SUBMISSION 13

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INQUIRY INTO COMPETITION IN THE BANKING AND NON-BANKING SECTORS

GE Capital Finance Australasia Pty Ltd ("**GE**") welcomes the opportunity to make this submission to the Committee in response to its Inquiry Into Competition In The Banking And Non-Banking Sectors (the Inquiry).

The purpose of this submission is to make 2 key points, in summary:

1. **Silo approach inhibits effectiveness of the regulatory system:** The Inquiry presents an opportunity for the Committee to take a broad perspective on matters that may have a bearing on competition, innovation, product development and distribution channels in the retail banking and non-banking sectors. Uncoordinated reform, undertaken within unduly narrow and limited terms of reference, inhibits the effective operation of the regulatory system as a whole. The Committee should request a review of the regulatory process to ensure that reform:
   - is undertaken in a coordinated manner, (rather than the prevailing piecemeal approach)
   - eliminates regulatory overlap, duplication and unnecessary complexity
   - is undertaken with adequate and timely industry consultation (and adequate implementation timelines)

2. **Regulatory discrimination against non-bank lenders:** The provision of financial services, including consumer credit, will always require a certain degree of regulation. Where regulation is necessary, the reason for regulating and the outcome that regulation aims to achieve, should be clearly articulated at the outset. From that starting point, the regulation should:
   - be designed to achieve its specified objective without unintended consequences
   - apply in a way which results in competitively neutrality

- not be introduced unless there is adequate evidence, or compelling logic, to suggest that it will achieve its objective

The current system of regulation of the bank and non-bank sectors fails, in many respects, to satisfy these conditions, and the result is to restrict competition and limit innovation. GE submits that the Committee should take this opportunity to undertake a broad review of the regulation affecting banks and non-banks, with a view to eliminating regulation that discriminates against non-bank financial institutions – unless any valid policy objectives can be identified to justify the discriminatory treatment.

GE's UNIQUE PERSPECTIVE ON FINANCIAL SERVICES

GE has several businesses operating in Australia, including GE Money and GE Commercial Finance.

Due to the range of products, distribution channels and number of customers, GE has a significant and distinctive interest in proposed reforms affecting the regulation of financial services, including consumer credit. Although GE conducts the 6th largest financial services business in Australia (ranking behind St George bank in assets) we do not take deposits and our perspective on proposed reforms is unlike that of any other financial institution operating in Australia. Further background information about GE's financial services businesses in Australian and New Zealand is set out in Appendix 1 to this submission.

COAG ANNOUNCEMENT OF 3 JULY 2008

GE notes The Council of Australian Governments' (COAG) communiqué of 3 July 2008 announcing, amongst other things, that it has agreed that the Commonwealth will take over responsibility for the regulation of all forms of consumer credit. While this announcement by COAG appears to pre-empt responses to options canvassed in the Green Paper[1], GE welcomes the decision. In GE's view, national regulation will enhance efficiency and is more likely to achieve simplification objectives [2].

However, the details of the plan to implement national regulation are not yet clear. GE implores the Committee to take this opportunity to ensure that arbitrary timeframes are not imposed, and that no timeframes are developed until *after* the processes, mechanisms and structure (including enforcement needs) required to achieve the enormously complex transfer of regulatory responsibility to the Commonwealth are fully developed.

Further comments with respect to the 2 key points of this submission are set out below.

1. SILO APPROACH INHIBITS EFFECTIVENESS OF THE REGULATORY SYSTEM

Regulatory policy makers operating in silos are unable to undertake cost-benefit analyses that recognise or give weight to factors beyond their limited terms of reference.

In GE's view, the following are illustrative of the shortcomings of this fragmented approach: (A) payments system regulation; (B) proposed privacy regulation reform with respect to comprehensive credit reporting; and (C) proposed regulation of credit fees and charges.

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[1] Financial Services and Credit Reform: Improving, Simplifying and Standardising Financial Services and Credit Regulation Green Paper June 2008.

