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# Official Committee Hansard

## SENATE

ECONOMICS REFERENCES COMMITTEE

**Reference: Competition within the Australian banking sector**

WEDNESDAY, 9 MARCH 2011

SYDNEY

BY AUTHORITY OF THE SENATE



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**SENATE ECONOMICS**  
**REFERENCES COMMITTEE**  
**Wednesday, 9 March 2011**

**Members:** Senator Eggleston (Chair), Senator Hurley (Deputy Chair) and Senators Bushby, McGauran, Pratt 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, 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 Bushby, Hurley, 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**

**DEITZ, Mr Andrew, Manager, Infrastructure, Competition and Consumer Division, The Treasury ..... 2**

**DOUGLAS, Mr Justin, Principal Advisor, Banking, Financial System Division, The Treasury ..... 2**

**LONSDALE, Mr John, General Manager, Financial System Division, The Treasury ..... 2**

**MURPHY, Mr Jim, Executive Director, Markets Group, The Treasury ..... 2**



**Committee met at 8.30 am**

**ACTING CHAIR (Senator Bushby)**—I declare open the eighth and final 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 31 March 2011. To date the committee has received over 130 submissions, which are available on its website. These are public proceedings, although the committee may determine or agree to a request to have evidence heard in camera. 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 a contempt. It is also a 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 to 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.

[8.31 am]

**DEITZ, Mr Andrew, Manager, Infrastructure, Competition and Consumer Division, The Treasury**

**DOUGLAS, Mr Justin, Principal Advisor, Banking, Financial System Division, The Treasury**

**MURPHY, Mr Jim, Executive Director, Markets Group, The Treasury**

**LONSDALE, Mr John, General Manager, Financial System Division, The Treasury**

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

**Mr Murphy**—I would just like to make some brief opening remarks in relation to the government's competitive and sustainable banking system reforms, including on some elements of the banking package that have been the subject of recent commentary. Treasury's previous appearance before this inquiry was the day after the government announced its banking package. At those hearings, I outlined Treasury's current policy thinking on the Australian banking sector and particularly noted the changed competitive dynamics in the industry in the post-GFC environment; the trade-offs and interrelationships between safety, stability and competition; public concern about rising mortgage rates and views about appropriate levels of profitability of the industry; and structural challenges facing the system, including the system's capacity to raise funding on cost-competitive terms in an environment of continuing volatility in offshore markets. I highlighted this policy thinking to provide the context for the challenging environment in which the government developed its competitive and sustainable banking system reforms.

To address these challenges, the government's banking package contained three broad streams designed in a structured and cohesive manner to empower consumers to get a better deal, support smaller lenders to put more competitive pressure on the big banks and secure the long-term safety and sustainability of the financial system. I do not intend to outline the each of the initiatives in each of the streams, but I think it is important to note that this is a comprehensive package of reforms that are designed to work as a package to make the banking system more responsive and competitive. The package should be seen and assessed on that basis, and each measure should be considered with reference to the package as a whole.

I will briefly comment on some of the matters that have been of topical interest. Following the announcement of the government's banking package in December, there has been heightened public interest and commentary on a range of issues. This broad and public discussion of banking policy is a significant positive development. With more discussion about banking issues, consumers are more likely to become increasingly engaged in the debate. Also, some consumers for the first time will probably start to think more critically about their choices of banking products and the actions they can take to get themselves a better deal. However, it is also important that the public commentary on banking issues is balanced and accurate. I would like to briefly touch on a few of the initiatives that have been the subject of recent commentary.

As I mentioned in relation to the ban on exit fees at Senate estimates a few weeks ago, it was Treasury's view that exit fees should be banned unless they reflect legitimate costs borne by the credit provider as the result of early termination. That was the advice we provided to the government. It is our view that banning this type of exit fee would enhance consumer empowerment by reducing the costs that a consumer faces when switching a mortgage, making costs more transparent for the consumer when they are entering a loan so they are more aware of what they are signing up for and ensuring that consumers will be able to exert a more forceful competitive discipline over lenders that become less competitive relative to rival mortgage offerings over time—that is, people can switch if they feel there is a better deal out there. They will not be tied to their current credit provider—in effect, they will not be at the mercy of their current credit provider in any other terms and conditions of their loan.

I would also note that there has been much discussion from sections of the industry about how the ban may affect their businesses, particularly smaller lenders. In short, no market participant should fear competition if they offer consistently competitive mortgage loan products to their customers. The ban on exit fees also needs to be seen in the broader context of the banking package; it is one measure as part of a structured and cohesive reform package. In relation to smaller lenders, the banking package contains a whole stream of reforms addressing support for smaller lenders, including a further \$4 billion in RMBS support bringing the government's commitment under this program to \$20 billion.

In relation to covered bonds and their impact on depositors, it is understandable that there have been observations made regarding the protection of depositors. However, there are three main reasons why these



concerns are, in our view, unfounded. The level of assets a bank can use to secure covered bonds will be capped to ensure sufficient assets are available for depositors in any future market turmoil. APRA uses a range of powers to supervise the banks and to ensure that depositors' money is not put at risk in the first place. Finally, as part of the banking package, the government announced that the Financial Claims Scheme is now a permanent feature of the Australian financial system. The Financial Claims Scheme provides certainty and security for deposits.

In relation to price signalling, amendments to the Competition and Consumer Act 2010 to address anticompetitive pricing and information disclosures in the banking sector are an important area of reform. A wide-ranging consultation on exposure draft legislation has been completed. As a result of this consultation some adjustments will be made to the legislation, although the main thrust of the amendments will remain. We continue to work with the government on the issues raised during the consultation process. However, the details of any changes are a matter for the government. The government has committed to introduce the legislation in the autumn sitting period.

In summary, the banking package reforms build on the government's action during the GFC to secure the financial system and to preserve the competitive foundations of the Australian banking system. The government is working as quickly as possible to implement these reforms efficiently and effectively, and to ensure they produce maximum benefit for consumers. It has also been pleasing to see competition intensifying in the mortgage market in recent months. Many market participants have abolished their exit fees, and this was prior to the government's ban coming into force. I also note that some in the industry are offering to pay consumers' exit fees if they switch from other banks.

The wellbeing of consumers is enhanced when banks focus on consumer welfare and the ways in which they can best attract customers to bank with them. That is exactly what is happening at the moment, and we hope that this environment is sustained as the banking package is implemented over the coming months. We are happy to take the committee's questions, thank you.

**ACTING CHAIR**—Thank you for those opening statements. There are just some questions arising out of those statements themselves. You mentioned that the government's competition package is a comprehensive package and that it is designed to work as a package. Does the use of the word 'comprehensive' imply that all possible reasonable and effective measures that the government could have taken have been taken in this package?

**Mr Murphy**—The package was developed over a long period of time and Treasury has been working with the government—since the Rudd government initially came into office and then with the Gillard government—to address concerns with the competitive position post the GFC. The package of measures that has been put forward by the government is comprehensive. It does not rule out that there could be further action in areas if the government felt that this approach was not providing the competitive stimulus and was not leaving the market in the competitive environment which the government thinks would be best for consumers. I would suggest that the government would take some time to see this package come into operation, let it settle down and let it have its effect. It is difficult to judge, at this point in time, the true worth of the whole package. It will take possibly 12 months to two years to see the full competitive impact. These are the measures that the government is going forward with at this time. It might, further down the track, look at other matters if it felt that this package was not effective.

**ACTING CHAIR**—So there are other options that government could look at—which Treasury may have advised the government on and which still could be reasonable and effective—but which the government has not decided to proceed with at this point?

