting about this competition in the deposit market is that there is only competition between deposit takers, whereas in the lending market of course there was competition between deposit takers and the non-bank lenders in the past. The very tight competition in the deposit market indicates that you can still have strong competition in your lending market without necessarily having the non-bank lenders competing in that market. So it is a good point and I think it is pertinent to the committee's inquiry.

Mr Sheffield—Speaking on behalf of CBA, we have been very strong in our rate advertising recently. We are reinforcing that we have the lowest of the SVRs out there. We are three to four basis points or 0.03 to 0.04 per cent behind other banks. Other ones are actually more than 30-odd points ahead of us, and they have not moved their rates and will not be doing so until next Monday. We have become very strong in demonstrating our competitiveness and trying to attract customers. As I said, we are stridently and fiercely competitive to win new customers to our organisation.

Mr PEARCE—You are in the mortgage area of the Commonwealth Bank. How many lending or mortgage products do you offer?

Mr Sheffield—I cannot tell you! Can I take that notice and get back to you? We have the widest range, probably, of all lenders. We try and meet all customers' needs across the country.

Mr PEARCE—But the point is that there are many.

Mr Sheffield—Yes, there are.

Mr PEARCE—Why do you think there is an impression quite often that there is a lack of competition? We have had evidence from other banks and nonbanks, and one bank in particular said that they had about 80 or 90 different mortgage products—an enormous range of products.

Why do you think there is a sense or perception in the market sometimes that there is not much of a range of products and not much consumer choice there?

Mr Sheffield—I am not sure that is the perception out there. About 40 per cent of our business comes from brokers, and brokers offer the wide array of products and try to select and advise customers on the right products for them. Our own staff are also looking at the customers' needs and making sure they are tailoring a product for now and the future, because obviously needs change. I think there is a massive array of competition, and most people know that because they are using brokers and have been increasingly using brokers. If you look at consumer research, consumers are saying, 'There are so many products out there it's hard to work out which one's right for me.' The customer research I am seeing is very different from what you are saying about perception. Customers are using brokers partly because there is such a bewildering array of choice, competition and lenders out there. They look to somebody who might be able to help them.

Mr Hossack—I think the point about perception is that—and I do not want to demonise the non-bank lenders—since August of last year there has been a lot in the media about the fact that non-bank lenders cannot get the funds as cheaply as they used to and that they believe they are not as competitive anymore. There have been claims that that is going to lead to a dramatic increase in bank lending margins in housing. That has not happened, but the claims have been made. As James and other banks have noted, since August of last year they have had a squeeze on their margins. That is because the wholesale funds have increased both at the short end and, perhaps even more significantly, at the long end.

Mr PEARCE—How many bank lenders are there in the Australian market?

Mr Hossack—When I went to the publicly available websites, as anyone can—CANNEX and InfoChoice—and put in 'home loans', I came up with, on/off, about 140 institutions offering loans. I understand that if you add up all their products it comes to something like 2,000 or 2,400 products, but that is standard variable, discounted variable, one-year fixed, two-year fixed, three-year fixed and variations, probably, within those. So there are a lot of products and 140 suppliers. It is probably unfair to say that there are 140 all competing on exactly the same basis because of the economic cycle. Because of the higher funding cost, that is going to advantage those who have deposits over those who do not have deposits, just as over the last decade those who purely sourced their funds from the financial markets had an advantage over those who did not. There is a cycle here and the cycle is of advantage to some competitors some of the time and others at other times. I think the fact that the margins are still declining is an indication that we have a good, competitive system.

Mr PEARCE—I am interested in whether or not you would agree with this proposition. I believe that the Australian banking and non-banking sector is highly competitive. I believe it is highly contestable. I think there are dozens and dozens of offerors in the marketplace and I think those offerors are offering dozens and dozens and dozens of varying products and services. Do you agree with that?

Mr Bell—Yes.

Mr Sheffield—Customer research is saying that there is so much choice that people find it quite confusing and bewildering.

Mr PEARCE—Yes, it actually indicates that consumers are somewhat confused by the array that they have before them. So, it is not a lack of choice, in your view?

Mr Sheffield—No.

Mr PEARCE—Mr Bell, I am interested in asking you a couple of questions about what you think are the potential flow-on consequences of the financial turmoil that the globe is in at the moment, particularly as it relates to Australia. Do you foresee any potential flow-on consequences in the banking system?

Mr Bell—In terms of the impact of the financial crisis on Australia's banking sector, there is a lot of evidence out there to show that we are in a very good position. Yesterday, the IMF, for example, released its report and, today, the Reserve Bank released its financial stability report, and I think it will echo the comments made by the IMF report. The evidence is that we are well regulated—and we are fortunate for that, and all governments have contributed to that—we are well capitalised—

Mr PEARCE—Particularly the last one, I am sure you would agree, with the creation of APRA and ASIC.

Mr Bell—and we are profitable. And there is very clear evidence that one of the reasons we are profitable, which brings benefits and stability to the banking sector, is that we make conservative loans. Compared with a lot of overseas counterparts, I think we are in very good shape. I regularly talk to my overseas counterparts and, in some respects, we are the envy of the world, and I think the Treasurer himself makes that point when he says that if you had to be anywhere in terms of financial markets Australia is the place to be. But, if the credit crisis continues, there is no doubt that there will be increased funding pressures as a result of the level of those indicator rates we have talked about and also volatility. All institutions that rely on those wholesale funding markets, including banks, are going to have to make decisions based on that.

Mr PEARCE—Earlier you made a very important point about people with their superannuation investments. You made the point that within those investments a lot of those people would have placed them with platform providers or retail funds or what have you, and of course they will have a mix of investment profiles. They will have a mix of domestic banks here in Australia and other organisations, but of course they are highly likely, aren't they, to have a mix of international stock as well?

Mr Bell—It is most certainly the case—if you look at the index, I think banks contribute 25 to 27 per cent of that index. So it is highly likely that a mainstream funds manager, a superannuation manager, is going to have domestic bank stocks in the portfolio. If the investor chooses to have overseas stocks, again, with the cost of the weight of banks in those various indexes, it is highly likely that he will have overseas banks as well.

Mr PEARCE—So, in that particular case, there could be some concern about the returns on superannuation investments that might be exposed to international stocks.

Mr Bell—If it is the case that a particular fund—and I am not an expert in this area—is exposed to international stocks, particularly international banking stocks, yes, necessarily there will be an impact. But presumably that fund manager would have made that assessment and, on the basis of their investment remit, made some changes. Getting back to your point, it is highly likely that most people in Australia who have superannuation would be exposed to bank stocks, which is probably a good thing.

Mr PEARCE—In terms of the domestic ones, I think that is right, and, depending on what happens across the world, I think it will be interesting. In relation to this particular inquiry, given the terms of reference, what would be the most substantial recommendation you believe the committee should make to the government?

Mr Bell—From our point of view we have come up with a number of very specific items, which we flagged in our opening statement and which I think other banks have also flagged. We think that the two specific suggestions are the need to have credit regulated nationally—that will make sure that we have more efficient banking system from that point of view—

Mr PEARCE—But there has been an in principle agreement through COAG for that to take place anyway.

Mr Bell—That is correct, but the devil is in the detail. The issue is how it is going to be legislated, and there are a number of paths which are being considering. One is to lift up the current legislation which the states have through template legislation through the parliament of Queensland and simply apply a Commonwealth statute to that. We support that; we think that is going to be quick and simple. The other is to use the Corporations Act, which we do not support because we think that will be complex and will take a long time. So the devil is in the detail of that and we certainly acknowledge the fact that the government has taken steps in that direction. The other item that we think could be attended to is this whole issue of national electronic conveyancing. Again, we have been pressing for this for some years. There has been some resistance from some states, but again we acknowledge that the government is supportive of this.

Mr PEARCE—So what does the electronic conveyancing involve in your view? Again, there would have to be some uniform legislation, wouldn't there?

