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Association of Building Societies and Credit Unions

Abacus
Australian Mutuals

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Mr John Hawkins
Committee Secretary
Senator Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600
By email: economics.sen@aph.gov.au

Dear Mr Hawkins,

Inquiry into *The Banking Amendment (Keeping Banks Accountable) Bill 2009*

Abacus appreciates the opportunity to offer our comments to the Senate Standing Committee on Economics in relation to the above Bill and we apologise for the late submission.

Abacus – Australian Mutuals is the industry body for credit unions, mutual building societies and friendly societies. Collectively, Abacus member institutions have more than $70 billion in assets and serve more than 6 million members.

The Bill is positioned as keeping banks accountable, however it will apply to all ADIs, including credit unions and mutual building societies. Abacus and its members do not support the proposed Bill for the following reasons.

1. Mortgage rates are not linked to the RBA cash rate

Mutual ADIs are run solely for the benefit of their members and so always seek to provide the lowest possible interest rates to their members. Cannex data suggests that credit unions and mutual building societies have consistently lower average rates than the major banks.

There's no link between the RBA cash rate and mortgage rates and therefore the cash rate is not an effective barometer for mortgage rates. Mortgage rates are determined by the cost of funds to institutions – that is, the cost of raising funds through either retail deposits or wholesale funds.

The cost of these funds has no direct link to the RBA cash rate. Attempts to link mortgage rate changes to changes in the RBA cash rate simply runs the risk that ADIs will be unable to run prudent loan books or that ADIs will be forced to limit the supply of credit – both poor outcomes, particularly in the current environment.

The most effective way to place pressure on interest rates is to ensure effective competition in the market, including by removing structural barriers to competition such as the premium differential on the government guarantee for large deposits and wholesale funds.

2. **Linking rates may inhibit competition**

Currently, ADIs will set rates according to the cost of funds and competitive pressures in the market. When competition is working effectively, ADIs may seek, or be forced, to change their mortgage rates independently of changes to the RBA cash rate.

Mutual ADIs have frequently reduced their interest rates outside of changes to the RBA cash rate for the benefit of their members. This Bill would place pressure on institutions to limit their mortgage rate changes to movements in the cash rate – this would not necessarily be of benefit to consumers.

3. **Limited price constraints may have unintended consequences**

The proposed Bill applies only to mortgage rates and therefore poses the risk that other forms of credit will become more expensive or that fees will rise. Younger people, who rely on personal loans and credit card debt, will find themselves subsidising those who hold a mortgage; a poor outcome for consumers.

4. **Monetary policy should be independent of political intervention**

Price intervention in response to a highly political and public issue will compromise the Reserve Bank's ability to act independently and sets a very dangerous precedent for the wider community.

It has always been government policy that interest rates are set independent of government. We do not support government intervention in rate setting in the manner proposed in the Bill.

5. **The Bill is premised on the assumption that the economic costs for individual ADIs are the same**

Mutual ADIs attain the bulk of their funding from retail deposits, whilst traditionally large banks access the wholesale market as well as the retail deposit market for their funds.

These markets do not necessarily move the same way, or with the same speed as each other, nor are they directly linked to the RBA cash rate. Accordingly, one sector may experience changes to their cost base in different ways to another sector, yet the Bill would require that their price behaviour is the same. This is clearly a poor outcome for regulated institutions.

Mutual ADIs will continue to put their members first in decisions about interest rates and fees – this is our core purpose. This Bill will not improve outcomes for members of mutual ADIs, but may cause unintended compliance and other costs that will inevitably be passed on to their members.

The mutual ADI sector acknowledges the importance of the Government guarantee in creating stability in the retail financial services market in Australia. The guarantee scheme has not cost the Australian taxpayer any funds, nor is it likely that taxpayer's funds will be at risk in the future. Indeed, the large deposit and wholesale funding guarantee scheme has raised significant revenues for the Government.

Abacus and its members firmly believe that price regulation is an ineffective way to achieve a good outcome for consumers of retail financial services. It's far more effective to ensure there's strong competition and choice for consumers and Abacus has called on the Government to amend the structural guarantee premium barriers referred to above, and to support measures to improve the access to wholesale funds for smaller ADIs.

We urge the Committee not to support this Bill.

Yours sincerely

Mark Degotardi
Head of Public Affairs