**Mr Murphy**—This package is, I think, the best of what we could come up with. It is a matter for the government to—

**ACTING CHAIR**—When you say 'we', do you mean the government or Treasury?

**Mr Murphy**—The Treasury in combination with the government. This is an iterative process.

**ACTING CHAIR**—Presumably there will be political constraints placed upon you by the government. It is their choice to put boundaries around the extent to which Treasury can look at these things.

**Mr Murphy**—To some extent. No. We respond to the government as quickly as we can. But at the same time it is a matter for Treasury. It is our responsibility to come up with suggestions and policy proposals for the government which we think would be in the best interests of the Australian community. We are concerned and we were concerned post the global financial crisis, given there was significant intervention by the

government, which was called for, that it would have an effect on competition. We have been concerned about it. We have been putting forward proposals. This trade-off between competition and stability in the banking systems is a world-wide phenomenon. The bottom line is that, at this point in time, this is the best raft of measures that Treasury can put forward to the government, and the government has agreed they are the measures to go with at this time.

**ACTING CHAIR**—You mentioned that you need some time to see how it will work. In some respects I find that a little ironic given the government's decision on exit fees. ASIC's *Regulatory Guide 220* was only put out in November, and then one month later the government came out and said they were going to ban exit fees. A lot of the evidence this committee has received suggests the approach to deal with exit fees that ASIC was taking through that regulatory guide seemed to be a reasonable and balanced approach to help to remove unreasonable barriers to switching. That was given no time whatsoever to work across the board. Obviously it will still work with existing exit fees, but across the board it was given no time to work before the government moved and took a more extreme measure to deal with exit fees.

**Mr Murphy**—ASIC's policy paper said they would look at unfair and unconscionable exit fees. I think the ban on exit fees is further consideration taken by government that to reposition consumers in the banking environment you need to set out some clear markers. The banning of exit fees is a clear marker. It has quite significant ramifications for competition.

**ACTING CHAIR**—We have discussed this before, but it has some negative potential. Certainly the evidence we have received is that it has some negative potential impacts on competition. You say that you need to look at it in the context of the whole package. Nonetheless, on its own it impacts on the business models of smaller financial institutions that have in the past competed strongly with the major banks and it undermines their ability to do so in future on the basis of those business models.

**Mr Murphy**—The banning of exit fees, in my view, is to put down some clear markers about how you want to change the consumer banking environment or the relationship between consumers and financial institutions. Yes, it has impacted differently on certain institutions. We have seen that some of the major institutions have already moved to ban exit fees. The ban on exit fees does not come into place until 1 July, but they have already done that.

As I mentioned in the opening statement, it is not just the price of the fee—the banning of exit fees significantly empowers the consumer to be able to negotiate what we think is a better deal with a financial institution. There were some prohibitive exit fees placed on some individuals by some institutions because it was felt that the only way that that institution could continue to be a competitive force in the market was to have a very high exit fee so that they locked in their customers.

**ACTING CHAIR**—But the ASIC approach would have dealt with that to a significant extent.

**Mr Murphy**—I think it would have, but at the same time I do not think you would have got that clear change in the competitive environment.

**ACTING CHAIR**—So you are talking more about a signalling effect than a practical effect?

**Mr Murphy**—No, I think it is a practical effect. By banning the exit fees we are throwing the ball back to the banking industry to say: 'You have to reposition how you deal with consumers because you just cannot lock them in.' This is coming from overseas, but we always thought the best thing you can do on competitive pressures is not intervention but through consumers switching—it is through consumers exercising their rights or going to their institution and saying, 'I am prepared to switch.'

When there are prohibitive or large exit fees—I thought the average exit fee was around \$700—it is a significant impediment to people even raising the issue of switching. So I think there have to be decisions made about what will give the biggest bang for your buck when trying to create a competitive environment. I think banning exit fees puts a clear signal out there to consumers that they can start to think about what they want to do about their institutions and at the same time it puts the institutions more on the back foot in their dealings with consumers.

**ACTING CHAIR**—But you talked about the need to look at the overall suite of measures and the overall impact, I would guess. You can look specifically at exit fees and say, 'Yes, if somebody is locked in that is going to have an impact and therefore it is a good thing if we can remove those so that they can switch easier.' One of the things that worries me, after hearing all this evidence, is that almost all, if not all, witnesses other than the four big banks had concerns about banning exit fees, but the four big banks were very comfortable with it. To me that is very telling.

**Mr Murphy**—I do not know if they are that comfortable with it.

**ACTING CHAIR**—That is the evidence that we have heard. Every financial institution other than the four majors indicated that they could live with it at best or had some issues right through to the other extreme where they thought this was going to be disastrous for their ability to compete. But the four big banks all said, ‘Yeah, not a problem; we are happy with it’. Two of them, as you noted, have already done away with exit fees. In the context of looking at the big picture, where you are trying to improve competition in the banking industry, that fact itself just concerns me, before you even start getting down and looking at the arguments.

**Mr Murphy**—I think the big banks may be putting a good face on something. One institution is continuing to argue and say that that is a poor policy response by the government.

**ACTING CHAIR**—But two of the four big banks do not even have exit fees. I do not think they are putting a good face on. They are not particularly fussed by it.

**Mr Murphy**—Well, I do not know. I think they will have to reposition themselves. We have had consultations with one of the major banks who have told us that they had a significant loss of business since they removed exit fees. I cannot go into that. We have to take them at face value. What they said to us was, ‘We think we’ve got a good product out there. We think our policy of consumers first is going to win us the day and we think our exits or wind-up of mortgages per month will return back to roughly what we think it should be, even though it would be higher than what we had when we had exit fees.’ So I think it has had a competitive impact. In terms of smaller lenders, you get onto the package where we have sought to improve access to finance for smaller lenders. We have spoken about that. I think you will find smaller lenders who used exit fees as a way of tying in the consumer. I suppose the government’s concern is the consumers. You are going to have a trade-off here.

**ACTING CHAIR**—The argument though that they have is not so much that they used them as a way of tying in the consumer but it was part of their business model to delay the cost of setting up the loans. For small institutions the administration costs is a much higher percentage of their overall costing than for the larger ones. They had the choice, but we could spend the whole hour and half discussing this.

**Mr Murphy**—I know that. We would say that there has to be some priorities in any policy. The government’s concern was the consumer and empowering the consumer to exercise their rights to drive competition. We started with the position that there was less competition post GFC. Realistically you can either have government intervention, which we do not want to do, or with the players we can have moral suasion with the institutions and encourage them to be more competitive. That is not going to wash.

**ACTING CHAIR**—It is happening on exit fees that, to some extent, the market is working because of the public debate. You are seeing that the big guys are actually making decisions because they think it is in the market interest. As you were saying, you have had some private discussions with one of them that indicate that they may be looking at how that is playing out. Nonetheless the market led them to do that, not government intervention.

**Mr Murphy**—Oh, I do not know. I think it is a spectre of the government ban. Put yourself in their position—you are facing a ban on something you have been doing so you may as well adapt and get some credit points out of it. I am no banker but I can understand why they would react that way.

**ACTING CHAIR**—Equally there is the possibility of when they did that that there had not been an announcement, but there was the public debate which led the government to then think that maybe this was what they may need to do, which then led banks to make decisions. It is all about the market. To make a decision like that is the market at work. Whether it is a threat of government intervention because the public are angry about something or otherwise, it is the market making the decision.

**Mr Murphy**—There was a lot of debate about this. I have been very pleased about, as we noted, the increased public debate and awareness about these things. A lot of people were not even aware that they were tied by exit fees until they got dissatisfied with a bank.

**ACTING CHAIR**—I think the disclosure stuff in the package is fantastic. I do not think anybody argues that you need to equip consumers with far more information and train them up and make sure that they can recite it all back to you before they actually sign anything. The more they know the better.