Mr Bell—There is certainly going to have to be a uniform approach. There have been earlier proposals by certain states to go their own way. We do not think that makes sense; it is just going to add inefficiency into the system. Any system where you have electronic conveyancing and a national approach to it has got to be more efficient than the current manual system that we have. If you introduce efficiencies to the system, you reduce costs and that will eventually flow through to the customer.

Mr PEARCE—But if there is some sort of national approach to that taken, it is likely to have revenue impacts on the states, isn't it? In your view, what are the chances of getting the states to agree to that?

Mr Bell—I think there is a good chance for it to occur. We understand the federal government is supportive of it at the very highest level, which we are grateful for, and we understand that there has been a lot of talking between the respective governments about the importance and the need to get this through. We think we will get there; it is just going to take a little bit of work.

Mr PEARCE—In relation to the happenings that have taken place in Australia's financial services market in the last week or so in relation to the ban on short selling, for example, was the ABA or the Commonwealth Bank consulted about that?

Mr Sheffield—I would not know, I am afraid. Sorry.

Mr Bell—In terms of short selling, we made a statement a couple of days ago. Typically, our view is that we do not typically welcome excessive regulation—

Mr PEARCE—My question was: were you consulted prior to the ban?

Mr Bell—We would have been spoken to. I would have to take that on notice for one of my colleagues because I was not in Australia at the time.

Mr Hossack—I think ASIC have been looking at it for a period of time and—

Mr Bell—Sorry, I can correct that. We were spoken to by ASIC about this some weeks and some months ago. So, yes, we have been in dialogue with ASIC and we will continue to be in dialogue with ASIC.

Mr PEARCE—So you were in dialogue with ASIC about the banning of short selling a couple of months ago?

Mr Hossack—About the issue of short selling. I was not looking after it at the ABA, but my understanding is that ASIC has been looking at it for a period of time. Whether the ABA was involved in discussions over the last weekend, for example, I do not know. I do not think so.

Mr Bell—No, we certainly were not involved in the discussions over the weekend. We have had discussions with ASIC about it over the last weeks and months. Clearly it is something they have been keeping an eye on because of—

CHAIR—Maybe the question is for ASIC in estimates, Deputy Chair.

Mr PEARCE—No doubt.

Mr BRADBURY—Thank you for coming before the committee. My first question to Mr Bell is: can you set out who your members are?

Mr Bell—Most certainly. We have 24 members. They are essentially all the retail banks in Australia, and we have some wholesale banks as well. If you think of any retail bank, they are a member of the ABA.

Mr BRADBURY—I have a question in relation to some comments you made earlier regarding the notion of the business model that some other competitors within the market, namely non-bank or non-ADI lenders, have—that is, the business model that relies significantly on funding from the wholesale markets, in particular in recent years the securitisation market. From the perspective of your members, I would imagine that at least a portion of some of those banks' funding over the years would have been derived from securitisation markets. Obviously it is going to vary across your membership, but what sorts of percentages might we be looking at in terms of the percentage of overall funds raised through the securitisation market?

Mr Hossack—It varies considerably. As a general rule, under 10 per cent of the major banks' housing books would be securitised, although I would say it is more likely to be about five per cent. Within the regional banks—James, you might have a more accurate figure—it tends to be a bit higher. Some might be up to 25 or 30 per cent.

Mr Sheffield—At the Commonwealth Bank five per cent of our funds are securitised.

Mr BRADBURY—I believe it is generally acknowledged right across the industry to be the case that over the last decade or a little bit longer margins have come down across the board. Largely that has been attributed the emergence of some of the non-bank lenders, and I note that in the ABA's submission there is a reference to Aussie, Wizard and other players of that sort. Doesn't that acknowledgement—that is, that the presence of these other players in the market and the aggressive means by which they have sought market share have led to greater competition—lead to the conclusion that a strong and healthy securitisation market is a key consideration that should be at the forefront of the committee's considerations of the future of competition in the banking sector in Australia?

Mr Bell—Banks source their money from three sources when they lend: deposits, international and domestic wholesale markets and securitisation mechanisms. In an ideal world, you want to have all those markets operating well. There is no doubt about that; we agree with that.

Mr BRADBURY—For banks?

Mr Bell—For everybody.

Mr BRADBURY—But obviously others are not able to access deposits in the same way. What percentage of your members' funding would come from deposits?

Mr Bell—It is plus or minus here, but the proportion is roughly 50 per cent from deposits. Again, different banks are either side of that average. The other 50 per cent comes from the wholesale markets. If you split the wholesale markets, it is roughly half from international and half from domestic.

Mr BRADBURY—But clearly that key component, which accounts for in most banks' cases about 50 per cent of their funding, is not an option for these other non-ADIs. It is clearly not an option for those providers, so, of their nature, they are going to have a greater reliance on the securitisation market and other wholesale funding markets.

Mr Bell—Correct. There is no magic pudding here. Money comes from three sources. If someone wants to wave a magic wand and increase the supply of money and it is not available through deposits because you do not have a banking licence or it is not available on the wholesale market or through securitisation, presumably the only option is for someone to stump up their balance sheet. I understand that the Treasurer has indicated that he is not keen on the government stumping up its balance sheet.

Mr BRADBURY—I note that Mr Hossack commented that the cheapness of money on wholesale markets, if I can describe it in those terms, was something that provided a competitive advantage to some of the non-ADI lenders over the last decade or so. If I am reading correctly between the lines, there is a suggestion that there has been a repricing and that that has perhaps shifted the pendulum slightly in the other direction. If we acknowledge that to be the case and we put to one side the issue of the relative price of funds on the wholesale markets, surely the conclusion that this committee must reach, given all the evidence—and I am sure you are aware of much of it—would be that a healthy securitisation market, whilst it might only be one of the three components through which your members obtain their funds, is a very significant market through which funds are sourced by those key competitors that have driven much of the competitive change within the sector. Surely the conclusion that we must be leading towards is that there should be great efforts to try and ensure that we preserve a healthy securitisation market.

Mr Hossack—I think that ABA would support a healthy securitisation market, there is no question about that. But to address your point more fundamentally, if you go back to the early 1990s when Aussie Home Loans came into the market, bank margins on lending were large. I think the chairman mentioned 400 basis points. As Aussie and a few others came into the market, they put a lot of competitive pressure on the banks and the margins started coming down. That actually forced the banks to do some quite unpopular things like closing some branches and putting up fees and so on. The point is that they were providing competitive pressure. But other things have changed since then as well that provide additional competitive pressure on the banks. For example, these days, unlike in the early 1990s, there is a very large broker network out there, so customers go to brokers and say, ‘Who should I finance with? Who has got the lowest rates?’ In contrast, back then you did not have that kind of brokering service. That provides a very strong discipline on banks to ensure that they are providing competitive products, because if customers are going to brokers and their product prices are too high, the broker is going to direct them somewhere else. That is a significant change in the market since then.

The other change which is worth noting is that in the early 1990s we did not have the foreign banks, the large branches or subsidiaries of foreign banks, competing in the retail space. When they came into the market in the late 1980s they were really concentrating on corporate lending, but these days—you know the names—we have these foreign banks very actively, aggressively competing in the deposit and lending markets in the Australian market, which we did not have back then. The point I am trying to make is that, yes, the securitisation market, the non-bank lenders, they are good competitors but you cannot say, ‘If we don’t have them then we are going to go back to the 1990s situation,’ because it is a very different market today.

Mr BRADBURY—On the issue of margins, I saw an article in one of the Sydney papers this morning that had some conflicting interpretations of some figures released by APRA. You may have seen the article in the *Daily Telegraph* this morning. I will read from the article, which states that in the March quarter the major banks had taken profit margins to a record 54 per cent, equivalent to one dollar in profit for every two dollars they charged in fees and interest. This is almost double the long-term average of 26 per cent. The article goes on with some comments from various commentators. I note that the articles states that the Australian Bankers Association issued a statement late yesterday to say the figures were open to misinterpretation and the reports of record profits are down to a statistical anomaly. Could you provide some explanation?

