Chapter 4

Competition

4.1 A competitive finance sector is essential to an efficient, resilient and growing economy. Competition is important to ensure that the financial system delivers high quality financial services at appropriate prices. It is important to driving innovation in products and services. It helps ensure that consumers can find the products and services that meet their particular needs.

4.2 Competition does, however, need to be balanced with financial stability. Many countries have learned painful lessons during the GFC regarding the importance of financial institutions being stable and resilient when under pressure. As Treasury recently put it:

> In the banking sector, unlike other sectors of the economy, initiatives to further competition must take account of this interaction between competition and financial stability.
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> • Banks are unique because of their particular mix of features which makes them vulnerable to runs with potentially systemic impacts and very important negative externalities for the economy. The fragility of banking systems was exposed during the recent global financial crisis.
>
> • For this reason, the potential benefits of competition between financial institutions must continually be weighed against its potential risks to financial stability, for example the risks that banks lower credit quality in pursuit of more customers or higher profits.[1]

4.3 Australian governments have long recognised the importance of ensuring competition amongst the dominant providers of lending in Australia, namely the big four domestic banks: the Commonwealth Bank, NAB, ANZ and Westpac. The need to ensure this competition has been enshrined in the so-called 'four pillars' policy, under which the Commonwealth government has indicated it will prevent amalgamations or takeovers that would reduce the numbers of these four players.[2] The four pillars policy was first articulated in 1990,[3] and was most recently reaffirmed by current Treasurer Mr Wayne Swan MP in June 2008.[4]

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1 Treasury, *Submission 102*, Senate Economics References Committee inquiry into banking competition, p. 5.

2 Treasury, *Submission 102*, Senate Economics References Committee inquiry into banking competition, p. 22.

3 Ruth Williams, 'Four pillars back on agenda', *The Age*, 14 May 2008, http://www.theage.com.au/business/four-pillars-back-on-agenda-20080513-2dsk.html (accessed 6 April 2011).

4 Treasury, *Submission 102*, Senate Economics References Committee inquiry into banking competition, p. 23.

4.4 While Australia's finance sector may be dominated by four banks, there are many financial corporations providing lending services across the Australian economy. Drawing on Cannex data, Treasury indicated that:

> Australian banking customers are currently served by a wide range of providers. These include 12 Australian-owned banks; 9 foreign-owned bank subsidiaries; 35 foreign bank branches; 11 building societies and more than 100 credit unions.
>
> Further, there are currently around 111 providers of over 2,200 mortgage products; 66 providers of over 420 different credit cards; and 114 providers of over 992 different types of deposit accounts.[5]

4.5 SMEs can access residential secured business overdrafts, residential and commercial secured variable business loans, residential and commercial secured five-year fixed business loans, and business credit cards. Data from Cannex suggests that there is an extensive range of credit and finance providers, although the field narrows when taking into account companies within the same banking group. For example, while there are 28 companies that provide commercially secured overdrafts these represent 16 banking groups.

4.6 The success of competition in the sector is evidenced by a long-term decline in bank net interest margins:[6]

> the major banks' overall interest margins across their lending portfolios have declined steadily since the early 1990s and have roughly halved since the mid 1980s. This trend can be attributed to financial deregulation leading to increased competition in lending, as well as the removal by banks of internal cross-subsidies through the introduction of a user-pays pricing system.[7]

The GFC and banking competition

4.7 The GFC has been marked by a rise in bank net interest margins, to levels equivalent to those experienced around 2004.[8] It has also been marked by a rise in the major banks' share of deposits. However, the latter has been driven more by acquisitions and mergers than by existing market players losing share:

> Following the onset of the financial crisis in mid-2008, the majors gained market share in deposits at the expense of other banks and foreign banks. Between September and December 2008, the majors’ share of deposits increased by 9.8 per cent. A significant part of this shift can be attributed to

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5 Treasury, *Submission 102*, Senate Economics References Committee inquiry into banking competition, p. 22. ABA made a similar point to this committee, also using Cannex data: *Submission 13*, p. 3.

6 A measure of the difference between the interest income generated by banks on their assets and amount of interest paid on their liabilities.

