



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS REFERENCES COMMITTEE

Reference: Competition within the Australian banking sector

TUESDAY, 14 DECEMBER 2010

SYDNEY

BY AUTHORITY OF THE SENATE

INTERNET

Hansard transcripts of public hearings are made available on the internet when authorised by the committee.

The internet address is:

<http://www.aph.gov.au/hansard>

To search the parliamentary database, go to:

<http://parlinfo.aph.gov.au>

SENATE ECONOMICS
REFERENCES COMMITTEE
Tuesday, 14 December 2010

Members: Senator Bushby (Chair), Senator Hurley (Deputy Chair) and Senators McGauran, Pratt, Williams and Xenophon

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Coonan, Cormann, Crossin, Eggleston, Faulkner, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Joyce, Kroger, Ludlam, Ian Macdonald, McEwen, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Stephens, Sterle, Troeth, Trood and Wortley

Senators in attendance: Senators Brandis, Bushby, Cormann, Hurley, Pratt, Williams and Xenophon

Terms of reference for the inquiry:

To inquire into and report on:

Competition within the Australian banking sector, including:

- (a) the current level of competition between bank and non-bank providers;
- (b) the products available and fees and charges payable on those products;
- (c) how competition impacts on unfair terms that may be included in contracts;
- (d) the likely drivers of future change and innovation in the banking and non-banking sectors;
- (e) the ease of moving between providers of banking services;
- (f) the impact of the large banks being considered 'too big to fail' on profitability and competition;
- (g) regulation that has the impact of restricting or hindering competition within the banking sector, particularly regulation imposed during the global financial crisis;
- (h) opportunities for, and obstacles to, the creation of new banking services and the entry of new banking service providers;
- (i) assessment of claims by banks of cost of capital;
- (j) any other policies, practices and strategies that may enhance competition in banking, including legislative change;
- (k) comparisons with relevant international jurisdictions;
- (l) the role and impact of past inquiries into the banking sector in promoting reform; and
- (m) any other related matter.

WITNESSES

BYRES, Mr Wayne, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority	2
CARTER, Mr Leon, National Secretary, Finance Sector Union of Australia.....	43
DALTON, Mr Chris, Chief Executive Officer, Australian Securitisation Forum	16
KHOO, Mr Brandon, Executive General Manage, Specialised Institutions Division, Australian Prudential Regulation Authority	2
KOCH, Mr Don, Chief Executive Officer, ING Direct.....	135
LAKER, Dr John Francis, Chairman, Australian Prudential Regulation Authority.....	2
LLOYD, Mr Richard, International Policy Adviser, Choice	27
MASSON, Mr Rodney, Director, Policy and Communication, Finance Sector Union of Australia.....	43
MOTT, Mr Jonathan, Bank Analyst, UBS Securities Australia.....	144
MULLINGTON, Mr Mark, Chief Financial Officer, ING Direct.....	135
MUNCHENBERG, Mr Steven, Chief Executive Officer, Australian Bankers Association.....	80
NAYLOR, Mr Phillip Gordon, Chief Executive Officer, Mortgage and Finance Association of Australia.....	67
SELL, Mr Alex, Chief Operating Officer, Australian Securitisation Forum	16
STACE, Mr Nicholas, Chief Executive Officer, Choice.....	27
STAMOLIS, Mr John, Statistics Director, Australian Bankers Association	80
SYMOND, Mr John, Executive Chairman, Aussie Home Loans	109
TATE, Ms Diane, Policy Director, Australian Bankers Association	80
ZINN, Mr Christopher, Director, Communications, Choice	27
ZUMBO, Associate Professor Frank, School of Business Law and Taxation, University of New South Wales	53

Committee met at 8.04 am

CHAIR (Senator Bushby)—I declare open this second hearing of the Senate Economics References Committee inquiry into competition within the Australian banking sector. On 28 October 2010 the Senate referred this inquiry to the committee for report by March 2011. To date, the committee has received over 100 submissions, which are available on its website. The committee will hold public hearings today in Sydney and tomorrow in Canberra. Further hearings are planned for Brisbane and Melbourne next month. These are public proceedings, although the committee may determine or agree to a request to have evidence heard in camera.

I ask photographers and cameramen to follow the instructions of the committee secretariat and ensure that senators' and witnesses' laptops and personal papers are not filmed. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as contempt. It is also contempt to give false or misleading evidence to a committee.

If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may, of course, also be made at any other time.

I remind members of the committee that the Senate has resolved that departmental officers shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions to superior officers or a minister. This resolution prohibits only asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

[8.06 am]

BYRES, Mr Wayne, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority

KHOO, Mr Brandon, Executive General Manage, Specialised Institutions Division, Australian Prudential Regulation Authority

LAKER, Dr John Francis, Chairman, Australian Prudential Regulation Authority

CHAIR—I welcome the Chairman and representatives of the Australian Prudential Regulation Authority. I invite you to make an opening statement.

Dr Laker—As you know, APRA has provided a submission to the committee to assist it in its inquiry. I wish today only to draw out two general points from that submission.

Firstly, APRA is a prudential supervisor and our main focus is financial safety. Our mandate is to promote the sound and prudent management of the institutions we supervise so that, in the case of deposit taking, the institutions meet their promises to depositors under all reasonable circumstances. We are required under our legislation to balance this objective of financial safety with efficiency, competition, contestability and competitive neutrality. Beyond that, we do not have any specific responsibility for competition in the deposit-taking sector. Of course, having prudently managed and well capitalised deposit-taking institutions surely lays the foundations for sustainable competition. Unless APRA are overzealous—and I do not believe we have been—there need be no difficult trade-offs between financial safety and competition over the longer term.

Secondly, the prudential framework in Australia applies with few exceptions to banks, building societies and credit unions equally. Where it does not, there are prudential policy considerations—long-standing in one case—that justify a degree of differentiation. Overall, APRA does not consider that the prudential framework or its risk based approach to supervision acts as an impediment to a competitive banking system in Australia.

CHAIR—Thank you for that and thank you for your submission as well, which is very useful for the committee in understanding the prudential regulation side of the banking industry. A lot of the submissions that we have received have raised issues with regard to access to funding, particularly from lenders other than the major banks, and the cost of that funding. A lot of the submissions have also raised the issue of covered bonds, which has since been addressed by the Treasurer in his reform package announced on Sunday. What is APRA's view on covered bonds?

Dr Laker—We have had a very simple view on covered bonds for a long period of time. I have articulated that in our annual reports. Under the Banking Act 1959—I think it is section 13 in its current formulation—depositors must stand first in the queue in the event that a bank or other deposit-taking institution is put into liquidation. That section in the Banking Act has always precluded the introduction of covered bonds in Australia. We have had extensive discussions with industry about structures that they have put to us over time, but these structures

ran into that very straightforward depositor preference requirement of the Banking Act. The proposals from the government have addressed that by stating that they will seek to amend the Banking Act to allow for the introduction of covered bonds. That opens that possibility up. We look forward to working with the government on a legislative framework that will allow covered bonds to be introduced into Australia while at the same time balancing the interests of depositors. We look forward to working with the government on that.

CHAIR—You mentioned that your views had been previously stated and were well known. Have you made any statements that would have gone any further than just the fact that the Banking Act says that depositors' funds should take precedence and therefore that is the only impediment?

Dr Laker—That is all I have ever said on the subject. We have not been required to form a view about a particular structure or another type of structure, because all of those structures have failed to meet the test of ensuring that depositors had first preference in a wind-up. Our role was really to enforce the Banking Act 1959, which is our role as the prudential supervisor.

CHAIR—One of the other so-called reforms was enabling a number of credit unions and building societies to assume the title 'bank', but the reality is that that is nothing new, is it? According to Abacus, there are 27 credit unions and building societies currently that could, as of right, approach APRA and seek to use the term 'bank'. Is that correct?

Dr Laker—That is correct.

CHAIR—Is there anything in the Treasurer's announcement that changes their rights to do that? I know that there is also a separate issue where they are going to explore—

Dr Laker—We will review.

CHAIR—So you will be charged with exploring the circumstances in which an ADI can call themselves a bank. I think the Treasurer referred to 20; Abacus there are 27. I am interested in your view of how many institutions could actually today claim the right to call themselves a bank. There is nothing that has changed as of Sunday?

Dr Laker—This particular issue has a long history. It goes back to a requirement that was in the Reserve Bank's authorisation guidelines. For an institution to use the term 'bank' in its name, it had to be an institution of substance. The substance test that was introduced by the Reserve Bank then was a \$50 million minimum tier 1 capital.

CHAIR—When was that introduced?

Dr Laker—That was in 1992. That has remained unchanged in our authorisation guidelines from that date, with the exception now that we apply it across the board—it encompasses banks, building societies and credit unions—and any of those authorised deposit-taking institutions that wish to use the word 'bank' in its name needs to meet that substance test. That is all it needs to do. The common parlance you read is 'we want to convert to a bank.' There is no conversion in this process. The only conversion is your naming and signage.

CHAIR—Because they already meet all the common requirements—

Dr Laker—Yes, and we supervise them on the basis of their risk profile and their likely impact on the financial system, not on whether they happen to be called a bank, building society or credit union. We have said all along to our institutions that if they wish to use the term ‘bank’ in their name, and they have the \$50 million in tier 1 capital, they can come to us and we would grant that exemption quite straightforwardly.

CHAIR—There was a change some years ago—and you mentioned in passing just then—where previously a mutual would have had to demutualise in order to become a bank, but that was changed some time ago as well. Is that correct?

Mr Byres—Could I perhaps answer that. I think what you are thinking of reflected the regime that existed pre-APRA, where the Reserve Bank supervised banks, and building societies and credit unions were supervised under a separate regulatory regime. If an organisation that was not a bank wanted to convert to a bank, they were not just changing their name but also converting to a different regulatory regime.

CHAIR—Between 1992 and when APRA was set up—

Mr Byres—In 1998.

CHAIR—You would have had to demutualise. But since APRA was set up and the ADI structure as we know it now was put in place, any ADI that had \$50 million in tier capital would as a right be able to call itself a bank.

Mr Byres—That is correct.

CHAIR—Have any of them done that since then?

Dr Laker—We would have to go back in time. Some building societies converted very early in the piece, but there has not been any conversion of the name that I am aware of.

Mr Khoo—I believe there was one around the transition period when the financial institutions, being the credit unions and buildings societies, transferred across to APRA. I think that process started just before.

CHAIR—Did that remain a mutual bank?

Mr Khoo—No, it did not.

Dr Laker—Credit unions and buildings societies can use the term ‘banking’ in their descriptors. So it would be quite acceptable under a general consent we gave back in 2000 for XYZ credit union to say, ‘Your banking needs met in your town.’ That usage of the term was cleared by us some years ago. It is only when you want to use the term ‘bank’ or the personal term ‘banker’ in the name of the institution that you need to pass that substance test.

CHAIR—What is the policy thinking behind the requirement that there is a level you need to reach before you can call yourself a bank?

Dr Laker—The thinking at the time that the Reserve Bank introduced it was, as I said earlier, a test of substance, that the community has a view that banks are intended to be strong, durable financial institutions. The Reserve Bank underpinned that view by saying that, to use the term bank in your name, you need to meet that substance test.

CHAIR—Is that for confidence reasons? Pyramid went under some years ago. It was very high profile but possibly did not have the same impact on public confidence in the financial institutions as if it had been a bank that had gone under.

Dr Laker—The term does have a cachet of durability and strength. That has been the policy environment for the last 20 years. But we have said to the government that we will review the policy, and I will go into that review with an open mind and see what the issues are. There are a number of complex issues involved here, including, most importantly, financial stability impacts and customer understanding impacts. It will need careful consideration, and we will do that.

CHAIR—The fact that the \$50 million threshold has not been reviewed since 1992 has already probably allowed a number of smaller institutions, in relative terms, to qualify as it is.

Dr Laker—It is not the \$50 million that has allowed some of the smaller institutions to qualify; it is the fact that there is no minimum requirement to become an authorised deposit-taking institution. I was not in APRA at the time but I think the decision then—and Brandon was involved in it—was to take the whole of the population of building societies and credit unions into the APRA fold and under the coverage of the Banking Act without imposing ex post facto a minimum requirement. To be a general insurer there is a minimum requirement of \$5 million in tier 1 capital and \$10 million for life insurance, so in the other industries there are minimum requirements. We have smaller ADIs that are below those cut-offs.

CHAIR—Some below \$2 million, I understand.

Dr Laker—That is not what we have been asked to look at, but it will be something that will obviously be part of our broader considerations.

CHAIR—It is relevant to the examination.

Dr Laker—The Productivity Commission also reviewed this issue this year when it was revisiting some of the regulatory impacts and its report argued, in a sense, for maintaining the status quo. It could not see a policy reason for changing that. So we will not be the first to review this issue.

Senator HURLEY—I am thinking of the Basel III reforms. If we start having reforms coming in with regard to capital framework, ratios and so on, suppose one of the ADIs either cannot make them or does not want to, is not any problem as a banking institution but wants to get out of it, what would be the process?

Dr Laker—You have asked two possibilities there: if they cannot but want to, or if they do not want to. On the first, if they want to but at the moment are unable to raise the capital, there are transition arrangements built into the introduction of Basel III. In the capital area there are quite generous transition arrangements which are available in the global framework. We, in all of the policy measures we take, will look at sensible transition so we would handle that particular set of circumstances by transition and allow enough time, provided the entity has a credible plan to build capital. We would work on that basis.

If an entity wishes to leave, we do not have a padlock on the door. We would be particularly interested in an orderly exit. A number of institutions have exited the ADI industry in Australia by merging with larger institutions. That is quite a common way in which the credit unions as an industry have handled exits, and that has worked very well. They can simply come to us and surrender the authority and, again, we would look for a sensible transition to protect the depositors all through that period as they were leaving. But that option is equally available to them so there is no padlock on the door. If they do not wish to be in the business, there is exit as well as entry into our banking system.

Senator HURLEY—But you do have control from when they make that decision through to the disposal of the assets?

Dr Laker—It is a very important process because all the way through the Banking Act requirements and our prudential requirements remain in place and we are particularly focused on the safety of depositors and financial stability more generally. A disorderly rundown of assets, a denuding of risk management staff and other key staff during that process are all of particular concern to us. We have managed run-offs in other industries, not as a common part of our business though it is not uncommon, and we are watching that process very closely right through to the very end.

Senator XENOPHON—Dr Laker, the safety of depositors is obviously APRA's primary concern, but you can still have a safe system and one that still delivers competition. They are not mutually exclusive, are they?

Dr Laker—No, and that is what I said at the outset.

Senator XENOPHON—So do you think that under our current system there is enough contestability and enough competition to deliver the best outcome to consumers?

Dr Laker—It is not an issue that APRA would have a view on because we are not a competition regulator. What we do when we introduce new policies is go through an extensive consultation process with industry. In that process we hear pretty loud and clear whether any of our particular proposals are going to cramp competition or favour one particular part of industry over another. We are certainly alert to that. People who contribute submissions are quite vocal in making those points to us and it is why in the end when we finally sign off and put our standards before the House as disallowable instruments we have in our view addressed those concerns, and we seek to apply those prudential standards neutrally.

Senator XENOPHON—Perhaps I could ask this another way. Do you think that if there were a greater degree of competition in the system, if competition were injected into the system, it

could be done without compromising the safety and stability of depositors' deposits and the safety of the system generally?

Dr Laker—The short answer to that would have to be yes. But I would caution that in the period 2002-03 we did see quite strong competition in housing lending which took the form of a dilution of credit standards, and that was a form of competition which we were uncomfortable with—

Senator XENOPHON—Were those the low doc loans, for instance?

Dr Laker—Not low doc loans, per se, but credit underwriting standards. No doc loans would be closer to the sorts of concerns we would have. But there was just a competitive pressure to meet the customer by finessing, overriding or changing strong credit standards in some cases and it was an issue that we were vocal about at the time. That is competition which does raise prudential concerns. And of course if you look at the subprime experience in United States, you will see that whole problem writ very large. As I say, we have to balance financial safety with these other considerations but there are some competitive behaviours which trouble prudential regulators and we need to address them.

Senator XENOPHON—Sorry, but can you elaborate on that?

Dr Laker—As I say, the competition for lending via reductions in your underwriting standards.

Senator XENOPHON—Finally, on pages 8 to 10 of your submission you refer to the Basel III reforms and this concern:

Australia cannot meet the LCR—

liquidity coverage ratio—

standard as originally proposed, because the supply of Commonwealth Government Securities and other eligible liquid assets are limited in Australia.

There is a perception amongst some that it will cost more for credit in this country as a result of stricter standards that are really designed for other countries that do not have as robust and as safe a financial system as ours. Is that so?

Dr Laker—I think I would be paraphrasing the governor, but both he and I have said this on separate occasions: the cost of finance globally is higher now than it was before the crisis and one of the major reasons is that risk was being underpriced in those heady days of 2005, 2006 and 2007. So the risk premium that was being built into the interest rates charged was too low for the fundamental risks and you are seeing across the globe a repricing of risk and that affects all banking systems.

Senator XENOPHON—And Basel III is part of that, isn't it?

Dr Laker—Basel III is underpinning the capital of the banking system globally and it is also strengthening capital and liquidity buffers in the global system. We are participants in the global system. That is the general framework for banking from 2011 onwards. When Basel brings out its proposals that is the new world that we will be operating in.

Senator XENOPHON—So Australia has to cop it because we are part of the global system in a sense.

Mr Byres—As John has said, there are two aspects to Basel III: one is on capital and one is liquidity. On capital, our banks came through the crisis very well. We have always said that the Australian banking system was well capitalised, and we do not think our banks will have particular issues in meeting these new capital requirements. When it comes to liquidity, this is the first time that the Basel committee has had a global liquidity standard. There is no doubt that there are challenges for our banks in meeting that standard but also it is not as though our banks sailed through the crisis without any liquidity issues. We know they needed the wholesale guarantee for offshore funding and the deposit guarantee. There were various sorts of assistance that were given to the banking system to help it through the crisis and to help make sure that it was able to continue to operate in an orderly fashion during the crisis. What the Basel III liquidity requirements are about is trying to lessen the need for that public sector support next time around. So it is not as though our banks were as robust on the liquidity front as they might have been or could say, ‘We don’t need any reform whatsoever on that side of things.’

Senator XENOPHON—Will the consequences of the Basel III reforms mean that we will be paying more for money in Australia? Will credit cost more as a result of Basel III?

Dr Laker—I think credit has cost more already as a result of the global financial crisis. I think that is the fact that we have all seen in the presentation from the RBA. We have seen how much those risk premiums have increased since the crisis. Over time when these new capital reforms are bedded down globally if that underpins more confidence in global banking systems you might like to think that some of those more extreme risk premiums can come down. But the reforms are not in place.

Senator XENOPHON—Sure. But do we expect that there will be an increase in the cost of money as a result of Basel III reforms and will that have a disproportionate impact on the smaller banks and the mutuals in Australia compared to the big four?

Dr Laker—If I can answer on the capital front, and as Mr Byres has said, we have always been conservative with our capital rules in Australia. They have served us well. We have said to industry that there will be some adjustment as a result of Basel III because it is a tougher regime globally. But we have already taken some of those harder decisions, back in 2005 and earlier, so we are well placed to meet that.

We will have a look at the differential impacts when the Basel III capital reforms are announced and we will then put that out for consultation. So we will have a long time to have a look at the impact of that. At first blush it may well hit harder on some of the larger of our institutions because there is a tightening of the deductions rules and a tightening of the eligibility criteria for hybrid capital instruments which our larger institutions make more use of.

Senator XENOPHON—So the big four will be affected more than the smaller institutions?

Dr Laker—We will have to look at the numbers on that. Prima facie they have more adjustments, but it depends on their starting point. On liquidity, the Basel III reforms will be out hopefully by the end of this year. They will acknowledge that Australia has unique circumstances when it comes to the supply of high-quality liquid assets needed for that buffer. We have been working with the committee for a sensible outcome and I think we will be able to announce that when we see the final language. We will also be saying though that the smaller institutions will not be subject to that LCR regime. Smaller building societies, maybe a couple of banks, but also our credit unions work on a simpler liquidity framework. It has served those less complex institutions well and they will stay on that.

Senator WILLIAMS—I want to take you to ADIs. I had serious concerns when the government guaranteed those deposits up to a million dollars with the registered ADIs but not in those smaller companies that were not ADIs. How difficult is it for those smaller companies to become ADIs so that they could attract the guarantee? What is the cost process and how long would it take?

Dr Laker—So that they could be covered by the financial claims scheme?

Senator WILLIAMS—Yes.

Dr Laker—We set out in the submission the requirements that an institution needs to meet to become an ADI. It needs to have adequate capital for the sort of business that it wants to take on. It needs to have a strong and robust board if it is coming into Australia and we are presuming it is here already but wants to be a locally incorporated ADI. It has to have strong risk management systems and strong personnel that can run those systems. There are a series of criteria that we will put these institutions through. It is the same for any applicant from any country, local or otherwise, the rules are applied evenly. It is a tough test to get past.

We are not in the business of allowing institutions to operate in a tough competitive market and fall over at the first knock. If I were to use a football analogy, we want to make sure that anyone who runs on the field to play is fit to play and is skilled enough to play. Much depends on what that institution's business ambitions are and whether it is really in the right place for what it wants to do. How long it takes depends on the quality of the application. It is not a quick process and some processes have been quite protracted not because we sit and wait to read the files but because we go back and ask for more information. The speed of the application is governed by the speed with which we can get that material from the institution. As you would expect, to become an authorised deposit-taking institution in Australia is not just turning up for a rubber stamp. It is not that at all.

Senator WILLIAMS—Was it the case in New Zealand that the investment guarantee by the New Zealand government covered not only those ADIs but also those smaller companies as well?

Dr Laker—It covered finance companies but that was in the context of considerable stress in the finance company industry and also in the context of these companies coming under the supervision of the Reserve Bank of New Zealand.

Senator WILLIAMS—Thank you.

Senator PRATT—In your opening remarks about competition, you emphasise financial safety. I am just drawing on Abacus's submission here. They have noted that you as a regulator are required:

... to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

To some extent our discussion with them yesterday highlighted that at times it seems that the rules seem to be created largely to suit banks rather than the broader array of banking institutions and that there could be a greater effort to look at the kind of regulation that could support a diversity of institutions without undermining that financial safety and security. What would you say to that?

Dr Laker—Without knowing what Abacus was actually quoting as examples, I would challenge the general proposition because the prudential framework in Australia and the way we actually implement it is quite neutral across those industries. We speak to Abacus quite a lot. I would like to understand what particular examples Abacus have in mind where they believe we have erred on the side of safety over competition. It is a very general statement and I would challenge it as a general statement.

Senator PRATT—Not being an expert in the nitty-gritty of these regulations, I can only draw on a rather simplistic example from their submission which I suppose does not really go to the heart of the financial security but rather to the marketing questions. We have had some discussion already this morning about use of the terms 'bank' and 'banking'. I believe they had problems last year in the use of the terms in their advertising campaign. I am interested in the history of that decision from your point of view.

Dr Laker—I cannot add to what I have already said on the subject. We will be reviewing the authorisation guidelines. We will be looking quite closely at how the community perceives these different terms and whether there is a concern about perception. We will be talking to the institutions who could call themselves banks but do not. We really want to understand the concerns, but we will do this review and I will go into that review open-minded. What is left out of the quote about our obligations is that we have to balance all of those various policy objectives but, in doing so, we have to promote financial system stability in Australia. That is in our act and that is our driving mantra: financial system stability. It is not as if I have a choice.

My colleague has drawn to my attention that one of the issues that Abacus raised is aggregation, and that was discussed yesterday. We have worked with the industry on proposals to deal with the raising of capital and there is an aggregation model that is now out in the industry. It has been approved by us. We have worked closely with them. We have had discussions more recently about an aggregation model for raising liquidity and, again, we are working closely with them. That is back with industry to work further on that. They know our requirements. We think we can see a way through with these things.

Senator PRATT—I think that is probably a good example of the emerging things that can be done where the capital is there but it is across a number of organisations. If it is possible to aggregate so that those institutions can strengthen their position in the market then that is a good

thing. That is a very good example of the kind of approach that should be encouraged so that the competitive neutrality of the way these things are arranged can be supported.

Dr Laker—In APRA we need no persuasion if institutions want to raise capital. We certainly would not be stopping that. We need no persuasion if institutions want to raise liquidity—the more the better up to a point. What we do need to make sure of is that when you are aggregating the mechanisms and the frameworks for raising capital or liquidity, you are not putting at risk the depositors of the individual institutions that form that aggregation. We have to look beyond the general principle that more is better to determine whether we have established a prudent precedent and whether we are allowing a structure which is built on a deck of cards, in a colloquial sense. So we look at that very closely and we did in the case of the capital raisings with the mutuals, and that structure is in place. We have not been an impediment. We are comfortable with it. It is a durable structure and we would look for the same durability in any aggregated liquidity facility.

Senator PRATT—Okay. The Bank of Queensland in its submission claimed that APRA's recent instructions regarding its interpretation of APS 120 were an impediment to competition. I want to know how you would respond to that.

Dr Laker—I do not particularly want to respond to an individual submission. What I would say is that what we did in clarifying our requirements was in fact promote neutrality, because we had a circumstance where some institutions were interpreting the requirements APRA imposes on securitisations quite correctly and others had interpreted them incorrectly. We felt it was not proper for institutions to be able to get an advantage on the basis of how they interpreted our rules, so we issued a statement clarifying those rules. We were really only trying to make sure there was a level playing field. I do not regard that as a negative regulatory intervention; I regard that as a quite positive clarification that ensures a level playing field. That is why I say we look at all times at what is the impact of our rulings, our letters on all sectors of the industry.

Senator CORMANN—From your opening statement, and you have mentioned it again now, your primary focus is on financial safety and you balance it off, to the extent you can without compromising that, against competition and other issues. In recent years there has obviously been an increase in concentration of banking in larger private institutions. With current policy settings, including the prudential oversight policy settings, do you think it is inevitable that that trend of increasing concentration in larger private institutions will continue, moving forward?

Dr Laker—We do many things in APRA, and I hope that we do them well, but we do not do crystal-ball gazing. I do not know what the next decade in banking will look like in Australia but there clearly has been, post the crisis, a consolidation in banking systems around the globe as a result of various rescues and rationalisations. There has been a consolidation trend globally. In APRA we in a sense deal with the cards that are dealt to us by the marketplace, so we need to respond but we do not seek to engineer a particular competitive structure or ownership structure.

Senator CORMANN—You say there has been a consolidation trend globally post crisis, but in Australia that consolidation trend was well and truly on the way pre crisis, wasn't it?

Dr Laker—There certainly has been a narrowing in the number of authorised deposit-taking institutions in Australia over the course of the last 20 years. That consolidation has mainly taken

place at the smaller end of the market through the merger and exit of credit unions; that has been a pronounced downward trend. But of the institutions that Mr Byres supervises, which are our more diversified institutions, he keeps reminding me that his numbers are not falling, that there are new entrants into the Australia marketplace from offshore which are continuing to provide a competitive impetus.

Senator CORMANN—Do you agree with the proposition that the large banks have in fact become too large to fail? What are the policy implications of that, if any, from your point of view?

Dr Laker—We never ever confess that any institution is too large to fail. There is a marketplace at work there and we have seen institutions around the globe that were household names that have moved into government ownership in other markets. What we seek to do is to minimise the risk that that will happen with any institution of any size.

Senator CORMANN—But experience through the crisis, again globally, has indicated that governments will not allow banks of a certain size to fail because of the social implications of that. That does not have any implications in terms of your own internal risk assessments on how you approach things?

Dr Laker—We approach each institution as an institution that is subject to market forces, to the risk of poor management and strategic mistakes. We do not ease back because of any perception in the community. But I would also add that there is a very vigorous debate taking place globally on ‘too big to fail’, and we regulators are constantly reminded that Northern Rock before the crisis might not have been deemed to be too big to fail but it did have a very important systemic influence. We are very reluctant to categorise.

Senator CORMANN—We are running out of time so I have two quick questions. You know that 25 mutuals are large enough to apply for a banking licence but have chosen not to do so. Have you any indication why they choose not to use the word ‘bank’?

Dr Laker—No. We have not talked to them about it. Brandon has had discussions with a couple of them. We will be talking to them about it in the context of that review.

Senator CORMANN—I have a final question. Some of the smaller banks have argued that the major banks are able to use the advanced approach rather than the standardised approach to calculating required capital and that, as a consequence, they have to hold significantly less capital against home loans. Is this right and, if so, what would these banks or large mutuals have to do to be allowed to use the advanced approach?

Dr Laker—The answer to that question is in the submission where we looked at that particular point, because it is raised from time to time. To be able to use the advanced status you need to have very sophisticated risk modelling, robust risk management and quite deep, extensive databases and then you can manage housing-lending portfolios using a much more rigorous method. There is a complete overlay of governance and controls on top of that. You need to do that not just for your lending to housing but for how you manage operational risk and how you manage interest rate risk on the banking book. So to be called an advanced bank requires a very comprehensive set of requirements.

Senator CORMANN—It is a barrier to entry for the smaller banks, isn't it? If you are a smaller bank using the standardised approach there is no prospect, even if you have a lower risk profile, that you could reduce your capital requirements?

Dr Laker—It depends on where you want to do the cut-off, but some of the non-major banks are talking to us about moving to that stage. We are in discussions with them. So it is not that exclusive. But I would just make two points, given the shortness of time. Firstly, this is a global framework; it is not an APRA framework. That distinction between the advanced and standardised banks is global and it was deliberate. It was done to encourage people to move to better risk management and risk modelling. Secondly, when we look at how it all washes out, with all the various changes, it is not clear from our evidence that there is a major difference in the impact of Basel II between the advanced and standardised banks when you put it all together.

CHAIR—Just one final comment: you mentioned that APRA is particularly focused on the safety of deposits. I guess, given the decision by the government to make the deposit guarantee permanent, what that effectively means is that you are now primarily concerned with ultimately protecting taxpayers funds? I will leave that open.

Dr Laker—Can I get the last word? The Banking Act says that we must 'exercise our responsibilities to protect the interests of depositors'. Unless that particular clause in the Banking Act is changed, our working mandate is set out in law and I know you will hold me accountable.

Senator BRANDIS—I am really pursuing the issue that Senator Pratt and Senator Cormann in different ways have pursued. I note, Dr Laker, you say that competition or competitiveness is not your primary responsibility, but there is a relationship, isn't there, between the extent of potential regulation and the extent to which the system will be competitive?

Dr Laker—Yes.

Senator BRANDIS—In particular, it is the case, isn't it, that the more onerous the prudential regulation the less competitive the system will become at the lower end if the smaller ADIs do not have the capacity to meet the prudential standards which the larger institutions would have no difficulty in meeting? That is generally true, isn't it?

Dr Laker—I said publicly that a prudential regulator that is overzealous in implying regulation can, in a sense, harden the arteries of the financial system and we are certainly alert to that. If we were overprescriptive, it is quite possible that we would be choking not just the smaller players but also the larger players.

Senator BRANDIS—Dr Laker, you said in your opening statement, and I wrote it down: 'We seek to apply these prudential standards neutrally.' But, in fact, there is no such thing as pure neutrality, is there, when the market has such a variety of different players, from extremely large institutions which are heavily capitalised to much smaller institutions which have a smaller market share. Can I suggest to you, with respect, that the idea that prudential standards can be competitively absolutely neutral is just not right?

Dr Laker—I have never said that they were absolutely neutral. To take an example of, say, governance, we apply those governance requirements across the board to our institutions. But

where we have been prepared to provide concessions and support it has been at the smaller end, because some of these institutions, for example, are not sufficiently resourced to have their own internal audit function or various other committees and we allow them to outsource.

Senator BRANDIS—That is right.

Dr Laker—In that case we look at the impact of our standards on the smaller players. In the case of our liquidity requirements there is a simpler set of requirements for the smaller institutions which meets our needs and meets their needs. So this is not a one-way street.

Senator BRANDIS—No, but there is a trade-off, isn't there, between competitiveness and freedom from risk?

Dr Laker—Yes.

Senator BRANDIS—I have one final unrelated matter. Was APRA consulted by the Treasurer in relation to the package of measures he announced on Sunday?

Dr Laker—Yes.

Senator BRANDIS—When was APRA first consulted by the Treasurer in relation to that package?

Dr Laker—This package has a long genesis and the issues that were traversed in that package have been issues that, for example, the Council of Financial Regulators has had on its agenda for some time.

Senator BRANDIS—But when were you first consulted specifically in relation to the package announced on Sunday?

Dr Laker—I am not sure of the exact time, but we are going back several months when this was in its early stages of being put together.

Senator BRANDIS—Did you put a written submission to the Treasurer?

Dr Laker—Not in respect of the package as a whole. Of course, we only saw elements of the package that were relevant to APRA, so we were involved in discussions about how the package would be put together.

Senator BRANDIS—What about the measure in relation to the badging of smaller ADIs as banks? Was that proposed by you?

Dr Laker—Was that proposal put to me?

Senator BRANDIS—No, was that proposal part of your submission to the Treasurer?

Dr Laker—I provided advice to the Treasurer on that particular part of the package.

Senator BRANDIS—Was that part of the announcement an announcement that arose from, among other things, a recommendation of APRA?

Dr Laker—The Treasurer, I think, was responding to a number of submissions that had been put to him by industry. He discussed that with me. I gave him our views on the subject and that has led to the request for a review. I have been asked to undertake a review, which will give us a little time to look at a range of issues that are caught up in this. We are quite comfortable with how that has been—

Senator BRANDIS—I do not want to trap you too closely—

Dr Laker—We have had this discussion before.

Senator BRANDIS—but was that an APRA recommendation? Was that part of the announcement among APRA's recommendations to Mr Swan?

Dr Laker—The announcement by the Deputy Prime Minister stated the fact that institutions could apply to APRA and we made that point very clear. The review was a request from the Treasurer, which we were happy to do.

Senator BRANDIS—I take that as a no. Thank you.

CHAIR—Thank you to Dr Laker and to APRA.

[8.53 am]

DALTON, Mr Chris, Chief Executive Officer, Australian Securitisation Forum

SELL, Mr Alex, Chief Operating Officer, Australian Securitisation Forum

CHAIR—Welcome. Do you have an opening statement?

Mr Dalton—Firstly, I would like to apologise for the fact that the Head of our Regulatory Subcommittee, Guy Bocacello of Westpac, is unable to join us this morning. The Australian Securitisation Forum appreciates the opportunity to meet with the committee this morning. With respect to your inquiry, we would just like to highlight the central thrust of our submission.

In our submission we raised three central points. Fundamentally, we believe that competition in Australia will be underpinned and sustained by the system and the participants having access to wide sources of funding and access to funding at cost-competitive and cost-effective rates. We point to the benefits and the recognition that securitisation has in the financing of both the bank and the non-bank sectors in the Australian financial market. Our submission argued that covered bonds have a role in expanding and widening the investor base and in diversifying the funding base of ADIs. Thirdly, we submit that the key to the continued recovery of the securitisation market in Australia revolves around improving and widening the investor base for residential mortgage backed securities and, more broadly, asset backed securities and that through the corporate bond market we potentially could have greater interaction and greater funding being provided by the superannuation sector of the Australian banking and securitisation markets.

They were the three major points in our paper. With the announcement by the Deputy Prime Minister and Treasurer on Sunday regarding covered bonds, we would be happy to speak more specifically this morning with respect to views on the securitisation market. We welcome the announcement by the Treasurer of the additional \$4 billion to be invested in residential mortgage backed securities. We have a number of thoughts around how that could potentially be most effectively utilised to stimulate the market. We are particularly supportive of and encouraged by the interest of the government in promoting and facilitating the evolution of bullet style residential mortgage backed securities. I have spoken about the benefits that we see for covered bonds. We would note that we see a potential for an Australian domestic market for A\$ denominated covered bonds to develop in the future, which would allow the smaller ADIs to have access to that form of funding. We would expect the larger ADIs and the major banks to be able to access international markets initially and more quickly.

In finalising these opening remarks we also highlight to the committee that our ongoing interest is in the coordination of the regulatory approaches amongst Australian financial regulators. We also argue that the Australian financial system, and specifically securitisation, will need to continue to work towards having global regulators deem and view Australia regulations to be equivalent to what they are now revising and establishing in their jurisdictions. Finally, we would like to point out that, whilst we welcome the confirmation of the permanency of the Financial Claims Scheme, we do have an interest in ensuring that that does not skew the

availability of finance for small business and the self-employed that may be funded through non-ADIs sources.

CHAIR—Securitisation in the Australian market was certainly a rapidly developing phenomenon prior to the GFC. Would the main form of securitisation in Australia have been residential mortgage backed securities?

Mr Dalton—That is correct. It has always been the dominant asset class, although prior to the crisis there was a more substantial sector for asset backed securities that financed, for example, vehicles—car loans, car leases—equipment leases and other forms of finance for business. We also had a reasonable commercial mortgage backed securitisation sector, which financed established commercial industrial properties. Post crisis, the commercial mortgage backed sector is all but in wind-down mode at the present time. It is encouraging that this year, coming up to the end of 2010, we have had 11 issues of asset backed securities, albeit of smaller size. That sector is showing signs of recovery and investor appetite, and I think that is particularly important for finance that goes directly to small business and self-employed—

CHAIR—And that is occurring without any assistance from government?

Mr Dalton—It is, yes.

CHAIR—It is just organically recovering.

Mr Dalton—It is organically recovering. Probably even pre crisis the market for those securities was largely domestic, so it has been the domestic institutions that have again been prepared to invest in these securities post crisis.

CHAIR—We have seen a degree of recovery in the RMBS, assisted by the AOFM.

Mr Dalton—Yes, the AOFM has played an important role in both fundamentally sustaining the businesses of some of the smaller players through the worst aspects of the crisis and providing important signals to the investment markets that the government sees that securitisation is an important sector of the financing of the Australian economy and that the government has an interest in seeing that the sector recovers.

CHAIR—What percentage have we got to now, in terms of activity or dollars, compared to where we were at the peak, prior to the GFC?

Mr Dalton—In round figures, at the peak securitisation probably accounted for around \$60 billion worth of issuance. With respect to RMBS, which was the major asset class issued offshore, probably half of that was purchased by global investors, so that is approximately \$30 billion. We expect for the entire market, come the end of December, that we will have issuance this year of around \$25 billion. A few billion of that will be related to the asset backed sector, so in the domestic market we are getting back to 80 per cent of what the domestic market was purchasing pre-crisis. What has been completely absent is the investment by overseas investors in Europe, London and the US.

CHAIR—That is consistent with what the Reserve Bank governor said yesterday, basically—that at a domestic level we are getting closer to what the natural level was prior to the GFC. But he did also state, though, that most of the international investment in Australian RMBS was conducted by institutions whose business models have proven unsustainable and they are unlikely to come back into the market. Do you agree with that?

Mr Dalton—Yes. I think it is just a statement of fact that vehicles such as the structured investment vehicles, SIVs, and some of the hedge funds are probably unlikely to come back. Certainly the SIV is a not a business model that is sustainable post-crisis. We would say, however, there are some of what we call ‘real money’ investors, particularly in London, parts of Asia and the US, that have invested and still have investments in Australian RMBS. They are very interested in the opportunity to purchase more. The issues have been, firstly, the taint that mortgage securitisation has attracted due to the experience of the US subprime debacle and also the fact that the economics of the market have not allowed Australian issuers to issue in non-Australian dollar currencies—US dollars or euros. Those global investors need to be able to invest in either euros or US dollars.

CHAIR—But given the brand damage that RMBSs sustained internationally, and given that a lot of the investors that existed prior to the crisis no longer exist in that form with the appetite to invest in RMBS, the potential investor base internationally is significantly reduced even if we get things going particularly well in Australia in terms of an attractive RMBS offering.

Mr Dalton—I think in the near term it is correct that the potential size of the international investor base is less than what it was at the peak, but we should not discount the significance and the importance of that international investor base. The Australian Securitisation Forum conducted some seminars in Hong Kong and Singapore earlier this year and we had a delegation from the Taiwanese life sector come across to Hong Kong. They were very interested in the quality of Australian RMBS and in the strength of the Australian economy and property markets. They have some regulatory issues that currently restrict them in investing in Australian RMBS, but there is a potential new source of investors in Asia which I think, looking forward, will become a more important geographic sector for global investors in Australian debt.

CHAIR—The reality—I discussed this with the governor yesterday—is that there has been a pricing premium added for risk for RMBS that does not necessarily reflect the risk in Australia. In terms of attracting additional investor interest, particularly from overseas, we had a suggestion yesterday from Mark Bouris from Yellow Brick Road that the government should look at regulatory assistance to foster the development of a new type of RMBS that is very specific. He used examples like securities only from certain postcodes or ones that have been given by people with certain demographic qualities, income levels and so forth. You would have a very high degree of transparency and a high degree of ability to assess the risk and would therefore be able to offer a very attractive product. Do you think that looking at innovative ways of approaching securities like that may be a way of promoting additional investor interest?

Mr Dalton—Yes, I heard those comments, and whilst our organisation has not considered that specifically we generally support any discussion of alternatives and potentials that could broaden and deepen the securitisation market. I would say a couple of things, though. In our discussions with institutional investors—and these are discussions with domestically based institutional investors—they are quite happy to look at a variety of structures and a variety of collateral,

because they consider themselves to be investment and credit experts. They see that their role is to undertake analysis and invest money where they believe that there is relative value. I did hear Mr Bouris suggest a survey of investors, which I think is probably a useful thing for us to consider. Particularly when you go to America and London, they have large teams of credit experts that are more than willing to undertake analysis, so providing them with a plain vanilla—

CHAIR—And yet they have probably overpriced the risk for Australian RMBS at the moment.

Mr Dalton—Yes, and they sort of underpriced the risk of US subprime as well. So I think the whole world learnt lots of lessons over the last five years. But I do think, as a serious and general point, that institutional investors would see it as their mandate to evaluate risk and reward for what they invest in. What we are encouraged about is the government interest and support with respect to bullet securities because we think that could widen the investor base here in Australia so that those that are less sophisticated in evaluating prepayment speeds and the pass-through principle that is a characteristic of RMBS might be attracted to buy a bullet security where they know they can invest in \$10 million today and get \$10 million back in three years time and treat it more like a standard bond. We also think that that bullet style of RMBS will help the market go back to the international community because they will be able to source a currency swap at a cheaper price than they would if they had to put in place a specialised or tailored currency swap to account for the prepayments of principle that you can expect comes through on the underlying portfolio of assets.

Senator HURLEY—I would like to continue talking about getting more liquidity into those asset backed securities. This was what Mark Bouris was talking about—that the government should set up a market, so to speak, in these securities so that they were more liquid. You were talking about people who are used to assessing assets and assessing instruments. Do you believe it is necessary for the government to get involved in setting up such a market?

Mr Dalton—I think the Securitisation Forum has in recent times embraced the idea that support is necessary to see the industry over the tail end of the effects of the crisis, and probably more recently the European debt crisis, but we do not believe that the government should necessarily continue in a permanent role in the markets—that what is needed is support to allow the private markets to regain confidence to be expanded and for the market to evolve structures that meet investor appetite, both domestically and internationally. Things like potential support through the AOFM to move along the evolution of bullet style RMBS is something that I think is considered by the ASF to be effective government support.