Mr Bell—I will lead off and get my colleague to provides further detail. This information came out the day before yesterday and it has taken on some time to wrestle these figures to the ground because, if you have seen the source data from APRA, there is a lot of it and it is quite complex. The points that I made on Sydney radio this morning were, firstly, that bank profits remain steady, so there has been none of this spiking that has been talked about in the *Australian* yesterday and the *Daily Telegraph* today. The reason this has occurred is because of a statistical anomaly in the way that a subsidiary of one bank has reported its data to APRA. So it is literally an accounting classification issue, it is not a factor of banks doubling, if you like, their profit margins—quite the opposite. In fact, if that were the case, this would have been exposed for all the world to see in March of this year when the bank analysts, who go through these things in some detail, in more detail than some journalists do, would have revealed that.

Mr BRADBURY—So what measures do you rely on when you assert, as you did earlier today, that those margins are still going down?

Mr Hossack—There are various ways of looking at margins. Typically, over the years, we have looked at the indicated variable rates as opposed to the RBA’s cash rate, but that has become much less reliable since August last year because of the kick-up in the market rates. What we have based our assessments on is really the comments that have been made by the individual banks and the reports they have been putting out since August last year, which have shown a reduction in their lending margins. It is difficult to aggregate and to find really strong data, but certainly the annual reports and the financial statements that the banks have been putting out have been showing continual contraction.

Mr Sheffield—In our annual report is published the impact on margins and the declining margins across lines of business. That is in the back of our annual report. We have not put that in the investment presentation which is on the website.

Mr Bell—As a general comment, the Reserve Bank has from time to time in various publications also made that same observation—that margins are continuing to be squeezed. So they have recorded it as a statement of fact as well.

Mr BRADBURY—It is increasingly important that we have greater transparency in this particular area, and the reason I think that is the case is that market share is shifting. I put it to you that the larger ADIs have been increasing their market share since the onset of the credit crisis—would you agree with that?

Mr Bell—Yes, there is evidence that the market share has increased.

Mr BRADBURY—So, if market share is increasing, the only argument that can be sustained, in a sense, to say that there is still competition, greater competition or sufficient competition in the marketplace, is to argue that margins are coming down, and as I understand it that is the point you are putting.

Mr Bell—That is one of them, yes.

Mr BRADBURY—And the others would be?

Mr Bell—That is the primary one. That is the clearest manifestation of competition. If margins are being squeezed, then we still have competition.

Mr Hossack—The margin share of the mutuals, credit unions and building societies are increasing as well. If any of you disaggregate banks, the larger banks are increasing their market share, that is true, so are the regional banks in lending and so are the foreign owned retail banks—they are increasing their market share as well. There is a lot of diversity out there with slightly different business models doing okay.

Mr BRADBURY—I would like to put a question to Mr Sheffield. I can certainly report back, as I discuss these issues with people in my community, that there is a belief—I guess the purpose of this inquiry is to determine whether or not it is a justified belief—that there is not sufficient competition within the banking sector. Obviously we are working through those issues to try to determine whether that is the case. I want to ask a question in relation to your appearance before the committee—and we do appreciate you appearing before us. This goes to the issue of, as I understand it—and correct me if I am wrong—your request to appear with the ABA. Is that correct?

Mr Sheffield—I did not personally. I was asked to come along to attend with the ABA, so I did not know that it was on that basis.

Mr BRADBURY—That is what I understand to be the case.

Mr Hossack—I was involved in the scheduling of it. There was a lot of difficulty getting dates and so on, and it made sense when we looked at the dates that—

Mr BRADBURY—Dates are one thing, but this is the first occasion on which we have had two organisations appear simultaneously before the committee. The reason I ask the question—and I am trying to get to the bottom of this—is that, given the background I have just painted, the concern out there in the community about a lack of competition, I certainly believe that it is sending the wrong message, the wrong signal, to people in the community. If the argument that is being presented to us is that there is sufficient competition, then it is sending the wrong signals to the community when our biggest bank appears with the representative body of banks. I do not say that to disparage the role of either of you as organisations, but I wonder whether or not you can provide some explanation as to why that would be the case. I would think that if we apply a reasonable person test, most reasonable people out there in the marketplace would believe that you would have a separate set of interests from the other members of the ABA. In a competitive environment one could expect that to be the case. Are you able to provide any explanation?

Mr Bell—Can I give the ABA's answer and leave the Commonwealth to give their own answer. From my point of view, there are two things worth mentioning. One is that it was literally a scheduling issue. We had terrible trouble getting the committee and us together. It made sense for both of us to arrive together. Secondly, there is precedent for this. In other inquiries the ABA has had other member banks, not including the Commonwealth, attend those hearings. I would not read too much into it.

Mr Hossack—The other point to make is that James has freely answered questions that have been asked of him.

Mr Bell—I have not got my hand up his back; he is his own man.

Mr BRADBURY—You might not have your hand up his back but you are holding his hand. I guess that is the concern that I have, that the ANZ, the NAB and Westpac have all appeared before this committee without a request to do so simultaneously with the ABA. My question is: why is that the case?

Mr Sheffield—I cannot comment on the reasons. I know there were issues around dates. I think you suggested October originally and there were all sorts of problems with dates, so it was easier for me to come along to make sure we were here to see you as part of the ABA. We obviously support the ABA strongly because obviously they are the representative body for our organisations. But I am here and hopefully I am answering the questions you want to ask me.

Mr Hossack—One of the advantages of having a bank along with the ABA is that at the ABA we do not, as you can imagine, actually run the bank. We are not in the department of mortgages and so on. So having people alongside us who can fill in the questions and help us out with answers is a very valuable service to us and we appreciate the Commonwealth Bank coming along with us.

Mr Bell—And it has been done before with other inquiries. We have had a technical adviser along—

Mr BRADBURY—I do not dispute that it has been done before, but it has not been done before in this particular inquiry.

Mr Sheffield—I am sorry, David, I am here and I am trying to answer questions. I am a bit confused about why you feel I am not.

Mr BRADBURY—I am concerned about the clear signal that sends to consumers about the extent of competition within the sector. I think most reasonable people would take the view that if there is an organisation that represents a collection of competitors within a marketplace then their interests that they may wish to advance before a committee such as this in relation to the issue of competition would be a discrete set of interests to the interests that are separately held by Australia's biggest bank. That is the proposition I am putting to you, and I think that to appear together sends a message that your interests are almost identical.

Mr Bell—Again, I am puzzled as to how James would answer any question differently if he was here by himself as opposed to being with us. I do not understand.

Mr BRADBURY—Yes, and I am puzzled why there was such a request. Moving along, in relation to the CDOs, do you believe there is likely to be any exposure on the part of the Commonwealth Bank to CDOs in the way we have seen from others?

Mr Sheffield—My understanding is that we have not got exposures there. I am not an expert. A lot of those are in the investment part of banking.

CHAIR—We are going to have to suspend the hearing, unfortunately, for about 15 or 20 minutes. We have a division. We will be back as quickly as we can. We appreciate your patience.

Mr Bell—Sure.

Proceedings suspended from 10.28 am to 10.42 am

CHAIR—We will resume the hearing. I think Mr Bradbury had further questions.

Mr BRADBURY—Mr Sheffield, if we track back over the course since the credit crisis really emerged, could you take us through movements in interest rates relating to credit cards and also business lending rates through that period? I know there has been a lot of focus, and I think rightly so, on the mortgage rates, but I am interested in credit card rates and also business lending rates. Would you be able to provide some details of those?

Mr Sheffield—I am afraid I do not run those books, so I cannot comment on what has happened in the pricing on those. Business lending is across in our business-banking side, which is a different division, and credit cards are in a separate team even from our team. In my team, it is retail products, which are deposits and home loans, so I am afraid I am not familiar with that.

Mr BRADBURY—Can I get you to take that on notice?

Mr Sheffield—Yes, sure.

Mr BRADBURY—Thanks.

Ms JACKSON—I will just start with a few questions to the Commonwealth Bank. Mr Sheffield, I am a Western Australian. I noted your comments about your views on organisations like a potential 'Aussie Mac' and the like, but I just wonder how familiar you are with the former state government's First Start shared equity loan scheme.

