SUBMISSION 39

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Inquiry Secretary
House of Representatives Standing Committee on Economics
Parliament House
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Inquiry into competition in the banking and non-banking sectors

The Finance Sector Union of Australia (FSU) welcomes the opportunity to contribute to the consultation process for the inquiry into competition in the banking and non-banking sectors.

The FSU represents 50,000 members employed in the finance sector across Australia. Our submission is fairly broad and primarily addresses 1(b) of the Committee's terms of reference, namely:

> ***1) The Committee will undertake a stock take of the Australian retail banking and non-banking industries, focussing on:***
>
> ***b) the current state of the retail banking and non-banking industries;***

Australia may have weathered the global credit crisis better than other countries but it has still had an effect on the lending market. The precise nature and extent of this impact is still unfolding; however it has undoubtedly had significant implications for non-bank lenders that do not hold deposits and rely on the global credit markets and securitisation for funding. Reports indicate that non-bank lenders have lost up to two thirds of their home loan market share in the last year and nine out of 10 mortgages are now being sourced from the banking sector.[1]

The FSU believes this raises difficult issues for the finance sector that the Committee should carefully consider. Research shows there has been an unfortunate correlation between the non-bank lenders and high rates of foreclosure and repossession[2] which can be used to argue that consumers are better off dealing with the major banks. This may be correct but it should also be acknowledged that the non-bank lenders have been a strong competitive force in the lending market and their departure would not necessarily be a positive development. The FSU does not have a definitive response to this issue; however we believe that legislated standards for responsible lending practices would help to ensure consumers are better protected regardless of whether they deal with a bank or non-bank lender. (Responsible lending is discussed in more detail later).

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[1] *Non-bank lenders lose home loans shares*, The Age online, 18/7/08

[2] *They still want to take our house: A further investigation into house repossessions in the ACT Supreme Court*, The Consumer Law Centre of the ACT and the Centre for Commercial Law (ANU), 2007. See also *Lenders launch 50 repossession notices a week*, Herald Sun 21/2/08 and *Banks Maintain Strong Lending Standards Compared to Other Lenders,* Australian Bankers' Association 30/4/07

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Mergers and barriers to entry

The FSU strongly supports and welcomes the recent statement by the Treasurer that the "Government sees no case for changing the four pillars policy which has served Australia well."[3] We believe that abolition of the 4-pillars policy would have serious consequences with the loss of between 10,000 and 20,000 jobs and the increased prudential risk that would accompany a merger between any of the four major banks. The 4-pillars policy ensures that there are four sets of risk management skills protecting the majority of Australia's deposits and loans – a lesser number equals a greater risk.

Arguments for abolishing the 4-pillars are consistently framed from an industry perspective using emotive language with no reference to any public benefit. The most common form this argument takes is based on the questionable premise that Australian banks must become larger to compete internationally.[4] Regardless of whether this is true the potential benefactors seem to be shareholders and banking executives rather than the Australian public. We note the brief and typical response by the Australian Bankers Association to the Treasurers statement on 4-pillars:

> "There has been a consensus over a number of years by the ABA and its members that the most rational public policy position is that bank mergers, like mergers in any other industry, should be assessed under the Trade Practices Act.
>
> It is important not to underestimate the influence of the Four Pillars policy on the nature and future of Australia's financial system.
>
> By retaining the Four Pillars policy, the prospect of Australia having a large domestically-owned bank of an international scale is unlikely."[5]

And in July 2007 the then CEO of Westpac, David Morgan, suggested that:

> "Set against consolidation worldwide and the globalisation of services, the (4 pillar) policy is an anachronism, a woolly mammoth dug from the Siberian tundra and shipped still frozen to Australia as a structure for banking".

There may well be a consensus amongst bank executives to abolish the 4-pillars policy but the FSU submits that there is also a consensus from both sides of politics, unions, consumer groups[6] and the wider public[7] to retain 4-pillars. We agree wholeheartedly with a recent commentator who suggested that the major banks have "clearly failed in winning confidence that community interests would be better served by further consolidation".[8] Industry is unable to demonstrate any public benefit from abolishing 4-pillars because none exists.

Recommendation 1: The 4-pillars policy should be retained.

