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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Banking and financial services in rural, regional and remote areas of Australia

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Wednesday, 26 February 2003

Members: Senator Chapman *(Chair)*, Senator Wong *(Deputy Chair)*, Senators Brandis, Conroy and Murray and Mr Byrne, Mr Ciobo, Mr Griffin, Mr Hunt and Mr McArthur

Senators and members in attendance: Mr Ciobo and Mr Hunt and Senators Brandis, Chapman, Murray and Wong

Terms of reference for the inquiry:

To inquire into the level of banking and financial services available to Australians living in rural, regional and remote areas of Australia with particular focus on the following:

(a) options for making additional banking services available to rural and regional communities, including the potential for shared banking facilities;

(b) options for expansion of banking facilities through non-traditional channels including new technologies;

(c) the level of service currently available to rural and regional residents; and

(d) international experiences and policies designed to enhance and improve the quality of rural banking services.

WITNESSES

Committee met at 9.17 a.m.

JOHNSTON, Mr Ian, Executive Director, Financial Services Regulation, Australian Securities and Investments Commission

VAMOS, Ms Pauline, Director, Financial Services Regulation Licensing and Business Operations, Australian Securities and Investments Commission

CHAIRMAN—The committee will commence its inquiry into the level of banking and financial services available to Australians living in regional, rural and remote areas. To date, 131 submissions have been received. The committee expresses its gratitude to all of those who have assisted it so far in its inquiry and, although the date for the receipt of submissions is closed, the committee welcomes and is still accepting late submissions. Submissions are available from the Parliament House web site or, alternatively, the secretariat can send a hard copy of a submission to those who wish to obtain it.

Before we commence taking evidence, may I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to the evidence they give. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction and fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before parliament or any of its committees is treated as a breach of privilege. Unless the committee should decide otherwise, this is a public hearing and, as such, all members of the public are welcome to attend. We will be continuing with a public hearing in Melbourne tomorrow.

I now welcome the representatives from the Australian Securities and Investments Commission. As I have already indicated, this is a public hearing and, therefore, the committee prefers that all evidence be given in public, but if at any time you wish to give part of your evidence in private that can be a request to the committee and we will consider moving into camera. Having said that, I invite you to make an opening statement, following which we will proceed to questions.

Mr Johnston—Senator, on this occasion we are happy to proceed to questions.

CHAIRMAN—I note that you issued a new draft of PS146 on 22 January and, according to what you have said, the revision will provide greater flexibility to licensees in the development and assessment of training courses for basic deposit products and related non-cash payment products. It removes the need for basic deposit product training courses to be assessed by an authorised assessor and placed on the ASIC training register. You have also said that this change will relieve licensees of having to arrange a course assessment by a registered training organisation. How has that update been received by approved deposit taking institutions, especially the smaller ones such as credit unions, who are particularly concerned about this issue and about which this committee has been particularly concerned over an extended period of time?

Mr Johnston—We have presented these changes to the various parties that are affected. We meet with the industry bodies on regular occasions, as I think you are already aware. We presented them, for example, at their industry conference at the time that we first mooted these changes, and that was warmly received. In my interactions with industry bodies and the interaction of our staff with industry bodies, they have been well received. Having said that, I do not think there is any doubt that these changes affect a sector that seem to have the view that this whole provision of the law should not apply to them at all. There is always that gloss over their acceptance but the changes have been well received.

CHAIRMAN—I note from your published statement that the licensee will remain responsible for ensuring that the course meets the required standard. How will you monitor the effectiveness of training courses that are not assessed by an authorised assessor or placed in the ASIC training register?

Mr Johnston—I will go back a step to why we did this in the first place. I mentioned in the media release when we issued the revised policy that we were responding to concerns expressed by the industry. We then looked at our own observations of the industry, of course. We do not simply respond to their concerns without verifying them. We also responded to the comments made by this committee and the fact that the intent of the legislation is clearly that basic deposit products have some sort of different treatment, because the law provides different disclosure requirements.

When we reframed the policy to try to make this more flexible, particularly for smaller and more remote area deposit-taking institutions, we wanted to make sure that we were not actually lessening the standard, but simply facilitating and making it easier for them to comply with the standard that is required under the act and under our own policy. To ensure that there is no lessening of standard, we do need to verify that the standards are being maintained. We would anticipate that we would have what we call a surveillance program, but it is really a compliance program, verifying that the training is being properly provided. We might get a registered training organisation to review some of the material from time to time to make an assessment of it, but that is something that we would then be doing rather than requiring the licensee to undertake that activity. It would be a series of compliance visits, having a look at the material, perhaps bringing the material in-house and asking a registered training organisation to look at it.

CHAIRMAN—One of the issues that the committee is examining is the potential and prospect for shared physical banking facilities as a means of maintaining services in rural and remote areas. There are several impediments apparent with regard to that possibility, some of which are internal to the banks. One of the impediments that has been raised relates to the provisions within the Financial Services Reform Act. The Commonwealth Bank has suggested particularly that there could be confusion as to under which licence an employee who is a staff member at one of these shared facilities has responsibility. Under the existing legislation, they believe that each financial institution would be jointly and severally liable for the actions of a staff member and thus, if there were inadequate training or documentation, that could result in a liability for each of the financial institutions involved in that shared facility. Can you respond to that impediment and is there a way of overcoming it?

Mr Johnston—The principle is one that we face not just in shared banking, but also how conglomerates deal with the issue, where conglomerates may have one licensee or more than one licensee within a group and then share services across the group—across licensed entities or contracting in the services of a non-licensed entity, even, within the group. It is not a concept that is unfamiliar to us. It is one that we have had discussion about and expressed some views on at the conglomerate level. We have not considered it outside that. We have not considered it at the shared banking level. The secretary of the committee was kind enough to provide us a few moments ago with some legal advice that had been prepared for the ABA..

CHAIRMAN—I was going to ask you about that as well.

Mr Johnston—To the best of my knowledge, it is not something that we have seen before. We have not even had time to read it, Senator, never mind consider it. I will ask Ms Vamos to talk about the sort of concept that we look at when shared services are used within an organisation, and that might give an idea of where we might move when they are shared outside an organisation.

Ms Vamos—The act contemplates that a person can be an authorised representative for more than one licensee. That is something that has been contemplated in the legislation, as a result of a lot of the industry submissions early in the development, in the acknowledgment that people would be acting for more than one licensee. What we have been seeing in a lot of our discussions with the industry is that they are looking at the contracts that they are arranging with their authorised representatives and the other licensees in order to clearly define the limit of the liability.

The act does contemplate that where a person does have a different authorisation for a different type of financial service, the licensee’s liability would be limited to the provision of that financial service. Where that person is providing the same service for two different licensees, there is cross-liability. This type of liability is not unheard of in the financial services industry and it has been part of the industry for quite some time. We have been giving some guidance to certain individual conglomerates on their positions in relation to employees who do act for more than one licensee within the group. Our key message there is that somewhere somebody in the group has to take responsibility for monitoring and supervision and there must be close liaison between the licensees. It is not an insurmountable hurdle.

CHAIRMAN—When you say that the situation is not unknown within the financial services industry—it is not directly relevant to this inquiry but I suppose, given the situation of the banks, it is somewhat analogous—the issue of the multiagents comes into that category.

Ms Vamos—That is right.

CHAIRMAN—My understanding from our inquiries into those issues earlier is that they are experiencing considerable problems in getting the licence provider to accept the cross-endorsement because of the liability issue. Is that being resolved? I ask it not so much in the context of that, although it is relevant, but how would that impact on this situation?

Mr Johnston—At this stage, Senator, we have not licensed more than certainly a handful—and perhaps even more than one—multiagent at this stage. We are not sure how it is going to play out. We are certainly aware of the discussion that is surrounding the industry that says that cross-endorsement is proving difficult to get. It is hard for us to gauge that when so few people have come through the door. As you are aware from evidence that we have given at other committees, we are up to about 700 or so applications under FSRA. That is not a huge number, but at this stage we have not seen the insurance distribution sector coming through the door, so we do not know how it is playing out. Someone does have to be liable for the conduct of the representative, and if they are representing more than one, there does need to be a cross-endorsement by each licensee to allow that representative to act in more than one capacity.

CHAIRMAN—Going down that path, given the recent conclusions from the survey with regard to the financial planning industry, I would have thought it would be beneficial and advantageous to try and get people endorsed as multiagents because that would increase their independence in terms of the advice they can give.

Mr Johnston—Yes, we certainly support the fact that the multiagent model can continue. We have nothing to say against that. The law requires that they be cross-endorsed. We have not yet seen evidence of whether that will work because it is just too early at this stage.

CHAIRMAN—But what plays out in that would be relevant to the bank situation?

Mr Johnston—I suppose inasmuch as there still needs to be an ability to sheet home the liability to someone, whichever model is used. I do not know if it would be the same factors, though. When I think about the banks using shared services, the issues might well be different from two advisers giving advice in respect of a series of products. It would give rise to different issues, although the same principle.

Senator MURRAY—The evidence we had yesterday contained themes of much that is at the core of the problem. The core of the problem is that rural, remote and regional Australia and, indeed, urban Australia believe that financial services are an essential service like water, energy or communications and should be provided to them at an affordable cost. From the perspective of a commercial return the hard-headed attitude is ‘if it doesn’t pay, I don’t want to do it’.

The banks are no longer in that mind-set, if ever they were, because, for instance from the evidence of Westpac, they are making real efforts to try and provide a service in as many circumstances as they can. Nevertheless, we had reflected to us the sense that if they will not do it, make them do it. There are a number of propositions before us, over and above the existing legislation. They include a legislated or mandated social charter, they include applying CSOs and they include more specific determinations such as ‘you must have a facility for so many people’ and that sort of thing.

One of the views, though, is that existing laws just are not being used enough by the regulators to actually put pressure on the financial institutions. When we discussed matters with APRA yesterday they made it painfully clear that they want to steer away from anything to do with customer needs and concentrate on prudential regulation.

Senator BRANDIS—In fairness, Senator Murray, I think the evidence was that they did not think they had either the statutory charter or the statutory obligation to do so.

Senator MURRAY—I have said nothing different from that. I will continue. They made it painfully clear that they did not want to go in that direction because of the way in which they were structured and the way in which their legislation determines them. If I recall their remarks correctly, they did not say that they were disinterested; it was just not their prime function. Then the question was whether the ACCC would have much input in that area—and they have some—or whether you had the prime responsibility in that consumer service area. By and large I accept their proposition. I do not think there is much more they can do in that direction. I am not certain about the ACCC, but with you here we can now hear from you whether you think it is a question you are able to tackle without additional regulation and without additional legislative or ministerial support. It may be a question of resources and focus; I do not know. With that long introduction perhaps you would give us some views on the matter.

Mr Johnston—I think the answer, Senator, is that we could not do it without legislative change and being given the jurisdiction. I would argue, as has APRA, that it is beyond our jurisdiction to tackle that issue. I do not think it is a case of resources. I do not think it is a case of ministerial support. It is simply not our charter either. If it sits anywhere, I would have thought it sits with the ACCC. For example, the ACCC was looking at the social obligations charter for banks, and I imagine it would sit in that remit.

We have, in the banking sector, the things that we do under FSRA, and I think the committee is familiar with those. Those things go to conduct and disclosure and to licensing. They do not go to prescribing standards as to how people interact with their customers, other than in a sense that is not false and misleading, other than they are making disclosure that is other than clear, concise and effective, and the other things that are contained within the act. But our power would not go beyond that. We can take action if we believe that—in this example—banks are engaging in unconscionable conduct or are acting in a misleading or deceptive sense, but trying to impose some social obligations or customer service level type of obligations is not something we can do.

Senator BRANDIS—It is an important point, Mr Johnston. It is not as with you, so also with APRA. It is not a case of a disinclination to act, with the implication that there might be neglectfulness; it is simply the absence of a legal power to act. It is just not something that you are empowered, by your act of parliament—nor they by theirs—to do.

Mr Johnston—That is correct, Senator.

Senator MURRAY—I will continue my line of questioning. This committee has not yet even discussed whether it would consider additional regulatory or legislative matters of the kind outlined: social charter, CSO or something of that sort. If it were to go in that direction, would it still be your contention that the emphasis should be directed towards more of the ACCC implementing that? I suppose an example is communications with Telstra. Specifically the CSO is under the ACCC’s act and there is a separate body set up to measure it. Against that measurement the ACCC oblige it to be implemented. If we were to consider matters in that direction—and I stress again we have not discussed it—would you still think you are not the proper body?

Mr Johnston—Firstly, I would like to make it clear that I do not pretend to be an authority on what the ACCC’s jurisdiction is either, as to how their legislation works and where the boundaries of their legislation fall. If we are talking about logically where that type of legislation would sit, I think it would sit more comfortably with the ACCC than with us. ASIC is a conduct and disclosure regulator that is not about engineering how services are provided or how adequately they are provided but how fairly and how properly they are provided. Our law always goes to conduct and disclosure issues, with the gloss over the top of that being misleading, deceptive or unconscionable conduct. I do not think it would sit with us as comfortably as it might with other agencies.

Senator MURRAY—On that basis, therefore, the chair’s questions really come down to whether regulatory requirements add such an additional compliance cost that, in fact, it is even more difficult or more costly for people in rural and remote areas to provide these services, because of the difficulties of training and getting people to be properly accredited and that sort of thing.

Mr Johnston—Senator, I might have missed the question that was in there.

Senator MURRAY—The question would be—and it was where the chair was going—whether you would be required to be cognisant of any areas of regulation which so added compliance costs to providers of rural and remote services that it made it even more difficult for them to provide those services. The follow-on would be whether there should be some kind of exemption, leniency or lesser standard, simply because getting the service there is more important than other aspects.

Mr Johnston—We certainly would not want there to be any lessening of the standard of conduct that applies to consumers. We do not think that is appropriate, regardless of where the service is provided, because we think that the consumer is still entitled to the same protection under the law regardless of with whom they are dealing. I can see the more difficult question being that, if the service is not provided in the first place, they are probably worse off. That is not something that ASIC can really address, other than providing the sort of flexibility that we have tried to provide with policy statement 146, to try to make it easier for people in those regions to comply with their obligations. My starting point is that we must not lower the standard, and that is why the same training standards apply to them, regardless of where they are. We recognise that perhaps the way they get to that standard could be more flexibly dealt with.

Senator MURRAY—There is a dispute over the necessity for all the training standards. For instance, this committee does not believe that basic deposits should be subject to the regime that they are subject to. The government has disagreed with the committee, but we have made that point three or four times. That is an example of an area where a specialist, relatively expert committee—I would not regard us as excessively expert—has consistently taken a view. That might be an area, for instance, where the government might be persuaded to be less rigorous if that were an additional serious impediment to the provision of service, because it is just the basic services that are being provided, and that is obviously a problem in rural and remote Australia. I understand that you cannot avoid your act; you must do what you are told by the legislation.

Mr Johnston—Yes. If I were to go further, I think I would be straying into areas that are more appropriately the responsibility of Treasury and government. We apply the act that we are given. The debate has raged long and hard and, as you say, the government has decided to apply the act across the board. It is our job then to implement it.

Senator BRANDIS—Following on from that, Mr Johnston, I appreciate fully that the provision of services by banks in remote Australia is not directly within the purview of ASIC. As Senator Murray was saying, some of the evidence that we have already received, and we received this in particular yesterday, does tend towards the conclusion that smaller financial institutions, in particular credit unions, are probably better placed to provide services to regional customers, and if they are in operation in a region they are probably more likely to stay there than the big banks. We heard evidence from the spokespeople from a credit union industry body who brought to our attention the burden of regulation on the smaller credit unions.

Having made that observation, I wonder whether, from ASIC's point of view, you would like to comment on that and in particular whether you can see any areas of the legislation administered by ASIC that might be susceptible to reforms so as to relieve the regulatory burden on the smaller financial institutions.

Mr Johnston—One of the things that we have emphasised through all of our policy development is that the concept of getting from ASIC a licence to operate, which deposit taking institutions need to do under FSRA, is a scaleable concept. Therefore, while the legal requirements are the same—and we set out in our policy statements the things that you need to demonstrate to us to prove that you are fit to be a licensee in terms of systems, compliance arrangements, the competency of your people and the number of people you have—it is scaleable to the service that you provide.

For example, when the legislation was being debated, we heard that the requirements for ASIC in terms of compliance plans are going to be too difficult for small operators. Our policy statement on that makes it clear that it is scaleable, depending on the complexity of the service that you provide and the type of service that you provide. We do not expect to see a Westpac style compliance plan coming out of, if it exists, the Burnie credit union. We do not expect to see the same level of system support in a small operation that we see in a large operation, and we fully accept that the human resources that are available to them will be different, not only in number but perhaps in type. Our policy allows for that. We have tried to make it appropriate to the circumstances of each individual licensee, while protecting the integrity of the system—that is, that people do need to be competent and that there need to be enough arrangements in place to be able to provide the service.

Senator BRANDIS—Do you think that has been sufficiently communicated to the credit union industry?

Mr Johnston—I met recently with the head of CUSCAL and with the head of the National Credit Union Association. We do discuss these matters and I meet with them on a regular basis. Ms Vamos meets more frequently with each of the industry bodies specifically on licensing matters. Pauline, could you advise the committee how we have explained this?

Senator BRANDIS—I will not delay you, unless you particularly want to speak to this. I completely accept your reassurance, Mr Johnston.

Ms Vamos—We have done a number of things, not least of which was to produce compliance guides for small business, and they were produced in direct consultation with small business. We hold workshops for credit unions and building societies to make sure that they understand the scaleable concept. We also have promoted online learning, which is cheaper and easier to deliver to regional areas. In particular we are reviewing a lot of the compliance documentation that they are producing for their members. The licensing analysts are looking at this documentation.

CHAIRMAN—As you are aware, Mr Johnston, through an earlier inquiry and report, this committee has taken some interest in up-front real-time disclosure of fees and charges for electronic banking. That is a matter of some concern to people in isolated areas, because quite their only regular access to banking service is through an ATM or EFTPOS transaction. In your *Guide to good transaction fee disclosure,* published in June 2002, you assert that in the longer term it would be desirable to have on-screen disclosure of the actual amount of a foreign ATM fee. How far have approved deposit institutions moved towards that goal?

Mr Johnston—I would have to take that on notice, I am afraid. That is not something that is directly within my area. It falls within our consumer protection area. In general, I have a view as to how the thing is going, but I must admit that I would not know specifically how they have progressed on that issue, but I can take that on notice and we will come back to the committee.

CHAIRMAN—And, if they are dragging the chain a bit, what we might be able to do to hasten that process. Also, in relation to overdraw fees, you say that, where a consumer undertakes an electronic transaction that will result in them being charged an overdraw fee, they should be notified of this fact and the amount of the fee in sufficient time to allow them to cancel the transaction. You say that for technical reasons it might not be possible for this principle to apply to EFTPOS or foreign ATM transactions, at least for the time being. Again, you might be able to advise us what progress is being made in that direction with their own ATMs, and also whether there is some interim measure that could be put in place there to assist consumers.

Mr Johnston—We can give you a view on that. We will be in a much better position to assess how the industry is actually meeting what we believe are its obligations 12 months or so from now. I think the committee is aware that we are implementing a review of compliance with the guidelines that we have published, and that is due to finish in about 12 months from now.

CHAIRMAN—The ACCC commissioned the Centre for Aboriginal Economic Policy Research to undertake research on the implications of the Trade Practices Act for Indigenous communities. It looked at seven investigations—Norwich, Colonial, Mercantile Mutual Insurance and Associates Pty Ltd, Collier Encyclopaedias, Saunders Sons and Associates, Baldwin’s Tractor and Truck Wreckers and IBIS—and concluded that they indicate that Indigenous people in remote communities may be particularly vulnerable to misleading practices, and that people or corporations operating in these areas should be particularly aware of their obligations under the Trade Practices Act. Do you have any examples or any views with regard to the vulnerability of Indigenous people to misleading practices in the delivery of financial services?

Mr Johnston—Yes, Chairman. It is a view that we would share, that there is a vulnerability there. We have certainly been active in looking at the practices of a number of financial services providers in their sales of products, particularly insurance products, into Aboriginal communities, and we have taken action against a number of providers. We have obtained at least one, and I think there are more, enforceable undertaking in respect of preventing conduct from being continued. There are other investigations under way right now, because of what we have seen as poor selling practices and, frankly, exploitative selling practices into some of those communities. We have also worked with communities to help them to understand the obligations that people have who come into the communities to sell product. We would share the ACCC’s view.

CHAIRMAN—There being no further questions, I thank both of you for your appearances before the committee and for answering our questions.

[9.53 p.m.]

GUERIN, Mr Michael Shane, Head of Rural Banking, ANZ

NASH, Ms Jane, Head of Government and Regulatory Affairs, ANZ

CHAIRMAN—This is a public hearing and, therefore, the committee prefers that all evidence be given in public, but if at any time you wish to give part of your evidence in private, you may request that of the committee and we will consider a request to move in camera. We have before us your written submission which we have numbered 121. Are there any alterations or additions you wish to make to the submission at this stage?

Ms Nash—No.

CHAIRMAN—I invite you to make a brief opening statement, following which we will proceed to questions.

Ms Nash—Mr Chairman, we do not wish to make an opening statement.

CHAIRMAN—Are there any questions?

Senator MURRAY—You have gone to the nub of one of the big issues facing us and that is in your introduction at page 3 where you say:

> The issue is how to reconcile the economic imperative of making an adequate return on capital in the current context with the obligations ANZ believes it has to the community broadly and the community in which it operates in particular.

In other words, social responsibility versus economic return. The urgings we are getting from some witnesses are that the committee, and therefore the government, should look at greater regulatory and legislative determination in these areas through mandating the social charter, as described, or through legislating CSOs, community service obligations, as some kind of imperative.

Plainly the banks would prefer that not to happen—at least I judge that on the evidence I have seen to date. Do you think the ANZ—and perhaps you are able to comment on the other banks—is working in such a way as to make that drive unnecessary? In other words, you are contributing to meeting financial services needs in rural and remote areas sufficiently?

Mr Guerin—I cannot comment on behalf of the other banks, but since the ANZ have put in place a moratorium on removing ourselves from rural communities, we have been working very hard on the sustainability aspect of what we have and in fact growing our representation across rural Australia. Examples I can give are the couple of branches we have opened and are opening in rural Australia and the moratorium we have had on closures since 1998. On other aspects of work—and I can use Wycheproof as an example—we have worked with the rural transaction centre program to provide a full banking service to a community but within the framework of the rural transaction centre which makes our business both sustainable and much more integrated within the community in which we work which, in this case, is Wycheproof.

The specifics on that one were that we had a branch in Wycheproof and were committed to staying there. The community were opening a rural transaction centre and we were able to move the branch within the rural transaction centre. That enabled us to remove some of the fixed costs and provide a sustainable business, not only by the economics of the business but by being much more integrated with the community because of the fact that the rural transaction centre was a community initiative and we were welcomed in. That is one example.

With openings in places like Koroit, and with other examples, the community has provided strong support to us going into communities we have not been in before. Another example would be that we are reopening in Merimbula in April, which is a place we left. The whole issue of sustainability and commitment to the social obligations to us comes together very neatly with a bunch of those things. We are planning to open more branches in rural Australia—going forward based on those premises.

Senator MURRAY—One of the areas the committee has been asked to consider is trying to reduce economic cost which includes compliance costs with regulation, so that meeting social responsibility needs is made more affordable. For instance, one of the views taken was in advice given to the ABA which said that the Trade Practices Act provisions at the moment prevent a grouping of financial institutions in one building, with a common bank manager and common staff allowing for bank sharing because of the provisions of the Trade Practices Act. That letter is available to you if you have not had it. Do you think that would assist the banks in those terms, if the committee could find as many ways as possible to lower costs and regulatory impediments that might exist there?

Ms Nash—Branch sharing is one aspect of the issue you are talking about. Regulatory type issues are just one issue. Obviously there would be trade practice type issues raised should banks want to share the same premises within a country town. It is fair to say that on these sorts of issues in the past the ACCC has demonstrated a willingness to work through these sorts of issues where it is shown that the public benefit outweighs any competition detriment.

Senator BRANDIS—Would there need to be an authorisation application for that to happen?

Ms Nash—Not to my knowledge, no. But the issue is not simply around the Trade Practices Act. As I say, it is one aspect. We know that those communities have issues around branch sharing to do with things like their own privacy—often we are talking about small places where one person knows everybody else—or to do with a concern that perhaps this is the thin edge of the wedge and there will be reduced employment, for example, as a result of banks being able to share premises because there would be efficiencies to be gained from doing it. There are those sorts of issues to be addressed as well, before we went down the sharing path.

Senator MURRAY—There was another practical example given to us yesterday of the ability of one bank in particular to lower its cost of service and that was by the Commonwealth Bank being able to piggyback on the back of the Australia Post facilities and use their physical network to deliver services because the infrastructure has already been invested in and is available. Is that an issue that concerns you? Have you, as a bank, approached organisations like Australia Post—perhaps there are other examples but that is the most obvious one—to try and get onto that network so that you can more cheaply provide your financial services?

Mr Guerin—We have approached various people, but we have some concerns from our own proposition to the rural community through things such as giroPost. To give an example: when you offer your service and product through a giroPost outlet, generally speaking the community will be dealing with someone who does not understand banking. So on some of the important aspects around a proposition from a trading bank—such as advice and budget settings; those sorts of issues—we cannot provide that sort of level of advice through a giroPost outlet. It is essentially a collection receptacle for transactions, as we see it. There are other alliances. The one that is public is the work we are doing with the Rural Transaction Centre Program. There are others we are looking at, but we do have some concerns around the proposition when you go that way.

We have 78 local link agencies at the moment around Australia which are typically non-bank businesses, like petrol stations, which will accept transactions on our behalf, but they run the same constraints as running through giroPost would, which is that we cannot provide advice and we cannot do anything outside accepting transactions and referring product sales and advice inquiries to the parent branch. We would have a preference to provide a full banking service in the communities we operate in and, as we expand, to provide that proposition as we expanded. They are some of the limitations we see with giroPost as it presently stands.

CHAIRMAN—Two of the major issues that we are interested in, as you would be aware from our terms of reference, are the capacity of new technologies to deliver banking services to rural and remote areas, and also the issue of shared facilities. I notice you addressed both of those in your submission. To what extent are the telecommunications facilities provisions adequate for people to be able to effectively use Internet banking, for example, as an alternative to a physical bank presence, particularly in rural and remote areas? Perhaps I can preface that by saying that I have had comments from people at Naracoorte centre in South Australia, which is a reasonably large centre. They have said that they have problems with their Internet connection to do their banking, with the line dropping out occasionally, and particularly with the speed and that sort of thing.

Mr Guerin—There are two ways I would approach that answer. The first is to say that a relationship with a person is important in banking, particularly in rural and remote areas, where there are some issues around, for example, being able to trust advice and things you cannot provide through technological means. We would not see the electronic delivery replacing the proposition we provide through the branches at the present.

