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

Economics Reference Committee: Competition within the Australian banking sector Inquiry

The Finance Sector Union of Australia (FSU) welcomes the opportunity to contribute to the inquiry into Competition within the Australian banking sector.

The FSU represents and advocates for more than 400,000 workers in the finance sector, including those employed in Australian banking. Our submission is a broad based one which identifies the principles that we say should underpin Australian banking, including competition.

Scope of Inquiry

As long term advocates, the FSU holds the view that our banking system has a social obligation to the Australian community in addition to their economic and commercial role. This is why the FSU is disappointed with the narrow focus of this Senate inquiry i.e. competition. Whilst the Inquiry's terms of reference arguably expands its scope, most of the media commentary and political rhetoric espouses the safe territory of competition as the panacea to address the issues in Australia's banking system.

Consideration of regulatory reforms and other measures needed to cement the essential nature of banking appears to have been ruled out before the inquiry began. That is disappointing.

It should be noted that the FSU does not champion the notion that there is a need for a "Son of Wallis" type inquiry that has been spruiked by the Hon. Joe Hockey MP. Rather, efforts ought to be made to implement the outcomes/recommendations from recent parliamentary reviews into the banking sector. We do not intend to republish all of FSU's arguments previously submitted to the many and various Inquiries here[1], however we will restate the recommendations of some of those submissions and provide the Committee with access to the submissions in full.

We also strongly believe it is long overdue for the parliament to act on some critical banking issues that have been avoided for a considerable period of time, namely offshoring of Australian jobs and conflicted remuneration models. The FSU says these two strategies alone drive a culture and behaviour in banks that sours the banking and working experience of many and any suggestion they can be arrested through non-regulatory competition policies is at best naive.

[1] www.fsunion.org.au/News-Views/Policies-Submissions/default.aspx

Australian Banking Principles

For over a decade, the FSU has publicly and politically advocated for banking to be recognized as an essential service and a vital part of our economy. We have long held the view through our industry policy positions[2] that Australian banks, particularly the big four, take far more than they give and that we need them to enter into a social and economic contract for the benefit of all Australians.

Like all other stakeholders, the FSU wants our banks to be as profitable and successful as they can be, but not at any cost. Our recent industry policy and campaign, *Better Banking – It's in your interest*[3]outlines some of the key issues confronting the nation's banking system and advocates appropriate reforms to combat them, including some that require regulatory change.

Additionally, the FSU has been discussing with a number of consumer and community sector organizations the sort of principles we believe ought to be the hallmarks of banking in this country. The following principles we believe provide the basis for banking in this country and should guide the Parliament when formulating outcomes from this inquiry:

[2] www.fsunion.org.au/News-Views/Policies-Submissions/default.aspx
[3] http://www.better-banking.org

Australia's financial system should function in an accessible, affordable and fair manner reflecting its status as an essential service. The financial sector should deliver products and services which better balance the needs of consumers, employees, shareholders, the economy as a whole and the broader public interest.

PRINCIPLES

To achieve an effective, well-functioning financial system in the best interests of the Australian community through:

1. Promotion of competitive outcomes for consumers

- shopping around and switching provider should be easy
- new market entrants should be encouraged
- all market participants should enjoy a level playing field
- financial institutions should not be allowed to have excessive market power
- regulators should investigate and respond proactively when problems arise

2. Effective regulation to support fairer outcomes, especially in essential services such as retail banking and superannuation

- financial services should be accessible and affordable for all consumers, regardless of their circumstances or location
- fees and charges should reflect costs only
- financial products and services should be provided transparently, responsibly and with a duty of care to all stakeholders

3. Community access to information about key elements of our financial system

- key information about Australia's financial system, including information about the size, nature and structure of financial institutions, levels of prices and fees in the market and wholesale costs, should be transparent and published regularly by our financial regulators

4. Removal of all conflicts of interest

- financial providers should act in the best interests of their customers and clients
- practices and structures that generate conflicts between the interests of financial providers and their customers should be eliminated

5. Balancing the operation of the financial system with the needs of the community

- policy development and implementation on financial services issues should include the voices of all groups in the community who are affected
- reflecting social and economic obligations, financial providers should strive to be Australian leaders in standards of corporate governance and behaviour
- the financial services industry should contribute to the development of the nation's skills and knowledge and the growth of sustainable and socially responsible local jobs

The 'four pillar' policy and bank mergers

FSU, against the recommendations of the Wallis Committee and sustained lobbying and argument from industry, maintained that the Australian Government must continue to ban any merger between the big four banks.