Mr Sheffield—Not that familiar. We have obviously looked at it. In the last year, I have been a bit distracted by other issues, but I am familiar with what they are trying to do. It is obviously affordability of homes and helping people get in. I believe that is the premise.

Ms JACKSON—So you would not know what, if any, involvement the Commonwealth Bank might have in those schemes?

Mr Sheffield—I am afraid not, at the moment; I am sorry. I certainly have not had dealings with it. In the home-lending space we have not had conversations yet, but I am not aware of being approached by the Western Australian government to look at it.

Ms JACKSON—I am just curious as to whether or not people see it as a viable sort of tool, which is not an impediment to competition, for assisting homebuyers.

Mr Sheffield—If it is similar to the schemes I think of, which are obviously some sort of shared equity and government backed, I think it is a good way to increase housing numbers in Australia. We have a severe shortage of housing in Australia. If you look at the American overhang which is driving their market down, they have more property than they need. If we could shift it up and plant it in Australia, it would be about right for all our migration coming into the country, especially in places like Western Australia. So, if it is a program where the government supports some sort of deposit base to get people into their homes, I think it is a really good idea.

Ms JACKSON—And you cannot see any impediment to the Commonwealth Bank getting involved and being part of those sorts of home loan arrangements?

Mr Sheffield—I do not know enough detail. I will have to look at it. I have looked at various shared equity products before for people, which are useful. I think that one difficulty for the one I looked at, which is not the same as a state government backed one, is that it implies that the bank has to take a share of the property as well—owns it—and the risk is also around the property prices, which obviously, as you have seen in America, can be unfortunate in its consequences.

Ms JACKSON—I wonder if you might be to find out for me whether the Commonwealth Bank has any involvement in that particular scheme.

Mr Sheffield—I will take it on notice.

Ms JACKSON—I would appreciate that. Some of the information that has been presented to the committee, particularly from Fujitsu Consulting, was that consumers in Australia on average are paying 30 to 35 per cent more than they should for their mortgages when compared with consumers in the UK and the USA. They indicated that that was probably because of inefficiencies in the Australian financial sector. I am just curious about whether you would agree with that statement and, if not, why?

Mr Sheffield—I will look to the ABA. They have had some studies on this issue, looking at this, I believe.

Ms JACKSON—I will ask the ABA in a minute. I am just curious.

Mr Sheffield—I am surprised at those figures because I think it is very hard to compare between jurisdictions. There are a lot of differing factors. One of our problems in this country—and I think it has been alluded to already—is that we have a fragmented legislative program around mortgages. They are very complicated and expensive products to create, because some states like Western Australia are asking for, say, certain font sizes and duplex. Every single state has its own little unique credit regulation around it. Then you have certain state titles offices which are all paper based, so there are a lot of people running around with bits of paper getting stamps and things. I think some of those costs are driven by that expensive process, where we have not really modernised and created a uniform economy of scale across Australia across these things and also used modern technology to drive that. So some of those costs are driven from there. But, again, it is really hard to compare because regulation often does create some of those cost bases and therefore drives up price because of that.

Ms JACKSON—On the issue of electronic conveyancing, I guess I am curious as to how far, in your bank's opinion, that should go. Are we talking about standard forms? Are we talking about standard documentation for products and mortgages?

Mr Sheffield—We need standard documentation of mortgages and those sorts of legal documents so they are all consistent across Australia so we are not creating a unique one for every state. That creates a huge overlay of cost and complexity. Some states want things duplex, printed both sides; others do not. There is space size and things. In this day of modern communication and electronic computers, we probably really need to modernise that. We have probably not kept up with best worldwide practice. That does drive a cost structure around home loans. They are very expensive vehicles to set up.

Ms JACKSON—But you would have no difficulties if that extended throughout the banks' products? All of the forms should be the same, theoretically. There is no reason why your bank should have a different set of forms, surely, to another bank.

Mr Sheffield—Every bank has its own. They have invested heavily in computerisation, so—

Ms JACKSON—It sounds like every state has its own unique investments in computerisation and stuff.

Mr Sheffield—In computerisation, no!

Ms JACKSON—It is all right for the governments to sort themselves out but not for banks?

Mr Sheffield—No, the banks are the first often to automate and use technology, so a lot of them have different systems bought from different suppliers and vendors. I will say that I agree with you that we obviously need to have some clear guidelines, and I think it would be good to have clear structures around how you describe and explain fees and things so that for customers there is a clear and open, transparent sort of process to be able to understand what they are getting into. I think it is really important, and we place a lot of emphasis on prudential lending. Part of that is that customers know what their responsibilities are—buyer beware. I think that is important, because from the non-financial institutions there has been a lot of confusion around that, where the upfront cost looks cheap because the price is low—that is, the interest rate—and then, when you look at the whole bundle, it is not as effective as maybe moving to other institutions where there is a bit more transparency about some of those fee structures. I myself and the Commonwealth Bank are really strongly looking at the moment at how you make them simpler and clearer. I have just paid for a 'plain English' writer to come in. My background is law, and I have a real thing about complex legal babble gobbledygook. I think all documents can be improved in quality.

The final thing I will say is that it has not helped with some government legislation like FSRA, which was overly weighty and it created the opposite effect of what it was trying to do. It created more disclosure, which meant more confusion. I think less is more is often quite a good principle when you go into legal documents and explanation of customer rights.

Ms JACKSON—I do not disagree with you at all. I think there is generally some support for standard sort of key fact documentation that again ought to be applied across the whole sector so that from a consumer perspective they know they are comparing oranges with oranges.

Mr Sheffield—I agree.

Ms JACKSON—If I can be clear, what you are saying to me is that you do not see there might be advantages, especially for consumers as well as for movement of accounts and all the rest from one provider to another or mortgages from one provider to another, if we had standard electronic forms, both front of house for consumers as well as for you as you interrelate with government.

Mr Sheffield—I think the back office forms in terms of interaction with state land offices and things. I think the danger with this—and I would have to look at the detail; the devil is in the detail—is that for competition to be strong you have to allow people to be competitive and do different things and be innovative. The one constraint is that if it becomes overly prescriptive you lose competition in the market because people cannot try and do different things or are constrained. So it depends on the detail. I agree with your sentiment and what you are trying to get at, which is clear customer understanding of what is probably the most complex financial transaction they will undertake in their life and the most important one, because they want a home, not a home loan, so they are focused on that. So I think it is important that we look at that and maybe have some defined terms that we all agree on that make it clear what exactly things are and what they are getting into.

Ms JACKSON—If I can use an analogy, it has been my experience in the superannuation area that everybody is keen about e-transactions and online information, but if you have ever tried to take funds out of one superannuation account or fund and put them into another one it becomes a very complex process. It seems to me that it is possible to have that consistency of information which would allow for much easier switching of accounts between banks.

Mr Sheffield—I do not actually see it in home loans. About 30 per cent of our business is switching business, moving around. I think brokers also obviously help that. I know our own lenders, if somebody comes in from another organisation, will go out of their way to help somebody come across to our organisation. I am certainly not seeing it in home lending. I think it is a pretty robust and competitive market in terms of people moving around and switching their loans.

Ms JACKSON—Do you agree with this view that it is estimated, even just on the small amount, a national conveyancing system for your external work would save quite a considerable amount of money?

Mr Sheffield—I do not know exactly the figure it would save but certainly setting up a home loan is a very expensive operation. If you cut those costs it makes it more competitive as a market and therefore those general benefits do, and the declining margins have shown, get passed on to customers in our fight for growth of market share.

Ms JACKSON—I guess I am curious, because the last burst of the move to information technology was going to save us money, but particularly from the 1990s over a 10- or 15-year period we actually saw bank fees and charges increase by something like 170 per cent. Are you confident that these savings are something that will flow to consumers?

Mr Sheffield—If you see the RBA reports the overall net margin of banks has declined over time. If you look at the overall position, banks are more competitive; margins have declined in total if you include those as well.

Ms JACKSON—Including bank fees and charges?

Mr Sheffield—Several RBA reports.