Secondly, I do not have a technological background, so the only real comment I could make would be that we provide our full electronic services to rural and remote Australia as we do to the metropolitan sites. As I said, on farms it takes a little longer for the screen to arrive; nonetheless, it arrives. That is about as far as I could comment on the technology side. For a user, the screen arrives but it is sometimes a bit slow and that is due to either the modem or the computer that the farmer is using, or something else. I could not answer.

CHAIRMAN—Has the bank entered into any discussions with Telstra regarding difficulties that rural and remote people might have in accessing bank services online?

Mr Guerin—Not as far as I am aware, no.

Ms Nash—No.

CHAIRMAN—You mentioned the financial advice aspect of your service. Obviously if a physical branch disappears that is lost in that local community. What measures have you put in place to substitute for that where branches have been closed—in terms of a farmer, for instance, or a small businessman in a rural area being able to get access to the equivalent of their bank manager to give them financial advice?

Mr Guerin—There are a number of aspects, I suppose. The moratorium on closures since 1998 has us saying that we do not believe you can provide a full substitution and, as an organisation, we should be providing that full branch service. Like the other banks, in some areas we have mobile relationship managers, for want of a better word, that will go out onto the farms and to the rural communities and talk to the people face to face. We have 78 local link agencies, which I talked of earlier, which, while they are not able to provide advice, can make appointments for people and we can go out to those places and talk to those customers at a predetermined time.

We are expanding our work with the rural transaction centre program, where we believe—and we used the Wycheproof example earlier—we can provide better economics and a better reach in our physical network. They would be the main aspects of it. But the personal relationship and doing business with a human being we think is an important part of the proposition. The branch network that sits around that is also important.

CHAIRMAN—How is the moratorium working out?

Mr Guerin—Very well, as far as we are concerned. We seek to be a stronger part of the rural communities across rural Australia. There are a number of elements we are working on towards that. The moratorium provided us with a very good platform to start that work from.

CHAIRMAN—Accepting the fact that, from the bank’s point of view, the branch closures that occurred were obviously initiated because of a perceived lack of financial and economic viability of those branches, those remaining obviously now are fixed in cement, as it were, by the moratorium. How are you finding those in terms of viability?

Mr Guerin—There was a perception a few years ago that the branch was a part of banking in the past and not a part of banking going forward, but certainly in the ANZ’s case that view has changed radically, partly by the way the customers want to deal with us. Also, most of our branches in rural Australia are now profitable in terms of being able to self-fund the direct costs and contribute to the shared costs around things like technology. Economics say to us that if you close a branch you may have a short-term windfall, but customers in rural communities will vote with their feet on convenience and, if there is a more convenient solution locally, then those economics soon disappear. We believe the economics of the branch network are fairly strong and, as I said, most of our branches, as measured by carrying direct costs, in rural Australia are profitable.

CHAIRMAN—For those services that can be delivered online and that customers can gain access to quite adequately online, how much effort do you put into encouraging customers to do that—and I say this as an ANZ customer. Certainly from time to time we receive brochures and so on, saying, ‘Do online banking,’ but is any effort made to encourage them? I guess I am a prime example. I could probably do it, but I think that I will need time to learn all that. Is there an effort made to encourage customers into that by saying, ‘If you come into the branch, we’ll sit down with a computer and show you exactly how to do it, take you through it,' rather than just leaving them to make a phone call and try and do it all by telephone?

Mr Guerin—Yes, there is. We are enabled in the branches to sit you down and walk it through. That is an active part of selling Internet banking—'Let's sit down and run through it while you're here.' Also, with a lot of visits to farmers in rural Australia—and I talked earlier about the screens popping up more slowly—we will spend time when they have that interest, running it on their home computer and running them through once we have them set up with passwords, et cetera. Again, we do not think you can substitute the human interaction in doing that training.

CHAIRMAN—I note in your submission you refer to the opening of a new branch in Koroit in Victoria?

Mr Guerin—Yes.

CHAIRMAN—Can you just take me through the process that you followed in reaching the decision to open a new branch. Was it as a result of the community approaching you or did you approach the community?

Mr Guerin—A bit of both, really. We had been focusing our minds on how we could provide a better proposition and become close to the rural community since the moratorium was put in place, and part of that is an increasing physical distribution network. That thinking and that development was going on at the same time that the Koroit community approached us. Part of the success in opening new branches in rural Australia, in our view, is in identifying a good demand for that branch, and a community who want the business to come to town and want to support it when it gets there so that it is sustainable.

The two came together neatly in the case of Koroit and in a reasonably similar fashion and quite neatly in the opening of Merimbula in a couple of months time. In the Koroit case, they approached us when their present bank announced that it was closing, and that just added to the emphasis of an opportunity and a sense by us that the economics were right. Again, most of our branches in rural Australia are economic as they stand. When the community asks for that facility, it is an easy process to go through if you have support from the community. The same goes for places like Wycheproof. Wycheproof obviously wanted continuing banking services and were putting their own money into a rural transaction centre. So, while it made sense for us to move in, it was also a community driven initiative.

CHAIRMAN—In section 3.1 of your submission, 'Points of representation', you say:

> There are nevertheless a number of ANZ branches which do not have an ANZ-branded ATM on site or located nearby. To accommodate this, ANZ provides a concession to customers transacting at these branches so that they are not paying more for their banking.

Do you maintain any ATMs in any location on a stand-alone basis where there is no branch?

Mr Guerin—We do. We have the view that a full proposition includes a branch and an ATM. Over the last year, we have been putting ATMs into branches where we do not have them, including in rural Australia, and that program will continue, but we also have some remote ATMs in places that we may have closed in the past.

CHAIRMAN—How do they operate, in terms of security, maintenance and those sorts of issues? Do you have problems with that?

Mr Guerin—Where we do not have branches, that is outsourced. All of the issues in relation to security and cash are taken care of on our behalf. There is a reasonable cost to running a remote ATM in isolation of anything else, and some of those situations are a leave-behind strategy, when we had a different view to branch banking in rural Australia.

CHAIRMAN—In relation to these examples where customers have to use a non-ANZ ATM because you do not have a branch or an ATM nearby, how does the concession rate work out and what are the criteria for people to be able to use that non-ANZ ATM? For example, do they have to establish somehow that they are local residents or can travellers passing through that area withdraw money from that non-ANZ ATM on the same basis? How does that all work?

Mr Guerin—Unless Jane can help me, I will take that question on notice. I do not have the detail with me. In general terms, if you bank in that town with the ANZ Bank, we provide a neutral fee structure, but I will take the question on notice about travellers coming through.

Ms Nash—I think the concession you are referring to enables a person to use an ANZ branch and do an over-the-counter transaction for the same price as an ATM transaction, rather than using another institution’s ATM.

CHAIRMAN—It is an ANZ over-the-counter transaction they use, is it?

Ms Nash—That is right, yes.

CHAIRMAN—What if there is no ANZ institution there?

Ms Nash—Then the customer would probably want to use a foreign ATM, and we do not have a concession to cover that.

Senator WONG—In relation to agencies, I think you said in your submission that you have about 70-odd third party agencies. Can you give me some sort of longitudinal sense on that? Are they recently in place or are they agencies which have been in place for some time?

Mr Guerin—I can give you a general answer or take it on notice for the specifics, but it has been a program which has gained momentum in the recent past.

Senator WONG—Recent past? Is that the last 12, 24 or 36 months, or are we talking five years?

Mr Guerin—Since the moratorium, so four to five years. They continue to open as we speak, but zero to 78 has essentially been since 1998.

Senator WONG—One of the attachments that the secretariat has provided us with is in front of you. If you could go to attachment 4, which is a table that does a bit of a longitudinal study of various points of access, I was interested to note—because obviously one of the things that is said is that the agencies are a way of replacing face-to-face banking—that there is a significant decline, on those figures, in bank agencies over that period. Firstly, in relation to ANZ, is that a trend that is replicated in terms of your agencies?

Mr Guerin—No, not in terms of numbers across rural Australia.

Senator WONG—Are you able to offer any analysis of this particular phenomenon?

Mr Guerin—No. I can offer some views about how we see agencies, to come back to our earlier proposition, which is that we prefer to have a full service proposition where we operate. In some towns where we are unable to do that at the moment, where we have customers—for example, business customers with cash requirements—we can provide a transactional facility through the local link agencies, but what we cannot do is provide the broader financial services proposition. It is an enabling device for existing customers in places where we do not have physical representation.

Senator WONG—Given your moratorium on further closures, what is your policy in relation to agencies? Is there a strategy by the bank to maintain your existing agencies or to increase them?

Mr Guerin—Broadly speaking, to maintain them. Where we increase our representation, we would rather do it in the style of the Wycheproof example. The local link agencies are simply an endeavour to look after our existing clients, where we are not doing anything else in the short term.

Senator BRANDIS—We heard some evidence from the New South Wales Country Women’s Association in Sydney yesterday about the operation of the shared facilities, and the lady who gave the evidence expressed concerns about privacy issues. Her point was that the shared facilities are better than nothing. However, people in rural communities, particularly, felt that having to transact their business at a shared facility was an invasion of their banking privacy. Does the ANZ Bank, in entering into agency relationships and shared facilities, take care in the physical layout and design of those facilities to ensure that that part of the facility that is devoted to banking sufficiently protects the privacy of customers? Is there, for example, typically an area set aside for people to fill out their deposit forms away from the rest of the business conducted at that agency? Is that one of your standards?

Mr Guerin—Yes, it is. It is also a primary concern of ours and, to use the Wycheproof example again, we have had one office in the rural transaction centre put aside for privacy in relation to selling product or discussing financial affairs. Also, in the design, we are very conscious of and working on privacy in the transactional area. Wycheproof is a pilot and one of the issues we are still working on with the local community is the exact issue of privacy for those that come in to use the rural transaction centre or Centrelink, or some of the other facilities in there, versus those that come in to do their banking business.

Senator BRANDIS—Mr Guerin, one other issue that we have heard some evidence about—and now I am talking about traditional branches in rural areas—is the role of the bank manager and the bank staff. The evidence we have heard from more than one witness is that the role of the bank manager in a rural town is a very important role in the social structure of that town as a community leader. Does the ANZ Bank have a policy of enabling the staff at rural banks to remain there for a good period of time or do the same practices of transferring staff as would be seen in cities and larger regional centres apply uniformly across the board in country areas too?

Mr Guerin—There are a couple of ways I would answer that question. Firstly, we have an active program in respect of succession planning, which looks at things like the ability to promote local people to run our businesses in local areas—for example, the work we are doing with employing Aboriginals in Aboriginal communities in the Northern Territory and providing much more discretion for the managers to run and own their own businesses locally. I mean 'own' not in a physical sense but in making the decisions. For example, I was in Tennant Creek last week, where we have a young branch manager aged 26 who would like to spend a large number of years building the Tennant Creek community as well as building ANZ. He is very aligned to the Indigenous communities and the things that are important around Tennant Creek, and that is a program we hope to expand because it makes good sense for us.

To put it another way, if you send someone out from Sydney to do their two years in the bush to prove themselves, then the local community are very polite and welcome them in, but they know that in two years time they will be going again. So the ability for us to work with the community is constrained by the fact that we bring them in and send them out. Our succession planning work is all around identifying talent in rural Australia who want a career in rural Australia and bring them through ultimately with the idea that they run our businesses in rural Australia. Tennant Creek is a successful example to date, although I would say we have some way to go.

Senator BRANDIS—But obviously it is an issue of which you are conscious and you are factoring into your planning. Thank you, Mr Guerin.

Mr CIOBO—You submit it is your view that ANZ has a social responsibility and has certain obligations. Can you outline what you perceive those obligations to be?

Mr Guerin—Some of the idiosyncrasies in rural communities are around a sense of community which is perhaps a little stronger than in the cities, around things like contribution to the wider good of the community. I can use Tennant Creek as an example again. In our view Tennant Creek has some issues around sustainability with the population and growth, with opportunities around things like tourism. If they can get the road from Queensland to Darwin, which goes 29 kilometres north of Tennant Creek, through Tennant Creek and provide the tourism infrastructure it would make a big difference. Our obligations are to be an integral part of that development and that community work, not only because the survival of Tennant Creek is important to us as a business in town, but because as we employ local people to operate our Tennant Creek business, they have an interest in that community as well as an interest in working for us. In our view, if the two are not connected properly then the system will not work very well. Our obligations, we believe, are very strong.

To take the other example we were talking about earlier, around succession planning, if you are looking, as we are, to take local people who have an interest in the communities and bring them through our organisation, then you must have that connection and that wider involvement in the community if you expect to be accepted by them. It is a big part of the commercial side of being involved in that community. That all sits together very nicely for us and that is why we are so serious about our views of the social obligations.

Mr CIOBO—It sounds as if that pertains to where you have an existing branch, for example. To what extent does this community obligation factor into your decision making about whether to close a branch or to open a branch in a community? Does it actually factor, or is it based on economic considerations?

Mr Guerin—No, it is an actual factor. I can use Koroit as the example for that. Another organisation chose to close and we chose to open. I would imagine that the pure numbers in those calculations would have been similar on both sides of the table, but the desire by the community to have us there, our social obligations, their intent to help et cetera all formed a part of the opening in Koroit. On the pure economics it may have been a different decision.

Mr CIOBO—That is encouraging to hear. You said earlier that most of your branches are profitable and you prefer a full service proposition, but I take it from that there are obviously, in a strictly financial sense, some low yielding or, indeed, uneconomic branches you maintain and cross-subsidise. Is that right?

Mr Guerin—The last time we calculated it there were very few, even in places like Norseman, where we are the last bank in town and it is a very small community. That operation covers the direct costs there, so very few. Again, coming back to Wycheproof, we are able to replicate a full branch and actually have a full branch within a rural transaction centre and defray substantially fixed costs. So there are innovative solutions like that.

Mr CIOBO—So you have models where you change the standard branch structure in order to maximise your opportunity to get a commercial operation going and maintained.

Mr Guerin—Yes.

Mr CIOBO—That is good. One of the questions I asked witnesses yesterday was: ‘What is your perception of what it is that customers in rural and regional areas want?’ There has been a broad recognition across the board from all the financial institutions that there is a strong antibank sentiment. I have also asked in what way have they contributed to that antibank sentiment. I asked that question because I was interested to know the message you are getting and the way in which you are responding to that message. It is well and good to talk about points of representation but fundamentally it is my view that most people are broadly happy with access to basic transactions, but what they have a problem with are more complex transactions or the need to lodge documents and those types of things. In what way do you take that into account?

Mr Guerin—ANZ has been part of an industry which has a reputation that has been talked about and we have been part of that, along with the others. A lot of the work we have been doing recently is trying to recognise what is behind that and address those issues so that we become sustainable and integral with all of the communities in rural Australia where we operate. To answer your question, we are very well aware of that. We think that things like personal relationships are important; things like providing the ability for people to talk about more complex transactions, to lodge documents and to seek advice around budgeting are very important. We are driving to be able to build the infrastructure to support that in a wider sense.

We have given some examples of it this morning. We are trying to address those issues from the past. The moratorium on closures in 1998 was the start of that program.

Mr CIOBO—Regarding things like the mobile relationship managers, obviously you do not have those everywhere in terms of rural and regional centres. How do you make a determination about where you will put a mobile relationship manager and where you will not?

Mr Guerin—We have all of Australia covered, inasmuch as people are responsible for a geographic area, albeit they might not live in that geographic area. It is driven by demand from the community, demand from the customers and business opportunity. A lot of them, for example, service agribusiness clients on the big beef stations in the Northern Territory. Those folk would come to town irregularly and they may need someone on their property for a day or two to talk through the complex transactions. All of those aspects are considerations for us. Again, a remote field force, in our view, without some form of physical representation or ability to transact and lodge cash does not add a full proposition, so it is a part of the pie, if you like.

Mr CIOBO—Sure. That is great, thank you.

Senator BRANDIS—As we all know there is always a controversy about bank fees and charges. We have evidence from others that the rural, regional and remote area part of their business is not the principal profit centre of the banks. To what extent, if at all, do the banks use the income generated from bank fees to cross-subsidise the cost of maintaining the rural and remote branch networks that they do? Has there been a study done on that? Are you able to tell me?

Mr Guerin—I cannot comment about a study but I could comment that 11 months ago the ANZ Bank set up rural banking, which I run. I came from New Zealand to run it. We are not subsidised in any shape or form. We have a PNL which is specific to us. We are accountable to the shareholders as well as the other stakeholders and deliver against targets. There is no cross-subsidisation.

Senator BRANDIS—So your business unit has to turn a profit on its own account.

Mr Guerin—Yes.

Senator BRANDIS—Thank you.

Senator MURRAY—That was a good question from Senator Brandis, because I picked up in your answers to a number of questions an internal language which indicated that you are cross-subsidising. Several times in your answers you referred to the fact that you were covering direct costs. In financial statements language, of course, that leaves indirect costs out, which would assume that you are not covering the entire costs and that you are in fact being subsidised, at least on the indirect cost side. Without revealing any secrets, could you give us an indication of what percentage, in cost terms, direct costs would form of total costs? Is it higher or lower?

Mr Guerin—I would have to take those questions on notice to give an accurate answer. In terms of my earlier comment that ‘most branches are profitable’, the last time we looked at it, between 95 and 97 per cent of our branches stand on their own two feet financially. I will take on notice the direct cost portion.

Senator MURRAY—I am not asking out of a prurient interest. I am asking for the same reason Senator Brandis was—for us to be given some kind of indication as to what costs are being carried by the corporation as a whole.

Ms Nash—Perhaps I can clarify. When we talk about ‘direct costs’, it is not just direct costs. When we say a branch is profitable, they also contribute towards things like central technology costs and the requirement for a return on investment. It is a bit broader than just covering the direct cost.

Senator MURRAY—All right. Perhaps you could you let us know what the relationship is so that we understand the context in which you give us that language. Thank you.

Senator BRANDIS—Pursuing that question: of the three to five per cent of your branches that do not, to use your expression, ‘stand on their own two feet financially’, what proportion are in regional, rural and remote locations?

Mr Guerin—I am talking within my business, so it is all of them.

Senator BRANDIS—I am sorry. I misheard you.

Senator WONG—I am a little confused between Ms Nash’s answer and yours. When you said 95 to 97 per cent within your sector of the business are profitable, I assumed you were referring to direct costs there. Was that not the case?

Mr Guerin—No.

Senator WONG—That was as if you were assessing a metropolitan branch.

Mr Guerin—Yes.

Senator WONG—With the various components of costs that you referred to, Ms Nash, they would be regarded as profitable.

Mr Guerin—Yes. We also have a view to add to that: with the work that we are doing on things like the Rural Transaction Centre Program, that tail end can be covered. The Wycheproof example took a branch with a high fixed cost component, removed that and provided a sustainable business. We hope to extend those sorts of models so that there is a full branch service and proposition to the community and that it is a sustainable one.

Senator WONG—Thank you.

CHAIRMAN—In your submission you have made reference to the issue of shared banking facilities—and this is one of the key issues we want to look at as a committee—shared physical facilities, as a means of maintaining services. My interpretation of what you said is that you are somewhat sympathetic to that option, perhaps more sympathetic than one or two banking institutions we have had before us. You refer particularly to the UK trial that is going on. You raise a couple of the regulatory impediments—the Trade Practices Act and the issue of joint and several liability of staff. Obviously they are regulatory issues that, in one way or another, we need to examine. One or two of the other institutions have raised the issue of the potential for customer grabbing, for want of a better term, from one bank to the other, which a shared facility might lead to. Are you not concerned about that issue?

Mr Guerin—We have a number of issues with all of the options that we are pursuing. We do have a view that we need to keep all options open and the solutions in different communities might be quite different. You walk around rural Australia and you find communities with quite different views and needs in banking and other services. It is an option that we believe is important to keep open and talk to communities about. We are, as much as we can be, driven by communities in what we provide. Koroit is an example that we have talked about today, as is Wycheproof and Merimbula coming down the track. Where there is a demand and a request from the community to provide that, there are issues but it is something we are happy to look at.

CHAIRMAN—You raise the issue of the danger of shared facilities resulting in more closures of branches. Could you expand on that, because I would have thought that the shared facility is perhaps a situation where you could put back a facility where all the branches have already closed, rather than it leading to further closures.

Ms Nash—I think we raised that in the context of that being a perception within the community perhaps—there was some concern that should banks share premises, they might think, ‘Oh, well, this is a good way of bringing down our overheads,’ which it is. In towns where there is more than one bank, the community is concerned that maybe there will be a sharing of premises where there otherwise would not be. They might be concerned that that leads to less employment, for example, within those towns. There is also the issue of privacy, which Senator Brandis mentioned before.

CHAIRMAN—I thank both of you for your appearance before the committee and for your answers to our questions.

Proceedings suspended from 10.39 a.m. to 11.00 a.m.

HARPER, Professor Ian Ross, Sidney Myer Professor of Commerce and Business Administration, Assistant Director and Dean of Faculty, Melbourne Business School

CHAIRMAN—I welcome Professor Harper to our hearing. Do you have any comment to make about the capacity in which you appear?

Prof. Harper—I have been asked to appear before the committee to answer questions about banking. Banking is an area of my academic specialisation, Senator.

CHAIRMAN—The committee prefers that all evidence be given in public, but if at any stage you wish part of your evidence to be given in private, you may request that of the committee and we will consider a request to move in camera. We do not have a submission from you, but we have been provided with one of your papers on financial institutions called *Globalisation and the Australian financial system*, which gives an insight into some of the issues we are examining. We would be pleased if you would make an opening statement on the issues that the committee is addressing, if you are able to do so.

Prof. Harper—I do not need to make an opening statement. I was asked to appear before the committee to answer some questions which I understood the committee had about the general area, and I am very happy to offer whatever expertise and assistance I can to the committee in its deliberations.

CHAIRMAN—In that paper to which I referred, you made this point:

> The IT revolution has fundamentally altered the economics of providing financial services. Traditionally, financial institutions relied on balance-sheet intermediation to transform assets with one set of maturity, risk and liquidity characteristics into liabilities with a completely different set of characteristics. This process, as old as the banking industry itself, required equity capital—usually lots of it—to backstop the risks inherent in the maturity, risk and liquidity mismatch.
>
> While the use of balance sheets backed by capital will continue into the foreseeable future, it is being displaced progressively and rapidly by the use of securities traded on financial markets. Securities trading is also an ancient means of satisfying people’s financial needs.

Could you enlarge on those two aspects?

Prof. Harper—I am happy to do that, Senator. In doing so, I point out that this same set of arguments is what underlies the theoretical framework that the Wallis committee used to recommend a reconfigured set of regulatory arrangements to the present government. Indeed, the logic that underlies the present construction of the regulatory arrangements, with APRA looking after prudential regulation and ASIC looking after conduct and disclosure regulation, is very much an outgrowth of this theoretical framework.

As I indicated in that paper, there have traditionally been two ways in which people who want to borrow money and people who have money to lend have interacted with each other, and those two ways have been through the intermediation of a third party—a financial institution—which has taken, as we say, an open position in the deal by borrowing itself from the lending party and then lending itself to the borrowing party and putting itself in between the two, thereby enabling the nature of the promise which is made to the two end parties to be very different.

That is one way to do it and that is what we have traditionally regarded as balance sheet intermediation. We use that term because, in order for the intermediary to be able to transform the nature of the promises on either side, it has to put in its own equity. It has to take a stand or risk in the deal. All forms of intermediation—certainly banking, but also insurance and other forms of nonbank financial intermediation like credit unions and building societies—are part of that camp.

CHAIRMAN—That is because, if you are talking about the intermediation role, they are borrowing from one group and lending to another group; is that right?

Prof. Harper—Correct, and those two groups do not do business with each other directly.

CHAIRMAN—Because of the mismatch in terms of the lending and borrowing, if one wants their money back earlier, the capital of the intermediary is used to provide that.

Prof. Harper—That is precisely right. In fact, that is the reason why the market had broken down in the first place. When the people who had money to lend faced the people who wanted to borrow, the folk who wanted to borrow said, 'We want it for 30 years,' the folk who wanted to lend said, 'I want it back tomorrow if I need it,' and the two parties simply said, 'Well, as much as we'd like to do business with each other, we can't.'

That provided the initial business opportunity for an entrepreneur to come in and say, 'Okay, I'll deal with you on your terms and I'll deal with you on your terms, and don't you worry about each other. I'll make up the difference.' Then when folks said, 'How could you possibly do that?' the answer is, 'Look, we've got capital at risk here and, if you turn up tomorrow and I've lent to you for 30 years, I'll pay you out of the capital and organise that myself. That's not your problem.' That is intermediation.

The other way in which the two parties—the ultimate borrowers and lenders—do business with each other, obviously, is by direct exchange. They write an agreement with each other, which they then exchange. That, of course, requires that the two parties are able to reach agreement about the terms, the maturity, the risk and the underlying characteristics. To the extent to which they can do that, the financial market is operable; it works. Both forms of engagement between borrowers and lenders are very ancient. However, banking or intermediation has always been, until recent times, the more ubiquitous of the two. The reason for that is that fundamentally what prevents ultimate borrowers and ultimate lenders from doing business with each other is what economists call information asymmetry which, in common parlance, would be the inability of the two parties essentially to trust each other fully, because they do not know enough about each other.

The intermediary, therefore, is not only able to offer maturity transformation services and liquidity transformation services, but is essentially able to say, for example, to lenders, 'Don't you worry about these folk over here, it's me you need to worry about. I'm the one who is making a promise to you. Can you trust me?' If the lender says, 'Well, I guess I can,' that is all you need to know. Similarly, on the other side, this might be said: 'Don't worry about the difficulty of divulging information to all of these depositors over here. You divulge information to me and I will keep that information confidential and that way you give me the truth. I don't tell them. I get good information.' And the whole system starts to work. The intermediary plays a special role.

If, on the other hand, the degree of information symmetry is such that the two parties know enough about each other to be able to do business directly and be comfortable about doing that, the market takes over as a way for the two parties to act. It should not surprise us, therefore, that the financial markets have grown first in those areas where information asymmetry is least, where the two parties to the deal, by virtue of the nature of who they are, are able to assure each other of their trustworthiness.

The markets started out with sovereigns borrowing—originally kings, of course—then governments and then, in more recent times, large international corporations and, in even more recent times, smaller corporations. As the information set has become richer and it has become easier for ultimate lenders to learn about ultimate borrowers from publicly available information and to be able to enhance the degree of trust that they have in those ultimate borrowers, they bypass the intermediary and go direct.

Ultimately—and this is a lesson which the economics-finance profession has really only learnt in the last 20 years or so—doing business via the financial markets is the more efficient way to go. It is the more efficient way to go because it does not involve the use of any capital. You are literally cutting out the middleman. The role that the middleman had played—

CHAIRMAN—This is using securities.

Prof. Harper—Absolutely. Yes, the second route is using securities. That is the open market. The role that the intermediary had always played was one, as I say, of enhancing trust and enabling the two parties to deal with very different instruments. It provided that glue in between the two sides, but that is expensive. It takes capital and capital is costly. If you can do away with that way of doing business and operate the market, it is quite clear that the market is the more efficient—that is, lower cost—way of bringing ultimate borrowers and lenders together.