It is significant that the overwhelming majority of commentators, policy makers, academics and regulators now credit the maintenance of the 'four pillar' policy, at least in part, as having contributed to Australia's banking sector avoiding the worst ravages of the Global Financial Crisis.

FSU continues to advocate that the 'four pillar' policy must be maintained. Our submissions to the House of Representatives Standing Committee on Economics *Inquiry into competition in the banking and non-banking sector* in July 2008, clearly sets out this position.[4]

Our recommendation to this Inquiry is that the 'Four Pillar' policy be retained. We note also that Senator Xenophon in his Minority Report to the Senate Economics Committee *Inquiry into Aspects of Bank Mergers,* recommended:

"That the Banking Act is amended to provide for an outright prohibition against any merger between the four major banks, so as to ensure that the 'four pillar' policy is given the force of law and can only be altered by Parliament."[5]

The FSU would support such a recommendation by this Committee.

Much of the discussion centering on competition in the banking sector has commented on the repercussions of decisions by the Australian Competition and Consumer Commission (ACCC) and the Federal Government in allowing mergers between Westpac and St.George and Commonwealth Bank and Bankwest to proceed.

In our submission to the ACCC in June 2008, FSU argued that:

> *"We submit that the ACCC should block the proposed merger on the basis that:*
> - *it will remove an effective and vigorous competitor from the market;*
> - *barriers to entry make it unlikely that a new effective and vigorous competitor will emerge;*
> - *a substantial lessening of competition will occur in markets for transaction accounts;*
> - *it will result in substantial employment losses;*
> - *there will be an increased likelihood of less competition in the banking sector through the four major banks launching takeovers for the remaining smaller players."*[6]

The current debate now fuming over the perceived problem of a lack of competition may well have been avoided if our submission had been acted upon.

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[4] Finance Sector Union submission to Competition in the banking and non-banking sectors, House of Representatives Standing Committee on Economics, July 2008. Page 2.

[5] Senate Economics Committee, Inquiry into Aspects of Bank Mergers, 2009. Minority Report by Senator Xenophon.

[6] Finance Sector Union submission to the ACCC on Proposed merger of Westpac Banking Corporation and St.George Bank Limited, June 2008. Page 1

In doing so we also noted that:

> *"The FSU is concerned that while there are mechanisms to identify competitive and prudential problems with bank mergers, there is no mechanism to evaluate the impact of mergers on people, communities (particularly rural and regional communities) and society."*[7]

Again, in our submission to the Senate Economics Committee Inquiry into Aspects of Bank Mergers, we reiterated this position and recommended that:

> *"Section 63 of the Banking Act 1959 or section 50 of the TradePractices Act 1974 should be amended to include a public benefit assessment to determine the merits of a proposed merger or acquisition that includes:*
>
> - *A social audit to determine the impact of the merger/acquisition in relation to the concentration of economic power, employmentlevels, communities and access to services;*
> - *A period for public consultation;*
> - *The capacity to require of the merger/acquisition parties binding undertakings to mitigate negative social impacts of themerger/acquisition"*[8]

In the same submission we also called for the strengthening of compliance measures and monitoring of merger conditions imposed on merging parties.

We also recommended that the ACCC and the RBA prepare annual reports on the state of competition and service levels in the banking sector and to empower the ACCC to be able to take action if it finds insufficient competition in the banking market, including divestiture powers.

We would ask that this Inquiry give much greater weight to and consideration of these recommendations given the now obvious, historical accuracy of the logic that underpins them.