[2] GE's response to the Green Paper (submitted to The Treasury on 1 July 2008) sets out GE's reasons for supporting national regulation of mortgages, mortgage broking and non-deposit institutions and other credit products.

(A) Reserve Bank of Australia's Payments System Regulation

According to the RBA, the overuse of credit cards (which are more costly to produce and transact with) resulted in an inefficient payments system, since higher costs incurred by merchants resulted in higher prices to consumers. The RBA's objective in regulating interchange fees was to encourage greater use of debit cards, by making them cheaper for cardholders to use than credit cards.

To achieve this, the RBA mandated reduced credit card interchange fees (which reduced revenues to credit card issuers, resulting in a reduction in product features and benefits offered by credit card issuers) and prohibited no-surcharge rules imposed by card scheme operators.

The RBA is only one of a number of regulators around the world to have taken action (in various ways) to try to force changes in the fees for credit card interchange. It is instructive to note that none of them has been able to identify an interchange charging system that they would find acceptable. This leaves card issuers and card schemes in a very difficult position - they are effectively being told by regulators to find a new way to deal with interchange[3], but regulators have not given any indication of what alternatives might be acceptable to them.

A recent study[4] (funded by MasterCard) concludes that the RBA's regulatory intervention has, by reducing the profitability of credit card issuing, stifled product innovation, reduced incentives for new entrants, made it more difficult for smaller credit card issuers to compete, and increased the need for issuers to fund the costs of issuing by imposing fees on cardholders. Australians are now paying approximately AU$480 million in additional credit card fees (for example, annual fees and rewards program fees) each year. Reductions in interchange fees have resulted in reductions in merchant service fees. However, there is no evidence that merchants have passed these savings to consumers. In other words, intervention has resulted in windfall gains to merchants, to the detriment of consumers and existing and potential credit card issuers. This has been recognised by the United States' Department of Justice and Government Accountability Office which have, in the course of considering the USA's proposed *'Credit Card Fair Fee Act of 2008'*, studied the RBA's intervention and concluded that the result in Australia may well have been to harm consumers, not benefit them[5].

However, the RBA does not claim consumer benefit as the objective that it aims to achieve by its intervention in the payments system by way of regulation of interchange fees. Rather, it seeks only to promote an economically efficient distribution of resources within the payments system (between the different means of making payments). This at once shows the limitations of allowing regulation to be formulated by a regulator whose frame of reference and range of desired outcomes are not sufficiently broad to encompass the full range of ways in which that regulation might affect society and the economy.

GE's view is that, even within the RBA's frame of reference, the assumption that fees in the payments system can only be justified on the basis of the actual cost of providing the particular service for which the fee is charged is misguided in two ways. Firstly, the focus on the relative costs of production of alternative payments methods as the way in which to ascribe value to them ignores

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[3] It is important to note here that the card issuers and the card schemes do not believe the current (or in the case of Australia, the previous) approach to setting interchange fees is impermissible.

[4] Robert Stillman, William Bishop, Kyla Malcolm, and Nicole Hildebrandt, "Regulatory intervention in the payment card industry by the Reserve Bank of Australia: Analysis of the Evidence" (28 April 2008), available at http://www.crai.com/ecp//assets/Regulatory_Intervention.pdf.

[5] This conclusion is based on a study conducted by the Government Accountability Office (GAO-08-558) and is stated in a letter (dated 23 June 2008) from Keith B. Nelson, Principal Deputy Assistant Attorney General to the Committee on the Judiciary, United States House of Representatives.

the relative benefits to consumers (convenience and security amongst other things)[6] and other societal value attributable to other, (that is, other than pure economic efficiency) broader features of different payments methods. For example, to the extent that interchange regulation encourages the use of cash (through debit facilities), the ability of law enforcement agencies to identify and trace criminal activity is likely to be reduced. Second, interchange is a service - and no commercial supplier of goods or services would only ever sell those goods or services at a price equal to the cost of production.

Given that the RBA is currently undertaking a review of its regulation of the payments system, the Inquiry presents the Committee with an opportunity to consider whether payments system regulation in its current form detracts from broader policy objectives.