The obstacle to the growth of that mechanism was always information asymmetry, and the richer the information set has become the closer we are to symmetry of information, not perfection of information. No-one is saying that this is a world in which there is no uncertainty. It is a world in which it is much easier for the two sides to learn about each other and to hold each other to account. In that sort of world, we expect financial markets to be dominant and eventually to displace the old balance sheet way of doing things.

Suffice to say the information revolution that we have lived through over the last 30 years has done precisely that. It ought to be no surprise that there is a tectonic plate shift taking place in the banking industry and the old way of doing business is gradually receding and being displaced by the new as information asymmetry enhances the efficiency of the market over against intermediation.

Inside all financial intermediaries—banks, insurance companies and, to a lesser extent but it is still there, the other nonbank depository institutions—this shift has been altering their strategic direction and has been causing tremendous pressure to arise inside the institutions over precisely which sets of skills are necessary for them to be commercially viable.

Again, you would appreciate, Senator, that the sorts of skills that a balance sheet banker requires to make balance sheet banking work are very different from the skills of a person who trades in the market. Traditionally, because these have been rival ways of doing business, there has been in the financial services sector a healthy, if you like, disrespect that crosses that boundary. The bankers have always regarded the people who trade in markets as fast and loose, and those in the markets regard bankers as stuffy and conservative. That is the sort of aura that has built up around the fact that the banker’s task is to kick tyres, to manage credit risk, to be suspicious, because the depositors, in a sense, have entrusted the banker with that task on their behalf, so the banker’s first answer is often ‘No.’ The banker wants all the information. The banker is using various means and mechanisms to get that information revealed.

The market, on the other hand, is about trading securities. The market specialist is looking for opportunities when paper is not priced correctly, and that requires, as you would appreciate, a very different mind-set and skill. One of the challenges that the large banks have been facing is how to manage this cultural shift, and of course they cannot grow market skills from a banking base. What they have done, in order to try to make this transition, is to buy the market skills and hope to goodness that they do not blow up as a result of mixing these two chemicals together.

CHAIRMAN—Could you just outline those skills for us?

Prof. Harper—Let me go back a step just to talk about banking more fundamentally. I have described the nature of what the bank is trying to do. It is trying to solve this information asymmetry problem. It is trying to generate trust where there was no trust and it is saying, ‘I know you wouldn’t lend these people money in a pink fit,’ either because they want the money for too long or because it is too risky or you do not know enough about them. With my mechanism, you do not need to know the answer to those questions. All you need to know is whether you trust me, the bank. My job is to help you to trust me, and the folk on the other side have a different deal.

That type of arrangement has evolved over the centuries into the three characteristic features of banking. One can modify, just to talk about insurance, but we will leave that to one side for the minute, but it is essentially a similar idea. The three things that we recognise about banks are these: first of all, the bank deals with debt on both sides of its balance sheet, constitutionally. Those who deal with banks—outsiders, not those who own the bank—do not deal with the bank in capital uncertain instruments.

The bank issues an instrument which is capital certain and it promises to pay a certain amount of money on certain dates. In other words, it issues classic debt. The bank does not issue floating instruments—instruments like, for example, units in a unit trust whose prices are fluctuating with the market. It does not do that. The bank says, ‘Here is the promise that I make to you. You give me $10, madam. At any time of the business day you may come and ask me for your $10 and I will give it back to you and, in the meantime, if you leave it with me, I will pay you interest at a certain rate on a certain date. Now, if I fail to do that, so help me God; you own the bank.’ The law has backed that up over the years. In our own country, our Banking Act has that enshrined—that the first claim on the assets of the bank goes to the depositors, by law. The depositors are the first claimants.

Secondly, the regulatory agencies, the Reserve Bank and now the Australian Prudential Regulation Authority, have as their charter to protect the depositors of banks. This has become so enshrined that the very instrument itself has taken on a special status in law and has a special name: deposit. A deposit is a debt instrument issued by a bank for a specific purpose and it has been around for so long that, as I say, it has an accumulation of legal and financial usage around it which gives it a special status. So there is debt on the liability side of the bank's balance sheet. The bank does not issue variable rate instruments.

On the asset side of the bank's balance sheet, it lends money. The bank does not, as a routine matter, take equity positions in companies. In fact, if the bank ends up with an equity position because the borrower has defaulted, that is the system having gone astray. That is not normal practice, and the bank will do its best if it finds itself owning television stations or small businesses. It finds itself very rapidly trying to do something about this, to get it away, because that is not how the system is supposed to work.

Why does the bank have debt on both sides? Because it is an essential element of the bank creating trust where there is no trust. It is a well-established proposition in the finance literature that the reason that debt is issued by corporations is as a form of pre-commitment to a certain type of behaviour. A company borrows money rather than raising money as equity so that it can actually tie itself to the mast, Ulysses-like, and say, 'We are so confident about our business that we are prepared to commit to these payments at these dates in these amounts, and if we fail to make those payments, we're in default and you can take us to court. That is how confident we are about our business.'

There is a lot of evidence to show that this is true: businesses that issue debt in the public markets are marked up by the financial system, because they are giving a signal that they are so confident that they can tie themselves to this particular mast.

The bank is interested in such people. The bank faces the same sort of problems that any lender faces. There is a sea of borrowers out there. Some of them are reliable, some of them are not. Some of them are truthful, some of them are not. How does the bank filter them? It is now filtering them on behalf of these lenders whom it has promised to do a better job than they could do. One mechanism the bank uses is only to lend, and it says to borrowers, 'This is how we give you money. You must sign a contract like this, and the contract says you pay us these amounts on these dates. If you do that, we want nothing further to do with your business. I do not want to sit on your board of directors. I don't want to own your business. I want to lend you money. Are you prepared to sign this?' If people say no, the bank says, 'That's fine. Good morning.'

Somebody else says, 'Yes, I'll sign that.' 'Ah, you're the sort of person I'm interested in, because, prima facie, you are prepared to make this commitment and you understand what it is. Please sit down.' The bank starts to talk about the debt deal and in that way begins the process of sorting the reliable borrowers from the unreliable borrowers, and it turns around and does the same thing to its own lenders, so it says to the depositors, 'Not only can you be confident that the type of people who do business with us on the asset side are people who are prepared to sign a debt contract, you can have confidence in us because we're prepared to do the same thing for you, and nowadays the law backs us up.' So that is debt.

The second element of banking that characterises it and is part and parcel of this deal is what is called the banker-customer relationship. The banker-customer relationship is a near relative of a doctor-patient relationship, and with the banker-customer relationship the borrowers are told, 'You can tell us everything about your business because it won't go any further than us.' The borrower says, 'But I must be cautious; if this information gets out, my business proposition is destroyed,' and the bank says, 'We understand that. That is why the information will go no further than us. What interest do we have in divulging your commercial secrets?' So they assure the borrower of commercial secrecy and, as far as the depositors are concerned, they tell the depositors nothing, again because it makes the depositors more confident about how the bank operates.

If it were the case, for example, that your doctor discusses somebody else's medical business with you, that is the day that you leave that doctor. The day that your bank manager discusses somebody else's financial business with you is the day that you change banks, not because this is unethical behaviour—it is unethical—but because it is very bad business behaviour. The reason the doctor insists on the patient being completely truthful and in return offering the patient complete confidentiality is that the doctor wants to make absolutely certain that he or she treats you correctly. 'You must tell me everything. The chances are, if you don't, that I will misprescribe and you will be worse. Tell me everything. I won't even tell your spouse.' That is the doctor-patient relationship. The banker says the same thing: 'Tell me everything about your business. It stops with me. If you don't tell me the truth, I might not be able to help you.' Debt on both sides of the balance sheet: the banker-customer relationship.

The third pillar of banking is the payments system. People often think that banks are engaged in the payments system simply because it is a convenient thing for them to do. Nothing could be further from the truth. The payments system is the third pillar that banks use to generate trust where there would otherwise be no trust. How does it do that? The bank, as you would understand, when it lends money to people, does not give them notes and coin. When you borrow money from a bank to buy a house, to buy a car or whatever, the bank does not say, 'Well, congratulations, here's a suitcase full of notes. We will look forward to your first repayment.'

They do not do that. What they do is open an account for you and give you an instrument to activate the account. They might write you, for example, a bank cheque. 'Here is your bank cheque. I hope you like your house.' 'Here is an overdraft with a book of cheques. Away you go.' The bank lends by giving you a liability on its own balance sheet. That is what it does.

It does that for two very important reasons. The first is that when it opens an account for a user, a borrower, it immediately has access to the information that it needs to make sure that this relationship stays on the rails. The overdraft is the clearest example. If I open an overdraft for you and your business, there it is sitting on my balance sheet. I can actually get from you, at the press of a button nowadays, all the information about your cash flows. All the information that I need to know, whether you are telling me the truth, whether your business is viable or not, is coming into my books every day of the week. I see every single payment that is coming in and going out because I operate your account. The second thing is, because I operate your account, if this goes off the rails, I can stop it. I have a big, red button on my desk and I can call you to account, just like that.

Banks engage in the payments system because, firstly, it gives them the richest source of immediate information about the financial health of their clients and, secondly, it gives them the ability to yank on their client's chain immediately and to stop inappropriate financial behaviour before it even gets away. What banks do is to take those three pillars and, down the ages, they have used those to create trust. That is why many banks use the word 'trust' in their names. They use those things to generate it. Capital gets involved because, as I indicated before, the whole process is subject to risk. It is a very effective way of doing business. It is particularly effective when information is highly asymmetric, as a result of which we are unsurprised to discover that in all developing countries financial systems start with banks and eventually move on to financial markets as their systems become more sophisticated and information enriches. That is the evolutionary path.

The markets, on the other hand, operate with totally different logic. There, what is being traded is a security. The entire promise is summed up in a piece of paper. The structure of the markets there is such that the information is sufficiently symmetric that we can engage in open trade of this financial instrument without all the rest of the apparatus that I have described. It is quite clear that using financial markets is more efficient than using balance sheets. You can almost see that for yourself when you think about all the machinery that goes into operating a bank, but it only operates with, if you like, filtered air. It only operates when the information is sufficiently symmetric and when the structure of legal protection is such that one can defend one’s rights in the market, otherwise you do not see the market existing at all.

In lots of countries where the legal structure is such and the information asymmetry is such that markets cannot exist, all you have is a banking system. That is all that is there. The IMF in recent times has sought to clean up the mess as a result of the Asian financial crisis. It has started by seeding banks, not markets. It has gone back to the countries that were victims of this and said, ‘You need to fix your banking systems and you need these rules to get the banking system going. Down the pike the markets will develop as you develop.’ There is the difference between the two. That evolution has been taking place. In our own country we have been on this—

CHAIRMAN—You mentioned there was a different skill set required.

Prof. Harper—The skill set for the banker, as you can see, is somebody who understands—

CHAIRMAN—You have done that. What is the skill set required for the market operators?

Prof. Harper—The markets? The skill set for the person in the markets is to be able to understand and price these instruments. Somebody makes a promise to repay money, either in certain circumstances or at certain points in time. The skill of the market trader is to know what price that promise will bring; therefore to be able to know what price the paper could be sold for in the market and whether the implicit value in the paper is higher or lower than the market is presently charging.

If the answer is yes, or somebody comes in, as they do—they go to an investment banker or to a trader or stockbroker—and says, ‘We want to float this stock,’ then the quintessential skill of the market person is to say, ‘Let’s take a look at the promise that underlies this. I think I can get this paper away for X.’ Thinking all the time, the implicit value of this paper is actually higher than that or lower than that and then trying to make a market by taking advantage of the difference between what the market is prepared to pay for this and what the trader thinks it is actually worth.

If the trader is right and gets the paper away for a higher price—the market is paying more than he thinks it is worth—he makes a profit. If he goes the other way and buys paper which, in his or her opinion, is underpriced relative to what he thinks the intrinsic value is, he makes money. The skill of the market maker is exactly that: is the market paying what this is actually worth?

You see, I hope, Senator, that is a totally different mind-set. Essentially the banker has nothing to do with trading. Nothing on either side of the balance sheet of a bank is a traded instrument—traditionally anyway. Mortgages, deposits—these are not traded instruments, they are obligations, they are claims that sit on the balance sheet, whereas the market maker has a book and in that book things are being bought and sold. The skill of a market maker, as the skill of a real estate agent, is to try to work out what the market would actually pay for this thing and try to arbitrage the difference between the two; whereas for the banker, the whole idea of buying and selling financial instruments is anathema. Is that clear?

CHAIRMAN—Yes. Can you perhaps then develop the theme as to how that has led to the removal of physical facilities from rural areas, which is one of the concerns of the committee and of this inquiry?

Prof. Harper—I understand that. The way it works out there is twofold: firstly, the whole business of banking has been moving in the direction of the markets. That is the future for banks, that is where they make their money—increasingly that is where they will make their money—and they are trying to make this transition. As that takes place the apparatus of traditional balance sheet banking begins to be unwound from the outer edge in. Bank branches in country towns, with the traditional bank manager there for two or three years in a stint, were the bank’s first line of defence for doing balance sheet business in parts of Australia about which they had very little information.

What they did was set up a branch in that place and put in a branch manager who would then get to know the community. That individual was not just doing this by virtue of being a nice person; this was part of the person’s job. It was that person’s job to be down at the Rotary Club, to be going to church on Sunday possibly, to be involved in the local school community. Why? Because the person was gathering information about the nature of the credits which he or she was about to make. That information is quintessentially banking.

It is also true that the bank would move these people every two or three years. This is a tricky game, you see. We are only human beings and so during the time that you are there you get to know these people. Beyond a certain point the process reverses itself and the branch manager runs the danger of getting too close to these people and is beginning to make decisions which are not in the interests of the bank. Traditionally what the bank has done is to move folk around, precisely for that reason. So the banks in country towns were pillars of the local community, not because they were community spirited; they are commercial organisations. They were doing this because this is the way that you make money sensibly. This is the way you do banking in an environment where information is very asymmetric.

Why are they suddenly reversing all of this? They are reversing this because the future for banks is not in this business. The future for banks is in trading markets, trading securities and, also, because the sort of capital which is required to underpin that business is now much more expensive than the business will justify, so they have to take it away. It is as if, for example—if I can think of an analogy, Senator—when we made the transition from coal fired ships to oil fired ships, a lot of shipping companies found themselves with large stores of coal and coal scuttles all around the world. Gradually, slowly but surely, they had to remove from their lines the old coal fired vessels. They were just too expensive to operate and they took them away which, of course, removed the livelihood of lots of folk who used to provide coal for ships and people who would put coal into the boilers of the ships. That has all gone because the technology has changed. The same thing is happening here.

That is one manifestation of it. There are various manifestations. The fact is that the banks are merging amongst themselves around the world; they are not just wanting to do it here. They are merging with insurance companies, they are bringing funds managers in. These are all indicators of the same fundamental change in the technology of banking.

CHAIRMAN—Does this mean, in effect, they are moving away from taking deposits?

Prof. Harper—Yes.

CHAIRMAN—And moving away from making loans.

Prof. Harper—Yes. The dilemma they face is that that business, for the moment, is still profitable but it has no future. How quickly do you shift? That is the dilemma. That is what keeps people like Mr Murray and Mr McFarlane awake at night. How quickly do you do it?

CHAIRMAN—If that has no future for the bank, what do the potential depositors in the future or the potential borrowers in the future do in terms of dealing with their funds?

Prof. Harper—There are two answers to that. The way of the future is simply for payments to be made. Obviously, electronically is a way of accessing this, but if we go behind that we can say that any other balance sheet can suffice. To give you one example, Senator—I do not think this is possible just yet but it is certainly not very far away—there is no reason at all why you cannot make payments using a mobile phone, for instance, and simply getting your account back through Telstra or Optus. I will come to how you settle that in a minute but let us deal with the front bit. Say you are driving down the freeway and there is an advertisement on the radio or on the side of the street or you want to pay Citilink, for example. You simply dial up on your telephone. 'Just dial this number, press this code and the payment is made.'

What happens then? Optus sends it back. You get your bill. Telstra sends you the bill and here are your telephone calls and here are also these other services which you purchased. There is no reason at all why you need a bank to do that. What about settling a debt? You could settle a debt in a variety of ways. One way in which that can be settled is simply through the exchange of financial securities using a mutual fund. That is the way forward. Anything—part of your superannuation fund, part of your property portfolio—can be unitised and you can make payments by essentially instructing a central unit authority to sell those units and transfer them in favour of the payee.

Those mechanisms exist in prototype at the moment and that is the way forward. You do not need bank deposits to run the payments system. The banks themselves understand that, which is why they are quite happy to move away from balance sheet banking and open up other opportunities for people to make payments to and fro.

CHAIRMAN—What about on the borrowing side?

Prof. Harper—On the borrowing side it is even simpler. On the borrowing side, people will be taking to the marketplace their promises. You can see this even more clearly. That is the latest product that Mr Symonds is pushing through his Aussie Home Loans business where he has now decided that he will be a broker for all sorts of mortgage loans and he will go and shop for you. Essentially, what he is doing is taking your promise. I would go to Mr Symonds and say, ‘I would like to borrow money for a house,’ and he says: ‘Okay, fine. Here is a standard instrument. You sign this, who you are and that you are prepared to pay these amounts of money against a house security.’ I say, ‘That’s quite right, Mr Symonds.’ He says: ‘Good, you stay there. I will go off into the marketplace and I will get the highest price.’

He goes off to the marketplace and he literally sells into the marketplace the instrument that I have created. He gets a buyer who is prepared to pay a high price for that and he introduces us, takes his fee and away he goes. ‘I have sold my paper. I have got my money. I have bought my house.’ Out there is a mortgagee who has my promise and is receiving a stream of income and Mr Symonds has performed the role of market-maker. That is how that works.

CHAIRMAN—In that sense, are you overcoming this issue of information asymmetry that you have referred to, because you are dealing with a lot of small—

Prof. Harper—The point is that the market for mortgages, as I described to you earlier on—the marketers, if you like—the beach head of the market has gradually encroached closer and closer over the centuries towards retail business. This is why the banks understand that the writing is on the wall. It started out centuries ago with only those institutions who were big enough to have information symmetry; then it was governments; then it was large corporates; now it is medium corporates; and now—have a guess what—it is suburban mortgagors. Enough information can be gathered for the market to operate for people to be prepared to buy mortgages. At this stage we still have a middleman. We have Mr Symonds who is adding various elements to that deal as he seeks to bring the two parts of the market together.

I can recall quite clearly, Senator, I think five years ago, going to a flea market in San Francisco in the United States and, amongst all the other paraphernalia, there was a chap there who was selling mortgages out of a barrow. That is the end game, when these things just become as familiar as corporate bills.

CHAIRMAN—Therefore, the banks perceive they do not need their rural branches.

Prof. Harper—They do not need them and they are too expensive. They are not too expensive because of the labour and the rest that people look at and say, ‘This is expensive.’ No, they are too expensive because they cannot service the capital which is required. The market knows what is happening to banking. The market is saying to the banks, ‘You service the capital that we invest in you at this rate or we will have it back, thank you very much.’ Around the world, not just here in Australia, banks have been answering that call in three ways. Firstly, they pay it back. All the banks have been paying their shareholders back, as have the big insurance companies. Why? Because they do not need the stuff. ‘It is too expensive and I can do the job without the capital. Here, take it back.’

Secondly, the banks that try and forestall being gradually bled dry by the international capital markets have said, ‘Okay, maybe we can use the capital that is in the industry more efficiently for a while so let’s merge and, if we acquire, we will shed the capital out to the owners of the company we have just bought and if we merge hopefully there will be efficiencies that are generated to enable us to hold the capital for longer while we work our way through this transition.' That is where bank mergers come from.

Thirdly, Senator, is failure and then the capital is simply burnt up by the bank. We in this country are striving to avoid that. Tragically, of course, it has happened with a large insurance company. This is all sub judice, clearly. A lot of it has to do with the issue of the management of that organisation but the management is also struggling, like banks, with this emerging trend that is fitting insurance as much as it does banking.

CHAIRMAN—You say the banks have recognised that but it seems the customers have not, as yet.

Prof. Harper—That is quite right.

CHAIRMAN—Although you are saying the facility is available to the customers but they are obviously not recognising that. They are saying, 'No, the services we are getting are not what we want or what we need.'

Prof. Harper—I am saying two things, Senator. The first is I am describing to you what I believe was occurring in the big picture and I would not be at all surprised if ordinary citizens did not understand that. That is a specialised thing. If it is of any interest to you, I often get asked by the banks themselves to tell them this story. These are difficult times for this industry. Secondly, it is also true that these adjustments do not occur smoothly and it is often the case that the space is vacated before it is filled by the next generation of products. It would not surprise me at all that you and your fellow committee members would be hearing from people who are saying, 'That may all be very well but nothing has yet filled this vacuum.' That would not surprise me.

My personal response would be to say, 'Yes, give it time,' and of course they are going to say, 'Yes,' but in the meantime they have to eat, which is true, and there is an issue there. It is not going to occur smoothly but it will occur. The other thing is that I believe there are services that are available that people are not fully aware of. I recall well a gentleman whom we interviewed on the Wallis committee from 400 miles, I think it was from memory, outside of Tennant Creek in the Northern Territory. Perhaps you and your committee members will hear from the same gentleman. He was concerned because they closed down the bank in Tennant Creek and he could not get access to the bank. When Mr Wallis asked him about the post office he said, 'They have closed the post office, too.'

Then we said, 'How are you having this conversation with us?' and he said, 'Over a satellite telephone.' 'Right. Are you aware that one of the banks actually lends money for mortgages and conducts all sorts of basic banking services by telephone?' The gentleman was not aware of that and independently confirmed that it was quite true and the bank itself was located in Sydney but it will conduct all sorts of operations over the phone. To be fair to him, that costs him a telephone call and a satellite telephone call is not cheap and he may prefer to drive his car the X-hundred miles to Tennant Creek once a week to do the job.

The point we felt quite comfortable about on the committee was that it was not true that this gentleman, in a very isolated set of circumstances, had been completely abandoned by the system. He had been offered a set of alternatives, some of which he was unaware of and some of which may be much more expensive than those he used to access. That is true. Over time we would expect that set to fill out and become cheaper but I am not going to sit here and tell you that that will be immediate or cheap or even 100 per cent effective, which is of course where your brief comes in. The market is not going to be flawless in this transition.

CHAIRMAN—One of the issues that is part of this transition, in a sense, is the decision by some banks to provide some alternative form of physical service, such as an in-store facility which Westpac, for example, set up; giroPost; the Commonwealth Bank working through the post office and so on. One of the issues that witnesses have raised with us in those situations is the issue of confidentiality, and this is something that you stressed as being an important part of the bank's relationship with the customer; that with an in-store facility, for instance, they are dealing with staff of the store and not bankers. They are people from the community and they may not want them to know their inner financial secrets and, although it might provide, in banking terms, 'the service', it does not provide this confidentiality which you said was an important part of banking service.

Prof. Harper—You are quite right, Senator. That type of thing is a pale shadow of what it was originally intended to do. The banks are responding to some community pressure and political pressure to try to manage this transition, with the wider public interest in mind. They will often say: 'The biggest public interest we're looking to is that we don't actually get into trouble financially. That's the nature of the pressure we're dealing with,' and others are saying, 'Well, be that as it may, please don't burn too much earth as you go out of here.'

The banks will try to do what they can but, because this is no longer a primary function for them, it does not surprise me that they would do it in a perfunctory way. They will meet the minimal set of requirements that they can. But you are saying, 'Where's the confidentiality?' and the banks are really saying to you, 'We don't need that any more, Senator. It's not the way that we do business any more.' So how do folk get these confidential details provided? The answer to that, I think, is the development of the financial planning industry where people will be advising those and keeping those details confidential. Needless to say, the financial planning industry is a long way behind the probity of banking and the law has been put in place and issues need to be dealt with there.

Without meaning any offence at all, if I were in your position I would be less saying to the people who are departing: 'Stop! Stop! Come back here. Get back to your posts.' That is Canute-like. It is not because the banks, in my opinion, are seeking to be antisocial. They are responding to forces which are very strong and my concern is that they be allowed to respond to these forces, because the consequences of not doing so are severe. Instead I suggest asking, 'Right. What fills this space when the banks have departed, and can we as representatives of the public do something, if necessary, through the public mechanisms to assist to catalyse the development of what comes afterwards?'

What comes afterwards will be a series of non-bank related services. There will be Telstra and Optus and oil companies, possibly, and community banks. People will come in and see these opportunities and offer these services, and they can. They should be catalysed. Financial planners are the people who ought to be the successors in handling people's affairs and giving them the confidence they need and the advice that they need. That is still a very imperfect industry. That needs to be catalysed and the public interest protected there. For my money, that is where the attention of the public sector ought to be, rather than really trying to reverse what I think is an irreversible trend. I am not just talking about the Australian industry here; this I believe to be international in scope.

Senator MURRAY—What you are talking about is added value. Missing in the discourse so far is the role that banks play, particularly in the regions—bank managers—in adding value. Financial planners now seek to do that and that requires not disconnection between individuals but connection—in other words, a physical presence; either somebody at premises or somebody visiting them—because adding value requires the kind of interchange we have now. If you had written to us, it has less impact than the face-to-face reaction. Right at the heart of the economic side of this—not the demand-led need side, but the economic side—is the question of adding value. How do I take my assets or my business or my property and either protect it from losing value or add value to it in a productive sense? To do that I need an interchange, an interaction, an intermediary, to use your language. What you are saying to us is that a bank may not be the proper mechanism for that but a financial service of some kind will have to come in and fill that need.

Prof. Harper—That is right, absolutely, Senator. The only part of what you have just said where I would hesitate slightly is the idea that the intermediary is necessary. What is necessary, I agree, is face-to-face relationship but that relationship can be with a specialist who, as it were, plugs you into the market. The point is increasingly—and we each know this, I think, as a result of the need for us to save for our retirement—that we are getting used to dealing with markets rather than with intermediaries. Indeed, people would say, the government would say, that any individual who saves for his or her retirement simply by putting money in the bank is crazy and, if that were the advice given by an adviser, that would be regarded as irresponsible. Not even the government itself does that. The government invests its funds in the markets through the central bank.

We are investing in markets. Putting money straight into the bank is neither advisable nor, increasingly, is it what the bank itself wants. How do you get access to the markets in order to enhance the value, as you say, of your business or your personal portfolio? You need expert advice. That is what you need. The expert advice can certainly be face to face in the form of specialists, like any other sorts of specialists—legal specialists, medical specialists—and they are developing, but it is early days. One of the things that concerns me is if we were to turn around and say to the banks, ‘Listen, you’re the guys who should be doing this. You should be providing these roles.’ I assume that you are aware of the degree of public concern about the advice which is given over the counter by bank officers. Why is this? They are not trained to do this. That is not the logic of the bank. Do not ask them to do it. Alternatively, wait for them to develop and respond to the market incentive and develop their own financial planning and advisory industry and meet the standards. Again, I would say to you, Senator, do not be surprised that a bank owned and operated financial planning agency is no more competent than an independent agency. There is no reason why it should be, none at all, because the expertise does not rest there. It rests in people who understand the markets, and we have to develop that.