**Mr Murphy**—To some extent, if you look at it in policy terms, the exit fees and large exit fees were a very easy way for all these institutions to operate vis a vis their relationship with the consumer. Now the ball is

back in their court to actually think of better services and better ways of retaining consumers. I think it is not a bad thing that fees are upfront, that it is transparent, that people know what they are paying.

**ACTING CHAIR**—So everybody has to pay the fees to subsidise those who might not switch, ultimately. We have been through all this. I do not want to go through the exit fees argument in detail, because we have had plenty of evidence on it before. In terms of competition and the market at work, I noticed in your opening statement you said that the government's package has led to some action from the banks and an increased level of competitiveness in the market. Do you think that you are overstating the impact of the package? The package came about as a result of huge public clamour and complaint, particularly about the independent increase in interest rates on Melbourne Cup Day. I see the government's package as more of a response to the public outrage, in the same way as the banks' increase in competitive activity is more a response to the public outrage than it is necessarily to the package.

**Mr Murphy**—Maybe that is what it seems in the public domain. The facts are that we have been working on and looking at competition issues in the banking market since post the GFC, early 2009.

**ACTING CHAIR**—I do not doubt that.

**Mr Murphy**—Yes, there has been consolidation in the lending market. It was a factor on the record that the major banks had increased their market share. Non-bank players had been squeezed out and then smaller institutions were affected by the GFC. So I do not see this package in any way—because there has been a lot of work in developing it and it is actually quite complex—as just a reaction to a Melbourne Cup Day rate rise.

**ACTING CHAIR**—No. I might have overstated that. I think the timing and maybe the way it has been put together may have had something to do with a particular focus on banking that the media and the public had at the end of last year.

**Mr Murphy**—No. The public's disquiet over banking has been bubbling along—

**ACTING CHAIR**—Absolutely. It certainly came to a head late last year.

**Mr Murphy**—As I say, this is a comprehensive package of measures which did not get dreamt up overnight. One puts forward these policy proposals to the government and we have interaction with the government to ensure those words—we want a competitive but stable financial system. These are carefully designed measures to ensure that we stimulate and get some competition but, at the same time, build on the good things we have. We have a very resilient and stable financial system.

**ACTING CHAIR**—Do you think that the public pressure, the public focus and the outrage that was quite clearly expressed by a lot of Australians late last year had an impact on the competitive environment?

**Mr Murphy**—I think that is for others to judge. It probably has. Financial institutions are in business. If the general public expresses views and there is disquiet and concern about the way they are being treated by financial institutions, you would think that the financial institutions would react to that. But I do not think the public thought that that would be sufficient and I do not think the government thinks that is sufficient. There needs to be some actual strategic changes, systemic changes in the banking market to enable competition to flourish. That is why you have exit fees, but you also the covered bonds and various other things.

**ACTING CHAIR**—I do not disagree with that. As you noted, during the global financial crisis the government took action to prioritise stability, and that did have consequences for competition. This committee has looked at that before. Coming out the other end, you need to redress the consequences of that, I think, but in a way that promotes competition. The question is the detail of how you approach it.

**Mr Murphy**—Yes.

**ACTING CHAIR**—On exit fees again, you also mentioned that they should be banned, other than to cover legitimate costs that the institutions incur. I asked about this at estimates a couple of weeks ago. Do those legitimate costs include administration costs of an institution, or is it just their out-of-pocket expenses, like paying land titles office registration?

**Mr Lonsdale**—They include discharge fees or costs that would ordinarily be incurred if there were not an early break in that mortgage. If the loan went for its full term and those fees had to be paid, then they are allowed, under the government's measures—

**ACTING CHAIR**—So if the full-term arrangement that a bank has also includes a \$300 fee for covering their costs of preparing the discharge of mortgage and things like that, that would still be included as an exit fee?

**Mr Lonsdale**—Discharge fees are included.

**ACTING CHAIR**—But there is a difference between a discharge fee that you actually pay to a land titles registration office and an administration fee that you charge for your internal costs of preparing that.

**Mr Lonsdale**—The general principle is that, if it is a fee that is triggered by the consumer's action to pay out the mortgage early, which would not ordinarily happen, then that is not allowed under the government's policy.

**ACTING CHAIR**—Is there any risk that they will actually impose—if they do not already—administration fees for preparation of end-of-mortgage documents and put it on all loans?

**Mr Murphy**—They cannot be unfair and unreasonable or unconscionable. What we are trying to address with the exit fees is the penalty that is imposed by the institution for someone deciding to move from that institution.

**ACTING CHAIR**—But in a lot of cases, particularly with the mutuals and the major banks, which have fairly small exit fees, they really are only designed to cover those types of things. So it might not have that much impact. You would pay those at the end of that loan anyway.

**Mr Murphy**—It has to be fair not only to the customer but also to the institution. There is a reasonable cost of administration in preparation of discharged mortgage documents and their trooper taking it down to the land titles office and doing all that. Could that be blown out and the penalty factored into that? We would say that that is where ASIC kicks in with unfair contracts and other administration to address that.

**ACTING CHAIR**—I have a final question about your opening statement, on price signalling. There has been speculation in the papers in recent days that there have been changes in the government's approach to price signalling and that you have backed off to some extent on some aspects of what was originally proposed. Is that the case?

**Mr Murphy**—The principles that the government set out for price signalling remain the same. The government is considering whether there should be some form of notification or authorisation prior to statements being made.

**ACTING CHAIR**—To allow some statements to be made that might otherwise be caught by the government's original proposal?

**Mr Murphy**—You will see in the Competition and Consumer Act arrangements whereby simpler certain conduct would be prohibited but you can seek consent or authorisation from the ACCC to engage in that conduct. The government is considering whether you could better target the price-signalling measure by accompanying it with some forms of authorisation and processes whereby authorisation or notification from the ACCC would be provided to give you the go-ahead to say something.

**ACTING CHAIR**—Have you worked out a draft process for that at this point?

**Mr Murphy**—That is being worked on. That would be along the lines of other forms of processes that are already in the act. It is not a new type of thing; it is just that it is being applied to price signalling.

**ACTING CHAIR**—There has been criticism of those other processes in terms of timing, particularly timing of reasons from the ACCC for why they have said no to something. That may have some commercial impacts where they are justified.

**Mr Murphy**—That may be the case, but that is a matter for the ACCC. No new things will be introduced. The key principles of the price-signalling measure will remain. However, it is a matter for the government to decide whether it wants to ameliorate the impact by allowing certain processes which are consistent with the way the ACCC administers the Competition and Consumer Act at the present time.

**Senator XENOPHON**—I want to follow up on that, Chair, if I may. Mr Murphy, further to the question from Senator Bushby, Treasury was given questions on notice, as I understand it, some time ago. You responded to a series of questions on pricing signalling, including this question:

Could a prohibition on public announcements be sidestepped by notifying customers privately and letting the media report it?

That was a very specific question. The answer that you gave seems to be that the government:

... that any proposal to address anti-competitive price signalling and other information disclosures will need to carefully balance the potential anti-competitive impacts of particular information disclosures, with the benign and pro-competitive effects of other information disclosures.

I think Don Watson, Paul Keating's former speechwriter, had a word for that sort of language. What does that mean? It is kind of being sidestepped. It was a very clear question from the committee. Senator Bushby has put it to you and it has been put to you in writing, but I think Treasury has failed to answer a very simple and straightforward question in relation to that.

**Mr Murphy**—We will do that now.

**Senator XENOPHON**—I was too polite to say what Don Watson said about that sort of language.

**Mr Murphy**—Maybe that is bureaucratic speak, but what are we trying to achieve? The question is that, if the institution notified their customers individually—

**Senator XENOPHON**—Or brokers, for instance.

**Mr Murphy**—Yes, and they have notified them of what?

**Senator XENOPHON**—That there has been a change in rates, or there is a proposal to change what they are charging in terms of fees or rates.