Ms JACKSON—A 170 per cent increase in those fees over the decade 1997-2007.

Mr Sheffield—I would not know the details of that but I do know there was an RBA report a few years ago and I think they do it quite regularly: they look at the overall position, and it shows clearly that if you look at net margins, which is fees and interest margins, you will see that declining.

Ms JACKSON—This is my last question for the Commonwealth Bank. I do not know what your exit fees are like for your mortgage arrangements, but would you agree with me that high exit fees or deferred establishment fees are intended to be a barrier or a hurdle for your consumers to leave your organisation?

Mr Sheffield—Not in our case. The cost of setting up a mortgage is very large, and the deferred establishment fee is part of the overall cost of setting up. The average customer term for us is about 4½ years. We waive all deferred establishment fees if you stay with us for more than four years, so the majority of our customers actually do not pay them if they exit us. The other thing is that when people go into a home and they are looking at getting a loan they are often stretching to get one, so a lot of people would rather not have to pay those upfront costs. When you look at things like that, you have to understand that obviously there is a cost in going into the new organisation, too, that people have to front. I think some of the ones you refer to, the more penalty-like deferred establishment fees, were driven by non-financial institutions, who make it a percentage of the balances, so you might have to pay 1½ per cent of the balance to exit. What I am trying to say is that they have upfront cheap prices but they will hit you at the back end to make sure they make their money. To me, that is not as transparent as our process. In our documents we are very clear about what the impacts and costs are. In the recent ASIC study, we were lower than the other major banks and also lower than the average financial institution in terms of those types of entrance and exit fees.

Mr Hossack—James has made a very good point there. The practice of deferring establishment fees did not come from the banking sector; it came from the securitised lenders in the early part of this century. What they wanted to do was to reduce the cost of getting customers across to them. They saw that as a competitive play.

Ms JACKSON—Not unfamiliar practice out there in the private sector—the chill winds of capitalism.

Mr Hossack—It was a competitive play by the securitisers. They introduced it, obviously it worked for some customers and now most banks will defer establishment fees as part of their products.

Ms JACKSON—Lastly, before I come back to the Bankers' Association—and forgive my ignorance—do you have a simple but useful online calculator or real-life demonstration model so an ordinary consumer can plug in what you are offering in your package and see what the real financial cost to them is of their mortgage, or whatever the product is, over time?

Mr Sheffield—We have calculators and things on our website which demonstrate to people how much they are borrowing, how much it would cost and what the aggregate costs are. That is something that I am trying to improve at the moment, because you can always get things better.

Ms JACKSON—That is part of the 'better information in planning' which you are talking about. So a financially not so conversant person could go on, plug in their salary or interest rate and know what their situation is going to be.

Mr Sheffield—My understanding is that there are budget sheets and comparative information available. I am a great believer in giving these tools to people because you get a better educated customer knowing what their commitments are. Any legal contract is between two parties, so you have to make sure that both parties are really clear about what they are getting themselves into, and a mortgage is the largest financial transaction most people make in their lives.

Ms JACKSON—Thank you. I would like to take the Bankers' Association through some similar questions. Have you had any involvement in, or do you have a view or policy position on, schemes structured like the First Start shared equity loan scheme that was operating in WA?

Mr Hossack—It is a product which allows an institution to take equity in a house, so in effect the customer can buy the same house for a smaller deposit. It is now a commercial product, and one of ABA's member banks offers it.

Ms JACKSON—Do you know which bank that is and where?

Mr Hossack—It was the Adelaide Bank, which is now Bendigo and Adelaide Bank.

Ms JACKSON—But that is not with government taking shared equity; it is with the organisation taking shared equity.

Mr Hossack—That is correct.

Ms JACKSON—What I am more curious about is if there has been any participation by your organisations in cooperation with this scheme in Western Australia, where the government is the shared equity partner.

Mr Hossack—To my knowledge, the operators of the scheme have not approached the ABA to either comment on it or to offer any advice. They may have approached individual banks, but as far as I know the ABA has not had any involvement with it.

Mr Bell—That is correct.

Ms JACKSON—You have heard my questions to the Commonwealth Bank on electronic conveyancing. I think that substantial consumer benefit could be gained from it. It is easy for you to see how desirable it is for the organisations and regulatory systems your member organisations deal with to have a standard and easy flow of information. Surely you would be able to concede that for consumers it is precisely the same.

Mr Bell—Certainly if there are efficiencies which are driven through electronic conveyancing those savings are typically passed through to customers, as I think the Commonwealth Bank said. That is why we support electronic conveyancing on a national basis.

Ms JACKSON—But you would not see standard forms for the banks themselves? In other words, could the form I fill out to apply for a mortgage be the same at every single bank, given that ultimately most of the information sought is precisely the same?

Mr Bell—We would have to take that notice. I will ask electronic conveyancing experts and we will come back to you.

Mr Sheffield—I would like to add one thing. One of the issues is credit risk assessment, and everyone has a different credit risk assessment. We are quite conservative and maybe ask more questions than others. The one danger you have with uniformity is that it does not allow for the different credit practices of organisations, and they are part and parcel of assessing a customer’s ability to pay now and in the future. The one danger of that—and this is really for your consideration—is that every bank has a different credit profile and a different credit practice, and those questions may be different for that reason. Non-financial institutions, say, might ask different or fewer questions than other banks.

Ms JACKSON—Isn’t what you have just said further grist to my mill? Most of the information required if you are going to make that kind of risk assessment is the same. What you are saying is you fall on the side of conservatism and ask more questions than other organisations, but there is no reason why a standard form could not include additional questions.

CHAIR—Best practice.

Ms JACKSON—Yes, a best practice form.

Mr Sheffield—Do you want to model it on our best practice!

Ms JACKSON—It does not prevent an individual financial banking institution from running their normal risk assessments once the information is there. It is a question of the information being provided.

Mr Sheffield—The thing is that every system has a different order. You often write forms because the system takes information in different orders. Rearranging that can create a hell of a lot of work. We even have problems internally, let alone what we would have trying to do something like that, because we have different systems for our broker, proprietary and branch channels. If there are different questions in different orders, there are often people sitting around trying to work that out, and that adds costs rather than removing them.

Ms JACKSON—To the Bankers' Association: I accept that costs might be there initially, but do you see any potential efficiencies in the sector out of that, particularly for consumers?

Mr Bell—Are you talking about a standard form?

Ms JACKSON—Yes. You want standardisation in e-conveyancing for back of house, for want of a better description; why doesn't the same logic apply front of house?

Mr Bell—You would have to cost it out. As James, who is the expert on this stuff, said: different banks have different systems. Presumably you want to apply it right across the ADI sector as well to be consistent, so it would then apply to building societies and credit unions. That would be very costly to put in place initially. If different institutions had different ways of collecting that data or had different data fields, there may not be any efficiencies generated.

Ms JACKSON—So it would do nothing to make switching accounts from one organisation to another easier for customers.

Mr Bell—I think the answer is that we just do not know.

Mr Hossack—I think the principle is that you want as much standardisation as possible but not to the point where it starts encroaching on competition. Where there is no competition, standardisation is a good thing, but, as James said, there may be some information that his bank wants from customers which other banks do not. If standardisation is going to prohibit his bank from gathering that information then obviously that is not a good thing. An assessment has to be made as to how far you want to take standardisation. But, yes, the principle is that the more you standardise the more efficiencies you derive.

Ms JACKSON—So your organisation is supportive of the notion of standard key fact documentation, whether that is available electronically or in paper form, across the sector?

Mr Hossack—We have had dialogue with government over the years about this. In fact, we wrote to the Treasurer saying that if we can standardise terminology for the housing market—what one fee is called relative to another bank—then we think that is a good thing. We have indicated a willingness to work with ASIC once there are national credit regulations up and running to really sort it out.

Ms JACKSON—But, given that you are the association for banks and all banks are members, it is passing strange that it is not something you have taken up as a desirable thing in your own organisation. You have been talking and writing to people about it for some years.

