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Mr Paul Zinkel
Inquiry Secretary
House of Representatives Inquiry into
Competition in the Banking and Non-Banking Sectors
PO Box 6021
Parliament House
CANBERRA ACT 2600

SUBMISSION TO INQUIRY IN THE BANKING AND NON-BANKING SECTORS

I am writing in response to your letter of 6 June 2008 to Ralph Norris, the CEO and MD of the Commonwealth Bank of Australia ("the Bank").

The Bank is Australia's largest financial services organisation by market capitalisation. It is one of Australia's leading providers of integrated financial services including retail, business and institutional banking, funds management, superannuation, insurance, investment and broking services. The Bank has the largest branch and ATM network of any of the banks operating in Australia.

The purpose of this submission is two-fold:

- to indicate the Bank's support for the submission made by the Australian Bankers' Association (ABA); and
- to highlight the importance the Bank attaches to some of the measures noted in the ABA's submission.

As a general comment the Bank believes the best way to promote competition in the banking and non-banking sectors is for there to be a sound but flexible regulatory and institutional framework which ensures maximum efficiency within the financial services sector. In such an environment there will be minimal friction points. For example, the legal framework would be kept as simple as possible and compliance costs and other 'costs of doing business' would be minimised.

Such an operating environment will therefore ensure providers have a strong focus on the consumer. Product innovation will be highly responsive to changing consumer needs. The price of financial services will also be lower than otherwise.

To this end the Bank strongly supports two specific measures which are on the Government's current agenda and which would drive down friction costs in the system:

- early implementation of a national system of electronic conveyancing (as has been agreed at the recent Council of Australian Governments (COAG) meeting); and
- national regulation of all consumer credit.

Electronic conveyancing

The Bank strongly supports the recent COAG decision to move to a national system for electronic conveyancing. Doing so will significantly improve the efficiency of conveyancing and the service standards experienced by consumers.

- Transactions will be able to be performed remotely and so at lower cost (rather than the current physical exchange of documents).
- Fewer settlements will be delayed because of lost or misplaced paper documents that need to be reissued.
- Settlements will be by electronic funds transfer rather than bank cheques, making settlement processes more convenient, quicker and less costly.
- Cross-border transactions will be easier to effect with greater certainty (for example, making the purchase of a property in Sydney conditional on the sale of a property in Melbourne).

The potential cost savings of a national e-conveyancing system have been estimated at $250 million p.a. for Australia.

In developing the new national e-conveyancing system the Bank encourages COAG to ensure that it goes beyond simply linking separate State and Territory systems. A national system must include a common set of rules and practices governing the business environment in which e-conveyancing takes place. Only then will the advantages of electronic conveyancing be fully realised.

National regulation of all credit

The Bank supports the Government's proposal for a national approach to the regulation of mortgages which has been outlined in the Financial Services and Credit Reform Green Paper (Option 3 of the "Green Paper"). The Bank can see no reason why any customer should be afforded a different level of protection or service than another on the basis of their State or Territory of residence.

However, the Bank believes that the Federal Government now has the opportunity to assume responsibility for <u>all</u> forms of consumer credit and associated finance broker regulation, as proposed in Option 2 of the Green Paper. This would afford a uniform standard of protection to a far greater number of consumers. The Bank, for example, has 2.7 million credit card customers compared with over 1 million home loan customers.

The Australian Securities and Investments Commission (ASIC) would be the sole regulator under any system of national regulation. This would simplify the regulatory regime for both consumers and industry in that they would only need to liaise with one regulator for all matters relating to consumer credit.

The migration of current responsibilities from the States and Territories to the Federal Government would result in the removal overlaps and gaps in regulation and provide benefits for both consumers and the consumer credit industry. Domestic and international reviews (namely the OECD "Going for Growth" report, the Productivity Commission's Review of Australia's Consumer Policy Framework and COAG's Business Regulation and Competition Working Group Plan) all point to the advantages that could be gained by moving to a single national regulatory regime.