Senator HURLEY—So in the context of the market that Mark Bouris is suggesting, you would think that the government would only participate in a form of regulation in permitting such—

Mr Dalton—I think our general point is that the role of government should be setting the appropriate framework, and we are encouraged when we hear Commissioner Medcraft from ASIC talk about his three Cs, one of which is caution with respect to the degree of regulation so that the regulators do not impede recovery and development of markets. We see that as a primary role for government because of the severity of the crisis. Also, recognising the importance of securitisation as a competitive element to the financial market in Australia given its concentrated

nature, we think that the support that has been provided through the AOFM program is needed for a time to allow the market to progress to what could be considered more normal levels of activity.

Senator HURLEY—Should these kinds of highly rated mortgage backed securities be allowed to count as liquid assets by the bank?

Mr Dalton—In terms of your specific point around liquidity in the markets, we would put that if residential mortgage backed securities and certainly the higher rated tranches could be held as eligible assets under the liquidity tests that Basel III will introduce for Australian banks. That by definition will create a liquid market, so it is somewhat of a chicken and egg situation given the nature of Australia's capital market. If these securities are eligible for repo at the Reserve Bank, if they were deemed to be eligible assets for liquidity with respect to the new Basel III guidelines, and recognising the absence of significant quantities of government debt to satisfy some of those tests, that would create liquidity that money markets and fixed income funds, superannuation funds and asset consultants would be very focused on in ensuring that they tracked indexes and held these liquid securities, knowing that they could sell them to banks who could hold them as eligible liquid assets or repo them to the Reserve Bank. So that would certainly be something that the Australian Securitisation Forum would see as a beneficial and positive step that the government could take through APRA.

Senator HURLEY—I guess we primarily have to be concerned about the safety of the markets and the stability of the markets and investors. During the global financial crisis it was the market for bank paper that seized up. So could it be regarded as truly liquid then?

Mr Dalton—I think the notion of liquidity in markets is a relative one, but I think generally our view would be that there is good liquidity when market conditions are stable and favourable, and when markets become stressed and disrupted that liquidity vanishes. I think the financial crisis demonstrated that, apart from sovereign debt and sovereign risk, there was little market in anyone's paper in the depths of late 2008 and early 2009. So I think you can argue that residential mortgage backed securities, by their nature, are not liquid securities but, in the way in which the market apparatus works through repo, through the central banks or APRA, in our case, deeming them to be acceptable as eligible securities, that then can create the liquidity perception that aids the market.

Senator HURLEY—In terms of the perceived security of these kinds of instruments, there was some discussion yesterday of whether there might be something like a requirement that there be a five or 10 per cent share in that instrument by the originating lender. Can I have your view of that? Is that something you would agree with?

Mr Dalton—Certainly that is something we have been focused on for probably 18 months given that IOSCO came out with their report on securitisation in September 2009, and this goes to what is colloquially called 'skin in the game' for retaining risk by the originator. We support that and what we point to is that that has been a feature of the way Australian structures have evolved over the last 15 years. We are in advanced discussions with ASIC with respect to establishing a standard to apply for residential mortgage backed securities in Australia. Our approach, which we have discussed with ASIC, is different from what the Europeans have put in place, which comes into effect on 1 January, and it is not similar either to what is being proposed

under the Dodd-Frank reforms in the United States. But we do think that it is a prudent and practical way to ensure that the alignment of interest in securitisation is maintained in Australia. Largely it sort of says that the securitiser, whether that is the seller of the assets or the originator of the assets, should retain an interest that reflects the level of risk in the underlying assets or has avoided the simple five per cent minimum.

Senator HURLEY—So you are saying it could be a sliding scale, depending on risk?

Mr Dalton—Absolutely. It could be something modest for prime pristine pools of mortgages or it could be something higher for non-conforming mortgages, equipment leases or credit card receivables, for example.

Senator HURLEY—And who would do that assessment: would it be the rating agencies or the investors?

Mr Dalton—What we are proposing to ASIC is that this will be a principle that the issuer will then need to satisfy and sign off and disclose in the offering documents. They will have the primary obligation for satisfying that principle and then ASIC will have its powers under the Corporations Act and work through its regulatory guides potentially to ensure that that is appropriately applied and, if not, take the appropriate action.

Senator HURLEY—So you are saying that ASIC should monitor those investments to make sure that the rating is appropriate?

Mr Dalton—No. The approach we have discussed with ASIC is that the responsibility should lie with the issuer of the securities—and that could be the originator or the seller of the mortgage assets together with their advisers. Primarily it would be an obligation that the directors of the special purpose vehicle issuing securities would have to ensure that the minimum requirements specified under this principle that we propose has been satisfied, quantified and disclosed in the offering document so there is transparency to investors.

Senator HURLEY—I will just change tack a bit. You mentioned in your opening statement that you would like to see better coordination of the approach by regulators. What exactly did you mean by that? Where is there not enough coordination?

Mr Dalton—We are probably picking up on one of the points that was discussed in the first session this morning. Securitisation is a financing technique that allows small institutions to raise funds at similar prices to larger institutions because the investment community is largely looking at the quality of the underlying assets and the structure as opposed to the corporate creditworthiness of the organisation behind the issue. So it is a financing technique that has benefits for smaller players. In the past it has also been advantageous for the smaller ADIs because they have been able to use it for funding to obtain cost-effective funds and term funding and to be able to do it in a capital efficient manner, so they got capital relief when the securitisation had been completed.

Dr Laker spoke to the clarification of the regulation under APS120, which requires an ADI, if they are to get capital relief, to satisfy APRA that there has been absolute transfer of the credit risk to third-party investors. Going back to the new requirement that we are discussing with

ASIC for retention of a portion of risk to align the interests in the transaction that then runs counter and makes it difficult to achieve complete transfer of credit risk and therefore get capital relief.

Senator HURLEY—I see—the APRA guidelines.

Mr Dalton—And it goes to the submission that I think Senator Pratt referenced from the Bank of Queensland. The smaller ADIs would like both to use securitisation for funding and to use it as a way of capital management for their balance sheets. That is where we as an association are pointing out that the regulators with their specific mandates will need to understand and somehow harmonise the objectives of both retaining risk to make sure that alignment of interests is maintained and satisfying the prudential regulator to say that the ADI is not retaining a disproportionate amount of the credit risk and this is not off balance sheet.

Senator HURLEY—Only the percentage of the originating lender that is decided upon?

Mr Dalton—Yes.

Senator XENOPHON—Do you think that the current framework in the securitisation market gives consumers the best deal in terms of the best offering at the lowest rates and, if not, how do you think it could be improved?

Mr Dalton—I think we would point to the fact that when you look back it was the evolution and the growth of securitisation in the mortgage market that drove down the margins that were typically applied to home loans. It was also at a time which brought innovation into the product features that were available to consumers. That I think is the benefit from a competition perspective of securitisation because, as I said, it allows both large and small securitisers to fund at a similar level. They are able to then compete on the terms and conditions and the features of the products that they are offering to the market.

Going back to the suggestion by Mark Bouris, we do not want to have things evolve so it then inhibits or takes away the innovation that securitisation inherently can bring to markets because part of the value proposition that a securitiser will bring is that they can offer products to meet needs or introduce products that are different to what is currently available from, say, more mainstream and plain vanilla product providers in the market.

Senator XENOPHON—Okay. But Mr Bouris in his evidence yesterday talked about having some standard form of assessing risk or the quality of an asset. He says it does not exist now; in other words, different institutions might have different standards and there should be a uniform standard in terms of that. Would there be benefit in that in the sense that there is an apples for apples comparison in terms of security?

Mr Dalton—I think we would argue that it is up to the marketplace for again institutional investors to form views, build skills to perform their own analysis of what risk there is in securitisations and what their appetite is for that risk. They can choose to invest—

Senator XENOPHON—I mean in terms of uniformity. I think that is what Mr Bouris is alluding to, some uniformity so that you can make a fair comparison as to the quality of an asset that is the subject of securitisation.

Mr Dalton—I guess what we would suggest is that the efforts that the forum has done with respect to increased and more comprehensive disclosure of the characteristics of the underlying portfolio, the calculation, for example, of arrears, that these things provide the necessary information for people to undertake analysis to ensure that they are then comparing apples to apples when they are making investment between an investment in a Bank of Queensland securitisation versus a BankWest or CBA securitisation. We believe that the market having information and skills in institutions or product providers, and there are a number in Australia and some of the overseas players coming into Australia offering analytical tools to help people make those apple to apple comparisons. As I say, we have not discussed the suggestion that came up in yesterday's hearing and we are happy to do so, but I think we would probably shy away from creating some sort of plain vanilla or commoditised offering which could then inhibit innovation and competition in the securitisation area.

Senator XENOPHON—Would it necessarily inhibit innovation and competition?

Mr Dalton—If I heard the comments yesterday correctly, things like maximum LCDs of 80 per cent, certain postcodes being designated as being safer than other postcodes, those sorts of things become very prescriptive and subjective. Markets change, views of risk change. I live in Melbourne and I was well aware of the housing market downturn in the early 90s and the collapse of Pyramid. Certain sectors have issues at certain times and then become stronger and change. So I think having a template that applies is always going to probably lag market views as to what is a degree of risk in any sector.

Senator XENOPHON—I am not sure this was covered earlier. In terms of your support for covered bonds, what would that do for depositors in terms of their current depositor priority arrangements? Do you have concerns about that in the sense that that will be a quantum shift in the way that depositors are treated in this country if we have covered bonds?

Mr Dalton—We put a submission to the Treasurer in July 2009 which set out the case for a legislative framework. We put that suggestion forward based on recognising the primacy of depositor protection and the importance of that in the Australian financial system and but we also put that because feedback from overseas investors said that they would look more favourably on a covered bonds framework that was legislative as opposed to structural.

We believe that in the proposal that we put forward, where there was both the active oversight and involvement of APRA in the amount of covered bonds that an institution could issue, and under the Treasurer's announcements on Sunday that there was consideration of a specific cap, that they provide adequate safeguards for depositors to ensure that there is not a disproportionate amount of the bank's balance sheet and mortgage assets that are encumbered, which could detrimentally affect the position of depositors with those institutions.

Senator PRATT—I want to ask about the investment in RMBS and the impacts of that in terms of the government's investment. I understand that it was \$8 billion initially and then

another \$8 billion, and I think there has just been an announcement of \$4 billion. How would you characterise the leverage that has come with each of those commitments?

Mr Dalton—You could think of it in three phases. The first \$8 billion was probably almost a lifeline to keep the sector going and particularly to provide funding to the smaller institutions. So it was almost a tranche of survival moneys. The second tranche I think the AOFM played a more expanding role to encourage investment by buying into the longer-dated tranches in the transactions. They also changed the way in which they would provide a commitment to some of the institutions, so there was greater certainty of ongoing funding as opposed to being somewhat of a competitive tender in each case, as the first tranche required.

With the last phase of the \$4 billion there is the preparedness for it to be used in ways that could aid, for example, the evolution of the bullet-style residential mortgage backed securities. We would like to see potentially the eligibility criteria in this next tranche be expanded to at least facilitate financing and participation through some of the non-conforming lenders and lenders that are not currently participating in the AOFM program so that there is support for more players in the market and also, because of the non-conforming sector, to provide finance which is directly going to the self-employed and small business.

Whilst we acknowledge the current requirement for securities to be rated AAA, we believe that that can be satisfied even in a non-conforming deal. The only difference would be that there would not necessarily be mortgage insurance underlying those assets in those non-conforming deals.

Senator PRATT—Part of what you are pointing to is, I suppose, the role of that investment in enabling smaller institutions to stay in the marketplace and compete with banks. Part of the reason we are here is that there is a sense that, as a result of the GFC, the banks have been able to take a more dominant position in the marketplace. But what you are saying is that, in terms of the vital role of a diversity of institutions in competing with banks, this investment has played a vital role.

Mr Dalton—Absolutely. I think it has been very positive and certainly in our discussions overseas, for example, international investors are aware of the government's support and involvement and see that as a positive. Specifically we have had comments from London-based investment bankers that it is in quite stark contrast to the absence of support and interest by the UK government in the securitisation sector there. So that is a sector that is still somewhat struggling and they look to Australia. Whilst the absolute aggregate volumes are not particularly large, there are a number of participations by smaller institutions in the program and so that is very positive for the Australian market.

Senator PRATT—We have had some discussion about covered bonds already this morning, but I wanted to ask about depositor priority arrangements and whether there is a sense that covered bonds would mean a weakening of depositor priority arrangements and the desirability of that: why is it desirable, is it not desirable, and would it be a retrospective reduction in the security of term deposits from the time when depositors agree to the interest rate that they would receive. What are your views about that?

Mr Dalton—Probably the short answer is that there is a lot of detail that has to be worked through on the way in which the covered bonds are to be introduced and the timetable in which they are introduced in Australia. We believe that, with the financial claims scheme and the legislative framework for covered bonds, it will be a very clear framework in which covered bonds can be issued, so there will be clarity around how depositors are protected; to what level they are protected, whether it is up to the current \$1 million for deposits or whether it is something less; what the maximum is; if there is to be a capped amount for covered bonds that can be issued by an institution; and, importantly, the ongoing role of APRA to provide regulation and supervision at a prudential level to ensure that depositor protection is not diminished or detrimentally affected.

Senator PRATT—Thank you.

CHAIR—I think in an answer earlier you raised the issue of the impact of some of the changes on non-ADIs. Were you specifically talking about making the guarantee permanent and the impact that that may have on their ability to raise funds, or were there other issues you were alluding to?

Mr Dalton—I think we are conscious that, in providing competition, the role of the nonbanks needs to be acknowledged, such as the former RAMS, Puma, Wizard and those sorts of institutions.

CHAIR—Which, as a sector, largely drove competition in the late 1990s and early 2000s.

Mr Dalton—Very much so.

CHAIR—It was based on the money they got through securitisation.

Mr Dalton—Exactly. A couple have hung on through the crisis. What we are putting forward is that there should not be, as part of the regulatory changes, any unintended impediments to new entrants coming in. Probably where you will get competition and innovation will be from new entrants coming in to offer products with either better pricing or unique features.

CHAIR—On first blush, do you see any potential unintended consequences?

Mr Dalton—The issue we would raise at this point is that we would like to consider what the level of the guarantee may be, whether \$1 million is going to skew investment through ADIs or—

CHAIR—Have you been consulted by the government on any of this?

Mr Dalton—Not at this point, and we have not raised it, either.

CHAIR—Evidence raised yesterday indicated that there is a proposal that some witnesses have been consulted on, but the details are not yet public. In terms of whether it is \$1 million or some other figure, whether there will be a fee paid and those sorts of things, the only thing that has been publicly confirmed is that the guarantee will exist, will be permanent and will apply to ADIs and nobody else.

Mr Dalton—Correct.

CHAIR—Thank you Mr Dalton and Mr Sell. I now call representatives from Choice.

[9.34 am]

LLOYD, Mr Richard, International Policy Adviser, Choice

STACE, Mr Nicholas, Chief Executive Officer, Choice

ZINN, Mr Christopher, Director, Communications, Choice

CHAIR—Welcome. Would you like to make an opening statement?

Mr Stace—Yes. Thank you very much for inviting us to give evidence to this inquiry. As we indicated in our written submission, we are part way through a major public listening program and will have further evidence that we will be able to give to you towards the end of your inquiry, probably sometime towards the end of February.

For the last 50 years *Choice* has been seen as the people's watchdog largely because of our ability to be able to speak out without fear or favour but also because we are funded by our 200,000 members. Our vision is that Australians are to be the most savvy and active consumers in the world and we seek to do that through giving consumers expert advice, information and support as well as campaigning for change where change is required. Our campaigning focus is on issues which affect everyone everyday and also on issues where the consumer interest is being forgotten. That is why for the last 50 years we have focused on the banking issues.

Something has begun to start changing over the last few months. I say that because of four particular reasons. Firstly, there is public recognition that politicians did the right thing at the time of the global financial crisis to ensure financial stability, but that the actions taken then have reduced competition now. Secondly, following the launch of the Better Banking campaign at *Choice* we received record numbers of supporters and members, consumers not only looking for a better deal for themselves but also wanting to be part of a wider movement for change in the banking sector. The third reason is that political leaders are falling over themselves to represent the consumer voice. And finally, Richard and I have met with a number of banks and the chief executives of banks over the last few weeks and I genuinely think that they are open to change.

So let me be clear about what we would like to see. Simply put, we want to see a more competitive and healthy banking system: a system where banks genuinely compete on price and quality and do not just rely on consumer inertia; a system where there are clear product disclosures for consumers and where products are easy to compare; a system where there are fewer barriers to switching and fewer barriers to new market entry; and where there are no unfair fees, hidden charges or unfair terms and conditions.

So what are our priorities for action? The government announced a series of changes on Sunday and some of the proposals were extremely well argued. We would go further on almost all of them, and that consultation period that they have announced gives us an opportunity to push them further. But now that the government has opened the door to reform in the banking sector it is our view that the banks should enter the room.

Our submission outlines some priorities and they can be summarised as follows: consumer focus priorities. Firstly, the government should stop the clock on unfair fees across the board so that within 12 months the banks should get rid of unfair fees and unfair charges or ASIC should issue guidance and enforce that guidance. Secondly, banks should immediately remove barriers to switching. Banks say that it can be done, and in private to us they said that they would welcome it, so the answer is that they just must do it and not wait for a feasibility study on the portable bank account numbers. Thirdly, we need to let consumers be the judges of whether it is working. We have long argued that it would be right for consumer organisations like *Choice* to be given super-complainant powers so that we can really test whether particular segments of the banking sector are working sufficiently in the consumer interest and, if they are not, that we could refer those cases on to the ACCC for immediate and speedy action.

We have also outlined three priorities in tackling underlying competitive forces. Firstly, we question how to make it easier for new entrants. A number of entrepreneurs we have spoken to have found that the rules have been burdensome and complex and we believe that the ACCC should investigate unnecessary barriers to new entrants. Secondly, we believe that there should be a level playing field for smaller players. Smaller banks need a hand up and that may also be through access to a branch network including, for example, working with Australia Post. Thirdly, we believe that regulators should take competition as seriously as financial stability and so we have been calling for a full market investigation and an annual health check by the ACCC on the state of banking competition in Australia. We are very happy to take any questions you may have.

CHAIR—Thank you very much for that. I thank you for your submission which I think is most useful. You have outlined some of your priorities there and one of those was the underlying competitive forces which have been a significant focus of a lot of the submissions and a lot of the evidence that we have received so far in the day and a bit that we have been taking evidence.

One of the issues that some questions have been asked about—and I have had a bit of an interest in this—is the ability of non-ADIs to actually provide competition. In the late nineties and the early 2000s, as all the evidence suggests, they were a strong force in actually driving down interest rates and in providing competition which led to better prices and a more diverse range of products being offered. Quite clearly, they do not have the same degree of regulation as ADIs do and also they do not receive some of the benefits—for example, the government guarantee on deposits that the ADIs do. Do you think that there are any changes that should be made to help foster competition from the non-ADIs? Essentially new entrants have to start somewhere and I would have thought that financial institutions that come up with innovative ideas, provided that they are appropriately regulated—as they still are by ASIC—can actually lead to consumer outcomes that are very beneficial.

Mr Stace—I will hand over to Richard in a second, but one of the things that I probably should have said in my opening statement is that we have spoken to hundreds, if not thousands, of consumers and we have spoken to most of the banks too and one or two entrepreneurs have come out of the woodwork. That is indicative, I think, of a market that is not that encouraging of entrepreneurs, that it has been really difficult to identify. In fact, we have been speaking to two entrepreneurs, ones that it might be worth your taking evidence from, who are really battling to try to enter the market and are finding significant barriers to them doing so.

Mr Lloyd—We agree that a more diverse playing field would be better for competition. We think it is a pity that the role of the non-ADIs has diminished in recent years. What we want to see as a first step, as we have suggested, is a review of what barriers exist now to entry into and growth in the market. As Nick has said, some non-ADIs have approached us and said they have found significant obstacles—for example, in accessing the payments clearance system. We are starting to see, in relation to the mortgage market, some very competitive offers from some brokers, for example. That is encouraging, but I think it is a remarkable situation that we have now where the market is so dominated by ADIs and there is not that challenge from the non-ADIs that we have had in the past. So, as I said, we would encourage you to recommend that the ACCC look quickly into what are the barriers to entry and growth, in particular with a focus on the role of the non-ADIs in this respect.

CHAIR—That is certainly something that we could recommend. But to an extent our terms of reference enable us to have a look at that as well, so we are very interested in the specifics of what might be presenting as barriers to the entry of new entrants, particularly in the non-ADI area as well as in the ADI area, but that is certainly as to the non-ADI area because I think that was a major driver of competition that led to some very beneficial outcomes for consumers in the period leading up to the GFC.

Mr Stace—There is a sense, certainly from one of the entrepreneurs that I met, that APCA is governed by the big four banks and the big two credit card companies, that they set the rules of the game and that in a sense there is really a disincentive for them to set rules that would make it easy for new entrants to come into the market. So one of the things that we have been saying is to question whether APCA should be governed in that way and to see whether it is right that APCA continue to be governed by the big four and the big two if they are not able to set rules which are right for the whole market.

Mr Zinn—I would add that with that heady time when those non-ADIs came in there was real consumer engagement with their products. There was some excitement. There was some way that people really related to them that really did shake up the market. Currently we have a situation where people are not satisfied but they do not feel able to move. There is a sense of inertia and ennui and it is refreshing to think back to what had happened in the past and think about what are the reasons why it cannot happen in the future.

CHAIR—Quite clearly, the global financial crisis had a significant impact on them directly and I think that there was a flight to quality that was naturally occurring. But I think the decision by the government to guarantee deposits of only ADIs reinforced that flight to quality. Do you agree with that? I see you nodding, for the benefit of the *Hansard*.

Mr Lloyd—We would completely agree with that and would go further: the guarantee in the way it is structured, particularly now that we have four ADIs that everyone knows will not be allowed to fail, has given those very large ADIs an extra competitive advantage courtesy of the government and the taxpayer. So I think there is a perverse consequence, and that is what we have said of the efforts to maintain stability in the system in the way that has been done.

CHAIR—In your opening statement you mentioned that a lot of the decisions that were made during the global financial crisis were required. You could argue about the way they were done, the timing and all sorts of things but, ultimately, steps needed to be taken. But one of the

consequences is that it has reduced competition, and this is a classic example. Senator Williams has pointed out to a number of witnesses that in New Zealand and other places a similar guarantee extended further than the equivalents of ADIs and included finance companies in some cases. There was always that option, which I guess would have enabled that sector of the industry that was providing the strongest competition to have a leg up to stay in the industry.

Mr Lloyd—Yes. Obviously consumers value stability in the system. Certainly, from my personal experience of being very close to near collapse in the financial system in the country I was working in at the time, it was right to take steps to prevent that. No-one would argue with that.

CHAIR—No, exactly.

Mr Lloyd—But I think it is interesting to look at what has happened in Europe, where regulators approved mergers, for example, to try and inject stability and actually to rescue the equivalent of ADIs in Britain that were on the brink of collapse. Subsequent to those decisions to merge being approved, on competition grounds reviews of those decisions led to requirements for newly merged institutions to sell off or divest themselves of chunks of their business.

CHAIR—Which I do not think we have regulatory power to do at this stage in Australia.

Mr Lloyd—Well, the world did not end in Europe when that happened. In fact, what did happen was that some new entrants were enabled to get into the market using some of the branch networks and infrastructure that, for example in the UK, Lloyds banking group and RBS were required to dispose of. So when we look at the post-GFC landscape our view is that nothing should be off the table in considering where we need the market to be and where we need the structure of the market to be if we are going to win back a truly competitive system.

CHAIR—Thank you. In view of the time I will ask Senator Hurley if she has any questions.

Senator HURLEY—Yes, I do. This committee is about trying to improve competition, but of course it does not benefit consumers if their organisation fails or if they lose their money, and it does not benefit taxpayers either if the government has guaranteed that money. And I am sure the opposition parties would be the first people to complain about government guaranteeing organisations that were going to fail. So I am a bit confused about where you want to see things happen. You are saying that there are entrepreneurs who want to set up who find rules burdensome and complex and that there are unnecessary barriers. You contrast this to Europe, but Europe are the most enthusiastic advocates of the Basel arrangement which is setting up barriers to entry and putting in more rules. I do not see where you see the Basel and international ways of ensuring that the financial system is more safe and stable and these entrepreneurs you are talking about. We know what entrepreneurs are like—they do not want any rules, really. They want to be able to have unfettered entry into the markets, but that does not necessarily benefit consumers in the end.

Mr Lloyd—You are quite right, Senator. We are not arguing at all for unfettered access and for anyone to be able to enter the market, call themselves a bank and cause problems for consumers in that way. We are absolutely, as I said, in favour of financial stability and rigorous oversight. I think everyone has recognised that the oversight of the sector in Australia has

prevented the kinds of collapse and problems for consumers that have been faced in other countries—

Senator HURLEY—Recession and unemployment and the whole—

Mr Lloyd—Indeed. So we are not arguing to remove the degree of oversight and the requirements to hold capital, for example, and what flows from Basel—absolutely not. What we are saying is that we think there is an argument that there are other systemic blockages to new entrants entering the market.

Senator HURLEY—What are those systemic blockages?

Mr Lloyd—The one we pointed to is the difficulty for innovators to get access to the payments clearing system. This is where we think there is an important role for the ACCC to investigate that. We are not a bank—neither do we want to be a bank—and there will be other witnesses who can talk you through this in more detail, but I think—

Senator WILLIAMS—The Choice bank?

Mr Lloyd—Thank you for the suggestion; we will take that away and look at it perhaps.

Senator CORMANN—A bit of entrepreneurialism.

Mr Lloyd—We are innovating in other ways. We are helping consumers to compare the market very easily through our website at the moment. Our basic point is that the regulators across the board and the government need to not trade off competition for financial stability. We do not believe that is necessary. What we believe is that there are other systemic reasons for new players who would meet the oversight requirements to get into the market and to innovate and challenge the existing players.

But where does that take us? I think it take us to asking the regulators to do two things. One, as I have said, is to take competition as seriously as stability and, secondly, specifically for the ACCC to investigate the market to ensure that there are not what we perceive to be unnecessary obstacles to people getting into the market and growing safely.

Senator HURLEY—You referred to ADIs that we know are not allowed to fail. But, in fact, all ADIs are not allowed to fail under the government guarantee which has been given to all ADIs and the indications are that that will continue. That was part of the Treasurer's announcement on Sunday. I take it that you support that. There are some very small ADIs among those.

Mr Lloyd—There are differences of guarantee and differences in the price of guarantees, which has disproportionately benefited the major banks. The point I was trying to make is that there are systemically significant players in the market, and, as everyone knows, were the government to allow them to fail, there would be such major consequences that that would not happen, whether or not there was a guarantee for their funding or their deposits.

Senator HURLEY—But you do not want that taken away, do you?

Mr Lloyd—We do not want the government to allow institutions to fail unnecessarily. What we also do not want, though, is for the government to ignore the fact that there are consequences of that guarantee in terms of competition. If you provide a guarantee to the majors at a cheaper price to the smaller players, you are lending them a competitive advantage at the expense of the taxpayer. It is that way of dealing with the systemically significant institutions that would essentially bring down the whole system if they were allowed to fail that needs tackling.

Senator HURLEY—Perhaps I am being a bit simplistic here, but are you saying that you should guarantee the entrepreneurs, the small ADIs and the large ADIs without any assessment of the risk involved?

Mr Lloyd—Again, there are different guarantees, and the guarantee that we support is the guarantee of consumers' deposits, which is what the government—

Senator HURLEY—That is what I am talking about. That is what you were talking about, were you not?

Mr Lloyd—I was talking about the government's guarantee of wholesale funding.

Senator HURLEY—Which has gone now.

Mr Lloyd—It has not gone yet; it is still there. If you guarantee wholesale funding as we are what you are doing is effectively saying to the market, 'In addition to the fact that everyone knows the majors will not be allowed to fail—

Senator HURLEY—But that is being phased out.

Mr Lloyd—It is being phased out, but it is still enabling the major players—

Senator HURLEY—That is why I am concerned.

Mr Lloyd—to raise money more cheaply than the smaller players. So again, in the context of the overall post-GST situation, what we have ended up doing by putting stability first is giving the majors an extra competitive advantage, and that needs unravelling.

Senator HURLEY—That is exactly why the government are now at the stage of saying, 'We've achieved stability; now we need to look at the competitive aspects of it.'

Mr Lloyd—Precisely.

Senator HURLEY—Right. You referred to 'unnecessary barriers'. What other barriers do you see? I am not talking about the whole system necessarily but in terms of the consumer.

Mr Lloyd—The key one has got to be barriers to mobility. In fact, I think quite a lot of the comments on the government's package have been that, where they are heading in the right direction, where Treasury did announce some positive moves in particular, was the recognition that switching is far too difficult. If you are a small player in the market, it is very difficult to grow when you know that 80 per cent of the population has not even considered switching in the

last two years, as our research found. It is very well known that the paperwork, the hassle and the difficulty for people to research the market easily is impeding consumer mobility. So one of our basic arguments is that, despite the fact that some people are saying everything is fine and competitive in the marketplace, we would say that the symptom that we would most point to that shows that is not the case is the lack of consumer mobility, and even some of the major banks are agreeing with that. NAB said that in their—

Senator BRANDIS—The 80 per cent of consumers who have not considered switching is actually more consistent with their being perfectly happy with their existing arrangements.

Mr Lloyd—That is one way of interpreting the data—

Senator BRANDIS—It is consistent with that too, isn't it?

Senator HURLEY—I think you made a good point in there about the difficulty of researching comparisons. When you look at the interest rates, the fees and the charges, it is very difficult for most people—and a lot of people do refer to this; they say all the banks are the same—to compare those fees and charges and decide which overall rate and conditions are best for them.

Mr Lloyd—Yes. Senator Hurley, would you mind if I respond to Senator Brandis's point as well as yours, together?

Senator HURLEY—Sure.

Mr Lloyd—Let me give you another way of looking at this. Our annual consumer satisfaction survey across the board for ADIs shows that the banks with the largest market share consistently have the lowest customer satisfaction ratings; in fact, they were at the bottom. You would think that, if they were competing genuinely on price and quality, that would not be the case.

Now, we do not know why 80 per cent of the population do not even consider switching, but there were very clear reasons given by those who considered switching but did not switch in the last two years: the paperwork, the hassle of researching the market and the belief, rightly or wrongly, in the case of individual products that there is not a better alternative out there in the marketplace.

One of the reasons Choice launched its Compare, Ditch and Switch website—and we have had tens of thousands of Australians using that tool since we launched it a few days ago—is to make it easier for people to compare products in the market and easier for people to use our data comparison to match one product against another. But, for lots and lots of consumers, the complexity of the information about products, the speed with which the market sometimes changes and the speed with which you need to be able to transfer, for example, your direct debits and direct credits to a different transaction account is just too much, and we have to recognise that.

The lack of consumer mobility in the sector has been debated for years and years. There are solutions. There are solutions that have been tried in Europe. There is a solution short of portable bank account numbers which we have supported, which is to require the new bank to take the

hassle out of switching for you as a customer by authorising them to deal with your old bank within a clear time frame and transfer your direct debits and direct credits across. We think some of the majors would welcome that or at least would not oppose that. That would require legislation.

But the bottom line is that consumers in Australia are not switching. The major banks know that there is inertia. That is a symptom of an uncompetitive market, we would argue, and for the vast majority of us that stay with our banks for decades it is not the case that we are in the market looking at how the players are competing on price and quality, as you would expect in a competitive situation.

Senator HURLEY—I have one more question regarding interest rates. There is a headline rate, and it is a bit concerning when you hear banks talk about people getting a discount off the headline rate for various reasons. It seems to me that that might well be of concern for people who are not sophisticated banking customers. First of all, they do not know that you can ask for a discount. I know a lot of people use mortgage brokers, but it concerns me that perhaps they do not know enough to ask for that discount and for certain fees and charges to be removed. Have you had any feedback on that?

Mr Stace—Yes. When we launched the better banking campaign a couple of months ago one of the first requests that we made of our campaign supporters was for them to phone their banks to ask for a better deal, and we gave them telephone numbers to do that. Interestingly, anecdotally we have had quite a lot of feedback from the banks that they were inundated over that weekend with customers calling. So I think when people actually make the call they quite often do get a better deal, and that was certainly the feedback that we got from our customers. But there is inertia largely based on the fact that people feel fairly resigned to the fact that they are not going to get a good deal. I think that is one of the most significant problems that we have.

Senator HURLEY—When you go for a home loan, for example, there is still the feeling that you are waiting for the bank to give you the nod and therefore you had better not make life difficult for the bank.

Mr Zinn—In fact we did some research on this and we found that, with home loans and also with transaction accounts, when people asked their bank for a better deal they did get one. Some people even claimed to get a one per cent reduction in their home loan—not many, but a few claimed that they got that. That is certainly some advice that we got.

Senator HURLEY—That is pretty significant, isn't it.

Senator XENOPHON—Mr Stace, the package announced by the Treasurer on Sunday was intended to put pressure on the big four banks to assist regional banks. Yesterday, though, it seems that the market spoke. The big four banks increased their value by \$3.4 billion. Bank of Queensland shares went down 40c, to \$10.97. Bendigo Adelaide went down 34c, to \$9.91. What does that tell us?

Mr Stace—I think you can read it in one of two ways, probably. One way is to say that the package is reasonable, we are going to take it further, the banks are going to step into the room and genuinely engage with reform and banks have got nothing to fear in the banking sector being

more competitive. We have been saying that what is good for consumers can also be good for banks. Ultimately, many consumers have shares in banks anyway; their superannuation is invested in banks. So it is a good thing that the banking system does not collapse to its knees. In fact it is a good thing if the banking system remains competitive but profitable.

Senator XENOPHON—The regionals are pretty down, though.

Mr Stace—Yes. But the other reading of it is that they do not think the package is reasonable at all—in fact they think that it will change very little in the banking sector, particularly for the big banks—or that the banks think they might outlive this government. Or of course they rule out the government. That is true. That is something no-one can argue with. But the reform package may not actually have the bite that the government intended it to. So there are a couple of readings. Of course the other one is the fact that the small banks—

Senator XENOPHON—So is it more bark than bite?

Mr Stace—Yes, I think it probably is in that sense. We noticed in our meetings with banks that until the government announced their reform package the banks were really quite nervous about what might be announced. In fact one of the questions we asked each of the chief executives was: what do you most fear? Almost in unison, what they feared was substantial legislation that was going to force them to do things that they were not ready to do. In the broadest sense, of course every industry probably fears that too. I think there was probably a bit of relief on Sunday night that the reform package as it stands at the moment is not going to change the world for those banks. Having said that, that is exactly the reason that on Sunday we also said it was an important first step but the government must keep the pressure up and there should be other phases to this reform process as well. The reform is not just a one-off. It is part of a package that should carry on.

Senator XENOPHON—There is a cartoon in one of today's papers of the Treasurer with a feather duster. Is that cartoon appropriate or fair?

Mr Stace—We were asked to give a school report. It is the end of term, isn't it, for most kids?—not that I am saying that the government is full of children. The end of term is a good time to give the Treasurer an assessment on this. For effort and commitment to bring about change I think the Treasurer gets seven or eight out of 10. In terms of what the package looks like so far, it is probably closer to five. We have the next three months when we can really improve the commitments that he has made. We will be very much in the room talking to the Treasurer to take that further. I think the feather duster is slightly unfair. Hopefully, the feather duster analogy will give the Treasurer a sense that he needs to go further.

Senator XENOPHON—Bernie Fraser will be looking at the whole issue of bank account portability, but in the meantime—and I think Mr Lloyd referred to this—are there other jurisdictions, similar to superannuation in this country, where there is a positive legislative mandate, so there is an obligation on your existing institution to do things to facilitate, say, switching lending institutions, in a very timely manner?

Mr Lloyd—The example we point to is of the Netherlands where that situation exists. In other countries there are voluntary schemes that deliver that sort of service. What we have said very

clearly to the Treasury and in general when commenting on Sunday's announcement is that we do think steps to ease switching of that kind are very practical. Steps towards better switching should not await the result of the feasibility study.

We have said for many years now that portable account numbers would be an important step not least in giving consumers confidence that they will not lose their direct debits and direct credits. We recognise that that cannot happen overnight. In our engagement with banks we have been discussing this in recent days and weeks. There is a system which we think would very much help consumers and consumer mobility and take the hassle from the consumer and put the onus on the new bank and the old bank to do the legwork for them. We would like to see action early in the new year. We would like to see very quickly emerging from this debate an analysis of what would impede at the moment in legislative terms that sort of system. It is probably a data protection issue, apart from other things.

Senator XENOPHON—Would you mind taking on notice to provide further details to the committee how it works in the Netherlands and any other jurisdiction as an interim measure before there is full bank portability through technological means?

Mr Stace—I suggest you also ask the banks themselves to provide on notice what the barriers are to them doing this. We have asked each of the chief executives and they have been a bit unclear and said they need to go back and look at that. I sense from the meetings we have had that they are genuinely interested to engage in this debate, but there has to be more than just interest here. If they think they can bring about some change quickly, they should do that.

Senator WILLIAMS—Mr Stace, thank you for your presence. I agree with basically all of your opening statement. We have seen the NAB and ANZ abolish exit fees. Has your organisation lobbied Westpac and CBA to abolish their exit fees?

Mr Stace—Yes, we have.

Senator WILLIAMS—And what has the result been?

Mr Stace—The result I suppose is for us to see now.

Senator WILLIAMS—It speaks for itself, because they still have them.

Mr Stace—No, we have. We think that exit fees are unreasonable and we think that unreasonable charges should be done away with immediately. We said in our opening statement that we think that should happen certainly within the next 12 months and they should be given perhaps that long to sort that out. That is not a sustainable business model and it is not one that consumers think is fair either.

Senator WILLIAMS—I would have changed banks two weeks ago except for the exit fees. I could have got a quarter of a per cent lower interest rate. Let us go back to the non-ADIs because I think this is a very important issue. We are talking about competition. Money is just like any grocery store or goods or services sold out in the community, and competition is what keeps prices down.

I agree with Senator Hurley that the government could not just guarantee any sort of willy-nilly Ponzi scheme and put taxpayers' money at risk, but we have a situation with the non-ADIs where we do actually have secured investment companies that have real security—farms, properties, houses et cetera—that lend to LVRs of 40, which are more conservative than many of the banks, yet when they advertise the ASIC regulations say that at the end of the advert they must say, 'You may lose some or all of your money if you invest with us.' Shouldn't there be a stage where we should group these debenture issuing companies and secured companies and alter their titles and give them a fair go? If you are going to advertise and at the end of the advertisement on the radio say, 'Be aware you may lose some or all of your money if you invest with me,' who is going to invest? But that is the regulations. Wouldn't it be better if those non-ADIs were classified into various groups? We do realise that among debenture issuing companies there are some crazy ones that gathered in money, lent it to themselves for commercial developments that went belly up. We do realise that government has stepped on them. But with real secured investment companies, if we do not give them a fair go they are never going to grow and in fact they will be lucky to survive, hence competition will be depleted more.

Mr Lloyd—One of the issues here, and you have hit the nail on the head, is how do we signal to consumers that they can have confidence in a certain institution. To take a bit of your analogy and apply it more widely, there is a labelling issue here. Consumers need to have a means of understanding whether the regulator has confidence in this institution or not or whether it is a fly-by-night cowboy operation that you should be wary of. One of the things we proposed, drawing on our experience in food labelling, is let's try and apply some of those principles and practices to financial services and products, traffic-light labels that warn you of the risk of the financial product or financial service you are engaging with. I think there was some recognition of this in the government at the weekend but there is probably a degree of caution about engaging as a consumer with the mutuals. I am not sure how many of the mutuals would want to call themselves banks—

Senator WILLIAMS—They probably do not want to wear the brand.

Mr Lloyd—Indeed. But I think this is where there are some important developments in thinking about the behaviour of consumers and what can encourage and nudge more consumer mobility and a different way of thinking about the market, that you do not have to hang on to your big auntie in times of trouble when you know that the regulator is giving oversight to certain institutions that you might not otherwise have thought of. So there is something that really needs to be done here on giving a clearer signal to consumers across the board in this market about what the regulator sees as a safe, less safe or risky proposition to enter into.

Senator WILLIAMS—To save time, I will pass questions on. Thank you for your input today. It is greatly appreciated.

Senator PRATT—The Competition and Consumer Act has been in exposure draft on anti-competitive disclosure of pricing and other information. I was struck by your statement that there is a perception that consumers find that there is not a better deal out there that is worth the hassle of changing all their paperwork, and I am interested in your understanding of the extent to which this bill is relevant. In the context of that you have also made statements about the need

for mutuals or a new entrepreneur or some other business model with some force to break into the marketplace. Could you comment on the relationship between those things?

Mr Stace—I will start and I will ask Richard to say a few words. The important thing about the new act is that hopefully it will make clearer the role of the ACCC in regards to enforcement and taking action. I gave evidence previously on GROCERYchoice to this committee some time ago and I was pretty critical and then of the role of the ACCC. I have to say I am pretty critical today as well of the role of the ACCC, given that I think that even without that act they could have gone further, even under the Trade Practices Act, to really focus on the role of banks in improving competition. I hope that this additional piece of legislation will make a difference. But more than anything else it is the leadership of the ACCC that really needs to make a difference on this issue and to tackle issues of competition across the sector.

In addition, that is why we have suggested that there be an annual health check on banks that the ACCC has responsibility for and, even prior to that, that there is a full market investigation into banks. There are issues here that we will be able to touch on—which we have already this morning—and I know you will in the course of your inquiry, but there are other issues as well which, unfortunately, just will not be exposed in the course of this inquiry but I think the ACCC should have responsibility for doing so.

So, yes, I hope the act will make a difference. One of the challenges within the act, clearly, is for us as a consumer organisation to really be very clear to consumers about what they can expect and what they should not expect and that, if they identify particular issues that are not working in the market, they should tell us. That is part of the reason that we have been calling for supercomplainant powers, so when we amass that evidence in banking—but it might be across other sectors as well—we can then refer those cases to the ACCC and they will then have responsibility to formally respond. I think banking, in particular, is a really good example of why supercomplainant powers would be really important.

In terms of new entrants, we spoke right at the start—where I got my acronyms wrong—about the rules that are set and the balance that needs to be struck between on the one hand financial stability and on the other hand innovation and entrepreneurialship. We are at one with the committee when members say, ‘We don’t want to encourage cowboys into the market.’ Neither do we; we protect the consumer. We are about raising consumer interest. That would be the last thing that we would want to see. On the other hand, at the moment, we are so risk averse in this sector that we do not allow new entrants to be given a fair go. It is only by having new entrants and some innovation in this market that I think we can really shake it up and actually take away the rather complacent attitude of some of the bankers.

I think that was in part what some said yesterday and what I would term as ‘in profitable denial’. In fact, the banks are doing rather well out of suggesting that the system that we have now works very well. It does work very well for the banks—and I think consumers are well aware of that point. Anything that we can do to allow new entrants into the market can only be a good thing.

Mr Lloyd—Specifically on the bill, you would have seen that we did not say very much—in fact, I do not think we said anything—on price signalling in our written submission. The broader point that we have tried to make is that the priority here is that the ACCC carry out a thorough

investigation of the market. Price signalling, they say, is a sub issue within that. I think the bill is difficult. It will be very hard to get this right—in particular, improving intent. The priority for us, as Nick has said, is for the ACCC to explain to consumers why it is, if they think that the market is operating competitively—and previous chairs of the ACCC have said that they think it is not relative to pre-GFC days.—and if they think that it is not operating competitively, what action they believe needs to be taken. Price signalling, to us, is in a lower order of priority to that bigger view and bigger role they have in relation to ensuring competition on behalf of consumers.