(B) Proposed Privacy Law Reforms: Comprehensive Credit Reporting

GE is strongly supportive of changes to privacy regulation to permit and facilitate comprehensive credit reporting. GE has made a number of submissions to the Australian Law Reform Commission's (ALRC) review of privacy laws. A summary of GE Money's position with respect to comprehensive credit reporting is set out in Appendix 2 to this submission.

The ALRC's terms of reference do not include assessing the affect of reforms on competitiveness in relevant markets. The Inquiry presents the Committee with an opportunity to consider the pro-competitive outcomes that could be achieved by the implementation of a comprehensive credit reporting regime. GE and many other non-bank lenders are currently at a competitive disadvantage vis a vis the banks with respect to our ability to assess an applicant's capacity and willingness to service debt. Due to the banks' larger customer bases and deeper relationships with customers (that is, their wider product ranges means that customers often have multiple products - including transaction or deposit accounts as well as loans - with one bank) the banks effectively have their own private, internal comprehensive credit bureaux - giving them a greater ability to identify and verify their customers' sources of income, and to assess the "financial health" of customers.

Often, bank customers have their salaries, wages or government benefits paid directly into their bank accounts, giving the customer's bank exclusive access to information that confirms the source and amount of that customer. This information gives the customer's bank a significant advantage when it comes to making lending decisions about that customer.

This information asymmetry is a disincentive to new entrants and puts existing non-bank lenders at a competitive disadvantage with respect to managing risk.

In GE's view, and as demonstrated by international experience, implementation of a comprehensive credit reporting model is likely to result in increased competition between banks and non-banks (resulting in competitive pricing for consumers), and between credit bureaux (resulting in competitive pricing and product innovation by those credit bureaux). Moreover, new entrants (both lenders and credit bureaux) would have access to the same information, thereby reducing barriers to entry into relevant markets.

(C) Proposed Regulation of Credit Fees and Charges

Certain credit fees and charges are already subject to regulation by the Uniform Consumer Credit Code, the common law doctrine of penalties and the ASIC Act. In addition interest rate caps in some jurisdictions[7] indirectly regulate fees and charges, since the interest rate is determined by formulae

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[6] See the discussion of Nicholas Hossack in *Guarantees, Interchange and Fees – Current Issues with Long-Term Implications", Economic Papers* Special Edition 2006, pp. 121-128.

(not consistent between jurisdictions) that includes certain fees and charges. Current initiatives at state level propose additional regulation of credit fees and charges[8].

The existing regulation and proposed reforms have been developed within terms of reference that focus on consumer protection – to the exclusion of an assessment of anti-competitive consequences. In GE's view, excessive regulation of credit fees and charges will stifle product innovation, since return on investment would have to be derived from interest on credit alone. Product differentiation based on features that present value to consumers (for example, an annual fee permitting lenders to offer interest free periods on purchases) would become increasingly difficult. Moreover, increased compliance costs, and the primacy of interest charges as the means of generating revenue, may increase the cost of credit to consumers.

GE supports the view expressed in the Green Paper that the Government does not intend to regulate bank fees and charges. We assume that "bank fees and charges" is intended to cover all credit fees and charges. A competitive market will provide the forces that put pressure on credit fees and charges.

2. REGULATORY DISCRIMINATION AGAINST NON-BANK LENDERS

In order to facilitate market efficiency, regulation should not create a competitive bias in favour of particular participants in a market. In GE's view, some aspects of existing regulation and proposed regulation discriminate against non-bank lenders, increasing their costs and decreasing their ability to compete with banks. The Inquiry presents the Committee with an opportunity to review the instances of regulatory discrimination against non-banks to determine whether specific policy objectives warrant such measures in light of the overarching policy objective of facilitating competition between banks and non-banks.