**Mr Murphy**—If you are notifying your own customers, I do not see how that actually goes to price signalling. Price signalling, which is called 'facilitating practices' in Europe, is actually announcing to the public at large or, where we have brought in a per se prohibition, is the CEOs of two institutions or their marketing people doing two things: ( 1) in a private deal, a private meeting, over coffee—it is like cartel contract conduct—they get together and say, 'I'm going to do this.' That is not a cartel under Australian law unless the counterparty in that meeting says, 'Yes, I will do the same thing.' At the moment the ACCC does not have the power to do anything about that.

**Senator XENOPHON**—I want to make this point—

**Mr Murphy**—I will be as quick as I can. If I go out to my own customers, I do not see how that is price signalling, because price signalling is targeting: a CEO of an institution getting up publicly and stating, 'This is what I'm going to do. If the Reserve Bank moves its interest rates, I will do this.' That takes the competitive edge from it.

**Senator XENOPHON**—Mr Murphy, very quickly, two things. Firstly, you were asked a direct question and you gave an incredibly oblique answer. Secondly, the question was basically about sidestepping. You notify your customers; the customer will not be prosecuted if they ring up Robert Gottliebson or Alan Kohler to say that this is changing, and it gets out that way. It is just once short step removed from the public knowing about it. It is a question of sidestepping, and that was not answered directly in that specific question.

**Mr Murphy**—I think that is a convoluted way. In my view, you could work your way around all these things, but I will think about it. Realistically, instead of being able to make a public statement to the world at large that this is what you are doing, this is trying to ensure that that uncertainty among competitors remains there.

**Senator XENOPHON**—So you let your customers know and, through your customers, the world at large can know that way, and that is okay?

**Mr Murphy**—I do not know whether many customers would ring journalists. They are your customers and you can set whatever price you like.

**Senator WILLIAMS**—Surely, Mr Murphy, the bank is only going to notify their customers after they raise interest rates. They are not going to write to their customers and say, 'Hang on, the Reserve Bank might raise its interest rates in a month's time by 0.25 and so, if they do, we're going to raise ours by 0.45.' In respect of Senator Xenophon's point, they are not going to write to their customers and say, 'We might raise our rates more than the RBA cash rate,' are they? If they did, it would be a very strange move, and perhaps something that would acquire attention from many in Canberra.

**ACTING CHAIR**—But they could presumably write to their customers and say that they have increased funding costs that are rising rapidly for various reasons and couch it in words that indicate that they would like to put up their rates to a higher rate than they currently have been, which basically is telegraphing the message in a way—

**Mr Murphy**—Price signalling is there to set the environment that allows competition to operate. There was concern expressed by a number of senior people in government and elsewhere that statements being made in the banking sector were leading to, in effect, reduction in competition. In Europe and the US certain statements that were being made would be prohibited. It is called facilitating practices—that is, you facilitate

what others do. By prohibiting such conduct if it is substantially lessening competition you are trying to retain within each institution that uncertainty as to what their competitor is going to do. The competitor is going to act sooner or later. Coming to the first Tuesday in the month, the CEOs or institutions have been opining what they would do if something happened. That is seen by a lot of people as potentially substantially lessening competition in the banking market.

**ACTING CHAIR**—Giving a degree of comfort to their competitors—

**Mr Murphy**—Yes, that is all it is. I would have thought it would not be that hard for the CEOs of major banks to be able to commentate on economic matters and on the economy without broaching issues relating to their own domestic internal pricing.

**ACTING CHAIR**—I guess the challenge of the government—and Treasury is advising them—is to come up with measures that will be meaningful in addressing the actual mischief without getting in the way of proper and legitimate commercial practice. Ultimately I suspect that the end result will lean more towards trying not to get in the way of legitimate commercial practice and maybe this will mean that the ability of the legislation to properly address the mischief might be less strong than it would otherwise have been, because it is a difficult balancing act. There is no criticism intended but you are probably better off letting a guilty man go free than putting an innocent man in jail.

**Mr Murphy**—Yes, but, as I said earlier, it puts a market down, it prohibits certain things, so people's conduct and behaviour adapts to these things. I would be very surprised if it led to action taken against an institution or a representative of an institution because I think they would have enough sense to see that that is an area that they should not enter into.

**ACTING CHAIR**—Has there been any consideration of how you would define 'purpose' in the sense of 'purpose of substantially lessening competition'? The challenge in terms of being able to address a mischief if it does occur seems to be able to prove, under the proposed legislation, that it was undertaken for that purpose.

**Mr Murphy**—Like all actions under the Competition and Consumer Act it is difficult to prove purpose in all these things but that is a trade-off: that is the protection of the individual versus being found guilty of conduct which is improper and illegal. That is really a matter for the ACCC, but my understanding would be that you would be looking at internal communications between parties that say they are going to make a speech and what they are going to do. I think, if you are in doubt, you will be able to go to the ACCC and seek some guidance from them as to how far you can take these things. That is how I think it will work. To prove purpose is always a challenge.

**ACTING CHAIR**—Absolutely, and it has been very difficult in other areas as well. Has there been any consideration of looking at a test that would have the effect of substantially lessening competition?

**Mr Murphy**—There was consideration of that. Treasury's view is that at this point in time it will be better to deal with purpose. If you try to do purpose in effect it weakens the provision even further. It would just be too difficult.

**Senator HURLEY**—I want to deal with the issue of mortgage insurance, which we have heard quite a bit about. In your submission you mentioned having a pool for mortgage insurance. Can you advise us on what is happening there.

**Mr Lonsdale**—The government announced in its package that it wanted to see whether you could have greater transferability of mortgage insurance. When a person moves from one mortgage to another sometimes that insurance is lost at the moment, so could you have a situation where it transfers to a new mortgage? That is the thrust of the measure that we are looking at.

**Senator HURLEY**—You said 'sometimes' it is lost. I had the impression that most of the time it is lost when you transfer. Is that not the case?

**Mr Lonsdale**—It is mixed, I think. But it is certainly an issue that we are looking at.

**Senator HURLEY**—So the government is looking at perhaps having a pool to assist the transfer of that insurance?

**Mr Lonsdale**—We are currently consulting with the key insurers and working out what possible options there would be on transfer or re-funding. There could well be other ways of doing that as well.

**Senator HURLEY**—So there could not be a situation whereby there was a holding centre for the mortgages that could be transferred over?

**Mr Lonsdale**—That goes to another part of this story. The government has announced that it is looking at a clearing house arrangement. The mortgage itself would be held in a clearing house so that, if people sold a property and moved to another, the new owner of the property would go through the clearing house. That would avoid some of the fees that currently apply. That is very much related to this measure.

**Senator HURLEY**—That is interesting because it is clear that people switch houses and mortgages far more than they initially think they are going to.

**Mr Lonsdale**—Yes.

**Senator HURLEY**—We have had clear evidence of that.

**Mr Murphy**—The average length of a mortgage is about five years.

**Senator WILLIAMS**—It is about five to seven years. You sell the house and get another one.

**ACTING CHAIR**—There is a lot of refinancing.

**Senator HURLEY**—That is another reason that exit fees are a bad idea. Speaking of clearing houses, we had the payment section talk to us about the payment system—the idea of making payments transfer easier so that you can get competitors in the market. It seems that the payments transfer between banks is quite clumsy at this stage, even though they are saying that they are trying to improve it. Is there any way to speed up what is happening there?

**Mr Murphy**—Payment systems are largely under the supervision of the Payments System Board.

**Senator HURLEY**—As I said, we did have the Reserve Bank in.

**Mr Murphy**—They have sought to get greater competition into that. I would have to take that on notice and think about it. Treasury is not a member of the Payments System Board. The governor and senior people from APRA, plus senior people from the private sector, have been appointed, and they have taken a number of measures over the last few years to try to get competition.