Mr Hossack—The reason that we had to write to the Treasurer about it is that the ABA does not reflect all mortgage providers. You have the securitisers, the credit unions and the building societies. Really, if you are going to try and get some standardisation in terminology and forms, you need a body which can coordinate amongst all of those groups—

Ms JACKSON—I understand what you are saying, but I guess I am saying that you never saw it as appropriate to do just amongst banks. You are saying it is only fair enough for you to do it when everybody else has to do it.

Mr Hossack—When you look at the market, there are a lot of different participants. It would be confusing, I would have thought, to the consumer to have banks reporting some way and then not be able to compare with securitisers or credit unions or building societies. If you are going to force standardisation, you are better off doing it comprehensively and getting everyone on board.

Ms JACKSON—The other question I put to Mr Sheffield was about the fact that I think it has been stated pretty clearly that bank fees and charges rose by 170 per cent between 1997 and 2007. I am just curious as to what you think the justification for that dramatic fee increase is.

Mr Bell—There has been a lot of explanation of this, both by us and by the Reserve Bank. The Reserve Bank publishes a bulletin each May on bank fees, and that gets wide publicity, of course. The explanation is as James gave it, which is that margins have been compressed quite significantly from four per cent to two per cent or thereabouts. Yes, some fees have increased because we have a user-pays system in Australia as opposed to cross-subsidisation. The Reserve Bank has previously concluded that, generally speaking, if you add the two up and net them off, people are generally better off with the current system. That is its conclusion.

Ms JACKSON—In that sense, you are really saying that the fees might look as though they have gone up but you are actually not paying any more than you used to. I am sure my constituents will be pleased to hear that!

Mr Bell—The net effect, generally speaking, according to the Reserve Bank, is that people—

Ms JACKSON—You are saying that the sole justification for it is the change in your margins?

Mr Bell—If margins are squeezed and banks are applying a user-pays principle then they have to generate a certain level of income to provide the product or service, so the way they have done that is to charge fees in some cases. Again, if you add the two together, the Reserve Bank concludes that people are generally better off.

Mr Sheffield—It is probably worth saying that what has driven profitability back is actually size, the volume of transactions, so we are growing as a business—not margins.

Ms JACKSON—Sorry, I did not hear the beginning of that.

Mr Sheffield—Sorry. The reason bank profits have grown has been the increase in volumes rather than the margins. The margins have gone down overall, but the size of the business is getting bigger, and that is what has driven that. But, as I said, the overall effects have been positive for the customers' pockets.

Mr TURNOUR—I am sorry I arrived late. I am the member for Leichhardt, so I am from tropical North Queensland. I will just pick up some of the questions from Ms Jackson. One of your recommendations is that you want standardisation of regulation across the country. You think there are great benefits from that, and obviously there has been some COAG discussion. Mr Bell, have you done any estimations of the potential cost savings? I know we have had some questions on this, but it is something you are recommending, and obviously there are great benefits to your banks, so I would have thought you might have done some estimates that we could have of the potential savings.

Mr Bell—I would have to take that on notice. There would be savings. The view is that, if there are savings, those would be passed on eventually to customers. That is the notion, but I would have to take that on notice.

Mr TURNOUR—I would really appreciate that, because obviously in our arguments about this it would be good to get that on the record, and it would benefit you. In relation to that also, Mr Sheffield, have you done any estimates of or do you have any idea about what it might cost your individual bank if we were to have some of those changes—savings?

Mr Sheffield—Not yet. Two states had different ideas a while ago, which would have been called more careless than anything else. We are looking, obviously, for clear proposals, to understand what it is. It needs that national agreement, and then you cost it out. It would obviously have some impact on costs for us to create the linkages into an agreed system and also costs for the titles offices of the states and lawyers so they can get involved in this. There obviously has to be an understanding of what exactly we are talking about before we can actually understand the costs, but I think it makes total sense to do, because, at the moment, the way we do these things is by people wandering around to do settlements and things and stamp documents. People have to run around cities and so on. If you make it electronic conveyancing, it creates a much quicker, cleaner system involving less paperwork.

Mr TURNOUR—Mr Sheffield, what is your standard variable rate at the moment?

Mr Sheffield—9.33.

Mr TURNOUR—On a standard variable mortgage, what is the exit fee?

Mr Sheffield—We do not have an exit fee; we have a deferred establishment fee, if that is what you are talking about.

Mr TURNOUR—If that is what you call it, yes. What is it?

Mr Sheffield—We have a $450 establishment fee and a $700 deferred establishment fee. The majority of customers do not pay it because the average life of a home loan in the CBA is about 4½ years, and we waive it after four years.

Mr TURNOUR—I realise that, but the other way to look at that is that I hang around for four years because I do not want to pay my $750, and I switch six months later. I take on board your view, but there is the other way that you could look at it as well.

Mr Sheffield—Hopefully you will hang around for great service from the Commonwealth Bank and its custom. That is why you hang around!

Mr TURNOUR—Sorry?

Mr Sheffield—We would like to think you hang around for great service from the Commonwealth Bank.

Mr TURNOUR—I understand that. I have asked this of other banks, but they are all around the $800 mark for what you have called deferred establishment fees or exit fees.

Mr Sheffield—Ours is lower.

Mr TURNOUR—It is $50 lower, I think, than the other couple that I have asked about. I suppose the issue for competition is that there is a great deal of similarity in those exit fees or deferred establishment fees across the big four banks, anyhow. I suppose that leads to some of the issues about whether there is competition or not. Just following on from that, I will give you a chance—you might want to comment on the statement I have just made.

Mr Sheffield—You have talked about competition. There seems to be a belief that non-financial institutions create competition, but they are the ones with much higher fees and exit fees. I think there is a bit of a skew there in that it is nice to take the information that non-financial institutions are great in competition, but then you look at that side of things and they have had practices like 1½ per cent of your remaining balance, which is a deterrent to leaving because that is a lot of money.

CHAIR—We have had evidence of $8,000 exit fees—

Mr Sheffield—Yes. We make it very clear at the start. In the loan documentation you get, it is very clear what your costs are and it is set in stone; it is not a percentage which means who knows what and might cost you a lot. Again, it goes back Sharryn's comment about making sure that terminology is clear. I think it is really important that these things are laid out really clearly—that people go in there knowing what their obligations might be if they decide to switch.

Mr Hossack—ASIC did a report that looked at the fees for switching out of a home loan.

CHAIR—ASIC appeared at the last hearing and actually gave evidence about those—

Mr Hossack—The non-ADI banks were over $1,000 more.

CHAIR—Yes, and that is where we had the evidence of the $8,000.

Mr TURNOUR—I suppose the issue that I am raising is that, when I look at the big four banks, you are pretty similar around the ballpark. If I have all my accounts with the Commonwealth Bank and I am going to borrow money and I come to you or to Westpac or ANZ, really there is not too much difference from that end in terms of all the other hassles in deciding to switch.

Mr Sheffield—I think there are a lot of differences. It depends on products as well, because different products fit different needs. Some people go in and want to have a three-year basic variable rate because they want a low-cost entry; others want a professional package, a wealth package, and that has different benefits. I see a lot of difference. I can see it in things like some of the pricing things, different drivers in sales each month. Who does well each month can often depend on the pricing. We are pretty aggressive to win market share and take each other on, so you will often see a lot of pricing offers, and you still do see a lot of pricing offers out there.

Mr TURNOUR—We like competition on pricing.

Mr Sheffield—I think there is a lot of that. But we have to be really careful about what it goes back to: it should not be just about price; it is should be about making sure the features fit your needs. So you have a conversation with the lender about: 'Do I need to redraw? What if I have a child later on down the track and we might not have two incomes?' I think it is really important that products should be about their design. You can go for the cheapest product, but it might not be cheaper for you. You have to make sure you understand that you have the product that fits the sort of usage you are going to get over three or four years. That is an important part of a good lender—to make sure people understand what is right for them. There is a danger when you focus overtly on just rate. There is more to life than rates. A demonstration of that is these punitive exit fees from non-financial institutions. They focused on rate and said: 'Great! There's a good deal.' Some of them are now sitting there saying, 'I can't get out of this bad deal now because rates have gone up. I am stuck here and I can't get out.' That goes back to transparency of what they are getting into in the first place.