We understand that the Committee is not specifically examining the proposed merger between Westpac and St George, however we believe that mergers are extremely pertinent to any discussion of competition in the banking sector and the proposed Westpac/St George merger provides a good illustration of a number of issues. The

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[3] *Ministerial Statement on Financial Stability*, Address to the House of Representatives, 2 June 2008.
[4] *Banking Concentration, Financial Stability and Public Policy*, Kevin Davis – Paper presented at The Structure and Resilience of the Financial System, RBA, August 2007
[5] *Australian Bankers' Association comments on two banking policies*, Sydney, 3 June, 2008
[6] *Westpac deal tests strength of 'pillars',* The Age, 14/5/08
[7] McNair Ingenuity Research, June 2008
[8] *Four pillars makes a strong edifice*, Milind Sathye, Australian Financial Review, 12 June 2008

FSU has made strong representation opposing the merger and our comments below reflect our submission to the ACCC.

We note with concern that section 50 of the *Trade Practices Act 1974 (Cth)* contains a 'substantial lessening of competition' test that guides the ACCC assessment but does not include any reference to 'the public benefit'. The FSU firmly believes that it should; especially when considering mergers of essential services providers such as banks.

FSU's experience from previous mergers such as Westpac/Bank of Melbourne and Commonwealth/Colonial suggests that mergers are often oriented towards short to medium term profit outcomes that have long term detrimental impacts on the interests of consumers, employees and communities.

A recent national poll of 1,000 people conducted by McNair Ingenuity[9] in relation to the Westpac/St George merger found that Australians are not satisfied with the current state of the banking market and sceptical about the merger delivering better outcomes for consumers:

- 87% believe that the big banks make too much profit;
- 75% believe that the merger would mean less competition;
- 72% are already of the view that there is not enough competition between banks;
- 89% do not believe that the merger would result in lower fees; and
- 69% believe that this merger would mean less pressure on banks to reduce fees and charges.

The FSU strongly believes that mergers between any of the 4-pillars and other medium size banks may have flow on effects, namely increased pressure for the other big banks to also acquire 'second tier' banks. This may be portrayed as competition in action by some sectors, however the FSU would argue that most major bank mergers effectively remove a competitor from the market and generally result in less real choice for consumers.

The existence of these second tier or medium size banks has long been recognised as having an important role in stimulating competition in all Australian banking markets. The Wallis Report in 1997 recognised that not only have regional banks become an increasingly important source of competition, but also have successfully lead the way on service, innovation and pricing on some products.[10]

In their paper on competition analysis of Australian bank mergers, Garry Goddard and Greg Walker outlined that such banks:

> ". . were considered to be efficient, innovative, geographically focused, close to their customers and sufficiently differentiated from the 'look-a-like; majors to provide an incentive for the major banks to remain competitive' by the TPC and later reiterated by the ACCC."[11]

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[9] McNair Ingenuity Research, June 2008

[10] G Samuel, "Competition issues in regional and rural Australia - speech to Australian Bankers Association 3rd Annual Regional banking and Agribusiness Forum", *ACCC* (09/09/05)

[11] Goddard, K and Walker, G, "Competition Analysis of Bank Mergers in Australia", *Journal of Law and Financial Management*, 1,1,2002

The affect of a significant acquisition of second tiered banks on domestic competition is a deep concern for innovation, consumer choice (in particular, the effect on bank fees), and customer satisfaction, particularly when smaller banks poll significantly better than their larger counterparts.[12]

The banking sector has a number of significant barriers to entry – prudential requirements, licensing, training, infrastructure and the rising cost of credit flowing from the 'sub-prime' crisis. Most of these barriers are entirely appropriate and reflect the important role that banking plays in society.

In addition, banking is an essential service and customers will often want a higher degree of trust in their relationship with their bank as opposed to other service providers. This element of trust is perhaps the most difficult for any new bank to obtain and arguably the most valuable commodity once it is acquired. This trust is usually earned over long periods of time as consumers and the market observe and form a view about a new institution.

Market theory suggests two things that can or should happen as a result of such mergers.

Firstly, consumers should benefit from better products, services and reduced costs as a result of increased scale and efficiency gains – we submit this has not been the case, especially in relation to fees and charges.