The limited timeframe in which to make submissions with respect to the Inquiry has prevented us from undertaking a thorough review of all applicable regulation that creates competitive advantages for banks, with a corresponding competitive disadvantage suffered by non-banks. However, following are examples of such regulation that the Committee should consider:

(A) AML/CTF Regime

The *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* and the Rules (the AML/CTF Act) apply to financial services offered by banks and non-banks alike. While the AML/CTF Act is based on risk-based principles, requiring certain measures to be applied in proportion to the money laundering and terrorism risks faced by the financial institution, it is nevertheless prescriptive with respect to certain aspects. All financiers are required to collect and verify minimum identification information about their customers - regardless of the self-assessed risks faced by the financiers. In this respect banks, which typically have extensive branch networks, have a distinct operational advantage over financiers (including GE) whose primary product distribution channels are through intermediaries. In other words, GE rarely physically meets its customers.

The operation of the AML/CTF Act's customer identification requirements therefore imposes a greater regulatory burden, and greater costs burden, on GE relative to the banks. Moreover, to the extent that customers perceive the banks to be "easier to deal with", because they can carry out

[7] *Consumer Credit (Victoria) Act 1995; Consumer Credit Act 1995 (ACT)* and *Consumer Credit Regulations 1996 (ACT); Consumer Credit (New South Wales) Act 1995* and *Special Provisions Regulation 2002; Consumer Credit (Queensland) and Other Acts Amendment Bill 2008.*

[8] *Consumer Credit Code Amendment Bill 2007*and *Consumer Credit Code Amendment Regulations 2007* - an initiative of the Ministerial Council on Consumer Affairs.

identification procedures more quickly and efficiently, there is a real concern that this competitive advantage enjoyed by the banks will result in GE losing customers to the banks. In GE's view, competition would be enhanced by amendments to the AML/CTF Act to remove this barrier to competition.

(B) Spam Act and Do Not Call Register Act

Typically, non-banks have more complex legal entity structures than banks - often necessitated by their funding arrangements. The Spam Act and the Do Not Call Register Act favour banks, because the existing customer relationships exceptions mean that banks are more likely to be able take advantage of the exceptions to market new products to their existing customers. By contrast, GE has a group structure (with different products being issued by different legal entities in the group) which is more likely to prevent reliance on the existing customer relationship exceptions - notwithstanding that from the customers' perspective the group structure of GE is invisible. These barriers to marketing new products to its customers put GE at a competitive disadvantage.

(C) Debt collection licensing in NSW

In New South Wales, GE's mortgage business needs to be licensed to collect its own overdue debts[9], whereas a bank with the same structure as GE's mortgage business would enjoy a specific exemption from the licensing requirements. This requirement increases GE's compliance burden (and associated costs) relative to banks carrying out similar collection activities.

(D) Broker regulation in WA

Western Australian finance broker legislation[10] requires GE's branch business (predominantly, personal loans) to be licensed, whereas bank branches conducting the same business do not require a licence. In GE's view, this exemption for banks is based on outdated model of finance broking (circa 1975) where brokers took customers' money and made investments on behalf of those customers. The licensing requirements were necessary to afford a measure of protection for those investments. Given that banks were already prudentially regulated, the licensing requirements did not apply to banks. The broker model circa 2008 is that brokers act as intermediaries, not as investment agents. Therefore, the exemption for banks is no longer justifiable. This licensing requirement in Western Australia increases GE's compliance burden (and associated costs) relative to banks carrying out similar activities.

(E) Proposed national broker regulation

GE supports the proposal to introduce uniform national legislation to regulate finance brokers. However, national regulation should not impose inefficiencies. GE remains concerned that, *if enacted in its current form*, the exposure draft of the *Finance Broking Bill 2007* (NSW) would have a material anti-competitive effect on the provision of consumer finance in Australia[11]. In particular:

- Finance intermediaries will have an incentive to move to exclusive or "first choice" arrangements to take advantage of exemptions proposed for such arrangements. In GE's

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[9] *Commercial Agents and Private Inquiry Agents Act 2004* (NSW).

[10] *Finance Brokers Control Act 1975* (WA).

