Submission to the Parliamentary Inquiry into competition in the banking and non-banking sectors

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Dated 24th July 2008

The Committee will also identify any barriers that may impact on competition in the retail banking and non-banking sectors, and policies to enhance further competition and product choice for consumers.

Proposition:
The natural bias of the Regulator will be to consistently ratchet up the requirements and regulation in each sector of the market particularly when circumstances arise where a number of failures in a sector occur. Parliamentary emphasis should be on establishing a structure which encourages and ensures that new ventures can be established recognising that some will fail. Consumer protection should focus on high penalties for fraud and requirements for full disclosure and education.

Submission:
Government regulatory bodies in the financial services sector (APRA; ASIC; and ASX and others) have and are responding with bureaucratic forcefulness to the local effects from the sub prime crisis and global liquidity crunch.

The Credit Crunch has already removed much competition from the market. Mostly after this event the regulators are tightening a range of requirements for those that remain which is adding to cost, pushing consolidation, increasing barriers for new entrants and generally reducing competition.

This is impacting in all sectors of the market from Banks, Building Societies; Credit Unions; Finance Companies; Stock Brokers; Financial Planners and Money and Asset Managers.

The big institutions can look after themselves and have effective lobby groups in place to ensure this. Many smaller participants don't. If they are still operating there is a fair bet that they are relatively soundly based and are likely to continue.

These small operators may be single person planners, small finance companies or credit unions. These small operators exist in most financial service sectors because they meet customer's needs which are unfulfilled and or poorly served by the larger more impersonal institutions. Future "Aussie Home Loan" operators just wont appear at all.

These small often innovative and customer responsive operations are under dire attack from the well meaning but unyielding government regulators. The end game for the regulator is to reduce the risk of having a failure on his watch by encouraging mergers or closure of smaller operators in each market segment. Their natural bias is to prefer a small number of very large well capitalized organizations in each sector. This is fine for the regulator and I am sure his Minister will be relieved at the possibility of not having to deal with another embarrassing failure.

Much of the increased regulation is focused on causes of past problems and superficially appears correct in attempting to prevent future problems arising. Most have the effect of substantially increasing the cost of entry and ongoing operations (increased regulation & compliance; higher capital, liquidity & insurance requirements among others); pressure is also being applied to Trustee Companies, Auditors and the press to monitor or report or assume greater responsibility beyond the scope of their original roles again increasing costs on market participants.

Some recent examples are:

1. The ASX is moving to increase minimum capital requirements for clearing house participation from the present $100,000 to $10 million.
2. ASIC has increased the pressure and compliance on non listed issuers of debentures and on other related players such as Trustee Companies and Auditors substantially increasing costs AND also imposed advertising restrictions substantially reducing competition. Critically the flow on from decisions for example re Trustees role has seen trustees outsource to 2 or 3 lawyers/ accountants their role adding substantially to direct and indirect cost of compliance.
3. ASIC is also increasing PI Insurance and other requirements for Financial Advisers under the FSRA in addition to the existing paper war required under the FSRA – I recently had to advise a family member to decline the advice from a planner in a major bank who produced a 45 page Statement of Advice which didn't answer the question but no doubt was passed by his compliance officer!
4. APRA is encouraging mergers and consolidation throughout the Building Society and Credit Union sectors.
5. Other industry bodies are supporting the move to consolidate such as the Australian Institute of Superannuation Trustees which for prudential (read anti competitive) reasons is seeking a minimum capital qualification for Trustees of $100,000 a fund.

This direction is fine if we are happy to end up having a couple of mega sized "Woolworths" and "Coles" in the finance sector.

When the Ministers next looks round and asks where is the competition to keep the big institutions honest; or we wonder why the innovation and flexibility, albeit higher risk, of the smaller operators are no longer present, the regulator will not say he has chased them away and the cost of entry is now too high for today's entrepreneurs – the small nimble operators will be an extinct species.

If we believe in a capitalist system we should be increasing the penalties for fraudulent operators but fostering a structure which encourages small operators whether that is for stock brokers; financial planners; finance companies or credit unions. Then there will be competition, innovation and customer choice and not just large institutions too significant to be allowed to fail!

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Geoffrey Hodgkinson has been a Director of unlisted debenture issuer Westlawn Finance Limited since 2001 – this business has been in operation for more than 40 years serving the needs of the customers in the northern rivers of NSW. He has been licenced under the FSRA and served as a director of a number of Responsible Entities for managed investment schemes. He holds a Bachelor of Economics degree; is a Fellow of the Australian Society of CPAs and is a Fellow of the Australian Institute of Company Directors. He has extensive experience in the banking and finance in Australia and overseas. He is a former Assistant Governor of the Reserve Bank of Australia and Managing Director of NM Rothschild & Sons (Australia) Limited.