Mr TURNOUR—I take that on board. You made some comments before in relation to 4½ years being the average length.

Mr Sheffield—That is for us.

Mr TURNOUR—Yes. What percentage of people would leave you in that first four years?

Mr Sheffield—I would not know. We have very low levels of people leaving us.

Mr TURNOUR—Five per cent, 10 per cent, 20 per cent?

Mr Sheffield—No, it would be much lower than that I would have thought.

Mr TURNOUR—So less than 10 per cent.

Mr Sheffield—Yes. I think about two per cent of customers leave to move to other organisations.

Mr TURNOUR—Mortgage customers?

Mr Sheffield—The statistics are that two per cent of people externally refinance. Others sell their properties because they are going into a different life stage. They might be selling to go back into the market in six months when they have found the right home for them. Historically, we have very low levels of external refinance. We like to think that is because we have different products and people can switch products to meet their needs. Also, when you get into the market as a first homebuyer, you might be really struggling to get in there and really stretching but then afterwards you might want to do different things like redraw your equity to buy a new car et cetera. It is really important that people get the right product for various stages in their lives.

Mr TURNOUR—So there are very few people leaving you to go and establish mortgages in other institutions?

Mr Sheffield—More come to us than leave us.

Mr TURNOUR—Does that percentage increase after the four years? Do you have any idea of what the percentages are?

Mr Sheffield—No, I am afraid not. I only look at it overall; I do not break it down by years.

Mr TURNOUR—I suppose the thing I am a bit surprised about in those comments is that you said it was easy for people to switch between banks. Evidence we have received previously—from Members Equity last week, I think—was that there was not a lot of switching going on. From what I understand, what you have just said there is a bit contradictory to what you said earlier to one of the other committee members—that it was easier to switch and people were switching around. Clearly, what you are saying is that they are not switching or moving away from you. I am talking about the Commonwealth Bank here.

Mr Sheffield—To be honest, I think we have the widest range of products. We have products to suit everybody's needs.

Mr TURNOUR—I understand—and you have made that point—but you made comments earlier on about people being able to switch and now you are saying that they basically do not leave you; they all stay.

Mr Sheffield—They all stay.

Mr TURNOUR—But a very small percentage—

Mr Hossack—The prudential regulator, APRA, looked at the housing mortgage market a little while ago to look at the practices going on there, and one of their findings was that there was considerable 'churn'—I think that was the word they used—in the market; that is, there was a considerable amount of switching amongst housing loans. So the broader picture is one of ease of switching. Whether or not an institution such as the CBA is able to retain more of its customers than others can, I do not know. But the broader picture, as APRA concluded, is one of considerable churn.

Mr TURNOUR—But you see the issue I am raising in terms of Mr Sheffield's previous statements—since you bought into this, Mr Hossack—and the statements now that it was easy to switch. We heard originally from the Commonwealth Bank that it was easy to switch but now we have heard evidence that a very small percentage is leaving the Commonwealth Bank. But, again, we are hearing from the ABA that it is easy to switch. I am a bit confused on the Commonwealth Bank's evidence and then the broader evidence.

Mr Bell—Can I give an ABS figure?

Mr TURNOUR—Yes.

Mr Bell—The ABS says that, of all new home loans, 30 per cent are refinances, so that is a fact.

Mr TURNOUR—What percentage of that are the big four banks?

Mr Bell—I do not know. We could discover that for you. Presumably it would be proportionate, but I do not know.

Mr Sheffield—Can I just clarify the CBA's position. People are switching to the CBA; that is what is happening at the moment. They have been doing it for the last 18 months, judging by market share, so they were doing it long before the credit crunch happened. We are not losing customers. From a benchmark I have seen, we have one of the lowest rates of customers leaving us. I would like to think that there are more factors to that than the barriers to switching. So it is easy to switch, but I think we offer other things and those are why people stay with us. Those are: the best distribution networks to give you access to service your account; the strength and stability of a AA-rated company that has been here since the start of last century and looks likely to be here at the end of this century. I think also we have had a real focus on customer service, and that has been demonstrated because the market share had been going up long before the credit crunch happened.

Mr TURNOUR—I appreciate that. You are obviously doing well. I suppose part of the reason this inquiry has been established is that there seems to be growth in the big four banks in terms of mortgages. You are doing well out of that and all credit to you, but I am sure you are getting those people from non-bank lenders and some of the people who have had some of their funding dry up because of the credit crisis. Obviously our concern is about the longer term issues in relation to competition. So I take that on board, but it also feeds into part of the reason we are having this inquiry.

Mr Sheffield—But, as I said, our market share has grown since about 18 months ago. I took over in March-April last year, which was well before the credit crunch happened, and our market share was growing then. That was partly because we had already had a focus, since our new CEO arrived, on customer service. Maybe we did take our eye off the ball, but I think most major banks have learnt a hard lesson and we are all now much more focused on giving customers great service.

Mr TURNOUR—In your discussions on customer service you must discuss why people leave.

Mr Sheffield—Yes. Obviously I look at things like retention figures. But there are different reasons why people leave. I would say that property sold is one reason—they just get out of the housing market. Another, obviously, is that they have paid off their loan completely. Because of our history in the housing market, we have a lot of customers who leave because they have simply paid off their home loan, which is a good reason to leave the home lending from us.

Mr TURNOUR—So, as a senior executive from the Commonwealth Bank, have you personally ever had any discussions within the bank about deferred establishment fees not encouraging people to stay rather than leave?

Mr Sheffield—None at all, and I have been running the book for about 18 months. You have to look at the cost of establishing a home loan. People struggle to get into it. Rather than charging those fees upfront, if you defer them, and they stay long enough to make that economically viable, which is the four-year period, you then get the benefit. It has been used by non-financial institutions as a deterrent, I am sure, from the way they have done it. But we make it very clear upfront. We have disclosed clearly about the fact that we will pay one, and the term of four years is our point. As I said, most customers stay 4½ years. That is average. A lot have stayed a lot longer. That 4½ years is only for the product they are in. You will see people switch products. We have many customers who have spent their whole life with us with home loans but have just moved products to fit whatever stage of life they are at.

Mr TURNOUR—Do you have any products that have no deferred establishment fees?

Mr Sheffield—No, I do not think so. I could take that question on notice, though.

Mr TURNOUR—How are you going with bringing a switching package in, in terms of moving to be able to participate in that?

Mr Sheffield—That is being run by the head of deposits, so I am not familiar with that. I know we are bringing one in, in line with things, and that is obviously supported by us.

Mr TURNOUR—I would appreciate it if you could take that question on notice. The Commonwealth Bank might want to give the committee some advice as to how it is going in relation to that switching package.

Mr Sheffield—Well, I know we are on schedule to have it in November.

Mr Bell—Can we report back on that, Chair?

CHAIR—Yes.

Mr Bell—We have an involvement with the switching package, of course, because we discussed and negotiated it with the government. The date is 1 November and the banks all report they are on target.

Mr TURNOUR—That is good to hear. Mr Sheffield, on nonbanks: obviously securitisation has dried up, and there has been a lot of discussion about that in this inquiry. Do you provide funds to nonbanks?

Mr Sheffield—I am not sure, actually. I think that, in the past, we might have had some warehousing but I am actually not familiar with that side of things. It is our investment and institutional business that does those sorts of deals. So I am not really aware of them. I could take that question on notice.

Mr TURNOUR—I would appreciate you taking it on notice. Perhaps Mr Bell could also take a question on notice as to what level of financing the big four banks are providing to the non-bank sector and how that has changed over the last 18 months since the financial crisis. The issue I am interested in there is, obviously: they are one of the reasons for driving competition over the last 10 or so years. We have had some discussion about that, and I think the ABA has agreed about that. Obviously now they are increasingly dependent—to my understanding—on ADIs for some of their funding, and the relationship between you guys and them is something that I would be interested in—the changes that have happened in the last year or two.