[11] GE made a detailed submission with respect to the exposure draft of the Bill, dated 29 February 2008, and has been actively involved in industry consultation. It is worth noting here that under the exposure draft of the Bill, coverage goes well beyond what is commonly understood to constitute 'finance broking', such that the proposed regulation should be more accurately described as 'intermediary' regulation.

view, this will result in less choice for consumers and will significantly disadvantage financiers (such as GE) whose business model involves a significant broker network.

- Vendor introduced finance is a significant distribution channel for GE. This point of sale finance would become an unworkable business model. Without the interest free and deferred payment offered to consumers by vendor introducers, consumers may be less inclined to use a GE finance product, resorting instead to traditional credit cards offered by the banks. This would reduce consumer access to and use of a GE product that can be a less expensive form of credit when used wisely.
- It will create a more favourable regulatory environment for the direct provision of credit via branches by credit providers that have branches, rather than credit that is provided by a credit provider through intermediaries (which is necessary when the credit provider does not have an extensive branch network). Finance businesses based on intermediary models will operate in a correspondingly less favourable regulatory environment.
- The offering of rental products will not be regulated – encouraging retailers (GE's vendor introducers) to offer them to consumers instead of regulated credit products. This will place GE at a significant competitive disadvantage and will reduce consumer choice.
- The obligations imposed with respect to offering advice to consumers about credit products will encourage finance brokers to cease offering such advice.

(F) Prudential regulation

Two of the legal entities in the GE Money group are licensed under the *Banking Act 1959* as Specialist Credit Card Institutions (SCCIs). SCCIs are a special class of authorised deposit-taking institution under the *Banking Act* (however, as previously mentioned, the GE finance businesses in Australia do not take deposits).

A requirement of APRA Prudential Standard APS110 Capital Adequacy is that authorised deposit-taking institutions must maintain adequate capital against risks associated with their activities. APRA has imposed a higher minimum capital requirement on SCCIs[12]. GE's SCCIs are required to hold capital calculated at 15% of their total credit card assets. This is a significantly higher minimum capital ratio than the 8% imposed on banks. This increases GE's costs of conducting its credit card business in Australia, and puts it at a competitive disadvantage to bank issued credit cards.

(G) Withholding tax discrimination

As previously stated, non-bank lenders typically have more complex legal entity structures than banks, often necessitated by funding considerations. In the case of GE, a group entity resident in Australia raises debt from three sources to fund the Australian financial services operations of other GE entities (including entities in the GE Money and GE Commercial Finance group). In GE's view, the application of the interest withholding tax rules inappropriately discriminates against one of the three sources of debt financing. This increases the cost of GE doing business in Australia. That cost is due to commercial circumstances outside of GE's control, including the limited size of the Australian debt markets.

[12] There are only 3 SCCIs in Australia – 2 of them are in the GE group.

A detailed paper explaining this discrimination is set out in Appendix 3 to this submission. The information contained in the attached detailed paper is commercially sensitive and confidential. GE requests that the Committee keep the contents of Appendix 3 confidential.

IN CONCLUSION

As a member of the Australian Finance Conference (AFC), GE has reviewed the AFC submission with respect to this Inquiry and, to the extent that issues raised in this submission are also raised by the AFC its submission, GE is generally supportive of the views set out in the AFC submission with respect to those issues.

GE has a significant and distinctive interest in proposed reforms affecting the regulation of financial services (because GE is unlike any other financial institution in Australia) and in all matters affecting the competitiveness of the environment within which we operate our businesses. Therefore, in GE's view, the 2 key points detailed in this submission:

- Silo approach inhibits effectiveness of the regulatory system as a whole; and
- Regulatory discrimination against non-bank lenders may no longer be justified,

should be considered by the Committee as matters particularly relevant to the terms of reference of the Inquiry.

If you would like further information about any of the matters raised in this submission, please call either Ardele Blignault (02 8915 6948) or Debra Kruse (03 9921 6859) in the first instance.