Senator PRATT—In terms of the four pillars that we have at the moment and the debate about a fifth pillar and what that looks like, how likely is it that those existing four pillars will start to compete more aggressively with each other to differentiate their products in a way that benefits consumers? When we are talking about a fifth pillar, is it important that there is a diversity of institutions within that, or would we see a benefit from another big player that could turn into another oligopoly?

Mr Lloyd—I think that on some products we are starting to see some differentiation and increased competition amongst the big four. In particular, among the big four, there is probably one that is trying to position itself as more pro consumer and anti-unfair fees and so on and is using that to try to win market share—and, obviously, we would encourage all the others to put customer service and a fair deal first. Broadly, on everyday banking facilities that consumers rely on, there is nowhere near that degree. There is a competition on deposits at the moment—as I am sure many bankers will tell you—but, for example, with transactions accounts and mortgages, there is not that degree of competition.

Senator PRATT—Okay. As exit fees phase out, because clearly for constitutional reasons they cannot all disappear, you would think that the portability that comes with that would see competition intensify there, but, in the same context, until there is more account portability for everyday banking, it is difficult to intensify that competition at this stage.

Mr Stace—Yes, that is absolutely right. I would add one thing. Even when exit fees have gone—and, as I say, we would call for that to happen sooner rather than later—there will be a moment in time where organisations like Choice and others—for that matter, we would hope the banks too—needs to encourage people to change their behaviour and move accounts, move mortgages and so on, because we have had centuries, if you like, of consumer inertia, and it does not just change overnight. So there is a period of time where it will take efforts on all of our parts, really, to encourage the market to work better than it has worked before, even with those new mechanisms.

Just a brief example: when we put up the ditching site for our members we had record numbers of people come to that site, and a quarter of those people, extraordinarily, have looked to move account as a result, so there is a real appetite. When you generate the demand and encourage people to do that and to take some action, I think people will. The problem is, up until now, there has been very little opportunity for people to do so. Then of course, once they get to the point where they are going to try and switch, it is then enormously difficult for them to do so. So removing those barriers is one thing; changing consumer behaviour will be the second thing.

Senator BRANDIS—Mr Stace, I want to take you back to some remarks you made a few minutes ago about the consumer interest. It seems to me that there are different consumer

interests to be served here. Consumers or bank customers have an interest in the stability of their financial institutions, you would agree. Bank customers also have an interest in banks and other financial institutions being competitive so that they can be the beneficiaries of what competition brings, and you agree as well.

Mr Stace—Yes.

Senator BRANDIS—Yet those are potentially inconsistent interests, aren't they? A perfectly stable system is not necessarily a competitive one and a perfectly competitive system will never be a stable one. It seems to me, Mr Stace, that the view you were putting to the committee was that perhaps at the moment we are in Australia placing too much weight upon the prudential aspect—the stabilisers—at the expense of the opportunities to expand the opportunity for competitiveness. Is that a fair reading of your message?

Mr Stace—I would not accept your premise that stability and competition are at odds with each other.

Senator BRANDIS—Well, they can be.

Mr Stace—It is true that if you go from one extreme to the other it certainly can be, so if you said, 'Actually, all that matters is stability—that is the only thing that matters and we will create a system that only has that as a focus,' sure, competition does not get a look in, which is where we think we are now.

Senator BRANDIS—Sorry, just pause there. Is that right? Choice's position is that the Australian system at the moment is at that extreme?

Mr Stace—It is more at that extreme.

Senator BRANDIS—Okay. Go on.

Mr Stace—Would you like to add to that?

Mr Lloyd—We think the balance needs to swing back towards competition and, as we have said, we recognise that it was right to put stability first during the GFC but we need to see the pendulum of attention swing back. We are not saying it is right at the extreme pole but clearly, as I have said—and it is not just our opinion but as the previous ACCC chairman has said—decisions that were taken during the GFC have moved the balance further towards the stability end of the spectrum and away from the competition end. So we want to see a rebalancing.

Senator BRANDIS—So it is Choice's position that the current prudential regulatory framework ought to be relaxed to introduce more competition even at the price of greater risk—is that is right?

Mr Lloyd—No, we were saying something slightly different. In fact, we said that we do not want to see the relaxation of oversight but we think there may be other barriers that impede new entry and growth. One of those is on the demand side in particular, which we of course always

emphasise because we are here to try to speak up for consumers, and that is the lack of mobility in the sector.

Senator BRANDIS—When you talk about mobility in the sector, is that a generic way of talking about the lack of switching between accounts?

Mr Lloyd—Yes. Absolutely we are not saying, ‘Let’s relax oversight.’ We all want stability, but we want to look for ways consistent with that that re-emphasise the importance of competition within a stable system. Our contention is that those two are not necessarily in conflict and that you can achieve stability and greater competition. In fact, if you are a confident banker you have nothing to fear from greater competition because, if you are competing on price and quality and consumers are more mobile in a stable sector, you will win.

Senator BRANDIS—Let me draw you out on one particular recommendation in Mr Swan’s announcement, as it appears to me, on a fair reading of it, and that is: lowering the threshold requirements at which an institution can describe itself as a bank. You might have heard Dr Laker from APRA, earlier on, acknowledging that the word ‘bank’ has a certain cachet in the consumer’s mind of being a big and stable institution, whether that is true or not it certainly has generally been true in Australia. Is it Choice’s view that the threshold requirements for institutions to describe themselves as banks should be lowered?

Mr Lloyd—I think there is a perception issue here. Certainly, we have found in talking to our members that there is an issue about confidence in some of the smaller players and there is an issue about a lack of information about the smaller players. If you are looking purely from a price point of view, many of the smaller players in the market who cannot call themselves banks right now are offering the best deals. So, from a consumer welfare perspective, if there are tools to encourage, firstly, consumers to move around the market and, secondly, to consider the whole market, we would welcome that. Whether re-badging institutions as ‘bank’ is a tool that will affect consumer behaviour, we remain to see. But I believe some of the mutuals, for example, are welcoming that and believe it would work. I think we have to look very carefully at this and it is why I was saying earlier that behavioural economics is not a precise science, but we do know some of the things that work and, in part, it is about perception of the security, for example, of your deposits with a particular institution, and we have encouraged people to look at the mutuals sector for that reason.

Senator BRANDIS—I understand that but it does seem to me, Mr Lloyd, that you are putting a very high value on mobility, even at the price of introducing a greater level of risk into the system.

Mr Lloyd—Respectfully, Senator, I have to disagree. I think we do not have to forgo stability and security for greater mobility.

Senator PRATT—You cannot create stability out of lazy consumers or disempowered consumers. Surely it is the job of the regulators to get that balance right.

Senator BRANDIS—To make consumers more agile, Senator.

CHAIR—Thank you very much, Mr Stace, and the other members representing Choice.

[10.37 am]

CARTER, Mr Leon, National Secretary, Finance Sector Union of Australia

MASSON, Mr Rodney, Director, Policy and Communication, Finance Sector Union of Australia

CHAIR—I welcome the representatives of the Finance Sector Union of Australia. I invite you to make an opening statement.

Mr Carter—Thank you for the opportunity to appear. The Finance Sector Union of Australia is the trade union that represents workers in the finance industry particularly in the banking industry. We welcome the opportunity to come along to the inquiry to make a submission and, obviously, to answer any questions that you might have.

The FSU believes that banking in this country is very much in a privileged position. Australians must engage with the banking sector system whether it is to save money, to buy their house, to invest money or whatever the hell it is, even just to get paid. It is an essential service. From our point of view and from that of the members that we represent, you must apply the tests of banking being an essential service. We believe that there are tests that must apply to the banking industry beyond returns to shareholders and profitability. We think those tests should include things like responsible lending, sustainability, greater transparency around fees and charges and a whole range of other behaviours that ensure that the banks are not just actually profiting from the community but also servicing the community's genuine needs.

Unfortunately, whilst the banks probably get very good marks from most people about their returns to shareholders and their profitability, the FSU and a growing list of organisations believe that they are failing the tests when it comes to broader behaviours within the country. We see banks continue to offshore jobs. We see banks continue to have structures that not only encourage but reward our members and their workforce to push onto customers debt beyond what they can afford and beyond what they need. We see them continuing to resist any link between the fees and charges that they put in place and the actual cost of doing the work or even linking them to service levels within branches and call centres.

The FSU over a long period of time have undertaken fairly significant public research. What we have found, certainly over the last three or four years, is that there is an increasing appetite being shown by the public to genuinely engage in a debate about what banking system this country deserves and needs. The other thing we have seen happen over the last couple of years is that the views of our members and the public have started to align. At the end of the day, the people who work in banks want a better banking system. They hate the way that banks are seen in the community. They hate the way that they are forced to sell products and worry about meeting sales targets rather than offering genuine customer service to look after the genuine need to buy a house or a car or whatever it may be. So we have seen both the public and our members say very loudly and clearly that they think that banks are in the wrong spot at the moment, putting more emphasis on making money than on customer service. Both the public and our members think that customer service levels have decreased. There are less people in

branches and in call centres looking after customers at a time when the banks continue to make multibillion dollar profits year upon year.

When we talk to customers about the fact that our members' pay, and often their employment, is linked to how much debt they sell to those customers, they are horrified. They do not understand that, when they walk into a bank branch, our members are forced to try and sell them products, whether it be insurance, credit cards, home loans—more money. And, when they do find out about it, they want it stopped. But our members want it stopped too—they do not reject the notion of performance pay or incentives, but they want to be rewarded for offering good customer service, for complying with the law, not for trying to on-sell debt related products.

One of the issues that we have with the debate that is going on at the moment is that it is too narrowly focused. We do not think that, somehow, competition is going to be the panacea that fixes all of the ills that this committee is looking at, that the parliament generally is looking at or that the community is every single day talking about. If competition genuinely would change the behaviour of particularly the big four banks then their behaviour would have changed by now. It is absolutely true to say that there is less competition with them, particularly since St George and BankWest disappeared, but they compete very, very vigorously with each other for customers. It is not true to say that the big four are not trying to cut each other's throats to get the customers through the door. But we have not seen that level of competition change the behaviour of the big four banks. There is this notion that somehow, just injecting more competition will do that. We support more competition; we think the sector should be more competitive and we support anything that levels the playing field. But, at the end of the day, it is not actually going to fix the problems that this committee is looking at and I am sure you are hearing from the general public particularly on their concerns about banking.

We think the only way that you will genuinely create a better, sustainable and responsible banking industry in this country is to stop thinking of regulation as some sort of dirty word which is anti competitive and anti profit. It is not. At the end of the day this country's banking system is in fantastic shape because of the regulations that we have in this country and many of the lessons we learned coming out of the Asian banking crisis. So regulation has been shown to be a positive instrument when it comes to banking systems. If you want to look at the complete opposite, you only have to look at the United States, which has a complete lack of regulation around banking and it drove behaviours. What we say is that the behaviours that people are most concerned about—interest rates, the level of indebtedness at the household level, the fees and charges—come from an ability by the banks to do what they need and what they want to do. At the end of the day they are driven by profitability and return to shareholders. That is the only genuine thing that gets them up in the morning and that makes them money. And if that means pushing sales targets and pushing debt onto customers, then that is okay.

Interest rates in this country is such a critical issue because of the level of indebtedness. We are rightly having a debate about how those interest rates should be set. But what we are not talking about is the fact that every single day in every bank branch and every call centre around this country there are rem systems which are designed to increase the level of indebtedness. The hurt from extra interest rate increases is much more acute because of the level of indebtedness, yet our banks, day upon day, are pushing that debt onto customers and there is no regulation around that. There have been some movements around consumer lending but there is still no sense of going back to the good old days where what the bank was concerned about was meeting

your genuine credit needs. We are not anti credit, we are not anti debt, but it should be genuine credit needs.

So we welcome any opportunity to talk about this issue, but we think that the scope is too narrow and that the debate is too narrow if it is just about competition fixing the problem. At the end of the day we think we need regulations that make mergers much harder and, where mergers are proposed, there is a genuine public interest test. There has to be an end to rem systems in our industry that encourage and reward the selling of debt related products. As we have done with financial planners, what this country needs is the introduction of a law that makes it crystal clear that the interest of the customer must be put first, not hitting a sales target or not making more money out of that person. If we do that, we think we will end up with a strong, sustainable but responsible industry that not only looks after shareholders and customers but also values the workers. Thank you.

CHAIR—Thank you, Mr Carter. You mentioned that you think the terms of reference of this inquiry are too narrow. This inquiry was set up to address specific problems but there have been public calls from a number of people and politicians for a broader inquiry into the financial services industry or the banking industry and certainly the terms of reference of such a broader inquiry could incorporate the issues that you are raising. On that basis would you support a broader inquiry?

Mr Carter—We would support a genuine inquiry that looks at the whole framework of our industry, so absolutely we would support it. What we are not interested in is a Wallis mark 2 particularly, because I think, again, that it would be a narrow debate about how the big four would dominate. But we would welcome any genuine debate. We think the public is more engaged now in this debate than they have ever been and I think they would welcome a broad inquiry to look at the system—

CHAIR—Presumably, a broad inquiry could look at the issues that Wallis and—

Mr Carter—Absolutely, and it would need to.

CHAIR—But it could also incorporate the types of issues that you are talking about and examine how those fit into the overall system, and the desirability and consequences, as such.

Mr Carter—Absolutely.

CHAIR—You were also talking about how the banking industry is different from other industries, and I think your opening line was that, effectively, consumers cannot choose not to engage if they do not like the service or the price that is offered because it is an essential service. That is consistent with what Joe Hockey was talking about with the social compact with banks—

Mr Carter—Absolutely.

CHAIR—So you are comfortable with what Joe Hockey was saying in that context?

Mr Carter—Dare I say, that we might have come up with a social compact long before Mr Hockey did.

CHAIR—But he obviously liked it.

Mr Carter—Absolutely, and we are happy to be quoted when we are right! From our point of view, there has to be a social contract in this country that goes beyond just the interaction with banks where they make money from us. They have got to put something back into the community, so we are very supportive of the notion that with an essential service come certain responsibilities.

CHAIR—And also, I guess, the additional unique characteristic of the banking industry is that unlike the industry of manufacturing expanded polystyrene products, or something like that, if a bank falls over it actually has an impact on the economy in the broader sense. So it is not just an essential service from an individual's perspective; it also has much broader consequences.

Mr Carter—We have seen the impact of banks collapsing right around the world.

CHAIR—Exactly. It is lucky that we did not see it first-hand here.

Mr Carter—I think your point is absolutely right and that is why we say that they are in a privileged position given how much the community and the economy has to engage in them. They cannot be just left to their own devices. We get frustrated because there is still the notion out there that at some point the big four will wake up and change their behaviour. They have had lots of time and lots of pressure to do that. At the end of the day, if left to their own devices, nothing will change. You can increase competition and that might change some of their behaviour at the margins but until we have a genuine debate about regulations and laws that force them to behave differently, I do not think that they will even genuinely participate in that debate.

CHAIR—So moves by one of the big four banks to reduce fees and remove some fees in some instances and to maintain their variable loan rate at the lowest level of the others—do you see that as a move in the right direction?

Mr Carter—I think it is. It is—

CHAIR—And you do not think that the market can work that out? There are obviously market pressures that are leading that bank to make that decision. Other than the fact that it would be commercial decisions driving those changes, those commercial decisions are driving changes that are in the best interests of consumers.

Mr Carter—Absolutely. And they will always at the margins. But at the end of the day it has not forced two of the other big four to drop their exit fees and reduce their charges.

CHAIR—That may come.

Mr Carter—It may well.

CHAIR—Let us hope so.

Mr Carter—But where NAB is at the moment, they are running a genuine strategy to try and be different to the other three. They are genuinely reducing charges and trying to do the right thing by their customers and, for the most part, their workers too. It is a genuine strategy; they are not just making it up. But at the end of the day they have to make money. Until we have a genuine debate that allows all four to behave in that way and not be punished, we will not have the change that we want. If you listen to the analysts talk about the National Australia Bank, they kick them from one end of the street to the other because they are dropping fees and charges. That is part of the debate that we have to have. It has to be okay to change the framework and structures of our industry to reward the customers, the workforce and the economy rather than Cameron Clyne getting a kicking for daring to drop exit fees because of the revenue that they will lose.

CHAIR—Understandably, your submission focuses significantly on remuneration structures and representing your members. How would addressing remuneration structures in the way that you talk about address issues surrounding competition, which is what is relevant to this inquiry?

Mr Carter—From a couple of different angles. If we can get it to the point where at least one or two of them start to have remuneration systems that reward customer service, compliance and responsible lending then they will have a competitive advantage over ones that have a sort of ‘do you want fries with that?’ mentality. Our members at the moment are forced to go through a script with every customer who walks into a bank branch, no matter what they are there for. It is: ‘Have you got a credit card? Is that limit high enough? Do you want another home loan? Blah, blah, blah.’ It goes on and on. If you offer a different banking experience where if you come and just want to drop off a deposit it will be looked after and done 100 per cent right and you can walk out the door whistling—which is what most customers want to do, rather than listen to a 15 minute sales pitch—we think that that will provide a genuine competitive advantage to whichever bank does that. That is part of the thinking that is behind that strategy. It will make a difference in competition. It will drive different behaviours.

CHAIR—But you are advocating that the banks be forced to change.

Mr Carter—Absolutely. They will never change. At the end of the day, their business model—

CHAIR—But if there is competitive advantage in it then why wouldn’t they choose to do it?

Mr Carter—Because they are not going to break ranks until they are forced to. That is our assessment. At the end of the day, it would be a very brave bank to drop the amount of revenue that comes from the sales culture currently within the industry.

CHAIR—But you think that it would be to their advantage if they did.

Mr Carter—Absolutely. In the same way, banks that do not offshore jobs get a competitive advantage. The Commonwealth Bank has never sent a single job offshore.

Mr Masson—Going back to Leon’s opening comments, which were about the way in which this debate has been cast in terms of competition and why we see it as being narrow, we think that if you address some of the behavioural elements around our banks’ operations and

behaviours then you would in fact increase consumer confidence in the sector and raise the professionalism bar of the industry more broadly. We think ultimately that would be a terrific outcome. Whether four, six or 10 banks are in operation would not matter necessarily providing the behaviours were in place to ensure that they were acting in the interests of the broader community as well as in the interests of their other stakeholders. In responding to the question about conflicted remuneration, we talk about it from a behavioural point of view as opposed to perhaps a competitive point of view, although we would maintain that the public will respond to some changes on that front.

CHAIR—Do all ADIs have similar remuneration structures? Do the mutuals or the smaller banks do it differently?

Mr Masson—There is some difference. The big four are particularly aggressive around sales targets. The next layer of banks, such as the regional banks, may have some variation in that it may not be put on to the individual but rather the bank branch; a collective target may be in play. Credit unions have varying structures depending on the credit union. It may impact individuals; it may impact the whole of the credit union—

CHAIR—They might still have similar approaches.

Mr Masson—They still have sales targets and incentives that, we believe, put their remuneration into conflict with the best interests of consumers.

Senator HURLEY—Continuing the discussion about service standards, you rightly pointed out that people are disgruntled with the way that banks do business and that is picked up by the staff. At least a couple of the banks have quite extensive campaigns talking about their service levels. Clearly, they are feeling this as well. Do you think that that is just to change perceptions or are they reflecting that in the way that they are providing their service?

Mr Carter—That is a really interesting question in lots of ways. If you look at the ANZ advertisements, which are enormously popular, they are actually reinforcing all of the stereotypes about why the banking system is not doing well from a worker or a customer point of view. But they have not led to a great number of people coming to ANZ. They are definitely responding to the feeling that they are picking up from the customers that customer service is something that is valued. But they do not offer anything new. What our members say to all of their employers is, ‘We are not allowed to offer good customer service because you force us to spend every minute talking to the customer about selling them something.’ Rather than the notion of engaging and listening, it is about using the script. If at the end of the day, at the end of the month or at the end of the quarter a staff member has not sold x number of credit cards, home loans or referrals then they get poor performance pay and could lose their job. They pick it up, but we would say that it is lip service, really. The fact that they produced a Barbara ad to make fun of their own stereotypes and turn it into a comedy show is not a great outcome as far as we are concerned.

Senator HURLEY—I was very interested in your point about the level of indebtedness. I suppose that we have focused a lot on the mortgage rate. But it is in a household combined with credit card debt and personal loans on cars and all kinds of other things. It does all contribute to the pressure that people feel.

Mr Carter—Particularly credit cards.

Senator HURLEY—Yes. We have seen some quite large variation in credit card interest levels. Do you think that that is a result of competition or some other factor?

Mr Carter—I am not really in a position to comment as to whether it is a result of competition. What we know is that the behaviours of sending unsolicited credit card offers and offers of increases to limits is about making money and hitting sales targets. At the end of the day, they set their rates to maximise their profit.

Mr Masson—Interest rates have been pushed up well in excess of Reserve Bank rates for mortgage lending. The consequence for the people we represent is that their targets are increased. They are not decreased as a consequence of greater pricing levels or customer backlash; they are increased. The pressures that are on our people remain. In terms of credit cards, interest rates may fluctuate. Because of the exposure around the amount of interest that is being charged, perhaps banks are feeling public pressure and reducing some of those things. But they will still continue to demand that their workforce move the maximum amount of credit cards and increase credit limits wherever possible; wherever it looks like the consumer has not quite maxed out their card. Those pressures remain.

Senator HURLEY—One of the things about transferring bank accounts or your mortgage is that banks bundle a lot of things together, such as the mortgage, the credit card and so on. That is part of a deliberate strategy and something that employees are asked to sell?

Mr Carter—Oh yes, absolutely. They know, as we all do, that if you have got five different accounts or five different arrangements with the bank but you are just unhappy with one of them, unbundling that is well nigh impossible. It is a deliberate strategy. Once upon a time it was called all finance or bank assurers; it has had all sorts of names over the years. What banks want to be now is the one-stop shop to tie you financially for everything from financial advice, deposit, get your pay, super, insurance—all of that sort of stuff. So the more they bundle it up the harder it is to break out of it.

Senator HURLEY—Exactly. You also made an interesting point about competition. There is no doubt that during the 1990s a lot of the new entrants then did promote competition and did shake up the banks in the way they provided mortgages. But from anecdotes that I was hearing it also pushed people into quite a bit of more debt than they probably would have taken on normally. That was due to competition. These smaller groups want to grow quickly and do well, and of course that is selling debt. So they often talked people into consolidating the loans they had and then being able to take on more debt. Is that your experience?

Mr Masson—With the new entrants that appeared in the banking area came I think a further pressure to drive these types of behaviours that we are talking about that we think bring the industry into some form of disrepute. There is no doubt that they loaded up the remuneration structures of the people that they had out there selling these new products on commission basis, which drove behaviours such as maximising debt for consumers. Naturally remuneration will drive behaviours. So I think much of the new remuneration models we now see in play across the industry are very much a consequence of some of those new entrants arriving.

Senator HURLEY—What you are saying in a nutshell is okay, have measures to increase competition, but while you are at it make sure that the consumer is protected at the other end by ensuring that people are not pushed into debt that they do not need.

Mr Carter—That is right. In some ways, having listened to Choice's view that they feel the pendulum is too far to the regulation side and needs to swing to a competition side, we would perhaps argue that maybe the pendulum is not that far out and we actually need to see even better regulation, particularly around the behaviours of the industry, rather than just talking about seeing where we can introduce fifth pillars and the like. We had a fifth pillar in this country and we argued before this committee and others that perhaps it was not in the interest of this country to allow that fifth pillar to be bought out by one of the big four. Unfortunately that was not how the government of the day and the ACCC saw that matter. We think we are now paying the penalty for that. Nevertheless, when we talk about where we are now and introducing more competition, we need to see greater regulation about the way our banks behave to ensure that consumers get the proper outcomes.

Senator XENOPHON—You talked about a lack of satisfaction on the part of customers with banks, and I think Choice in their evidence and their surveys support that. However, the Australian Bankers Association in their submission say that surveys of bank customers show that overall customer satisfaction with their bank is high, with average satisfaction levels being 76 per cent. Who is right and who is wrong?

Mr Carter—Not to be too unkind, which maybe I am about to be, but the ABA has got to figure out what it wants to be in this debate. We would say that at the moment they are just apologists for the big four. We think they could actually have a positive role to play in a genuine debate about the banking system in this country, but to do that they have got to stop pretending that there is nothing wrong. I can remember the ABA right up until the world melted down through the global financial crisis saying that there is nothing wrong, that we and others were running around like Chicken Little. At some point they have to come to forums like this and debates that are going on and say there is actually something wrong, it is not all perfect, and the banking system in this country does need looking at. We have been holding our breath and trying to have that dialogue with the ABA for a long time and I hope that they take this as the opportunity to genuinely get into the debate and stopped just being apologists.

Mr Masson—Just on customer satisfaction levels, though, I think the important thing about that, for the people we represent, is that they go out of their way to try and service customers, and they are not given a great deal of assistance to do so. They are usually understaffed in the sense that there is never any relief provided for absentees and that sort of stuff, they have to deal with people who are now located offshore as a result of having lost colleagues who were retrenched by the bank in favour of cheaper labour and they are loaded up with sales targets. But they do try to do their utmost to service their customers in those difficult circumstances. We would like to think that customers recognise that it is not the fault of the individual they are dealing with that the service is maybe not as great as it could be. So in responding to the surveys they might think, 'I'm not going to whack the person who did their utmost to help me, so I'll give them a reasonable mark.'

Senator XENOPHON—Sure. Choice also made reference to the ACCC. I think it was an oblique, or perhaps not so oblique, criticism of the ACCC for showing a lack of leadership with

respect to their role in relation to mergers, particularly St George and Bankwest. What is your attitude in terms of the ACCC's role in bank mergers and competition generally? You are protected by parliamentary privilege.

Mr Carter—I am just trying to figure out how unkind I am! We had very vigorous exchanges—

Senator XENOPHON—A straightforward answer would be good.

Mr Carter—Absolutely, which I think I will do. We had very vigorous exchanges with the ACCC around that, particularly the St George merger. We made it crystal clear to everybody we spoke to and particularly the ACCC that if they green-lit that merger they would essentially end competition against the big four. As Rod said, we had a fifth pillar; it was called St George, and Westpac were allowed to purchase it. We think that the ACCC completely went missing at a time when they needed to stand up.

You could argue that, in the Bankwest sale, there was a bit more distress. They had a parent who was going to offload them one way or another. So on Bankwest I think they probably get a pass, but on St George they completely dropped the ball. We would say they completely missed their obligations to ensure greater competition by not allowing that merger to happen. They would say that their act does not allow them to stop that merger; we would disagree with that, but it is often why we say that the act has got to be changed to introduce some sort of public interest test to allow them to say no. So we think the ACCC completely dropped the ball on the St George merger, and since that merger there have been a number of public utterances from them in which I think they acknowledge that, if they had the decision over again, they would look at it very differently.

Senator XENOPHON—A bit late now.

Mr Carter—Absolutely. A thousand people lost their jobs as a result of that merger, and there are probably 2,000 or 3,000 more people who are going to lose their jobs. With the fall of St George, we have lost the only genuine competitor to the big four, and up to 4,000 people are going to lose their jobs out of it. No-one has won out of that.

Senator XENOPHON—Do you and the FSU trust the ACCC when it comes to looking after the interests of consumers in relation to the whole issue of the banking sector?

Mr Masson—Do we have trust in the regulator? Apart from, obviously, the position that we have put around some of their merger considerations, yes, of course. We trust regulators to do their job. Perhaps what we really need to see is a strengthened hand for regulators to be able to exercise a form of oversight of the industry.

Senator XENOPHON—But they did not do that with St George?

Mr Masson—No, they did not; and, as we have argued before, we were concerned about that decision. We think there are certain things that the ACCC might need—and we put those in recent submissions—and there may be changes required to the Trade Practices Act to make sure that they give greater scrutiny to those decisions.

Senator XENOPHON—I have two final issues. You recommended that the ACCC be given divestiture powers; how would that work, from your perspective?

Mr Masson—Where we see a major concentration in the market—for example, with particular superannuation and other investment platforms—we would think that the ACCC should be able to continually assess how the market is working where those levels of concentrations are and, where it is required, seek that there be divestiture by the parent body.

Senator XENOPHON—Finally, on the whole issue of the push marketing of debt, what you are saying is that it is relevant in the context of this inquiry because that affects the level of competition in the banking sector. You are saying that these sorts of practices distort the competitive framework.

Mr Carter—As Rod said before, primarily, it drives the behavioural agenda but in the context of this inquiry we think it is something that the inquiry should look at because it absolutely impacts on the behaviours and the competition that consumers are able to engage in.

Senator XENOPHON—Thank you.

Senator PRATT—We have had some discussion based on your submission and your evidence here today about the conflicted remuneration models of staff. I want to ask whether you felt that the consumer credit code would have any impact on, I suppose, that internal conflict or whether it, perhaps, would make the situation worse because staff will have a legal obligation and yet still be subject to these performance outputs.

Mr Masson—I think that is absolutely right. They will have a responsible lending element that they have to make sure that they have complied with and we think that is a good thing. We welcome the initiative by the government on that front. However, nothing within the current consumer credit act goes to the issue of conflicted remuneration at this point. We would encourage the government to have a very close look at this because imposing a responsible lending duty whilst remuneration is still applied through volumes of sales and the like seems to us to be at complete odds.

There is also work going on in the future of financial advice area for financial advisers as a consequence of the Ripoll inquiry which understands that you must also get rid of conflicted remuneration as well as lay over a fiduciary or best interest duty on people providing financial advice. Similarly, that philosophy should be moved into the broader financial services area including very much in the credit area. It is not currently on the agenda with the current reforms proposed by the government.

Senator PRATT—Thank you.

CHAIR—Thank you very much.

[11.13 am]

ZUMBO, Associate Professor Frank, School of Business Law and Taxation, University of New South Wales

CHAIR—Welcome Professor Zumbo. Would you like to make an opening statement?

Prof. Zumbo—Thank you once again for the invitation to attend today to give evidence. I will make some brief opening remarks simply to put my submission into context. Firstly, I will start by saying that the community and consumers are right to be concerned with the level of competition in the Australian banking sector. We have one of the most highly concentrated banking sectors in the world which ultimately is costing consumers very dearly.

We have heard in evidence to this inquiry that the Australian banking sector is competitive. We need to be very careful in the way that we use the word ‘competitive’. When we talk about competition we need to be careful to define what competition means. When I talk about competition, I talk about intensive competition, quality competition, that helps to drive down prices, in this case interest rates, and helps to keep down fees.

Competition can also mean workable competition or lazy competition or weak competition. The fear as to the Australian banking sector is that competition is less intense, weak and of less quality than it used to be. When I say ‘used to be’, I talk about the period between 2000 and 2007 when we had very intensive competition as demonstrated by the reduction of net interest margins during that period. We had St George, BankWest, Aussie Home Loans, RAMS and Wizard and those players provided intense competition that did keep the big four banks honest. With the removal of those competitors—St George, BankWest, Aussie, RAMS and Wizard—as independent competitors you saw the ability of the four big banks to start increasing their net interest margins, and they have been increasing since the removal of those independent competitors. So we need to be careful when we talk about competition.

In this sector competition could be more intense. We need to be careful to understand what has happened in the past and how we got to this position because there are lessons to be learned in this sector that are equally relevant in other sectors. Once again we need to prevent the concentration of markets because the concentration of markets is what is detrimental to consumers over time as price competition becomes less intensive. So we may have lots of products in the market and we may have quite a number of financial institutions in the market but it is the intensity of competition that we need to be mindful of—and it is less intensive.

We need what Senator Cameron talked of: countervailing power. There is a real absence of countervailing power. Seeking to rely on consumers to provide countervailing power is, with all due respect, naive simply because the competition has to happen at the institutional level between the financial institutions. Sure, we can empower consumers but if the offer in the market is very similar—so if we have the four institutions, the four big banks, shadowing one another on price offering the same terms and conditions or very similar ones and if it is difficult to exit from one institution to another—then consumers have very limited power. So that is the particular context. We do need to strengthen our competition laws because I believe we do have

some of the weakest competition laws in the world. They may be consistent with competition laws around the world but the reality is we have highly concentrated markets. That means we need to be extra careful to protect what independent competition we have left in those markets.

CHAIR—Thank you, Professor. You talk about the need for quality competition. We had evidence yesterday from the Reserve Bank governor and, I think, also from Treasury that the state of the market is highly competitive and they used terms that you raised then about the diversity of products and the number of institutions that are out there. So I would be interested in your view as to whether you think the market is currently highly competitive. Further, on the assumption that there is a high degree of competition that still exists, I asked the Reserve Bank governor whether that was, in fact, a legacy of the competitive factors that were in place prior to the GFC, particularly in the late nineties and early 2000s, which were being driven largely by the non-ADI lenders and, in the absence of those now, what would drive competition and deliver the quality of competition that you are talking about.

Prof. Zumbo—To answer that question, no, I do not believe that the market is highly competitive. The benchmarking that I use is to compare what is happening now with the period between 2000 and 2007. It may be useful at this time to say that I have drawn on Reserve Bank data, in particular a graph of which I have copies here, which is very instructive in terms of looking at net interest margins. In the period 2000 to 2007 we had net interest margins falling. That was because of the quality competition that was being provided by Wizard, RAMS, Aussie, St George and BankWest. As I said, we have got to be careful to define what we mean by competitive. I am looking for intensive competition. Intensive competition is driven by independent players providing intense competition. If you have got four major players dominating the market and the rest of the players are not offering that intensive competition, you do not have a highly competitive market.

I see net interest margin as a barometer of competition, the level of competition and the intensity of competition. The more intense the competition, the greater the pressure on net interest margins. As those net interest margins were falling, we could say that the market was highly competitive. It is always a matter of perspective and looking at the time period. It is clear that Wizard, Aussie and RAMS did shake up the sector in a way that other institutions have not been able to. Those players were very aggressive and we do not see that aggression today and, as a result, it is not as competitive as it could be.

CHAIR—You are saying that institutions like Aussie, Wizard and RAMS were key drivers of competition during that period that you are talking about. Where is the driver likely to come from now? If you cannot see a driver arriving without some form of intervention, what form of intervention would you recommend to help foster a sector of the market that does drive real competition?

Prof. Zumbo—We need to foster the securitisation market. There is no doubt that we need to foster a very competitive, securitisation market. The ideas that Yellow Brick Road put yesterday are ideas that need to be explored. We need to offer alternatives for a funding base and the securitisation market provides that alternative funding base. The period when there was a very health securitisation market in Australia was a period of the most intensive competition we have seen because those players had access to that financing and that level of funding, and it was competitively priced and they could deliver real competition to the four major banks. So we do

need to explore injecting real competition into the securitisation market and more liquidity into the securitisation market. The \$4 billion that the federal Treasurer announced for RMBS is just a drop in the ocean. We need greater liquidity in that market. We need to explore ways where that market is more sustainable over a period of time such that that funding is available to those non-major banks to provide cheaper home loans, for example.

CHAIR—The Reserve Bank Governor yesterday indicated that the level of securitisation that is occurring in the domestic market is approaching normal levels and that the remainder of the activity that we were seeing before the GFC was largely international interest in the Australian RMBS market, and that a lot of that was based on unsustainable business models like SIVs, which are not going to be in the market again. Where are we going to find the investors that are willing to invest in this expanded securitisation market? How do we promote a larger securitisation market in Australia?

Prof. Zumbo—We do need to explore opportunities to get those investors back in. They are coming back into the market. They are very tentative. I think they need to be nurtured and fostered back into the market. There needs to be a role for government to promote that confidence in that securitisation market. Over time, those investors will come in if they feel that the securitisation market is a secure market. There are models around the world. I point to the Canadian model as a way forward for—

CHAIR—How does that work?

Prof. Zumbo—There is government involvement. They guarantee—

CHAIR—I know you are not an expert in finance and securitisation; you are a competition expert. I do not expect too much detail.

Prof. Zumbo—What basically happens is that there is government support for that market. There is a program in place whereby the government guarantee supports the RMBS market such that it encourages investors to have confidence in that market. One of the recommendations I have put is that the Australian government should explore the possibility of that model and conduct a feasibility study through the Productivity Commission about the possibility of having that model here. The bottom line is we need to nurture confidence in that securitisation market—confidence that was rattled during the global financial crisis.

CHAIR—Obviously, the Treasurer announced a package of reforms on Sunday. Some of those reforms are aimed at trying to reinvigorate the securitisation market, but they also address other issues. As a competition expert, what are your views on the package as a whole? Do you think it is going to have much impact in ultimately reducing interest rates and otherwise introducing competition into the banking industry?

Prof. Zumbo—I have to say quite honestly that I am disappointed in the package. I believe the package that the Treasurer announced was a missed opportunity. I believe that there are aspects of that package that will support the big four banks and further undermine competition in the marketplace. For example, the ability to issue covered bonds will certainly be of greatest benefit to the four big banks, on the basis that they will be in a better position to offer covered

bonds, which will certainly be more appealing to foreign investors, for example, if they are issued by one of the big four banks.

The removal of the exit fees is only for new loans as of 1 July next year. The danger with that is that, firstly, it does not benefit existing mortgage holders. Secondly, there is a real danger that the banks will make it up in other ways in other fees, inflated fees, through interest rates. While we do have laws dealing with unfair fees, I have to say that ASIC has been very slow to enforce those laws, and suggestions that individual consumers can go to ASIC and that that will lead to an investigation are, I believe, once again naive. The reality is that agencies like APRA and the ACCC have limited resources. If a single consumer were to raise an issue, they would be likely to get back a form letter saying that it is not a priority area, it is just an isolated instance and the consumer has the ability to pursue private actions. The concern is not so much about prohibiting fees; it is not about outlawing fees. The question is about making sure that those fees are reasonable.

CHAIR—That is theoretically what ASIC is charged with looking at at the moment.

Prof. Zumbo—Theoretically, but the test for unfair fees and terms under that legislation may not directly focus attention on the issue of reasonable cost. I think that could be made explicit with amendments to the legislation itself, and that is one of the recommendations that I have put. You also have to be very cautious about references to unconscionability. Unconscionability is a very high threshold. It has not worked in practice. In terms of unfair contract terms, that legislation needs to be enforced. It is going to be very hard to enforce that legislation in particular circumstances because, firstly, the threshold for unfair contract terms is high also. It is not as high as unconscionable conduct, but it is still a high threshold, which means in practice it will be hard to enforce that legislation.

The point is that we need that enforcement action to occur. We need clear guidance, not just through a publication but through the courts having to look at and give some substance to those laws. At the moment they are not being enforced through court action, and the sooner they are the better it will be. I am not suggesting court action or litigation. I am suggesting that for those existing mortgage holders, unless action is taken through direct enforcement to provide an example of a type of fee that will be unfair, the danger is those unfair fees will continue.

Senator HURLEY—You started off by saying that we have not got enough competition in the banking industry. Measures have certainly been undertaken to improve that, and that is of course what this inquiry is set up to investigate. You used the interest rates and margin for the major banks. How about the Treasury submission to this inquiry? They include a chart on bank net interest margins and they say they have used:

... RBA data on bank net interest margins since 1981. It shows that bank NIMs have declined steadily since the early 1990s and have roughly halved since the mid 1980s. They were at historic lows prior to the onset of the financial crisis.

This trend can be attributed to increased competition in lending as well as the removal by banks of internal cross-subsidies through the introduction of a user-pays pricing system.

Chart 7—

Which is the chart you distributed—

shows the NIMs of the major banks since 2002, indicating that these have increased slightly since the onset of the crisis in mid-2008. However they are still well below 2002 levels. In addition, they declined on average in 2010.

What do you think of Treasury's assessment of that?

Prof. Zumbo—Senator, I should point out that in a period from 1980, yes, we did have competition and competition did drive those net interest margins down. What we are talking about is a period from 2000 to 2007 when the intensity of the competition increased even further, such that those net interest margins were driven down further. We do have periods of competition, 1980 through to 2000, in the sense that we did have more regional banks. We did have more competitors out there. But through a process of consolidation, mergers and acquisitions, the big four banks have become bigger and bigger. Over time you had the import of players such as Aussie, RAMS and Wizard. When those players were taken out, when St George and BankWest were also taken out, we did see a change.

The interesting thing about the graph that I circulated is that the net interest margins on Australian operations are healthier than in terms of consolidated global operations. The Reserve Bank points out in that case that the four big banks have been better able to recover their increased cost of funding in Australia. The point I make there is that when we look at the banks' cost structure we also have to look at their revenue. In terms of looking at their income, we cannot simply look at the increased cost of funding. We have to look at their ability to raise revenue, to raise interest rates. The reason I focus on that is that it helps to explain why they are making record profits. While their cost of funding has been going up, in Australia—

Senator HURLEY—You are saying they are making record profits—that is in absolute terms, and we have had the NAB saying that their return on equity and so on, their relative profit has gone down.

Prof. Zumbo—I will get to that, but just to paint the picture: you cannot just look at increased costs of funding, because you have to look at their ability to raise their interest rates. The reason I focus on the ability to raise interest rates and to raise revenue is simply that that is also a reflection of the level of competition in the marketplace. That is, if there is more intensive competition, their ability to recover those costs of funds will be reduced. Hence the explanation for graph 26: in Australia the Reserve Bank does point out that the four major banks have been more able to recover their increased cost of funding through higher interest rates than they have been overseas. That is a point of difference. Because the level of competition in Australia is less intense, you have got a situation where the four major banks are—

Senator HURLEY—You are saying that Australian competition is less intense than overseas?

Prof. Zumbo—Less intense, yes, because it is a more concentrated—

Senator HURLEY—Than overseas operations?

Prof. Zumbo—Overseas they have not been able to recover their cost of funds in the same way that they have been—

Senator HURLEY—Because of competition?

Prof. Zumbo—Yes.

Senator HURLEY—Let's talk about securitisation. You said that the \$4 billion that the government has now committed to put into the RMBS market is a drop in the ocean. How much would you like to have seen the government put in?

Prof. Zumbo—It is for others to say the amount of money that could be provided. I take the view that we need more liquidity. I am supported—

Senator HURLEY—And it is the government's responsibility to do that?

Prof. Zumbo—Ordinarily, the government should have a minimal role in properly functioning markets; that is the basic premise on which I start this conversation. However, where you do have market failures, I believe it is a legitimate role of government to intervene in those market failures. We currently have a market failure in relation to the securitisation market, because there is a lack of confidence. In the same way that the government provided confidence with retail guarantees on deposits to prevent a market failure of money shifting around the system to cause instability, the government can provide stability within the securitisation market by overcoming an existing market failure. But, once that market failure has been removed and confidence returns, the government withdraws, and that is the beauty of government involvement. It can come and go to fix a particular, specific problem.

Senator HURLEY—So you are talking about the Canadian mortgage backed securities program. I did not really get how that worked.

Prof. Zumbo—The Canadian model works by providing a government guarantee of the RMBS, the security part of it.

Senator HURLEY—That would not be anyone who wants to put up an RMBS—or is it the banking—

Prof. Zumbo—It is a source of funding that is available within that market. I am suggesting that we explore that in the same way I am suggesting that we explore Australia Post offering banking services. The purpose, obviously, of the inquiry is to have a debate about ways to move forward on this issue. It is about exploring possibilities to overcome existing market failures. There is a model in Canada that works, as I understand it.

