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9 November 2010

The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By on-line submission through <https://senate.aph.gov.au> website

Dear Sir / Madam,

Submission to Inquiry into Competition within the Australian Banking Sector

I am a solicitor working in a law firm in regional Victoria, as well as being a registered tax agent, accountant and financial planner. I have worked as a solicitor for over 12 years, 11 of which have been in country Victoria.

In my submission, I shall respond to the 6 matters raised in the inquiry's investigation.

Paragraph (a) the current level of competition between bank and non-bank providers

Since the Global Financial Crisis ("GFC"), there has been a significant reduction in the availability of finance from non-bank providers. There is also an increased public perception that non-bank providers are "unsafe" and prone to collapse. Many ordinary people still (incorrectly) believe that a Federal government guarantee continues to be in place over the banks, and this gives the banks a significant competitive advantage over non-bank financial institutions, since it gives them easier access to cheaper funding from local depositors / investors.

Paragraph (b) the products available and fees & charges payable

Each of the major banks have a range of different products available for home lending, business banking, etc. The way fees and charges are applied do vary from product to product, and between banks. For example, some have higher fixed fees, but lower transaction charges. However, the increasingly large profits earned by the 4 major banks show that regardless of how the fees and charges are structured, the products are quite profitable to the banks.

Paragraph (c) how competition impacts on unfair terms that may be included in contracts

Increased competition would likely reduce unfair terms included in contracts, since consumers are likely over time to choose products without such unfair terms if they are offered in the marketplace.

Paragraph (d) the likely drivers of future change and innovation in the banking and non-banking sectors

In the banking sector, increased competition is likely to be a driver for future change and innovation. Otherwise, a continuation of the current low-competition environment is likely to lead to stagnation within the Australian domestic market as the 4 major banks consolidate their current oligopoly.

Aside from competition, the only likely driver of future change and innovation in the banking sector is likely to be the desire for greater profits. As opportunities for expansion in the domestic market seem to have dried up (with the ACCC veto of the proposed NAB takeover of AXA Australia), foreign expansion seems the only way forward for the banking sector. The ANZ Bank has already started this process with its takeover of former RBS banking operations in Asia, and the expansion of its existing operations.

In the non-banking sector, future change and innovation is likely to be driven by the need to gain greater market share in the deposit and lending markets from the major banks. However, this is likely to be difficult as the major banks have greater access to capital, have extensive local branch networks and a public perception that they are (or would be) guaranteed by the Federal government.

Paragraph (e) the ease of moving between providers of banking services

With deposits or transaction accounts, it is relatively easy to move between providers.

However, with lending products, it can be quite difficult and costly to change providers. The following are normally charged by banks where a consumer wishes to refinance to another bank:

1. Exit fees, which can vary from a moderate \$200.00 fee to over \$1,000.00;
2. A loss of profits fee where the interest rate had been fixed and general interest rates have since decreased;
3. Additional miscellaneous fees which vary from bank to bank (e.g. settlement fee, discharge fee, legal fees).

The new refinancing bank usually also charges its own establishment fees. Consumers thus do not usually find it easy to move to a better loan product with a different bank.

Paragraph (f) the impact of the large banks being considered 'too big to fail' on profitability and competition

This perception give the large banks a large competitive advantage, which they have consolidated since the GFC, with their profits growing ever larger. The major part of retail lending is now controlled by the 4 major banks. An oligopoly has developed in the domestic lending and deposit markets. This oligopoly allows the 4 major banks to

set interest rates at levels which guarantee them large 'monopoly'-style profits. These profits can then be used to fund dividends to shareholders and fund 'loss-leading' operations in new markets. For example, the 4 major banks now control a significant share of the financial planning market.

This market share is increasing through the banks offering consumers "free" financial plans. Over the years, I have seen a number of these plans prepared by various banks for my clients. They all have 1 feature in common: the products recommended are always those of the relevant bank or its associated insurance / managed funds arms.

For example, a financial plan produced by a Commonwealth Bank planner will invariably recommend Commonwealth Bank term deposits, Comminsure insurance products and Colonial managed fund investments.

The banks do not charge upfront fees for these plans since their financial reward comes from the profits earned on the actual products recommended by the plans (which are effectively owned by the banks).

Recent legislative moves to remove trailing and other commissions from financial products will further reduce competition to the banks in the financial planning sector since they only disadvantage non-bank independent financial planning competitors. The latter will now have to charge fees for their financial planning services.

Consumers are likely to choose a "free" financial plan from a bank rather than one they have to pay for from a non-bank financial planner. This will allow the banks to further dominate the financial planning sector over time.

Paragraph (g) regulation that has the impact of restricting or hindering competition within the banking sector, particularly regulation imposed during the global financial crisis

I do not comment on this regulation as I do not have sufficient knowledge or information on it.