Yours sincerely

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APPENDIX 1

GE Money

GE Money is the consumer finance division of the General Electric Company, a company that has provided financial services for 70 years. GE Money is one of Australia's leading consumer finance companies, offering an extensive range of consumer finance products, including personal loans, auto loans, credit cards, mortgages, insurance and promotional retail finance. GE Money has assets in excess of AU$36 billion and more 3 million customers across Australia and New Zealand and its financial services are distributed through numerous sales channels, including over 12,000 retailers, 2300 accredited auto dealers, 5,500 brokers, 400 branches, a direct sales channel, and the Internet. GE Money's Australian operations commenced in 1995 and have since grown rapidly through organic growth and major acquisitions. GE Money now employs more than 4,500 people in Australia and has established its headquarters in Melbourne.

GE Commercial Finance

GE Commercial is the commercial finance business of the General Electric Company, and operates in more than 35 countries around the world. GE Commercial Finance's customers range from small and medium size enterprises up to multinational organisations. GE Commercial Finance has assets in excess of AU$10 billion, and more than 150,000 customers across Australia and New Zealand. Its Australian operations commenced in 1991 and have since grown rapidly through organic growth and major acquisitions. GE Commercial Finance is a full service provider of financing solutions, managing credit applications, credit underwriting and funding, credit authorisation, billing, remittance, customer service and collection. With its registered office in Melbourne, GE Commercial Finance now employs more than 1,100 people in Australia.

APPENDIX 2

GE Money Summary: Comprehensive Credit Reporting

Credit risk assessment is fundamental to GE Money's business, and many of GE Money Australia's key personnel are recognised experts in the field. Their expertise has been recognised across the US, UK, Europe and Latin America. Mike Cutter, the GE Money Australia & New Zealand CEO and President was involved in the formation of the current credit bureau system in the U.K. GE Money's extensive international consumer finance presence (54 countries and territories) gives the local GE Money team access to global expertise in credit risk assessment.

GE Money is strongly supportive of changes to privacy regulation to permit and facilitate comprehensive credit reporting (also known as "positive credit reporting").

The customer data currently available to lenders from credit bureaux in Australia only permit a lender to see one aspect of customer payment data, that is, when someone has fallen into bankruptcy, had a default or serious credit infringement (the "negative" events only).

In many studies, in a diverse range of international markets, positive credit reporting has been proven to add more predictive power to assess an applicant's capacity and willingness to service a loan than the demographic data supplied by an applicant on an application form. This is due to positive credit reporting having 2 clear advantages over relying on data supplied by an applicant on an application form:

1. Data cannot be manipulated

Unlike application form data supplied by an applicant, credit performance data sourced directly from a credit bureau cannot be manipulated, exaggerated or omitted.

2. Stronger causal link

The causal link between previous good performance on a loan and the expected performance on a new loan is much stronger than the causal link between demographic data (for example, time with current employer).

Public Benefits from Positive Credit Reporting

- Positive credit reporting promotes responsible lending, since it has the potential to reduce the number of consumers who take on unsustainable levels of credit commitment.
- Increased transparency to consumers will give consumers the means to "repair" their credit records, and will facilitate increased financial literacy.
- As demonstrated by the U.K. & U.S. experience, a positive credit reporting model is likely to lead to increased competition between lenders, resulting in competitive pricing for consumers - and competition between credit bureaux is likely to result in a greater range of related services available to consumers and lenders.
- Data accuracy would be improved, since fully automated systems would replace the manual processes currently used by many lenders and by credit bureaux.
- Access to comprehensive data would greatly enhance credit providers' ability to detect and prevent money laundering and other fraudulent activities.

Benefits to Lenders

- Positive credit bureaux data adds significantly to lenders' ability to accurately assess applicants' credit risk. This improved capability will enable lenders to more accurately assess risk, which may in turn reduce credit losses (including fraud losses), a cost that is ultimately borne by consumers.
- Positive credit reporting would greatly enhance lenders' ability to comply with an obligation to assess consumers' capacity to repay debt.
- The cost to lenders of contributing "full" data files under a positive reporting model would be significantly less than the cost of reporting limited data at "triggers" such as number or days overdue for payment.