You saw legal action taken by the major credit card providers against some of the reforms to the Payment Systems Board, so they have pushed for that. One of the inherent difficulties in the whole system is the network. My understanding is that the payments systems network was actually developed by the major banks and is owned by the major banks, so to push through reform is a challenging exercise.

**Mr Lonsdale**—Just to add to Mr Murphy's comments, one related issue that is being looked at here is that the government announced that Bernie Fraser would examine portability of account numbers, and whether account numbers could be made more portable. That is a feasibility study that is happening now, which will pick up some of the issues that you raised.

**Senator HURLEY**—On the return on investments of the banks, I think in an answer to one of the questions on notice you said you do not track return on investments as compared with other sectors of the industry. The banks have been telling us that 13 or 16 per cent, which they seem to be getting, is relatively modest. I have been told that the return on investment of different sectors of their business varies markedly too, that the return on investment for the retail banking and mortgage side is much higher than other sides, and in the consolidation of their accounts it comes out to that percentage. Is there any tracking of that kind? Is there any reporting of different business units? If not, should there be?

**Mr Murphy**—Do you mean comparisons between companies or business units within companies?

**Senator HURLEY**—Within companies.

**ACTING CHAIR**—They would have that information.

**Mr Murphy**—They would have that information, yes. We look at comparisons of profitability of companies and major institutions in Australia. But it is hard to draw comparisons between different industries.

**Mr Lonsdale**—Senator, just to be clear: are you talking about return on equity?

**Senator HURLEY**—Yes.

**Mr Lonsdale**—My view would be that you could always mine more data. We always ask ourselves: what will that tell us? In a sense, what we say in the submission is that return on equity is really just one factor that you might take into account in looking at competition in the industry.

**ACTING CHAIR**—The banks rely on it for their arguments.



**Mr Lonsdale**—They may rely on it—and we rely on it, too, as one indicator. But there are net interest margins as well, as another important profitability indicator. The number of products in the market, the number of providers in the market, funding costs—there is a whole range of indicators.

**Senator HURLEY**—Yes, it is part of the competition aspect, but only insofar as the banks say, ‘You can’t pull back our fees or impose anymore costs on us, because then we won’t earn the required return on equity.’

**Mr Murphy**—Of course, they would run the best argument for themselves.

**Senator HURLEY**—And why wouldn’t they. I totally understand that. I am trying to get to the bottom of how justified it is.

**Mr Murphy**—We look at their competitive position. There is a range of factors, as John has relayed. I do not see anyone withdrawing from the market because of lack of profitability.

**Senator HURLEY**—No. I am looking to maybe reduce it even further!

**Mr Murphy**—And I do not see any reduction in the products being offered. We are concerned about competition. At the moment competition needs to be enhanced.

**Senator HURLEY**—Even if it were enhanced, which might entail a smaller return on equity for the banks, you believe they could still be viable?

**Mr Murphy**—Yes.

**Mr Lonsdale**—They would still attract investment.

**Mr Murphy**—The big argument internationally is: how much are they a utility? That is one of the issues going to consumers’ disquiet. Everyone knows the financial system—and that is why the government is concerned—is such an important part of everyone’s life. Post GFC, international debate has raged: are these just private sector profit-making entities, as we view them in Australia, or are they a hybrid, providing an essential service to the community? I think that is why governments have started to look very closely at the operations of banking institutions. As you saw in the GFC, those institutions can virtually bring down a government. They are so powerful in terms of their influence in the community that governments have to be mindful of their operations. There are not many areas in the economy where the government will step in and say, ‘We want to have a deposit insurance scheme; we want to in effect underpin the banking institutions.’ Government does not underpin other industries. So that leads people to say, ‘Maybe banks should’—I am not trying to restrict their profitability—’be cognisant of that fact.’

**ACTING CHAIR**—Exactly, that social compact idea—Joe Hockey’s.

**Mr Murphy**—I am just saying there is an international debate over that. That said, I think, to end that quickly, the financial system in Australia has served Australia very well. That has been a private sector financial system that has served as very well.

**Senator HURLEY**—Yes, the private sector and the regulatory system in Australia have worked well together to give us a very stable system. We certainly do not want to jeopardise that. However, we certainly do not want private companies to use government backing to make unreasonable profits either, hence this inquiry.

I would like to move on to the ATM fees. You provided an answer to a question on notice from Senator Xenophon, so I may be stealing his thunder a bit here, about ATM fees and the difference between those who are withdrawing and simply getting access to their account balance. You say: ‘The majority of ATM transactions do not incur a direct charge, but it is often the same for withdrawal and balance inquiries. Nonetheless, in around 30 per cent of cases, the balance inquiry charge is lower than the withdrawal charge.’ Is that 30 per cent of transactions where a charge does occur or 30 per cent of transactions?

**Mr Lonsdale**—Our understanding is that most transactions—about two-thirds—currently happening through ATMs do not attract a charge, and that is because they are done at the person’s home ATM. But around 30 per cent are done at foreign ATMs and will attract a charge.

**Senator HURLEY**—But you cannot get information about how many are balance queries or how many are withdrawals?

**Mr Lonsdale**—We could check that, Senator.

**Senator HURLEY**—And then you note there are a number of alternatives to ATM balance inquiries.

**Mr Murphy**—I think we have got a review going on between the Reserve Bank and Treasury on competition in ATMs. The issue of people being charged for account balances et cetera is one of the things

squarely on that. The review has reported back to the government in terms of the impact of ATM charges on Indigenous people and—

**Senator XENOPHON**—Has that been published?

**Mr Lonsdale**—No, it has just been provided to the government now.

**Mr Murphy**—Because there were concerns there about people in remote areas, and because a lot of people there are on government assistance, there seemed to be more account inquiries made than the norm in other communities, and there are charges for those account inquiries.

**Senator HURLEY**—It would not be only Aboriginal communities. Generally speaking, people who do not expect that they have a large balance would need to check it before they make any kind of payment or purchase.

**Mr Murphy**—That is right. So we are seeking to look at what can be done in those areas, not only in the Indigenous areas but also the wider issue that some people might say it is unreasonable that there is that charge for making an account balance inquiry.

**Senator HURLEY**—I do not necessarily agree. It might cost the bank some amount to maintain the balance inquiry in that way. But it can be difficult for people if they are about to make a purchase and there is no home ATM near them and they then have to pay.

**Mr Murphy**—That is the key thing. There are limited ATM service providers in Indigenous areas. That is a problem.

**Senator HURLEY**—And not only in Indigenous areas.

**Mr Murphy**—The trade-off there is if we want service providers to provide ATMs in remote areas then they have to be able to make a reasonable return.

**Mr Lonsdale**—There is a trade-off between the fee and the coverage that is provided as well.

**Senator HURLEY**—Yes, and having lived in a remote area myself I know how difficult it is to get tradespeople out to service all that kind of stuff. I do understand that.

**Senator XENOPHON**—Mr Murphy, if can we go back to the issue of price signalling, has Treasury looked at what is in force in other parts of the world to deal with price signalling and the effectiveness of those legislative regimes?

**Mr Murphy**—Yes. One of the drivers—and we can get you more detail on this—is that, as I mentioned, in the US and Europe and the UK, there are provisions which are targeted at facilitating practices. It seems that there is a gap in the law in Australia where you are seeking to ensure that arrangements or understandings or agreements between competitors are restricted in what can happen there, and facilitating practices is just a further extension. We looked at this when we issued a discussion paper back in January 2009 on the meaning of the word ‘understanding’. That was one way we were seeking to extend what we thought was a gap in the law. Public submissions on that led us to take the position that that was not the best policy approach. What started off as facilitating practices has turned into price signalling, which is what it is about.