In that respect, they are the same pressures I face at the university. The market is calling out all the time for us to supply trained specialists in markets. That is what they want. They do not want bankers. People who come to this country looking to establish businesses—and I get these messages back through Axiss, the Commonwealth agency which is supposed to be pushing Australia as a financial centre—and the big institutions come to us and say, ‘How many trained people can you get us—not bankers; financial analysts?' and we often cannot supply enough of those people. That is the way forward. You will get your personal relationship and, if an organisation can make it operate with large numbers to keep the scale economies up, there is no reason at all why that cannot be offered on a retail basis to folk of relatively modest means to be able to get those services.

CHAIRMAN—This is very relevant to our inquiry which covers the full gamut of the availability of financial services in rural and remote areas, not just banking.

Prof. Harper—Yes, I understand that.

CHAIRMAN—Have you thought through any prescriptions or policy directions that could be put in place to manage this transitions phase?

Prof. Harper—Senator, the regulatory framework that we recommended to the present government, which was adopted in all but one respect, was precisely intended to facilitate this transition. That is why oversight of financial services was given to ASIC. That is why the Financial Sector Reform Act has been passed—to strengthen the framework within which advisory and financial market trading takes place; centralise under one agency, central licensing authority, stricter standards. That is why that is there.

Let me speak of my personal perspective rather than that of my fellow members of the Wallis committee. I felt that the best the government could do in this instance was to provide for this new world the appropriate underpinning—legal framework—so that people can actually say, 'This is rotten service. What do I do about it?' 'Ah, there's an agency you can complain to and there's a law which actually says, "Yes, that's wrong."' Whoosh! You prosecute the guy. In fact, I think Treasurer Costello is correct when he says that Australia is in the vanguard of these developments. I know that for a fact, because other countries have followed us. The Germans, for example, have introduced a system very similar to ours, based upon what we recommended, so I think we are on the right track here.

If the legal framework is sufficiently robust, which I have no reason to believe ours is not—set aside the insurance thing which has now been fixed; there are different aspects of this which are going to take us by surprise; that will happen because we are in a transition here—and if we can make sure that the laws are accessible, available, understood and, where they are broken, prosecuted, that seems to be about the best we could do.

If you want to go beyond that, you are saying, 'I need to actually subsidise this industry and develop it.' I would hesitate to do that, because I am not convinced that I can see precisely where this is going to go. I know in my bones that it is the market that will succeed, but I do not know who is going to be best at doing that. People say, 'It is almost obvious; surely the banks know.' Almost the opposite reason; the banks are seeking to shed themselves of 300 years worth of tradition which has served our country very well over that time; but they themselves are rapidly changing. That is why they are buying funds management organisations. That is why the CBA bought Colonial. That is why the National Bank bought MLC. That is why they did this: to infuse their culture and their system with skills they cannot grow themselves.

It will be obvious to members of the committee that this is not an easy thing to pull off; not an easy thing—right down to the details of how an individual is paid in the market. Bank officers were never paid with those sorts of packages because to do so would invite corruption. Yet the market is quite comfortable with that because it is demonstrable. ‘Did you actually earn this money by buying and selling? I can see all of the records; there they all are. The contract is you get X per cent of that. Here is your cheque.’

Senator MURRAY—If technology enabled banks to withdraw from rural and regional Australia through the introduction of ATMs, phone banking and all that sort of thing and if the missing link is what I would call—and just with respect to the economic side—the personal, added value interaction, is it possible that technology can do that job, too?

For instance, using video links you could either have that direct to the business or farm concerned, or you could develop a kind of Internet cafe but with video links. You lock yourself in there and you would have direct access to somebody you would know. You would see their face and you talk to them personally and so on. Is there that kind of technological solution to the very real need for people to interact with other people rather than with machines?

Prof. Harper—Indeed, Senator. Here is where you might like to bring some experience from South Africa to Australia, if I may say so. I was at a conference in Sydney just last week when a gentleman who runs an institution—the short name of which is First Rand—spoke to the assembled company of bankers about developments in South Africa with precisely these sorts of things. It was a very powerful speech in a number of respects. What South Africans are doing with mobile banking and mobile technology is just extraordinary. They are leaping over the need for lines and physical facilities because the communities, as you would be aware, they are dealing with are very remote, very poor, often illiterate. Yet the sorts of banking services which are being taken to those communities are, in many cases, very sophisticated. Ordinary villagers in South Africa are just as concerned about their financial affairs. They can count beans like anybody else can count beans and they know which side of their bread is buttered. They just need access to these facilities. If you were inclined to make those inquiries it is a very useful case study.

The other interesting case study on this sort of thing is from Canada. The Canadians have also done—not as much as the South Africans—a lot for their Indigenous people in particular. The remoteness thing is the common link there, although we do have a common issue with Indigenous banking as well as to how they get access to remote communities and how they bring those services remotely. They have done a lot as well. The answer I believe is, yes, the South Africans have used technology to bring face-to-face banking. They have a truck they go around with and the truck is connected via satellite and people come to the truck, like children to an ice-cream truck. They queue up and there is the person and they do their business in a little booth and it is all done over the Internet and away they go. The folk do not have to be able to do anything more than make a mark to indicate they are who they say they are. The rest is done by the bank. It can be done all right.

CHAIRMAN—We have raised this so far in our hearings with several of the banks. One of those submissions, from Tasmania I think, recommended or sought to explore the issue of mobile banking.

Prof. Harper—Yes, that is right.

CHAIRMAN—But the banks have been a bit negative. They have said, 'There are security problems.' Thus far they do not seem to have been sympathetic to the idea. Again, given what you have told us, is it perhaps the mobile facility in the future—if that is a way to solve some of these problems—is not to be provided by the bank but perhaps by the adviser or the sort of person that Senator Murray referred to?

Prof. Harper—It could easily be.

CHAIRMAN—Perhaps if you would just respond to this—

Prof. Harper—The mortgage-broking business front ended the banks. The banks were caught flat-footed by the mortgage brokers. The mortgage brokers not only eroded the margins that banks were earning in that business; they added a whole raft of services. Some of us, Senator, are old enough to remember having to literally crawl to the bank manager to get some permission to borrow money. In my case it was at least being told to get out because my wife was the one who was earning the money and I was just a mere student and, because she was a female, that was the end—so much for our borrowing of money. This was in the 1970s.

Contrast that picture with people on motorcycles, raiding auctions and virtually chasing people down the street to sign them up for mortgages. That has its extremes as well, but contrast those two pictures: I used to have to crawl to the bank; now the bank crawls to me. If it is not the bank, it is the bank's agent; it is the front end, the person who drives around in the little car and comes to see me on a Saturday afternoon to sign me up. What I say is that that has only happened because there was a market opportunity and the market pressure built and away it went. But I will also say that it took years for that opportunity to be exploited. It sat there for years until eventually Macquarie Bank teamed up with Mr Symonds and away they went. It could be the same in this case; what we see as an opportunity and think should be something that people would pick up, it may take some time for the market to do. I do not believe the banks are necessarily the ones to do that. I do not believe it is true, because the banks frankly have bigger fish to fry. They have bigger concerns on their minds and they also, quite rightly to the extent to which they see this as social welfare, do not consider themselves in that business any more.

Mr HUNT—Professor, going back to the analysis you were using before, if you think of the set of services provided to traditional banking communities, what I want to do is unbundle those, to find what those services were. Let us look at the number of them—I can immediately see four—to see which of those are being met, where there are gaps and therefore which are the areas we ought to be concentrating on in terms of filling those gaps, whether it is through the old banks or through the new mechanisms. I can see at least four services that were provided to traditional customers: one is as a lender; two is secondly as a provider of payment systems; three is as a provider of financial advice; and four—this is the one I have most difficulty with—is as a provider of security for cash deposits, particularly for small businesses, people who trade in cash.

Looking at those—there may be other services—which of those have alternatives to fulfil them now? Where there is not those and there are gaps, what are the things that we should do to try and solve those gaps?

Prof. Harper—The first three of the services you have indicated there I believe can all be conducted over the telephone and from banks that are not even in Melbourne, for instance. The question of what you do with cash is a good one. One arrangement that can be made, of course, is that people like Brambles or people who move cash around have long offered a service where they would come and collect cash or dispense cash as you wish. You can subscribe to that service and they go to and from the bank, so you get an armoured car. That is one answer to that.

The other answer is that you encourage people to use the electronic means of payment, both to take cash out and to make cashless payments. One of the things the banks advertise with getting people signed on to EFTPOS is that you can reduce the amount of cash you keep in your till by saying to folk, 'You can get cash out. Would you like cash out, sir?' '$50, please.' That is 50 bucks I no longer have in my till.

The banks encourage you to do that. That mechanism works two ways. The electronics can help with the cash management and, to the extent to which the bank is not nearby, it is possible to get people to come and take the cash away. The other three services I believe can be connected over the phone.

Mr HUNT—Are there any other principal services that are missed in that assessment?

Prof. Harper—Taking deposits and making loans. That is what banks do. The payments system is connected with that, because you can shift who owns the deposit. There is not much else there.

Mr CIOBO—That is what I wanted to check. Perhaps it is a case of that is what banks did, based on the evidence that you have produced.

Prof. Harper—Yes.

Mr CIOBO—I wanted to pick up also on the point that you made about the opportunities that present themselves, because in my mind it comes down to a very strong demand side equation still, where you have masses of people—albeit perhaps low yielding people—that have an expectation. It is not something that is confined to regional centres, but perhaps it is more pronounced there because the shift has been more rapid in regional centres than it has been in metropolitan centres. What do you envisage then for policy makers like us as the best mechanism to do two things. The first is to encourage another provider to recognise the demand and to move into that demand, because effectively what I glean from your comments is that we are talking about two separate markets and the bank, as an institution, is leaving one market in favour of another market.

Prof. Harper—Migrating.

Mr CIOBO—In terms of the original market then, which is the core of what we are discussing here today, if there is to be a new supplier to that market, who is that likely to be? I know we have had some discussion about it being maybe financial planners, but clearly, to me, a financial planner is not that person in the traditional sense of the words 'financial planner', because there is not the deposit taking ability and there is also not access to the payment system. Who is going to do that role and what are the policy settings that we need to facilitate that?

Prof. Harper—A financial adviser can certainly gain access to deposit taking. They can be an agent and they can plug in themselves. They can easily do that. The average suburban solicitor can do all that, just by using his or her own banking links. If Mrs Jones cannot do it, certainly her solicitor or financial adviser can do that. More generally, though, I agree. I hesitate to make too many predictions about what is going to fill that space, in general terms. I am much more confident to tell you that the space is there and that it will not be filled by banks than I am to say who is going to fill it, which does not help you. I understand that, but I am trying to be reasonable here within my limits of competence.

What do policy makers do? Policy makers can identify what they consider to be the public issue here. When you ladies and gentlemen have finished your inquiry, you will say, ‘Yes, there is an issue of public importance here and it would appear as though the market is either sluggish or it’s not doing what we think is necessary.’ How can you catalyse or lead the market? The traditional way in which the government has done that is to auction off some form of subsidy or inducement. What you basically say is this: ‘We want these services provided to these people in these areas and the government is prepared to catalyse this by spending so much money. What are we bid?’ Even if you do not want to specify the money, you can simply turn around and say, ‘Here’s a list of services we want provided, make us an offer,’ and then the government can look to see how much it is prepared to spend on that particular piece of public policy relative to the many other demands on its funds. That is what you can do.

Badgering banks to do it will not work. Putting your money up and saying, for instance, as the government does with some categories of beneficiaries, ‘You can open an account with any bank to receive this and, when you go in there, take this little chit,’ and it says to the bank, ‘Please debit the costs of running this account to the Department of Social Security.’ Maybe a neater example is the pensioner benefit card or the health card, where the government basically says, ‘If you qualify on these criteria, we will pick up the cost essentially of providing you with these medical services. Take this letter to your medical services provider. He or she will provide the service and send the bill to the department of health.’

Mr CIOBO—What I am interested to know is this: with your expertise, do you see it as an out-and-out CSO or do you see it as a market opportunity, devoid of the need for government subsidisation?

Prof. Harper—I think it is a market opportunity. If you then say to me, ‘Why isn’t the market doing something about it?’ I will say to you that market opportunities can exist for long periods of time before somebody takes them up, and I would cite as evidence for that the fact that banks were charging margins for home mortgages that were well in excess of the true cost of providing that service for years, until somebody took the opportunity to do what has happened. I cannot predict when the market is going to act.

CHAIRMAN—Do you think, in the isolated and remote areas, there is a market failure here?

Prof. Harper—I do not think there is a market failure. I think what has been happening in rural and regional Australia is part of a much bigger picture. If you were looking at the banks in isolation, you would have enough of a problem, but the issues that I have discussed are unique to the banking industry without having begun to tell the story of globalisation and what is happening to the Australian economy. What is happening to rural and regional Australia, in my opinion—and at the risk of simplification—is that rural and regional Australia are suffering not just from what is happening in banking, but from what is happening to the Australian economy generally.

The root cause of that is still the same thing. It is the information revolution. It is the fact that the rest of the world is now closer to us than it has ever been in our history, and that is a two-way street. You build a double highway to Bendigo and as many people will leave Bendigo and come to Melbourne as those who will build a weekender in Bendigo and go up to Bendigo. We have now built a quadruple-lane highway between Australia and the rest of the world, and that creates dynamics in the structure of the Australian economy which are only just beginning to emerge. One of them is centralisation, which is a bit ironic, in a sense. There is the force of what I call the centripetal force and the centrifugal force, and it is unclear at this stage which of those is going to be dominant.

The rural and regional Australia issue is caught up in that, along with tectonic changes in the industry. You might be able to do something about the banks or about financial services with a bit of subsidy, let’s say, but if you did that and you ended up still not being able to stop the retreat of rural cities, I do not believe you could hang me out to dry. I would simply say to you, ‘Yes, but this was part of a much bigger story, and can you stop the impact of globalisation on the Australian economy?’

CHAIRMAN—In your view, do the rural transaction centres provide a model for, if you like, this transition period?

Prof. Harper—I am not 100 per cent familiar with them, Senator. Are these places where you can deal with multiple banks?

CHAIRMAN—Deal with banking and other services, where a service is withdrawn.

Prof. Harper—I see. Are they a sort of one-stop shop, where you can do your banking, postage and other stuff there?

CHAIRMAN—Yes.

Prof. Harper—Are these commercial operations or are they subsidised?

CHAIRMAN—They are supported by the government, to a degree. The local community puts together a submission and receives funding to develop them.

Prof. Harper—That is another way in which people can bring their needs to the government and the government can decide. In my personal opinion, it is entirely appropriate for the Australian government to be easing the community through this transition. My concern is not that that not occur; my concern is that the motivation behind it is not to stop the advance of a tide which is simply unstoppable. By all means, provide tax breaks to regional areas and subsidies that are targeted. Provided they are competitive, they can seed this process. Sometimes all that is necessary is to publicise the opportunities. Sometimes that works. The market, as you will hear from Mr Moore in a moment, can be very innovative in filling these gaps.

Senator MURRAY—It is blind-side economics. It is a different thing. Blind-side economics says if you want to have a regional development policy—if you want to develop your inland areas—you start by providing the essential services at an extremely low cost, so that you can kick-start the market. In my view, energy, water, communications, transport infrastructure and financial services are all part of that and governments are heavily involved in the first four and not in financial services yet.

Prof. Harper—Well, they were, Senator, for a long while.

Senator MURRAY—And the question is: how can they do so effectively at low cost and as an incentive to regional development? That is not fighting against globalisation; that is simply trying to add value to your country by developing areas which are presently underdeveloped.

Prof. Harper—Yes, except that one needs to recognise that the amount of money you need to put into that may be larger than it otherwise would be, because the tide is receding. You are walking into a moving stream.

Senator MURRAY—At the early stages.

Prof. Harper—Yes, sure. These things need to be seeded. My answer to that is, yes, it is. As Mr Ciobo was saying a moment ago, it is a classic community service obligation. My concern is that that community service obligation be fully funded and not imposed on the institutions, and the reason I say that is that if it is true that building rural and regional Australia—or, let us say, working against the decay of certain areas of rural and regional Australia—is genuinely a public priority, then it is a priority for taxpayers to meet, not just the shareholders of banks. It is extremely unfair, in my personal opinion, to impose a public obligation on a subset of the Australian community.

Senator MURRAY—But governments have already done that in Australia by requiring the communications sector to be upgraded in such a way that banking and financial services are now made much more cost efficient because somebody else has provided the telecommunications infrastructure, which Telstra would not have done without the government insisting on it.

Prof. Harper—I think we are talking, Senator, about means rather than ends, if I may say so. I have no problem at all with the government paying for various private sector agencies, for the most part, to engage in this sort of activity. My concern personally is that if you either say that this can only be done by a public agency or public corporation or we are going to force the shareholders of Telstra to take lower profits because they have this obligation imposed upon them, again I say that is unfair. The private shareholders of Telstra are citizens of this country. They have an obligation, as do all taxpayers, to meet public need, and I happily do that as a citizen of this country, but I say I do that along with other citizens, not along with the other shareholders.

It is a question of means rather than ends and, to be frank, I think the government is in a much stronger position to actually detail the things that it wants in a tender. It holds a public tender, it writes a contract and then it can hold these parties to account. That strikes me as a much more effective way of achieving the government’s objectives than of handing over a general obligation to a public trading enterprise and saying, ‘You do this and you’ll have to account to the parliament once a year.' I just do not think that that is as effective. That opens a much wider issue, but we are not disagreeing about the legitimacy, I do not believe, of the government spending money to enhance rural areas in this country.

Senator MURRAY—I did not want to distract the committee. My point was really that the government has embarked upon a process of regional development through developing the communications link. They have done the other things, water and energy and transport, and that automatically makes the financial services effort less onerous, because so much of it depends on the technology.

Prof. Harper—Are you asking me whether therefore you need to do more for the private sector financial institutions or whether I think that enough has been done?

Senator MURRAY—Well, you may, but you are already down the road.

Prof. Harper—Yes, you have to step up; I would accept that.

Senator WONG—You have partially answered this, Professor. With respect to your comments—which I concur with—about the withdrawal of these services from rural and regional Australia being part of a broader economic change, and much of which I do not think governments can do that much about, I am not sure how that meshes with your assertion that there is still a market opportunity in these areas for other providers of financial services. I accept that there may be opportunities for institutions or persons who do not have some of the rigidities that the banks do, but really one would have thought there are declining economies of scale and declining opportunities in those areas that would render them not particularly attractive market opportunities, regardless of who is providing them.

Prof. Harper—Senator, I am not a businessman so I hesitate to decide whether there is money to be made there or not. My intuition is that an operation which was cleverly enough conceived could service this market for as long as it exists, particularly if it is an add-on to a wider business proposition. If the proposition were that we are going to service these areas and these areas alone, then obviously it is a dying business, the market is shrinking, and that is not the sort of thing you would want to get into.

But I would have thought, as part and parcel of a broader service offering, that it was certainly viable; there was money to be made for as long as it is to be made. To some extent, to follow Senator Murray's line of inquiry, if these developments were to slow down—how shall I say it?—the centralisation of rural areas, it is not the complete denuding of rural Australia. It is agglomerating into bigger bits following the scale economies, so that it may well be true that this agency, let us say, sets its business up in major rural centres of Ballarat and Bendigo in this state, and it reaches out into the smaller communities in Victoria. Over time those communities will disappear and the business will go with it, but where do the folk go? Well, if they do not go, certainly the next generation goes to the next major regional centre, and the business there is growing. If it is not, you retreat to the next biggest centre. The same sort of technology that you would set up and the same business opportunity that that involved I would have thought could be migrated very easily from one place to another.

Senator BRANDIS—Professor Harper, arising out of that last answer, I have the impression from hearing you speak earlier that basically your view is that the big banks are interested in other forms of economic activity and it really does not fit with their business profile any longer to be servicing rural and regional Australia through their retail banking network. Do I understand from your last answer that what you are saying is we can have rural and regional banking through the big banks but have a different business profile as an add-on? Is it that, or is it that we need community banks or smaller economic units that are more specific to that market and are not an add-on to a broader business?

Prof. Harper—My answer, Senator, is that, in my opinion—setting aside the community banks thing, which I can comment on in a minute, if you wish—the banks are not going to go back into that with banking. That is what has gone.

Senator BRANDIS—So who is going to do it?

Prof. Harper—What will take its place is some form of market trading activity, be it through financial planners, be it through solicitors, be it through agencies which are nonfinancial—some access to the financial markets and to the trading business. My prediction is that that is not going to occur through traditional balance sheet branch banking. That is not going to occur.

So why can't the banks simply expand the activity into the rural areas like, as I suggested, other financial planners might be able to do? Because they are operating with a model which is no longer appropriate for that business, and the business cannot sustain the costs of traditional banking. The banks are having to change their mode of operation right across the spectrum, and the rural and regional areas happen to be, if you like, at the margins and are therefore the first things that we see. But I think, as Senator Chapman made the point before, it is not just them. It is suburbs in Melbourne, suburbs in Sydney.

Senator BRANDIS—In effect, Professor Harper, when we hear representatives like the gentleman from the ANZ Bank this morning, who was saying, 'We have a moratorium on closures, and 95 to 97 per cent of our rural branches operate at a profit,' do you say that, as an active policy, by declaring that they will continue to service rural and remote Australia, the banks are in that informal way assuming a kind of community service obligation?

Prof. Harper—I cannot speak for the ANZ Bank, Senator. Clearly the amount of public pressure which is being brought to bear on this whole issue is giving an opportunity for some of the banks to bare their souls and say, 'Let's change for a little while,' and the ANZ Bank is entitled to do what it thinks is appropriate to generate its public profile. I would stick by my argument, though, that the sorts of pressures that I have described are exactly the pressures that Mr McFarlane and his team had to deal with, and nothing has changed there. I will be interested to see what range of services Mr McFarlane continues to offer in these centres, how he funds that and how he operates those branches. If he has found a way to move the sorts of services that I have been talking about into those areas and operate them differently from the traditional balance sheet basis, then he may well have found the market opportunity, and good luck to him. I would be very surprised.

Is it willing adoption of a CSO? I doubt it very much. The market will determine whether or not this is sensible. Let me just clarify that: we lived through 40 years of asking the Australian banks to perform social services in this country and all of the evidence that came up before the Campbell inquiry was that it did the exact opposite. Mr Keating, I thought, was amongst the most powerful spokesmen on this issue and he demonstrated, when he spoke to the Labor Party back in the 1980s, what was wrong with these policies—that they had delivered the exact opposite to the constituency they had been designed to effect.

That is what is rotten about it. If you asked the private institutions to do public services for which they are not intended, they will do it badly. That is what is naive about it. I do not for a minute believe that he is doing it for a CSO. There will be some commercial advantage and he will answer to his shareholders about that issue. I just make the point about community banking, which is another initiative of a different bank, that the ladies and gentlemen of the committee should look very carefully—and Mr Moore will be able to help you with these inquiries—at how these things are structured. Look who is taking the risk. Look where the equity is being supplied.

I do not know what Mr McFarlane is doing, but he is under exactly the same pressures as any of the institutions are, including the Bendigo Bank. They all have to move from this traditional area to something else. Can they do it? Maybe. Are there alternatives? Yes, there are. Is there a role for the government to try and catalyse this? Absolutely. How should it catalyse it? Using some form of financial incentive, not by demanding that it be done or by loading it onto individual institutions through CSOs. I think that is inappropriate and, more to the point, ineffective in the longer term.

Mr CIOBO—I was after your comments, Professor, with regard to competition in the banking sector.

Prof. Harper—The brief of the Wallis committee was to go through all of the regulatory arrangements that faced the banking system in this country and to remove any of them that would impede competition in the system. The brief was to revise the regulatory framework so that it could maximise competition, subject to the proviso that the system remained stable. Our brief was this: people suspect this industry is not competitive. Take away all of the entry barriers, anything that is stopping it from being competitive. We did; we recommended it to the government and it did everything bar one: the four pillars policy, which stands in the way of competitive markets. That is an inconsistency.

The ACCC, under Professor Fels, has inquired into the banking industry on numerous occasions, has followed up various allegations about the industry behaving anticompetitively and none of them has been found to hold water. During the various requirements for mergers amongst the major banks, the commission has always insisted on certain things being done by the banks concerned and they have been done. I am not accusing you, Mr Ciobo, of doing this, but for people who ask what is wrong with our system and say the banking industry is uncompetitive, I challenge such people, (1), to point to any regulatory intervention which has this effect that is not, on balance, outweighed by public benefit on another score, namely stability and, (2), to demonstrate why the ACCC has been defective in its duty in not pointing to anticompetitive aspects and prosecuting anticompetitive behaviour where it has found it. The ACCC has gone through the banking industry, if I may use this expression, like a packet of salts and there is absolutely nothing that would stop Professor Fels and his colleagues taking the banking industry to the cleaners if they decided that was necessary—and they would. So my opinion is that the industry is as competitive as we can make it within the structure of our existing law.

What else can we do? We can encourage people who are not in the industry to eat the banker’s lunch. What did we do on Wallis? We took away all of the rules that stopped non-banks getting into the banking business. Have any of them got in? No. What else did we do? We said to the Reserve Bank, ‘You go off and deal with this issue of payment systems because the rules seem to keep people out who are not banks.’ What has the Reserve Bank done? Struck those rules down. Has Coles Myer got into the business; has Telstra; has Mobil Oil; Shell? No. They are doing business with the banks.

I am yet to be faced with any single piece of evidence which convinces me that the industry is less competitive than we could make it through public policy. If you are asking me whether the banking industry is perfectly competitive, the answer clearly is no. But that is the wrong ideal to hold it to. Is it competitive enough given the laws that we have put in place in this country which trade off competitiveness against other desirable public interest criteria? The answer to that question, in my humble opinion, is yes.

Senator MURRAY—Deal with the four pillars policy briefly for me. I have a view that the TPA merger provisions are pretty good, really. I have the view that those market provisions have been enhanced by very good changes to Corporations Law and taxation law, both of which have made the market far more flexible and competitive.

I think the real issue is post-merger. I think the only way in which you could ever contemplate getting rid of the four pillars policy was if this country had antitrust legislation; in other words, a divesture of power which enabled people to consider a post-merger situation if it got out of hand, as being capable of being dealt with. There is only limited divestiture of power in the TPA and it is the post-merger position which is difficult in trade practice law, not anything else.

Prof. Harper—There are two issues there, Senator. I am on record as being very critical of the government in having upheld the four pillars policy. It was the one recommendation of Wallis that the government did not take on. The reason that I am critical is that, in my opinion, we have the machinery in place to deal with mergers amongst the banks; moreover, the banks are denied natural justice in this matter by the four pillars policy. The banks never, ever had the opportunity to put before the Australian public, let alone the ACCC, the costs and benefits as they see it of bank mergers.