Senator HURLEY—On the Australia Post type one or the RMBS?

Prof. Zumbo—No, I am saying generally that we need to explore ways to inject competition. In the securitisation market, we can explore the Canadian model. In relation to direct competition in the Australian sector, we can look at Australia Post. So it is about exploring ways of injecting new competition. Let me be absolutely clear: there is nothing in my submission or in my comments to suggest that I would want to weaken the four major banks, absolutely not. We all—

Senator HURLEY—Well, you have talked about divestiture. If it is not them that you are targeting, who else would it be?

Prof. Zumbo—The divestiture power is the power that would not be unique to Australia. It is available in the United States; it is available in the United Kingdom, and it is only available in certain specific situations—that is, as an absolute last resort.

Senator HURLEY—So you are not saying that we need divestiture now. You are reiterating a general principle. You are not talking about the banking system as such.

Prof. Zumbo—Let me talk about divestiture; let me be very clear: I am talking about a power of divestiture. I am not saying—

Senator HURLEY—Yes, I understand that, but you presented it in terms of this inquiry, so I am asking if you are just pursuing your general case for divestiture, which we have heard before, or if you are implying that there is some need for divestiture of the banking system.

Prof. Zumbo—I am implying that there is a need for a power of divestiture that is applicable in a sector like the Australian banking sector.

Senator HURLEY—Specifically or generally?

Prof. Zumbo—I am very concerned about industry-specific legislation. I think the general principle has to be that legislation has to be of general application which allows—

Senator HURLEY—Yes, I understand that, but I am asking: are you raising this because you think that, in order to increase competition, the banking system is ripe for divestiture now? Do you see this as one solution—increasing competition?

Prof. Zumbo—I am not suggesting an immediate divestiture of banks, absolutely not. I am suggesting there needs to be a power available to our regulators, a regulatory device that could be used in future in appropriate circumstances in the same way it is available in the United States and the United Kingdom.

Senator HURLEY—You have also recommended amending the Banking Act to provide for 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 be altered only by parliament. Do you see any moves by the four major banks at this stage to merge or is that, again, just a general policy of yours?

Prof. Zumbo—Maybe I can answer that question by saying that, if there were not a four-pillar policy, the four major banks would seek to merge with one another. Time and time again we hear CEOs of the major banks call the four-pillar policy into question, and other commentators have called into question the four-pillar policy. My deep concern is that it is only a policy. It could at any point in time be changed at the whim of a particular government in power, the suggestion being that the particular government may justify the removal of a specific four-pillar policy by simply saying that there are competition laws that would prevent mergers between the four major banks. I have a lack of confidence in those competition laws, those anti-merger laws, to

prevent the four banks becoming three or two. To safeguard the consumer interest, the public interest and, ultimately, the national interest, I do believe that parliament should have the final say as to whether those four banks are able to merge and, hence, to specifically legislate the four-pillar policy.

Senator HURLEY—Thank you.

Senator XENOPHON—Out of an abundance of caution, I should disclose that I have covered the travel expenses of Professor Zumbo to Adelaide for the purposes of a number of meetings. It has been quite a while since then, but it has happened in the last couple of years. Professor Zumbo, the committee has received a submission to this inquiry from Mr Brent Fisse, cautioning that amending the Trade Practices Act will not stop price signalling because corporations are likely to react strategically in ways that pursue their rational self-interest while avoiding liability. What is your response to that? Is it possible to constrain the banks in what they say to their shareholders, either privately or publicly, to the media and to other banks before moving rates?

Prof. Zumbo—That is a very good question. There has been a lot of focus on price-signalling, and I think we need to put that into some context. Price-signalling is a symptom of a problem. Price-signalling is not the cause of the problem. The underlying problem is a lack of real, quality, intensive competition. The underlying problem is the greater concentration of the market that we have seen, the increasing concentration we have seen. Where you have a highly concentrated market you do have a problem with price-signalling, but the price-signalling is a reflection of the highly concentrated market.

Price-signalling is one of those areas that is very difficult to tackle from a legislative point of view. What Brent Fisse and other commentators are suggesting is that, if you get the legislation wrong, it will have unintended consequences. It can distort competition. As a long-time advocate of reforming the Trade Practices Act and the Competition and Consumer Act I have no problem with strengthening the legislation and no problem with proposals to strengthen the legislation. However, we have to be very careful that, when we do draft the legislation, we do make sure that we hit the mark and that we clearly identify the evil. I believe the evil in relation to price-signalling is that you have one competitor basically telling another competitor in a variety of ways that if that other competitor behaves in a particular way on price, the competitor making the comment will also behave in a particular way. That is why price-signalling legislation has to be highly targeted to the particular mischief that we are concerned with.

Senator XENOPHON—You mentioned the question of intensive competition in your opening statement and the like. Cameron Clyne, the CEO of the National Australia Bank, said yesterday—and I think you were here—that the number of competitors ‘does not really matter’. I am trying to paraphrase him fairly. He said that is not the issue, that in the United States they have 8,000 banks, and he raised issues that there is a lack of competition and that their market is not as good as ours. He said it is about exit fees and transaction costs and the like. What is your view in terms of Mr Clyne’s general comments that it is not the number of competitors that is significant?

Prof. Zumbo—I agree with Mr Clyne that it is not the number of competitors that is necessarily the issue. It is the intensity of the competition provided by those competitors in the

marketplace. You could have one of the big banks providing intensive competition if they so chose, and to some degree NAB is providing some level of tension. However, in an oligopoly structure, there is little incentive for one of the players to be aggressive because, all that does is cut their profit margins over time. They simply fall into a cosy club arrangement. So what you need is those independent competitors who, for lack of a better word, disrupt the oligopoly.

Senator XENOPHON—Isn't NAB doing that to some extent by going outside the field in terms of abolishing penalty fees and the like?

Prof. Zumbo—Even within an oligopoly structure, one of the oligopolists may engage in periodic bouts of competition or, as I describe it, the odd angry shot—that they will seek to jockey or position themselves. To say that oligopolies never compete at all is not correct. They will compete to varying degrees. It is the intensity of the competition that you look at. Yes, NAB is firing those odd angry shots at the moment, but will that continue over time?

Senator XENOPHON—They would probably argue that it is more than an odd angry shot.

Prof. Zumbo—Or shots. But, yes, if we had intensive competition provided by the oligopolists, that is fine, but in practice, as a matter of market behaviour, they will go into a particular pattern over time. I cannot emphasise enough the impact that Aussie, RAMS and Wizard had. Through my contacts in the banking sector over many years I can tell you that when Aussie, RAMS and Wizard were in the market there were crisis meetings occurring at the four big banks to respond to the competitive threat. They took those players seriously, it ruffled the big players' feathers, and those four big players could not wait to remove those players.

Senator XENOPHON—We are hearing from John Symond from Aussie Home Loans later today. You are saying that it is no longer a significant player because its ownership structure has changed?

Prof. Zumbo—Yes. Ultimately, they are neutralised to some degree. We wait to hear the evidence later this afternoon, but the reality is that, if one of the significant shareholders is a major bank, that may limit your freedom of action to some degree. To the extent that it does is a matter for others to give evidence on.

Senator XENOPHON—Finally, the FSU in their evidence talked about the fact that they saw St George as a fifth pillar in the banking system and that the merger of St George with Westpac, or Westpac taking it over, was a very bad move for competition and that the ACCC made a bad call in relation to that. Very briefly, how significant was the merger of St George with Westpac in terms of competition in the marketplace? Do you consider that there ought to be a strengthening of the merger provisions in terms of the ACCC with respect to any future potential mergers?

Prof. Zumbo—There is absolutely no doubt in my mind that the St George acquisition by Westpac was a huge mistake. It was the beginning of the end. It was the tipping point. St George was an intensive competitor, particularly in relation to small businesses. St George was very active in the small-business lending market. That was the tipping point. St George could have become the fifth player and probably would have become the fifth player. St George was a great success story, from being a building society through to being a smaller bank, becoming a larger

bank and, potentially, a major bank. Having taken out St George, the four big banks basically took out one significant threat to them overnight.

Senator XENOPHON—You do not see that the mutuals are really competing when it comes to small to medium business finance in any significant degree?

Prof. Zumbo—I am a great supporter of credit unions. I believe that over time they will provide competition. There does need to be some consolidation in the credit union sector. There needs to be support in terms of a retail guarantee to provide total confidence. Particularly with input from players like Yellow Brick Road, in terms of providing the finance expertise that the credit unions traditionally have not been renowned for, credit unions can be a strong competitive force over time, but the real limitation of the credit unions at this point in time is the lack of a widespread branch network. That is why I have suggested that Australia Post should be considered for its own banking licence, because it has a very extensive branch network.

Senator XENOPHON—Which the chairman of Australia Post does not want to be involved in. Only last week, Mr Mortimer said he did not want to do that.

Prof. Zumbo—That does not stop us from undertaking a feasibility study. The model works very well overseas. The opinion of an individual, obviously, has to be taken into account, particularly given he is the CEO—

Senator XENOPHON—He is the chairman.

Prof. Zumbo—The chairman—but ultimately the government has the final say as the ultimate owner of Australia Post. Obviously we need to test that proposition.

Senator XENOPHON—Mr Hockey's suggestion—and I think others have suggested this—is that you use the retail branches of Australia Post as a distribution network rather than it being a bank itself. Won't that make a difference, rather than Australia Post setting up as a bank in its own right?

Prof. Zumbo—Absolutely. As an alternative, I suggest that Australia Post explore the possibility of a joint venture whereby it becomes a distribution channel. It is doing that currently; but it could become a wider distribution channel in particular products rather than simply facilitate people in doing their transactions through Australia Post.

Senator CORMANN—There seems to be this tension between the need for appropriate regulatory oversight—prudential oversight—and competition. This morning APRA has told us that their focus is on financial safety by keeping competition in mind. The representatives from Choice have told us that regulators should take competition as seriously as they do financial safety and that probably the balance has gone too far the other way. Do you think that the current level of prudential oversight has contributed to the level of concentration among large private providers in the banking sector?

Prof. Zumbo—Our prudential system is a very good system. I think it has been very helpful in insulating us from the worst excesses of the global financial crisis or from those things that led to the global financial crisis. I do believe in a very strong prudential regulatory system

because there is a real danger that, if you do not have a strong prudential system, the level of risk-taking by institutions increases—that is what gave us the global financial crisis—and then that undermines the whole system. So we need a strong prudential regulator; we need a strong prudential regulatory system. That is integral to a secure banking sector.

Senator CORMANN—Don't the larger banks have the best of all worlds? They benefit from the fact that strong prudential regulations make it harder for the smaller players to compete and, at the same time, the larger banks are too large to fail. So, while they are privatising their profits, they have a capacity to socialise their losses, so to speak. Isn't there an area in terms of the policy settings that needs some adjustment?

Prof. Zumbo—Absolutely. The issue of 'too big to fail' is something that we need to consider very carefully. I do believe that the four big banks are too big to fail. There is no government that I could ever anticipate letting one of those big major banks fail. The devastation to the economy would be so great that no government could tolerate that. So that does give those four big banks an implicit advantage—a considerable implicit advantage. It is certainly an advantage that the other players do not have or that they have to a much lesser degree. So, while the government may stand by and let a credit union fail, it certainly would not stand by and let a big bank fail. That has to be factored into the matrix because it creates a competition distortion that the regulatory framework does benefit the four big banks. That distortion needs to be countered by reviewing how we look at these other institutions. It is a very valid point in terms of whether that regulatory framework is distorting competition to some degree—and it is.

Senator CORMANN—Given that the big banks, as you say and as you agree, have reached a point where they are too big to fail, how does that then impact on their level of risk-taking compared to some of their competitors?

Prof. Zumbo—You need to watch those four big banks very carefully. One would hope that they are sensible in risk-taking. This is where bonuses and performance measures and what-have-you need to be carefully designed to minimise adverse risk-taking, because if you are creating these perverse incentives to behave in a particular way then that encourages greater risk-taking. So we do need to make sure that APRA, in particular, maintains careful vigilance over the four major banks, and I expect that they do.

Senator CORMANN—In terms of the policy settings and the tension between prudential oversight and competition, you think we have got the balance right. You would not be arguing for a lowering of prudential oversight in some circumstances in order to facilitate competition.

Prof. Zumbo—No, I would never advocate a weakening of our prudential system. I would, however, ask that we carefully review any barriers to entry in terms of the cost and time it takes to get a banking licence. But I am more concerned about promoting greater competition than about weakening or tampering with the prudential regulatory system.

Senator CORMANN—You talk about barriers to entry. However, big businesses, whatever the industry, will invariably find it easier to deal with significant and increased regulatory burdens than new businesses wanting to come in. Aren't those statements contradictory in themselves? Isn't it contradictory to say: 'I want to do something about barriers to entry but I want the prudential oversight, or I want it to be even more stringent than it is today'?

Prof. Zumbo—Once again, in talking in the abstract we have to be very careful. We talk about barriers to entry as an abstract term but it does not mean that we do not look at each and every one of those barriers to entry to see whether there is any finetuning of a particular barrier to entry, whether it is relevant or whether it maintains its relevance, or whether we can do it in some other way. Ultimately, a level of real competition in the marketplace is what benefits consumers over time. The prudential regulatory system is important to maintain confidence in the system because that is essential to underpin the system.

Senator CORMANN—In order to have enough competition you have to have enough players in the market.

Prof. Zumbo—Absolutely.

Senator CORMANN—I order to have enough players in the market, you have to have enough players who want to get into the market. If there is a regulatory framework that makes it too hard for anybody else to come in, other than those who are already there—

Prof. Zumbo—The point I would add is that not everyone needs to be a bank in order to provide that level of competition. Competition can be provided in a number of ways. When we talk about banks, there is a certain view of what banks are and obviously there has to be a strong prudential regulatory system there. There is securitisation and other mechanisms—property trusts, superannuation trusts—and they are all providing finance and tension in the market. So, ultimately, you have to look at it comprehensively rather than selectively.

CHAIR—Before we go to Senator Pratt, Senator Brandis has a follow-up question relevant to that.

Senator BRANDIS—It arises from Senator Cormann's question. It seems to me that the difficulty in trying to apply a pure competition model to this sector of the economy is that, whereas in all the other sectors of the economy that you can think of, where firms are in competition with each other, the difference with banks is that banks are deposit-taking institutions and therefore there is appropriately a higher level of prudential regulation for them than there is in other sectors of the economy. But the quid pro quo, or the trade-off, that we make in this country is to say that, in order to protect the interests of customers, we are prepared to accept a lesser level of ruthless competition among the banks? Would you agree generally with that proposition?

Prof. Zumbo—I would look at it this way: the quid pro quo should be a greater level of corporate social responsibility—an ability to share the pain. I think there is a deep community concern that, while everyone is doing it tough—everyone's cost of funding is going up; everyone's cost of living is going up—the banks seem to be doing very well. We talk about rates of return on equity and what have you, but banks do have an implicit guarantee by government.

Senator BRANDIS—Indeed, an explicit one.

Prof. Zumbo—Indeed. But inevitably they will always have an implicit guarantee because no government, as I said, would allow a big bank to fail. But there are express guarantees. There is

a strong prudential system that they get the benefit of. So the quid pro quo would be a sharing of the pain with the community.

Senator BRANDIS—And guarantees against failure are hardly characteristic of a competition market; in a sense they are antithetical to it.

Prof. Zumbo—Exactly. The theoretical risk of failure is what keeps players honest. If that theoretical risk of failure is gone there is no constraint in that regard on the four big banks.

Senator BRANDIS—Indeed. Thank you.

Senator PRATT—Professor Zumbo, I am looking at, I think, page 11 of your submission. We have already had some discussion this morning about your recommendation that the Productivity Commission assess the impact on competition. We have been talking about the impact on competition and that is why we are having this inquiry. We can all recognise that the absence of those players from the marketplace has had a profound impact on competition. The absence of the players is one thing, but there a variety of reasons behind why those players are absent. There are a diversity of reasons. With BankWest there were critical issues overseas with the parent company, and there were RAMS and Aussie, and it seems that Wizard's access to finance dried up. I am not all that familiar with what happened in the case of the St George Bank. It would appear to me that the government also recognises that the absence of those players is significant, which is why things such as the RMBS are important and why the work being done to assist companies to secure finance is significant. I would ask you to comment on that.

Prof. Zumbo—I think we have to have an analysis of why we got here. The easiest one to respond to is the St George Bank. That was simply an acquisition by a larger bank. There was no issue of a global financial crisis or whatever. With BankWest there was a fear, but around the time when the CBA took out BankWest the UK government bailed out the parent company. So in that context maybe the urgency was removed. I believe that CBA got a bargain in relation to BankWest. In terms of the other players, the securitisation market needs to be secured and sustainable over a longer period. I keep coming back to the proposition that we do need to have an assessment of what has happened and we need to support the securitisation market. My suggestion, respectfully, is that the federal government could do much more in that regard. We heard evidence from Yellow Brick Road yesterday on ways that that support could be provided, and I would certainly endorse all those suggestions.

Senator PRATT—It appeared to me that, as the merger between the St George Bank and Westpac continued, frankly, the St George Bank was behaving in much the same way as other members of the oligopoly, as you characterised them—and I do not disagree with that. In terms of the smaller players, what are the characteristics that we should be supporting to underscore competition between them?

Prof. Zumbo—The point you are making there is that we need to have independent competitors. Those independent competitors can arise in a number of ways. The key way is obviously through a lack of connection with the big major banks and the ability and willingness to break into the market and an aggression within that market in order to capture business from the four big banks in a way that Wizard, RAMS and Aussie did in the past—perhaps they will accept a lower profit margin; they work on turnover and more of it to get that profit margin—

and, in some cases, the ability to accept a lower return simply to get their foot in the door. But basically you have to provide the conditions conducive to those players emerging and that is where securitisation is a very good start. But ultimately, as I said, we also need to explore the possibility of Australia Post, in some way, assisting those smaller players to have products out in the marketplace.

Senator PRATT—Thank you.

CHAIR—As there are no further questions, we will adjourn for lunch.

Proceedings suspended from 12.04 pm to 1.01 pm

NAYLOR, Mr Phillip Gordon, Chief Executive Officer, Mortgage and Finance Association of Australia

CHAIR—I welcome our next witness. I invite you to make an opening statement.

Mr Naylor—Thank you. Einstein reportedly said that the definition of insanity is to keep doing the same thing but expect a different result. That is the essence of our submission. If that is too cryptic, what we are suggesting is that, if there is no further dynamic applied to the lending market in Australia, it will not change. In the mortgage market, banks are now writing 90 per cent of all business, which is up from 78 per cent pre-GFC. Nonbanks are writing about three per cent, compared to 13 per cent just before the GFC, while credit unions and building societies have held their own at around seven per cent. I have passed up a document which shows a history of those comparisons over the last two decades. You might refer to that to verify my comments, but you can see there has been a period where the non-bank lenders did not exist. They got up to a point of having 15.2 per cent of the market, which has dropped away again, whereas the banks have moved conversely and the credit unions and building societies have been pretty stationary throughout that period. The reason that the innovators and competition forces in this market—that is, the nonbanks—in the nineties and pre-GFC had their market share smashed is the collapse of the securitisation market, and that is clearly evident when you look at that document.

To its credit, the government has recognised this with the injection of \$16 billion of funds through the AOFM and the promise of another \$4 billion in the banking reform package. While that is welcomed, it will not be sufficient to revive the securitisation market and, therefore, will not have a significant impact on enhancing competition in the lending sector. In fact, the banking reform package is really a package of peripheral changes which do not attack the real problem of lack of competition in the industry. In fact, one of its planks, the banning of exit fees, will have the reverse effect by causing non-bank lenders to lose their most effective weapon in competing with banks: the deferred establishment fee. This seems to be a massive overreaction considering ASIC has only just recently announced guidelines for exit fees and deferred establishment fees and the method by which they will be judged to be unfair or unconscionable.

It can be seen by the document I passed up that non-bank lenders are clearly the providers of the lowest interest rates in the market. Some research I did yesterday on the internet rate comparison site Canstar showed that the average standard variable rate of 24 non-bank lenders and mortgage managers was 7.01 per cent, while the big four banks were at 7.79 per cent and the credit unions were at 7.32 per cent. This afternoon I checked the tier 2 lenders, the second level of bank lenders, and their average rate is about 7.68 per cent. So you can see that the non-bank lenders are clearly the price leaders in the market and always have been.

Two of the big banks have already dropped exit fees, so the organisations which are going to be most hurt by this banning are the non-bank lenders who are doing the most of all lenders to assist borrowers. This proposal clearly shows that the government has not understood the dynamics of the mortgage market. It is regrettable that it chose not to consult with the MFAA on this and in fact ignored our submissions. This is particularly galling as the MFAA has been the government's greatest supporter in the introduction and implementation of the National

Consumer Credit Protection Act 2009 through Ministers Sherry and Bowen and the very consultative officers of the Treasury. In our submission to the House of Representatives inquiry into this sector in 2008, we argued that what was needed was not a temporary or a bandaid fix but a permanent system whereby lenders could be assured of access to funds, irrespective of the economic environment. We pointed to the Canadian model of a good example of what can be achieved by a government. That suggestion was not taken up, primarily, it seems, because of the view at the time that the non-banking sector would regain its market share when market conditions normalised again. We had far less confidence that this would occur anytime soon than the authors of the report of that inquiry, and quite clearly we have been proven to be right. I regret to say that there is nothing in the banking reform package that will materially change this.

In the submission that we have tendered to this committee we have continued our argument for the government to look at the Canadian example and develop an Australian version as the dynamic necessary to bring about a change in the conduct of the Australian lending market. An independent review of the Canadian Mortgage Bonds Program carried out by KPMG in early 2008, just at the start of the impact of the GFC, commented:

In the current environment, some small lenders have recently entered the prime market or have expanded their presence in this market with the funding support of the CMB program. They can compete more on price since margins are wider and funding is reliable. Some can originate enough volume to be a challenge to the large lenders' market share. This seems to be changing the competitive dynamics, with small lenders becoming price leaders from time to time, and large lenders matching their rates.

I interpose here by saying that this is exactly what John Symond and Aussie did in the 1990s. The review continues:

This highlights the role of the CMB in supporting the competitiveness of the mortgage market in difficult market environments, and encouraging some pass-through of the funding cost advantage to consumers.

As I have indicated in the body of our submission, the large Canadian lenders all access the CMB program. In fact, 83 per cent of all issuances come from them. There is a good reason for that: pre-GFC the funding cost advantage of a Canadian mortgage bond versus the next cheapest alternative source of funding was 23 basis points. In early 2008, when the impact of the GFC had hit, the cost advantage was 105 basis points. So banks and nonbanks in Canada were accessing funding which were 105 basis points less than the next cheapest source of funding.

We accept that it is not as simple as just importing an overseas model holus-bolus into the Australian system, but there are many similarities between the Australian and Canadian economies and banking systems. There is a similar population and a similar provincial state structure. There are four major banks in Australia versus five in Canada. Most importantly, both countries have a robust and prudent banking system and a strong economy which has avoided the worst impacts of the GFC. We also accept that it would be a great leap in policy making that the federal government has previously declined to take, and it has long argued that the market is the best allocator of resources. We would normally agree with that rationale, provided—and this is an important proviso—there is an effective competition market in operation which we argue does not yet exist in Australia. It is instructive to note that of the 13 Western economies and banking systems considered by the KPMG review of the Canadian system in 2008 only two, Australia and the UK, had no government involvement in the mortgage market on the rationale

that the market is the best allocator of resources. Of course, history shows that that now does not apply to the UK, where effectively most of the banking system is owned by the government. The Canadian government took its decision to intervene initially by the issuance of mortgage backed securities in 1987 and then Canadian mortgage bonds in 2000 because it wanted to ensure competition in a residential mortgage market and to ensure an adequate supply at a low-cost mortgage funding to financial institutions. I would have thought they would be the aspirations and the objectives of the Australian government and Australian society.

On the independent analysis of KPMG, the Canadian system has achieved those objectives on an ongoing basis, whether in fair economic weather or foul. Furthermore, it has passed the most rigorous stress test in the past 80 years with flying colours by coming through the GST without missing a beat. The Canadian model, as well as achieving those social economic objectives, produces a profit for the government and a competitive rate of return for investors in the program.

As I implied at the outset, the Australian government has a hard decision to make here. It can do something short term, of a bandaid nature, and hope that things will turn out well, such as the \$16 billion injection into the securitisation market or in fact Sunday's banking reform package—that is, do the same thing and expect a different result—or it can grasp the nettle, as the Canadians have successfully done, and make a deliberate policy change that really makes a difference. Politicians usually say that they entered parliament to make a difference; well, guys, here's your chance. But everyone should understand that there will be no meaningful changes to competition in this industry until there is a strong and viable non-bank sector. History demonstrates this in Australia, as does the successful Canadian model. Thanks, senators. I am open to questions.

CHAIR—Thank you, Mr Naylor. When you talk about nonbanks, are you talking about non-ADIs?

Mr Naylor—Yes, I am. I will clarify that. I know that statisticians sometimes call credit unions and building societies nonbanks, but in using the terminology in our sector I am talking about non-ADIs, yes.

CHAIR—I assumed you were. I just wanted to clarify that to make sure. I think I used the NBFIs label yesterday with the Reserve Bank and they queried what I was talking about. You have outlined a lot of the characteristics of the Canadian mortgage bond model that you see as advantages that could be transposed onto the Australian system. How does the Canadian system work? What do they actually do?

Mr Naylor—The Canadian government has set up an institution called the Canada Mortgage and Housing Corporation—

CHAIR—That has been in existence a long time, hasn't it?

Mr Naylor—it has been, yes—and it does three things. It provides the normal things that a government department does, policy frameworks and so forth for the government; it acts as a mortgage insurer, but it also guarantees the mortgage backed securities; and it has now set up another body, called the Canada Housing Trust, which actually issues the Canadian mortgage

bonds. But the thing that underpins the whole system and the thing that attracts investors is that the whole issuance of the bonds and the mortgage backed securities are in fact guaranteed by the government, so that is seen as—

CHAIR—That is the key to—

Mr Naylor—That is the key to it, yes.

CHAIR—what they are offering and why investors are willing to invest in those bonds. Because there is a government guarantee, particularly in circumstances where confidence is damaged in certain types of securities, they can feel pretty confident.

Mr Naylor—Yes. The interesting thing is that, even though most Canadians live within a hundred miles of the US border, the Canadian system went through the whole GFC without missing a beat. I think during the GFC they issued \$300 billion worth of bonds or mortgage backed securities, so they were pretty well insulated from the problems that we and of course the USA had with securitisation.

CHAIR—You mentioned that the Canadian government make a profit out of it. How do they raise income from this? There must be more to it than just providing a guarantee—or do they provide the guarantee for a fee?

Mr Naylor—I think they provide it for a fee. I am not really au fait with the fine detail of it. But it is on the record: you can go and look at their accounts and you can see that they do make a profit out of it. In fact, that audit that I referred to earlier that was done by KPMG, published in 2008 and entitled *Canada mortgage bonds program evaluation*, sets out all the details of the program, how it works and its history, and it goes into fine detail as to the funding and the returns.

CHAIR—Have you spoken to Treasury officials or other government members regarding this model and its applicability to Australia?

Mr Naylor—I have tried to. As I indicated, there has not been much consultation on this in the last couple of weeks. The impression we got the last time we pursued this, which was in 2008, was that the view of the House of Reps committee and the government was, ‘This is going to pass over and we don’t want to make commitments to set up some permanent institution if the storm clouds are going to disappear.’ We were not very confident they would disappear and, while I do not claim to be any great predictor of the future, it turned out that we were right.

Our view is that, if you are going to try and solve this once and for all, you cannot go into it with just band-aids; you have to set up an institution that ensures there is funding available at low cost to not only non-bank lenders but also lenders right across the stream, whether they are credit unions, building societies or whatever, so that there is access to that and so that you can weather any future storms.

CHAIR—It is a fairly significant move for a government to make. Do you think it is something that should possibly be looked at as part of a broader inquiry into the financial

industry to fit in and help fund nonbanks, particularly, but also ADIs in the overall scheme of things?

Mr Naylor—As I said in our submission and in my opening statement, yes, it is a big change. But the risk is that I will be back here in two years time before this committee and the non-bank lenders will have disappeared from the market, credit unions and building societies will still have their five or six per cent and the banks will have 95 per cent and the inquiry will be saying, ‘Well, that didn’t work in 2010; what are we going to do now?’ To answer your question: yes, maybe it should be part of a wider inquiry but let us not leave it too long, because most of the nonbanks who are still operating do not have a lot left. In two years time they will not be here if nothing is done.

CHAIR—The housing finance market share growth that you give demonstrates very clearly how the nonbanks manage to claim a significant amount of market share. It looks like they may already have been slightly declining by the time the GFC occurred but then there was a rapid decline.

Mr Naylor—Yes.

CHAIR—We have had evidence here over the last couple of days that indicates—I think even from the regulators—that as the claimed that market share they were effective drivers of competition within the industry both in terms of price and products on offer. So they are clearly valuable in relation to the terms of reference of this committee, which is to look at the state of competition and where we go from here. Looking at the reforms that were announced by the Treasurer on Sunday, do you see anything in that package or that suite of reforms that will be of any advantage to the non-bank financial institutions—using your definition as non-ADIs?

Mr Naylor—As I said in my opening statement, the only one is the injection of the further \$4 billion. But that is not going to save them; that will keep them going for a little bit longer. I said at the start that I really regretted that the package seems to ignore the non-bank sector. They were the heroes of the past but now they have been cast aside.

To go back to your point: yes, the non-bank sector started to lose a little bit of market share just before the GFC. What happened then was that the banks decided to fight back. They realised that their service offering was not all that flash and they realised that mortgage brokers who were distributing a lot of the non-bank products were making inroads, and they started to compete by setting up their own channels of mobile lenders and so forth.

CHAIR—Which probably is not a bad thing for consumers because—

Mr Naylor—More competition—

CHAIR—banks are actually improving their service levels to try to win back the market share.

Mr Naylor—Exactly, but the point about it is that they would not have done that of their accord. They only did it because of the competition.

CHAIR—Because the competition was forcing them to do.

Mr Naylor—Yes.

CHAIR—Which is a classic example of the benefits of competition. On the specific measure of the removal of exit fees, you were saying that exit fees allow a lot of the non-bank lending providers the opportunity to compete. So what you are saying there essentially is that they compete on lower interest rates and then make up some of their costs through things like the exit fees. Is that right?

Mr Naylor—Not really. The offer that they make to consumers is: ‘We can offer you an interest rate which is at the moment around 0.7 per cent less than the banks, but to come on board with us we want some assurance that you are going to stay with us for a reasonable amount of time. Also, to make it attractive, we won’t change you any upfront fees, any establishment fees. But if you leave us within three years’—or five years, depending on who the non-bank lender is—‘we will then ask you to pay those establishment fees’; thus the term ‘deferred establishment fees’. Look at the comparison rates at the moment you would have to wonder why anyone would want to leave a non-bank lender to go to someone else.

I know that there has been a focus on non-bank lenders charging \$7,000 as a deferred establishment fee, and I suppose people always tend to look at the worse possible example to prove their point. Yes, that could happen, but it would only happen if someone had a pretty high loan—about \$700,000—and they switched within the first 12 months of the loan. I guess that is a decision they would go into understanding that. The ASIC rules that came down make it quite clear that whether those sorts of fees would stand in the future would depend on an ASIC assessment of them one by one as to whether they are fair and conscionable.

CHAIR—What is the consequence for non-bank lenders of the move to ban exit fees? How will that affect their operations? Will they have to put up their interest rates? What are they likely to do to try and retain market share and what impact will it have on their ability to compete?

Mr Naylor—They will have to put up their interest rates. Whilst you can say, ‘Oh, well, that’s fine’, if they put up their interest rates they are no different to the rest of the lenders in the market and why would there be any attraction for borrowers to go to those lenders if they were charging the same interest rates as the banks? The key to them being able to keep their interest rates low and operate at a low margin is to be able to have some stickiness in terms of the customer—not saying, ‘You’ve got to stay with us forever’, but at least for lower rates and no establishment fees upfront saying, ‘You agree to stay with us for three to five years.’

CHAIR—If they do maintain their rates at a level lower than the credit unions and the major four banks, as you have outlined here, surely people are not going to want to switch. Can’t they still compete on the basis of their interest rate offering and their service and keep people in that way?

Mr Naylor—In theory they could, but the reality is that to be able to go out to the market with confidence with those rates you need to have some certainty that you are going to be able to keep the customers. It would be futile for them to offer, to take an extreme example, 100 points less

than the market only to lose the customers the next day to someone else. So they really need some certainty that the customer is going to stay with them for a reasonable amount of time.

CHAIR—Also, I believe the non-bank lenders, because of their business models, probably have greater costs in attracting customers in the first place, through mortgage brokers or whatever, than banks, which have shopfronts and people employed permanently. Are there greater costs in getting people in the door in the first place?

Mr Naylor—I do not know that that would be the case, but they certainly pride themselves on keeping their costs as low as possible. That is one of their attractions.

CHAIR—I am not talking so much about the cost to the customer directly but about their actual internal costs, their operational costs.

Mr Naylor—I am not sure that I could answer that precisely. I will find out for you. The other point I will make about the exit fees is that, even though there has been a lot of media and hysteria about it, this is what mobile phone companies do every day of the week. They say, ‘You come and join us and sign up on a two-year contract and instead of charging you \$800 for the phone you can have it for free—but if you leave during the course of the contract we’ll charge you an exit fee.’ So it is not a model that is novel to this industry; it happens in other industries as well.

CHAIR—It attracts a bit of criticism there, too.

Mr Naylor—It does.

Senator PRATT—I want to ask your view of the Australian securitisation market drying up during the GFC despite the strength of Australia’s housing market. Despite the underlying security of that investment, why did that market dry up for lenders?

Mr Naylor—It dried up because we suffered unfairly from the odium that came from the US market. A lot of investors in the Australian securitisation market were overseas investors, and as soon as you mentioned the word ‘securitisation’ to them they disappeared. In Canada also there was a private securitisation market. That also dried up, for the same reasons, but people were less worried about a securitisation market that had some guarantee from the government.

Senator PRATT—Clearly a lot of action has been taken to try and build up some confidence in that, particularly in terms of government investment. But in terms of private funds, again from overseas, what are the perceptions of Australia in those markets now in terms of confidence to return and rebuild the sector?

Mr Naylor—Judging from the public statements from some of the securitisers, the market is starting to show a little bit of light. But there is still a fair amount of unease and wariness from overseas investors about the concept of securitisation without some sort of a guarantee.

Senator PRATT—Regarding competition factors, how significant is access to funds in allowing you to get back into the market to provide that competition?

Mr Naylor—It is crucial because the nonbanks do not have any other source of funding. They do not have deposits, so pretty well the only way they can get funding is through securitisation, and if they do not get securitised funds they cease to exist.

Senator PRATT—I would like to ask about offshore structured investment vehicles in the market and what kind of role they might play in the future—how important that they may or may not be.

Mr Naylor—I have to plead ignorance on that subject. I am not an expert on that.

Senator PRATT—We were talking just a moment ago about exit fees. You stated in your submission that much of the debate that we are currently engaged in—and it has been flying around over the past few days—has revolved around name calling, vilification, controlling interest rates and an over attention to regulating exit fees to encourage switching. Could you unpack that statement for me.

Mr Naylor—I wrote that comment about a month ago, but—

Senator PRATT—I would say that it is probably still true of the debate that I have seen take place over the last couple of days.

Mr Naylor—What we were concerned about was the bank bashing and some of the vilification and so forth of the players in the market. We did not see that as helpful. The point I was making there was that banks are like any other businesses. They have shareholders. They are expected to maximise their returns and that is what they do. You cannot blame them for that. They do things that people think are unfair or improper because there are not many competitors constraining them. That is the only point that I make. If there were more competitors in the market, they would not be able to do some of the things that people do not like them doing. That was the background to the statement. I have hopefully answered on the exit fee issues. We think that that is a sideshow. It is not the real issue.

Senator PRATT—So the real issue is competition.

Mr Naylor—And funding to ensure that there is competition.

Senator PRATT—Should the current program of AOFM support for securitisation be continued? Should its coverage be expanded or does reliance on government support for raising funds in the longer term indicate some problems with the business model? When do you think government support should be withdrawn? What should the sustainability of this sector look like in order to provide that competition?

Mr Naylor—If you look at the Canadian model, 30 per cent of all their mortgages are securitised through the national scheme. That is a big chunk. If you look at the Australian system, when it was at its peak in about 2003-04, 25 per cent of all the mortgages in Australia were securitised. So it looks like that if you get a critical mass of 25 per cent to 30 per cent of the mortgages in the market being securitised and available to non-bank lenders that you have some competition. For us to get to that in Australia would be difficult. The mortgage market in

Australia in the last 12 months was about \$170 billion. To get to 30 per cent, you would need about \$50 billion a year, so \$4 billion is not anywhere near that.

Senator PRATT—Returning briefly to the topic of exit fees, you have said that your sector can provide lower interest rates. I would have thought that on that basis customers would not want to leave if you are offering the lowest interest rate in any case and that there might be some benefit to the sector, when you look at the extent to which customers are currently bound to their banks, in intensifying the competition when you are already in the marketplace offering a lower interest rate.

Mr Naylor—In theory, that is right. But, as I said before in answer to Senator Busby, those players in the market are operating very much at the market edge. If they are going to operate offering the low rates that they do they want some certainty that they are going to hang on to the customer because you do not make much money out of a mortgage over the first few years. The longer the customer stays with you, the more money that you make. The reason that that deferred establishment fee is there—and we have always called it that, not an exit fee, because it is really the upfront fees that have been deferred to the end—is because they need the certainty of having the customer for a long period of time.

Senator PRATT—But is it really a sustainable business model if that exit fee is up near the \$7,000 mark?

Mr Naylor—If you are assuming that they are relying on the payment of the fee to keep them going, it is not sustainable. But they do not. In fact, I do not know that too many non-bank lenders collect the DEF payment. It is there to make sure that the customer stays with them for a certain period of time. They do not build their model on the assumption that everyone is going to leave in the first three years and therefore they are going to get \$7,000 per customer. That would be dumb. That is certainly not the business model.

Senator PRATT—We have had some discussion about the Canada models this afternoon. Your submission referred to the Canada Mortgage and Housing Corporation and Canada's National Housing Act mortgage backed securities. How does that act relate to mortgage securities in Canada specifically?

Mr Naylor—As I understand the sequence of events, the Canada Mortgage and Housing Corporation was set up initially to advise the government on housing policy. Then it got involved in mortgage insurance. Then it got involved, through that 1987 act, in underwriting or providing guarantees to those mortgage backed securities. I have not gone through the act in detail, but that is my understanding of what the act enables, which is the issuance of those securities.

Senator XENOPHON—Further to Senator Pratt's line of questioning, you referred to the \$7,000 exit fee. Even if it is for a \$700,000 loan, surely that is completely out of proportion to what the administrative costs incurred would be. Wouldn't that be unconscionable if it were for a variable rate loan?

Mr Naylor—I cannot answer the question. The point that I would make is that ASIC has put in place processes to determine that. If someone wanted to challenge—

Senator XENOPHON—Has that been tested yet, though? It is still early days.

Mr Naylor—No, it has not. ASIC only announced them in November. But they set out quite clearly the rule that you can only cover what are reasonable costs. If that amount for that particular mortgage was seen as grabbing an unfair or unconscionable fee, it would not be allowed.

Senator XENOPHON—What is a reasonable cost is not determined by the size of the loan; it is determined by what a reasonable administrative fee is in terms of termination or exiting.

Mr Naylor—The ASIC rules set down a list of criteria as to what they would take into account in determining what the costs are.

Senator XENOPHON—Sure. Yesterday, Mark Bouris from Yellow Brick Road financial management talked about the need for having a common standard—an apples to apples to comparison—for securities. In terms of residential backed securities, this would mean that you could actually see the quality because there would be consistency in how the assets used were assessed. Do you think that it is a good idea to facilitate a more liquid asset?

Mr Naylor—That makes sense to me. I have not thought it through; I have not heard it expressed before. But, off the cuff, that makes sense to me.

Senator XENOPHON—What is your view on Mr Bouris' view that there ought to be great liquidity to ensure that mortgage backed securities can be tradeable assets? Do you have a view on that?

Mr Naylor—I agree with him. The more liquidity attached to those assets, the more likely it is that you are going to get sustainable non-bank lenders in the market.

Senator XENOPHON—On the issue of competition for the sort of securities that your association deal with, Aussie Home Loans will be giving evidence later this afternoon. When there was fierce competition between Aussie Home Loans, Rams, Wizard and St George, was the market different from your perspective in terms of what your association had to deal with?

Mr Naylor—If you go back to 2003 when the non-bank lenders had a 15.2 per cent share of the market, all of the things that we are arguing about now—deferred establishment fees, for example—were all in existence then but no-one had any issue with them. The market worked then. People switched if they wanted to and there were no issues. But because we have a market now that is far less competitive, all the rocks are starting to come to the surface. They will continue to come to the surface the less competition that we have in the market.

Senator XENOPHON—Is your view that any further mergers or any further concentration in the marketplace would be a bad thing from your industry's point of view?

Mr Naylor—The mergers that have taken place certainly have not been good from a mortgage broker point of view. Mortgage brokers are the majority of our membership. The offer that the mortgage broker makes to the consumer is: 'Come to me. I can go through a whole range of different lenders and a whole range of products and find the most appropriate deal for

you.’ So the fewer lenders there are in the marketplace lessens the attraction of the broker and the pressure they can bring in terms of competitive forces in the industry.

Senator XENOPHON—Since the merger of St George with Westpac and other developments that have occurred, such as with RAMS and Wizard, have you had feedback from your members that it is not as easy to get that choice of service and, with that, as competitive and as robust a market?

Mr Naylor—Yes, absolutely.

Senator XENOPHON—What sort of complaints are you getting?

Mr Naylor—The complaints are mostly on how it affects the brokers themselves. I mentioned in my submission that there are conditions imposed on brokers, such as clawback provisions. If the customer decides to switch, the broker gets penalised by having their commission taken off them within a certain period of time. Some lenders have volume hurdles that say, ‘We won’t let you deal with us unless you produce so much business to us.’ Those sorts of things make the broker’s role more difficult. At the edge of the market, brokers who cannot comply with those conditions find it difficult to continue. As I have said, brokers are part of the competitive force in the market because they provide the retail face to the competition. A lot of the stuff we have been talking about is behind the scenes, the funding, but brokers provide the retail face.

Senator XENOPHON—How many fewer brokers do we have now since the GFC?

Mr Naylor—I can give you our membership figures. We had 13,800 members just prior to the GFC and we now have just over 12,000. So we have lost close to 2,000, and that trend is continuing.

Senator XENOPHON—It is continuing?

Mr Naylor—Yes. It is slow but it is continuing.

Senator XENOPHON—Thank you, Mr Naylor.

Senator WILLIAMS—Mr Naylor, you have talked about more competition. Correct me if I am wrong, because I am just a broken-down shearer not an academic expert, but the government had a wholesale guarantee for our institutions when they borrowed money overseas especially. The bigger institutions, the big four, had a higher credit rating so they could borrow at a cheaper rate. The credit unions, the smaller players in the game, had to borrow at the rate of the big institutions, plus some. They could not borrow as much. If the government were to reintroduce that wholesale guarantee on those small institutions at a nominal fee, not a hugely expensive fee, would that help in relation to letting those smaller institutions get their funds in at a lower rate so that they can be more competitive?