**Senator XENOPHON**—If you could take it on notice and send the material, that would be quite useful.

**Mr Murphy**—All right.

**Senator XENOPHON**—I am not sure whether Senator Bushby covered the issue of a superprofits tax. Has that been covered at all?

**ACTING CHAIR**—No, I did not.

**Senator XENOPHON**—There were media reports on 2 February of documents obtained under FOI relating to discussions with Treasury, involving yourself, about a possible superprofits tax. Can you tell us about that? Presumably this was on the basis that it was a tax on economic rents. Where is that at?

**Mr Murphy**—That was an internal discussion. It was driven by us seeing in some overseas jurisdictions that there have been needs to impose such taxes—

**Senator XENOPHON**—On the banking sector?

**Mr Murphy**—Yes, or discussion of whether you should do that. Largely, it was because of governments taking equity in the institutions.

**Senator XENOPHON**—I see. In which jurisdictions?

**Mr Murphy**—In the UK and the US.

**Mr Lonsdale**—A whole range. So Sweden have a sort of bank tax approach, as do the UK, the US and a range of European countries.

**Senator XENOPHON**—Not Venezuela.

**Mr Lonsdale**—I don't know about Venezuela, Senator.

**Senator XENOPHON**—Mr Lonsdale, the reason I mentioned Venezuela is the comparison that Mr Smith of the ANZ made between Joe Hockey and Hugo Chavez. That was the allusion. Has it been brought into any of those jurisdictions?

**ACTING CHAIR**—He apologised for that.

**Senator XENOPHON**—To who—Joe Hockey or Hugo Chavez!

**Mr Lonsdale**—It is mixed, Senator. Sweden has a regime. Other countries, as I said, have flagged their intention to bring in such an arrangement, particularly where countries whose governments have taken stakes in the banking system.

**Senator XENOPHON**—So is that the key determinant—

**Mr Lonsdale**—That is one determinant. The purpose of it is also very mixed. In some jurisdictions it is for resolution funds. In some jurisdictions it is to inhibit risk taking by banks. In other jurisdictions it is for climate change reasons. There are a whole range of different purposes. The document that I think you are referring to is really an internal discussion about how other countries might be operating and whether that is of relevance to us, and it is something that we normally do.

**Senator XENOPHON**—Sure. It would be bad for public policy if those internal discussions were misinterpreted as being the way the government was going, wouldn't it? It is healthy to look at what other jurisdictions are doing.

**Mr Murphy**—We look at things which the government ask us to look at, and we have to have ongoing regulation and give advice to government so we look at a range of things. The only other thing on that matter is that it is on the G20 agenda, so it is being discussed by the finance ministers.

**Senator XENOPHON**—Just to make it clear, just because it is being discussed does not mean it is being considered by government as such. It would be remiss of you not to advise government on what other jurisdictions were doing, I guess.

**Mr Murphy**—Yes, and to develop our own policy thinking.

**ACTING CHAIR**—It is not something that has been ruled out?

**Mr Lonsdale**—In this case, the Treasurer has made a very clear statement that there will not be one.

**Senator WILLIAMS**—He said that about the carbon tax as well.

**ACTING CHAIR**—Fair call, Senator Williams. That is one all now, Annette!

**Mr Murphy**—I think the point made was that there are various reasons for other governments doing this and, to some extent, we have not had the problems which those governments have had to address.

**Senator XENOPHON**—Insofar as in one jurisdiction it seems to be a question of a resolution tax, it is almost a form of hypothecated revenue to deal with a specific issue, isn't it?

**Mr Lonsdale**—In that case, yes.

**Mr Murphy**—Yes, for their particular financial system. Up to a few years ago governments in Australia thought that they did not need to have any form of deposit insurance, because they thought that they could manage the financial system without it. It is horses for courses, I suppose.

**Senator XENOPHON**—I know Senator Hurley has touched on the issue of mortgage insurance. An issue that has been raised with me by finance brokers and mortgage brokers—such as Ray Hampson Finance in Adelaide—is the level of the burden. That is a big issue for them amongst their customers. Has any assessment been done as to the potential costs of that? Apparently, in response to Senator Hurley, people switch loans every five to seven years; if they have to get new mortgage insurance, what does that cost consumers in real terms? You may want to take that on notice.

**Mr Lonsdale**—We are looking at that as part of this review. We are trying to get an empirical basis on which to form some judgments going forward on how this is best handled.

**Senator XENOPHON**—Consumers are probably losing hundreds of millions of dollars on an annual basis, aren't they—would it be that much?

**Mr Lonsdale**—Without putting a quantum on it, because I would prefer to answer with the figures, it is certainly a non-trivial amount.

**ACTING CHAIR**—On that point, in the review, are they examining the extent to which the premiums are based on the circumstances that currently exist? No doubt you are looking at whether LMI is actually in a competitive market. In a competitive market, the premiums that they write would be written to reflect the fact that they are turned over so often and that generally people do not get refunds and all those sorts of things. They would be written to be a competitive price for those premiums, given all of those circumstances. So if you start having forced refunds you create portability of insurance, and the model changes and the premiums would have to go up in a competitive environment. But that all assumes that it is competitive in the first place and they are not making super profits out of premiums at all. Is that the sort of thing that is being looked at in the review as well?

**Mr Lonsdale**—We are looking at the pricing of the insurance as well. That will come into effect. Just to clarify the other point that has been made a few times, it is not always that refunds are not given—

**ACTING CHAIR**—That is what I said—in most cases they are.

**Mr Lonsdale**—Even in most cases. We are aware of many cases where refunds are given, but there are also cases where they are not given.

**ACTING CHAIR**—One other question on that then: does the insurance act—I think it is 1984—apply to LMI insurance? If my rusty memory is correct, from years ago when I used to do a bit of insurance law work, you have to pay a refund of premiums based on the proportionality of time that it was covering and so forth. In which case, if they are not paying them then maybe—

**Mr Murphy**—They might be able to exclude it through the contract they enter into.

**Senator XENOPHON**—Usually the contract is between the bank and the insurer, not the individual and the bank.

**ACTING CHAIR**—Hopefully you are looking at that aspect of it too.

**Senator XENOPHON**—Mr Lonsdale, what time frame is there for that review of mortgage insurance—what it actually costs consumers?

**Mr Lonsdale**—At this stage there is no formal time frame, but we are aiming to do it this year. We are proceeding quite quickly on it.

**Senator XENOPHON**—Is there any time frame for there being an informal time frame? Will it be this year or next year?

**Mr Murphy**—It will be this year. The government has made it pretty clear that they want action on all these matters.

**Senator XENOPHON**—That is a good enough time frame: sometime this year. That is fine. Could I go to the issue of securitisation. One of the arguments put to this committee and, I think, publicly and privately, is that if you want to shake things up in terms of competition to ensure that consumers get lower rates—assisting credit unions, that is all very worthy. That tier is all well and good. But the effect of securitisation makes a big difference, and I think the RMBS scheme has played a key role in that. I asked a question of the finance minister to the Treasurer last week in question time about Aussie Home Loans, about the AOFM, but I think it is within your purview and it was a decision made by the Treasurer. I still cannot quite understand why Aussie Home Loans was excluded. I think the answer given was that it was a subsidiary, but any legal definition—

**Mr Murphy**—The Treasurer made it in statements that the RMBS and the AOFM program was there to stimulate the smaller lenders, not to assist the major institutions. I think the Commonwealth Bank owns 30 per cent of Aussie Home Loans—

**Senator XENOPHON**—Thirty-three per cent.

**Mr Murphy**—Yes, 33 per cent.

**Senator XENOPHON**—And they have got two board positions of six—two out of six.

**Mr Murphy**—Yes. So the decision was made that it would be counter to the Treasurer's public statements—

**ACTING CHAIR**—That was a policy shift late last year, wasn't it?

**Senator XENOPHON**—I am not sure it a policy shift.

**ACTING CHAIR**—Up to that point the AOFM had been able to write—

**Mr Murphy**—We had a written agreement with the major banks that they would not be participating—

**ACTING CHAIR**—But the AOFM gave us evidence that they were very well advanced in putting that package together before the announcement of the Treasurer's package in December, which then put it all to an end.