I get agitated about this not just because it is a question of natural justice, but because, as I have described the forces which our banks are subject to, in my opinion, they are substantial, significant and unrelenting. Moreover, the very same people who worry about bank mergers would be absolutely beside themselves if one of our banks—and I quickly add there is no evidence that this is happening yet—were ever to get into financial trouble.

Senator MURRAY—But the proposition I put to you is that—never mind just the banks—for most companies who become a danger, or perceived as a danger in competition, it is post-merger because you cannot, at merger stage, envisage all the subsequent situations. That is where antitrust legislation is so effective because it allows the consequences of size to be addressed far later than the early merger situation, or the early technological situation.

Prof. Harper—Senator, I am not a lawyer, but let me say this: my understanding is that not only is it the case that the ACCC could decide for itself whether a case for a merger existed on public benefit grounds—and that could be appealed to the tribunal—but that, if we got rid of four pillars, it is not at all clear that the ACCC would allow a merger to go through, having done all the sums. The sums are never done because the four pillars policy stops the process. That is point No. 1.

Let us say they did the sums and then they decided that they would allow a merger subject to conditions. The ACCC is certainly able—as you point out, Senator—at merger stage to impose conditions to require divestiture and actually to demand that certain behavioural undertakings be assented to at that time.

Senator BRANDIS—Or to enjoin the merger?

Prof. Harper—Or to enjoin—

Senator BRANDIS—If it is an anticompetitive merger.

Prof. Harper—Exactly. That is right. Just to stop the whole thing outright. Any attempt on the part of the merged entity, if the merger goes through, to flout these requirements—and I am not a lawyer—can simply be prosecuted by the commission. That is quite clear in my view. Certainly if something was not envisaged at the time of the merger and the behaviour was alleged subsequently to be anticompetitive, then the whole thing can be hauled up before the ACCC again.

Senator BRANDIS—Professor Harper, I agree with you, but just being the devil's advocate for a moment, what could not be done or would be extremely difficult to do would be to unravel the merger.

Prof. Harper—That is true of any merger, Senator.

Senator BRANDIS—Yes, true.

Prof. Harper—We either have confidence in the ACCC or we do not. If we have confidence in the ACCC to make rulings in the oil industry, in the trucking industry, in the food industry, in the telecoms industry, why not the banks, for goodness sake? What is so difficult about the banks? I would have thought, relative to some of those industries, they are easy customers to deal with. Also, it seems to me that if we do not have confidence in the ACCC then let us change the law. It may well be that the report which comes out from Mr Justice Dawson will deal with some of those issues.

Senator MURRAY—The point I make to you is that you cannot change the law in this instance unless you have antitrust legislation because you do not have that extra measure of competition law in this country to deal with the consequences of excessive size and power. You just do not. It is a mechanism which exists in the most dynamic country in the world, America, and yet we refuse to introduce it in this country. Of course you are not going to get—

Prof. Harper—Yes, but any move, Senator, which results in a substantial lessening of competition in a substantial market is against the law—anything. Even though it may be the case that the merger originally—subject to conditions, let us say—is judged by the commission not to result in a substantial lessening and it goes through, then your point is—

Senator MURRAY—But that ignores the fact that companies—

Prof. Harper—Then you prosecute them.

Senator MURRAY—No, it ignores the fact that companies arrive at situations of concentration of power which are not the result of anticompetitive behaviour. They are simply the result of the accretion of power through size and economies of scale. For instance, an obvious example would be an airline, a brewery, a media company or a computer company. At the time of the merger, or even subsequent to the merger, there may not be behaviour of that sort, yet the difficulty I want to explore with you is whether you recognise that the four pillars policy has to be there in the absence of the full panoply of competition law as expressed in international jurisdictions where therefore you do not have to have the four pillars policy.

Mr CIOBO—Isn't that the whole purpose of section 46? To me section 46 deals directly with what you are talking about. I do not see why there is the need for divestiture. I say that because I do not agree with your point.

Prof. Harper—I respond by saying that I do not accept that, Senator. The reason I do not accept it is that I believe the machinery is perfectly capable of dealing with this matter after the fact. With respect to the things you have described, size of itself does not necessarily connote market power and, if it does connote market power, that will result in a substantial lessening of competition. The exercise of market power through various mechanisms, like full-line forcing, collusion on price—all of these things are against the Trade Practices Act and are prosecutable under law. One of the remedies of that is divestiture. Another remedy is imprisonment and fines and things of that sort. I beg your pardon; let me withdraw that remark. That is a matter which Professor Fels—

Senator BRANDIS—Professor Fels wishes there was imprisonment under the Trade Practices Act!

Prof. Harper—Yes, you are quite right. Let me withdraw that.

Senator BRANDIS—Professor Fels would like there to be flogging under the Trade Practices Act!

Prof. Harper—Let me withdraw that one and say that there is a range of penalties. I guess my position would be this: if we believe that the matters you raise, Senator, are correct then we ought not just have a four pillars policy; we ought to go back to the days of two airline policies and fixed numbers of other mechanisms—

Senator MURRAY—No, you miss the point. The point is that you say the one remaining impediment is the four pillars policy. I say to you that from a public policy perspective that is going to remain until such time as people feel assured that the law will cater for changed circumstances. You are missing an element of competition law. You may disagree with that, but that is a fact in other jurisdictions.

Prof. Harper—Senator, what I would like the banks to have and the Australian public to have is the opportunity to actually test whether a merger would produce a lessening of competition. That is what the four pillars policy stops. What worries me, Senator, is that the government has made an arbitrary decision that any mergers amongst any of the four major banks in this country would be prima facie anticompetitive or possibly, following your line of argument, Senator, at some point down the line anticompetitive and we could do nothing about it.

My proposition is that we have machinery in place in this country to test that in the public arena. I think the banks should have the opportunity to put their case. As this committee has pointed out, there are many aspects of banking which ordinary men and women in this country are simply unaware of. Let us give the banks the chance to actually talk about what goes on in their industry and why merger, in their opinion, is a commercially viable strategy. To answer that they do not have the opportunity to do it while the four pillars policy is in place, in my opinion, is to deny them natural justice.

Senator BRANDIS—But, Professor Harper, I think you said it yourself about 10 minutes ago, when you said that perfect competition is not the goal.

Prof. Harper—No.

Senator BRANDIS—Sufficient competition is the goal.

Prof. Harper—Correct.

Senator BRANDIS—And the desire to have competitive markets must be balanced against other socially desirable outcomes.

Prof. Harper—Correct.

Senator BRANDIS—It seems to me that the four pillars policy may not be justified purely in terms of dictating a competitive outcome, but it does serve other, arguably desirable, social values, including cultural values in this country that people have about the wish for there to be a minimum number of large banks. That may not be economically rational but that is not to say that it is not a value.

Prof. Harper—That is quite right, but the commission is given a brief which is not purely and simply about economic efficiency either. The commission is given a wider brief and the Trade Practices Act in the end gives the Treasurer the right to overturn or simply not to accept the advice from the commission. In the final analysis the Treasurer must approve mergers. What the Treasurer, Mr Costello, has done is to say, ‘Don’t bother bringing me mergers amongst the four because I tell you now I won’t approve them.’ That is the four pillars policy. My proposition to the Treasurer is, ‘Treasurer, we ought to allow these matters to be discussed publicly using the machinery that we have and bring the evidence before you. You still have the right to say no. If the commission comes forward and says, “Treasurer, in our considered opinion, this merger would not be anticompetitive,” you still have the right, sir, to say no and to say to the public, “I’ve overridden these concerns with other concerns that my colleagues and I in the cabinet have about this.”’ For my purposes, I would far rather go that way than to have a blanket statement. It bothers me that this blanket ban on discussions of mergers amongst the major four hides from the Australian public the importance of what is going on in this industry.

Senator BRANDIS—I suppose, Professor, what you are identifying is a particular example of a more general issue and that is to what extent economic regulation ought to be sectorally specific, or to what extent it ought to be generic.

Prof. Harper—Yes, that is correct. I do not believe there is any reason for a special set of rules for the banking industry any more than there is for the media industry.

Senator BRANDIS—Exactly.

Prof. Harper—I believe the ACCC is sufficient to deal with these matters and there is an override for the Treasurer, forgetting the banking one. The Treasurer also has an override under the Trade Practices Act for the purposes of setting aside those decisions. For my money that is quite sufficient. Let the inquiry be held. Let the Treasurer make his decision and defend that decision before the bar of the House.

CHAIRMAN—There being no further questions, thank you very much for appearing before the committee today, Professor Harper. I think we taken about double the time we allocated, which indicates the interest in the views you have put and the information you have imparted to the committee. It is going to be very helpful to our inquiry.

Prof. Harper—Thank you very much, ladies and gentlemen. I appreciated the opportunity to present to you this morning.

Proceedings suspended from 12.39 p.m. to 1.01 p.m.

MOORE, Mr Timothy John (Private capacity)

CHAIRMAN—I now welcome Mr Tim Moore to our hearing. Is there anything you wish to say about the capacity in which you appear?

Mr T. Moore—I appear as a private citizen with a particular expertise in bank branches and community banking gained via the completion of a Masters of Economics by research at Monash University. I am no longer at Monash; that has all been passed and finished. I am now working for an economic consulting firm in the city, but I am here in a private capacity.

CHAIRMAN—The committee prefers that all evidence be given in public, but if at any time you wish to give part of your evidence in private we would consider such a request and consider moving in camera. We have before us your written submission which we have numbered 107. Are there any alterations or additions you wish to make to the submission?

Mr T. Moore—I was looking through some other submissions last night, but getting information on the coverage of various services in rural areas is difficult. There are a lot of aggregate statistics. One of the questions I did not analyse as part of my research was use of the Internet and Internet banking in these four small towns I looked at, so I just pulled it into a table last night which basically showed that 14 per cent use Internet banking in these four communities. I just thought I would bring it along and add it to your pile of statistics.

CHAIRMAN—Do you wish to table that?

Mr T. Moore—Yes.

CHAIRMAN—That is received as an additional submission. I invite you to make a brief opening statement, following which we will proceed to questions.

Mr T. Moore—Yes. I will keep it brief because I am really here to answer questions as well as I can. I will just pick up perhaps from some of the information that Professor Harper spoke about. I came along to hear him specifically, so two economists would not result in three opinions.

At the end you were dealing with the four pillars and I do not necessarily want to get into that in any way, but this idea of community service obligation versus a functioning market is a very interesting one. It is difficult to look at community service obligations in terms of branch numbers and branch retention. It is very difficult to work out who to allocate those to and what criteria to base that upon.

If one relies on the market, you want a market that functions as well as possible. There are a number of areas—again, specifically looking at branches and branch closures—where the market is perhaps not as responsive to consumers and those affected as it could be. That might be a useful path to move down in terms of findings of this committee and the policy.

One of those is transaction costs associated with banking. When a branch closes there are some burdens placed upon the customers. In the market mechanism, if a branch closes and they wanted it open, the theory should be that they register that annoyance or dissatisfaction by moving to another financial institution. There are two problems with that: one is that sometimes there is not necessarily another bank offering a branch in that area so there are no substitutes; secondly, there are transaction costs involved in doing it. There are direct ones, being some duties and fees in terms of loans collected by government, but also there are the fees if you were to open at another bank or financial institution. There may be fees there but there may be fees also in closing down your account with your bank. There are also indirect ones in terms of search costs and information costs.

In the Hawker inquiry, *Regional banking services: money too far away*—I did not really come across it in any of the submissions I quickly looked through—there is some talk of banks closing a branch and retaining a high proportion of their business; they might retain figures of the order of 60 per cent, 70 per cent, 80 per cent. I do not know, but certainly if that is occurring you can see a situation where the market is not reflecting the preferences of the consumers because of their paucity of options and difficulties in accessing those options.

Suggestions from the CUSCAL submission talked about ensuring ease of transfer between financial institutions. Also recommendation 18 of the Hawker inquiry dealt with removing stamp duties when people were moving as a result of a branch closure. Another one dealt with fees; No. 20 dealt with the waiving of fees. But those sort of things are good regulatory responses to increase the functioning of a market so that branch closures, even though they will occur, occur in a way that better reflects the market.

The second one is the high profits in banking, the high return on equity. I do not know the basis on which banks choose to keep a branch or not, but certainly they are more profitable than some other businesses in the community. That must colour how they analyse the choices. Perhaps there we go to oligopoly, the market power and some of those implications. Perhaps getting some transparency around that would be interesting. The question to ask various banks would be: is there a particular rate of return upon which they base their closure decisions? If you look at return of equity of banks, it tends to be in the region of 10 per cent to 20 per cent. Obviously if they are basing them on those sort of figures then, again, closure can move ahead of what might be ideal in a market where the returns did not need to be so high.

The third element in terms of this idea of local banking markets—and it is the area I specifically looked at in my research—is that there is a strong argument that bank branches, particularly in small towns, generate positive externalities. Externalities benefit the flow to members of the community, irrespective of whether they are customers. Some of those might be community wide, so it might be that there is a stronger local economy or it improves a sense of town identity. Some of those might be specific—depending on an individual’s role in the community.

An example might be a supermarket owner: someone might come to use a bank and also visit the supermarket but if the bank branch was not there they would not visit the supermarket. But the bank cannot go down to the supermarket and say, ‘That customer, or 20 per cent of your customers, are only coming in because we have generated that business. We are generating a positive benefit for which we are getting no value.’

With externalities, probably the most common example of a negative externality is pollution. If that is unconstrained, overproduction occurs relative to what might be the welfare maximising level. In this situation, if you believe that there are positive externalities to bank branches, closure can occur when that is not welfare maximising, so it closes too early because those externalities are not taken into account.

All this is prefaced on the idea that demand for bank branches has diminished over time, for all the reasons that I am sure have been very well articulated. But the timing becomes askew because of these reasons, so how do you deal with those externalities? Community banking, I suggest, is one way with which it is dealt. If you are ever going to have a subsidies argument or a support argument on total welfare grounds, rather than equity grounds, then 'externalities' does provide one. We were very high level at the end with Professor Harper. That is just to bring it down to local banking markets and the ways in which banks do not necessarily respond to the signals of all the people affected. Some of those might be able to be lessened or resolved; some may not.

CHAIRMAN—Thanks very much.

Senator MURRAY—Mr Moore, one of the things going through my head, which was crystallised by Professor Harper's remarks, is whether we might have it the wrong way around in the sense of talking about the provision of banking services and financial services separately, with a focus on banks and the traditional view of how they have operated. In rural, regional and remote areas where a physical facility is still needed and desirable, maybe a single local monopoly should be provided which is a financial services provider which includes banking. It would not be a bank which has other things, but financial services in their full range of which banking is but one part. You have looked at the community bank kind of development. Has there been any thinking that that is where it needs to go; that rather than community banks we need community financial services of which banking is just a part? That is a bit of a difficult concept to wrap up.

Mr T. Moore—When we talk about financial services, the vast majority of them are covered by a bank and the various ways you can access that. As to the idea of local accountants, solicitors and financial advisers—in some of these towns they are not necessarily there in any case. With Professor Harper, there was a very strong emphasis on information and expert advice, but for a lot of people it is simply being able to go and do transactional banking. I see banks, credit unions or building societies as the financial service advisers people would most frequently want to visit. That model of a broader local monopoly might be difficult.

I did have an idea which might run into trade practices problems but is something that would be good to explore. If a bank branch closes, you would basically grab that whole market and get together everyone who wants a branch, find out the basic characteristics they want in terms of their banking services and, in a sense, tender that out to a bank. The problem is that in these smaller markets a branch might have closed 10 years ago but 30 per cent of the population are still using the bank. If they were able to coordinate their actions, which is what community banking allows—certainly much more than traditional banking—perhaps a community could retain its bank branch for as long as people will collectively commit to it.

Senator MURRAY—When I listen to the various witnesses, what emerges is that in a community sense the demand for basic transactional banking services is where the numbers lie in terms of people. The margins are very low and costs are high. On the financial services side is where the returns are higher but the numbers of people are lower: a few businesses, farmers, so on and so forth. In urban or large centres you can disperse those services into different institutions but in a small community you cannot. I wonder if anyone is doing any work on ways in which you can blend. Traditional discussion is about a multiagency approach but I am talking more about a multiproduct approach from one body, one company, one operation.

Mr T. Moore—I would not have complete knowledge in this area. RTCs and government bringing in additional services seem to be the best examples I can think of so far; not too much in terms of a private initiative.

CHAIRMAN—According to the main director of Bendigo Bank, the paths to opening a community bank can be long and arduous. Apart from all the community work involved, he has indicated it needs to generate at least $250,000 a year in profits to be viable. It needs about 50 per cent of the population of a small town to use that bank and make it viable.

You said in your submission that the fact that community bank branches have closed creates the potential to have an unrealistic picture of their future: there will come a time when the benefits they provide are outweighed by the costs of keeping them operating. Can you expand on the major obstacles to establishing a community bank and the fact that they might need to close. Can you also comment on whether there is a role for the government in assisting with the establishment and maintenance of community banks.

Mr T. Moore—In terms of getting a community bank branch going, basically the communities approach Bendigo Bank. Then they need to raise a small amount of money to undertake a feasibility study if both parties think it has potential. That tends to cost in the region of $10,000 to $20,000. Mr Gillett could clarify that tomorrow in his evidence. There is a role for government there. The Victorian government has put aside some funds to provide money for communities to conduct feasibility studies. That involves a survey and some analysis of likely costs and returns to the community. By ‘community’ I mean the community shareholders. One way to think about it is that Bendigo Bank is the franchisor. There will normally be 100 to 200 local shareholders who will put in money and they will get any profits from that section. Bendigo Bank will get other profits, based on a division of revenues and costs.

There are a lot of media articles which say they split profits. They do not split profits. They split responsibility for revenues and costs, which means that one could be making a profit when the other is not, or one could be making a higher profit when the other is not. That is just something to consider in terms of understanding what is motivating a community to get involved and what is motivating Bendigo Bank to get involved.

Then they will, these days, put out a prospectus, raise these investment funds. Originally they were around $150,000 or $200,000. Now they are up to $600,000 or $800,000. That money has to be raised locally by the community. Once that is raised and a local board is formed, then that entity gets going, finds the premises, finds staff. Bendigo Bank train the staff, add them to the network and put all their products in there. I do not know the shortest time that process can take. I would be surprised if it was done in less than six months. It has taken up to three or four years. Some of them start to raise the funds and then they tend to stall. In my view, if they are stalling longer than 12 or 18 months, I would question whether it is worth going through with it.

Regarding closure, at this stage none have closed. There is a five-year agreement in place between the two parties, which can be extended for two further five-year periods. If you have an initial amount of capital—take $400,000—early on that capital will be eaten into as the costs are greater than the initial revenues. I do not know the figures but I would not be surprised if in some situations that capital has all been used; in fact, that Bendigo Bank have had to come to some arrangement, whether by overdraft or something, to allow that bank branch to get profitable, so that over time, hopefully, it turns around and that money goes back in. The initial profits from the community then can repay that, can ensure that there is enough equity there, and any additional can either go to dividends or to community projects.

If these close, then it is a question of at what point they close. If the community put in $400,000 and they close when there is $400,000 equity there, everyone gets paid out what they put in and we have had a bank branch for a time so it all works out pretty reasonably. If $400,000 was put in, we keep going but the community bank branch is not doing particularly well and it decides to close and there is no money in there, then Joe, who has put in $5,000, will lose that; Margaret, who put in $500, will lose that. It is an interesting question: if someone gets an additional bank branch for, say, a period of 10 years but loses an additional $4,000 in the process, is it worth it?

It will be really interesting to see how Bendigo Bank do handle this process because I do not agree with the view that they will be around forever, where they have been. They still have to face greater technological substitutes. Certainly they will not be there as a physical branch form because of greater substitutes, competition, decreased dependence on bank branches by customers. They face all of those same forces. There will be some closures. Hopefully, they will be handled in the best interests of the communities so that they do not get the double whammy of losing a bank branch at the same time as losing a significant amount of savings in the community.

With respect to government involvement, I think some sort of oversight, if that were possible, would be good in that regard. I believe APRA do not look significantly at community banks in themselves at the moment. They look at it simply as part of Bendigo Bank. It might be useful if they kept an eye on that. If you are looking at access or you are trying to support these positive externalities to keep these bank branches going in these towns, then perhaps there is a role for government to subsidise—in effect, increasing the capital in there, which hopefully then is managed well over time. How that is actually done, I do not really know.

CHAIRMAN—Obviously to get the community banks going, there is a lot of community enthusiasm and activity required.

Mr T. Moore—Yes.

CHAIRMAN—Once they are up and running, is there a tendency for that enthusiasm to be maintained, or once people have their bank back, as it were, does apathy tend to set in? Does that perhaps lead to the tendency of them not surviving, or create the possibility of not surviving in the longer term once that initial wave of enthusiasm has gone?

Mr T. Moore—The main voluntary capacity required, once it is up and running, is the board of management. That is all voluntary. I think there possibly is a danger that they will struggle to find new members for that over time. There will definitely be some very enthusiastic people involved. I met some great people involved in local community bank boards as I visited these towns. Certainly strong leaders with good community networks are crucial to these community banks getting up, and doing well once they are running.

When the bank branch is first mooted, there is the local investment but there is also a survey done. If I am a member of a community, I would get a survey: would I be willing to shift these products over? That is a good thing. It allows some sort of signalling for me to say, ‘I’m willing to do this if we get a community bank branch.’ The danger is that over time I get complacent about that community bank being there. I am not getting any of those signalling mechanisms, I am not being asked whether I am willing to give more, or whether I am willing to keep that there. Then I might not give the community bank branch any consideration. There is a danger that the coordination that is strongest when community banks are established can dissipate over time.

I think it is a good idea for them to allow some periodic review—‘This is where we’re at. We’re going to get back into the community and see if we can improve it’—and really hold an appropriate incentive, keeping the bank branch secure but using some of those dividends to support community projects, which all of the boards have the discretion to do.

Mr HUNT—Mr Moore, you outlined the fact that the Bendigo Bank branches effectively work as franchise arrangements, with the ownership of the franchise coming from community members who each purchase a share.

Mr T. Moore—Yes.

Mr HUNT—If those are put in place where traditional bank branches are closed and you have all the transaction costs of going through that process in the community, is there anything which prevents traditional banks adopting that model for a certain percentage of branches? I just want to see whether there is any reason why they would not be able to do that.

Mr T. Moore—Theoretically, there is not. There is a question of trust and credibility and positioning. I think the first community bank came about after Mr Rob Hunt, the CEO of Bendigo Bank, was at a dinner where members of a community—I believe it was Rupanyup and Minyip—approached him. They had heard him floating an idea and they were willing to give it a go. If you are a community member who is concerned about this, then you need an avenue to negotiate with other banks. You need to be able to communicate with them and believe that they respect your interests and have your interests at heart, to some degree, and that there is some credibility in the commitments on both sides. For example, a community may choose to have a similar arrangement with another bank. They have to be confident that this bank will not pull the rug from under them in a couple of years. That commitment has to be in terms of definite time lines because there is not enough good faith on the issue of branches for that to occur.

I listened to the end of ANZ’s evidence this morning. The moratorium is good, but I think they would get a better response from a community if they said, ‘This branch is going to be here for five years.’ The nature of a moratorium is that it is here at the moment but it can change at a particular point in time. I would not necessarily say that people expect that change. Certainly I think the banks are interested in what is happening in community banking. It is nearly five years since the first one started and while it is of a scale where it is still a small speck on the financial services industry, it is significant and it is growing and it has momentum.

In terms of resolving this social issue of branch closures, any way in which we can encourage other banks to think along these lines and think about following a community bank model or making a hybrid community bank model is a good thing. I think there is scope and opportunity there.

Senator WONG—In your submission at page 5, where you talk about the benefits of a community bank structure as opposed to a nonbranch service or a rural transaction centre, you are referring there to the additional services as being the advantages of a community bank. Is that what you are referring to?

Mr T. Moore—Yes. I am saying that there is an issue of quality that can get a bit lost in the discussion of whether, ‘This person can visit an agency; this person can jump on the Internet.’ There are people who want to visit a bank branch and not a credit union. There is a notion of quality where some people have a preference for banks and some people have a preference for branches, as opposed to other face to face methods. It is not simply a matter of asking, ‘Can they do it?’ It is really a matter of which way they would prefer to do it, and whether we are able to find a way where that is feasible in a market sense.

Senator WONG—There were two issues that you identified as being relevant to bank closures. One was whatever particular rate of return that the banks set as their benchmark against which they might assess the performance and, therefore, a decision to close or not close a branch. The second was where you referred to a lack of regard to positive externalities associated with rural and regional banking—neither of which I necessarily disagree with, but I struggle to see what role government would play in addressing those two factors for the purposes of trying to minimise or lessen closures. It seems to me that, yes, you are right and there is a community cost as a result, but what is it that governments could do, other than to regulate?

Mr T. Moore—Short of heading down some elaborate information, community service obligation path where banks would come before a body and say, ‘This is why we want to close,’ and they could be told, ‘Come on! You’re making 10 per cent return; wear that,’ the government cannot do a lot directly in that regard. I think the government can provide better information about what is driving this, because I think sometimes communities do not always understand what is happening and, if they responded in some cohesive way, then it might create more options for them; get them thinking about why these closures are occurring.

The other one that goes back to my original statement is decreasing the transaction costs associated with the closures. If we look at the National Australia Bank closing 56 agencies or branches—we could have a definitional debate on what they were—and the ANZ coming in and saying, ‘We want to buy those,’ that might have been a convenient claim to make. If they were honestly wanting to do that, then really there should be a market where, even if the NAB refuses, they can come in, set up a branch for approximately the same costs and get all of those NAB customers going over to them. That does not happen because of switching costs, search costs; customers generally staying where they are. You cannot reduce all of those transaction costs but certainly some of them should be looked at and reduced wherever possible.

Senator WONG—I assume in your submission, regarding bank closures, your suggestion would be that the protocols applicable to bank closures would involve some sort of requirement to negotiate and consult.

Mr T. Moore—Yes.

Senator WONG—How does that fit with the banks saying, perhaps legitimately, ‘This is fundamentally at the end of the day a business decision that we make, and we’re not going to get into a position of negotiating that decision with the community’? How do we get around that?

Mr T. Moore—It is a legitimate business. I am suggesting that if they said, ‘This is what we need to keep this branch open,’ it is giving the community an opportunity to respond to that. I will give you an example of where that does not happen. I will talk about the NAB and its closures. I recall it was announced that there were going to be 56 agencies closed in one week and, ‘We will announce those on Monday.’

Basically, it is saying, ‘We don’t care what response you’re going to have to that. We’re going to close in these locations.’ Any kind of signalling and allowing customers to respond and allowing them mechanisms where, in small towns, they can network, as is allowed in community banking, will make that easier, because I might make a different decision when I can talk to a wider range of people in that community than if I were to make choices on what would be most convenient and cheapest for me.