Mr Naylor—Yes, as long as you are not focusing only on credit unions and building societies.

Senator WILLIAMS—No, on many.

Mr Naylor—Yes, because I think the banking reform package focuses on building societies and credit unions as being the saviours of competition. Whilst they are important, they are not the sole providers of finance. In short, my response to your question is yes, but I still think that, on a long-term basis, we really need to look at more of a systemic change, such as that which the Canadians have in place.

Senator WILLIAMS—An issue I have raised with other people is that the retail guarantee goes on the ADIs but not on other companies that may well be secure, well-established companies. They were excluded, and it is obviously making it harder for them to get money invested into their companies when people say, ‘We don’t have the guarantee of the government on our investment so why should we invest with you?’ Even though they are conservative, secure companies with LVRs that are very low—in many cases, 40 or 50—they still find it hard, and they have had many of their funds withdrawn to go into the ADIs because of the government guarantee over the last couple of years.

Mr Naylor—You are right. I guess that is probably behind what I am saying. I have heard the argument, ‘The government should not get involved in guaranteeing securitisation.’ They have already done it in other areas. Whilst in the pure competitive model we would always be out there as a business organisation saying that the government should stay out of business and let business do what it needs to do, it seems that we have a difficult situation here in that the government has already stepped in to help some lenders. We are saying: bring in a more sustainable approach where everyone is helped and the government is not at risk.

Senator WILLIAMS—One of the more sustainable approaches would be to encourage more of our super funds to be invested domestically. We have \$1.3 trillion stashed aside for workers’ retirement and that could be invested here, there, and everywhere around the world. A carrot, perhaps, to attract more of that into our domestic institutions, with so much reliance on foreign borrowings, would bring it back to a domestic issue.

Mr Naylor—Senator, you are right. In fact, I remember sitting here two years ago and a senator asked me that very question. I just said, ‘I just happen to have spoken to a couple of superannuation funds and said to them, “Would you be interested in investing in mortgages?”’ and their response was, ‘Cautiously’, because they have other people’s money to think about. They said, ‘In principle, yes, but we need a lot of assurances about the guarantees and the safety of those funds.’ In principle, I think there is a market for them. They are interested, provided they have some guarantees.

Senator WILLIAMS—I used the words ‘blue chip’ yesterday, which I do not think was appropriate. But, if we do package together securitisation packages that are without risk—50 per cent equity in homes et cetera—that can then be offered to superannuation funds at a more inviting rate than just the deposit rate at a bank. Surely that would be inviting to them.

Mr Naylor—I would have thought so.

CHAIR—You mentioned that you needed an effective market for competition to work—that competition is fine, but if it is not effective competition then you will not get the right outcomes. Treasury noted in their Red Book advice to the incoming government after the 2010 election that the banking industry was oligopolistic in nature and that it needed careful watching by the

government to ensure there were no negative outcomes. Given that Treasury is labelling the industry as oligopolistic, do you think that backs your claims that there is a need for further steps to increase competition?

Mr Naylor—I think it does. I would refrain from using words like ‘oligopolistic’ because it sounds like a bit of a pejorative these days. Nevertheless, I think I have demonstrated that the industry is not as competitive as it has been and could be. Those general comments by Treasury support what I have been saying.

CHAIR—The reform package, as announced by the Treasurer on Sunday, is allegedly intended to improve and enhance levels of competition. I think you used a term similar to ‘playing at the edges’ in your opening statement.

Mr Naylor—Yes.

CHAIR—What do you think the actual impact of the measures will be? Do you think that it will enhance competition at all, that parts of it will, or that, on balance, it will have a negative impact on competition? Would you care to outline that?

Mr Naylor—As a package, it could be seen as addressing the symptoms rather than the problem and, therefore, it will not have much effect at all on changing competition. With respect to the effect of abandoning exit fees for non-bank lenders, it will have a negative effect on competition. On balance, it will have either nil effect or, maybe, a negative effect overall.

CHAIR—The CEO of the National Australia Bank yesterday indicated that he believes his costs will continue to rise and that the interest rates offered to consumers would continue to rise in the coming year. Do you think that the reform package will have any impact on interest rates?

Mr Naylor—I do not think so.

CHAIR—Thank you very much for your time, Mr Naylor.

[1.44 pm]

MUNCHENBERG, Mr Steven, Chief Executive Officer, Australian Bankers Association

STAMOLIS, Mr John, Statistics Director, Australian Bankers Association

TATE, Ms Diane, Policy Director, Australian Bankers Association

CHAIR—Welcome. Would you like to make an opening statement?

Mr Munchenberg—I would. Thank you for the opportunity to appear before the committee today. I would like to make a brief opening statement, but I am happy to be guided by the committee's questions on the issues of most interest to you.

The ABA represents 23 banks operating in Australia. That membership covers the four major banks, the regional and smaller Australian banks and the international banks operating in Australia. Our view is that we do have effective competition both between banks and between banks and other participants. The GFC has undoubtedly had an effect on the Australian banking industry and the nature of competition within the industry. As others have mentioned, before the GFC, the intense competition was on the lending side, to the advantage of borrowers; today, the intense competition is on the deposit side, to the advantage of savers, including many pensioners and self-funded retirees and others.

The other factor that has changed is that funding sources have been hit. Some markets have become less active and all markets have become more expensive. This change has hit smaller lenders in particular. So, while we believe there is effective competition, we also believe that there are constructive measures that government can put in place that will, for example, speed up the recovery of the securitisation market. The government support for securitisation through the AOFM has been vital to rebuilding confidence in that market. We welcome the extension of the AOFM program, as well as government support for other instruments, such as bullet RMBS and covered bonds. Competition will be enhanced by promoting access to broader and deeper funding sources. We also believe initiatives can be taken to encourage savings, improve levels of financial literacy and promote better regulation. With that, we more than welcome your questions.

CHAIR—Thank you very much. On page 2 of your submission, you say:

Australia's banks continue to provide financial products and services to consumers and provide employment for a significant portion of the Australian population.

This would be the case regardless of the number of players. There is a demand for banking services. In fact, they are viewed by many as essential services—people do not really have the option to choose not to use banking services in today's society. So, regardless of the degree of monopoly or oligopoly in the banking industry, the banks would still provide financial products and services to consumers and provide employment.

Mr Munchenberg—Good banks exist, yes.

CHAIR—That is right.

Mr Munchenberg—That statement is not being put forward as a rebuttal of concerns about competition; it is a statement of fact.

CHAIR—It is a statement of fact, but it is used in the context of arguing that there is not any problem, in a sense.

Mr Munchenberg—Not necessarily; I think it is just a statement of fact about the industry. There is plenty of material—which I am happy to discuss—in the submission as to why we believe there is still effective competition.

CHAIR—That was just something that, when I read it, stood out to me. In terms of small business lending, you note:

The market for small business finance has become more competitive through 2010 ...

On what basis do you support that statement?

Mr Munchenberg—We have seen an increase in the amount of small business lending. In the couple of years leading up to the global financial crisis, for example, we saw a surge in small business lending. In some quarters it was growing at 25 per cent on an annualised basis. Obviously, that changed during the global financial crisis. This year, we have been seeing the level of lending increasing. Partly that would be supply driven; partly that would be demand driven. There undoubtedly have been issues in small business lending. We believe those have largely been driven by capacity issues—the ability of the banking sector and others to provide credit—but we are seeing that slowly recovering.

CHAIR—So you are basing your claim that it has become more competitive on the fact that there is more happening?

Mr Munchenberg—There is more lending happening. Also, as you would be aware, a number of the banks are marketing quite aggressively into the small business area.

CHAIR—That is probably more to the point then. Quite clearly an increase in lending could be demand driven and not necessarily indicate a more competitive market. It might just mean there is a greater degree of demand.

Mr Munchenberg—It may, yes.

CHAIR—I was interested because of the way you put it—'has become more competitive throughout 2010.' Given the terms of reference of this committee, I am very interested in evidence that suggests that that particular market, the small business market—which has suffered more than most in the last two years—is becoming more competitive, and on what basis you make that statement.

Mr Munchenberg—I am happy to elaborate but, as we have explained, we are seeing an increase in the amount of lending. That will be partly supply driven and partly demand driven. We are seeing banks actively marketing in those sorts of areas, trying to win customers from each other. It is showing signs of being a more competitive, dynamic market. But, having said that, it is hardly back to where it was prior to the global financial crisis. There are legitimate issues in small business lending, both around access to finance and indeed the price. There are some concerns around price.

CHAIR—We have talked to one of your major members yesterday to some extent about the pricing in business lending and the pricing for risk that is involved in that. To what extent do you think that the pricing for risk for small business actually reflects the risk, or is there still a degree of over-reaction or caution that is lingering as a result of the events of the last two years?

Mr Munchenberg—To be honest, Senator, you have the opportunity to question banks directly on that and they obviously have different settings and everything on their risk profiles. I think it is fair to say that there is still nervousness around some segments of small business. We are still seeing insolvencies very high, we are still seeing loans that are 90 days in arrears, the standard benchmark is very high. The risks in small business lending may have diminished since the economic consequences of the global financial crisis, but there are still risks there. Whether individual banks have been adjusting their risk profiles I am not aware.

CHAIR—I had a discussion about pricing for risk with the Reserve Bank Governor yesterday. Particularly in the context of RMBS, where there were no problems with Australian RMBS and yet, because of brand damage done internationally, Australian RMBS has been priced higher because of risk, even though the risk probably was not there. From your analysis and discussions with your members, do you think the risk in business that has led to the higher price is also overpriced in the same way that RMBS appears to be in Australia?

Mr Munchenberg—The issue with RMBS was more global loss of confidence in—

CHAIR—in that type of security.

Mr Munchenberg—Yes. And, as was noted yesterday, investors who were active in that market are no longer in existence.

CHAIR—Similarly, business loans in other parts of the world probably suffered high levels of impairment and default than were experienced in Australia. And I suspect there is probably a degree of brand damage in terms of banks approaching business loans, particularly small business loans, that has led in part to the increased cost of small business loans.

Mr Munchenberg—I think banks have been responding, initially to anticipated difficulties in business lending—and of course pricing is a forward exercise; you are trying to anticipate what the risks are going to be going forward with your lending. So there would have been an element of that last year. There are still segments of the economy which are performing less strongly than other segments of the economy; I think that is widely recognised. So there will still be areas where there is some concern. In particular segments, like commercial property, we also saw banks getting close to their capacity to lend to those given risk profiles and the distribution of risk and APRA's expectations in those areas.

In terms of the small business issue writ large, our view would be that the most effective thing that can be done for small business is to increase the capacity of the whole banking system—and I use that to include all the ADIs and even some of the non-ADI lenders—to serve that sector. There has naturally and appropriately been some risk repricing for small business, as there has been for large business, but the single most important thing that could be done to assist small business to increase competition in small business lending—and if there is a lag in winding back with respect to risk repricing—is to improve the capacity particularly of the smaller lenders to service that segment and create stronger competitive dynamics there, which will then flow through in terms of the risk repricing, which we want to remain appropriate. For a number of banks the Reserve Bank has suggested that, prior to the GFC, risk repricing was probably inappropriate. We do not want to go back there, but that competitive force will drive those things. So again the solutions that we are putting forward for broader competition issues will address some of the small business concerns as well.

CHAIR—You note in your submission, from memory, that a broad based inquiry into the financial and banking system in Australia is probably something that should be held on a semiregular basis, but given the circumstances of the last couple of years now is probably not the time. Is that a true summation of what you said?

Mr Munchenberg—That is a reasonable summation. As you are aware, there are a number of calls for a Wallis style inquiry at this point in time. We are reasonably neutral about that, except to note that we are still waiting to see what the international regulatory requirements are going to be. We think it is appropriate to have those set at the international level but also to have a deeper understanding of their implications and how they are going to be applied in Australia, because they are going to have a profound impact on the industry going forward. It would be useful to have some certainty.

CHAIR—Dr Laker indicated that we should have a better idea of that before Christmas.

Mr Munchenberg—I think at the international level, at that point, once APRA has the Basel III international requirements settled—they have remained unsettled but hopefully by the end of the year will be settled—APRA will then start on a process of working out, in consultation with the industry, how they will be applied in detail within Australia. There will be some uncertainty for some time, but as a general principle we are neutral on—

CHAIR—I think there is some sort of special recognition of Australia's circumstances in what is being negotiated under Basel III. I believe that it is close to finalisation, according to what we have heard.

Mr Munchenberg—We need to be a little careful about this idea of special recognition. It is recognition that internationally, particularly in those countries with high government debt—and Australia for a long period of time has not had high government debt—there are well developed government bond markets, which we do not have here. So the five-second grab from us is that, even if the banks bought all of the government bonds on issue, we would not have enough to meet the liquidity requirements.

CHAIR—No, I understand that.

Mr Munchenberg—So it is not special treatment for Australia; it is recognition of that.

CHAIR—No, it is recognition of special circumstances.

Mr Munchenberg—We still have to meet the same liquidity requirements.

CHAIR—Yes. There are practical challenges in being able to do that, given the circumstances in Australia, and I suspect—although he is not in a position yet to elucidate—that some accommodation has been discussed and probably worked through to enable banks to meet appropriate requirements.

Mr Munchenberg—We would certainly hope so, but we do not have any details.

CHAIR—My point is that that will hopefully be dealt with in the coming months and worked through with banks, and an inquiry like the Wallis or Campbell inquiries is not something that you would hold over a period of months. It would take some time to hold properly. Given that it would probably take 12 or 18 months, that would give plenty of time for the sorts of issues that you have raised to be worked through and to be built into the outcome.

Mr Munchenberg—Again, we are not opposed to the concept of such an inquiry. I think it would be better to start that process once we have greater certainty rather than run them in parallel, because that is likely to complicate it. To do it properly and comprehensively, it seems—

CHAIR—It would take a while to get it up and running if there were a decision to do it anyway.

Mr Munchenberg—Sure.

CHAIR—In terms of exit fees, as I understand it, you as an association are quite comfortable with the decision to remove exit fees.

Mr Munchenberg—No, I would not quite characterise it like that. Obviously different banks have taken different views on exit fees. Our position is just to note that exit fees do reflect genuine costs incurred by banks and others. To the extent that they are genuine costs, removing the ability to recover those costs is likely to hit smaller lenders disproportionately compared to larger lenders.

CHAIR—Is that likely to have an impact on their ability to compete in other ways?

Mr Munchenberg—Any cost impost is going to have an impact, and where cost imposts are greater for smaller lenders it will ultimately have some impact at the margin on their ability to compete. There is no doubt about that. Equally, and I am sure Senator Williams will question me on this shortly—

Senator WILLIAMS—I doubt it.

Mr Munchenberg—I am happy to let that one go through to the keeper! Equally, any cost in moving from one provider to another is effectively a barrier. It is a question of whether those costs are appropriate and striking a balance between minimising barriers to people switching and, at the same time, making sure that people are able to recover legitimate costs.

CHAIR—Given that, how do you feel about the fact that from 1 July next year it is likely that exit fees would be banned?

Mr Munchenberg—It does probably hit smaller lenders more. It is stated government policy now and we will live with that and implement it.

CHAIR—When you say it will hit smaller lenders more, are you talking about members of your organisation as well?

Mr Munchenberg—I am. Smaller banks.

CHAIR—Smaller banks would be impacted by that.

Mr Munchenberg—The extent to which it is an issue for them will depend, and I do not have the inside information, on recovery of costs bank by bank.

CHAIR—Do you have any idea of the range of exit fees that are charged by your members? Obviously you have got at least two majors that charge none, through to what at the other extreme?

Mr Munchenberg—Across the full membership I am not sure what the range would be. Prior to the decision made by two of them recently, it was around \$700 for the majors. It may vary product by product. ASIC did a report, as I am sure you are aware, a couple of years ago where they looked in quite detail into these. There would have been changes since that time but they are around the \$700 mark for most products.

CHAIR—You raise ASIC. As an association were your members comfortable with the new powers that ASIC had been given to look at the fees and particularly exit fees and consider whether they are unconscionable? Do you think that could have delivered an outcome that would have been a reasonable balance for consumers and the banks?

Mr Munchenberg—It is a little early to judge outcomes because it has obviously only been out—

CHAIR—It is early to judge outcomes, but it has already being gazumped by a new measure that is basically going to push it aside.

Mr Munchenberg—We have noted that. It is important that ASIC has the power to look at these fees. That will apply some rigour in the industry. Our view prior to and subsequent to seeing the ASIC guidance was that the industry was in a position to defend the fees as appropriate. Two majors have decided for competitive positioning reasons, I would assume, to get rid of those fees. They are entitled to do that. Undoubtedly the ASIC approach will introduce

more rigour into looking at these fees, but equally we remained confident that we would be held to meet whatever the standards were and I have not had any reason to change that view.

CHAIR—You recommended in your submission a number of measures that could enhance competition, some of which have been picked up in the Treasurer's reform package announced on Sunday. What measures have you recommended that have not been picked up? Could you outline those to the committee?

Mr Munchenberg—It is a fairly broad thing but I suppose the important area to cover off is the issue of funding. In our view, the fundamental thing that changed in terms of competition through the global financial crisis was not so much the removal of some players, and I am happy to talk about that in more detail; it was actually the fact that for those players that remained, particularly the smaller players, their funding structures came under considerably more pressure. Obviously the major four banks compete very closely against each other as well. Where we have seen real change is in the ability of smaller lenders, including my smaller banks who are members of the ABA, to access funding at a price that allows them to sustain their competition with the major banks. So the government's announcements on the weekend particularly in relation to continuation of the AOFM program, which we have seen as of vital importance to keeping that market alive, and also the RMBS, as important first steps, but we would not want to see those as being the be-all and end-all of supporting those smaller banks and others either.

CHAIR—I think in your submission you actually are in favour of covered bonds being allowed to be issued.

Mr Munchenberg—We are in favour of covered bonds. We have not put those forward specifically as a competition measure.

CHAIR—I guess you would have a mix of opinions amongst your members on that one.

Mr Munchenberg—The ABA position as agreed by the members is that we support covered bonds. The distribution of the benefit is probably uneven. Certainly initially covered bonds are going to be more helpful in diversifying the funding of larger banks and allowing them to access cheaper markets internationally, which will take some of the funding cost pressures off the majors banks. But equally covered bonds could become a vehicle for domestic funding as well. The only reason is that there are existing covered bond markets internationally that the majors will be able to tap very quickly. It will take time to develop a covered bond market in Australia but we do not see any reason why that should not occur. So covered bonds will ultimately provide some assistance if that market is developed here.

CHAIR—I distracted you. I was hoping you would answer the question about which recommendations have not been taken up.

Mr Munchenberg—In terms of strengthening the funding of smaller lenders, we are still keen to talk to the government about the potential for some guarantees in that area.

CHAIR—Guaranteeing of what?

Mr Munchenberg—Guaranteeing of RMBS. I should say, with all of these, that none of them come without issues associated with them as well, so careful consideration will be needed.

CHAIR—I do not think any of this comes without the need for careful consideration.

Mr Munchenberg—No. We are not advocating a mass transfer of risk from the banking sector to the taxpayer, for example.

CHAIR—The Reserve Bank governor expressed some concerns about that potential yesterday.

Mr Munchenberg—There are some issues here. We are still waiting on the settlement of the Basel III issue, but we have not given up on the hope that we will be able to see some consideration of RMBS in banks' ability to meet their liquidity requirements. Again, there are issues around that, around the liquidity of the market and everything, but equally we have a strong and reliable mortgage sector in Australia and we think that there are areas that need to be explored there.

We would also like to continue discussion with the government around what is known as the agency model or, more frequently, the Canadian model, where you can have an entity that is active in the securitisation market with appropriate considerations and constraints around it and playing a role in the recycling of mortgages from lenders to keep the market going. I am happy to talk about each of those individually, but none of them come without some issues as well.

I note that one of the areas that I think has been neglected, with respect, by the committee's inquiry is the role of international banks in Australia. Despite suggestions that international banks have left the Australian market, that is not the case. I think one, Societe Generale, did leave. Some in certain markets, during the GFC, did decrease their activity. But we also have very vibrant international banks operating here, and they have provided and continue to provide real competitive pressure—the INGs, the Rabos, the Citis, the HSBCs and some of the smaller banks like Arab, Laiki, Bank of Cyprus and others, who are particularly important in certain segments. The international banks tended to be neglected. I do not think there was much in the package for them on the weekend.

CHAIR—I saw nothing that would necessarily—

Mr Munchenberg—Some of the securitisation stuff will help them.

CHAIR—Although the government made it quite clear that not one dollar of the securitisation money would go to banks.

Mr Munchenberg—The AOFM money.

CHAIR—The AOFM money—that is right.

Mr Munchenberg—I will need to check. Major banks—

CHAIR—Major banks, I think it said actually, yes. In terms of foreign banks, the APRA information is that the Australian owned banks have \$2,000-odd billion worth of assets, but between the foreign banks in Australia there is \$330-odd billion worth of assets, so you are right: it is quite a significant investment in Australia.

Mr Munchenberg—For example, if a foreign bank wishes to bring money into Australia to lend which is overseas raised deposits, there are taxes on that money which make it less competitive for them to do that. The government has committed to winding down those taxes over a period of time, which we welcome, but we also encourage the government to consider fast-tracking that, because again the international banks could provide further competitive pressure in the Australian banking system.

CHAIR—What would be the cost to revenue of that, do you know?

Mr Munchenberg—I would not like to give you a figure off the top of my head, but we can certainly provide that. It may well be in the submission. We do have, I think, an estimate of that, so we can provide that to you.

CHAIR—Are there any offsetting benefits to revenue through company tax or other—

Mr Munchenberg—Presumably there would be.

CHAIR—Are there other measures, or are they the main measures that have not been picked up that you think would be—

Mr Munchenberg—We do believe that there is an important role for empowering the ability of customers to manage their own financial situation. It is not the be-all and end-all, but equally we think areas like financial literacy are important. We have been waiting to see the government's national strategy on financial literacy, and we are aware that a lot of work has gone into that. We are keen to see that.

The ABA itself plays a role in that area. It sounds like a small thing, but it is important that we host a biannual conference where we bring together a whole range of people involved in financial literacy to develop their understanding of what can be done et cetera. We think that financial literacy—that is, giving people the tools and the skills to manage what are often complex choices—is very important and we are keen to do more in that role. We will wait to see what the government is proposing to do, so we are not at risk of duplicating what the government does. There are a number of things that we have put forward.

Very briefly, the other point that we would like to make is that government needs to consider the impact of new regulatory requirements upon smaller lenders. Smaller lenders typically have less capacity to absorb the costs, as all small business does, of new regulatory requirements. That is not to say that the regulatory requirements are not appropriate; we just want to ensure that that is also taken into consideration when—

CHAIR—Due weight given. I have read your submission and looked at those points. I understand that there are some issues around those, but are there any to which you would give priority which you think would have maximum impact on enhancing competition?

Mr Munchenberg—We certainly believe that supporting funding of the smaller banks and other lenders is an area where you can make the greatest impact on the competitive dynamic within the banking—

CHAIR—The government would argue that that is what its reform package does.

Mr Munchenberg—Their reform package, I think, is a good start. We certainly welcome what they have done and we welcome their ongoing commitment through the AOFM. They have been involved in that area. That has been vitally important.

CHAIR—They have been involved in that since Malcolm Turnbull first suggested it.

Mr Munchenberg—I am not aware of that.

CHAIR—It was quite public at the time. I think Wayne Swan actually gave him a hard time about suggesting it first and then a week later adopted it.

Senator CORMANN—I find it hard to believe that he, being an expert in this industry, would not be around to see it.

Mr Munchenberg—It is a complex area. I cannot claim to be that new to the role, but I had a narrower focus on banking until the beginning of this year. What has been done is good and we would like to continue discussions with the government about what more can be done. I have no reason to believe that the government would not want to continue those discussions, either. I am not aware that the government sees this as the final word in this area. Indeed, this committee will no doubt make recommendations.

CHAIR—Do you see securitisation as the answer in terms of addressing the shortfall of cost-effective funding for smaller players?

Mr Munchenberg—Absolutely. The thing that has fundamentally changed through the global financial crisis, the thing that led to Aussie, RAMS and Wizard and others no longer being, as I understand it, viable competitors in the market and the thing that has had the biggest impact on competition is funding for the major banks, particularly around costs but less so around access. Funding around both cost and access has been an issue for the smaller lenders.

I should caveat that by saying that we are not suggesting for a moment that we need to return to the conditions as they were prior to the GFC. If we thought that we were trying to recreate conditions we are bound to be disappointed. Nonetheless, there are at least temporary measures that can be put in place that would speed up the recovery of some of those funding sources, which would speed up the recovery of the competitive dynamic.

CHAIR—The reason why I ask that is that yesterday the Reserve Bank governor indicated that he thought that the securitisation market in Australia was getting closer to where its normal level would be—certainly at the domestic level—given that a lot of the activity in the market prior to the GFC came from foreign investors, many structured in what he described as unsustainable business models, and that the likelihood of that degree of interest from overseas

investors again is very unlikely. If you take them out, we are actually getting very close to the point where we would have been prior to the GFC.

Mr Munchenberg—I do not know what the natural threshold would be or upon what basis that judgment is made. Certainly, there were investors in the market that no longer exist and so will not be returning any time soon. Australia has—and has had for a long time—a very stable, reliable housing market. Those residential mortgage backed assets are in fact very high quality, notwithstanding the broader damage that has been done to RMBS. I suppose the issue is: are there new investors out there who we can attract into that market? I do not think we should put a limitation upon it.

CHAIR—No.

Mr Munchenberg—I am sure there will be a natural limit.

CHAIR—All the evidence suggests that the problem is lack of funds and securitisation seems to be the answer and I am hoping that it can be.

Mr Munchenberg—I must say that, while we would be very keen to see support in that area, we do believe that the smaller lenders need some support to get through the ongoing consequences of the GFC. We are very happy to discuss the fact that we actually do have a competitive banking sector. What we are looking to do is to enhance existing competition. It is not as though we do not have competition in banking at the moment.

CHAIR—Just a different level or degree of competition to what existed prior to the GFC. The market has certainly changed.

Mr Munchenberg—There has been a shift in that competition as has been pointed out. If anything, savers were perhaps penalised prior to the GFC as all the focus was on competition in lending. We have seen that pendulum shift, if you like. That is not to say that we need to fully accept that situation and we should not look for constructive measures to improve competition in lending but equally we do need to look at the fact that we are enhancing an existing competitive banking sector rather than trying to address a fundamental flaw in the banking system.

CHAIR—My concern is that there was a clear driver of competition in the late 90s and early 2000s coming from the non-bank financial sector, the non-ADI's, your Wizards, your RAMS, your Aussies. That type of institution was driving a high degree of competition which I think all the evidence suggests actually did result in lower prices and diversification of products that were available. Although we may still have a market which can be characterised as competitive in most ways, without a driver—particularly in a situation which is described by Treasury themselves as 'oligopolistic in nature'—there is potential for the state of competition that we currently do have to actually go the other way rather than become more competitive unless we are reactive in terms of how we promote further entrants and so on.

Mr Munchenberg—We are not going to dispute the role that the mortgage originators played. They undoubtedly did play a role. We are not perhaps as convinced as others whether it was in the run up to the GFC, but certainly in the 90s, in the early part of the last decade, they were playing an important role. The role of mortgage brokers has I think has been overlooked. As the

mortgage brokers entered the market you had greater transparency in the market that helped customers shop around as well. I think that put a lot of competitive pressure on as well.

CHAIR—And also potentially your members responding to the competitive pressures that were being brought by other sectors of the industry which is what competition is all about.

Mr Munchenberg—Absolutely. We also had the international banks and I know that ING—the only reason that I am singling them out is that I know they are coming in this afternoon—played an important role in deposit competition with online deposit taking and those sorts of things.

CHAIR—And Billy Connolly.

Mr Munchenberg—And Billy Connolly and now we have an orangutan—

CHAIR—Has anything changed!

Mr Munchenberg—There was a lot to be said for a whole range of competitive dynamics that were playing out. I think it is also fair to say that mortgage originators relied very heavily on a long period of very stable, very cheap credit globally. There is no real sign that we are going to go back at a global level to that situation at any time soon. I have nothing against the mortgage originators but if we were to see them as the be all and end all of the answer to the competition problem—

CHAIR—I guess I saw them as a driver of competition at that time and I'm concerned to ensure that there are future drivers of competition.

Mr Munchenberg—Indeed. I think that helping the funding of the continuing players—the international banks, the smaller Australian banks, the credit unions and building societies, the non-ADIs—is the area where the more that we can do to ensure that they can access sustainable, reliable and competitive funding the better. There are limits upon that and there are limits on government intervention in that area, as I am sure you can appreciate, but measures in that area are going to create the dynamics. We do not know where the next real competitive pressure is going to come from. We could not predict mortgage originators. It is more of an issue of making sure that there are plenty of opportunities for different players.

CHAIR—Which is really where we are coming from. Thank you.

Senator PRATT—I note that your submission talks about housing lending and purports that it is a competitive sector with 100 institutions and over 500 products, but what that does not reveal is that, as I understand it, 75 per cent of home mortgages are with the four major banks. I really just wanted to ask how that could possibly represent real competition and why it is those border forces that you chose to underscore in your submission, rather than where the dominance in the market actually is.

Mr Munchenberg—To start with there is no reason to assume there is no competition between the four major banks. As I think the NAB CEO indicated yesterday, it has been a long time since we have seen the banks differentiating themselves so much around mortgages in

terms of where their interest rates are. We have seen banks behaving quite differently at different times around how they have treated their funding costs and everything, so I think there is quite strong competition between the major banks as well as from other sources.

The key reason the major banks increased their market share—and this has often, including before this committee, been presented as a pejorative thing—is that when certain business models were not able to survive the global financial crisis the major banks stepped in to fill that lending. People were no longer able to get mortgages from certain quarters but they were still able to get mortgages, and that was a critical element in maintaining the Australian economy, in particular the Australian housing market. We have seen what has happened in places like the UK, where the banking system was not able to meet the demand. There have been other effects, including unemployment, but we have seen major downward movements in housing prices.

So the reason the major banks' market share increased was to fill that gap, and we are seeing that starting to reverse. In October—and my statistician will correct me if I get this wrong—the housing figures showed that 80 per cent of new mortgages being written were being written by lenders other than the major banks, and that was before we had the changes in interest rates in November. And Abacus mentioned yesterday their market share is greater now than it has been for a long time. So there was an increase in market share. We are starting to see the signs of that shifting around.

Senator PRATT—Can I ask about the diversity of members that you represent. In the evidence put before us in the last couple of days, people have underscored a lack of competition between Westpac, Commonwealth, ANZ largely because, I suppose, there is not much point in them competing with each other for market share in the sense that it will just create another big player which would undermine further competition and have said that really we need to see the competition come from elsewhere—that we need to see those banks competing against each other but that they are not going to have the incentive to compete unless other players, other ADIs and other banks, have a real incentive to compete. Among your members there are the four big banks but I think you have about 23 members. What are the smaller banks and the regional banks saying to you as to the things that would help them compete more effectively?

Mr Munchenberg—There are a couple of points you raised that I want to touch on, but the main thing they are saying is that their funding has been impacted. They are providing competition at the moment. Their concern is their ability to sustain that competitive pressure if their funding sources do not recover quickly enough. That is the fundamental issue we are trying to deal with.

Maybe I misheard, Senator, but I think there was an implication in your question that there is not competition and no reason for the four major banks to compete with each other.

Senator PRATT—It is not as strong as it could be perhaps might be a better way to characterise it.

Mr Munchenberg—I would like to see someone bring forward some evidence, because not just with this inquiry but for some weeks now there has been somewhat of a banking debate and I have heard this assertion made either explicitly or as part of the implicit assertions that people have subsequently put forward.

If the four major banks, which undoubtedly do dominate the banking sector in terms of their market share and size, were not competing with each other then we would be seeing much greater margins on those banks, we would be seeing much greater returns on equity on those banks, we would be seeing measurable demonstrations that they were less than competitive—and we are not seeing those. So the only suggestion I have put forward as to why there has been a reduction in competition is that some players are no longer in the market, and that may have had an effect. I have put forward another proposition, which is that the funding of the existing players in the market is under pressure. I am happy to debate it if people can bring forward evidence but we have not actually seen evidence to show that the major banks are not competing with each other or are not players in a competitive market.

Senator PRATT—I think many of the submissions do point to those.

Mr Munchenberg—They are from competitors to the major banks as well.

Senator PRATT—Yes, that is right. Can I ask about customer portability in terms of exit fees and portable bank account numbers. Many players seem to oppose that kind of portability. But what strikes me, if you were really looking for competition drivers, is the analysis of consumer organisations saying that customers really do need a greater capacity to use their feet in order to get a better deal and that is really what underpins competition in any sector but, because of the bureaucracy associated with banking, customers are not as free as they might like to be to participate in driving that competition.

Mr Munchenberg—I think there are two issues we need to separate out here. One is this narrower concept of account number portability. So this is where I am with bank A or credit union B, I have a particular account number and I want to change that account to another institution. That would be a very complex and difficult and expensive thing to bring in. Other countries have looked at whether that can be done and have decided that it is not viable. I have heard comparisons drawn with mobile phone numbers: ‘If you can do it here, why can’t you do it there?’

Senator PRATT—Or health records.

Mr Munchenberg—There are a number of differences there. One is that we are dealing with an industry which has been around a lot longer and has a lot more legacy issues than mobile phones, which was a relatively new industry at the time. We have heard, as a number of the other associations have said, that different lenders in the market have different ways of dealing with their account numbers, so there would be a lot of complexity there. Between the banks, credit unions and building societies, we have over 100 ADIs that would need to be involved, whereas there is only a small number of mobile phone companies, and we interact directly with some quarter of a million other organisations from Centrelink and Medicare through to a whole range of employers and merchants and other things. It is about the account number portability issue and obviously we will need to deal with this with the inquiry and the investigation that the government has announced by Mr Fraser. But in that narrow sense it would be very expensive. Also, we are not going to get to a situation where you can flick a switch and move from one bank to another. To give an illustration of that, all lenders currently have identification requirements, so you still need to go in with your identification, and from 1 January we will have responsible lending obligations which mean that if we do not inquire properly into your capacity

to take credit, for example, we can be subject to the potential for criminal action. So there is a whole host of complications. Having said all that about the narrow account number portability, there is probably more that could be done to make it easier for people to move from one bank to another and, now that we have got this investigation with Mr Fraser, we are happy to work with the government to look at that. We are happy to explore what the industry can do to make it easier for people to have a more effective ability to move about.

Senator PRATT—So you would in that sense acknowledge that, because there are things that could be done to make it easier and because choice is part of what drives competition and therefore the capacity for people to move from one institution to another, there are, in fact, some competitive impediments currently?

Mr Munchenberg—No. What we are saying is that we are happy to explore what could be done to make it easier.

Senator PRATT—If it is not really easy now—

Mr Munchenberg—I am not saying it is not—

Senator PRATT—then clearly more things could be done to advance competition between banking institutions.

Mr Munchenberg—We could always look to see whether we could improve on a situation. We know that large numbers of people already switch between accounts. APCA has put in a submission to you which shows that some 3½ million accounts are changed each year, so there is a lot of activity already. We are happy to look at what impediments there may be. There may be bank imposed impediments and there may be regulatory impediments that could be streamlined as well. So there are a number of things that could potentially be done to make it easier still.

Senator XENOPHON—Mr Munchenberg, thank you for submission and for the co-operative way the ABA has engaged with this inquiry. Leon Carter from the FSU, the Finance Services Union, said today that the ABA is an apologist for the big four banks. What is your response to that in the context that the Bank of Queensland boss, David Liddy, told the *Australian* that the package announced on Sunday was disappointing, that it was not even a copper bullet, let alone a silver bullet, and that the Bendigo and Adelaide Bank managing director was disappointed at the absence of a guarantee on mortgage backed securities.

Mr Munchenberg—I did not witness Mr Carter's comments, so I do not know the context. I have 23 members and, if Mr Carter were correct, I cannot understand why 19 of them would still be members.

Senator XENOPHON—But there is a distinction. With some of the regional banks and the smaller banks there is a difference of view, or a difference in the approach of some of the smaller players, compared to the big four.

Mr Munchenberg—Undoubtedly. As I am sure there is with any industry, there are issues upon which people have a different view. It runs both ways. We have seen two major banks, for example, deciding to get rid of exit fees, which would be a much harder thing for the smaller

banks to do. They may have a different view on exit fees to some of the major banks. Our approach is that the things that unite us are greater than the things that divide us. Certainly we are very consciously putting forward a position that says there is quantifiable competition within the banking sector, but there are things that can be done. I can understand why Mr Liddy and Mr Hirst are disappointed, and I have indicated that we hope to continue the discussions with the government on some of the proposals that are important to the smaller banks. We see that what has been done is important, but we want to continue pushing for further support in that area.

Senator XENOPHON—Doesn't that raise a tension within your organisation if the big four banks are relatively comfortable with the package, but the regional banks, the overseas banks that are based here, are uncomfortable with the package? We have heard what Mr Liddy and Mr Hirst have said. How is that resolved within your organisation in terms of representations you make and the advocacy you do on behalf of the banking sector?

Mr Munchenberg—We continue to advocate for the things that members want. The major banks are not standing in the way of us advocating on behalf of the smaller banks that more be done around securitisation. We have had some measures on the weekend. We intend to continue discussing with the government what needs to be done further in that area. That is not a concern. I have already indicated that covered bonds will be an issue that will be of more advantage to the major banks than the smaller banks initially, but, again, the industry as a whole has agreed that we need to do more to assist securitisation and do more to diversify the funding of all lenders.

Senator XENOPHON—It is a genuine question: what happens when there is a significant policy difference between, say, the big four banks who have the lion's share of the market and your other 19 members? Where does that leave the ABA in terms of advocacy? Do you put both points of view or do you have to step away from it in terms of advocacy?

Mr Munchenberg—To be honest, in the nine months that I have been there, I have not faced that situation. We have undoubtedly had discussions within the industry when members have come from different points of view, but we have been able to resolve those to be able to strongly put forward a position that is agreed by all. You have our submission in front of you and that submission was developed with all of our members.

Senator XENOPHON—The charts on pages 15 and 16 of your submission show interest margins declining gradually until the GFC, when they turn around. I think the ABA's position is that this shows banks chose to absorb higher funding costs for a short period during the GFC. But what do you say to the alternative story that the reduction in competition since the GFC has allowed banks to start widening margins?

Mr Munchenberg—You have not asked me about this, but obviously there has been a long run of declining margins brought about by a competitive, dynamic industry. From the beginning of 2007 we saw wholesale funding, particularly international funding and short-term funding, increase in price significantly. For the first six months of that the banks absorbed that cost and that will have had an impact on their margins, so we have had a bit of a dip, if you like. Banks then started to pass some of those costs on, but they also started to reprice for risk, which will cause an increase in the net interest margin. Net interest margins of course cover all forms of lending from household lending through to small business and major corporate lending.

Senator XENOPHON—The gap for small business has widened, hasn't it, in relative terms compared to the household lending market?

Mr Munchenberg—Yes, due to risk repricing.

Senator XENOPHON—Could it be a combination of risk repricing and the fact that some of the smaller players have contracted away from the market?

Mr Munchenberg—I am not aware that that has been an issue, but equally we would not deny that there is less lending capacity for smaller businesses in the market as well. The cause and effect I am not aware of. I certainly would not be able to say that this portion is due to risk and this portion is due to any other consideration. Now we are seeing those net interest margins come back again. Again, that can be a sign of competition returning and that can be a sign of risk repricing more favourably to the borrower. There are a number of other considerations—

Senator XENOPHON—I guess related to this is the issue of a level playing field and the perception that small lenders are disadvantaged. Has the government guarantee entrenched the position of the larger players in terms of the cost of it, because for BBB class and below and unrated it is 150 basis points and for AAA to AA-minus it is 70 basis points? Do you see that as entrenching the position of the various players, be they large or small, given that differential?

Mr Munchenberg—There is no doubt that those smaller players who access the wholesale guarantee, if you like, paid a double premium—they not only had the government's imposed differential but also had the market looking through that guarantee at the underlying rating as well. There is no doubt that that was the situation and that has meant that funding for those smaller banks that use the guarantee increased markedly from the situation before the global financial crisis. That also led some smaller banks to not use the guarantee as well. The guarantee itself obviously is no longer accessible, but some banks are continuing to pay that fee and others are not. There is an impact there undoubtedly.

Senator XENOPHON—Almost all people would agree that what the Rudd government did back at the end of 2008 was the right thing to do for stability in our financial system, but is it fair to say that one of the unintended consequences of that was to make the big players bigger and to in a sense keep the smaller operators at a relative disadvantage?

Mr Munchenberg—It had an impact on the pricing of the smaller players. The ABA's position, certainly as far as I am aware of it, was that that differential in the fees should have been reduced at the time when the guarantee was still available to lenders. The government chose not to do that. To some extent I suppose you could argue that government support now for smaller lenders is not specifically addressing that issue but offsetting the extent that the larger banks may have had an advantage during the use of that wholesale guarantee. That is being offset now by support for securitisation and other markets. The AOFM money, of course, is available to lenders other than the major banks, for example.

Senator XENOPHON—Mark Bouris, from Yellow Brick Road, yesterday said that, if there were an apples for apples comparison in terms of having a robust method of assessing independently or a benchmark to assess the quality of security, that would be a good thing in terms of the securitisation market. He also said that the securitisation market ought to be

something that is more liquid—that is, they could be tradeable. What is the ABA's view in relation to both of those proposals?

Mr Munchenberg—As to the first one, I have only become vaguely aware of it in the last 24 hours, to be honest, and I do not know whether we have a view as to—

Senator XENOPHON—Would you mind taking the question on notice? It is quite interesting evidence and it is in his submission and in the *Hansard*.

Mr Munchenberg—Yes, certainly. What was the second issue?

Senator XENOPHON—The other issue was that these assets become more liquid in the sense that they could become tradeable in terms of mortgage securitisation.

Mr Munchenberg—If his point is that there is not an effective secondary market for these, then, yes, we would agree that a secondary market would also help towards attracting investors back into securitisation. Off the top of my head, I am not 100 per cent certain what, if anything, we have proposed to achieve that dynamic of the secondary market. Certainly there is an effect on the market if investors feel that they will not necessarily have the opportunity to on sell the assets that they have purchased. So that secondary market provides a reassurance to investors that, having taken on board the asset, they can then on sell it.

Senator XENOPHON—And do you think that would make a big different in terms of the securitisation market?

Mr Munchenberg—I can understand at least in theory that it would add to investor confidence to invest in that market. If you know that in buying an asset you have a way of then on selling it if you wish to, obviously the risk of buying it in the first place is reduced.

Senator XENOPHON—In relation to the perception of customers of banks, you refer to a Roy Morgan Research—a very reputable research organisation—that said that the average satisfaction levels were 76 per cent.

Mr Munchenberg—For major banks.

Senator XENOPHON—Yes, for major banks. Choice and the FSU have conducted their own research which gives a contrary position. Would it be fair to say that there is a public perception that banking competition ought to be more robust, that things could be better in terms of level of service?