Mr Hossack—It is an important issue as to what are the sources of funding the nonbanks have. You are right: they can turn to some of the domestic banks here, either the Australian owned or foreign-owned, or indeed they can try and get finance from banks overseas which do not have an Australian presence here. From the lender's point of view there is no competitive issue. Of course, the nonbanks always have the option of diversifying their funding base, trying to get into deposits and those sorts of things. There are options out there apart from securitisation to run their business.

Mr TURNOUR—That leads me to the last area I am particularly interested in. We talk about Freddie Mac and Fannie Mae but the Canadians have a government backed system which is different from that. Are you aware of that and do you have any comments on it from the ABA's point of view?

Mr Hossack—We are aware of it. I suppose we have looked at the issue solely from the point of view that it is the government balance sheet that will be used to help securitise loans, and so whether it is the Canadian model or other models like Fannie Mae and Freddie Mac, which used to be government-owned before they were privatised, we looked at the issue simply from that point of view, that this is the government entering the market. As we said earlier, our members have differing views on that. There is a liquidity benefit in it not only for the nonbanks but actually also for the banks. Presumably if a scheme was established, banks could access that as well. So there is a liquidity benefit there. But we do know that there are some costs to it as well.

Mr TURNOUR—Governments have entered the market to increase liquidity over the last period of time. I suppose the issue is that the banks have been able to access that rather than the non-bank sector.

Mr Hossack—The Reserve Bank does have its repay facilities for deposit takers. It really offers short-term lending to overcome difficulties for short periods of time. The Reserve Bank is not into long-term lending, which I think is what the securitisers are really after.

Mr TURNOUR—I understand the Treasurer's views, but I think the difference with Freddie Mac and Fannie Mae is that you have got an organisation that is actively out there doing it whereas the other one is about the government in the Canadian model providing a framework that makes those AAA mortgages or whatever very solid. I would say similarly that I do not think this government would allow any of the big four to fall over—not that you are going to—for a whole of reasons that we are seeing in the United States. I suppose the Canadian model is a bit different to having an institution that is government-owned or predominantly government-owned now in America managing and lending mortgages, which is my understanding of what Fannie Mae and Freddie Mac used to do.

Just to pick up on Ms Jackson's point, I think the issues about standardisation are really important. Does the ABA have a policy on that? We have heard evidence from various banks saying they welcome that. As the banking association, do you have a policy? You have written to the Treasurer about it and said it is a good idea, I gather, but are you actually putting forward, 'This is what we think some of the terminology should be, this is what all banks agree on,' and so on. I think that might be useful.

Mr Hossack—We have written to the Treasurer, as you indicated, and said that we think there are issues around terminology and we are willing to look at that and we are keen to look at it. It needs to be run by ASIC because ASIC has reach into all the lenders. They are reasonably busily at the moment, but as soon as ASIC convene the working group the ABA will participate.

Mr TURNOUR—It certainly needs to be run by ASIC, but the big banks have some experience and it would be good from the ABA's point of view to put forward some ideas in a bit more structure about those issues, and maybe some of the other issues Ms Jackson raised about standardisation in the front office. I take on board that we can have lack of variation in competition issues, but you could have some very standard forms and you could have one or two that varied depending on the product and what the system was.

CHAIR—I have one more question because it has not been covered so far. On switching, you have helped to negotiate and develop the model that is there and clearly you support it. Did you look at other switching initiatives such as portability of accounts or the Dutch model of a central registry? These obviously go further than what is there at the moment.

Mr Bell—Yes, we did.

Mr Hossack—I think there are three options, if you like, that have been talked about in relation to Australia. One is number portability: once you have your bank account you can move it around. As we discussed that with our banks, it became very clear that it is a very difficult thing for them to do in terms of their systems—

CHAIR—It is a bit like the mobile phones, isn't it? The telcos said that was pretty difficult at the time but it is not.

Mr Hossack—Probably the relevant comparison there is telephone numbers. I moved house last year and I wanted to keep my number and I could not. Telstra told me, 'No, you have gone sufficiently far away from where you lived that you have to get a new telephone number.' I think that is probably a more relevant comparison than mobile phones.

The other one is a sort of central registry. APCA looked at that as part of the consultation and their conclusion, which we support, was that it just looked as though the benefits of that were going to outweigh the costs—the costs outweigh the benefits, sorry. One of the reasons is that with a central registry you have to register every single agreement, whether the customer is going to switch or not. Every single standing instruction needs to be registered and updated in that registry, and that seems to us to be a very difficult proposition.

CHAIR—The argument against that is that the Dutch system actually has lower costs overall in terms of its banking structure than in Australia. Obviously there are costs in implementing something like that—

Mr Hossack—As the current switching package has a lot of costs which we are estimating.

CHAIR—I was interested in whether you had looked at them and, second, if there were any issues other than costs. I am not trivialising those at all, you obviously need to do the cost-benefit analysis, but are there any other issues of a technical nature? From your answer, I think it is the cost impost that is the issue.

Mr Hossack—There are different systems. In Australia, you set up your standing instructions on your account differently to most other countries in the world and I think also the Netherlands. In Australia this came after lobbying by the merchants, who wanted to be able to reach agreement directly with their customers, not through the banks, about billing them on a regular basis, Telstra or the utility being able to reach into the customer's account and take out what they owe after each quarter or each month. In the UK that was not the case. But the merchants wanted that because being able to get one of those agreements is a cheap way of getting their payments and a certain way of getting their bills paid, so they really liked it. And customers like it as well because again it is pretty cheap: once they have got them set up they can kind of forget about them. The problem with it is that when they go to move accounts it is a little more of a hassle. That is what we are trying to address: with this very low cost, very convenient payment system how can we just deal at the margin of that problem when they want to shift and it is a bit of a hassle to do it. We have got a good package which we have negotiated with the government over and it will be up and running on 1 November. We think consumers will really benefit from it.

Mr BRADBURY—On the two possible options, portability of numbers or some central registry—

Mr Hossack—I am not sure that portability of numbers is actually possible given the underlying plumbing of the system. I am not classifying that is an option but I said it is one of the things that have been discussed.

Mr BRADBURY—So there is still a question mark in your view as to whether that is literally possible?

Mr Hossack—Presumably if you started systems from scratch then you would be able to introduce it, but whether you could actually go back into the systems now and maintain the essential character of the systems and introduce number portability, I have my doubts.

Mr BRADBURY—In respect of both options, no analysis has been undertaken to quantify what the cost might be to this point?

Mr Hossack—In relation to the central registry, APCA did a public consultation on that and they looked at costs and benefits. I am not sure whether they put numbers on it—

CHAIR—They gave us some evidence but they said that in terms of costs and benefits they did not actually consider the benefits to the consumer; they were only looking at the costs and benefits of the financial institutions. That was a concern to us.

Mr Hossack—We have heard that in fact I think the Office of Fair Trading did a report recently on the UK system and that was either explicitly or at least implicitly critical of the system for switching in the UK. For a long time that was seen as one of the better systems around. So I think you need to be careful about trying to identify what is going to lead to a consumer benefit and what is not.

Mr BRADBURY—I see it as being a two-stage process once you move beyond that issue, and that is ascertaining what the cost is and then determining who may bear that cost. But the point I am getting to is, do we have any analysis available that has quantified that cost to a point that we could say, 'Well, it is going to cost X dollars'?

Mr Hossack—X dollars, no, not that I am aware of. To get an X dollar estimate you would need a very specific proposal, because unless you can tell the banks exactly what processes and procedures they need to go through, how could they cost it?

CHAIR—Thank you for your attendance here today. It has been a longer morning because we have had the ABA and the Commonwealth Bank here together. You have been asked to provide some additional materials, and if that can get to the secretariat as quickly as possible that would be greatly appreciated. We do appreciate your submissions and input today and the opportunity to ask you questions. You will be provided with a copy of the transcript and if there are any errors that you need to correct, please get those back to us as quickly as possible. Thank you again for your appearance here today.

Resolved (on motion by **Mr Bradbury**):

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

Committee adjourned at 11.37 am