Parliamentary Joint Committee on Corporations and Financial Services

Access for Small and Medium Business to Finance

April 2011

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Members of the Committee

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Ms Laura Smyth MP	VIC	ALP

SECRETARIAT

Dr Ian Holland, Secretary

Ms Erin East, Principal Research Officer

Ms Ruth Edwards, Administrative Officer

Ms Christina Schwarz, Administrative Officer

Suite SG.64
Parliament House
Canberra ACT 2600

T: 61 2 6277 3583
F: 61 2 6277 5719
E: corporations.joint@aph.gov.au
W: www.aph.gov.au/senate/committee/corporations_ctte

Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

  (i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

  (ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

Terms of Reference

That the Parliamentary Joint Committee on Corporations and Financial Services be required to inquire into and report on the access for small and medium business to finance, and report by 30 April 2011, with particular reference to:

(1) the types of finance and credit options available to small and medium business (SMEs) in Australia;

(2) the current levels of choice and competition between lending institutions, but not limited to, credit availability, fees, charges, comparative interest rates and conditions for business finance;

(3) credit options available from banks, non-bank lenders and second tier lenders;

(4) the impact of financial institution prudential requirements and banking guarantees on lending costs and practices;

(5) comparison between the credit options available to SMEs located in regional Australia and metropolitan areas;

(6) the impact of lenders' equity and security requirements on the amount of finance available to SMEs;

(7) policies, practices and strategies that may restrict access to SME finance, and the possible effects this may have on innovation, productivity, growth and job creation;

(8) the need for any legislative or regulatory change to assist access by SME to finance; and

(9) any other related matters.

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Abbreviations

ABA	Australian Bankers' Association
ABS	Australian Bureau of Statistics
AFC	Australian Finance Conference
ACCI	Australian Chamber of Commerce and Industry
ADI	Authorised Deposit-Taking Institution
APRA	Australian Prudential Regulation Authority
APESMA	Association of Professional Engineers, Scientists and Managers, Australia
Basel II	Global Regulatory Framework endorsed by the Basel Committee on Banking Supervision
Basel III	Regulatory Framework of the Basel Committee on Banking Supervision (October 2010)
CAFBA	Commercial Asset Finance Brokers Association of Australia
CBA	Commonwealth Bank of Australia
COSBOA	Council of Small Business Organizations Australia
GDP	Gross Domestic Product
GFC	Global Financial Crisis (2008)
MBCOP	Mutual Banking Code of Practice
NAB	National Australia Bank
NFF	National Farmers' Federation
OECD	Organisation for Economic Cooperation and Development
RBA	Reserve Bank of Australia
REIA	Real Estate Institute of Australia
SME	Small or Medium (Business) Enterprise

Recommendations

Recommendation 1

1.21 The committee recommends that the Government assess the value of developing uniform definitions of 'micro', 'small' and 'medium' business to be applied for data gathering, policy development and analysis by Commonwealth and state agencies.

Recommendation 2

3.48 The committee recommends that the Reserve Bank of Australia specifically track the impact of the introduction of Basel III on the cost of small and medium business finance and residential mortgages.

Recommendation 3

3.68 The committee recommends that the Code of Banking Practice and the Mutual Banking Code of Practice be amended to include a standardised notice period for notifying business borrowers of changes to loan terms and conditions that may be materially adverse for them.

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.

Chapter 1

Introduction

Terms of reference

1.1 On 25 November 2010, the House of Representatives resolved that the Parliamentary Joint Committee on Corporations and Financial Services would inquire, and report by 30 April 2011, into access to finance for small and medium businesses with particular reference to:

(i) the types of finance and credit options available to small and medium business (SMEs) in Australia;

(ii) the current levels of choice and competition between lending institutions, but not limited to, credit availability, fees, charges, comparative interest rates and conditions for business finance;

(iii) credit options available from banks, non-bank lenders and second tier lenders;

(iv) the impact of financial institution prudential requirements and banking guarantees on lending costs and practices;

(v) comparison between the credit options available to SMEs located in regional Australia and metropolitan areas;

(vi) the impact of lenders' equity and security requirements on the amount of finance available to SMEs;

(vii) policies, practices and strategies that may restrict access to SME finance, and the possible effects this may have on innovation, productivity, growth and job creation;

(viii) the need for any legislative or regulatory change to assist access by SME to finance; and

(ix) any other related matters.

Conduct of the inquiry

1.2 The inquiry was advertised in *The Australian* newspaper. Details of the inquiry were placed on the committee's website. The committee invited submissions from a wide range of interested organisations, government departments and authorities, and individuals. The closing date for submissions was 7 February 2011. 19 submissions were received, as listed in Appendix 1.