Mr Munchenberg—Of all people, I am very conscious of the public's views on banking but, undoubtedly, there are concerns about banking and, undoubtedly, those concerns are real. I think it is quite the case that people can be quite satisfied with their own banking experience but can still have concerns about the industry as a whole. I do not think that is in dispute. Where we are more concerned is that some of the assertions are made off the back of that perception and therefore is used to justify further regulation in the industry. There is the assertion that there has been a massive fall in competition, which we do not think is supported by the evidence. There is the view that somehow banks are inappropriately raising interest rates and as a result people are

paying more for their mortgages—which, again, is highly contestable. Those arguments are then being used to argue for very direct interventions in the industry. That is where we have our concerns. But, undoubtedly, the community concern is real. I think that part of the reason for that is that as an industry we have not done as good a job as we should have in explaining a lot of these issues.

Senator XENOPHON—Mr Naylor, on behalf of mortgage brokers, said that the number of mortgage brokers has reduced since the GFC from about 13,800 to about 12,000—nearly 2,000 have been lost—and that isn't that proof in the pudding that there is less choice out there and that there is less activity. He indicated on behalf of his members that they felt that there is less choice in terms of being able to access finance.

Mr Munchenberg—I do not know why the number of brokers has fallen, but you are still talking about 12,000 brokers out there. For all I know, there may have been consolidation in the broking industry. I am not sure. I am sure Mr Naylor will explain to me on the way out what has been going on.

Senator XENOPHON—I am sure he will; he is waiting for you.

Mr Munchenberg—Yes, I am sure—and he can join the queue! I did not hear Mr Naylor's testimony before the committee but I felt, having heard some of the discussions yesterday, that the important role that brokers have played in bringing competition into the market had actually been understated. But it is more for Mr Naylor to sell that, I suppose, than for the ABA.

Senator XENOPHON—Sure. The submission from Mr Carter and the FSU—I think I can paraphrase this correctly—was very critical of banks in the sense that they push people to get increased credit and buy more services and that there is a commission basis so the whole system of remuneration is fundamentally wrong. I think you may be familiar with the union's arguments in relation to that—in other words, the system is one of aggressively getting people to borrow more and spend more. On page 59 of your submission, in section 5.3, one of your key proposals is to encourage individuals 'to save and plan to their future'. Is there a disconnect between that proposal or approach and what the FSU is saying your industry is doing with some of the commissions based services encouraging people to spend more rather than to save more?

Mr Munchenberg—I do not believe so. I take it that I am not on Mr Carter's Christmas card list this year. I think the CEO of one of the banks indicated yesterday that, to the extent that customers have incentives, of course part of the incentives is actually to sell deposit products, not just credit. Rather than debating with the absent Mr Carter about what banks may or may not do in this area, probably the easiest answer is that from 1 January, regardless of whether there is an issue or not—and we would maintain there is not—we will have responsible lending obligations imposed upon us. Banks and other lenders will be required to ensure that products are suitable for customers and that customers have got the capacity to repay, if it is a credit product. The implications of not doing that right are quite severe, including, in some instances, criminal cases. So I am not acknowledging that there is a problem, but to the extent that there could be a problem then I would suggest the responsible lending rules—

Senator XENOPHON—You are saying there isn't a problem, but if there were this would fix it up?

Mr Munchenberg—We often seem to be in a situation where we are having to put in place solutions to problems we would not think were there in the first place, but nonetheless—

Senator XENOPHON—Mike Smith, the CEO of one of your major members, compared Joe Hockey to Hugo Chavez, who has said capitalism leads us straight to hell, amongst other things, and has nationalised assets and all sorts of other things. I know you are not responsible for Mr Smith's comments but do you think that sort of comment is probably unhelpful in the public debate?

Mr Munchenberg—Senator, you have the opportunity to ask Mr Smith that tomorrow, I understand.

Senator XENOPHON—I am sure I will.

Mr Munchenberg—I am sure the committee could even get Mr Chavez to appear before them as well and explain his views. I will leave it at that, if I may.

Senator XENOPHON—Okay.

Senator WILLIAMS—Thank you for your time, Mr Munchenberg. I think it was about 21 August that Sir Ralph Norris flagged that the CBA might have to move their interest rates above Reserve Bank cash rate movements, and of course on 2 November we saw that 0.45 rise. The argument of the banks is that it is because their cost of funds has increased, right?

Mr Munchenberg—That is correct.

Senator WILLIAMS—Looking down the road three or four years, because they roll a lot of these borrowings over in three-year periods, if the economy is slowing and the Reserve Bank lowers its rates by, for example, a quarter of a percent and your costs of money have gone down, no doubt the Australian public can look forward to the banks lowering their rates more than the Reserve Bank rate. Would that be fair enough?

Mr Munchenberg—I am not really in a position to speculate about what the banks might do in their individual pricing. I understand you will have the opportunity tomorrow to ask Mr Norris that question directly, and I am sure you will take that opportunity.

Senator WILLIAMS—Yes. What I am saying is what is good for the goose will be good for the gander, won't it?

Mr Munchenberg—All else being equal, when we see funding costs start to come down—and, putting aside European sovereign debt risk issues and all sorts of other things, we would expect that to happen—we would expect to see that, as happened in the early nineties: when bank funding costs actually fell more sharply than the RBA, banks did cut interest rates by more than the Reserve Bank. And, of course, we have put deposit rates up by considerably more than the Reserve Bank has as well over the course of the last few years.

Senator WILLIAMS—Getting onto the exit fees, are you saying that small institutions prefer to keep exit fees, that they are the ones that really want them to remain?

Mr Munchenberg—No, not necessarily. My point is simply this: exit fees represent the recovery of actual costs for lenders. As with any cost, the capacity of a smaller business to absorb that cost is proportionately less than the capacity of a larger business. We are not making a judgment about whether fees should stay or go; we are just pointing out this fact that for smaller lenders it is potentially more of an impost. If government has decided that removal of those fees is necessary for competitive reasons, so be it. But we just point out that they represent legitimate costs and it is more difficult for smaller lenders to recover or to absorb those costs.

Senator WILLIAMS—When I took a home loan out a couple of years ago with a credit union there were no establishment fees and no exit fees. It was a rather small organisation.

Mr Munchenberg—They made their decision commercially to operate that way.

Senator WILLIAMS—Yes. There are many credit unions in that position. Of course we have seen NAB and ANZ abolish their exit fees. Your association will go with the flow. Are you saying that once exit fees are removed, if the legislation suggested by Mr Swan goes through on 1 July, banks may put in place upfront fees and establishment fees?

Mr Munchenberg—No, I am not making any predictions about what individual banks or businesses might do about those. My point is simply this: those fees represent actual costs. It will be down to individual institutions, as it has in the past, as to what they will do about those costs. As you say, some credit unions have not had exit fees and some banks have now got rid of exit fees and some lenders will presumably retain them until such time as the legislation is in place. It will be a matter for individual lenders as to how they deal with those things. Our point is simply this: they are legitimate costs.

Senator WILLIAMS—This committee is looking at competition and banking. Surely exit fees do stifle competition.

Mr Munchenberg—Well, again, my comment earlier was that any cost, whether it is monetary or through effort, or whatever, in moving from one source of business to another is going to act as a barrier. It does not mean that those barriers are inappropriate. The fact that you have to go in and provide your 100 points ID is a barrier to switching but it is there for very sound reasons. The fact that banks have various security systems in place is sound but may add barriers. Is it a barrier? Yes, but so are the new responsible lending requirements when they come in. It is not to say they are not appropriate, but any cost associated whether monetary or otherwise with switching will be a barrier of some sort. The question for us is to try and get the right balance between those costs and the benefits associated with addressing those barriers.

Senator WILLIAMS—I put it to you exit fees do reduce competition. On my own experience, I could have shifted banks two ago—

Mr Munchenberg—I understand. You have put that to me consistently for a long time.

Senator WILLIAMS—from 7.22 per cent down to 6.97 per cent but the exit fees stopped me from doing that. I am broken down shearer not a banker—

Mr Munchenberg—I take your word for it, Senator.

Senator WILLIAMS—and from my own personal experience, I see exit fees are stifling competition.

Senator CORMANN—Do you think our current regulatory framework has contributed to a concentration of our banking sector in the big four?

Mr Munchenberg—What do you mean by ‘current regulatory framework’?

Senator CORMANN—The level of prudential oversight—the level of regulatory requirements.

Mr Munchenberg—No, I do not believe so. There are obviously some issues that were touched on this morning by APRA where some of the smaller ADIs are continuing to discuss issues around Basel II accreditation with APRA. But, all in all, the prudential standards are about ensuring that depositors can be confident that their money will be there when they go to withdraw it from the ADI. That is an important public policy objective. At the ends there is a trade-off between competition and stability. There is no doubt about that. We have seen areas where competition has been given priority over stability, resulting in instability in the system. You could also argue that you could end up in a situation where stability is seen as the be-all and end-all and that could stifle the competition. But I do not think we are in that environment.

Senator CORMANN—The reason I am asking is that, in your submission, you make the point:

The Federal Government should examine the extent to which Government licensing and regulatory burdens act as disincentives for potential entrants into the financial services and credit markets.

So you must have a view about the fact that there could be or is a problem.

Mr Munchenberg—We were trying to identify areas where constructively we could examine whether there are issues. We have not identified any specific issues.

Senator CORMANN—So this is just a bit of a fishing expedition?

Mr Munchenberg—It is giving an opportunity. If there are market entrants who would be market entrants who claim that there is a problem, we are happy to look at what they might see as being the problems. What we would not want to see is prudential standards weakened for some players, indeed any players, in a market. We do not want to create a situation where we have a less prudentially regulated set of players in the market, because that is where you can run the risk of contamination, if you like, of a market.

Senator CORMANN—The bigger you are the more able you are to deal with more onerous prudential requirements, aren't you?

Mr Munchenberg—As a matter of principle the bigger you are the more you are able to deal with any regulation. That is one of the impacts.

Senator CORMANN—And the smaller you are the harder you will find it to deal with more and more prudential requirements.

Mr Munchenberg—Potentially, yes.

Senator CORMANN—Everybody is very nervous about going there. Even the representatives from Choice this morning started off by suggesting that the balance might have gone the wrong way. I am quoting here. They said, ‘Regulators should take competition as seriously as financial safety.’ But when we pressed them on it, they shied away from really following it through to its logical conclusion, which is whether we have gone too far from the point of view of ensuring appropriate levels of competition in pushing the level of prudential safety requirements.

Mr Munchenberg—No. Apart from a few specific issues. Certainly among my members the smaller banks are not raising that as a general proposition. I have touched on the issue of the Basel II treatment, and Dr Laker gave the APRA view on that this morning. Some of the international banks feel that sometimes there is a double-up in their prudential requirements, because they are required to demonstrate both the prudential regulation of their parent as well as theirs in their own right. So there are some issues there which we will continue to discuss with APRA and the government. But, as a general principle, no I would not suggest that it has swung too far.

Senator CORMANN—You talked before about trade-offs between competition tensions and the level of regulatory supervision and prudential oversight—I think that is what you said a bit earlier.

Mr Munchenberg—I am sorry, what was that?

Senator CORMANN—You were talking about the trade-offs between competitive tensions.

Mr Munchenberg—At the margins.

Senator CORMANN—So you do not think that is an issue at all?

Mr Munchenberg—No. We can give a number of illustrations where there are concerns. I gave two a moment ago. But is the prudential system per se stifling competition in Australia? I would say not. Are we at risk of competition being driven so fiercely that it is going to compromise the stability of the system? No, I do not believe so. I have not seen all the proposals that have been put before the committee. There is undoubtedly a balance there but, broadly speaking, I would have said it was right.

Senator CORMANN—So what would the federal government be meant to examine when you talk about looking at the ‘extent to which government licensing and regulatory burdens act as disincentives for potential entrants into the financial services and credit markets’?

Mr Munchenberg—There may be difficulties. I have already mentioned one in terms of the international banks feeling that sometimes the prudential treatment is more onerous for them relative to their size, and that it doubles up. There is scope there to look at whether it is necessary

to have that doubling up of prudential requirements on international banks. We would like to encourage more international banks to increase their activities in Australia. It may be worth talking to a number of international banks that have opened up recently. We have about half-a-dozen Chinese banks, for example, that have started to open up offices here. It may be worth talking to them about whether they have found any difficulties. If the core of your question was whether we have in mind a range of specific things that we feel need to be addressed, the answer is no. But, equally, if we are looking for ways that we can test whether there are barriers to competition, it would be worth looking at those areas.

Senator CORMANN—You talk about more international banks coming to Australia. In the mid-eighties the government announced that about 16 foreign banks were to be given banking licences, and there were hopes of increasing competition, yet the big four local banks now have a larger market share than they did then. Having international banks come to Australia does not seem to address the issue though, does it?

Mr Munchenberg—If we look at a start point some 20 or 30 years ago and an end point now and try to draw comparisons, I think we miss a lot of the story in between. Clearly when the international banks came in in the eighties they focused particularly on commercial lending, and that intensified competition. Ultimately it led to some problems, and this is where we do run risks between competition and stability.

More recently we have seen international retail banks come into the area. I will probably get into trouble with my other members, but I mentioned the ING role in bringing in online deposit accounts, for example. Those international banks can bring both competition and innovation into the market. The reason why we have the four major banks having such large market shares at the moment is that they stepped in to fill the gap created by a very unusual set of circumstances known as the global financial crisis. So when you look at the full story, the fact that competition does wax and wane over the cycle—

Senator CORMANN—The whole move towards greater consolidation and, I guess, concentration of banks globally has been a phenomenon post GFC. In Australia it has been going on for a very long time—over the last two decades, essentially. It has accelerated and got worse in a way since the global financial crisis, but it is not a new phenomenon in Australia as such, is it?

Mr Munchenberg—I am not sure. There is a long history. If you look at the family histories of the major banks, there has been consistent growth through acquisition throughout their long histories. We have seen similar things happening in other segments of the market. Over time you do get this process of consolidation, but equally you get new players entering the market as well. It was noted earlier, I think, that St George started as a building society, I believe, that grew in part at least through acquisition. I know, because it took over a bank some years ago that I was with. It grew through that process while newer players were coming in and growing as well. That is an ongoing part of the competitive dynamics.

Senator CORMANN—APRA in their submission told us that 25 mutuals are large enough and fulfil all the conditions to apply for a banking licence but have chosen not to do so. Have you got a sense as to why they are not moving down that path? There is an opportunity for new members for you.

Mr Munchenberg—If they do, I am sure we will be happy to entertain their applications. That is a question for the credit unions and possibly for APRA.

Senator CORMANN—I thought that, in your pursuit of a growing banking industry, you might have been interested in what might—

Mr Munchenberg—Consolidation of my membership.

Senator CORMANN—Diversification of your membership.

Mr Munchenberg—No, I have not looked into what reasons there may be behind that. There are others who are in a much better position to answer those questions.

Senator CORMANN—That is all right; I was just interested. My final question goes to the issue of banking fees. How effective are policy measures to target specific individual fees in ensuring sustainable, best possible value for banking customers?

Mr Munchenberg—I think we need to be very careful about targeting particular fees or other charges that any industry puts in place, particularly to the extent that those fees represent a genuine cost to the business. As a general principle, we know that if you target a particular area it is going to create distortions. It was a general question; I am giving a fairly general answer. But, as a matter of principle, we do not think that targeting particular fees or practices is going to be the best way to drive competition.

Senator CORMANN—I do not mean for it to be a general question inasmuch as we have had suggestions that the parliament should target fees around credit cards, we have had the debate about ATM fees and we have had the debate about exit fees, of course. It seems to me that all these various fees are a bit like 150 rabbits running down 150 different rabbit holes—you deal with one and there is another going in another direction and they spring up everywhere. Unless you are able to put the appropriate tensions into the system from a competitive framework point of view to ensure the maximum benefit at the lowest possible cost, you are constantly chasing your tail, aren't you?

Mr Munchenberg—Our view would be that, if you want to enhance competition or strengthen the capacity of competitors, those issues will be resolved through competitive dynamics rather than putting in place regulations which are likely to have unintended consequences.

Senator CORMANN—So you are suggesting that targeting specific fees is not necessarily all that effective in ensuring a sustained solution to the perceived problem of not having the best possible value?

Mr Munchenberg—It raises the prospect of unintended consequences. If we have time I am happy to talk about the ATM fees, for example. If those fees were to be targeted—if we could only charge a cost, for example, for those things—there would clearly be some consequences around access to ATMs and the availability of them, particularly in high-cost areas. It would have implications for half of the industry: the banks—ADIs do not provide to all ATMs. Where you seek to target a particular fee or charge you do run the risk of unintended consequences.

Senator CORMANN—Earlier you talked about the fact that the government could support the smaller banks through supporting their funding requirements. That would distort competition too, though, wouldn't it?

Mr Munchenberg—Our argument there is that there are some particular circumstances that have arisen as a result of the global financial crisis which justify some form of temporary government intervention, including intervention by the AOFM, which I now know was an idea put forward by the coalition. Particular circumstances may warrant particular interventions. A countervailing argument and one of importance is that we also do not want to create a situation where certain markets or certain participants require permanent government support, because that situation would be a problem if it arose. We very much see it that particular consequences have flowed out of the GFC. We would believe them to be transient. Time may recover them, but if things can be done to speed up the recovery process—

Senator CORMANN—Over a time limited period?

Mr Munchenberg—Yes.

Senator BRANDIS—Mr Munchenberg, I am pleased you acknowledged the obvious trade-off between competition and stability. That is not a relationship that was acknowledged or admitted by some of the earlier witnesses today. But it seems to me it raises this question: if we accept, and I do, that there is a trade-off between competition and stability, then any attempt to make this sector more competitive as between the players potentially is going to be at the cost of lessening the prudential regulation applying to it—not necessarily, but potentially.

Mr Munchenberg—Let's use the Australian illustration from the late eighties and early nineties, where we did see a considerable intensification of competition in business lending, which led to a decline in lending standards, which then lead to major problems, with major institutions being put in a very difficult situation. Yes, there are scenarios where that can happen; there are real-life examples where that can certainly happen. So it is certainly something that needs to be weighed in the balance with any consideration of measures to increase competition.

Senator BRANDIS—And it seems to me that this is a very fertile field for the law of unintended consequences to apply, so that one would hasten slowly towards measures which, in the name of enhancing competitiveness, potentially exposed the players in the market to a lower level of prudential regulation and their customers in turn to a greater level of hazard.

Mr Munchenberg—It is an area where, yes, matters need to be considered very carefully and thought through. You can never be 100 per cent certain when you change some part of a dynamic system as to what the full consequences are going to be. But I would agree that we are not in the crisis situation we were in two years ago, so it is an area where more deliberation does need to be given to what measures might be put in place.

Senator BRANDIS—Given the unusual structure of this industry, in which there are four very large players, there are almost another two dozen smaller banks and then there is a multiplicity of other non-bank institutions, it would be fair, wouldn't it, Mr Munchenberg, that changes to the application of the prudential regulatory standards could never be neutral. I think Senator Cormann took this up with you before. They will affect the different players in different

ways, if only simply because of their size and their capacity to deal with changes of the threshold of prudential regulation.

Mr Munchenberg—Just to note in passing, the structure of our industry is not unique in Australia.

Senator BRANDIS—No, I accept that.

Mr Munchenberg—We would actually be quite loath to see changes, and I do not think we have advocated any changes to the prudential regulations per se as a response to this situation. We would certainly not support any weakening of prudential regulation or supervision in an attempt to generate competition, because I think that is a very dangerous path to be going down. We have advocated a number of other measures which could be done that strengthen the arm of smaller competitors but do not go to undermining the stability of the system, we believe—or certainly not the prudential situation. But, yes, as a matter of principle the idea that you would weaken prudential supervision and regulation to give a competitive edge to certain players would be of concern to us.

Senator BRANDIS—The ABA put in its submission to this inquiry before Mr Swan's announcement was made last Sunday. You have no doubt had an opportunity to consider his announcement. There are a number of issues that arise from it, but in the time available to me let me focus on just one. On page 17 of this rather splendid document called 'Competitive and sustainable banking system' there appears to be an instruction to APRA to conduct a review of current guidelines for approval of the use of the term 'bank'. I asked Dr Laker twice this morning whether or not that was in response to a recommendation from APRA. Twice he declined to tell me that it was, so I assume that it was not. Does the ABA support the view that the use of the term 'bank' and all the associations that that has in the minds of the market ought to be made more liberal so that smaller institutions which at the moment would not be entitled to call themselves banks should be able to call themselves banks?

Mr Munchenberg—As you have noted, there are a number of those institutions which already meet the current qualification but have not taken that up.

Senator BRANDIS—Yes.

Mr Munchenberg—But I cannot speculate as to the reasons for that.

Senator BRANDIS—But this goes a little further than that.

Mr Munchenberg—Yes, I understand that. For all that Senator Xenophon has pointed out there are community attitudes around banks, there is no doubt that one of the community's longstanding views is that banks are safe and secure. We do carry that cachet and we would be very concerned if there were moves that would increase the potential for that brand to be damaged. Having said that, there are ADIs which are subject to the same prudential regulations as the banks. From our point of view there is not an issue if they wish to be considered to be banks.

In terms of the capital requirement, those ADIs that do not meet the capital requirement, to be honest, are still subject to the same regulation. If they are subject to the same supervision I cannot see that there would necessarily be a problem there. We have not formed a strong view on that, but we do have a strong view that the term ‘bank’ carries important cachet—never more importantly than at the height of the global financial crisis. One of the many factors that helped Australia through was that we did not have any institution called a ‘bank’ that failed that, had it done so, would have sent a message to the international markets that we were subject to the same problems as the US, the UK and other countries. That is a very real aspect of that.

Senator BRANDIS—So you would be concerned at any measure the government took or even foreshadowed to lower the threshold tests for what institutions are entitled to call themselves ‘banks’.

Mr Munchenberg—I would draw the distinction between the absolute capital requirement—I am not sure there is anything magic about the \$50 million capital requirement—and the fact that, with one or two exceptions that Dr Laker certainly knows more about than I do, they are all still subject to the same prudential regulations. So I think the points you have raised, Senator, are valid but would not necessarily preclude changes in that area.

Senator BRANDIS—What about the issue of the government, through its agency, certifying certain institutions?

Mr Munchenberg—Is this a reference to the government guaranteed deposits—

Senator BRANDIS—The ‘Government Protected Deposits’ symbol.

Mr Munchenberg—Even my smaller members are concerned that there is a perception that deposits with smaller banks are somehow less safe than deposits with larger institutions. Again, we need to strike a balance here. We think—and we promote—the fact that that deposit guarantee applies to all ADIs, not just to larger banking institutions. Equally, larger banking institutions do have a competitive—what is the word—

Senator BRANDIS—‘Weight’.

Mr Munchenberg—weight in terms of people seeing them as more longstanding. They are longstanding institutions and they are more highly rated. I have one bank, Rabobank, which is even more highly rated; it is AAA. So we would not want to set up a situation where the underlying rating of the major banks was discounted; equally, the reality is that all ADIs benefit from the Financial Claims Scheme, the deposit guarantee, and your money is ultimately just as safe in any of those institutions.

Senator BRANDIS—What concerns me—and I hope this is not where this public debate is heading—is that, in the excitability about the blessings of competition, we lose sight of the fact that a more stable system, as you have described, is a system with fewer attendant risks—as the Australian banking system demonstrated during the global financial crisis. It seems to me that those who advocate enhancing competition in the system sometimes, perhaps unintendedly, are advocating a course which would introduce greater competitive risks into the system. That is a

feature of a competitive market, but the cost is less security of deposits. What do you say about that?

Mr Munchenberg—I think that it is absolutely right that both of those considerations need to be weighed in the balance in looking at any measures. I am aware—and we may be able to provide the committee with a little bit of information about it—of a study done in the UK, for example, which showed that consumers have actually paid a lot more because of instability in the UK system over a period of time than they have because of any less than optimal competitive outcomes in that situation. In fact, I think instability has cost consumers four times as much as any sort of suboptimal competitive situation. So there is undoubtedly a situation there where a balance needs to be struck between those things, and the enormous benefit that Australia and Australian consumers have had from a safe and sound banking system over the last few years is not often talked about but is worth a lot as well as competition.

Senator BRANDIS—Thanks, Mr Munchenberg.

Senator XENOPHON—I have a supplementary question to Senator Brandis's line of questioning. You do not see stability and security of deposits in any way being compromised if it were easier for customers to switch banks through either an easier way of shifting banks or a bank account portability system?

Mr Munchenberg—No. Off the top of my head I cannot see that that would be a significant issue. My understanding of Senator Brandis's questioning—and I cannot speak for him but he is here—was more around if we weaken—

Senator XENOPHON—I understand that.

Mr Munchenberg—But are there things that we can do to enhance competition that will not weaken the stability of the system? I believe so. Should we always have in mind the importance of the stability of the system when looking at things that we propose to do? Absolutely.

Senator XENOPHON—One of those things could be bank portability, which does not affect any of the issues that Senator Brandis has raised in terms of stability or security.

Mr Munchenberg—If not done well, it may affect the stability of the payment system. That is a different issue.

CHAIR—Thank you, Mr Munchenberg and the other officers representing the ABA.

Proceedings suspended from 3.21 pm to 3.32 pm

SYMOND, Mr John, Executive Chairman, Aussie Home Loans

CHAIR—Welcome. Would you care to make an opening statement?

Mr Symond—I certainly would. First of all, a couple of minutes on history. Aussie Home Loans was formed in February 1992 and in 1994 we partnered with Macquarie Bank to be the first to introduce wholesale funding by securitisation, which benefited mums and dads by way of their mortgages. It was the first time that consumers had access to wholesale funding.

CHAIR—Are the photographers distracting you?

Mr Symond—They are okay. So it was the first time securitisation was introduced to benefit mums and dads by funding their home loans. On the back of what we did, RAMS, Wizard and a whole number of other non-deposit-taking nonbanks were formed and ultimately in 1997 the Commonwealth Bank were the first to drop interest rates by a total of just under three percentage points. That impacted their whole loan book, all the banks, mutuals and everyone else.

The purpose of this committee is how to bring on competition. I am disappointed that the Treasurer in announcing his initiatives has failed to consult with that sector that brought on competition. The nonbanks, being than non-deposit-taking nonbanks, have been totally shut out of the current funding environment. There is nothing in these initiatives that helps those that brought competition to the marketplace. It was not the banking sector that brought competition, it was not the mutuals. I am a fan of the mutuals, but to suggest that the mutuals can become the fifth force in banking, quite frankly, is a joke. They are small corner stores, they do not have infrastructure, they do not have technology, they do not have the clout and reach. We need the government to go back to firstly understand where competition came from. And I have got some strong comments about AOFM.

One misnomer I want to make sure I clarify is that I get upset when quite often in the press I read that Aussie Home Loans is controlled by the Commonwealth Bank. Two years ago the Commonwealth Bank pursued me to take a passive 33 per cent minority interest, legally documented and with no say in the running of Aussie Home Loans. We do not even have a product through the Commonwealth Bank. What they did was to assist us in arranging a third-party warehouse funding arrangement, arms-length, through the money markets as they do to many other third-party customers. As far as I am concerned Aussie Home Loans is extremely independent. I am fiercely independent and the Commonwealth Bank has no say in the way Aussie Home Loans runs its business. It is very important that this is understood.

There are aspects of what we have been hearing the last few days about exit fees and I am happy to expand on that because I do not think people totally understand where the problems are with exit fees. Basically, I think the single biggest problem stifling competition today is the lack of wholesale funding to the sector who brought on competition. It is the oxygen and there is no oxygen there. Secondly, I think it would be easier for consumers to switch loans and there is room for improvement but there are real impediments that are beyond exit fees. Exit fees are a secondary problem. It can be improved on but again I am happy to expand on that if you would like.

CHAIR—Thank you. You opened by giving a short lesson on the history of the industry that you are involved in and how that has introduced competitive factors into the banking industry that were not there before—

Mr Symond—And changed the industry.

CHAIR—Absolutely. We earlier had some evidence that was put forward and we were given a copy of the housing finance market share which was taken from the ABS housing finance data which indicated that going from essentially nothing in 1992 the non-bank financial sector, meaning non-ADIs, reached a peak of about 15.2 per cent in 2003 and then dropped off a little bit before the GFC. The explanation we were given as to the reason that it dropped off prior to the GFC was that the banks were then stepping up to match what your sector of the industry was doing, highlighting the fact that you were introducing a high level of competitive activity into the overall market leading to the banks trying to take some share back because they could see they were losing it and they needed to lift their game.

Mr Symond—In service, product and pricing.

CHAIR—So you would agree with everything I have just said then?

Mr Symond—Yes.

CHAIR—Okay, that is good. I guess it is fair to say that in your view through that period the main driver of competition in the banking industry was the non-bank sector.

Mr Symond—Yes, absolutely. We were the catalyst, we as in the non-banks not the mutuals. In fact, when I stepped into the market in 1992 the mutuals, building societies including banks all charged about the same high interest rates. The mutuals provided a better service. They were the corner store but in terms of pricing they were all the same.

CHAIR—Okay. Looking at where we currently stand in coming out of the other side of the GFC quite clearly the influence and the ability of the non-bank sector of the industry to compete aggressively has been severely hamstrung as you note primarily through the lack of funding availability to them.

Mr Symond—Virtually shut down.

CHAIR—It had virtually shut down. We have had evidence over the last couple of days that the banking industry remains competitive in the sense that there are a number of operators still operating and the diversity of products still exists. I challenged that evidence as to whether the industry is competitive. Is that a legacy of the period when we had a sector of the industry actively driving competition? Without such a sector actively driving competition, where will we head in terms of competition within the industry? If nothing is done to revive the non-bank sector, even given the measures that the government is looking at introducing to try and promote the mutual sector, where do you think the industry is heading in terms of competition?

Mr Symond—I will comment on what you said about where the industry is at at the moment. Fortunately, we do have strong banks that did not need bailing out and that is a big plus. The big

banks have learnt their lesson from the last recession and have picked up their game. Fortunately, they have proved to be better managed and more safe, which is good for the country. And they did have to compete to win customers and keep customers. The current situation is a legacy of the changed customer behaviour. Customers were educated to realise that they can get good service and demand a better deal, and that is the expectation of consumers today. Consumers today have not really been hindered in trying to go and get a home loan. Fortunately, the vast majority of consumers can still get a home loan today.

My concern going forward is that there is a lack of choice. The big banks are in a privileged position and they have got the market to themselves. At one stage they were getting over 90 per cent of the business. It is all very well to address exit fees, but what are people going to do? Exit one big bank so that they can go to another big bank? My concern is that there will be creeping of margins and increasing fees because, let's face it, in life you get away with what you can get away with! My concern is that we will allow the big four banks to dictate and we will not have competition. I do not believe competition will be strong enough. I am not criticising mutuals but I do not believe they will be the answer because of their structure. There are some credit unions that have three staff members operating out of an office on the 30th floor of a commercial building. They are dysfunctional and they will not join together. There is a whole array of problems for them to become a very strong, united force. But, unless the government do something to assist those prudent competitors who work hard for consumers and ultimately force the banks to get their act together, nothing is going to change; in fact, things can only get tougher for consumers. I am concerned that the government has not consulted. I have spoken to the MFAA. They have not been consulted; they tried to. No-one has spoken to me. I see that as a real problem. It means the government has missed a golden opportunity and just does not get it.

CHAIR—The government would say that on Sunday they released a package which, in their view, will stimulate further competition in the banking industry and go a significant way to solving the issues. I take it from what you have said so far today and also from what has been reported in the media that you do not fully agree with that.

Mr Symond—What they did roll out has confirmed in my mind that they absolutely do not get it. Why did they not consult the organisations with a proven track record of forcing competition? They gave the whole industry a wide berth.

CHAIR—They have not consulted?

Mr Symond—None whatsoever.

CHAIR—Despite that, sometimes when you do not consult you still manage to deliver something that might actually help. Is there anything in the reform package that you think would help the non-bank sector of the industry?

Mr Symond—I cannot see anything in there that will play any significant part in assisting competition. Yes, there are a lot of nice things. Let us talk about exit fees to start with. Anywhere around the world, including in the early years of the non-bank competition, people paid an application fee. You go to the UK, the US, anywhere around the world, and you will pay some thousands of dollars as an application fee. Who pays the cost of the evaluation report? Who pays the cost of the legal documentation and all the rest of it? It is in an application fee. When

competition hotted up, the application fees were then rolled into a deferred establishment fee to make it easier for the mums and dads not to fork out a few thousand bucks. However, there is room to improve the exit fees, because there are some lenders out there that do not reward customers who have stayed for sufficient years for them to recoup, out of the margin, the cost of those upfronts.

But the biggest inhibitor of switching—in over half the cases we see, probably 70 per cent—is not the exit fee; it is the duplicating cost of mortgage insurance. If you borrow over 80 per cent of the value of your property, you have got to obtain mortgage insurance. That can cost you anything. It can cost you \$10,000 or \$7,000. That is just a deal breaker. Mums and dads do not have that money. So all this talk about \$700 or ‘We don’t charge a fee’ or \$3,000 there—yes, there are some fees that need pruning and what we have seen with ASIC is quite good, because we have been a proponent of bringing in regulation to try to ensure that the non-bank industry becomes more professional. However, they have said that you can recoup actual out-of-pockets. So, to say that the government will just wipe out exit fees—there still will be fees to cover those costs. That can be either an application fee or it can be a higher interest rate. The problem I see here is that, with the benefit that the big banks have got—cross-subsidisation, big businesses, big profits—they may squeeze the smaller lenders by saying, ‘You know what, we’re not going to charge the application fee.’ And the smaller lenders that are bleeding most are the ones that need to try to cover their costs.

CHAIR—So it will reduce the ability of your sector of the industry to compete.

Mr Symond—Yes, because the big banks can say, ‘We’re not going to charge an application fee.’

CHAIR—Ultimately if people sign up to contracts that have an exit fee on them, but they stay for the minimum period, then they do not pay it all at the moment, whereas, if it were upfront, they would be paying it regardless.

Mr Symond—That is right. The method of exit fee calculation really does need an overhaul, because in many cases loyal customers have not been rewarded. They might be with you for seven or eight years, and there are some lenders there that might slug them a couple of thousand dollars. I am all for rewarding loyal customers. But, hey, if you write a loan today and absorb the cost of all the upfronts and they want to switch their loan in nine months or 16 months, any lender is out of pocket by some thousands of dollars. You have got to be fair with this. This business about banning exit fees—it is not as simple as that. Mortgage insurance is the biggest inhibitor, from what I see. And, let me say, we process \$1 billion every month in new home loans.

CHAIR—I will let others follow up on exit fees. I am sure Senator Williams will ask you a question or two. In terms of looking forward, if the government had consulted you, what advice would you have given about reinvigorating the securitisation market?

Mr Symond—I have made a lot of public comments saying that the government should look at a system similar to the Canadian system, where the government—with a similar population—over five years have stood behind \$300 billion in mortgage backed securities. I do not believe

they have lost a dollar. Consumers have retained low interest rates and have not been impacted by the GFC.

CHAIR—When you say ‘stood behind’, do you mean they guaranteed it?

Mr Symond—They supported it, yes.

CHAIR—So they provided an official guarantee which gives investors confidence to invest in these products.

Mr Symond—And then they charge a lower interest rate because they have got the—

CHAIR—Government guarantee.

Mr Symond—sovereign guarantee. To Wayne Swan’s credit, he suggested that they were going to look into our super funds investing in AAA-rated mortgages. Now are they going to do that? That is another area that we and others have mentioned because to invest in AAA-rated mortgages fully insured by the super funds is a great investment—no-one has ever lost a dollar—and it frees up liquidity domestically. So I think if the government gives more than rhetoric and says, ‘Yes, we’re going to look into that,’ that could be something very good. Increasing the AOFM is really critical, but there are a lot of prickly points with the AOFM, not just the fact of \$16 billion going to \$20 billion and not just the fact that it does not hit the sides. That would finance probably two weeks of the 52-weeks funding requirements for Australia.

It is also about who is eligible to participate in that. Let me tell you this: if you go and look at the \$11 billion or so that has been already supported, you will note the average loan to value ratio of those bonds has somewhere around 30 to 40 per cent equity in each mortgage. In other words, those organisations using the AOFM to attract investors have got to cherry-pick their portfolio and only look for those loans where people have got a 30 or 40 per cent deposit. Imagine if I had a heap of AOFM money and I went out with an advertising campaign and said, ‘Come to us but you have got to have a 30 or 40 per cent deposit’. Go out in heartland mortgage land and say that—you have got to be kidding! These people are flat out finding 10 per cent.

CHAIR—What would the LVR have been on the average RMBS prior to the GFC?

Mr Symond—It varied because there were tranches, but a lot of them would be at 85 per cent or 95 per cent loans and there is an average. But let me tell you that for the one that we are looking at at the moment our average is a 62 per cent loan to value ratio.

CHAIR—And that is because you have to at this stage in order to attract investment.

Mr Symond—That is because unless we keep it around those numbers investors will not buy. If they buy and I increase the LVR, we will be paying an interest rate higher with the cost than what we can lend it for. Now what would that end up forcing us or others to do? Increase interest rates. This is the opposite of what the government are saying they want to do.

CHAIR—On that, and then I will hand over to others because we have limited time, and in terms of the AOFM, your suggestion is that they look at support for alternative levels of RMB

securities. So it is not just the very top level; they also help to restimulate some of the still-safe securities but lower rated levels of RMBS.

Mr Symond—Yes. They need to expand—

CHAIR—Into B-notes and things like that?

Mr Symond—Given the way it is now, I would challenge anybody to find \$1 of the \$11 billion AOFM funds that has created a lower interest rate or competition for consumers. All it has done is help some lenders who are stuck with a warehouse paying 10 per cent to empty out their warehouse, issue the bonds but make no money out of it. The other problem—and this is something that has just been sprung on us, which I am obviously very unhappy about, and again it comes to my clarification as to the Commonwealth Bank—is this. We received an email a week ago when we were about to issue a large RMBS bond. The AOFM, at the 11th hour, has advised us that unfortunately the Treasurer has indicated that because you have some shareholding with a major bank the AOFM will not participate.

CHAIR—Because they are not putting any of their money into major banks through this?

Mr Symond—But they are a minority passive investor—

CHAIR—Exactly. I understand.

Mr Symond—that has no say in running our business. Is that creating competition or is it the opposite?

Senator XENOPHON—Have you put it to the Treasurer to reconsider that?

Mr Symond—We went back to the CEO of AOFM, and I am quite happy to read you the response. Would you like that? It will only take a minute.

CHAIR—Go for it.

Mr Symond—It says:

Michael Bath, acting chief executive officer, wrote to our lead managers underwriting it. I tried to call you a couple of times today—

this is Friday of last week—

CHAIR—This is AOFM, is it?

Mr Symond—Yes. It continues:

I am afraid that contrary to previous advice the AOFM is not going to be in a position to support the transaction based on CBA's ownership of OHL.

Note: ownership.

Specifically, the Treasurer has clarified his expectation that RMBS program not support the major banks or their subsidiaries—

which we are not—

whether fully or partially owned. Secondly, in light of this clarification, AOFM will not be in a position to support the Aussie Home Loans transaction at this time.

What this means for us is that the investors will now finance at a higher interest rate.

Senator PRATT—Could I ask for that to be tabled, please, if you are quoting from a document?

CHAIR—Mr Symond, are you happy for that to be tabled?

Mr Symond—I am.

CHAIR—Thank you. Dr Grant will assist you with that. So in your understanding is that a new requirement that came in on Sunday?

Mr Symond—This came at the eleventh hour and AOFM were apologetic and embarrassed.

CHAIR—The first time I was aware that the government were making it clear that not a dollar of their securitisation money through the AOFM was going to—

Mr Symond—First time! And this is way down the track, being ready to issue these bonds.

CHAIR—It is stated in there, and I suspect that may well be the first time that it has actually been stated.

Mr Symond—Yes. We were all thrown, including AOFM. We asked the CEO to go back, and he came back and said: ‘This is a matter for the Treasurer. It is the Treasurer’s directive.’ I think it is pathetic, especially if you look at this. I do not want to chest-beat, but which other organisation has done more for competition in this country in the last two decades than Aussie Home Loans? We have been singled out, wrongly, and this means that we will have to pay a higher cost for funding, above the higher costs that already exist. This is plain dumb.

CHAIR—It makes it harder for you to compete against the major banks, which is theoretically—

Mr Symond—It is ridiculous. It has no logical sense to it.

Senator CORMANN—Have you ever had a conversation with the Treasurer about any of these issues?

Senator HURLEY—Chair—

CHAIR—We will try to do this in an orderly way. We will come to you in a minute, Senator Cormann.

Senator HURLEY—This 30 per cent ownership by CBA—

Mr Symond—It is 33 per cent.

Senator HURLEY—Okay, 33 per cent. Presumably they put in equity money to achieve that.

Mr Symond—We do not give away ownership. You have to pay if you want to buy something that is decent.

Senator HURLEY—Exactly.

Mr Symond—They paid a lot of money.

Senator HURLEY—So those funds that you got from that CBA share—

Mr Symond—It is in my bank account—John Joseph Symond.

Senator HURLEY—That is terrific, but surely that enables you to give lower interest rates to your customers, because the cost of that equity is less than—

Mr Symond—Excuse me, but if you sell your house do you go and give it away to your neighbours? I built this for 19 years, made no money in the first 10 years, and I sold—

Senator HURLEY—So you have pocketed that equity from CBA and you have not passed it on to your customers. Is that what you are saying?

Mr Symond—Absolutely, but we have always been offering interest rates way below the banks’.

Senator HURLEY—So now you want the government to come in and make up for that.

Mr Symond—I do not understand the sense of the question, with respect. This is an asset that I have built. If you buy your home and you make a profit, do you give it away to charity when you sell?

Senator PRATT—It sounds worse than the big banks and the debate about their profits.

Mr Symond—I can debate bank profits too. They are huge.

Senator HURLEY—So you want the government to step in and help you now with the cost of your funds? You are saying—

Mr Symond—The industry, I am talking about. We are part of the industry.

Senator HURLEY—Okay, but you in particular. In your submission you list the likely drivers of future change and innovation in the banking and non-banking sector. You say:

- Aside from bringing greater cost efficiencies and making things easier for consumers, technology has to be further developed to enable seamless transfer of customer information between banks and non-banks ...

Then you discuss the ease of moving between providers of banking services:

Whilst not an exhaustive list, the following factors tend to act as barriers for customers to move between institutions:

- Customer inertia;
- Mortgage upfront and exit fees;
- Hard-to-switch transaction accounts; and
- Bank bundling of products ...

Of those things, the government has addressed mortgage upfront and exit fees and hard-to-switch transaction accounts.

Mr Symond—No, they have not addressed that, with the greatest respect. You are wrong. How do you address paying a mum and dad, hard workers, who have not got much money and who find they have got another \$8,000 mortgage insurance to pay?

Senator HURLEY—Let us leave that aside. You said that the government have given you nothing in their policy, and yet they have—

Mr Symond—They have given the non-bank industry nothing to compete with the big banks.

Senator HURLEY—So they have given you no advantage over the banks.

Mr Symond—No.

Senator HURLEY—Not that they have given you nothing. That is different from what you said in the beginning. You said that they had been given nothing. Now they have not been given ‘nothing’. They have given you something but—

Mr Symond—They have give us zero.

Senator CORMANN—On the same weekend they made things worse for you, didn’t they? They made things worse for you on the same weekend!

Senator BRANDIS—On the very weekend that Mr Swan was claiming to make the industry more competitive, he was in fact making the most competitive sector less competitive.