Senator BRANDIS—To my mind, the issue of community banking raises the question of the adequacy of the capital of the banks themselves. Many, but not all, of the witnesses we have heard in the last couple of days seem to have lit upon community banking as a good fit for regional communities. I am pleased to observe in your submission that you say that it is not a panacea. Nevertheless, you seem to favour it as the best alternative, in the event that there is a closure of a traditional branch of a major bank. Have you thought about the greater exposure that communities served by community banks might have because their financial institutions will be more thinly capitalised? The capital that will be at stake will be the capital of local businesses and families which have, presumably, relatively modest means. In particular, have you thought about what, if any, additional regulatory requirements might need to be imposed upon community banks to protect those who invest in them?

Mr T. Moore—There is exposure in terms of the money the community bank receives in relation to fees, its portion of the interest, its costs in terms of building and its staff. In terms of exposure in relation to banking products and credit risk, that is borne by Bendigo Bank. If a loan turns bad, Bendigo Bank would resolve that, and no risk would be borne by the community.

Senator BRANDIS—That is not a uniform structure among all community banks, is it?

Mr T. Moore—I believe so. It would be a good question to ask Mr Gillett tomorrow. If you were to go down the path of the community being responsible for credit risk, for example, that is a worrying development, because unit banking—single branch banking—really fell over in the 1890s in Australia because a particular area—agriculture, for example—had some bad years, and you cannot diversify risks across a broader network.

Senator BRANDIS—That is really my point. If you were to have a community bank in a rural area, based around a large rural centre, and most of its business was to lend to agricultural producers—to people who grow grain, for example—the ordinary security which a bank would take in those circumstances would be a crop lien. Let it be assumed that a number of bad lending decisions were made so that there was a default and the security did not sufficiently cover the debts, so the bank fell over. That would have a devastating and highly localised impact in that community. For that reason, I wonder what, if any, additional requirements ought to be imposed upon community banks, in terms of their holdings of capital, lending guidelines, or some other way, to avoid those risks which, it seems to me, are not as great with larger institutions with greater access to large volumes of capital.

Mr T. Moore—From my understanding, community banks will run into issues because of the size of the deposits and the number of people going into their local bank branch. That could be affected by, for example, the current drought. I return to my earlier point about whether in some way APRA, or a suitable agency, can keep an eye on—

Senator BRANDIS—Incidentally, I think that you are wrong about that. APRA's evidence yesterday afternoon was that it does oversee community banks under its statutory obligations, and those cover community banks just as much as they cover other banks and other financial institutions.

Mr T. Moore—In terms of credit quality, APRA oversee overall bank reserves and so on. In normal practice it goes back to directors, directors' duties and taking due care. In this situation, it is possible that they could ride their luck too far in that they could use all that capital before closing—because it is keeping the bank branch there. It is not necessarily a profit maximising entity. Perhaps nothing can be done with that in terms of oversight. Perhaps the first couple of instances when community banks close will reveal what steps can be taken. In terms of the broader question of oversight of exposures, because of the franchise arrangements most of those risks reside with Bendigo Bank rather than with the community banks.

CHAIRMAN—Thank you very much, Mr Moore, for your presentation and for your answers to our questions. It has been very helpful.

BECK, Mr Anthony Joseph, National Secretary, Finance Sector Union of Australia

CHAIRMAN—I now welcome the representative of the Finance Sector Union of Australia. The committee prefers all evidence to be given in public, but if at any stage you wish to give evidence, or part of your evidence, in private then you can make such a request and the committee will consider moving in camera. We have before us your written submission which we have numbered 69. Are there any alterations or additions that you want to make to the submission?

Mr Beck—There are no alterations, Mr Chairman, other than a clarification at page 7 where we talk about our concern on relaxation of the four pillars and the consequent impact of branch closures and job loss. At 5.2.2 the estimate of over 4,000 jobs that will be lost refers to 4,000 jobs in rural and regional areas. The job loss would be substantially more than that. That is just clarifying that that number, based on our analysis, would be the impact on rural and regional areas, but the total job loss would be greater than that.

CHAIRMAN—I invite you to make a brief opening statement, following which we will proceed to questions.

Mr Beck—Thank you, Mr Chairman. I will be very brief. The FSU appreciates the opportunity to speak to the committee today. We have made a number of submissions over the years to various parliamentary inquiries and this submission is a bit briefer than previous submissions we have done. In essence, what we have tried to do is outline some of the experience from previous inquiries and summarise the work that various state governments have done in inquiring into this very issue. We have made some very brief commentary around the community banking experience because we have some particular views about that. At page 6 or thereabouts we have drawn from the evidence and tried to outline and articulate in a bit more detail the actual impact on individuals, businesses and communities of branch closures.

Moving through to page 7, our principal concern is with four pillars. We have been concerned about this for some time, so it is a defensive measure, but we do say that the committee should think about this as a particular recommendation—to state its view that the four pillars, for the foreseeable future, should remain. In previous submissions we have talked about different international experiences. We have talked about the Community Reinvestment Act in the US. Taking a bit of a left-field approach here we have talked about Canada. In Saskatchewan some local cooperative work is being done there. It is not particularly unique—the Bendigo Bank is an example, and credit unions here are further evidence of that. The point we are trying to draw out is the importance of a closer connection with communities to get satisfactory results.

Ultimately I guess we are led to the view that says, ‘We have had plenty of inquiries. There is plenty of evidence. We think there is a significant problem. It is really now time for some particular initiatives to address these concerns.’ We have talked about a social charter for some time. In summary, our recommendations are: a clear statement around four pillars; we would like to see some support or consideration given to the notion of a social charter—and we would need to have a fairly significant philosophical debate in that regard. We also talk about a public interest impact assessment. Whether that goes into the Banking Act or the Trade Practices Act, we are not sure.

What we can tell you is that every time there is a bank merger and competition issues are discussed—and quite properly so—if issues go to the public impact on employment, jobs and the community dimension, it seems to us there is no reserve power or no legislative capacity for that to be properly considered. I will leave it at that, Chairman. I welcome any questions.

Senator MURRAY—Mr Beck, it seems to me that the weakness of RTCs is that they are only directed at one part of the need, and that is for basic transactions. But a person, most of whose banking interaction may in fact be of that kind, will nevertheless be likely at some stage in their lives to have a need for more sophisticated services, such as advice about a mortgage, or what to do with superannuation or something of that sort.

You might have heard my question earlier to Mr Moore—and there are many ways in which the model could be created; it could be a franchise, a community cooperative or provided by the government; there are all sorts of ways—but the essential proposition I ask is whether you think there is a chance of providing a market mechanism which is profitable by a kind of multiproduct operation which provides all financial services of which banking is but one part. That can also be a focus through which technology can run. For instance, it can include an ATM attached to it, or it can include video link facilities, so you can talk to real specialists in certain areas—that sort of thing. I see that you refer to some international precedents. Has your union looked at these sorts of flexible models in any way?

Mr Beck—To be honest, Senator, we have not. We looked a bit at the RTC experience and it seems to us it is a very inadequate response to a major crisis in rural and regional Australia. During all the time the program has been up and running, at least based on our research, only 49 have been established. It is a very limited response. If your question is whether the union and I can envisage a multiproduct delivery, do I presuppose there are multi-enterprises backing that up, or is it a single enterprise doing it?

If it requires cooperation between the enterprise and our industry, I would suggest to you that it would not occur. I cannot envisage our enterprise, our employers, coming together in a constructive way and saying, ‘Here’s a community problem. How about we come together and cooperatively work up a solution which might be shared delivery in a particular area?’ I cannot envisage that based on our experience.

I might be wrong, but there has been no evidence of a cooperative or a social dimension to the major banks in particular. I can give an example of the industry training authorities that have been established. Our major banks do not participate in those because they jealously guard their own individual enterprise comparative or competitive advantage as they see it. My short answer would be that, based on their track record, based on their past experience, based on their obsession with their own enterprise capability, I cannot imagine them coming together in a cooperative way to provide a solution to what you have outlined.

If it is not a multi-enterprise solution and you are asking whether the market suggests that such a multiproduct capability is supported, I would suggest to you the fact that Bendigo Bank goes into these communities where the major banks have withdrawn—and, again, based on our knowledge, all of the outlets have been successful and viable—demonstrates to us that what the major banks are doing is that, because they have very high return on equity requirements, it is not transparent, it is not disclosed to communities and communities do not know what the hurdle is. They do not know what is required in terms of viability and profitability. From a public policy point of view no-one knows that information, but the banks unilaterally, with very little notice, shut down an outlet. We do know that where Bendigo Bank has come in and filled that void, purportedly they have been able to do it profitably and successfully.

Senator MURRAY—The professor who spoke to us earlier put a useful concept back on the table. He did not use this exact term, but he said that a market vacuum simply takes some time to fill—in other words, it is not a market failure, it is market delay. It seems to me the evidence is pretty conclusive that in many of these circumstances it is not possible to have a number of stand-alone enterprises—banks. They just cannot make money on a commercial basis, so either you have to make them be there on a noncommercial basis—and the professor says that is simply counterproductive because they will be very unwilling participants—or you end up with a local monopoly and, even in those circumstances, because of the limited range a single enterprise has in terms of production, it may not satisfy the needs of the community.

To me, the multiproduct option has to need at least some examination and, if your view is that the banks will not do it, you are almost forced back to the government's proposition that they had to create the rural transaction centres. It was not the financial institutions that joined together to create them. It was a government initiative.

Mr Beck—It seems to me, Senator, your question has two principal features to it. I did not hear Professor Harper's presentation, but it was around there being a market vacuum, not a market failure, and that it just needs some time to fill the vacuum. My response to that would be to say that, going back over the last 10 years, the major banks have been allowed to acquire and aggregate all the regional and state banks and create a market in their own image and, in oligopolistic fashion, set the price, dominate the market and decide where they will or will not provide a service.

The example in our submission is very real to us in Victoria. The Commonwealth Bank bought the State Bank of Victoria for good and proper reasons. The State Bank of Victoria was run into the ground, of course, but the impact of that was 7,000 jobs being lost, 3,700 retrenchments and the loss of 301 branches in Victoria. In a changed environment later in that decade, Westpac bought the Bank of Melbourne; the old Melbourne Building Society. There were 120 branches throughout the Melbourne metropolitan area and in some of the rural areas. Westpac made a bid. We went to Professor Fels at the ACCC and said, 'We are concerned about this. We are very concerned that all that is going to happen here is Westpac will acquire the brand, the infrastructure and the market share and then proceed to shut down the points of representation.'

Under the Trade Practices Act, in terms of Professor Fels, we had no recourse. He simply said, 'My only criterion is competition. Is it going to diminish competition in a sustainable way in the market?' He then took a broad view of the market, which was the Australian market and not the Victorian market, and allowed it to proceed. Westpac gave certain guarantees. Three years later, the net effect is that Westpac have shut down all of those Bank of Melbourne branches. They have bought the market share and reaped the benefits and cost savings of that rationalisation. Professor Fels's theory was that, the bank having reaped those savings, the consumer would see a reduced price. He said to us, 'Yes, there is going to be job loss, but that is going to reduce costs, therefore prices will come down.' The evidence, in our view, is that prices have not come down. Westpac's pricing in Victoria is no different from anywhere else in the country, and they have reaped that advantage.

My response is that the banks cannot now say, ‘Look, these areas aren’t viable for us,’ because they have had 10 or 15 years of aggregation. They dominate the market like no other banking market in the OECD world. They have a return on equity such that, if it does not approach 10 per cent, the CEO has failed and will be terminated. We say the market is not just Rupanyup or some rural area. That is not the market. The market is the broader Australian market, where you are getting an ROI of 20 per cent. You have massive sustainable profitability. That is the market and, because of your dominant market position, you have an obligation to provide a service.

In relation to the question about financial viability, Professor Harper says you cannot force enterprises into nonviable operations. No-one has ever tested that. There is no disclosure. We just do not know. When the National Australia Bank closed those 56 branches, no-one was provided with information that demonstrated that any of those branches were not viable. There was no disclosure at that point, and we say that one thing that has to come out of this is some transparency, accountability and disclosure. Of any sector of the Australian economy that needs it, it is the financial services sector. The NAB unilaterally declares that those 56 branches are not viable by their criteria, but I would guarantee that they are viable; not as viable as perhaps they would like, and perhaps not returning 20 per cent ROI, but they would be profitable and viable.

You are looking for a solution which is a legitimate, right and proper thing to do. We are not quite at that stage. We are still doing a critique of why we are at this point, and should we then start to talk about alternatives when that, in our view, lets the major players off the hook. It allows them to avoid their responsibilities.

Senator MURRAY—Without putting concepts into the committee’s head, broadly speaking, we have all been looking at this from two directions. One is demand satisfaction; people express a need and how you are going to satisfy that need. The other is working at the supply end, with an intention of promoting regional development by the availability of an essential service, which will then contribute to adding value to that particular local regional economy.

Returning to our discourse, what you have outlined there is classic competition theory that an enterprise will act in its own self-interest and move along the scale towards monopolisation, because that guarantees maximum profit and return. There is nothing irrational in that. Your proposition goes further to say, if you wish to correct that, you have to correct that through law and through requiring either a social charter or community service obligation approach.

One of the things we have been looking at is whether there should be a combination of those things. Again, I am not putting words into the committee’s collective mouth, because we have not considered this, but one of the possibilities is to lower the cost and the regulatory difficulty by providing some relief in various areas for regional, rural and remote operations—for instance, giving discretion under the Trade Practices Act, and at the same time adding to that a requirement that, in conjunction with a banking licence, you have to ensure that you maximise service to a representative range of Australian situations. I would assume you do not really mind, as long as a mechanism is found to provide the jobs and to do what is necessary.

Mr Beck—That is right. It is a matter of public policy for the parliament eventually to get these balances right. We simply stress the point that this industry has been the epitome since, under the Keating government, the banking industry was deregulated and foreign banking was brought in. We were the epitome. We were the model of a deregulatory experiment or regime integrating the Australian financial services sector in the global economy. After 15 years or so, we think that it is right and proper for this community to look back fairly carefully, expose industry to some scrutiny and say, ‘Well, yes, there’s a market and market forces are right and proper,’ but also assume low barriers to entry to allow new competitors to come in to make sure there is price competition.

We say that the net effect of banking is that the foreign banks have not really been able to provide price competition. It has aggregated in the four major banks. They have swallowed up their competitors. They are effectively price setters rather than price takers, and the market is, to that extent, dysfunctional. We also say that, by having a banking licence or an ADI—approved deposit taking institution—that is a very particular authority and privilege to have in the Australian economy. With that comes certain responsibilities. The industry is regulated in a way that demonstrates that it has a particular place in the smooth functioning of the Australian economy. It has a whole range of privileges and, we say, comes with very high returns for shareholders, executives and directors. But there must also be some responsibility attached to it and we simply cannot see, through the Banking Act or the Trade Practices Act, any meaningful, effective capability for rural communities and the people that I represent to actually make the banks accountable in any way. That is why we say a public impact assessment should be a fundamental requirement for any merger.

The short answer to your question is that we would not oppose creative solutions going forward. You talk about lowering the cost. I immediately think about that, for my members, as involving wages and conditions. I obviously hope they are not under threat, and we are not talking about a differential or a substandard employment regime for our members who would be working in that environment.

Senator MURRAY—That has not been raised, as far as I am aware.

Senator WONG—Mr Beck, with respect to the social charter that you have attached to your submission in relation to branch closures, do I read it correctly that you are not suggesting anything which prevents a bank from ultimately making a decision to close? You are more focused on process; a longer time frame obviously than the current banking protocols would impose and some consultation process.

Mr Beck—Precisely. We are not trying to be King Canute and stop structural adjustment. We are saying that, for reasons I have outlined, the major banks do have a social obligation. Whether they like it or not, whether they accept it or not, they do have an obligation. If, like the National Australia Bank, they are going to announce 56 branch closures, they do have an obligation in our view to be transparent and open, to give proper forewarning of that and to allow the local communities to respond and say, ‘Well, what do you need? What is a financially viable branch operation? Give us an opportunity to meet that.’

Senator WONG—On page 13 of your submission you set out a summary, as I understand, of obligations you say should be attached to the bank’s licence to operate, for want of a better term, and that is the provision of various fee-free accounts et cetera. What does the second dot point mean: ‘Low fee no free’? Is that a typo?

Mr Beck—That is a typo.

Senator WONG—I thought there might be some term of art I was not aware of. Has the union turned its mind to how that might be transacted in terms of the government? Is that a CSO obligation that the government would pay for or are you saying this is simply a regulatory requirement? The banks' argument is, 'This is an impediment to our ability to operate profitably,' et cetera.

Mr Beck—Again, the social charter tries to deal with a whole range of issues to do with structural adjustment. The American experience has been that major banks red-lined complete districts. Lower socioeconomic groups were red-lined and the major banks in the American environment withdrew. What we are saying is that banks have a responsibility not only to serve rural and regional Australia but also lower socioeconomic groups. They need to have access to the payment system. A transactional capacity is a fundamental human right, in our view, or a civilian right. It is like access to power or water.

Senator WONG—I do not disagree with that. I am just asking whether the union has a view—it may not—about how that is paid for.

Mr Beck—No, it does not have a particular view.

Mr CIOBO—Mr Beck, shouldn't you have a view? It is well and good to put forward a proposal but it is a whole separate issue to cost the proposal and to make the proposal pertain to the commercial realities of the day.

Senator Wong interjecting—

Mr CIOBO—No, I do not mean costed in that sense; I mean at least generate options. Yesterday one of the witnesses was the New South Wales Local Government Association, who share certain aspects with your social charter about the need to provide basic services. I asked them what their proposal would mean and whether or not they believe that cross-subsidisation should be from all Australians or from only those communities to which they would seek to apply these community service obligations. I put to you the same question as I put to them.

Mr Beck—It is a legitimate question. To be honest, we just do not have the necessary expertise to go through the full economic analysis of what the particular costing is. As a trade union we try and deal with our members' concerns and hopes and aspirations. Part of the development of this proposition came through consultation with a range of community groups—underprivileged communities, churches, welfare groups. It was an attempt to incorporate the objective without, as you quite properly say, going through the more detailed analysis of how it should occur.

It could occur in three ways. It could be a requirement of the banks, given their profitability and their capability—that is, cross-subsidisation could occur through a proportion of lower shareholder returns within the banks' own operations. It could become a public policy question, a government question, and the government could then provide a subsidy to offset that cost. It could be a combination of both. They are the three alternatives.

Mr CIOBO—That is effectively the point, though. It is not that I would say anyone would disagree with the objects that you are putting forward. It is just that in the real world the consequences would be that either that needs to be paid for through taxation, which means an increase in tax, or alternatively those costs need to be passed on to consumers. Given that you are trying to provide for a significant number of consumers to not pay fees, to not have a user-pays system, those costs would therefore need to go to those consumers that generate and have more business with the bank. Alternatively, as you said, it would mean that those costs are absorbed by the bank in terms of lower returns for shareholders. What is the rationale for that? At the end of the day, shareholders are made up of ordinary members of the community.

Mr Beck—It is a right and proper question you ask, and that is a reality. I will tell you my reality. My reality is that we deal with employers who describe lower socioeconomic groups as bozos. That is David Murray's description—'below zero'. Their value to the bank is below zero; they are bozos. The banks behave and act and construct products and distribution in a way that drives those people out of the network. They do not want to service those people; they are bozos. All we are saying is that we do not think that major banks, with the dominance they have in the market, should be able to behave like that. In our view, they put in discriminatory pricing structures. If you go into a branch and do an over-the-counter transaction, it costs substantially more. Economic rationalisation says, yes, they can cost it, therefore they price it accordingly. But in our view, in the last five years that was designed to force people away from face-to-face contact onto the electronic network where there are low or no fees. Once the migration has occurred, the branches are shut down and then the pricing goes up on the electronic network.

My view is that the major banks act in their own interest. I do not think they have any interest at all in acting in the social interest. Don Argus made a pronouncement—I think it was before the Hawker inquiry, and I appeared after him, and the ABA made the same pronouncement—that banks have no social responsibility, and that is the way they behave. Yours is a legitimate question. I do not have the answer to it, but the reality that I face is to work with people, groups and representatives who face that sort of behaviour from those sorts of employers.

Mr CIOBO—Then what about, for example, the fact that one of our witnesses said—and this was just internal for their organisation—that for every dollar in deposits they obtain from a regional centre they reinvest $2 back into that local community? That would seem to run contrary to your assertion.

Mr Beck—I have not heard the evidence. I would have to take that on notice. Take the Commonwealth Bank, which was 'the people's bank'. Post privatisation, in the last 10 years, they have closed 850 branches. A large proportion of those are in rural and regional Australia. They have shed 17,000 jobs; they have halved their work force. At the same time, their profitability, their return equity, their executive remuneration, have gone through the roof. That is not extraordinary behaviour. That is typical of this industry we are dealing with. What we are saying is that after 12 to 13 years of deregulation there are certain behaviours that are manifesting themselves. I do not have any confidence in the industry self-regulating its way out of that.

I have heard all the statements from all the CEOs announcing moratoriums on branch closures and, to be honest, I do not understand how that works. They have all made those pronouncements, but APRA last week announced that there have been a further 136 branches or points of presence closed by the four major banks. All CEOs have said there is a moratorium. They give their solemn word, their solemn pronouncement, 'There's a moratorium.' But APRA says that within the last 12 months 136 further points of presence have closed. Westpac is the only one that has had a marginal increase.

Our submission is simply to say that, if you want to know what the future looks like in this industry, just look back over the last 10 years. That is what it is going to be like without a strong and effective response from this committee. That is what the future looks like.

Mr HUNT—Mr Beck, in the FSU submission, particularly under recommendation 5, you are talking about the distinction between transaction banking and comprehensive financial services, and you say that some of the remedial efforts to fill in when a banking point of presence leaves a town might deal with the transactional but do not deal with the comprehensive financial services. I hope that is a fair representation. Isn't it the case that a lot of the comprehensive financial services were not handled by the banks themselves but were handled by central points of presence and via the telephone or through visiting, that those services were not handled by the local banks in any event?

Mr Beck—That is more accurate than not. It depends on what time frame we are talking about.

Mr HUNT—In the last decade.

Mr Beck—Most recently, that is right. Ten years ago every branch had a branch manager who had a lending discretion and who could handle basic small business, commercial and personal lending capability. During the decade, that was centralised into hubs. They had what they called a hub and spoke model. There would be a branch that had credit skills and capability. The branches were on spokes and fitted into the hub. Your point is quite accurate. The only qualification I would make is that the branch, notwithstanding the fact that it may not have had a manager with a particular discretion for lending, was a very direct link to that hub, to provide that credit capability, further financial planning advice or whatever. If you take the branch away, it does militate against that access.

CHAIRMAN—As there are no further questions, I thank you very much, Mr Beck, for your appearance before the committee and for your answers to our questions.

[2.21 p.m.]

BARBER, Mr William, Investment Manager, Latrobe City

FRANCIS, Mr Christopher Michael, Director, Organisation Strategy, City of Ballarat

EDWARDS, Mr Troy, Senior Adviser, Public Policy, Municipal Association of Victoria

YU, Miss Kerry, Policy Adviser, Municipal Association of Victoria

CHAIRMAN—I welcome representatives of the Municipal Association of Victoria. The committee prefers that all evidence be given in public. If at any time you wish to give part of your evidence in private, you may request that of the committee and we will consider a request to move in camera. We have before us your submission, which we have numbered 114. Are there any alterations or additions you wish to make?

Mr Francis—No, Mr Chairman.

CHAIRMAN—I invite you to make a brief opening statement, at the conclusion of which we will move to questions.

Mr Edwards—I will make a couple of overarching comments first on behalf of the Municipal Association of Victoria and the local government sector. We made a submission to the 1997 Hawker inquiry into rural banking. Many of those issues still remain today. Local government, as the level of government closest to local communities, continues to have concerns about the availability of banking services for their communities, be it personal or business banking. We acknowledge that developments like Bendigo Bank have assisted rural communities, but local government is still working quite hard in many places to assist communities to secure new types of banking services. That will continue to be the case. It is worth noting that, for small regional communities, even contributions to feasibility studies and the like continue to place substantial strain on the finances of those smaller councils.

I do not want to say too much more than that today. We have representatives from Latrobe and Ballarat here to perhaps give you some on-the-ground views about what is happening in their municipalities. Then we can try to answer any overarching questions.

CHAIRMAN—Is there anything you wish to add to the opening statement?

Mr Barber—Yes. Thank you very much. For my submission I purposely went out and spoke with the community so that it was not only the gospel according to the council; it was the gospel according to the community. My major concerns and the concerns I found from the smaller towns where banks did close were that it was a bit like losing the local priest, politician, parson or whoever.

Senator BRANDIS—I am surprised that the loss of a politician would be seen in some parts of Australia as cause for lamentation.

Mr Barber—We are very pleased with ours. In our area we have one of each, so we are very happy. It is balanced. But the problem of concern for the smaller communities is that, when a bank or school closes, really the heart stops pumping in those communities. The other area of concern too is that the older generation—which you tend to have in regional, rural or remote areas—are not necessarily computer literate. Also, the bank manager is often seen as the local alternative to the mother or father confessor in relation to business. Particularly in areas like East Gippsland, where we have had terrible and severe bushfires, the interaction with the bank manager, who may be seen as a personal friend or confidante, is very important. That situation does not really exist these days in the banking fraternity because people tend to be faceless and behind a mask somewhere, maybe not even in the rural or regional area.

Mr Francis—The submission that the City of Ballarat has presented to you was formulated from discussion within council following, as Bill has said, a general calling for comment from the community. The points we have tried to put to you relate more to what we believe are broader questions, rather than necessarily dealing with specifics. The first one is about the potential for practical solutions to be developed.

It is probably very salient that, at the same time as this inquiry is being conducted, another inquiry is being conducted in cost shifting. The Hon. Wilson Tuckey is involved with that. Many of the same issues are relevant, including the role of local government and the pressures being put on us to deliver a range of services from which the other levels of government have chosen to withdraw or to reduce funding for. We are now faced with a reduction in private sector run services. There is the expectation that we will pick those up in some form, maybe through the provision of banking services within council offices, electronic funds transfer or other services. That is one level. We are really seeking practical solutions to some of the problems you are going to hear and have heard about.

The second point is that we wholeheartedly support the views expressed in other submissions with regard to the development of a social contract between the financial services sector and the people of Australia. For that to be in some way developed through consultation with the community is probably a preferable way that process could be discussed. We have gone one step further to suggest that should be enforceable under Commonwealth legislation, with penalties for noncompliance equal to those under Corporations Law. When you consider the range of penalties for fair trading and trade practices, we believe this is not necessarily an unreasonable extension of the current legislative framework.

The third point is that we take into account the number of studies done and the number of reports presented to the Victorian parliament and other bodies. In particular, we endorse the findings of the Economic Development Committee of Victoria’s report to parliament in May 2002.