Recent Parliamentary Inquiries

It has been as recent as two years ago since the last parliamentary examination into competition in the banking sector[9]. The House of Representatives *Inquiry into competition in the banking and non-banking sectors* made a number of recommendations including:

- Review the Trade Practices Act to extend the powers of the Australian Competition and Consumer Commission (ACCC);
- Reform Australia's credit reporting system;
- Review account switching
- Introduce transparent entry and exit fees and address the unfair ones;
- Consider regulating unsolicited credit card limit increases;
- Treasury develop standardized key facts document for mortgage products to help consumer choice

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[7] Ibid., Page 2

[8] Finance Sector Union submission to the Senate Economics Committee Inquiry into Aspects of Bank Mergers, February 2009, page 8.

[9] Competition in the banking and non-banking sectors, House of Representatives Standing Committee on Economics, November 2008

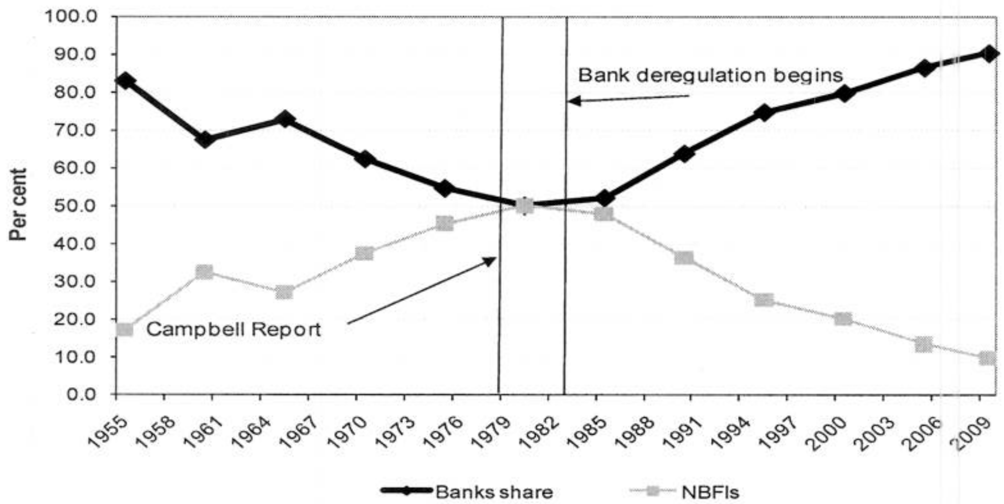
We note that the Government is or has already taken steps to action some of these recommendations and that it continues to be active in pursuing additional reforms impacting the banking system eg Consumer Credit Act and the Future of Financial Advice. On these measures and all other endeavours undertaken to pursue reforms in Financial Services, we commend the Government.

Notwithstanding these efforts and the attempts to have banks take the initiative themselves on some of the 2008 recommendations and avoid the imposed will of the Parliament e.g. exit fees, the banks simply refuse to alter their behaviour. It is only now, some two years down the track and because of the public scrutiny upon them due to their interest rate hikes, that our big four banks are starting to publicly canvass the abolition of exit fees in some forlorn PR exercise.

Instead and since the 2008 Inquiry, the banks have continued to complain about spiraling costs whilst at the same time announcing record profits. They have also of course led the chorus of anti – regulation cheer leaders who say any regulatory response will by definition be anti competitive.

History however paints a different picture and indeed suggests that the lurch to deregulation in the early 1980's was a catalyst for the big four banks cornering the lions share of the market and in turn, stifling competition.

The following graph illustrates the results of such policies by tracking the market share in loans and advances across all financial institutions in Australia since the mid-1950s. The top line traces the shares for banks and the bottom for non-bank financial intermediaries (NBFIs), which include building societies and credit unions as well as finance companies, mortgage originators and a host of other financial institutions. The figure shows that soon after World War II, banks occupied a dominant position in the credit market, holding 83 per cent of all loans and advances. By 1980, however, their share had shrunk to 50 per cent. Significantly, this period of decline was dominated not by faith in competition but by regulation. When the deregulation phase that began in the 1980s was complete, the share of overall lending attributable to the banks had increased again and now exceeds 90 per cent. [10]



Source: RBA.[11,12]

[10] The Australia Institute, Money and Power The Case For Better Regulation in Banking, Institute Paper no.5 August 2010.