CHAIR—Order! Senator Brandis. If we could maintain a bit of order with this. Senator Hurley, you have a few more questions.

Senator HURLEY—You have had half an hour.

CHAIR—We had an opening statement as well, thank you.

Senator HURLEY—Very close to half an hour—

Senator PRATT—And I also have questions.

Senator HURLEY—Mr Symond has made an attack on—

CHAIR—Mr Symond is giving evidence as to the way he sees it.

Senator HURLEY—Yes. So I want to question him on that.

Senator BRANDIS—Senator Cormann and I have questions as well on that, as does Senator Xenophon.

Senator HURLEY—The chair can deal with that, but I want enough time to do this.

CHAIR—You will have an equal amount of time with the other senators.

Senator HURLEY—So you are saying it is not enough that the government address these issues that you have identified in your submission; you want them to skew the playing field in favour of the nonbanks rather than the banks. Is that what you are saying?

Mr Symond—I am saying that the list of what you read out then will not make a significant difference to consumers by way of competition or lower interest rates.

Senator HURLEY—Why did you ask for it then?

Mr Symond—I said it will help.

Senator HURLEY—This is your submission.

Mr Symond—I said it will help, but my focus has been on wholesale funding.

Senator HURLEY—All right.

Mr Symond—These are nice little things but they will not make a significant difference.

Senator HURLEY—Okay. So the significant difference is in wholesale funding.

Mr Symond—Yes.

Senator HURLEY—And so—

Mr Symond—That is the oxygen.

Senator HURLEY—the government have said that they will give another \$4 billion—

Mr Symond—It will not hit the sides.

Senator HURLEY—Another \$4 billion—

Mr Symond—That is two days of funding.

Senator HURLEY—to AFOM—

Senator BRANDIS—That is pocket-money for your government, Senator Hurley.

Senator HURLEY—to add to the wholesale funding mix. Four billion dollars isn't enough for you?

Mr Symond—Chickenfeed—

Senator HURLEY—Chickenfeed.

Mr Symond—for the Australian people—

Senator HURLEY—This is taxpayers' money.

Mr Symond—to receive.

Senator HURLEY—Four billion dollars—

Senator BRANDIS—Labor is starting to develop an interest in taxpayers' money!

Senator HURLEY—on top of the \$16 billion that has already been put into that pool—

Mr Symond—It will finance fewer than two weeks of the 52 weeks funding required for home loans.

Senator HURLEY—So you want that to be made bigger, I presume.

Mr Symond—Increased.

Senator HURLEY—You also want, in the way that Canada has done, the government to put in a guarantee to underpin that market. How much government money do you want poured into your industry? How much are we talking about here?

Mr Symond—If the government want to make a difference and promote competition, they would have to invest at least \$30 billion to \$40 billion a year, and that is only a small amount.

Senator HURLEY—That is a lot of money to pay for competition so that you can get 30 per cent equity of CBA and pocket it.

Mr Symond—I have not got 30 per cent equity of CBA at all. Do you know what I am proud of? I am proud of leading the charge in dropping interest rates—

Senator HURLEY—So you can sell 33 per cent of your equity in CBA.

Mr Symond—so that all Australians—

Senator HURLEY—So the government—

Senator BRANDIS—Order! Senator Hurley.

CHAIR—Senator Hurley.

Mr Symond—So I am very proud of what we have done.

Senator HURLEY—I haven't finished.

CHAIR—Senator Hurley, your point is simply relevance.

Senator BRANDIS—You are making absolutely no sense whatsoever.

Senator HURLEY—It makes perfect sense to me.

Senator CORMANN—Mr Symond has obviously touched a raw nerve.

CHAIR—Mr Symond is entitled to make his own business deals.

Senator BRANDIS—Since when did Labor senators develop this doe-eyed concern for public money?

Senator HURLEY—Senator Brandis—

CHAIR—Senator Hurley, can you please focus on asking the witness questions that are relevant to the terms of reference, please.

Senator HURLEY—I cannot see that this is anything—

Senator BRANDIS—I think Senator Hurley has had as much time as you had, Mr Chairman. It is time for somebody else to have a go, isn't it?

Senator HURLEY—I cannot see that it is anything but relevant to the issue of competition that Mr Symond is asking the government to spend in the order of \$30 billion a year in order to prop up competition. And I am just pointing out that the competition that is being propped up is in the non-bank sector, which can be held by private individuals or small companies such as Mr Symond's. He has sat there and said that he has sold 33 per cent of that company to the Commonwealth Bank and taken that money for himself, so I am—

Mr Symond—Can I ask: what is the difference between floating my company on the stock market—

Senator HURLEY—If I could finish, Mr Symond; if I could make my point. So I am asking how important it must be to the government to prop up organisations such as yours that they would spend \$30 billion a year of taxpayers' money?

Mr Symond—If the government were worried about the Australian consumer they would be helping consumers pay less interest rates—like the non-bank industry created by dropping interest rates by three per cent across the board. And it dropped the inflation rate of Australia, it saved mums and dads from being thrown out of their homes and all Australians benefited. I am saying the government has not even consulted that sector of the marketplace, which I find amazing.

Senator HURLEY—The Australian Securitisation Forum say they were consulted, and they are the people who are looking at the wholesale market that you say is so critical to you. They say they were consulted.

Mr Symond—They did not do anything for me to get securitisation launched in this country when we did that in 1994. I am not criticising them, but who are they? You ask the consumers out there who they are. It is another body talking technical.

Senator HURLEY—It is not a matter—

Mr Symond—What I am interested in is Australian consumers being looked after, having competition, not paying too much in interest rates or fees. And unfortunately these initiatives will not achieve that.

Senator HURLEY—For \$30 billion a year surely the government could look at directly subsidising interest rates for individual mortgage holders. Why should it put it in the pocket—

Mr Symond—The government make money out of this investment. This is not a donation. And they are 100 per cent guaranteed not to lose money. They have never lost a dollar. This is making profit and helping consumers along the way.

Senator HURLEY—If it is such a good investment, why aren't other people, other institutions, investing? You said—

Mr Symond—That is what they call a GFC.

Senator CORMANN—That is normally a lesson that we get from you guys.

Senator HURLEY—According to the coalition the GFC, if it ever existed, is well and truly over.

Senator BRANDIS—Senator Hurley, we would not want you putting our arguments.

CHAIR—Senator Hurley, could you ask your last question please.

Senator HURLEY—No, I will not because I have a lot of questions to ask—

CHAIR—Well, we all have a lot of questions.

Senator HURLEY—and I have had seven minutes.

Senator CORMANN—We might have to reconvene.

Senator XENOPHON—Chair—

CHAIR—You started at 3.56—

Senator HURLEY—I had seven minutes.

CHAIR—You started at 3.56, thank you very much. You have had 11 minutes.

Senator XENOPHON—Chair—

CHAIR—I only asked questions for 11 minutes as well.

Senator HURLEY—Well, clearly—

CHAIR—If you are going to take that attitude I will move on to Senator Xenophon.

Senator XENOPHON—No, Chair, I just want to—

CHAIR—We will extend time, but I call Senator Xenophon.

Senator XENOPHON—Can we extend time? I am just trying to be fair to Senator Hurley. I have a number of questions but—

CHAIR—I had more questions I could have asked as well. I am going to pass the call to you, Senator Xenophon. If you would like to take the call you can; otherwise I will pass it to Senator Cormann.

Senator XENOPHON—You are giving me a Hobson's choice here.

CHAIR—Senator Cormann.

Senator HURLEY—I protest, Chair—

Senator XENOPHON—Chair, I was just trying to be fair to Senator Hurley.

Senator HURLEY—that I have had, with several interruptions from the coalition side—

CHAIR—I will come back to you, but Senator Cormann now has the call, thank you.

Senator HURLEY—a very limited amount of time.

CHAIR—Excuse me. Order! Senator Cormann has the call.

Senator CORMANN—Mr Symond, we have now got a copy of the email that you talked about before in relation to the AOFM. What sort of transaction was involved here again?

Mr Symond—Several hundreds of millions of dollars in mortgage backed securities.

Senator CORMANN—So initially you were told that the government would support this through the AOFM—

Mr Symond—Yes.

Senator CORMANN—and then they changed their mind on Friday?

Mr Symond—At the 11th hour.

Senator CORMANN—Had anybody talked to you before they changed their mind?

Mr Symond—Never. It came out of the blue.

Senator CORMANN—In this whole process around improving competition in the banking sector, have you ever had any conversation with the Treasurer, Wayne Swan, or any other representative—

Mr Symond—We have not had any discussions with anybody from government or anyone associated with government about any aspect of competition, including AOFM, since they have been in government.

Senator CORMANN—So on the same weekend that the Treasurer makes an announcement where he essentially is trying to make people believe that they will improve competition in the banking sector they have actually taken action in relation—

Mr Symond—That was the Friday before.

Senator CORMANN—This is the Friday before the Sunday—

Mr Symond—A week ago.

Senator CORMANN—where they were actually undermining competition in the banking sector?

Mr Symond—Yes. The organisation that led competition to this country.

Senator CORMANN—And so the circumstances for the non-banking lenders overall have not improved at all through the package that the Treasurer announced on Sunday?

Mr Symond—I have spoken to several of the nonbanks, as in the non-deposit-taking banks, and not one of them is happy. You have already heard from Phil Naylor, CEO of the MFAA, and he also made it clear that, in his view, the government avoided talking to him.

Senator CORMANN—So, at best, what the government announced on Sunday is window-dressing. At worst—given what has been happening in recent days, including this email to you, the situation today is worse than it was last week.

Mr Symond—Correct. I think the government took the view that the fifth pillar was going to be mutuals and unfortunately did not do their homework. As I said, there is no way in the world that can happen.

Senator CORMANN—The government could fix this. Wayne Swan could pick up the phone and call Mr Symond—we'll save you!—and he could sort this out.

Mr Symond—It is not a question of our company—

Senator CORMANN—No, but on behalf of the—

Mr Symond—And the \$16 billion to \$20 billion does not hit the sides. Not one dollar of that has helped any mum or dad get a cheaper interest rate.

Senator CORMANN—If the Treasurer and the government were serious about improving the situation—

Mr Symond—We could give them some very strong hints about how they could improve competition.

Senator CORMANN—They should talk with people like you and other representatives of the non-bank lending sector about how to improve competition.

Mr Symond—Only if you want to talk to that experienced sector that has a proven track record, that drove down interest rates and created competition—only if you want to talk to that sector.

Senator BRANDIS—Mr Symond, this letter you have tabled indicates a change of policy. It says 'contrary to previous advice'.

Mr Symond—Yes.

Senator BRANDIS—What was the previous advice?

Mr Symond—They would support us.

Senator BRANDIS—How long before you received this letter had that advice being given to you?

Mr Symond—Consistently, because we had been working on it for months.

Senator BRANDIS—All right. There is no explanation given, other than these two brief subparagraphs, as to why there is this reversal of policy. How much is this decision of Mr Swan's likely to cost your customers?

Mr Symond—It depends on what the pricing is struck at. That will determine whether we make any money, whether we lose money or whether we have to increase interest rates.

Senator BRANDIS—Right. And those decisions have not yet been made?

Mr Symond—We do not know what the pricing is going to be from the other institutions who will invest in our bonds.

Senator BRANDIS—As much as you can, are you able to make a prediction as to what the effect of this reversal of policy is likely to be?

Mr Symond—It will cost millions of dollars.

Senator BRANDIS—How much?

Mr Symond—Millions.

Senator BRANDIS—And that will be borne either by your company or by your customers.

Mr Symond—Or a combination.

Senator BRANDIS—Or a combination of the two. To the extent to which it is borne by your customers, it will be in the form of increased interest rates.

Mr Symond—It is a possibility.

Senator BRANDIS—And, to the extent to which it is borne by your company, that will make your company less competitive than it was before the reversal of policy was made by Mr Swan.

Mr Symond—That is correct.

Senator BRANDIS—And, as Senator Cormann said, that was in the week when this very slight document was produced, claiming to be the government's answer to competition in the banking sector.

Mr Symond—Correct.

Senator BRANDIS—Mr Symond, if you have a view, why do you think the government did not consult you or other members of the non-banking sector in relation to this competition review?

Mr Symond—I do not think they fully understand how it works. They do not fully understand what impacts on consumers. They have made a big song and dance about exit fees. Exit fees need to be overhauled and I am fully supportive of that; they can be improved on. But the big hindrance there, as I said, is the mortgage insurance, which impacts more than half of the people. Yes, they can save some of the exit fee cost in some cases, but that is not going to create competition to help people get into housing at a lower cost, have money more freely available and have a bigger choice of lenders.

Senator BRANDIS—So the only thing the government did last week was in fact make the lending sector less competitive?

Mr Symond—I think the mutuals and the big banks are in a great position, in a privileged position. I think the mutuals feel this is great. They can have a little symbol saying, ‘Guess what? We are sort of like a bank.’ But the only sector proven to bring on competition has been given a wide berth and no consultation whatsoever—the only sector with a proven track record in bringing on competition that dropped interest rates in the mid-nineties by three per cent off mum and dad’s after-tax dollars. That is what I am upset about.

Senator BRANDIS—Thank you.

CHAIR—Senator Pratt.

Senator PRATT—Mr Symond, can I ask how much you received from the Commonwealth Bank when it bought into your business?

Mr Symond—No, I think that is confidential. I would not ask you what you sold your house for or what you sold your car for or what you sold a diamond ring for.

Senator PRATT—I bought it for \$540,000. I think it is probably worth a lot less than yours. What was the dollar amount that you received?

Mr Symond—They bought 33 per cent of a business that was then established 17 years—a very strong consumer brand because of its track record of performance, honesty and trust and delivering to consumers what they could not get from banks and mutuals previously.

Senator PRATT—Do you meet with representatives of the Commonwealth Bank? How often do you meet with Ralph Norris?

Mr Symond—The bank attends bimonthly board meetings. They have two people attending.

Senator PRATT—You had a go at mutuals in your opening remarks. How can consumers trust that you want to compete with the big banks when you are partly owned by the Commonwealth Bank?

Mr Symond—I am proud to say that we have got a track record of competition and doing the right thing for 19 years, and no-one else can say that.

Senator PRATT—But you are partly owned by a bank that was the very first bank to raise its interest rates in November.

Mr Symond—Yes. And let me tell you your super fund and everyone else invest in those exact banks.

Senator PRATT—You are arguing for the Canadian model, but I would say that, in terms of ongoing government commitment to bailing out the sector, isn't that exactly like Fannie Mae and Freddie Mac as it happened in the United States? Isn't that what caused—

Mr Symond—Totally the opposite.

Senator PRATT—the global financial crisis?

Mr Symond—Because Fannie Mae and Freddie Mac invested in non-conforming mortgages, people who were unemployed, NINJA loans—no income, no jobs, no assets. Australia and Australian banks, to their credit, did not go down and lend to people who were not creditworthy, and they are all mortgage insured.

Senator PRATT—So you have pointed out we have a very different market here.

Mr Symond—Yes.

Senator PRATT—But wasn't a strong and vibrant RMBS market the key driver of competition before the global financial crisis? Isn't that why you were able to do business? The falling down of that market—is that why you had to sell out to the Commonwealth Bank? I did not see any mutuals do that along the way.

Mr Symond—That was not the reason, because we were very profitable, and we saw an opportunity that in the future we may grow and we may get wholesale funding which we have not received from the Commonwealth Bank.

Senator PRATT—It seems to me that today it is okay to debate bank profits but not yours, but in any case—

Mr Symond—Well, we are not a public company. Do I ask what your salary is?

Senator PRATT—My salary is a matter for the public record. In fact, the price of my house is a matter of the public record; I have to disclose these things.

Mr Symond—Well, my business isn't. You can go into ASIC records—

Senator PRATT—It is all on our disclosures.

Mr Symond—and have a look at our profits, and it's there.

Senator PRATT—It is all on our parliamentary disclosures, but we are not here—

Mr Symond—It's there, but I do not have to tell you how much my watch is worth and what I sold my car for.

Senator PRATT—Well, we are here talking about mum and dad Australians, people who have mortgages, so why don't you recognise that taxpayers are in fact investing a huge amount—\$20 billion—to support lenders through the RMBS market? Why is it all about you being in the position and taking the high moral ground here today?

Mr Symond—They could get more than \$20 billion back in interest savings, and the government makes a stack of money by doing it. They can divert the profits of that into well-needed areas, whether it is in housing, hospitals, health or transport. It is a very safe investment. It is not something where they are spending it on pink batts or whatever.

Senator PRATT—I think you have just made the point that you are clearly politicising this debate today—

Mr Symond—Absolutely not, and I will place on record—

Senator PRATT—rather than debating the real issues.

Mr Symond—over the last 10 years I have voted equally both sides of parliament. I am bipartisan.

Senator PRATT—Let's get back to what we are really here to talk about.

Mr Symond—I will support those who are performing.

Senator PRATT—Why is it that smaller lenders, like the AMP, credit unions, Liberty Financial—organisations like that—have said that the government support for the RMBS has helped them compete with the big banks and in some cases cut their interest rates? Do you disagree with the positions taken by these institutions?

Mr Symond—Any help for them is some help. Maybe I am just a more controversial, honest, free-speaking person because I do not have to play politics. You cannot go out there and say, 'Isn't the Liberal Party a fantastic organisation.' I can say, 'Banks are terrible,' if I believe they are terrible. I can say what I want to say about politicians ripping up and wasting most of taxpayers' money with bureaucracy and everything. I do not have to play politics and I say what I believe, regardless of who I am talking to.

Senator HURLEY—And whether it is right or wrong.

Mr Symond—Well, no; it is just my opinion.

Senator BRANDIS—That is an arrogant thing to say, Senator Hurley.

Senator HURLEY—Talk about the pot calling the kettle black!

Mr Symond—It is my opinion and I can say, thank goodness, that I have a track record in the community of doing the right thing and producing the runs on the board.

Senator PRATT—I have no doubt that the RMBS and access to funds is what has enabled companies like yours to offer—

Mr Symond—Pre-GFC, correct.

Senator PRATT—and drive down those interest rates. That is exactly what we are debating today in terms of what things will enable other institutions to drive down rates through competition. There is no argument with that.

Mr Symond—Can I make one important point on that. In 2002 I exited by 95 per cent using mortgage backed securities. I got out of using securitisation because I was concerned about the volatility eight years ago. I changed my business model and we are the least impacted. Less than five per cent of our billion dollars a month is used by mortgage backed securities—95 per cent is brokers, credit cards and everything else. We also drove down the cost of credit card interest rates. So I am not here saying that my business is at risk. I will tell you that in the last two years we have had the greatest, most successful performance we have ever had. So I am not here crying poor; I am here being critical about poor decisions.

Senator PRATT—You have already said that you support lenders' mortgage insurance.

Mr Symond—I support lenders' mortgage insurance because without it consumers would not be able to buy a home. My concern is that it is so expensive that when you switch your loan the contract ceases and consumers then have to go and double up again. That is something that the Treasurer said he was going to have a look at, and I think that is a great thing. To have a look and do something about it would be fantastic.

Senator PRATT—Yes, and the government is moving on line to do that.

Mr Symond—The government said they were going to look at it. I commend that fantastically.

Senator XENOPHON—Mr Symond, can I just refer to the letter from Mr Bath, where he says that the RMBS program will not support the major banks or their subsidiaries, whether fully or partially owned. I think some of us would see 'subsidiary' as meaning some level of control.

Mr Symond—Control. They do not have control.

Senator XENOPHON—Mr Norris attends your board meetings and—

Mr Symond—He does not. He never has.

Senator XENOPHON—Sorry; who attends?

Mr Symond—Two representatives of the bank on a board of six. There are four directors from my side and two from their side.

Senator XENOPHON—Is there an arrangement for any directives or to consult with the Commonwealth Bank about your advertising, policies or—

Mr Symond—None whatsoever. It is documented. They can have no involvement in the daily operation of our business. If we were to go out and say, ‘We are going to buy—

Senator XENOPHON—Sorry, to clarify: as part of the Commonwealth Bank buying a 33 per cent share in Aussie Home Loans the sale agreement makes it clear that they are not to direct—

Mr Symond—It is documented legally.

Senator XENOPHON—It is documented.

Mr Symond—Yes.

Senator XENOPHON—Is that a public document?

Mr Symond—No, it is not. But the ACCC saw that when we sought ACCC approval for the transaction to go ahead.

Senator XENOPHON—What can the Commonwealth Bank say to you or direct you to do in terms of the conduct of your business?

Mr Symond—If I went out and said, ‘We want to go and buy something for \$100 million,’ I would have to get their consent to agree as a shareholder.

Senator XENOPHON—So there is a threshold requirement if it involves a large transaction.

Mr Symond—Yes, and that is all.

Senator XENOPHON—And it is a \$100 million threshold or something of that order?

Mr Symond—No. It would be a significant acquisition.

Senator XENOPHON—And that is not defined.

Mr Symond—No.

Senator XENOPHON—So in terms of the ordinary meaning of ‘subsidiary’ you would say that you are not a subsidiary in that.

Mr Symond—Absolutely not. It also specifies that we do not have to take any product at all from the Commonwealth Bank. They are not using Aussie as a vehicle to put out their products and label it Aussie. We do not have a product from Commonwealth Bank in two years.

Senator XENOPHON—Do you offer any products through the Commonwealth Bank?

Mr Symond—None whatsoever.

Senator XENOPHON—Any Commonwealth Bank products? Surely you do in terms of—

Mr Symond—No, only on our broker panel; we support all the banks. Only on that.

Senator XENOPHON—Can you indicate whether, since the Commonwealth's acquisition of the 33 per cent in your business, there has been any weighting or any bias towards the Commonwealth Bank in terms of the broker panel?

Mr Symond—Their volumes have dropped.

Senator XENOPHON—So it's the opposite!

Mr Symond—Because their servicing standard at one stage was crap.

Senator WILLIAMS—Does that mean not good?

Mr Symond—That means not good. So in terms of our 800 brokers and 150 shopfronts—and, mind you, all the banks' standards at certain stages dropped—our brokers will go with the easiest one to deal with. But, overall, the volume that has gone to the Commonwealth Bank, I can tell you categorically, has dropped.

Senator XENOPHON—So when I put a question yesterday to a witness and referred to those that have lost their independence—including Rams, Wizard and St George—and I included you, I made a big mistake then.

Mr Symond—Yes.

Senator XENOPHON—I apologise for that.

Mr Symond—This happens nearly daily, so I am not picking on you about that. People do not understand it. We have the Aussie MasterCard, which forced down interest rates on credit cards.

Senator XENOPHON—Who do you connect with for that?

Mr Symond—We partnered with ANZ Bank. After we had signed an agreement with the Commonwealth Bank, for example, with mortgage protection, we narrowed down the tender to two: AMP and Commonwealth Bank. Guess who we went with? AMP. So we have got a track record that there is absolutely no bias and we are not obligated, otherwise AMP would not have got the business.

Senator XENOPHON—So, to summarise, you are saying that the definition of 'subsidiary'—

Mr Symond—Should be 'control'.

Senator XENOPHON—Is your company making representations direct to government in relation to that and what you see as an anomaly?

Mr Symond—No, because it is not the government. We get comments: Joe Hockey refers to Aussie being ‘gobbled up’; other politicians do; media journalists do.

Senator XENOPHON—But in terms of Mr Bath’s email—

Mr Symond—This has only happened days ago, and we are sitting down now saying, ‘How are we going to approach this?’

Senator XENOPHON—And you are saying that the consequence of that decision is that it will cost you more to access finance.

Mr Symond—Yes.

Senator XENOPHON—What impact will that have in the number of basis points?

Mr Symond—It will weaken us as a consumer advocate. When you issue a bond you have got to have what is called solvency and a margin sufficient to manage and look after those mortgages for 30 years. You have to have a minimum margin. If we breach that we are going to have to increase interest rates. But I cannot answer that question until I know what the pricing is going to be and it is going to be very, very tight. There is going to be no money in it; we will be lucky to cover the solvency. The last thing I would want to do is increase interest rates. We have a history since day one of always being significantly below the banks’ lending rates on mortgages.

Senator XENOPHON—So how much time have you got to sort this, if this decision does not change?

Mr Symond—We have got to do something on this over the next probably 10 days, before Christmas.

Senator XENOPHON—Otherwise you will be locked into getting finance at a higher rate?

Mr Symond—Yes.

Senator XENOPHON—On the package of reforms, you acknowledge that there are some good aspects of the reform package in terms of mutuals.

Mr Symond—It will help. There are good aspects that will help, but it will not create significant competition and it certainly, certainly, will not drop interest rates.

Senator XENOPHON—If we had a Canadian type of system in place, which your research says has not cost to taxpayers any money even through the GFC, you are saying that would fix the problem.

Mr Symond—They have not lost any money. The government makes money from it. They have not lost by it being a dud investment.

Senator XENOPHON—And you are saying that approach would be appropriate for Australia in the context of opening up the market.

Mr Symond—It is a proven method. Many other people have made comments saying the government should do this. I am but one of many.

Senator XENOPHON—Essentially, you have got 10 days to try and sort this?

Mr Symond—On our own individual problem, yes. Forget Aussie for a minute. I read the other day that a subsidiary or a part of the Commonwealth Bank had invested 9.3 per cent or something in Mortgage Choice. If they are going to want to do this, they are going to find themselves in the same position. This is a very important decision that the Treasurer has made. It will lessen competition and make it harder for many of the nonbanks, which are struggling to survive.

Senator PRATT—No, those not partially owned by banks.

CHAIR—Order!

Senator XENOPHON—In terms of the costs, are you saying that the fact that you could offer low interest rates, particularly in the nineties—

Mr Symond—We always are.

Senator XENOPHON—From the day you started? Is that because of the access you had to wholesale funds, or is it lower operating costs or what? What are the key issues?

Mr Symond—We are not deposit takers, so we have to borrow wholesale funds for everything, unlike the banks. It is by providing a better service to consumers. We give them choice by having lower operating costs and lower profits and we understand consumers better. One thing we do understand is that banks are not good at marketing and communicating.

Senator WILLIAMS—This inquiry is all about competition. You say that the Treasurer did not consult you whatsoever about his package of last Sunday.

Mr Symond—Never, not in four years—anyone from the government.

Senator WILLIAMS—That was my next question. I respect you for what you have done to bring in competition and the magnificent things that you have achieved. You are saying that over four years Wayne Swan has never communicated with you on anything.

Mr Symond—Correct, nor anyone involved in the government or working for anyone from the government. In other words, I have had no contact whatsoever.

Senator HURLEY—Have you ever tried to contact the Treasurer?

Mr Symond—No.

CHAIR—Thank you, Mr Symond. We wish you well.

[4.33 pm]

KOCH, Mr Don, Chief Executive Officer, ING Direct

MULLINGTON, Mr Mark, Chief Financial Officer, ING Direct

CHAIR—Welcome. Would you like to make an opening statement?

Mr Koch—Yes. Good afternoon. ING Bank Australia Ltd, trading as ING Direct, welcomes the inquiry and appreciates the opportunity to appear today and be heard as a key player in the banking industry. I would like to make a short address to begin today's questioning, mostly to clarify some points about our brand in the Australian market and to mention some key topics that we are here to discuss. ING Direct has been an ADI since 1994 and is now the fifth largest retail bank in Australia, employing over 900 full-time employees. We are part of the global ING Group, one of the world's largest financial institutions. Locally, we hold over \$22 billion in savings and have a loan portfolio of over \$37 billion. Some other interesting statistics: 1.2 million Australians save with us and over 200,000 Australians hold mortgages with us.

ING Direct has always operated as a separate legal entity to the other ING entities in Australia. Recently, in 2009, ING's wealth management and insurance business, which was in a joint venture with ANZ, was completely sold to the ANZ Banking Group and has recently been rebranded to OnePath. ING Direct has no association with ANZ or OnePath and is unaffected by that change.

Today ING Direct is ING's flagship brand in Australia and continues to strive to provide Australians with surprising alternatives to the mainstream banks and to challenge the status quo by offering a genuine and fairer banking alternative to customers. As you may be aware, ING Direct pioneered branchless banking in Australia, launching its high-interest online savings accounts in 1999 and, more recently, our award-winning Orange Everyday account, which changed the face of transactional banking, basically giving back to customers who are subject to ATM fees.

Our home loan products are also highly competitive, due to their low fees and simple, straightforward structure. In this sector, we are primarily a broker bank supporting the non-bank sector. We have most recently won an award from *Money* magazine, being the best value housing loan award for 2011.

While we have a direct channel for customers in mortgages who wish to deal directly with us, we have never encouraged a two-tiered pricing scheme. We have a single pricing mechanism into the marketplace. We have been and will continue to be transparent in the channels of choice for our consumers.

Regarding the recent announcement on initiatives, it is important that the term 'smaller lender' is not restricted only to regional banks, mutual credit unions and building societies. It should include all second-tier banks such as ING Direct, which is one of a number of parts of a global

financial institution and a key player in this sector. Creating a distinction between classes of player could ultimately limit competition.

With the initiatives, we are concerned with the absence of reference to the interest withholding tax regime which we recommended in the package of reforms, notwithstanding the proposed changes by the government earlier in the year. Banks such as us, if given a level taxation playing field in the savings market and internationally, can access large pools of overseas funds which will then place downward pressure on the broader cost of wholesale funding.

ING Direct in its submission detailed four key areas that are current barriers to competition to second-tier banks such as us. The first was customer funding. The second was interest withholding tax. The third was the ability to switch and compare products successfully. The fourth was the future of the government deposit guarantee.

In concluding, we would like to thank the committee for inviting us to comment. We look forward to addressing your questions.

CHAIR—Thank you. Some of the proposed measures that you raise have been addressed to some extent by the Treasurer's reform package announced on Sunday. There are some reform proposals that will address switching costs and the future of the government guarantee. Looking at the whole package, do you think that that is going to provide enhanced competition from your perspective? Firstly, will it make it easier for your bank to compete better against the big banks and, secondly, will it more broadly enable an increase in competitive forces?

Mr Koch—I think the number of the initiatives are all aimed at increasing or providing better direction in the terms of competition. As I think the Treasurer said, there is no silver bullet. These go on a number of paths. However, the interest withholding tax item, as an example, was missing from the package.

CHAIR—And that is of particular importance to you?

Mr Koch—It is of particular importance to foreign subsidiaries—not foreign branches, foreign subsidiaries.

CHAIR—And you are a foreign subsidiary—just for clarification?

Mr Koch—We are a foreign bank subsidiary.

CHAIR—On that, you mentioned that, if that had been addressed and you had a level taxation playing field, there would be considerable amounts of money that you could bring in, presumably to loan out to customers in Australia. Would you care to expand on that? What are we talking about in terms of funding? Would it be funding coming directly from your head office or would it enable you to attract foreign investment from outside of the ING Group? How would that work?

Mr Koch—I will conceptually explain and then pass to Mark to go into little bit more detail. ING Direct globally has pools of savings. We are in nine of the top 10 countries for savings in the world.

CHAIR—By savings you mean deposits with ING.

Mr Koch—Deposits of people in those countries. In those countries there is an excess of savings over lending, so they are looking for quality assets. The Australian environment is short savings versus residential mortgages. We actually have quality assets in Australia and we could attract and use some of those pools of funds.

CHAIR—That will come directly through ING Direct?

Mr Koch—Correct, from a country like ING Direct US, for example, or ING Direct in Germany or a number of other ING group entities.

CHAIR—And they would make that available directly to ING Direct in Australia to on-lend or would it come in through securitisation processes?

Mr Koch—It would come in as a loan and we would then securitise the assets.

CHAIR—You talked about a significant amount of money and said you had \$37 billion worth of loans written at the moment. Are we talking about the potential to have a 10 per cent increase or 50 per cent increase or double the amount of loans that you could write if you have access to those funds on a level taxation playing field?

Mr Koch—On a different taxation regime in the interest withholding tax environment we would increase our money into the Australian marketplace. Again it would depend on the amounts we would be able to draw from those various countries.

CHAIR—But a substantial degree? Are we talking at the fringes or would you be able to make what would be a very significant difference in terms of how much you could loan out in Australia?

Mr Koch—We are growing at over five per cent per annum. We would grow by more than that. I would need to spend some time on that.

CHAIR—But it could make a significant difference.

Mr Koch—Correct.

CHAIR—There have been a number of calls for a broad examination of the banking industry in terms of the Campbell and Wallis inquiries. I think the Campbell inquiry initially made the recommendations that led to the deregulation of the banking industry, allowing the presence of institutions such as yourselves. Do you think that it is useful to consider the idea of holding such an inquiry in the coming years?

Mr Koch—It has been some 16 years since the last inquiry, early to mid-1990s. Having an inquiry for an inquiry's sake is probably not the right thing, but in terms of doing a regular review it is always good for any environment.

CHAIR—And a lot has changed in the last 16 years, particularly in the last two or three.

Mr Koch—Particularly in terms of how organisations and in particular Australia has come out of the global financial crisis.

CHAIR—I would imagine that such an inquiry could examine issues like the issue you raise about withholding tax and looking at how the interaction between the various participants in the banking market occurs and the various regulatory challenges that each faces in terms of how they all work together. Although probably a small aspect in terms of a broad-based inquiry, something like your withholding tax could form a major part of that, although I imagine you would probably want to progress more quickly than that.

Mr Koch—The Cooper review and the Johnson review, two recent, I would not call them inquiries but reviews of various components of the financial services sector, both recommended the reduction/abolition of the interest withholding tax over a period of time.

Mr Mullington—And also the Henry tax review. So all reviews have recommended that this would be a positive thing to do for banking in Australia.

CHAIR—I can understand why the Henry review would be coming at it and I can understand the Johnson review, which is focusing on Australia as a financial centre. In the superannuation review what was the advantage that Cooper saw in removing the withholding tax?

Mr Koch—More competition in the general taxation regime.

CHAIR—How would that relate to superannuation?

Mr Koch—In the general taxation structure of the financial services industry in Australia, not specific to superannuation.

CHAIR—So it is just a general—

Mr Koch—A general comment.

CHAIR—You also indicated that you are primarily a broker bank. What do you mean by that?

Mr Koch—We have no branches. We have a relationship with several thousand brokers, including Aussie Home Loans, for example. They are brokers who actually sell our mortgages on our behalf.

CHAIR—You mentioned that you have a single pricing mechanism. That is in reference to direct sales as opposed to sales through brokers?

Mr Koch—Where a consumer comes directly to us.

CHAIR—How do they come directly to you if you—

Mr Koch—Over the phone or through the internet. And then we have a home loan specialist who deals with them over the phone.

CHAIR—Okay. Senator Hurley.

Senator HURLEY—ING is a subsidiary of—

Mr Koch—ING Group.

Senator HURLEY—Does ING Group have a similar banking institution in other countries, or is Australia the only one that operates in that way?

Mr Koch—ING Group is present in over 65 countries, and it has millions of customers around the world. We have 10 ING Direct subsidiaries or branches around the world, including in such countries as the UK, Canada, the US, Germany, Spain, Italy and France. In countries such as Poland, India and Thailand, we have part ownership of large-scale banking organisations and in other countries we have wholesale businesses—so it is wholesale banking environments.

Senator HURLEY—Do they all operate in the same way as a broker bank?

Mr Koch—Some of the banks in those countries have branches. For example, Thailand, India and Poland have 500 to 600 branches and also internet capability. The ING Direct businesses are basically branchless. We come into a country with a licence and evoke competition, particularly in the saving space—so that is the entry product—through the internet and call centres.

Mr Mullington—Probably the most important difference between the banking business in Australia and the banking businesses elsewhere is around the balance of savings and loans. In Australia, we have nearly twice as much in loans as we do in savings. That is pretty consistent for the Australian industry. If you look across the banking industry, it is pretty much the same as that. Elsewhere there is typically an excess of savings over loans. Most European countries and the North American countries have an excess of savings over loans. What we as a group would like to be able to do is take some of that excess and bring it to Australia and put it into Australian mortgages, because across the world Australian mortgages are now recognised as a very attractive investment. We would like to be able to take some of that excess money from places like Germany, the UK and the US and bring it to Australia, into the bank here, and use that to fund more mortgages. For our whole group, that makes a lot of sense because we are not going out to the markets and borrowing money to fund mortgages; we are taking it from related companies. It makes a lot of sense for the bank here in Australia and it means that, in the end, we will fund more Australian mortgages. What stops us from doing that is interest withholding tax.

Senator HURLEY—And that will not end until 2013.

Mr Koch—No, that is for the branches. For subsidiaries, there is a proposal to reduce it from 10 per cent down to five per cent over the 2013-14 time frame.

Senator HURLEY—Between the other branches and the company there is no withholding tax.

Mr Mullington—Typically not.

Mr Koch—Not that we are aware of.

Senator HURLEY—Would covered bonds go some way to assisting you? Would you make use of covered bonds and would they assist you?

Mr Mullington—We have been talking to the government for quite some time about covered bonds. Within ING Group, we have quite a lot of experience with covered bonds, particularly out of Europe. We are a very significant bank in Europe—in Germany and in the Netherlands, obviously; it is our home market. Covered bonds are a significant financing instrument. What is most interesting about covered bonds in Australia is that they really enable banks that have different credit ratings to access markets at the same cost. Let us look at a typical senior debt: if the Commonwealth Bank issue a five-year senior debt instrument, they are going to pay today, let us say, 80 basis points. If we issued a five-year instrument, that would probably go out at about 150 basis points. If one of the BBB banks issued—that is, if they could; they probably cannot—that would be 200 plus basis points. So there is a significant difference in the cost.

Because covered bonds add that security, the gap in cost between a AA issuer and a single-layer issuer, or even a BBB issuer, is much narrower. So, as a funding instrument, it means that we are hopefully getting towards a level playing field whereby we can fund mortgages. If the cost of funding is about the same, you can be competitive in terms of the rate you offer to customers.

Senator HURLEY—So in Australia your group would be able to buy covered bonds from you and that would go some way to making up for the withholding tax problem?

Mr Mullington—No, because of the withholding tax we—

Senator HURLEY—That would still apply with a covered bond?

Mr Mullington—Covered bonds, RMBS, direct debt are all capped.

Mr Koch—Any return, so any interest paid or coupon or whatever.

Mr Mullington—But we are very interested in being able to issue covered bonds within Australia.

Mr Koch—There is another source of funding in the mix.

Senator HURLEY—You have been doing quite well and, as the ABA mentioned, a lot of that success is driven by innovation. Apart from the interest withholding tax, are there any other significant barriers to you further expanding?

Mr Koch—Generically, the whole cost of funds in the whole mix and the access thereof that Mark talked about in terms of the structure, from the credit-rating perspective of the AA versus any other rating created in the last period, is a cost barrier that does not run off for another 18 months to two years and will be a significant inhibitor in creating what you could say is a level playing field. It is just the cost for that period. We anticipate post two years out that the costs of funds will come down, relative to others.

Senator HURLEY—So with respect to any assistance that the government may be able to apply—I am not talking about the interest withholding tax—we are looking at it being phased out in two years or something?

Mr Koch—It would obviously depend on the economics and circumstances of that period. But in general terms we can see through our plans an understanding that, in theory, the cost of funds, all things being equal, will start to come down in that post two-year time frame. I think we said we issued stuff at roughly 20 points. It has been much more expensive over this last two or three years. That five-year money runs off.

Mr Mullington—Just to clarify that point: a large part of our funding comes from term debt. If you think about the funding of a bank in Australia today, roughly 50 to 60 per cent comes from savings, probably 30 per cent from term funding and about 15 to 20 per cent from short terms. When we talk about the costs of funds rising, probably the biggest single impact is the cost of savings. The cost of savings rose dramatically during the financial crisis. We used to have retail savings at a rate below the cash rate. Now, it is significantly above the cash rate. I note that one of our posters on the bus stop in front of Parliament House shows a 6.35 per cent interest rate and the cash rate today is 4.75 per cent. So all banks in Australia are paying a lot of money for savings. That is the biggest driver of the increase in cost of funding. About 30 per cent of our funding comes from term funding. As Don mentioned, in July 2007 we did an issue of five-year term debt. That went out at 20 points over. As of today, for us to do five-year term debt it would cost us maybe 150 basis points over. So that cost has risen dramatically.

In terms of our cost of funding continuing to rise, of course, that five-year money in July 2007 will not expire for us until July 2012. So that is still in our portfolio. That is part of our funding that is still at 20 basis points, which is great. But, as those funds mature and roll off, new money at 150 points comes in. So, if nothing changes from today, if everything stays the same as it is, our average costs of funds will continue to go up for about the next 18 months, till about July 2007, because that is when the expensive money—

Mr Koch—July 2012.

Mr Mullington—July 2012, sorry.

Mr Koch—That is when the peak comes off.

Senator HURLEY—Thank you.

CHAIR—Senator Pratt.

Senator PRATT—Thanks for your evidence today. How significant is small business? Most of the debate has been about home loans and other banking services.

Mr Koch—Small business?

Senator PRATT—Yes. Clearly, small businesses found it much more difficult to get finance, and I am interested in your position in that market.

Mr Koch—We are not a well-known small business entity. There are around 40,000 small businesses who save with us, so the interest rates are helping them out there. In our lending facilities, we have around 300 clients who are in the commercial property business environment, and that has been tough, but we have been able to stay with them over that period of time. So it is a fairly consistent business entity of around \$3 billion.

Senator PRATT—Okay. Thank you. That is all I have, Chair.

CHAIR—Senator Brandis.

Senator BRANDIS—Have you considered the government's announcements in relation to amending the competition laws for price signalling?

Mr Koch—We have considered.

Senator BRANDIS—This is the proposal, via Mr Swan, to adopt the coalition's proposal to introduce a specific prohibition on price signalling into the Trade Practices Act. Have you studied the draft legislation, by the way?

Mr Koch—No, not in detail.

Senator BRANDIS—All right. Assuming the government's bill follows closely the bill presented by Mr Hockey in the last week of the parliament and subjects price signalling to a competition test—in other words, the prohibition only operates where there is a demonstrated purpose and effective anticompetitive conduct—what influence do you think that will have on the sector?

Mr Koch—My opinion is that price signalling in any context, in any sector or in any business, should be checked and controlled.

Senator BRANDIS—Sure. Now, it is set against the proposal that it will have a chill effect on conveying into the public arena information in relation to price. If it is subject to a double purpose-and-effect competition test, do you see that as a problem?

Mr Koch—I would need to spend some time looking at the legislation, I am sorry. But I can give you an opinion later.

Senator BRANDIS—All right. That is fine. But, by and large, you are supportive of the proposal to legislate in relation to price signalling specifically?

Mr Koch—For any sector and any industry, I do not think price signalling is appropriate.

Senator BRANDIS—Okay. Thank you.

CHAIR—I have one final question. In your submission, you commend the government for tasking ASIC to look at termination fees and giving ASIC the powers to ensure that those fees are appropriate and not unconscionable. Do you think they have had enough time to see whether they would work?

Mr Koch—I think we would need to spend time with ASIC to understand that. We are actually in regular contact with ASIC; we work with them. I do not know whether or not, in their opinion, they have had enough time.

CHAIR—Okay. I ask because the government announced at the weekend that they are going to regulate to ban exit fees from 1 July next year, and that seems to be contrary to what you say in your submission:

ING DIRECT strongly discourages the introduction of further regulation on fees.

I presume, when you made that point, you were talking about termination fees, because it directly follows a sentence where you were talking about termination fees.