The final point is in relation to the financial services strategy. As we have indicated, we have some severe doubts about whether that is a strategy which can deliver the goods, so to speak, in rural and regional areas. The reliance upon delivering Internet based services and moving of customers into that realm depends on factors over which the banks have no control and in which they have no investment, such as education in the use of IT and telecommunications infrastructure.

It is no good having banking online if you do not have a usable phone line. If you talk to small rural councils like Yarriambiack in the north of the state, you will find that is the crisis they face. You talk about the information highway and they are on the information dirt road. It is no good having a wonderful financial service like online banking if your people do not have access to it.

There is also the issue of how you educate the community to use those services. As I pointed out in our submission, reports from the United States and from the National Centre for Social and Economic Modelling—even our study in western Victoria—indicated that only approximately 30 per cent of the population is online. Based on the figures we have, those 30 per cent are going to generally be educated or at least high school or tertiary educated people with a substantial income of probably around $40,000 or more.

NATSEM once again has released a paper in 2000 of the growing gap between rural and urban salaries or wages. Given the fact that the predominant growth is in under $40,000—that is, between zero and $25,000 in rural and regional areas—poor people are not necessarily going to go online. Why? They do not have the money to bank with, so they have no desire to pay neighbourhood cable or other providers for the service. What value is it to them?

We really doubt the banks' strategy. It is fine in urban areas where you have people who are educated, are familiar with IT and have the wherewithal and the resources to be able to use it. What value is it elsewhere? Until some of those infrastructure issues are dealt with, we simply do not believe that the uptake is going to be sufficient to justify the strategy of removing face-to-face services and replacing it with something which really is not going to be taken up by the community.

CHAIRMAN—Thank you very much. In relation to the last issue of banking, you have indicated that obviously one of the problems is the telecommunications system. To what extent, in your view, has that facility improved over the last few years, or been upgraded to get people off the dirt road and onto the information superhighway?

Mr Francis—From our perspective, within the Ballarat region, we would suggest that there has been only marginal improvement. Once again, from a technical point of view, certainly we can have microwave links and we can have fibre-optic cable and all of that. For example, Ballarat has a strategy to develop IT business, but we simply do not have on the ground the kind of infrastructure which enables us to attract sustainable IT at the moment. That is an issue we are trying to address, but we have power outages, electricity failing and problems with coverage of mobile.

The opportunities for mobile computing, the opportunities for communication and information are key elements here. The ability of people in isolated areas to actually get the information about whatever it is is still a problem for many users in rural and regional areas. I cannot speak for other councils but certainly—let us say through some of the Networking the Nation funding—we have seen success stories in South Australia and in south-western Western Australia where small councils have banded together to try to overcome some of the limitations they have in terms of information infrastructure and telecommunications. But, once again, we are using Telstra's backbone. Once again, the direction that the major players take on the ground has a great influence on the availability and the sustainability of those services and the cost. It is a number of factors. We just really do not have the confidence that those issues are being addressed.

CHAIRMAN—Given those technological limitations, do you think the banks themselves could do more to encourage and familiarise their customers with electronic banking—tutor them in it?

Mr Francis—Their roll-out has been appalling. The biggest issue in selling online services is to explain to a person how it benefits them. I will give an example of when I log on to St George, which is my bank. First of all I have to have a computer and a modem. I then have to get to the site and log online. I then have to put in my card number or my bank number, my password and my security password. Imagine what a 75-year-old person, with no exposure to a computer, is going to make of that. Unless you train people, unless you educate people about the use of the technology and show them that there is some benefit in it, they are not going to be interested.

Brisbane City Council and certainly other local government authorities have tried to implement telecommunity centres, and that is one way of doing it. Ballarat does that—we provide free tuition in computing for people—but we are doing it at a local level. I do not see the financial services people coming to us with $50,000 to say, ‘Let’s help you out to educate the community about how to use our services.’ Once again, it is fine if you are an IT literate person, but the research indicates that obstacles to the uptake of Internet—and therefore online banking—is highly related to the education level of the person. That work has been confirmed in Australia and in the US. Are we there to educate people about how to do their online banking? Once again, local government is being forced to take on a role which really we do not believe we should have.

Mr Barber—I make the point also that one of the major problems with the electronic age is, of course, that copper cabling is still used extensively throughout country Victoria. It was amusing at the time, but I remember one person telling me that the only way they could effectively log on with their computer was to go outside and switch off the electric fence because it was interfering with the connection with the copper cables. I guess we still have a way to go in some areas.

CHAIRMAN—You may have heard Mr Moore’s evidence previously on the work he had done in relation to community banks. I must admit I meant to ask him a question on this supplementary table he submitted to us. Part of the research he did in relation to those four small towns of Avoca, Heyfield, Lancefield and Coleambally, indicated that 45 per cent of households across the four towns on average used the Internet at home or work, but only 14 per cent used it for Internet banking. There is quite a distinction there between people who use the Internet and those who use it for banking, which is a much smaller group.

Mr Francis—The Internet has proven to be exceptionally useful for information gathering, sports and private entertainment at home. But its value as a business tool is questionable. Let us go away from private customers into the business sector and look at the uptake amongst businesses. Once again, a business has to feel that its transactions are secure. The National Office of Information Economy produced a report a couple of years ago about online fraud and the perceptions in the community are that it is very easy to be defrauded in doing online banking. I have seen no real promotion by the banks to make people feel that online banking is secure.

That is another area where the banks are their own worst enemies in terms of not promoting the safety and the security of it. That really is something they need to address. It is no good telling people it is secure if they hear a myth that someone has had all their money taken by someone in the States getting their credit card details or their banking details by hacking into Visa card or the Commonwealth Bank. The perception of online banking for the general population is that it is not secure. Once again I would suggest, somewhat respectfully, that rural and regional people are more concerned, more conservative, and are probably not going to want to risk doing online banking if they think they are going to lose their money to some hacker overseas somewhere. Those issues are not being addressed by the banks. That is an educative process which I do not see the banks doing at a local level.

Senator WONG—I am not going to comment on a lot of the things you have said, when you talked about the importance of banking and financial services in rural and regional communities. That is a pretty consistent theme in the evidence and it is really unquestioned. The question is: what can a government do about it? What is appropriate for a government to do about it? Mr Edwards, I am not clear what you are actually saying in your submission about bank closures. Are you suggesting that what is important is to have an appropriate protocol relating to those?

Mr Edwards—Part of it would be to have that protocol—ensuring, however, that the community has access to a service. Chris has pointed out some of the cultural issues that go with that as well. If you have a protocol and there is an alternative service, are the educational processes in place to deal with that? Local government's view is that it is not necessarily its role to pick up that activity. It is just part of a broader trend.

Senator WONG—In relation to one of the issues you raised, Mr Francis, you would love it if a bank that was closing said, 'We'll give you a grant to assist all these people who will now have to use the Internet with developing these sorts of skills.' Is that something that, if the protocol were to talk about negotiation in consultation with the community prior to the closure, might be explored? I am not suggesting that government could make banks do that but that the community might have at least a right to have those discussions with the bank prior to closure.

Mr Francis—Most definitely. The rate of change is much easier in withdrawing a service than replacing it. If someone only comes in every Friday to do their banking—and I am not talking about 200 kilometres into the sticks, but someone who works on a farm and has a property outside Ballarat and is within half an hour of the town—some shopping, things such as that, for them any changes occur at a different rate than for the banks. For them it can appear as though things have changed overnight. The bank might have been foreshadowing a closure for quite a while, but its customers are not necessarily aware of that.

The parallel with, for example, local government, is that if we were to close a road to do roadworks, we can put adverts in the paper, make radio announcements and put up posters, but people who live in that street will tell us that they did not know we were doing it. The point is that we would certainly like to see a protocol agreed to. We understand that it is a business and we are not trying to bash capitalism. We are simply saying that we believe in a responsible form of capitalism that gives the community enough time to make some adjustment, so that a person who has banked with that branch for 40 years has an opportunity to think about how they might do that differently. It is really important to stress that that is part of the negotiation of change in a community.

Mr Edwards—There is almost a need for Australians to deal with the fear and loathing that is generated when the local paper picks up the headline that the bank is closing. The knee-jerk reactions are the ones that sit at the forefront of the community's mind, and there seems to be little strategy by the banks to deal with that effectively.

Mr Barber—Senator, I might make your afternoon by saying that I do not believe that the government should provide any assistance to banks to run their business. A fact which has upset many of us is that the banks have realised that they have been losing business and that the easy thing for them to do is to shut down branches. For argument's sake, if you look at post office services 10 years ago compared to those that are supplied today, they are entirely different; they have moved with the times. I always take the attitude that you either do things better or you do them differently. Unfortunately the banks did not do that. It might be being very nasty to banks, but maybe in some areas banks could consolidate. Even the churches—God bless them!—are looking at consolidation. For example, the Anglican and Uniting churches work together now in communities. They have closed one church but still use the other for services for both. I wonder why some of the banks have not been wise enough to get together in the smaller areas and have a smaller service. Sure, you will lose 50 per cent of the staff and two banks. One bank closing is bad enough, but it is a lot better than losing 100 per cent of the staff and leaving the area without a service.

The other concern of the communities that I have spoken with is that, when a bank closes and people decide to do business somewhere else—perhaps they have to go 20 or 30 kilometres or, as was the case when I lived in western Victoria, 90 kilometres—while they are there they frequent a particular supermarket or Kmart, or whatever it may be. It is a lose-lose situation—firstly, the community has lost a bank and, secondly, the community is suffering shrinkage or leakage because people, while they are in that other area, will undertake shopping for other items in that region, when ordinarily they would not necessarily get in the car to drive 50 or 100 kilometres to buy other things.

Senator BRANDIS—We have heard evidence from quite a number of witnesses about community banks, and a number of people have suggested that they might be at least part of the solution to the closure of traditional branches by the large banks. In the second-last dot point of your summary, I note that you say:

> The growth of suitably geared credit unions/building societies which are prepared to complement banking services should be encouraged and expanded with whatever assistance is feasible from Federal, State and Local Governments.

I assume that that observation extends to community banks as well.

Mr Edwards—Most definitely. Some councils expressed concerns to the MAV—and I am no expert on financial regulation—about prudential barriers to local governments moving some of their business to these community banks in certain places.

Senator BRANDIS—That was the very question I was going to ask: is it the policy of the MAV, or its constituent councils, to place its business with community banks or other localised financial institutions and, to the extent to which that is not the policy, are there regulatory or other barriers to prevent them from doing so? It seems to me that, in a regional area, the municipality itself, as a major employer and a provider of public works and so on, is one of the largest, if not the largest, source of funds that could support a community based financial institution.

Mr Edwards—We certainly take the position of supporting councils in regional and, indeed, urban areas that may choose to support community banking by moving elements of their business there.

Senator BRANDIS—Are there no regulatory barriers to prevent them from doing so?

Mr Edwards—It is my understanding that there are some prudential barriers to local government shifting its business to some of those areas.

Mr Francis—We would normally tender our banking services. Obviously, we are also in a position where we need to have the best deal for the community. We cannot force a community bank to tender for the range of services that we may need.

Senator BRANDIS—It becomes a bit circular, doesn't it? You, the local municipal authority, in that capacity, want the most economically efficient outcome from your point of view and from the point of view of your ratepayers. The bank's point of view might be, 'The most economically efficient outcome from the point of view of our shareholders is to withdraw from an unprofitable rural centre.' Wearing the one hat, you are criticising them but, wearing the other hat, as a guardian of the interests of your ratepayers, you are doing the same thing yourself, and it is all basically about economic efficiency.

Mr Francis—We are also constrained by the tendering provisions in the Victorian Local Government Act in that respect. I would certainly want to see—and I am sure that other local government authorities have the same view—some local business preference clause within the tendering provisions to allow us to give weighting to a community bank as opposed to another bank. The difficulty, and a political reality, is that the community itself would have to support a political commitment to still go with that in order to support it at that level—for example, if the weightings were such that the community bank did not necessarily offer the lowest price for its services.

Senator BRANDIS—What about transaction services? A lot of those transaction services—not all but some—are fee free, aren't they?

Mr Francis—Which ones were you thinking of, Senator?

Senator BRANDIS—I cannot immediately answer your question, Mr Francis. Let me put a slightly different point to you. Would you recommend that, in this committee's report, one of the avenues that we should recommend to be explored to support community banks is a relaxation by state and territory governments of whatever statutory inhibitions there are on municipal authorities transacting their business through community banks and other regionally located financial institutions?

Mr Edwards—Yes, we would certainly support that.

Mr Francis—I feel a comment needs to be made in regard to an issue which was raised earlier. The idea that the banks give back to the community on a two-for-one basis—and I think it has been mentioned here—is not quite the way it works out in terms of sponsorship of local community groups or whatever. Yes, the banks do provide local funds to community events such as arts festivals, sporting clubs or whatever, but that is primarily promotional. It is marketing for them and it is a relatively small amount—$5,000 here, $2,000 there. For the banks to suggest that this is their reinvestment back into the community by supporting the junior soccer club is drawing a very long bow when they withdraw a whole branch and 50 jobs at the same time. It is not a one for one.

Senator BRANDIS—Mr Francis, I suppose they would also say that what is really missed within a community is their physical presence.

Mr CIOBO—That is what the compensation is directed towards.

Mr Francis—I would suggest that is not how it is perceived. It is perceived as a marketing exercise promoting them as a bank.

Senator BRANDIS—It may not be. Being the devil's advocate, from the banks' point of view, I think their attitude is, 'Well, our presence in rural communities is taken for granted.' The gentleman from the FSU said that the provision of banking services is a human right. One could argue about whether or not that is true, but it does reveal a habit of mind that I think everybody in this country has—that they do have a right to a bank down the corner—and, from the banks' point of view, of whom this expectation is demanded but who are obliged to consult their own bottom line and their own profitability, they do not see it that way. Maybe part of the problem is to shape and possibly even downgrade expectations of what banks may fairly be demanded to do.

Mr Barber—I understand where you are coming from, Senator. I think the banks really have to work out where they are as much as the community does. One of the problems is that the banks have taken certain actions but still perceive that the community should support them in the same manner. My belief is, if banks wish to go away, that is obviously commercial reality. I spend a lot of my life in the world of commercial reality, and that being the case, so be it. I think the problem from the community point of view, as far as the banks are concerned, is that they have taken the easy way out and maybe the easy way out in some areas in the long term is the only way out.

I would like to comment on your earlier question about the councils and the local banks—Bendigo Bank et cetera. In our area if there was a bank wishing to open—and we do have Bendigo Bank—and we had some buildings or accommodation, we would be happy to talk to them about some sort of peppercorn rental as part of our in-kind activity to get a bank in the region. That would have the proviso that there was no bank already there, because you are almost looking at trade practices problems.

You would be aware, I am sure, that a lot of councils are involved in organisations which are not strictly council—the local creche or whatever it may be—and in our council quite often we have pushed the idea to the people under section 86 committees or, alternatively, operating under a loose umbrella of council that the community banks are there. In our council, some of those organisations have opened bank accounts; admittedly they are not substantial sums, but it is proffering to those banks the fact that we do appreciate them being there and it is one way of saying thank-you from a council viewpoint.

Senator BRANDIS—I am not being ungracious about your comment on peppercorn rent for facilities and so on. I am sure arrangements like that would not go unnoticed. However, I think what any financial institution is mainly concerned with is the throughput of transactions, particularly in a relatively small localised community in regional Australia. It seems to me that municipal authorities, more than almost any other economic entity engaged in transactions, are probably going to be the authors of more transactions than most. If you corporately, as spokespersons for municipal authorities, want banks to support you in small communities, then it cuts both ways.

Mr Barber—It is an interesting point. I am sure you are aware that with the Kennett government there was an amalgamation of councils in Victoria and in some areas we were probably seen as councils going through the same trauma and heartache because council offices closed. There were some very small councils which were then amalgamated with others. We are very mindful of some of the problems that have come to pass because of that, and we have council people go out and spend half a day over a week or a fortnight so that there is access. I know parliamentarians do the same thing in smaller areas: you make yourselves available. I guess in some areas we could be held up, unfortunately, as also being purveyors of the same sort of problems that the banks went through.

Another example, which would open a can of worms, would be if council offices in some areas provided access to banks. You would be aware that present and previous Commonwealth governments have helped with rural transaction centres throughout Australia. I feel that banks really have to come to grips with the situation that they are not as they were 10 years ago, and neither are post offices, but a lot of organisations, including local government and post offices, have moved with the times and I do not think the banks did.

Senator MURRAY—The issue of portability has been raised with us. I will give you an analogy. The worst practice for a redundancy situation is where 50 people lose their jobs, they are paid off; out the door and off you go. The best practice is where there is a placement and counselling service to try and make sure that people can find alternative employment in the transitional period. The portability issue relates to where there might be two branches in a town, one closes down, and people find it very difficult to have their financial situation easily transferred from one branch to another and the transition assisted, particularly when there are contracts such as mortgages or financial details. Representing the people that you do, have you had much feedback or input on that problem? Do you have any views on it?

Mr Barber—We have seen a lot of those problems in the Latrobe Valley power industry, where hundreds and, indeed, thousands of people lost their jobs. The world must move on. I think the important thing is to try and find other programs or projects, as we have in our council area, where people can use their skills.

Senator MURRAY—Mr Barber, you may have misunderstood me. I was using it as an analogy. As far as we understand, from the limited evidence we have had, banks do not make it easy to transfer from one branch to another when one closes. Have you had any feedback on the difficulties of moving out of one to the other?

Mr Barber—No, not really. I made the comment earlier that maybe the banks need to start to look at that and maybe they could work together and cohabit, albeit in a smaller way, in those areas so that people could continue to do business there. For example, when I used to work in Edenhope in far western Victoria, there were two banks—the National and the Commonwealth—and the Commonwealth closed down. It would have been good if there had been some agreement where both banks could have worked out of the same premises. That would have helped from a portability viewpoint. Also, we must appreciate that one bank looks at the other bank as a competitor and if a bank closes down maybe they rub their hands together and say, 'You beaut, we've got all the business in that town—including ours—and also the former bank's.'

Mr Francis—Senator, it does relate to once again the level of education the customer has about their new circumstances. If you have been banking with a particular branch or a particular bank manager for a number of years, there is a level of trust about how your affairs are best structured, about why you bank there. As we have referred to in our submission, the leadership role the banks have traditionally had within the community of providing financial advice to people—how they should invest, what they should do, how to run their businesses—is not picked up in the current arrangements. What has happened is that, because there is this disjunction now between transactions and financial advice, people are not necessarily going to get the same level of advice they did previously. If the bank closes, what do you do with all of your financial stuff? You do not know.

Senator BRANDIS—One thing you can do is go to your accountant, or some other financial adviser. Mr Francis, what you are describing is as much a cultural change as an economic change. The world is shifting away. We have heard other witnesses speak to this as well. The world is shifting away, even in rural Australia, from the days when the bank manager was like the local minister of religion or schoolteacher or head of the police force, as a community leader and a trusted community confidante. That has been a cultural feature, particularly in smaller communities. I am sure in our grandparents' generation it was a cultural feature of the suburban bank branch in the cities, too. But the world has moved on and the role of the banks as economic actors has perhaps entirely overtaken whatever communitarian role a bank manager, by reason of his office and esteem in a small community, may have had. I am not sure to what extent you can arrest cultural change by legislative fear.

Mr Francis—I appreciate that it might seem we are looking to the past as the golden days of the banking industry. I assure you that is not what we see.

Senator BRANDIS—Taking up that point, whenever somebody mentions the golden days I always want to put them in a time machine, send them back to the putative golden days and say, 'Imagine if we had things like the Internet,' or 50 years earlier, 'Imagine if we had things like telephones.' Some of the range of services, even to people in the remotest communities today, are far greater than they ever were in the putative golden days of yore.

Mr Francis—As you will appreciate, the financial planning industry has not exactly come up roses recently with the quality of its advice, so I would not necessarily be saying that the portability issue is solved by sending people to a local financial planner or accountant. The question there is one of values. If the committee were to examine the work of Robert Putnam, an American who has done a lot of work in what he calls community capital, community sustainability, he actually advocates a return to those sorts of values you are referring to—the role of civic leaders in building community sustainability.

The fact that we have in regional areas the loss of some of those civic leaders has an effect on the community, its sustainability and its ability to bounce back from periods of drought or difficulty. That is an issue in itself. What replaces that? All we are saying is that the loss of that for many people in rural and regional Australia is the loss of someone they did rely upon. Who you replace that with, I do not know, because we are saying if the bank moves out you lose not just the transactions but you lose the local knowledge of the local business people of suggesting how they might expand.

In Ballarat we are relatively lucky because we have not suffered like many other regional areas, but there is no way that local government could provide financial advice or subsidise some arrangement where we could give impartial financial advice to people. Transactions may be something we could be involved in—no problem. But local government’s role is not to provide financial advice to people. The portability issue then is, if you have moved out of this banking arrangement, look at the numbers of products that are on the market these days. It is confusing to even a relatively educated person faced with the number of different arrangements you can come up with. It can be overwhelming for someone who has had that comfort level to suddenly be told, ‘The bank is closing. You’ve now got to find a new bank and it is all different.’

That is part of the protocol about shifting—the education process of taking people through that and saying their financial planning should be part of that process so that they do not have to worry about what they are going to do.

Senator MURRAY—We have been given evidence which says in the United Kingdom they have laid down statutory minima by which time the closing bank must ensure that the products or services they provided are transferred. They wrap up the mortgage within 10 days. They wrap up the cash account or cheque account within a couple of days—those sorts of things. Portability simply means somebody else substituting for the service that you previously enjoyed. I wondered if you had much feedback on that.

Mr Francis—We would not have much feedback as a local government authority because most people would not speak to us about it.

Senator MURRAY—Yes.

Mr HUNT—My question is for Mr Edwards and Miss Yu. Does the MAV have any pattern or information about trends in terms of towns where banks have been closed? Is there anything particularly obvious about them? Are they towns where the population is already declining? Will there be bank closures even in towns where there has been an increase in population? I am interested in whether it reinforces an existing trend of certain towns in decline, or whether it is irrespective of that.

Mr Edwards—The short answer is that we have not done any detailed research on that type of thing. Certainly working through some of the submissions from Victorian councils you can see particular places where the economy is struggling, there is an ageing population and they certainly feel the pressure of bank changes, but that is the same in pockets of metro areas as well. As a small organisation we would like to have the resources to do that type of work, but we have not.

Miss Yu—It is an interesting point you bring up. No doubt you would be aware, through the Macedon Ranges Shire Council's submission, they have raised the issue of experiencing eight branch closures in the past few years, despite population growth in some areas. It is certainly an area that is worthy of more investigation. It is not just out in Hindmarsh, in the backblocks, where the population is declining and ageing that the banks are pulling out.

Mr Edwards—There are certainly pockets here in the east of Melbourne where ageing communities are struggling when local branches close. I can think of the Ashwood part of the City of Boroondara which you consider as a leafy kind of middle Melbourne but the community is really struggling with an ageing population and a local branch has closed. The council has been working there to try and deal with the options. It is not just rural and regional and remote, in that sense. But there is nothing beyond the anecdotal.

Mr Barber—In relation to your question, one of the things we are doing in Latrobe City now is working very closely and constantly with the banks. Regarding the comments you made earlier, Senator, we are trying to second-guess the banks to some degree as to which way they are heading. If a bank decides that they are going to close, they are going to close, but what we are trying to do now when these sorts of things happen is to make it a little less traumatic. In the last year or two—particularly the last 18 months—we have been working very closely with the banks, and they are now starting to talk to us. That makes a bit of a difference, because at least if there is a crunch or a brick wall coming we can slow down the car before it hits. As a local government, that is about all we can do. We can also talk to the banks and ask, 'What about additional product?' In some areas, we have asked, 'Okay, if you can't open your bank every day of the week, can you open it maybe on two days a week or something like that?' In other words, ease the punishment to the local community by at least supplying a service.

In the case of, say, Churchill—the university town—where the Commonwealth Bank is the only bank, they now close for lunch. My attitude is I would rather them close for lunch and not have a service for an hour and a half through the day than not have a service at all. They are the sorts of things as a local government—in our area anyway—that we are particularly talking to the banks about. I am not saying that they would necessarily have closed that bank, but to me that was the start of what I saw as a concern. We helped them get the message across to the community, 'We're sorry, but the bank isn't going to be open at lunchtime when you may want to undertake a transaction, but at least between 10 and 12 and two and four you've got a banking service.' That is always better than nothing.

I think it is important for local government particularly—and it is something that we have taken on board—to make sure that we do interact very closely with the banks and other commercial organisations, credit unions and suchlike, to ensure that we try to help them and our customers, as I call our ratepayers, if there is a potential calamity we see coming. If local government continues to do that, that might also help. Indeed, it also probably shows some of the banks that we are interested in what they are doing and not there just to keep bashing them, with the idea of seeing if we can find a way through their calamity, as well as the possible calamity that they are going to thrust upon people.

CHAIRMAN—I thank all of you for your appearance before the committee this afternoon and for your contribution to our investigations.

Mr Barber—My council has asked me if I could, on behalf of our mayor, Tony Hanning, and my chief executive, Richard Hancock, say how much we have appreciated the opportunity of being able to present a submission and come before you this afternoon.

CHAIRMAN—Thank you for assisting us.

[3.14 p.m.]

BROOKS, Mr Walter Richard, Executive Director, Council of Small Business Organisations of Australia

CHAIRMAN—I welcome the representative of the Council of Small Business Organisations of Australia. The committee prefers that all evidence be given in public. If at any time you want to give part of your evidence in private you may request that of the committee and we will consider a move in camera. We do not have a written submission from you, so we look forward to your opening statement, following which we will proceed to questions.

Mr Brooks—On behalf of the Council of Small Business Organisations of Australia I would like to make some opening remarks. First, thank you for the opportunity to appear before the committee. The Council of Small Business Organisations of Australia—COSBOA—has for a long time been concerned about the impact on small business, in particular those in rural and regional areas, of changes in the banking system. COSBOA is encouraged by this review and keenly awaits the completion of the review and the final report.

COSBOA does acknowledge that a number of significant steps have occurred in recent times to improve the relationships between the banking industry and small business. Particular reference is made to the establishment of a consumer consultative forum at the Australian Bankers Association, to which I am the representative for COSBOA. Likewise, COSBOA was invited to participate in the establishment of the banking code of practice. A number of changes were made to the code to recognise small businesses. Unfortunately for the banking industry, it is still very early days with these initiatives and a number of small business issues need to be addressed.

I will briefly touch on some of these issues and identify the impact on regional and rural businesses. The advent of ATMs many years ago was seen by many in business as improving consumers' access to funds, possibly leading to increased sales in the retail sector. I do not think, however, that some of the changes which ultimately occurred were ever expected. Certainly 20 years ago businesses did not expect a significant reduction in bank branches throughout the country and their replacement with ATMs and facilities ranging from supermarkets and video stores to purely and simply an ATM in an office wall. One of the more significant impacts for business is that some of the banking functions have now moved to the business sector, rather than being bank responsibilities. I would like to address an issue that to many might be seen as very small.