[11] RBA, 'Statistical Tables'.

The before profit tax of the big four banks (ANZ, CBA, Westpac and NAB) rose collectively from $1.777 billion in 1986 (0.7% of GDP) to $23.413 billion in 2009 (1.9% of GDP).[13]

To further illustrate the deregulation domination of the big four banks, the ANZ, CBA, Westpac and NAB now account for 82% of all lending in Australia and 78% of all bank deposits, leaving the remaining 50 banks to contest the remainder.[14] These figures hardly support an assertion that regulation is anti competitive.

<u>Environment for Change - FSU Commissioned Independent Research</u>

In April 2010, the FSU commissioned independent nationwide surveys of the Australian public and of Australian bank workers.[15,16] Both surveys showed high levels of concern existing amongst the community and workers alike about how banking is conducted in Australia and what needs to be done to turn it around.

Importantly, both groups firmly believe that greater regulation has a significant role to play moving forward.

Some highlights of the respective survey results are:

Public

- 25% believe their bank is moving in the right direction and 38% believe they are going in the wrong direction.
- 63% believe that banks are getting worse at maintaining a healthy balance between keeping the bank profitable and keeping banking affordable
- 45% are uncomfortable with their level of debt and 43% being most concerned about rising interest rates with their debt levels
- 57% report having to wait in a queue or on a phone for service and 46% identify a lack of staff as a problem
- 79% support government regulating to limit bank interest rate charges to the levels set by the RBA
- 59% were unaware of bank workers salaries being tied to the selling of debt products and 30% overall were unconcerned with the practice
- 79% want sales targets of credit products de-linked from wages for bank workers
- 87% believe there should be a requirement for banks to seek their permission if they wish to transfer personal customer data offshore
- 41% indicate that highly profitable banks are good for the economy
- 76% believe personal debt is a significant problem that requires tougher regulation to rein it in
- 90% want banks to stop offshoring Australian bank jobs and commit to developing local jobs and skills

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[12] RBA, *Statistics: Australian Economic Statistics 1949–1950 to 1996–1997*, Occasional Paper No. 8, various dates.

[13] The Australia Institute, *Money and Power ,The case for better Regulation in banking*, Institute Paper #5, August 2010

[14] Australia Prudential Regulatory Authority, Statistics: Monthly Banking Statistics, April 2010, 31 May 2010.

[15] Essential Research, *Better Banking, Australian Public,* April 2010

[16] Essential Research, *Better Banking, Australian Bank Workers*, April 2010

Bank Workers

- 29% believe their bank is moving in the right direction 49% believe they are going in the wrong direction
- 73% say their unit does not have enough staff
- 46% say customer service levels have got worse in recent times
- 53% said their employer values product sales over customer service
- 59% indicate selling and sales targets have become high priority in recent years
- 81% say their employer does not adjust credit/debt product sales targets during periods of difficult economic conditions
- 43% reported being placed under pressure to sell credit/debit products to customers regardless of their ability to afford them
- 79% said personal debt levels had reached the stage of requiring regulation to control it
- 79% expressed concern with the offshoring of Australian jobs
- 93% want banks to stop offshoring jobs
- 90% want sales targets and wages de-linked
- 82% say that there should be a direct link between bank fee increases and customer service levels.

On any measure, these survey results clearly demonstrate that the Australian public and bank workers have identified major problems with the our domestic banking system and their appetite to have them dealt with. They are ready for change, they want change and they have an expectation that Parliament will deliver real change.