Secondly, if consumers are unhappy with the merged entity then new entrants will emerge to exploit these opportunities. We submit that this is unlikely given that a banks brand recognition and the level of trust consumers feel towards it are usually developed over several years or even decades. This is a large qualitative type barrier to entry combined with the more quantitative hurdles noted earlier

In addition, it is unlikely that foreign banks will enter the Australian retail banking market to fill any void. The national market share data shows that individually (and even collectively) foreign banks are very small players in the retail market and "have a larger presence in the business banking market, reflecting the focus of foreign bank branches on wholesale operations."[13]

The FSU is concerned that while there are existing mechanisms to identify competition and prudential issues with bank mergers, there is no mechanism to evaluate the impact of mergers on people, communities (particularly rural and regional communities) and society.

We agree wholeheartedly with the sentiments of the Consumer Action Law Centre who observed that:

> ". . the consideration of social issues in bank mergers is an issue that tends to fall between the regulatory cracks in Australia."[14]

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[12] "Not so satisfied with NAB", *the Sheet* (retrieved 30/05/08)
[13] *Foreign-owned Banks in Australia*, Financial Stability Review, *RBA,* March 2007
[14] *Defining 'public benefit' - Social and Environmental Considerations in Part VII of the Trade Practices Act 1974 (Cth)"* Consumer Action Law Centre, August 2007

Recommendation 2: Section 63 of the *Banking Act 1959* or section 50 of the *Trade Practices 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, employment levels, 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 the merger/acquisition.**

Sales targets and responsible lending

Competition in the banking sector has undoubtedly delivered benefits to consumers; however the FSU doesn't accept that the mere presence of competition in a marketplace is automatically good or an end in itself.

We submit that a large amount of activity in the banking market is based more on short term competition for growth or market share rather than sustainable practices to meet genuine consumer need. This type of activity is often expressed as sales targets for finance sector staff which are increasingly used as the only way staff can access increased remuneration.

The culture of sales targets is, by definition, designed to maximise sales which (even inadvertently) will lead to a higher risk of inappropriate sales occurring. If staff are constantly under pressure to achieve sales then this will inevitably lead to some consumers being sold products that they may not be capable of repaying or even need.

We stress that the FSU does not automatically object to the principle of performance pay for meeting targets. The FSU's policy on performance pay and targets[15] is that they should only exist once a system based on a guaranteed CPI increase is in operation. If wages for finance sector employees cannot go backwards, then the pressure to meet sales targets will inevitably be lower.

A recent survey of FSU members, predominantly in the established banking sector, found that:

- 52 per cent of workers felt obliged to try and sell debt products even when a customer didn't need them;
- 63 per cent felt that inappropriate sales targets are having a negative impact on their ability to provide responsible customer service; and
- 59 per cent felt pressured to make inappropriate sales to meet sales targets.

The principle and practice of disclosure is widely accepted, particularly in the financial services marketplace. There may not be the same direct link between the individual sale and the specific financial incentive that exists in other areas; however the fundamental issue is that targets do create a link which should be made transparent to the consumer.

[15] FSU Policy – *Regulation on Performance Based Pay* – 2007 (www.fsunion.org.au)

Sales targets carry the implicit message that ever increasing sales are good and desirable – the FSU does not share this view and believe it is detrimental to consumers, finance sector staff and the provision of good customer service.

Purchasing any financial product is a serious matter, especially a home loan which is usually the biggest financial commitment a person will make in their lifetime. The financial regulatory system should try to ensure that the majority of loans are appropriate and do not result in people becoming overly financially committed.

A recent report by Fujitsu predicted that the number of households experience 'mortgage stress' in June 2008 was approximately 750,000 with over 300,000 of those experiencing severe mortgage stress.[16] In Treasury's evidence to the Senate Inquiry into housing affordability it was stated the home repossessions have doubled in the past four years, rising to approximately 10,000 homes repossessed in 2007.[17]

Given this increase in people experiencing difficulties we believe that any regulatory regime should enshrine some form of principles to mandate 'responsible lending' practices. The FSU believes that such measure would ensure 'healthier' competition in the finance sector. In line with this belief the FSU has been developing a draft "*Charter of Responsible Lending"* which has been included as **Attachment 1** of this submission.