I recently made inquiries amongst some of the members of the Timber Merchants Association and National Home and Building Suppliers Association, the organisations I represent on a daily basis. Significant frustration was raised with regard to the fact that small business is more often than not providing some of the banks' former functions; for example, providing change and cash to the community. As you now know, when you go to an ATM you normally receive $50 bills. The result is the retailer or small business person is now providing you with the change. Unfortunately, with the closure of bank branches, it is more difficult now for businesses to obtain a cash float to provide to you, the customer. In some cases banks are attempting to charge retailers and small business for the provision of change. Naturally, this happens in particular where businesses have moved away from 'the big four' and have to go to one of the big four to obtain their change because they are not in all the regions.

The closure of bank branches has caused a number of difficulties with regard to access to banks for depositing the daily business takings. For example, on the west coast of Victoria down at Anglesea, a place where I spent some time last weekend, one of the big four closed just prior to Christmas. I took the opportunity yesterday to speak to a local business person in Anglesea and he advised that he was banking with the branch that closed. The situation now is that the Commonwealth Bank branch opens part time. A business person I spoke to yesterday indicated that, although he can make deposits for his bank at the post office—his bank being another one of the big four—he is limited to cash deposits of no greater than $3,000 per day and is unable to obtain change. As a retailer, especially during the summer period, it is now necessary for him to travel approximately half an hour each way to Anglesea, or even on to Geelong, to complete his banking business, thus causing significant cost and disruption to his small business.

It is understood that Australia Post has limitations because of security and staff issues. However, it is felt that alternative arrangements should be considered by the banking industry. I would suggest that maybe it is an issue of increasing the security in branches such as post offices. The business I mentioned has a regional relationship manager in Geelong. He indicated that, provided the staff changes are infrequent, the arrangement has been very satisfactory. Unfortunately, in one 12-month period he had three relationship managers. These changes did bring about significant difficulties in transferring the history of his business. After 50 years with the same bank he felt that the loyalty and good history was sometimes lost because of the failure of the bank to ensure a proper transfer of information and stability within its management team.

These comments have been emphasised by a number of business people I have spoken to. Although they indicate that the concept of a relationship manager is a significant improvement on recent years, they bemoan the fact that the manager of the local branch has gone. The manager of the local branch, with direct knowledge of the local community and business, was a person they saw as a significant asset to their banking relationship. The constant change of staff, both at the counter and management level, results in a loss of knowledge. An issue expressed yesterday was that some people travel a significant distance when they want to cash a cheque or something like that. The process to get authorisation becomes very difficult because of the constantly changing people at the front end in the banking system.

In talking to businesses, mention was also made of the use of technology and the telephone. Unfortunately, many people in small business have not reached the point of having an adequate level of computer literacy and are limited in their ability to use computers as a means of accessing banking facilities. Industry is making significant efforts through training organisations to address this. I believe it is only a matter of time before even people with no current experience in that area will be able to handle many online transactions.

A particular area that has raised concern is the use of call centres and making contact through the telephone. There are occasions where people have to wait extended periods of time on the phone. In one case a small business person told me of an experience that occurred last year, where they were attempting to arrange a loan for a member of their family who was establishing business as a plumbing contractor. This person, having recently completed a plumbing apprenticeship, went to a number of banks and tried to get finance but was refused. He accepted that, went along to his father and asked if he could get some support. The father indicated that he would be prepared to guarantee a loan. The father requested information via email from the bank where he had been a long-term client. After four weeks there was no response. Subsequent inquiries, using a call centre, were successful and he received adequate attention from the person at the call centre. Information was provided by the father to enable a guarantee to be set up and a reference number was given for the son to contact the bank to finalise the arrangements and provide his personal information.

A further period went by before contact was made with the son to advise that the bank did not want to accept guarantees, albeit this was the recommendation of the person at the first point of contact. Following this discussion a suggestion was made that a joint facility should be taken out. Again these arrangements were put in place. A query was then raised about what benefit the father was going to receive out of the account. Advice was provided by the bank that they would not agree to a joint facility and that a guarantee would be a better arrangement. The final outcome was an account was put in place with the father guaranteeing his son in his new business. From start to finish this took in excess of eight weeks and placed the family under significant pressure.

I am an accountant by profession and I have been representing and involved in small business for a long period of time. If you look at small business people in a rural area away from facilities such as the local branch, you can understand the pressures that would have caused. This is the sort of issue small businesses are finding extremely difficult to deal with in their relationships with large banking corporations. Small businesses in rural areas have also identified the impact that reduced access to banking has on their liquidity and the downstream effect it has on the community, as they are not in a position to settle their accounts in a timely fashion. That is because they hold on to their takings for an additional day or two to save that trip to the regional centre. That does have an impact on their normal day-to-day liquidity. It also brings about the situation where they are holding cash to pay the wages and thus exposing themselves to an increased security risk within the business premises.

Likewise, in many cases where banks have closed, the members of the community and surrounding area are now travelling a greater distance to do their banking in regional centres. This has resulted in them taking the opportunity while they are in the regional centre to do their shopping. Consequently, businesses in smaller towns with reduced banking facilities are suffering a downturn in business and significantly reduced viability.

A matter that I was advised of a short time ago goes back to the point about the relationship within a regional community. As you all know, recently we have had a significant number of bushfires in the state of Victoria. I recently heard of a business which had commenced negotiation to refinance with one of the big four. When the fires arrived in the local area, the owner of the business went off and spent two weeks fighting bushfires. During that period of time the bank reviewed the facilities and started to apply pressure on the wife of the business owner. Obviously, if managers are in a significant country town away from the local area, they do not have local knowledge of what is occurring in the region.

The Council of Small Business Organisations believes it is important that an adequate banking network is established within regional and rural areas, in a form that enables a full range of transactions to occur. I do not believe anyone within COSBOA thinks there should be anything to force banks to have branches in every regional centre. However, it is important that there are arrangements with organisations like Australia Post, or that alternative arrangements are in place, to enable a full range of services and, for example, for cash and security arrangements to be in place. It is not considered, however, that it is the responsibility of the community to pay for these services. It should be part of the banking industry's charter that its services are maintained in regional communities.

Senator MURRAY—The difficulties that have been presented to us have been those which arise from regulation and law, such as impediments to banks sharing facilities and so on, to those which arise from cultural and attitudinal problems. For instance, the FSU believe that banks, even if they could share facilities, would not want to on a multiproduct basis. One of the things this committee has to look at is not so much market failure but an inability to have the right signals and incentives and regulations from government which will permit the market to work more effectively.

That implies not just the provision of basic transaction centres—the RTCs—but also the provision of a broader range of financial services in small areas. Do you think there would be any resistance to—or, putting it more positively, do you think that a small business would welcome—multiproduct facilities; a single building or facility where basic banking transactions and fairly sophisticated financial services were available, either in person or via video link or via other technologies, on a multiproduct basis, so that you could go in there and it is one stop for pretty well the full range of what you might need?

Mr Brooks—I certainly believe that the small business sector would see that as a significant advancement in the area. There is, for example—I think it is in Mansfield, Victoria—a situation where the local supermarket has a range of banking services that it has put in place for one of the big four. If that sort of service were enhanced to encompass multibank facilities, that would be very positive. However, having attended a meeting with representatives of the banks, I would have to agree with the comment by the FSU: it is very hard to see all of the banks agreeing to share facilities.

Senator MURRAY—It was well put to us earlier in the day that there is also the need for people to have good financial planning services across the range of entities or accounts they may have. The spread of superannuation, for instance, has introduced Australians who are not of a business background into quite different set-ups. From the perspective of small business, they would react positively, I would have thought, providing that service is available. They do not really mind who delivers it.

Mr Brooks—No, I do not believe they mind who delivers it. It is certainly true that financial advice is also important. I heard the submissions earlier with regard to the traditional role of the bank manager, whether it be in the metropolitan area or the country. Twenty to 30 years ago the bank manager was seen as almost a partner in many businesses. That situation has changed. I think what small business needs is an opportunity to go to someone who can talk to them about the alternatives they have with regard to how they finance their business; if they want to get a letter of credit or something like that, what does it involve; likewise, issues such as you raised with superannuation: 'What are my alternatives there?' There is a need in centres to have access to that sort of information, and we would encourage that approach.

CHAIRMAN—You referred to the in-store facility that one of the big four operates. One of the issues that has been raised with us in relation to those sorts of facilities compared with the traditional banking facility is the issue of privacy. In days past, when people went to their bank they were dealing purely with banking matters and had confidentiality, whereas if they are dealing with one or other of the staff of a store, who is providing a banking service as a sideline in a sense, there is not that same dedicated person dealing with their affairs and there is this perceived loss of privacy. Is that an issue that has come to your attention?

Mr Brooks—I believe that is an issue. There is the issue of privacy in that sort of environment. Obviously, there is the potential for a small business, whether it be a supermarket, a hardware store—whatever it may be—to have a number of staff. Its practice would be to have a number of staff who were multiskilled to service that function. Where in a bank there has traditionally been a very strong commitment to privacy and security, it is possibly not as adequate in that sort of environment.

Another area that concerns our organisation and the people I represent, from the point of view of building material suppliers and the like, is that if they went into that arrangement there are security risks. I know they have considered putting ATMs, for example, in their businesses. They were concerned about the additional security risk of having a large quantity of money sitting in a machine in the middle of their shop. Issues arise such as how they reload it and how they finance it. The actual physical security of the cash and resources is also an issue in that type of environment.

Mr HUNT—In relation to post office banking, from a small business perspective is that seen as a reasonable outcome, at least in relation to cash transactions through the giroPost system?

Mr Brooks—The people I spoke to about the banks taking their deposits with cheques and a small quantity of cash saw that as being a very adequate process. When it came to the issue of taking a larger volume of cash—as I said, the $3,000 limit—that, in a rural town, does not take long to build up, especially during a holiday period in a seaside area or something like that. The problem is that cap of $3,000 and also the fact that they cannot get access to change for a float.

Mr HUNT—Does that cap apply per transaction or is it for a particular time period?

Mr Brooks—I have been advised that it is $3,000 per customer per day.

Mr HUNT—Per account per day?

Senator MURRAY—That takes no account of seasonal conditions or peaks at weekends or anything of that sort.

Mr Brooks—The business I was talking to in Anglesea yesterday—and I spoke to someone in Violet Town as well—indicated that, during seasonal times, it is not very difficult for them to hit the $3,000 limit. In Violet Town, for example, they would then head off to Benalla or Euroa to do their banking.

Senator MURRAY—Has there been any record kept of increased security or theft problems as a result of people having to carry more cash than they formerly did?

Mr Brooks—I am unaware of any, Senator. I know that the Institute of Criminology was doing some work in the retail sector about 12 or 18 months ago. I do not know if they have that information.

CHAIRMAN—In relation to the cash issue, I note that in the past Australia Post participated in cash delivery to rural areas, but ceased that several years ago because of concerns about security. Do you know whether there has been any resumption of that service provided by Australia Post?

Mr Brooks—It was expressed to me that there was a security issue, but I understand there was also an industrial issue.

CHAIRMAN—I understand that organisations like Mayne Logistics, Armaguard and Chubb Security Services have offered to provide cash deliveries—and pick-ups—to small businesses in rural areas.

Mr Brooks—I think the issue there becomes a matter of cost from the point of view of small business versus large organisation. For example, if you look at large companies in the timber and building supplies area, they all have Chubb or Mayne or someone go around and collect their cash and do all that handling for them. The cost of that for a small business, I am told, is prohibitive.

CHAIRMAN—Thank you very much, Mr Brooks, for your contribution to our inquiry and appearance before the committee.

Mr Brooks—Thank you for the opportunity to make a presentation.

Proceedings suspended from 3.36 p.m. to 3.44 p.m.

[3.44 p.m.]

MOORE, Mr Stan, Interim Chief Executive Officer, Australian Retailers Association

CHAIRMAN—I welcome the representative from the Australian Retailers Association to this hearing. The committee prefers that all evidence be given in public but, if at any stage of your evidence you wish to give that in private, you may request that of the committee and we will consider a move in camera. We do not have a written submission.

Mr S. Moore—No, I am sorry, there is no written submission.

CHAIRMAN—I will ask you to make your oral submission, at the conclusion of which we will move to questions.

Mr S. Moore—Thank you very much for the opportunity. I will, firstly, give you a little background. The Australian Retailers Association is a national organisation representing in excess of 12,000 members Australia wide. We have retailers from the largest retailers in Australia down to the small, individual, sole proprietor as members of our organisation. In fact, 95 per cent of our membership employ 20 or fewer full-time staff. From an industry representative point of view, we pretty much reflect what is out there in the marketplace. However, just about all the major retailers are our members, and what we call ‘chain retailers’, although only small in number, are also members of our organisation.

The Australian Retailers Association is a representative body and issues such as merchant service fees, costs of doing business and so on are of interest to us. At the end of the day we want retailers to remain viable in their business, because retail is an extremely competitive industry sector. Productivity Commission figures indicate that, on average, the retail sector has a net profit margin of 3.2 per cent, which is a pretty skinny net profit margin. It is a very competitive industry and, in order to survive, retailers are required to be very savvy in their business practices. They are constantly looking at how they can shave costs in order to remain competitive.

In relation to your current inquiry, some comments by way of introduction may be of some assistance. The banks’ deliberate strategy of replacing branches with other means, such as ATMs and EFTPOS or point of sale, has allowed them to close branches, many of which have been quite costly for the banks to run. In turn, they have received services from my members, who can provide effectively a banking service for those communities where banks have left town, removed their services and closed their branches. A very important role for many merchants, including retailers—and I include operations such as Australia Post, particularly those who are providing EFTPOS—has been to fill the breach and to continue to provide a banking service, despite their not being a bank.

One of the current issues being debated is that of EFTPOS. Banks pay ATM owners a service fee for running and operating the ATM. Banks have been paying a fee to the retailer’s bank and, in some cases, directly to the retailer, for the provision of EFTPOS services. Currently before the ACCC is an application for authorisation from a number of financial institutions wanting to amend that process. They want to move to a zero interchange, which means that they will no longer pay the retailer’s bank, or the merchant’s bank, a service fee for providing that very necessary service. To us, that is inconsistent with the banks’ approach to ATMs. From your inquiry’s point of view, as banks leave towns, who else will fill the gap if there is no incentive by way of a service fee being paid to merchants to fill that gap? That is very much a current issue and one that I think might have some very unintended consequences, should the banks be successful. That is by way of opening.

This issue in regional and rural areas is important to us as an organisation, because we have members from that area; in fact, if businesses are not viable in those areas, we find that it flows right through the economy and, therefore, has an impact, as the drought is having at the moment. We have noticed the impact on our industry and I am sure that will flow into economic activity. I will leave it there and, if there are any questions, that is possibly the best way of handling the issues that you want to draw us on.

CHAIRMAN—I wonder if you can clarify for me the issue of the fee that you have raised. In the context of a previous inquiry this committee conducted into the level and transparency of fees charged by banks for electronic banking services, one of the issues raised was the so-called ‘interchange fee’ that banks pay to each other for using each other’s ATMs. My recollection is that the Reserve Bank decreed that that interchange fee be removed, because it was regarded as excessive in relation to the actual costs of providing the service. Is this the same figure that you are referring to?

Mr S. Moore—In another language, the interchange fee is a wholesale fee between the issuer and the acquirer—that is, the customer’s bank and the retailer’s bank. The issue relating to credit cards was probably the main area that you focused on before. However, there was some recognition in relation to EFTPOS, because there is a wholesale fee that passes between the issuer and the acquirer.

For clarification, in the credit card system the flow of funds goes from the acquirer, or the acquiring institution, back to the issuer’s bank—that is, from the retailer’s bank back to the customer’s bank, there is a flow of funds in relation to credit cards. We argued at the time, and the Reserve Bank agreed with us, that based on the costs of providing that in relation to credit cards, they could not see justification of the particularly high cost—almost one per cent of the value of transactions was a wholesale fee being passed from the retailer’s bank back to the customer’s bank.

That was the RBA’s position in its original discussion paper. In its final recommendations paper, it indicated that it would designate and reduce that fee, but it did not choose to remove it. Effectively, that has meant that the cost of processing credit cards by retailers is significantly dearer and it costs the retailer a lot more than if the retailer were to process an EFTPOS or cash transaction. We are not saying that cash does not incur a cost; based on our survey data and substantiated by the Reserve Bank, cash costs approximately 12c per average retail transaction, approximately 17c for an EFTPOS transaction and approximately $1.04 for a credit card transaction. Clearly, the flow of funds from the retailer’s bank back to the customer’s bank increased the cost, and it was a hidden cost which ended up with the customer.

You talked about the issue of transparency. In that transaction, the lack of transparency occurred for a number of reasons, but mainly because those who chose to use credit cards and to reap all the benefits were being subsidised by those who used EFTPOS and who used cash, because retailers would price product based on one price no matter what the tender type. Those who were smart enough to use their credit cards wisely were the ones who benefited largely from that system. One of the Reserve Bank's reforms was to allow retailers to surcharge. In theory that works well and that is something we did support; the clause in merchant agreements said if somebody provides you with a credit card you cannot charge them an additional fee for the processing cost.

Whilst we did support that, we recognised that it was unlikely in such a competitive sector that retailers would actually move to surcharge. That was the experience in the UK; that is the experience we have currently in Australia. That part of the reforms, with the best intent, probably is not yet achieving—and may not achieve—the levels of transparency required to get the competition happening in the provision of merchant services. But the other two platforms of the Reserve Bank in credit cards might, in that you have the issue around addressing the actual quantum of that wholesale fee, the interchange and also, very importantly, the area we think it will have a big impact is access.

Moving now to EFTPOS, the current structure—and some claim, including the Reserve Bank, and I suspect the Reserve Bank possibly has not looked at all situations in all Western economies, because they reckon the Australian system is unique. Our information is that it is not. It is unique from the point of view that the wholesale fee rate flows from the issuer back to the acquiring institution. It flows in the opposite direction to credit cards. It is flowing from the customer's bank back to the retailer's bank. That flow back to the retailer's bank is by way of service fee. In fact, that was even highlighted in the financial institution's submission to the ACCC, which they lodged last Friday. That is actually a service fee.

It is provided there just like ATMs in that there is a service provided and the owner of the ATM gets a service fee. The difference between credit card and EFTPOS is that under the EFTPOS transaction the retailer and, in turn the retailer's bank, is providing access directly to the customer's account. It is not going off to some card association or somewhere else out there in the ether. It is actually doing a similar function to what an ATM does, or if you do it on the Internet or whatever. It provides the customer access to their account.

Under the current scheme on EFTPOS in Australia a service fee is flowing from the customer's bank back to the retailer's bank by way of service fee which is encapsulated in an interchange fee and an interchange fee that is negative. If you have a look at a numbered continuum and you put zero here and it is on the negative side and you bring something back to zero, it is actually going to increase the cost. That is what it is going to do: it is going to increase the cost to the retailer's bank.

Again, in the submission that has just gone before the ACCC, seeking authorisation for this process, they have identified that their proposal is to reduce the interchange fee on EFTPOS to zero, or move it to zero—it is not reduced. They say it is likely that merchants will face higher costs. As you and I know, if merchants' higher costs are there and in such a competitive sector, whilst some of it will be absorbed by merchants, ultimately consumers will pay.

Our concern with this current process has been that, whilst we are trying to encourage customers to move towards EFTPOS, a further barrier has been put in place and that is through increasing the costs. I know it is a complicated area, but hopefully we can work through it.

CHAIRMAN—You referred to some of the in-store facilities that banks have worked in cooperation with some retailers. One of the issues raised with us in relation to those in-store facilities is the loss of privacy compared with what was enjoyed by bank customers previously when they were dealing direct with their physical bank facility, in that they went to a bank and it was a bank-only instrumentality. The staff were bank staff and so they could be reasonably assured of the confidentiality of their financial affairs. Now they go to a facility that is providing a broad range of services, of which banking is one and retailing is another and so on. The staff there are not so cognisant of the strict banking disciplines, if you like. The customers are concerned about this loss of privacy with regard to their financial affairs, particularly in smaller communities.

Mr S. Moore—Obviously that could very well be an issue. It is possibly already currently an issue in small communities with banking staff anyway. Because of the close-knit nature of the community it is a factor. Some say that everyone knows what your business is in a small community. Businesses other than banks providing banking services clearly have to understand the confidentiality aspects of it. There are recent privacy laws that are now applied to corporations and that picks up most of those corporations that are directly providing the full level of banking services.

You will tend to find that the smaller operators will only provide limited banking access which would be by way of either direct purchase of goods or goods plus EFTPOS cash out, not the other aspects of banking and being able to make deposits and do that sort of banking.

Senator BRANDIS—That is what I wanted to explore with you, Mr Moore. Perhaps I do not have a very clear picture as to what your constituent organisations are, but we have heard evidence that one of the varieties or modes of provision of banking services to replace traditional branches is agencies which more than provide cash out facilities. They provide over-the-counter banking services and are co-located with, for instance, Australia Post. I am wondering which categories of your constituent organisations provide similar services. I was also going to ask what opportunities you see from among your members for an expansion of that kind of activity, co-locating facilities with banks but providing a full range of transactional banking services.

Mr S. Moore—It tends to be, in our constituency, the large retailer who will provide that sort of service. Woolworths, for instance, has an alliance with CommBank directly providing full banking through their easy banking system. That provides full banking services. That is face to face at a Woolworths store. I believe there are some pods, stand-alone, similar to what they are doing in Europe. Coles Myer have chosen a slightly different system, where it basically is a cut down version of an ATM provided in-store. That is the level, at this stage, they have. It is still developing.

Interestingly, that range and level of services currently being rolled out in Australia is not dissimilar to what is happening in Europe and the UK in particular. One of the big drivers in Australia clearly is the branch replacement but it is also the customer convenience in that they do not have to go to their bank and queue up to do their banking. They can do it while they are doing something else. There is a big aspect of customer convenience as well.

Senator BRANDIS—Mr Moore, if you cannot tell me this off the top of your head, perhaps you could give the answers to the committee in writing later. I am interested in knowing how many retail outlets—at least those for which you are responsible—provide co-located face-to-face banking facilities with their principle business.

Mr S. Moore—Full banking, being able to make deposits and withdrawals?

Senator BRANDIS—Yes, that is what I mean by, in shorthand, face-to-face banking. What is the rate at which those services have expanded over, let us say, the last five years?

Mr S. Moore—Based on the number of outlets, not the number of businesses?

Senator BRANDIS—The number of locations.

Mr S. Moore—You are really looking at the number of shopfronts or stores. I would not have that with me, but that is something that I am quite happy to go away and research and bring back to the committee.

Senator BRANDIS—When you do could you perhaps tell me the breakdown of that by state and territory for each of the last five years and, if you have projections as to the growth of that activity, what those projections are over the next five years.

Mr S. Moore—I am happy to take that on notice and I will get back to you on that.

Senator BRANDIS—What I am interested in here is non-capital city.

Mr S. Moore—Yes.

Senator BRANDIS—In other words, we are trying to get a handle on the manner in which regional, remote and rural communities have dealt with the closure of traditional bank branches. The kind of co-located facilities of which we have been speaking is we know one of the modes of replacement of those services. Confine it to rural, remote and regional locations.

Mr S. Moore—I will cover it for our membership, but I am aware that there are others who provide that sort of service in some regional locations who would not be members and would not qualify to be members of our organisation. I think I can give you some pretty good numbers in relation to our members. I am happy to do that.

Senator MURRAY—Some of the evidence we have had suggests that there is a greater cost to retailers from the closure of bank branches in country towns, because they have to carry much more cash over a longer period. That implies that they would need larger safe facilities—perhaps different kinds of safe facilities, such as post box safes, so that the only people who can open them are the armoured crew outfit—and it also implies that the criminal element in the country would be aware of that and might go after them a bit more. Do you have any anecdotal or actual research which indicates the extent of that phenomenon—namely the increased cost of carrying cash—and, secondly, whether there are increased security and theft problems?

Mr S. Moore—This is something that we have talked about within our organisation. We have a group that is a bit of a task force that was set up to have a look at the whole banking issue. The issue has been raised, but I am not aware of any hard data that we have in that area. I am surprised that you did not also mention the issue of insurance, because—

Senator MURRAY—I should have!

Mr S. Moore—that is one of the areas that concerns retailers and possibly could add to their costs. I am aware that now there are many insurance contracts that will not cover cash held on premises. That is specifically excluded and that, therefore, raises the risk to retailers. It first came to my attention in Tasmania.

Senator MURRAY—You have always had caps on insurance policies, namely that you cannot carry more than a certain amount. Are you saying that you cannot carry any at all?

Mr S. Moore—No, you can carry cash, but you cannot have it insured at all.

Senator MURRAY—Good God!

Senator WONG—There is an exclusion in some policies of any cash holdings at all.

Mr S. Moore—Yes, and it first came to our attention with some retailers in Tasmania. Apart from that, the issue of management of cash and how you do your banking when there is no bank about and you are required to be the bank cuts a little bit both ways, in that some retailers have now chosen to move to a cash out facility, which then reduces the level of cash that they are required to hold. Those that provide that facility can lessen the holding of cash.

Senator MURRAY—Tell me what that means.

Mr S. Moore—Cash out means that a customer can use EFTPOS facilities similar to an ATM— purchase an item and take additional cash—and that is possible under the Australian EFTPOS system. We have one of the world’s leading systems. It has relatively high levels of security and integrity, and is world class in giving people access to their funds in their bank account at a point of sale in a retail outlet. It really is world class. It comes back to the issue of what retailers who have taken cash can do with that cash if they are unable to give it back to customers. That is very much an issue. One thing that we would like to see happen, particularly in those situations, is the customer use something other than cash, be it EFTPOS or credit card. Under the current cost structure, those are more expensive for the retailer to accept. One of the solutions may be to reduce the reliance on cash and move to more electronic forms of payment, but I have no numbers on what the cost is. I have heard exactly that line from some smaller retailers, but we have no idea.

Senator MURRAY—As I understand it, these armoured car services run services through to a number of country towns. I do not know how many. Just anecdotally, has that increased because of the closure of banks?

Mr S. Moore—No, I am not aware of that.

CHAIRMAN—In relation to the theft of money, as you mentioned, insurance is not obtainable. Who bears the liability for that in an in-store banking facility—the bank or the retailer?

Mr S. Moore—If it was in an ATM, that is the ATM owner and the bank or whoever owns the ATM. It may not even be a bank. It might be another financial institution that is in the business of providing ATMs. In relation to the point of sale cash transactions, that is the retailer's responsibility. They may have an on-site safe, but now cannot get insurance for cash they may hold.

CHAIRMAN—Has this only developed since the so-called recent insurance crisis, as it were?

Mr S. Moore—Yes. Once upon a time there were lots of things that were included in insurance policies. Nowadays, the exclusion clauses are getting longer.

CHAIRMAN—There being no further questions, thank you very much.

Mr S. Moore—Thank you. I have some notes to get back to you and I will undertake to come back through the secretariat on that one. Thank you very much for the opportunity.

Committee adjourned at 4.13 p.m.