Paragraph (h) opportunities for, and obstacles to, the creation of new banking services and the entry of new banking service providers

Over time, the monopoly-level profits earned by the 4 major Australian banks are likely to attract the attention of foreign banks and introduce new banking service providers to the domestic market.

However, the entry of new banking service providers is likely to take some time. The high Australian dollar makes it expensive for any new foreign operator to set up banking operations in Australia. In addition, the currently fragile state of the global economy makes it difficult for foreign banks to raise sufficient capital to fund an Australian expansion.

So, despite the current profitable opportunities for a new banking service provider in the Australian banking market, it is likely to be some years before any foreign

competitor takes up these opportunities. Locally, I am not aware of any move by the Australian private sector to set up a 5th major bank.

Paragraph (i) assessment of claims by banks of cost of capital

I cannot authoritatively comment on this issue as I do not have experience working with a Treasury department of a major bank. However, if the banks are complaining about the cost of foreign capital, is there any reason why the banks cannot simply borrow from the Reserve Bank of Australia?

Paragraph (j) any other policies, practices and strategies that may enhance competition in banking, including legislative change

At present, the only proposal for legislative change to enhance competition in banking is a proposal to prohibit exit fees. Whilst this would be a welcome move, I do not believe it will actually enhance competition in banking and choice for consumers.

If consumers are given the opportunity to leave their current high fee / high interest loan without having to pay crippling fees, they will still currently be faced with limited opportunities to find a better loan product. The major banks dominate the market, and their products all ensure an excessively high profit for the sponsoring bank. This is reflected in the increased profits declared by all the major banks.

So long as they continue to dominate the banking sector, there is no incentive for the major banks to moderate their fees or interest rates.

Personally, I do not believe excessive government regulation is the answer. As soon as one discreditable banking practice is outlawed, the banks will simply come up with some other new fee or charge to effectively reverse the effect of the legislation on their profits. Introducing further new prescriptive rules will also make it harder and more expensive for new competitors to enter the banking sector.

I submit that the better policy response would be for the government to take the least intervention necessary to achieve the desired result (in this case, greater competition in the banking sector for ordinary Australians and small business). In my view, this can be achieved by the government simply introducing a new bank offering low fees and reasonable interest rates.

This new bank would need to be government-owned (since a privately-owned bank would simply join the existing 4 bank oligopoly and charge high fees and interest rates).

Its charter would prohibit the bank from charging interest rates greater than 2% above the then prevailing Reserve Bank rates, with any shortfall in funds (not funded by retail deposits) to be borrowed from the Reserve Bank. This should guarantee a reasonable profit for the bank, which can be used to fund expansions to the bank network, with the excess to be paid to consolidated revenue.

In residential lending, the bank should be a specialist bank which only lends to

owner-occupiers (i.e. for people buying their own homes) but not investors. With business lending, it should only lend to small business.

The new bank could be started with initial seed funding from the Federal government, and could initially operate through an agency arrangement with Australia Post (similar to that in place with the Commonwealth Bank). It could grow its branch network organically through investing part of its profits to establishing new branches.

Having the new bank as a specialist bank would introduce essential competition into the banking sector for poorer borrowers without compromising the ability of the major banks to continue earning super profits from richer borrowers. I believe that this measure (coupled with a ban on exit fees for poorer borrowers) would introduce essential ongoing competition into the banking sector with a minimal amount of interference in the market, and without the need for excessive government regulation.

In terms of the financial planning sector, the competition problem alluded to in my response to paragraph (f) above is more difficult to solve. The banks are effectively eliminating their competition in the financial planning sector by purporting to charge less (i.e. offering “free” financial plans). They can afford to adopt this strategy as they own the products being promoted.

In my view, the easiest way to deal with this problem would be to amend the Corporations Act and the Banking Act to:

1. Prohibit a bank from offering financial planning services (as a condition of its banking licence);
2. Prohibit a financial service provider (as a condition of its AFSL licence) from recommending a product owned or operated by the provider or a related corporation of the provider. This would bring the bank-owned financial planning sector into line with the non-bank financial planning sector by removing the hidden profits / commissions which the banks currently enjoy by recommending their own financial products.

A 2 year transitional period should also be introduced to allow the banks to restructure their operations so as to meet the above requirements.

Such a separation of the banking and financial service industries is necessary to ensure continued non-bank competition in the financial advice sector. Such a separation is feasible, and there is precedent for it in the cross-media ownership laws (preventing a newspaper publisher from also being a television station owner, and vice versa).

Paragraph (k) comparisons with relevant international jurisdictions

The key comparison would be the New Zealand example of Kiwibank, a government-owned bank which introduced much-needed competition into the New Zealand retail banking market. The bank is both successful and popular, and continues to fulfil its mandate of making banking services accessible to members of the public at reasonable rates.

Paragraph (l) the role and impact of past inquiries into the banking sector in promoting reform

I do not have sufficient knowledge on this issue to comment.

Paragraph (m) any other related matter

I have no other submissions to add.

Yours faithfully,

Suryan Chandrasegaran