We note the comments of the Financial Stability Forum in April of this year who observed in relation to the US sub-prime crisis that:

> "The combination of weak incentives, an increasingly competitive environment, low interest rates and rapidly rising house prices led originators and mortgage brokers to lower underwriting standards and to offer products to borrowers who often could not afford them or could not bear the associated risks."[18]

We accept that the a major aim of any business is to maximise profits, however we would argue that the sale of major credit products such as home loans has an ethical dimension as well as wider implications for society if inappropriate lending practices become widespread or systemic. Institutions that engage in riskier home lending practices may lose a percentage of profits when things go wrong, however they will almost always have some form of security or mortgage insurance to minimise these losses.

In contrast, the potential impact on a consumer may be devastating and have wide ranging effects such as increased demand for welfare services, lower work productivity due to stress and absenteeism, and greater reliance on support networks to survive. The majority of the negative impacts when things go wrong are primarily absorbed by the consumer and society – not the institution engaging in the practice.

We submit that a legislated regime for responsible lending will help to ensure that consumers are better protected and that Australia can never head down the sub-prime path. The transfer of credit regulation to the Commonwealth provides the perfect opportunity to include 'responsible lending' in a new regulatory regime.

Recommendation 3: Principles to mandate 'responsible lending' practices should be enshrined in legislation.

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[16] *Anatomy of Australian Mortgage Stress*, Fujitsu, 2008.
[17] *Senate Select Committee on Housing Affordability in Australia*, 1 April 2008 Canberra.
[18] *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience*, Financial Stability Forum, 7 April 2008.

If you have any questions in relation to this submission please contact Rod Masson, National Communication and Policy Manager, on (03) 9261 5330 or James Bennett, Senior Policy and Research Officer on (02) 6247 7172.

Yours sincerely

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Attachment 1

Finance Sector Union – Charter of Responsible Lending
DRAFT - June 2008

The Finance Sector Union of Australia calls on all members of the finance industry and the Australian Government to adopt, implement and adhere to a national Charter of Responsible Lending. The key principles and regulatory initiatives underpinning the Charter are as follows:

- A consistent Commonwealth regulatory regime covering the provision of financial products should apply to all credit products and providers; incorporating on the highest standards of disclosure and procedural fairness, access, and affordability of redress for consumers,
- All loans and credit products must be based on a genuine assessment of the consumer's needs, the suitability of the product to meet those needs, and demonstrated capacity to meet the repayments;
- No unsolicited pre-approved credit offers should be made to consumers;
- Sales targets for finance industry staff should only be linked to remuneration if a living wage and across the board, guaranteed minimum salary increases are already in place;
- Consumers must be informed of any commissions, bonuses, incentives or remuneration implications that those making the sale may receive as a result of selling a financial product;
- Consumers must be allowed to 'opt-out' of receiving unsolicited product offers in their dealings with their financial institution;
- Information about assistance mechanisms for people facing financial hardship must be made easily available;
- All institutions must be members of an alternative dispute resolution scheme with the powers to resolve disputes without redress to the courts;
- Financial literacy and education programs must be encouraged and supported by the industry and governments and provided to the community, particularly to vulnerable or disadvantaged groups.
- Financial institutions will improve their credit risk management by developing comprehensive programs, and contributing capital, to enable consumers to reschedule credit repayments during periods of short-medium term cash flow asymmetries.

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Background

The finance industry plays an essential role in Australian society as a provider of capital, insurance, investment, personal credit, financial advice, assessment and deposit taking. In Australia, the finance industry makes up approximately 40% percent of the value of our stock market and employs around 400,000 people.

The people and practices in the finance industry determine public goodwill and confidence in its reputation and sustainability – without these it could unravel causing enormous damage to the Australian economy.

The Finance Sector Union (FSU) accepts and understands that the finance industry must be a very competitive industry; however finance products can have serious or long term implications if sold inappropriately.

Purchasing any financial product is a serious matter, especially a home loan which will usually be the biggest financial commitment a person makes in their lifetime. Financial institutions should always try to ensure that products are appropriate to a persons circumstances and do not result in people becoming overly financially committed.

Australia's level of personal debt is at record highs and continues to rise. In 1981 personal debt as a proportion of GDP was 50% by early 1999 it had risen to 100% and in 2007 it was 156%. If the current trend continues, it will reach 200% of GDP by 2015.[19] Given this trend the FSU advocates that all financial institutions adopt and that Government's enact the necessary regulation to give affect to this Charter of Responsible Lending to preserve the good reputation of our industry, the financial welfare of our citizens and the economy of our community.