Financial Claims Scheme - post-event funded levy

The Bank also advocates that the Financial Claims Scheme, which is currently being designed, involve a risk weighted levy for any post-event funding. Such a feature would minimise the moral hazard distortions which will be introduced by the Scheme and are of concern to the Bank.

Once the Scheme is implemented most depositors (ie the approximately 80% covered by it because they are individual customers with no more than $20,000 in deposits) will have a reduced incentive to prudently choose the Authorised Deposit-Taking Institution (ADI) at which they place their deposit because the deposit will always be insured. As a result, the retail funding for ADIs with riskier lending practices will be subsidised by those with more prudent lending practices.

However, including a risk weighting for any post-event funded levy would at least ensure that in the event of an ADI failure the surviving institutions with riskier balance sheets contribute a higher proportion of funding to cover the shortfall left by the failed institution. It would therefore help discourage those riskier practices or better price for it.

Aussie Mac

A final issue of concern to the Bank is the call by some commentators for the creation of an ‘Aussie Mac’ scheme (akin to the US Fannie Mae and Freddie Mac schemes) in response to current funding pressures, especially in the Residential Mortgage Backed Securities (RMBS) market.

At best the creation of an AussieMac would be premature. The proponents of AussieMac assume the RMBS market will be permanently closed (at least on any reasonable measure of price) or that the RMBS market will suffer frequent closures of significant duration. It is highly unlikely that the market will be closed permanently and it is difficult and premature to tell if disruptions will be frequent with significant durations – this is the first major disruption of any size in the RMBS market in Australia since it first emerged in the mid-1990s.

At the heart of the current RMBS problem is the fact that many RMBS (most notably offshore) have been bundled into products (like Collateralised Debt Obligations, CDOs) which are very new and not very transparent and consequently have been mispriced. This is unlikely to be repeated. There are already signs that the environment for prospective issuance of RMBS is improving.

Aussie Mac would also have many shortcomings.

- It would be *inefficient*. It would distort capital markets by mispricing risk and as a result shift even more investment into housing. Australian housing, at least that part financed by through AussieMac, would become a generic Government AAA-rated investment risk because of the Government guarantee compared with the current implied rating of around BBB for on-balance sheet, prime mortgages[1].
- It would *increase the riskiness of the domestic banking sector* because the proportion of prime mortgages held by banks on their balance sheet would contract. Bank balance sheets would change to having a higher proportion of 'non-conforming' mortgages, unsecured personal lending and corporate assets, as is the case with many banks in the US. This has potential negative implications for earnings volatility, capital ratios and debt ratings in the domestic banking sector which will be borne by consumers and shareholders.
- It would *support unsustainable business models* for mortgage lending. The business model of non-banks exclusively reliant on securitisation funding has been proven to be unsustainable. Policy-makers should not support unsustainable business models where there are proven sustainable alternatives that adequately meet the demand for mortgage credit (ie ADIs).
- It would create *an additional bureaucracy*, without a proven governance model, to achieve the same objective as the Reserve Bank of Australia's (RBA) recently expanded RMBS repurchase facility.
- It *could ultimately jeopardise the Government's credit rating* of AAA if the Government had to bail out Aussie Mac (eg because of poor investments). This prospect has already been raised by Standard & Poor's in relation to the US Government and its schemes.

I trust this information will be of assistance to the Inquiry.

Yours faithfully,

John McLenaghan
Head of Government & Industry Affairs

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[1] Of course on-balance prime mortgages can be made into AAA-rated RMBS through enhancements and structuring. However, lenders pay a market determined price for such activity which is reflected in the mortgage rates they offer to borrowers. Unless the cost of the Government guarantee on an Aussie Mac issue is fully passed onto borrowers, which seems unlikely, interest rates on mortgages funded via Aussie Mac would fall and so drive up the demand for housing finance (all other factors being equal – eg no RBA response).