7 Treasury, *Submission 16*, p. 7.

8 Treasury, *Submission 16*, p. 7.

> the re-classification of the deposits of St George and BankWest as belonging to the 'majors' following their acquisitions by Westpac and the Commonwealth Bank respectively.[9]

4.8 Treasury reported that since the GFC, 'the major banks' share of total outstanding business lending has increased from around 60 per cent to 70 per cent'.[10] The RBA reported that lending by small banks is well below its peak in 2008, while lending by non-bank firms has decreased by nearly half.[11]

4.9 There are two potential reasons for this. First, as ANZ has argued, the business models used by second-tier lenders 'were not sustainable and did not reflect the full cost of providing financial services throughout the economic cycle'.[12] Second, as the AFC has also noted, the cost of obtaining funds for lending significantly increased as a result of the GFC.[13] The exit of market participants, whose business models meant they could no longer compete, has seen the major banks picking up that market share.

4.10 Despite this trend it is also the case that credit unions and building societies have increased their market share in some sectors, such as home loans, since the GFC hit. Abacus, representing Australian mutuals, considered that its members had 'significant potential for growth' in small business lending.[14]

A reduction in competition?

4.11 Stakeholders making submission to this committee did express unease about the state of competition in the business lending sector. Mr Lawler, representing Abacus, commented:

> The structure of the market has changed as there are fewer lenders, fewer people out there. Through the change in the sources of funding some sources of funding have disappeared and others sources of funding have become more expensive. Also there has been the consolidation that we have seen in the banking market. We have seen some foreign banking competitors exit and we have seen some regional banks swallowed up by the majors.[15]

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9 Treasury, *Submission 102*, Senate Economics References Committee inquiry into banking competition, p. 12.

10 Treasury, *Submission 16*, p. 3.

11 RBA, *Submission 3*, p. 8.

12 ANZ, *Submission 14*, p. 14.

13 AFC, *Submission 15*, p. 2.

14 Abacus, *Submission 18*, p. 2.

15 Mr Luke Lawler, Abacus, *Proof Committee Hansard*, 4 March 2011, p. 4.

4.12 A reduction in the number of market participants has been a recurring theme in submissions. The Commercial Asset Finance Brokers Association of Australia (CAFBA), which represents finance broking firms that distribute equipment finance facilities to small businesses, said:

> We used to have on our panel of lenders typically 20 to 25 lenders or places where we could go to obtain products for our clients. Now there are only eight main players and there are some second-tier lenders who are a little more expensive and more specialised. So we have got fewer places to go. Our clients have found it more difficult to raise funds in the market that they are in. Our members have found it more difficult to raise funds for their clients and we have been severely impacted by the GFC, for two reasons: the number of lenders and the more risk-averse nature of lenders for the last two or three years.[16]

4.13 Others, such as REIA, also argued that the loss of small lenders was reducing competition:

> That competition in the banking sector has declined following the GFC can be seen by the increase in concentration of credit in a few financial institutions and by the increase in lending margins by the major banks relative to the small ones. The changes in the concentration of business lending and net interest rate margins (NIM) by the major banks indicate that small lenders are being pushed out of the market and the big four banks are consolidating their market power.[17]

4.14 Urban Taskforce Australia agreed:

> In our view, there is no longer a sufficiently deep or competitive market for commercial mortgages to property developers…The number of lending institutions competing for the business of property developers has shrunk considerably. This was facilitated, in part, by the Australian Competition and Consumer Commission's decision to authorise the takeover of BankWest and St George by members of the big four.[18]

4.15 A drop in the number of players is related to, but not the same thing as, an increase in concentration. Increased concentration in the banking market is marked by existing companies taking an increasing proportion of market share.

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16 Mr David Gandolfo, committee member, Commercial Asset Finance Brokers Association of Australia, *Proof Committee Hansard*, 4 March 2011, p. 15.

17 REIA, *Submission 7*, p. 3.

18 Urban Taskforce Australia, *Submission 1*, p. 2.

REIA commented:

> The recent increase in market concentration by the major banks can be explained by several factors such as:
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> • Mergers and acquisitions in the banking sector
>
> • Higher bank's funding costs
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> • Closure of securitisation markets and constraints in other funding markets.
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> Lack of competition in the banking industry brings about credit restrictions and higher funding costs. There is evidence that bank concentration increases financing obstacles and decreases the likelihood of receiving bank finance. In business, this results in small businesses being more affected compared to large firms.[19]

4.16 Some submitters were concerned that a strategy such as the 'four pillars' policy would not be enough to prevent further market consolidation, and argued for stronger measures:

> Based on current levels of competition, the Government should rule out any significant future merger and acquisition activity in the Australian retail banking system and the wider financial services sector which would consolidate the dominance of any one of the four major banks. ACCI would encourage initiatives to assist in the development of a "fifth" or additional pillar to provide effective competition to the existing large incumbents.[20]

4.17 ACCI in addition noted studies showing that the high bank profit levels in Australia imply a lack of sufficient competitive pressures.[21]

4.18 Despite this, Treasury has noted that, while Australian banking is dominated by four firms, concentration in Australia is not significantly greater than in other countries.[22]

Recent measures to enhance competition

4.19 In December 2010, the Commonwealth government announced a large number of measures intended to enhance competition in the provision of finance. These measures fell into three categories: consumer empowerment; supporting smaller lenders to compete with the large banks; and securing the long-term safety and sustainability of the financial system.

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19 REIA, *Submission 7*, p. 4.

20 ACCI, *Submission 6*, p. iv.

21 ACCI, *Submission 6*, pp 13–15.

22 Treasury, *Submission 102*, Senate Economics References Committee inquiry into banking competition, p. 13.

4.20 The measures included:

- Ban exit fees for new home loans
- Boost consumer flexibility to transfer deposits and mortgages
- Introduce mandatory key facts sheet for new home loan customers
- Empower ACCC to investigate and prosecute anti-competitive price signalling
- Fast-track legislation to get a better deal for Australians with credit cards
- Launch *Bank on a Better Deal* — community awareness and education campaign
- Establish taskforce with Reserve Bank to monitor and enhance ATM competition reforms
- Build a new pillar in the banking system by supporting the mutual sector
- Confirm the Financial Claims Scheme as a permanent feature of our financial system
- Introduce a third tranche of support for the RMBS market
- Accelerate development of bullet RMBS market for smaller lenders
- Allow Australian banks, credit unions and building societies to issue covered bonds
- Develop a deep and liquid corporate bond market.[23]

4.21 This initiative, announced by the Treasurer, includes measures to facilitate consumer education and awareness that are intended to further level the playing field between major banks and other market players whose prudential provisions are equal in nature. This includes allowing these institutions to call themselves 'banks' if they wish, and the introduction of a 'protected deposit seal' to help consumers understand that 'mutuals and regional banks are just as safe as the big banks.'[24]

4.22 The committee notes that a number of the government's actions are consistent with suggestions made by submitters to this inquiry and with recommendations of the Senate Economics Committee in its June 2010 report on *Access of Small Business to Finance*.

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23 Commonwealth Government, *Competitive and Sustainable Banking System*, December 2010, p. 3.

24 The Hon Wayne Swan P, 'Competitive and sustainable banking system package', Transcript of press conference, 12 December 2010, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=transcripts/2010/004.htm&pageID=004&min=brs&Year=&DocType (accessed 8 April 2011).

4.23 The committee also notes that in March 2011 Choice released a report *Better Banking*,[25] in which the organisation set out a range of recommended reforms. Some of these, such as the banning of mortgage exit fees, mirror some measures already announced by the government.

4.24 Choice also emphasised that consumers needed to educate themselves about products and take action in the marketplace:

> Do not accept the unacceptable but become more active. Compare the market using an objective comparison website; ask your existing bank for a better deal; but if they will not, or if their customer service is poor, take your business elsewhere by switching to a different financial institution.[26]

4.25 The committee notes that on 15 March 2011, the Australian Securities and Investments Commissioner launched a new personal finance website 'MoneySmart'.[27] The website is part of the National Financial Literacy Strategy, and provides '26 calculators and tools...to help people take simple steps to get quick answers to their questions about money'.[28] Subjects covered include credit cards, loans and margin loans.

4.26 The committee agrees that consumer education and awareness are important, particularly in regional markets, where banks other than the big four may be key sources of business finance. The committee is also particularly keen to see the government follow through on promised measures to enhance the vibrancy of the mutual sector.

Recommendation 4

4.27 The committee recommends that the government undertake further work to explore policy measures which may strengthen the mutual sector as a 'fifth pillar' of the banking system and thereby promote competition.

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25 Choice, *Better Banking*, 2011, http://www.choice.com.au/reviews-and-tests/money/banking/saving-money/banking-report.aspx, (accessed 5 April 2011).

26 Choice, *Better Banking*, 2011, p. 4.

27 http://www.moneysmart.gov.au/.

28 Australian Securities and Investments Commission, 'MoneySmart.gov.au – simple guidance you can trust', Media release 11-4MR, 15 March 2011.