<u>Driving Cultures & Behaviours - Offshoring and Conflicted Remuneration Models</u>

Offshoring

The National Institute of Economic and Industry Research (NIEIR) predict that if public policy settings stay as they are, up to 850,000 services jobs could be offshored from Australia over the next twenty years[17]. The FSU estimates that in the last few years alone, upwards of 5,500 Australian bank jobs have already been offshored[18].

HSBC have just advised the FSU and its staff that it intends to offshore up to 105 positions to Manilla from April 2011.

There is no dispute about the rationale behind offshoring – it is a strategy employed by banks to reduce costs by using cheaper overseas labour[19]. For bank workers it is unconscionable at any time for their employers to banish thousands of their co-workers and their families to dole queues because their work can be done more cheaply overseas.
It leaves an even more bitter taste when offshoring occurs with a backdrop of record bank profits and spiraling bank executive pay packets.

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[17] National Institute of Economic and Industry Research, *OFFSHORE AND OFF WORK, The future of Australian service industries in a global economy, A call to action*, May 2008
[18] FSU submission, Senate Standing Committee on Environment, Communications and the Arts, Inquiry into Keeping Jobs from Going Offshore, (Protection of Personal Information) Bill 2009
[19] Australian IT, *ANZ Bank ups the ante, ANZ CEO Mike Smith to Investors briefing*, December 18 2007

It is the FSU's stated position that Australia's finance sector, of which banks are an integral component, will be and need to be one of our growing and sustainable industries. To this end and as part of a broad social and economic contract with the Australian people, our banks must be responsible and accountable for the future growth of jobs and skills.

FSU's submission to the Senate Economics Committee *Inquiry into Aspects of Bank Mergers* noted that:

> *"Australia's finance industry has failed to engage in industry planning predominantly on the grounds that this may undermine individual company's competitive advantages. Longer term planning around skills for the future to meet aspiration goals, such as developing Australia as a global financial hub, has also been absent from the industry."*[20]

Our submission went on to recommend that:

> *"Recommendation: That the Government facilitate and support the development of a finance industry plan that focuses on investment in employment and skills development.*
> *Recommendation: In return for the considerable Government assistance received by the banking sector there should be conditions attached including an immediate cessation of off-shoring Australian jobs.*
> *Recommendation: That legislation be introduced that requires service providers to disclose the country where their employees are located at the time of transaction.*
> *Recommendation: That any financial or personal information shall not be sent off-shore without the express permission of the consumer."*[21]

Parliament must provide the environment for banks to embrace this challenge and to jettison their offshoring ways. The views of the Australian people have remained constant on these matters since at least 2006 and it is clear they want the Parliament to act accordingly[22].

Conflicted Remuneration Models

Whilst the Ripoll Inquiry[23] concerned itself with conflicted remuneration models as they relate to the financial advice industry, the underlying principle of a potential conflict of interest when an undisclosed commission arrangement from product sales exists, can and should equally apply across our banking and finance industry.

This starts at the top of the tree with executive remuneration that is significantly geared to reward short-term and sometimes risky practices focused on increasing market share or reducing costs, often at the expense of longer term, more sustainable outcomes.

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[20] Finance Sector Union submission to Senate Economic Committee *Inquiry into Aspects of Bank Mergers,* February 2009, page 11.
[21] Ibid,. page 12
[22] McNair Ingenuity Research, *Attitudes to Offshore Labour, Report prepared for Services Unions of Australia*, 652 FS, May 2006
[23] Competition in the banking and non-banking sectors, House of Representatives Standing Committee on Economics, November 2008

In our supplementary submission to the Senate Economics Committee *Inquiry into Aspects of Bank Mergers,* we noted:

> *"The banking system plays a critical role in the economy and the consequences when things go wrong are significant, widespread and long lasting. The FSU believes that one of the primary 'drivers' that led to the GFC was a short-term approach from many finance executives that had been institutionalised by instruments such as large STI's.The finance industry must entrench a long term and sustainable approach in all itsactivities, including CEO remuneration, to ensure that we never experience GFC2."*[24]

While we recognise that some work has been done in this regard by the Government, we are still of the view that CEOs and executives in our sector still have remuneration levels that are way out of balance with community expectations and still loaded up with massive short term bonuses and incentives.