**Mr Murphy**—I think there might have been a misunderstanding by the AOFM. The reason for the government's AOFM packages was to stimulate the securitisation market primarily for the non-major bank lenders. That has always been the case, and then I suppose the difficulty—and you could go either way on this—with Aussie Home Loans was that it was a substantial shareholding by the Commonwealth Bank. So it was government's policy, and the Treasurer made it very clear that the securitisation program under AOFM was there to support smaller lenders.

**Senator XENOPHON**—Chair, I would like to pursue a line of questioning, if I may—and there is a reason. The reason given initially was that Aussie Home Loans was a subsidiary of the Commonwealth Bank. Is that the case?

**Mr Lonsdale**—It is a reason given by whom?

**Senator XENOPHON**—It was a reason given by government that Aussie Home Loans—and it was in correspondence given to Aussie Home Loans. We heard from the AOFM, who said that it was in advice from Treasury, and it is on the *Hansard* that it is a subsidiary.

**Senator HURLEY**—That was correspondence to Aussie Home Loans. Have you got that?

**Senator XENOPHON**—That was tabled.

**Senator HURLEY**—Was it? Because it was a subsidiary?

**Senator XENOPHON**—I think. And then AOFM advised that it was a subsidiary in evidence before this committee.

**Mr Murphy**—Well, legally, I think I would have to look to say whether legally it is a subsidiary, but it is 33 per cent owned. That is the issue—whether it is a subsidiary or not.

**Senator XENOPHON**—Corporations law 101: isn't it 51 per cent? Would you agree that the universal definition of a subsidiary is a controlling interest?

**Mr Lonsdale**—But I do not think this is an issue of whether it is strictly a subsidiary or not. This is a policy issue. And what the government has said is that the purpose of this program is to support competition for smaller lenders. In the view of the government, a holding of 33 per cent of Aussie Home Loans does not constitute a small lender.

**Senator XENOPHON**—This is very important to me. It is to provide competition for small lenders, but ultimately the policy outcome is to drive down interest rates in the marketplace to have that level of competition.

**Mr Lonsdale**—More competitive environment.

**Senator XENOPHON**—Yes, no question about that. So we all agree that it is about having a more competitive environment. Now, we know the role that Aussie Home Loans—and I have no commercial relationship with them.

**Mr Murphy**—No, I appreciate that.

**Senator XENOPHON**—I think Aussie Home Loans has donated to both the Liberal and Labor parties in pretty equal measures.

**Mr Murphy**—And it has been a very successful business.

**Senator XENOPHON**—Sure. But they did have a role in the 1990s to push down interest rates. It seems that, once they entered the marketplace, and were quite aggressively discounting, they actually did have a very good influence in terms of competition. I think that is acknowledged. That is a fair summary, isn't it?

**Mr Murphy**—Yes.

**Senator XENOPHON**—In the 1990s when they got into the marketplace, they did have a key role and they opened that market out to others as well, which is I think an unambiguously good thing. The Commonwealth Bank does have a 33 per cent share. It has two board seats but they are outvoted four to two by John Symond's interests, by his shareholding. The contribution that they would make to the Commonwealth Bank's bottom line is miniscule. I think it is \$10 million or \$11 million a year. I do not know what it would be but it is several million dollars; it is not in the tens or hundreds of millions. In terms of the policy objective, isn't there an issue here? You are actually knocking out one of the competitors, or reducing their ability to compete as aggressively as they used to be able to?

**Mr Murphy**—No. You can look at it that way. Alternatively, there is nothing to stop them entering and using a securitisation market which is not sponsored by the AOFM.

**Senator XENOPHON**—Having AOFM sponsorship makes a big difference though, doesn't it?

**Mr Murphy**—It probably makes a big difference to certain people who are struggling to get finance or who need that finance. But Aussie Home Loans, I do not know. The other issue about—

**Senator XENOPHON**—I am not suggesting Aussie Home Loans is struggling; I am just suggesting that they cannot access the money as cheaply because of not being able to access AOFM.

**Mr Murphy**—The Treasurer made it very clear that this initiative, the AOFM initiative, from day one was not to assist the major banks. That is my understanding.

**Senator XENOPHON**—Okay. But it is not a major bank.

**Mr Murphy**—Yes. But the Commonwealth Bank—and we will just go back to this and round and round—has a substantial shareholding in it. You can say it is not a subsidiary but, under the takeovers law, if you have up to 20 per cent of a company, you can exercise influence. That is takeovers law. You have to make a formal bid. We would say that, under foreign investment law, if you have up to 15 per cent you can influence.

**Senator XENOPHON**—But this is a private company; it is not a public company. Takeovers law does not apply here.

**Mr Murphy**—What I am saying is that analogously—in effect, a 33 per cent shareholding is a substantial shareholding. It is not five per cent. I am just saying. So I suppose, if you look at Aussie Home Loans and you look at what the Treasurer's statement was—that is why the decision was made.

**Senator XENOPHON**—I will give up on this in a minute. Can you take on notice: if the policy intent of this is to encourage competitive pressure in the marketplace, which we all agree on, given the role that Aussie has played in terms of being a very competitive player in the market place historically and today, isn't denying them access to the AOFM and the RMBS really going counter to the benefit it will provide to consumers by taking out this particular player and taking away that competitive edge?

**Mr Murphy**—I do not think it is taking out that layer.

**Senator XENOPHON**—Not taking it out, but it is actually making it more difficult for them to raise finance at the most competitive rate.

**Mr Murphy**—I think they have been a successful business and they are operating successfully in the market. Maybe they have missed out on getting some assistance from government, but there are other parties out there who would also benefit from assistance from government.

**Senator XENOPHON**—It is on the public record who gets what from the RMBS, isn't it?

**Mr Murphy**—Yes.

**Senator XENOPHON**—So I can access it myself. Hopefully, the Treasurer will see me and have a chat with me about this soon.

**Senator WILLIAMS**—In your submission I note that \$70 billion from the banks was lent to governments. Did that include local, state and federal governments?

**Mr Lonsdale**—Where is this from?

**Senator WILLIAMS**—In your submission you talk about total bank lending of \$1.765 billion being outstanding on their balance sheets. You have there that there is \$70 billion in government lending. Is that to all tiers of government, do you know?

**Mr Lonsdale**—Do you have the page there, Senator?

**Senator WILLIAMS**—Page 5 of your submission.

**Mr Murphy**—I would say that would be across the board, yes.

**Senator WILLIAMS**—It would be local, state and federal?

**Mr Murphy**—Yes.

**Senator WILLIAMS**—The big issue of this banking inquiry—if I read Senator Xenophon's mind—is that on 2 November, Melbourne Cup Day, there was a 0.25 per cent increase by the Reserve Bank and the Commonwealth Bank went 0.45 per cent. Their claim was that the cost of funds increased so much so they increased their margins. Looking back on it now, how much of their costs increased and have they stabilised? Mr Murphy, I am seeing long-term interest rates going from 6.7 per cent to 6.3 per cent to six per cent. They are obviously lowering their retail investment deposit rate. So how have their costs of funds been in the last six months—have they gone up much or are they stable? What is the story?