Regulatory arrangements

Under the current national regulatory regime, most financial service providers are required to hold an Australian Financial Services (AFS) licence. This includes banks, credit unions, insurance companies and financial advisors. Licensing conditions include training requirements and membership of an industry alternative dispute resolution scheme.

However, the provision of credit is regulated under the Uniform Consumer Credit Code which is enacted through State based legislation. Under this regime credit providers are not automatically required to hold an AFS licence and consequently may not be members of a dispute resolution scheme.

The FSU also calls for the regulation of credit to be brought into a Commonwealth regulatory regime, consistent with other financial products to ensure that consumers have the same level of protection and avenues for redress. In addition there should be national legislation to regulate the conduct of finance brokers in the marketplace.

As part of such a regulatory regime, all providers of credit must be members of an alternative dispute resolution scheme.

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[19] *Deeper in Debt - Australia's Addiction to Borrowed Money*, Dr Steve Keen September 2007.

Credit assessment and increases

Institutions must not sell credit products to a customer unless they have carried out a genuine assessment of the customer's needs and capacity to repay the credit product.

This process must sufficiently consider the debtor's financial situation to satisfy a diligent and prudent credit provider that the debtor has a reasonable ability to repay the amount of credit provided or to be provided.

Institutions should obtain information about the customer's financial position with specific regard to:

- level and type of income; and
- all credit accounts and applicable limits and balances;
- other repayment commitments; and
- credit history.

If this process suggests that a consumer will have difficulty meeting the repayments then approval should not be given unless changes are made that would ensure the consumer has sufficient capacity to make repayments.

Institutions should not increase the amount of credit available unless the consumer has requested the increase in writing, and the credit provider has carried out a satisfactory assessment as previously outlined.

Where credit limit increases are offered they should include details about what the new minimum repayments would be if the consumer accepted the increased limit.

Unsolicited offers of credit, including credit cards and increasing credit card limits must not be made.

Sales targets and finance sector employees' remuneration

The FSU is concerned that the industry is increasingly moving towards a culture of sales targets and incentive based remuneration for employees. Achievement of targets is now explicitly linked to remuneration outcomes – unfortunately, achieving targets is now becoming the only way employees can access pay increases.

The culture of sales targets is, by definition, designed to maximise sales which (even inadvertently) will lead to a higher risk of inappropriate sales occurring. The FSU policy on performance pay[20] clearly states that sales targets or performance hurdles should only be linked to remuneration outcomes where across the board, minimum pay adjustments already exist to provide employees with sustainable cost of living and real wage growth increases. Base salary levels should reflect the professional nature of the service being provided and reflect the need to attract and retain a skilled and responsible workforce.

In addition, consumers must be informed of any commissions, bonuses, incentives or remuneration implications that finance sector employees may receive as a result of selling a financial product.

[20] *FSU Policy - Regulation of Performance Based Pay*, 2007 – www.fsunion.org.au

'Opt out'

Financial institutions that wish to offer superior customer service should offer consumers an 'opt-out' mechanism. Under such mechanisms, customers can indicate they do not wish to receive unsolicited offers of products either when dealing directly or indirectly with their financial institution. This would ensure that consumers who are not interested in additional products do not feel pressured by constant unwanted offers and ensure that finance sector employees do not have to persistently make such offers.

Assistance for people facing financial hardship

A proportion of consumers will experience financial difficulty at some stage of their lives. In many cases this will be temporary and institutions can help consumers to manage these periods if they have policies and procedures in place to provide assistance, advice and information.

These procedures should include:

- clear contact points for people experiencing financial difficulty;
- discretion to grant relief mechanisms such as deferred repayments or penalty waivers;
- contacting customers who appear to be having difficulty managing their repayments;
- referral to free and independent financial counselling where appropriate; and
- information regarding dispute resolution procedures.

Financial Literacy and Education

Given the increasing complexity and essential nature of financial services it is critical that people have access to education and information to increase their level of financial literacy. This is particularly important for young people and other potentially vulnerable groups. Industry should take a leading role along with Government in providing these education programs and include them as part of the mainstream curriculum in secondary schools.