One of the consequences of this type of remuneration at the executive level is that it then cascades down throughout the organization creating unsustainable and conflicted remuneration models which drive behaviours of bank employees.

The Australian Securities and Investments Commission (ASIC) noted in its submission to the Ripoll Inquiry the historical basis for the links between manufacturers and advisers:

> *"Remuneration of distributors of financial products was historically set by the product manufacturer. It was based on the value of products sold and deducted from the amount paid by the consumer for the product. These remuneration settings encouraged product distributors to sell certain products.*
> *As the market for financial advice services has grown, the historic connection with product manufacturers and this remuneration structure has conflicted with investors' needs for quality unbiased advice and their perception that this is what financial advisers provide."*

It is common practice throughout the banking industry for significant numbers of employees to have their wages and conditions outcomes and in some cases their employment predicated on employer imposed sales targets associated with the sale of products, very much including credit products. The FSU contends that this encourages a culture of product pushing onto consumers, with little regard for whether it is the right product for the consumer or their ability to afford it[25],[26].

Recent reaffirmation of the behaviour of our banks came in the form of a blog post on November 3, 2010 with a bank worker confirming the internal pressure applied to them by their superiors to sell more debt[27].

This again illustrates and underscores the FSU's position that our banks, when left to their sense of right and wrong, will more often than not chase what they crudely internally refer to as a "greater wallet share". Regulation is needed to stop this behaviour.

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[24] Finance Sector Union supplementary submission to Senate Economics Committee *Inquiry into Aspects of Bank Mergers.* May 2009. Page 4

[25] www.fsunion.org.au/News-Views/Policies-Submissions/default.aspx, FSU Charter of Responsible Lending 2008

[26] www.fsunion.org.au/News-Views/Policies-Submissions/default.aspx, FSU Submission, ASIC Consultation Paper 115, Responsible Lending

[27] http://www.better-banking.org/get-up-you-stuffed-up-a-bank-workers-view/

The FSU recommends to this committee that the principles established by the Ripoll Inquiry to ban conflicted remuneration for providers of financial advice be extended to all providers of financial services.

Summary

The FSU believes that the current environment provides an infrequently available opportunity for the nation's parliament to genuinely respond to the needs of our citizens. Public dissatisfaction with Australian banks, particularly the often refereed to big four (ANZ, CBA, Westpac, NAB), has never been higher and nor has the public expectation that those elected by the people, from the people and for the people will respond accordingly.

But it is not merely greater competition that will satisfactorily address Australia's banking system. Our second tier lenders have frequently said for many years that until the playing field is levelled for them, many of them will continue to struggle to compete with the big four.

They cite for example the comparative cost of funds between them and the large banks and the seemingly unscaleable mountain of credit ratings to highlight the competitive difficulties they confront. We have also of course witnessed the ability of the big four to absorb short term reductions in revenue in response to a second tier lenders initiative to ensure medium to long term protection of their market share.

These are genuine competition issues that may require a regulatory and or public policy response. It is disturbing that some politicians rule out support for regulatory changes to address these issues before they are even contemplated by this Inquiry.

Additionally, the Inquiry must also look at the social and economic contribution we want banks to make to Australian society. Banking is an essential service to our nation and its citizens and must be viewed as so. In this light, it is entirely proper for the Inquiry, for the parliament and for the nation to establish the future banking environment in Australia.

Australians do not have the day to day capacity to simply opt out of the banking system. Banking is connected and integrated into our ability as citizens to function and exist in modern society. The essential nature of this system to the nation behoves our Parliament to ensure that it operates fairly and equitably for all Australians.

We ask that the Committee revisit the recommendations that the FSU has put forth previously as regulatory responses to the problems identified in the banking industry and that those recommendations be adopted and enacted in recognition of the need for broader and meaningful reform for the benefit of all stakeholders.

Yours faithfully

Leon Carter
National Secretary

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