**Mr Murphy**—We have some pricing information.

**Mr Lonsdale**—On page 14 of the submission we talk about—

**Senator WILLIAMS**—I am sorry that I have not read all of your book. I do apologise for that.

**Mr Murphy**—We can draw your attention to the issues.

**Mr Lonsdale**—So I think the cost of funds, as I think we have mentioned before, has increased since the global financial crisis and part of that reflects the securitisation market, part of that reflects a switch from short-term to longer term funding and part of it reflects a switch towards deposits—so all those things that would put upward pressure on funding costs. I guess what we would say more recently though is that the funding markets have settled down quite a bit. Certainly when you look at some of the offshore wholesale markets I think margins have come in a touch since then. We think that, although the securitisation market is still very fragile, there are some positive signs, and I point to Westpac's issuance of \$1 billion of RMBS last month. That is not assisted by AOFM. So, while it is still very fragile, there are very positive signs. Those positive signs would tend to put downward pressure on pricing the cost of funds.

**Senator WILLIAMS**—The problem I have is simple. The banks complain that their costs of funds are going up and they have to move their rates above the Reserve Bank margins and then they declare these record profits. As I said to Ms Kelly, they failed to sell their message that the cost their funds were going up so their profit was shrinking and their margins were tightening. Then they declared a \$6.3 billion profit, the highest ever. The equation to me does not add up.

**Mr Lonsdale**—The cost of funds is one element. At the end of the day, these are commercial decisions by banks. They bring into play other competitive pressures, such as those we have talked about a lot today, and what their market strategy is. There are a whole range of factors that would feed into rates.

**Senator WILLIAMS**—You will keep an eye on the cost of those overseas rates, especially the wholesale rate? I believe that last night Ms Kelly said that when those rates come down they will lower their rates.

**Mr Murphy**—That is very pleasing to hear, but I think there was a time period set there—the next few years.

**Senator WILLIAMS**—I think it was 12 or 18 months.

**Mr Murphy**—The cost of funds has gone up post the GFC. Funding is never going to be as cheap as it was pre the GFC. We know that. The constitution of the funding has changed, as Mr Lonsdale mentioned, from shorter term funding to longer term—to give some more stability in the system. They have been competing heavily to get more deposits into their banks. So it may be that, while cost pressures have gone up, they are profitable in other areas. That is why I think it is very hard to look at one indicator and determine whether the banks are making superprofits or not—and what is driving that. They are obviously well-run businesses and that is good.

**Mr Lonsdale**—Another thing I would mention—and it is something that we have not talked about much—is covered bonds. It is another part of the securitisation puzzle that will mean that banks cannot only diversify their funding sources but hopefully raise funds at cheaper rates.

**Senator WILLIAMS**—On exit fees, smaller companies have complained that they may be the ones hurt most of all. I support the abolition of exit fees because of my personal experience—I could not leave my bank and get a cheaper rate because of my exit fee. By the time I paid the exit fee, I was not in front, virtually. Because of their economies of scale compared with the big end of town, smaller companies would have an

argument that it costs them more to establish a loan and to close down a loan. That argument would be strong, would it not, for a small institution?

**Mr Murphy**—As we have said on the issue of exit fees, they can recover the costs they face in breaking a mortgage. There is going to a trade-off here between, on the one hand, empowering the consumers and getting more transparency into the system and, on the other hand, business. They may have to reposition their business model to account for this. I think it would be more an encumbrance and a burden than something that would prohibit these people from being in business.

**Senator WILLIAMS**—Would you have a problem if the exit fees on ADIs were removed but if that removal were not made compulsory for those ASIC companies, those non-ADIs, those smaller businesses? Would you have a problem if it were optional for the smaller businesses to keep those exit fees? Those smaller businesses have had a hard time. They did not get their deposits underwritten up to a million dollars and they had a lot of money withdrawn from their businesses as a direct result of the government underwriting the ADI companies. Would you have a problem if those smaller businesses had an option to leave their exit fees in place?

**Mr Murphy**—Even if you did that—and I do not think that is a good idea for a number of reasons—given the publicity and the issues about exit fees, people now, when they borrowed money, would be thinking that there would be no exit fees, I think. The government has given an indication that exit fees would be prohibited. If you tried to differentiate the market, I think you would find that consumers would discriminate against non-bank lenders if they had exit fees. So I think you have to have one rule for everyone.

**Senator WILLIAMS**—But we differentiated the market when it came to underwriting the deposits, did we not?

**Mr Murphy**—Yes, because the government looks at the financial system and says: ‘This is the core of the financial system. We want competition from non-bank lenders and we want competition from smaller players, but we must ensure the core is resilient and stable. We cannot cover everyone.’

**Senator HURLEY**—I have a question about covered bonds. Some of the smaller banks have said that having covered bonds in the securitisation market would not directly advantage them because they do not have the AAA rated assets and the strength to put such bonds out onto the market, although they did acknowledge that they would benefit from the general increase in the securitisation market. With the assets that back a covered bond, can a mix of different rated assets add up to a certain asset rating, or must they be uniform?

**Mr Murphy**—No, the assets underlying the bond could be deposits. We have been looking at ways that small institutions can benefit from covered bonds. I think that it is up to those institutions, especially the mutuals, to see the opportunity and put themselves in a position where they can benefit from it. The government is going to facilitate this. It is really up to the institutions to organise themselves to benefit from it.

**Mr Lonsdale**—In some overseas jurisdictions, they have aggregation models—Spain, France and other European countries for example. That is something that has been put to us during the consultation—whether we could have something that would allow smaller players, such as credit unions and building societies, to issue covered bonds in aggregate. That is something that we are looking at and putting a cost to the government on. We are also looking very closely at the issue of the actual securities that go into the cover pool—what sorts of mortgages—

**Senator HURLEY**—It was not that the securities were not AAA rated; it was that they, the smaller banks, were not AAA rated entities, so they could not enter the market.

**Mr Murphy**—They might get an upgrade in their rating through aggregation.

**Senator HURLEY**—It would be possible for them to get an upgrade through aggregation?

**Mr Murphy**—Yes, we are hopeful. That is what we are trying to see if we can do.

**Senator WILLIAMS**—That is clearly one of the problems—the cost to the second tier banks of borrowing money compared to the big end of town. Where is the level playing field? Of course there is no level playing field but, if the playing field were level, it would give fairer competition.

**Mr Lonsdale**—That is probably another example of where you have to look at the package as a whole. Yes, you have covered bonds sitting there, but you have the AOFM program sitting there as well—\$20 billion directed to smaller players, including regionals.



**ACTING CHAIR**—I have a follow-up question to Senator Williams' question about cost of funds. There have been reports in the media that the aggressive approach of the major banks in competing for retail deposits has been very successful, and that some of their forward projections of loan demand suggest that they have more funds than they need at this point. Is that the sort of thing that you have been following and seeing? If so, what impact is that likely to have on competition for deposits and is that likely to lead to greater competition for loan customers—which might then deliver better outcomes for consumers.

**Mr Murphy**—It could. The majors' share of mortgage business has dropped off a bit. That is, I think, others coming back in. If they find they do not need as large a deposit base as they have, that will obviously lead to lower rates for term deposits. It may be that competition is starting to emerge again. When we went into this, there was concern that two of the majors, especially, had taken the opportunity to move into the market in a more aggressive way. Maybe that will be a good thing, that there is a levelling out, a stabilisation.

**ACTING CHAIR**—It might make it easier for some of the second tier and mutuals who rely heavily on retail deposits to access more of that—

**Mr Murphy**—Yes, to move back in.

**ACTING CHAIR**—and then be able to get out there and compete a bit.

**Mr Murphy**—I hope so.

**Committee adjourned at 10.04 am**