Mr Koch—Let me check those words because I do not know if you are aware, but we are one of the very few organisations that have no fees on savings, no fees on our transaction account, and we abolished our deferred establishment fees in November for all ING Direct housing loans. I think we went one extra step, if my memory serves me correct.

CHAIR—On page 4 of your submission, right at the bottom of the last paragraph, you say:

ING DIRECT commends the Government on the release of the Australian Securities and Investments Commission (“ASIC”) guidance for mortgage lenders on mortgage early termination fees. ING DIRECT strongly discourages the introduction of further regulation on fees.

Mr Koch—I think that is in the context that the Australian consumer will choose the right outcome and the marketplace will bring that to bear. A number of lenders have removed their deferred establishment fees recently.

CHAIR—Which I think is a great thing, but do you still stand by your strong discouragement of—

Mr Koch—It was written in the context that there will be no need for regulation because the market will do that.

Mr Mullington—As a general principle, we do not believe more regulation will create more competition. We think that to deliver better results for Australians is really about competition. It is about ensuring that companies like ours can get access to funding at the right cost to be able to go out there and compete with the big guys. That is our mission; that is what we are about as an organisation. We think that is the solution. We have had some good dialogue on those issues, but we think there is an opportunity to do more.

CHAIR—Very good. Thank you very much, Mr Koch and Mr Mullington.

[5.02 pm]

MOTT, Mr Jonathan, Bank Analyst, UBS Securities Australia

CHAIR—Welcome, Mr Mott. I think you are the first witness that we have had in the last two days that we have not had the benefit of a submission from first, but that is because we sought out a banking analyst to come along and talk to us to assist us with the inquiry. I invite you to make an opening statement. I notice you have handed out a document which I presume is an analysis of the banking—

Mr Mott—Yes, it is just some research notes that we have recently published on the topic. We did not submit it to the inquiry as UBS research but we are happy to give it to you. There are a couple of slides in there that I am happy to talk to as well.

CHAIR—Okay. Would you care to make an opening statement?

Mr Mott—Firstly, thank you for the opportunity to present to the committee on this inquiry. I work as a bank analyst within equity research at UBS. I have been covering the bank stocks for about the last 12 years. I have four key points that I would like to address and I will go through them quickly. The first point is that the strength of the Australian banking system has been critical to the strength of the economy over the last several years. One thing that we can be very proud of is how strongly the Australian economy has performed, particularly through the period of the GFC. There are a number of drivers of that and it is worth touching on them. Obviously, the rapid loosening of monetary policy by the Reserve Bank of Australia was very, very important, as were the government's efforts to stimulate the economy. There are a couple of other things that are worth nothing. The strength of the Chinese and the Asian economies was obviously very important in terms of trade and in the resources sector, but it should also be remembered that the Australian banks performed very well during this period.

Unlike many other countries, the asset qualities on the Australian books were in very good condition, so we did not have a bad and doubtful debts cycle anywhere like we have in other parts of the world. The Australian banks also raised substantial amounts of equity from shareholders. It is probably worth noting that over two million mum and dad shareholders participated in the recapitalisation of the Australian banking system during the GFC, putting their hands into their wallets and helping to recapitalise the banks, and that the Australian banks did continue to lend substantial amounts of money to households and to corporates in Australia and they supported some of the government initiatives, including the first home owners grant and other products to help stimulate the economy through the period. While they did benefit from the government guarantee on wholesale funding—I think everyone would acknowledge that fact—they did use this money to stimulate the economy and the housing market in particular. We can see how well that went through that period. The behaviour of the Aussie banks, you would have to acknowledge, was in stark contrast to a lot of other banking systems around the world.

The second point I would like to raise is a question on the profitability of the banks. Banking profitability is actually consistent with long-term averages and below that of many other

industries. One of the numbers that is consistently quoted—you see it very often in the press—is that the banks are very profitable because they made \$21 billion worth of profit in 2010. This has led to many people accusing the banks of gouging their customers—that ugly term that people like using. But there are a few things that it is very important that people need to remember. These are very large organisations. The banks represent one-quarter of the entire Australian Stock Exchange. To put a few other statistics out there: the banks have total assets of \$2½ trillion and have equity of \$150 billion. As equity analysts, when we are trying to gauge the profitability of these very large companies, we do not just look at that \$21 billion. To me that is irrelevant. What I look at it is that relative to the size of the organisation. One of the key measures that every equities analyst in the world will look at is the return on equity. In 2010 the banks generated a return on equity of 16 per cent. They also generated a return on assets of 0.91 per cent or 91 basis points.

I think there are two facts that everyone must acknowledge. I will turn to a chart that I put in on the very last page of that presentation, on the third tab. There are two charts there. What I have put there for today's presentation is, firstly, the return on equity for the Australian banks over the long term. We have had some analysis looking at the return on equity back to 1980. You can see that, over that 30-year period, the average return on equity of the major banks has been 16 per cent and in 2010 it has been 16 per cent. So that is bang in line with the long-term average.

It is also worth comparing in that top chart the return on equity for the banks relative to other leading Australian corporates. Equity investors are always comparing where people should put their money. Here are a few numbers. Australian major banks generated a 16 per cent return on equity, AMP 27 per cent, BHP 28 per cent, Brambles 30 per cent, CSL 20 per cent, Foster's 22 per cent, Rio Tinto 29 per cent, Telstra 31 per cent and Woolworths 28 per cent. When you compare the banks to those organisations, 16 per cent is not out of the realms. So it is difficult for us to say that the banks are gouging the customers. It is also worth remembering that the Aussie banks employ over 174,000 people, which is now higher than the peak in 1996. In the last half, it finally beat that 1996 peak. When we look at those numbers, it is very hard for us to agree with the term that the banks are 'gouging' or making excess profits.

Point No. 3: be careful undertaking measures aimed at increasing competition which may weaken financial stability. While everyone in the Australian community welcomes competition within the financial services industry, it is important that competition does not come at the cost of financial stability. There are numerous examples overseas where we have seen intense competition in banking leading to reduced profitability in core products. This has encouraged many organisations to increase risk and, as has been seen overseas, that has had some disastrous consequences. I will give you an example. There was no shortage of competition for mortgage products in the UK or the US between 2002 and 2007. There was excessive competition. There is one thing worse than a very profitable banking system and that is a very unprofitable banking system. The Australian banking system, along with the Canadian banking system, is the envy of the world. When we travel the world and I speak to investors around the world, that is one of the questions which we constantly get asked: why did the Aussie banks do so well? There are a range of factors—good supervision, good regulatory environment—but the Australian banks have performed extremely well. It is essential for the Australian economy that the Australian banks stay very financially stable and are able to maintain their AA rating.

Point No. 4: make sure that measures to increase competition in the banks do not result in a risk transfer from the private sector to the taxpayer. There are a number of initiatives proposed by the Treasurer to increase competition within the banking sector. While I broadly agree with most of these initiatives, there are a number of issues. Firstly, I become concerned when taxpayer money is used to artificially support markets and results in a risk transfer from the private sector to the taxpayer. For example, many organisations' business models came under intense pressure when the securitisation market froze in 2007. It could be argued that many of these business models were flawed as they were too heavily reliant on a single source of funding which was only available at economic levels during a boom or a bull market. While there is some evidence of thawing in this market, pricing is very unlikely to revert to pre-GFC levels any time soon. Substantial amounts of taxpayer money are now being used to artificially stimulate these markets. At present, the risks taken are low, given taxpayer money is only invested in the AAA tranches of RMBS. However, I would be very cautious over any moves to use taxpayer money to go further down the capital structure of RMBS to the subordinated tranches such as BBB or equity or any proposals to have a government guarantee on those issues. This would lead to a material risk transfer from the originator of the mortgages to the taxpayer, especially at a time when household leverage in Australia is the highest in the world and everyone acknowledges that housing is unaffordable.

In addition, it is very important that we look at the recourse of a mortgage origination and that we do not move to an originate-to-sell model, which was one of the primary causes of the US subprime crisis. If we learn one thing from the GFC, it is that the writer of the loan must retain the majority of the risk; otherwise, bad lending practices will develop.

Finally, there is one proposal to make the government guarantee on retail deposits permanent using the government protected deposit slogan. Again, I do not disagree with this policy. The government must acknowledge that there is risk transfer here. Eventually an ADI in Australia will fail—it is inevitable at some stage; this will happen—and I believe that ADIs should pay a premium for this taxpayer guarantee, similar to the FDIC in the United States. Such a levy would help protect taxpayers in the inevitable event of an ADI failing.

I will repeat those four points in conclusion. Firstly, the strength of the banking system in Australia has been critical to the strength of the Australian economy. Secondly, bank profitability is consistent with long-term averages and below that of many other industries. Thirdly, be careful undertaking measures aimed at increasing competition which may weaken financial stability. Finally, make sure that measures to increase competition in banks do not result in a transfer of risk from the private sector to the taxpayer.

Thank you again for your time. I am happy to take your questions.

CHAIR—Thank you, Mr Mott, for that analysis and for this as well. I did not manage to track a copy of yours, but I have managed to get copies of some from one of your competitors and I have had a bit of a look at them.

Mr Mott—The quality of ours means they are disappearing.

CHAIR—I have not had a chance to read yours. I read some of theirs, so I cannot compare yet. One of the ones I looked at was an analysis that was conducted and put out yesterday of the actual reforms proposed by Treasurer Swan. Has UBS done an analysis of those reforms?

Mr Mott—We have not published a detailed report on that package as yet.

CHAIR—You have not published one. Have you conducted an analysis?

Mr Mott—Definitely.

CHAIR—You mentioned that you were generally supportive of the direction.

Mr Mott—We have read it and we have discussed it internally. We have just not published a detailed report on it as yet.

CHAIR—What is your opinion on whether those reforms will actually lead to an increase in competition?

Mr Mott—I think that there are some very important elements of it. When you look at it, the deposit side especially is the area where I think you are going to see a substantial increase in competition. One of the key reasons for that is that it is very obvious that there are a lot of people who are not happy with the major banks at the moment and the government, having the terminology that they use, which is effectively a ‘government protected’ deposit, and advertising that, most likely in a blanket television campaign, is going to encourage some people to look at transferring their deposits from the major banks in particular to the regional banks and to the mutual societies, and I think that will happen.

It will probably happen at two levels. I think first of all you are going to see some people who have transaction accounts, day-to-day accounts, now being more comfortable moving to the nonbanks and to the regional banks, and they will transfer over. To an extent you will see more competition because it is likely that some of the other banks will use that slogan on the top of their advertising campaigns to try to attract some of the term deposits at the top level of savings—high interest rate accounts. We heard ING talking about 6.3 and 6.4 per cent. Smaller banks will be able to use that to try to attract some deposits.

CHAIR—No doubt the advertising sign they put outside Parliament House will have one of those seals on it.

Mr Mott—I guarantee it will look exactly like the ‘Australian made’ logo from the 1980s but it is going to be Australian guaranteed deposits, and it will be blanket. It will encourage competition coming through there, so I think that measure will be successful.

Some of the other measures are going to be a little bit more challenging. I think the proposal to have account number portability will be very difficult. When we look at this, a lot of banks have the BSB number and the account number; the various banks have different numbers. Remember that some of the IT technology and the core banking processes go back to the 1960s and that there are more than 100 ADIs in Australia. Every bank has to try to redo their IT systems. Some of the banks that we have spoken to over the last couple of days and previously

have suggested that it will cost the major banks several hundred million dollars each to implement this account number portability.

The issue is that the major banks could probably afford that, but can a regional bank, a credit union or a building society afford to undertake those packages?

CHAIR—We had evidence yesterday from Abacus that their numbers are too short. They do not have enough numbers in their account numbers—

Mr Mott—Yes. To change the computer it is just like 1999 and the millennium bug. It is a huge issue and it is going to come through. I think there is one other very important point there, and it goes to financial stability. We have seen runs on banks overseas. Northern Rock is a classic example. When there was a run on a financial institution, the IT system spontaneously crashed. That was convenient but it meant that not as many people could go online and transfer their savings across. The queues went out the door and there were not that many tellers there. That slowed the run on the bank, and it eventually failed anyway. If you have account number portability, in the event that rumours go around that there could be a financial institution under stress, it will lead to instability. Remember that even though it is government guaranteed, a lot of people do not want to sit around and trust that guarantee; they want access to it. We saw the other day when one of the major banks had an IT glitch that it caused serious disruption to the financial system. You will see people jump online and transfer their money out, and I guarantee it will transfer to a major bank and probably the Commonwealth Bank. We saw that before in the GFC.

As a result, account number portability is actually going to lead to financial instability in the event of a rumour going around. If you think about the Basel committee's reforms on liquidity, we want sticky deposits and we want term funding. With account number portability, it is diametrically opposed to sticky deposits because, by definition, deposits will become less sticky.

Senator XENOPHON—Not if you have got a term deposit.

Mr Mott—Correct. Term deposits are locked. I am talking about savings and transaction accounts. Think about it from this perspective: once you start to look at this, APRA has to make assumptions on the stickiness of their deposits to comply with the new Basel III liquidity regime. I did not see their presentation but I am sure they may have mentioned this. If we have account number portability, increased competition and people more actively transferring their deposits out, it is likely that they may need to change that assumption on the stickiness of deposits, which will mean that banks will need to hold more term funding at equivalent, and that means that a mix change to more expensive funding will go up and the banks' average funding costs will rise as a result. That may lead to margin repression or it may lead to banks considering whether they need to further increase rates outside the RBA cycle.

CHAIR—Most of the banks have been making the point that almost all the changes that will be coming through from Basel III may have some consequences for their costs.

Mr Mott—The only other thing I think is important to consider in the proposal for the fifth pillar is that the issue that I see within the mutual society is actually not funding, it is capital. If you consider the numbers, the mutuals at the moment have about four or five per cent market

share. For them to get to around 10 per cent market share, they are going to need to substantially increase their lending. But at the moment, even if they use RMBS it is very difficult for them to sell off the BBB and the equity tranche. APRA put out a letter yesterday saying, 'Unless you sell off that equity tranche we are not going to give you capital relief.'

So, for example, if they go from around four per cent to 10 per cent market share, which is what the government is intending, the amount of capital in the system for the building societies and the mutuals would need to rise from \$6 billion to around \$10 billion to \$12 billion, and maybe even a bit more. A couple of things worth remembering are, firstly, that mutuals do not have access to the capital markets, by definition. If a bank needed that they could go to shareholders and raise equity. Secondly, the return on equity in the mutuals is about eight per cent versus around 16 per cent in the major banks, so they do not generate enough capital organically to be able to do that. The only alternative would be to go to their members and ask them for capital. If you are a member of a building society or a credit union, I do not think you will be too happy if the mutual—

CHAIR—That is not why you become a member of a building society or a credit union.

Mr Mott—If you go back to the 1980s and the early 1990s, it is worth thinking about why all the buildings societies demutualised to become banks. It was because we were going through a period of very large credit growth and they needed access to the equity markets to continue to be viable. The big issue that I think will make it difficult for that policy to succeed on the lending side is access to capital for a mutual. As an equity investor we spend our entire time looking at the equity of the major banks and, when I cast my eye over the numbers that APRA provides on the buildings societies and credit unions, that is the area that I—

CHAIR—So that is a real structural limitation even if they could get access to the funds to loan, even if they have the demand.

Mr Mott—I think it is.

CHAIR—It is a pretty hard one to get around because under—

Mr Mott—It is difficult, and it goes back to the point that I was talking about before, which is the taxpayer taking on the risk. One proposal would be that the taxpayer starts buying further down from the AAA tranche, all the way down to the equity and the BBB tranche, where all the risk is actually held. That is why a lot of people are saying that RMBS is very secure at the AAA level, and I agree with that. But once you get down to the equity, that is where your risk is. If the taxpayer takes that, and there is a big push for it, that is when you really are transferring significant risk to the taxpayer and you are also moving to an originate, yourself. The person who originates a loan no longer has a liability to that loan.

CHAIR—They have no skin in the game.

Mr Mott—So if it defaults, they are gone: 'That is the taxpayer's problem. I don't care.' The other thing would be a government guarantee on the RMBS but, again, you are transferring the risk to Mr Taxpayer. I am sure that all of us in this room do not want to take the risk, because you start moving toward an originate-to-sell model, which was the primary cause of the US

market failure, where people just decided: 'I don't care what I write. I'll sign the Ninja loans off and I'll do the others. It's not my problem.'

CHAIR—Make the money on the way, get rid of it and then move on to the next lot.

Mr Mott—True. Flip the ticket: 'Not my problem.' It is OPM: other people's money. It is Mr Taxpayer who is taking that risk. I am very happy for any building society, credit union, regional bank or major bank to sell their RMBS tranches all the way down to the BBB and equity tranches, sell it to someone else who is prepared to get a return on that, to another investor, but selling it to the taxpayer I totally disagree with.

CHAIR—How realistic is it that they could sell it to another investor, given the current market?

Mr Mott—I am not a bond adviser. I am an equity adviser, so the numbers that I am quoting are rough estimates. For the major banks it would be several hundred basis points, or closer to five or six per cent would be a very broad number. For the nonbanks, given that customers do not know those brands as well as a CommBank, an ANZ, a NAB or a Westpac, I am not even sure whether there would be a price at the moment. If there is, I am sure that it would be well outside that of a major bank.

CHAIR—You do not see that that is likely to change in terms of the international appetite for those sorts of things?

Mr Mott—At that level, it is difficult. When you speak to offshore investors, you find that they are very concerned about the level of leverage in the household sector in Australia and they are very concerned about housing prices in Australia. When I speak to equity investors at the largest fund managers in the world when we travel offshore, it is one of the questions that we get asked constantly. I can totally understand that because they have just seen it in the UK, in Ireland, in Spain, in the US and in so many other markets in the world, and they look around the world and where is the one area that has not been hit? It is Australia and New Zealand. Who controls the Australian and New Zealand banking markets? It is the four major banks, the regional banks and the building societies and credit unions.

CHAIR—In their analysis of the reforms your competitor noted in bold at the top that 'if anything, major banks are perhaps long-term relative winners from the reforms'. Is that the conclusion that you drew?

Mr Mott—I cannot talk on behalf of my competitor.

CHAIR—No. That is what they said. In your analysis did you draw a similar conclusion?

Mr Mott—There are elements that will be very beneficial for the Australian economy and for the major banks. The primary area that I think is very important is covered bonds. I think that is an obvious help to the major banks. I will use the Treasurer's words that 'it is not a silver bullet solution', but it does help.

If you put it into perspective, looking at what they have done in New Zealand, where covered bonds are already allowed, and at other areas of the world, including the Canadian banks which are coming to Australia and selling covered bonds to our investors into our banks, they cap it at around five per cent, which is a number I think the Treasurer used the other day in his release. Of the \$2.5 trillion worth of assets in the Australian banks about \$2 trillion is actually in Australia then there is New Zealand and other operations. If you say five per cent, that is about \$100 billion dollars of funding in aggregate. Remember that the role and the funding requirement of senior debt for the major banks is around \$120 billion to \$140 billion per annum. So covered bonds are not a be-all solution but they will help. Every little bit helps—the securitisation market improving helps; senior bonds and senior debt coming in helps; covered bonds helps because it is another area.

There is one thing with covered bonds which is very, very important and it is that when the government guaranteed wholesale term debt was issued back in 2009 and early 2010 most of that was issued with a three-year role. That will come up for maturity in 2012. The majority of investors in that paper were AAA people and most of them do not have the mandate to invest in the senior paper of the major banks—it is just not in their mandate. So having a covered bond provides the major banks with a product that they can sell to those investors rather than having to give them their money back and go to the big fixed income investors of the world and try and sell them more senior debt.

Remember that Westpac and Commonwealth Bank are No. 3 and No. 5 issuers of senior debt in the world and the biggest is the percentage of their balance sheets. The Aussie banks are huge issuers into the debt markets and it is not a finite pool. At some stage the fixed income investors of the world—and I do not know whether that point is known—will max out in Australia because their chief risk officer will say, ‘I have just had enough’. That is a point that no-one wants to find out what it is. That is one of my No. 1 fears as an equity investor in the major banks.

CHAIR—Most of what you were talking about there was the major banks and how that is going to assist them.

Mr Mott—Correct.

CHAIR—That is primarily because of covered bonds. What would you say the minimum offer in terms of dollars would need to be if you were going to go to the market with a covered bond offer?

Mr Mott—I do not know the answer to that because I am not a debt investor. I would guess a few hundred million dollars would probably be the size. As a result I am sure you are going to say to me, ‘Well, it is not viable for the non banks.’

CHAIR—That is right. So it is a pretty big ask for a lot of the smaller ones.

Mr Mott—I actually think they could get around that. You could pool them together.

CHAIR—There is some talk about how they could do that.

Mr Mott—It is not an issue that this is good for the majors to have for the others. Find a solution so it is good for everyone. There are a lot of very smart people out there who can try and find those solutions for you.

CHAIR—You are a market adviser on banks, and we have seen in the last 24 hours the bank shares go up dramatically.

Mr Mott—They have given most of that back today.

CHAIR—Okay. We have been in here all day so we have not heard that. How far have they developed?

Mr Mott—I did not see the closing prices but they were down over one per cent today. One reason for that, remember, is that the equity markets will pre-empt policy. So during last week the market was talking about what they thought the government was going to introduce in the Treasury's policy. There were fears that it could have been a lot more negative for the major banks than it actually was. There was hope that it was going to be a lot more positive for the regional banks than it actually was.

CHAIR—Which fell yesterday.

Mr Mott—That is right. Yesterday's move was just from what market expectations were to what the reality was. It was just a gap down.

CHAIR—That was moving to where the reality was yesterday. Why has it come back today?

Mr Mott—I do not know. I have not been in the office to see why. I just saw the prices.

CHAIR—What happened to the regional banks?

Mr Mott—I think they were down as well.

CHAIR—Okay, so they went down yesterday and stayed down.

Mr Mott—Yes.

CHAIR—Relative to the major banks.

Mr Mott—If you have a look at the share prices for some of the regional banks over the last few weeks they have been rallying aggressively. It is also worth remembering that the Bank of Queensland had a profit warning last week and also was moved to credit watch negative by Moody's at the end of last week, which is going to have a potential significant impact on its share price.

CHAIR—I might hand over to Senator Hurley, if you have questions.

Senator HURLEY—I want to go back to RMBS for a while and the Canadian model. I do not know much about the Canadian model and how far down it goes, or whether it goes to below AAA or whatever. Would you have any problem in the Australian government following the Canadian model if it was only for AAA?

Mr Mott—I still think that you are transferring risk to the taxpayer. Everyone says that the Canadian economy has never lost money on that—well, not yet, but one day it may. There is still a transfer of risk to the taxpayer. If you have a look at that, that is one step short of the Fannie and Freddie American model where that is transferred, so effectively you are transferring RMBS and other securitised paper onto the government's balance sheet, so onto the taxpayers' balance sheet. Eventually you can transfer it to a third party. What happened in America was that those RMBS that got transferred to the investment banks then got packaged into CDO and CDO-squared and other kinds of products and got re-rated. That is when the shadow banking system took that to another degree. So I am still cautious.

Personally I do not know as I am not a Canadian banks' analyst. I know a little bit about it, but I think it is an alternative that the government and senators should look at. But at some stage there are likely to be losses. When we look through the history of the Australian housing market it has proven to be a very good asset. A lot of people offshore are happy to invest in the Australian banks, but that will not always be the case.

Senator HURLEY—You are talking about the writer of the debt having to retain the majority of the risk. There has been some discussion during this inquiry of perhaps the writer only retaining something like five or 10 per cent of the risk. We heard I think from John Symond that generally the retention of risk was around 60 or 62 per cent.

Mr Mott—I did not hear John Symond's presentation.

Senator HURLEY—But that is a big difference, isn't it?

Mr Mott—That is right. I do not know the number and I am sure John has his views. What I mean by that is the originate-to-sell model, where people write mortgages and distribute it to someone else and then have no recourse to that loan, is fraught with danger because, as soon as you do that, you are in a volume game because you get paid the more you pump out. Remembering that we have the highest level of household debt in the world and housing affordability is at an all-time low, is now the time we want Australian mortgage lenders to be accelerating credit growth to people who are already heavily indebted? We all know first home buyers out there who are struggling to get that. If that is the case and we do go to an originate-to-sell model, you are going to see house prices move up further and you are going to see more lending, but is that a good thing? That is what you really need to think about.

From my perspective, housing competition is a symptom. The disease is housing affordability. The Governor of the Reserve Bank said yesterday that he would have moved them to that level anyway. Moving rates to 7.8 per cent on the standard variable—and most people get a discount on that, so let us say it is around 7.5 per cent or 7.3 per cent—is creating mortgage stress out there. I acknowledge that and everyone acknowledges that. They are not excessive rates. I do think anyone who has been around for a few years is going to think 7.5 per cent is a particularly high mortgage rate but it is creating substantial amounts of stress.

From a government perspective there is a very high correlation between mortgage stress and marginal electorates, so I can understand why they are very concerned about that issue. Let us be honest about it: it is a key issue in a lot of marginal spaces. A lot of the initiatives we are talking about here go to what? Providing more credit. Is that the answer or is addressing affordability the answer? That is not the topic you are here to inquire into. But what is the symptom? Competition. What is the disease? Affordability.

Senator HURLEY—I would like to talk about the portability issue. You were talking about bank account numbers and BSBs. There is nothing to say that the switching mechanism needs to incorporate the existing banking number, does it?

Mr Mott—No.

Senator HURLEY—It could be a unique identifier that is developed.

Mr Mott—I think the former Governor of the Reserve Bank is investigating this and will come back. I think it is going to be very technically difficult. Let us look at mobile phone number portability. Mobile phones were a new technology and there were only a handful of mobile phone providers. The technology was new, the systems were new and you could adapt to it.

But in the case of banks you are talking about IT systems which in some cases go back to the 1960s. They are archaic in some of the major banks and some of the major banks at the moment are replacing these. The Commonwealth Bank, the National Australia Bank and all the banks are going through programs to update these big systems. But it is not that simple. As you say, some accounts have six numbers and some have nine numbers. I am not an IT expert, but I do not think it is going to be easy to have a portable account number. If you have to replace, update and re-code systems written in the 1960s and 1970s, I do not think it is going to be cheap.

Senator PRATT—It is going to have to happen sometime, though, surely?

Mr Mott—At some stage it might do, but at some stage the systems will go. The first point is that it will, but will the small credit unions and building societies be able to afford that? Remember that their return on equity is only eight per cent. They do not have the profitability to be able to invest in that. Should taxpayers use their money to help them out? Maybe. It might happen one day, and that is fine, but I think that it might become technically difficult. Then, obviously, the other issue is stickiness of deposits in that event and whether that would lead to higher interest rates being paid by all the consumers. Remember Basel III has just gone through with the liquidity paper, looking at the liquidity coverage ratio, which is otherwise known as the Lehman rule—that is, how much you actually need to have available in the event of stress on the company. If you think about that, the more portable account numbers that you have the less sticky they are, which means the assumptions on the stickiness of your deposit base fall, which means you need more wholesale funding. Your funding cost is going up not down, then. And what is the impact of that on households? Eventually it is going to get passed through.

Senator HURLEY—I do not want to labour that point too much, but you could also argue that if consumers have more portability then it is up to the banks to develop that stickiness by providing good service.

Mr Mott—Ideally, yes. That is right, in a normal situation, but with financial stability you do not look at the normal situation; you look at the adverse outcome. As I was saying, there is one thing worse than a very profitable banking system and that is an unprofitable banking system. We have seen how collapses in small organisations in Australia and overseas have a very, very large impact on the economy and the Australian taxpayers. So I do not disagree with that in a normal situation, but the role of APRA and the Reserve Bank and the regulators is not to look at the day to day. That is why, when you look at it, profitability and competition are diametrically opposed to stability. That is the way it is. I know it is a difficult challenge for you, but at some stage you have to do it.

Senator PRATT—I have one quick question on that theme. Surely we should be relying on good regulation rather than sticky consumers?

Mr Mott—I think that is dangerous. I think you need sticky consumers. Regulators are the backup. You want the banks to self-regulate. I view the regulator as the person in the corner watching, who only jumps in when a fight breaks out. At the end of the day, you want the players to be moving around and making sure that they are self-regulated. Self-regulation is the best regulation.

Senator PRATT—It is best for stability, but is it best for consumers? Surely the job of regulators in the middle is to get that balance right? No consumer advocate is going to come in and argue that.

Mr Mott—I do not disagree with competition. Competition is great and we need it. There is competition in the banking system. Most people have argued that; I am sure some have not. But you have to be very careful, when you are making changes, of what the unintended consequences are, not in the day to day but as the government, representing the taxpayers for the long term, you have to make sure that what you come up with today, tomorrow or next month or when the inquiry is due does not have an effect in five years time on financial stability. We see what has happened in the UK and the US.

Senator PRATT—But, just as exit fees are being progressively removed, if we were to reach account number portability it would be no different. It would be phased in over time.

Mr Mott—It is hard to phase in portability. As soon as you flick the switch it is on.

Senator PRATT—It will be done as various institutions are able to introduce it.

Mr Mott—Maybe that is right. But eventually there is going to be a deadline for it to happen. I do not disagree with that. You just have to think about what the consequences of account number portability are for financial stability. It is not as simple as saying, 'Yay! We're here. Now we have great competition.' The impact of that will be assumptions on the stickiness of deposits. I would encourage you to speak to APRA about that because they are the referee and they are going have to make the assumptions. The Basel committee is meeting at the moment and the liquidity papers will probably be out in the next few weeks and they will have a direct impact on that. So it is those unintended consequences which we have seen can be so important for the financial system.

Senator XENOPHON—Can I just pick up on the issue of bank account portability. You have quoted a figure of \$700 million—

Mr Mott—Several hundred million.

Senator XENOPHON—Okay. Is that for each bank or for the whole sector?

Mr Mott—Each bank.

Senator XENOPHON—Okay. It could be anywhere between 100 million to—

Mr Mott—I do not know. Every bank will be different.

Senator XENOPHON—But where do you get that figure from?

Mr Mott—From discussions with the banks. As equity investors we make rough estimates. Obviously, they are big organisations, they have a lot of costs, but it is not a simple product. That is my estimate and that is what I have made from early discussions with the banks, but I encourage you to ask them and not only them. It is worth asking the credit unions and building societies how much it will cost them and whether it is feasible for them to do it as well. I know other things like exit fees are a significantly greater cost for the credit unions and building societies than for the major banks.

Senator XENOPHON—Let's go back to the issue of bank account portability. In the evidence that we heard earlier today from Choice they said an interim measure or an alternative measure that is relatively low-tech would be similar to the system in the Netherlands where, if you want to transfer financial institutions, you go to the new institution and then, with your authority, they forward it off to your existing institution. They have a mandated onus to do that within a certain number of days and do it expeditiously. What would be wrong with that approach compared to the technological changes—

Mr Mott—That is a halfway house.

Senator XENOPHON—But it would be an improvement on the current system.

Mr Mott—Correct. Except in the event that a financial institution comes under stress and everyone walks into the Commonwealth Bank and says, 'Please transfer from XYZ building society and credit union today,' because it would be mandated to provide you with that money.

Senator XENOPHON—Hang on, there is a bit of an assumption there isn't there? It is almost as if you are saying that it could lead to instability if you had more portability in accounts.

Mr Mott—Correct, because in the unlikely event, which will eventually happen that a financial institution in Australia comes under stress—

Senator XENOPHON—So it is an unlikely but inevitable event.

Mr Mott—Correct. Eventually a financial institution will fail. It is inevitable that out of a hundred organisations in Australia something will go wrong—they will make some bad loans. Financial institutions are leveraged 20 times. Only a small amount of problems with your loan book can wipe out the equity of a bank pretty quickly.

Senator XENOPHON—But that is why we have APRA, that is why we have strong regulation.

Mr Mott—Correct, but the regulator cannot prevent everything. The regulator cannot prevent poor lending.

Senator XENOPHON—Why not? Why not have reasonable standards of lending?

Mr Mott—They can attempt to and I hope that they do but I do not think we can assume that we are never going to have a financial institution in Australia come under stress. If you look at a few of the regional banks in Australia, we saw them come under some substantial stress and need to be merged in with major banks during the GFC. We have already seen that happen. I have great regard for APRA and a great regard for the Reserve Bank but we cannot assume that we are never going to have a financial institution in Australia come under financial stress and have some customers want to transfer their money out. Even though there are government protected deposits customers are still going to be nervous that there will be a NAB like incident and want to move their money.

Senator XENOPHON—But isn't it, to give a totally different example, a bit like aviation safety, you need to do everything possible to mitigate the risk?

Mr Mott—Correct, but occasionally planes fall out of the sky. It does not stop it. They do everything they can to prevent it happening but eventually sooner or later something happens and there is an accident.

Senator XENOPHON—Perhaps aircraft are not a reasonable example. I should not have given that example because with an aircraft something can go wrong in a split second.

Mr Mott—With a bank something can go wrong in a split second.

Senator XENOPHON—Can it?

Mr Mott—Yes, take Barings. It went broke when Nick Leeson stole money. Risk systems can be in place but someone can work it out. Banking is a highly leveraged organisation which is why it is so heavily regulated by APRA. With the numbers I gave you, you have \$2.5 trillion worth of assets, you have \$150 billion worth of equity. Only a small change in those asset values can wipe out the bank's capital very quickly, which is why banking is such a heavily regulated service and industry in Australia and the rest of the world and why Basel is so focused on financial stability. If we were having this debate in any other country in the world, excluding Canada and Australia, people would be saying, 'We've seen hundreds of banks fail.' In the United States banks fail at a rate of two to three a week. That is why the FDIC is there, to protect the depositor in such an event. So it happens.

Senator XENOPHON—And that protection is for how much in terms of deposits? Is there a ceiling?

Mr Mott—Yes, there is. I do not know the exact number. I think in Australia at the moment the debate has set it at a million dollars and the Treasurer has stated that they will be reviewing that number. But it is substantially lower.

CHAIR—It is US\$250,000 from memory.

Senator XENOPHON—Thank you, Chair.

Mr Mott—That is right. I think that is the number. It is around that number. But, again, it is there for a purpose.

Senator XENOPHON—If I could go back, and I know the inquiry is not directly looking at this but I think it puts it in context. You have said affordability is the disease and competition is the symptom. Is that what you said?

Mr Mott—Yes.

Senator XENOPHON—There is an issue here. You are probably familiar with the demographic surveys that say that it is now seven times average annual earnings for a house compared to three times that 30 years ago or something like that. It is along those lines. I was taken to task by a leading real estate agent in Adelaide when I spoke about that. They said, ‘You’re not doing a fair comparison because the average home today is quite different from the average home of 40 years ago. It was just three bedrooms, one bathroom—

Mr Mott—Real estate agents will give you every reason why house prices are going up.

Senator XENOPHON—But houses are much bigger now.

Mr Mott—Correct.

Senator XENOPHON—But is that one of the factors? So there is a greater consumer expectation as to what they expect?

Mr Mott—It is a factor. I can give you a thousand reasons for it as an explanation, but at the end of the day Mr and Mrs Smith want to buy a house—

Senator XENOPHON—So the average home today costs a lot more—

Mr Mott—than it did. Everyone knows that. Everyone is going to accept that. Mortgage stress is the reason why there is such a big—I am sorry; I will not say it is the only reason, because some people do not like the fees. Some people got hit with exception fees, which I agree were excessive. The major banks have taken them off. Some people do not like the exit fees which are there. My point is 7½ per cent is not an excessively high interest rate, but there are people out there who might not be technically under mortgage stress from a bank perspective but, as everyone in your constituency knows, there are people out there who are feeling the pinch

at the moment. There were a lot of people who felt ripped off when the Reserve Bank moved by 25 and the major banks moved in excess of that. In reality, I am sure that people go and buy into banks for it, but the Reserve Bank governor himself said he would have moved rates to that position anyway. It might not have been on Melbourne Cup day but it probably would have been at some stage in early 2011.

Senator XENOPHON—You talk about the return on equity of the large Australian banks. It is similar to that for other large companies in Australia but should the returns be lower given the relatively lower risk of banking and the fact that it has had the benefit of a strong regulatory framework and it has had the guarantee that was there earlier? In other words, there is an element of support by virtue of the regulatory framework and other mechanisms of support.

Mr Mott—There is one big problem in that analysis. The four major banks in Australia fund the current account deficit, so all the offshore funding that comes to lending out to fund Australia's growth and prosperity effectively comes from the four major banks. Now when they go and borrow offshore, they do that at a relatively cheap cost relative to other banks in the world because they are AA rated. If the profitability of the Australian banking system goes down, in all likelihood the banks could see their AA rating being removed or reduced to be put on negative watch. What that would lead to—

Senator XENOPHON—Sorry, you are saying that if the banks between them announce \$22 billion in profits—as I think they did in the last 12 months; is that right?

Mr Mott—That was for financial year 2010.

Senator XENOPHON—Yes, for 2010 \$22 billion.

Mr Mott—A 16 per cent return on equity.

Senator XENOPHON—Yes, a 16 per cent return on equity. Are you saying that if they announced a 10 or 12 per cent return on equity that could affect their credit rating?

Mr Mott—If the rating agencies felt that the return on equity falls and it is likely to be permanent it would be—

Senator XENOPHON—To what level though?

Mr Mott—I am not a rating agency. It is probably worth speaking to Moody's or S&P to get their view on it. But if that falls their view is to try to protect the senior debt holders. Remember, I am an investor involved in equity. They are looking at senior debt. If the return on equity falls the buffer that enables them to pay the senior debt holders is going to come under pressure and therefore there is a risk—and this is a material risk—that they will have a credit rating downgrade. For an Australian bank going offshore to the global debt markets to raise money, the cost of raising that senior debt will rise because a fixed income investor offshore will demand a higher return on that money because it perceives the Australian banking system as not being as profitable and strong and as likely to pay them back.

Senator XENOPHON—But when margins were a bit tighter during the GFC and when they had to write off bad debts in the last couple of years, when their profits were narrower, not as generous, they did not lose their AA credit rating, did they?

Mr Mott—They were put on credit watch negative by some of the rating agencies, but, remember, a very large number of financial institutions in the world did lose their AA ratings, to the extent that there are only around seven in the world, including the four major banks. So we are in a privileged position in Australia with the strength of the financial institutions with the AA rating. If they lose that, the interest rates paid by every mum and dad mortgagee in Australia will go up.

Senator XENOPHON—So it is a paradoxical effect, you are saying.

Mr Mott—Exactly. As profitability falls, interest rates will rise.

Senator XENOPHON—Finally, on the Basel III reforms, some have said that we are having to pay for the sins of others, in the sense that there will be tougher liquidity requirements, whereas we have been pretty robust. What is your estimate of what the Basel III reforms will mean in terms of the cost of money here in Australia?

Mr Mott—I have not seen the final reforms yet.

Senator XENOPHON—But it will cost more?

Mr Mott—Yes, it will, but I cannot give you a number.

Senator XENOPHON—Fifty basis points? 100 basis points?

Mr Mott—I cannot give you number because I have not seen the—

Senator XENOPHON—But it will be appreciable?

Mr Mott—Correct.

Senator XENOPHON—'Appreciable' means more than 50 basis points?

Mr Mott—I cannot give you a number. That is your number, not mine. But the banks may have to hold higher levels of liquid assets because the amount of deposits is assumed to be less sticky, because the rules that the Basel committee come out with are higher, or APRA's interpretation of them. Remember Australia cannot comply with the liquidity requirements of the Basel committee because we are in the great position of not having enough government debt. That is a fantastic outcome that there is not enough government debt—

CHAIR—The government is working on it!

Mr Mott—Hopefully they get there by 2013 if that is the case. But at some stage the banks are going to have to hold more liquid assets, which will invariably push their funding costs up because you have to have more term debt. That is again why covered bonds are so important,

because they are allowable for the liquidity programs. This is another reason why covered bonds are just essential.

Senator XENOPHON—To offset Basel III?

Mr Mott—No. It is allowable for Basel III. Just as government debt is allowable, so are covered bonds. That is why these things are so important. It is so intertwined. With such a leveraged organisation, a small change can have huge unintended consequences.

Senator WILLIAMS—Do you support the government's guarantee of the retail deposits?

Mr Mott—I support it but I do not think it should be free. My view on it is: you are transferring risk to taxpayers; they should be rewarded for that.

Senator WILLIAMS—That is the point I was going to make. You were saying that at some stage in the future an ADI will fall over—whether it be five years, 50 years, 150 years or whatever—

Mr Mott—It is inevitable.

Senator WILLIAMS—so at some stage the taxpayer will suffer that risk and pay for it.

Mr Mott—Correct. Reading the Treasurer's policy, he has stated that the other financial institutions will be levied to repay the government, so taxpayers are protected. But, remember, in the event that one financial institution falls, it is likely that the others are going to be under stress. That is the time that they are least able to do it. So it is not an easy solution, because all these other financial institutions are probably under the same stress and inevitably it will be in a recession. So it is difficult. My view is that, if they want to have government guarantees on retail deposits, look at systems offshore. This should not just be a free taxpayer guarantee—'No worries; go out; that's fine; don't worry about your systems; the taxpayer will look after you.' I just look at risk transfer from private to taxpayer, and the taxpayer needs to be rewarded for that, just as government guarantee on wholesale term debt is making the government a substantial amount of money at the moment. They are providing their AAA credit rating to the financial institutions and they are providing that at a cost. You need to have a payment. Taxpayers are not a free service.

Senator BRANDIS—Is the recommendation in relation to covered bonds in your view the most important part of the Treasurer's announcement?

Mr Mott—I think there are many elements which are very important. I would not want to rank which is the most important. I think it is an extremely important recommendation and a very sensible recommendation by the Treasurer, but I would not want to rank them in order.

Senator BRANDIS—Going back to your evidence earlier, you in very unambiguous terms said: if bank profitability goes down, interest rates will go up.

Mr Mott—If the credit ratings of the banks come under pressure because the fixed income investors are worried that they are less likely to be paid, they will demand a higher rate of return,

as every investor would, and fixed income investors are the same as equity investors. That means that the average funding cost for the Australian banks will rise and that will lead to the Australian banks needing to pass that through. It is a vicious cycle. The more your funding costs go up, if you do not pass it through, your profitability falls. Your profitability falls, your rating falls. Your rating falls, your cost of funding goes up. The only way that the banks can do that is to pass that through to the consumer. Isn't that fine?

The Governor of the Reserve Bank is looking at the effective rate that the households are paying on their mortgages, not the cash rate. That will be taken into consideration by the Reserve Bank. But if profitability of the banking system is materially impacted as a result of increased measures to push up competition, it will probably lead to higher rates, not lower rates, and higher instability within the financial system. But if it is a marginal impact and it makes consumers able to move better and there is a little bit more competition, I am all for that. That is a good thing. But remember, any measures which materially reduce profitability of the banking system are not a good thing. The only thing worse than a very profitable banking system is a very unprofitable banking system.

Senator BRANDIS—It is the case, is it not, Mr Mott, that in the tension between stability and competitiveness we sacrifice stability for every incremental gain in competitiveness. You used the phrase before, I think, that they are 'diametrically opposed'. If we sacrifice stability for competitiveness, not only do we have, ex hypothesi, this stable system but, the more competitive the system is, isn't it the case that the banks will also factor in a greater premium for risk?

Mr Mott—Correct.

Senator BRANDIS—Which will have the effect of?

Mr Mott—Pushing up interest rates.

Senator BRANDIS—Thank you.

CHAIR—Thank you, Mr Mott.

Committee adjourned at 5.57 pm