1.3 Public hearings were held in Canberra and on 11 March 2011 in Sydney. A list of witnesses who gave evidence at the public hearings is at Appendix 2.

1.4 The committee thanks those organisations and individuals that made written submissions, and those who gave evidence at the public hearings.

Note on references

1.5 References to submissions in this report are to individual submissions received by the committee and published on the internet.[1] References to the committee Hansard are to the official Hansard transcript of the public hearings, for which only a proof transcript was available at the time of writing.[2] Please note that page numbers may vary between the proof and the official Hansard transcripts.

Background

1.6 The health of Australia's financial system and the support of small and medium businesses are two issues of enduring concern to the Australian parliament. The committee acknowledges the work of other parliamentary committees, both past and ongoing, in looking at important issues in relation to SME finance. The House Standing Committee on Economics presented its report 'Competition in the banking and non-banking sectors' in November 2008. The Senate Economics References Committee's June 2010 report 'Access of Small Business to Finance' provided an important backdrop to the current inquiry. That committee is also currently inquiring into competition within the Australian banking sector. As this committee's report will note in chapter 4, competition amongst lenders is important to ensuring affordable finance for SMEs, and the committee notes recent government initiatives in this area.

Definition of SMEs

1.7 Evidence presented to the committee highlights that multiple definitions of small and medium enterprises are used across the finance sector and other regulatory sectors. As Treasury advised, the criteria used to define SMEs can vary between industry participants:

> There is no single universally accepted definition of a small or medium-sized enterprise. A variety of definitions are used by industry participants. These are generally based on the size of a business's annual turnover, number of its employees, the size of its borrowings, or a combination of these characteristics.[3]

1 Submissions to the inquiry are available at the following link: http://www.aph.gov.au/senate/committee/corporations_ctte/sme_finance/submissions.htm (accessed 27 April 2011).

2 Transcripts of the committee's public hearings can be accessed at the following link: http://www.aph.gov.au/senate/committee/corporations_ctte/sme_finance/hearings/index.htm (accessed 27 April 2011).

3 Treasury, *Submission 16*, p. 2.

1.8 The National Australia Bank (NAB) referred to definitions adopted by market researchers DBM Consultants, which define 'microbusiness customers' as businesses with turnover under $1 million, 'small business customers' as businesses with turnover between $1 million – $5 million, and 'medium business customers' as businesses with turnover between $5 million – $50 million.[4] The Commonwealth Bank of Australia (CBA) referenced the definition in the Australian Prudential Regulation Authority's monthly reporting requirements; 'that is, client loan balances less than $2 million'.[5]

1.9 The definition of SMEs can also vary between members of a banking group. For example, the Westpac Group advised that Westpac defines SMEs as businesses with up to $1 million in business lending and up to $2 million in total borrowings, while St George Bank defines SMEs as businesses with lending of up to $1 million and turnover between $1 – $5 million.[6]

1.10 For the Mutual sector, the 'Mutual Banking Code of Practice' contains two definitions of 'small business':

> "Small business" – A business having few than: a) 100 full-time (or equivalent) people if it involves the manufacture of goods, or, b), in any other case, 20 full time (or equivalent) people.[7]

1.11 Definitions used by lenders can be contrasted with definitions adopted by SME representatives. The NSW Business Chamber referred to the Australian Bureau of Statistics' definition of small business as a business employing fewer than 20 employees.[8] Similarly, CPA Australia advised that its Asia Pacific Small Business Survey 2010 focused on businesses with fewer than 20 employees.[9] The Australian Chamber of Commerce and Industry (ACCI) advised that its definition of SMEs is based not on the number of employees but the size of the loan:

> I suppose for the purpose of our representations here, it is probably more in the order of up to $2 million. Beyond that, it is probably ‘medium-sized business’. That is how we would consider it.[10]

1.12 The definition of SMEs also varies across relevant Commonwealth legislation and agencies. 'Small business employer' is defined for the purposes of the *Fair Work Act 2009* and the Small Business Fair Dismissal Code as an employer that

4 National Australia Bank, *Submission 19*, p. 5.

5 Commonwealth Bank of Australia, *Submission 17*, p. 1.

6 The Westpac Group, *Submission 9*, p. 2.

7 Abacus – Australian Mutuals, 'Mutual Banking Code of Practice', January 2010, p. 28.

8 NSW Business Chamber, *Submission 8*, p. 3.

9 CPA Australia, *Submission 10*, p. 3.

10 Mr Greg Evans, Director of Economics and Industry Policy, ACCI, *Proof Hansard*, 2 March 2011, p. 16.

employs fewer than 15 employees.[11] By contrast, Treasury advised that for taxation purposes a medium business is 'in most cases, defined as an entity with annual total income of greater than $10 million',[12] while a separate definition applies to small businesses:

> Broadly, a small business entity for taxation purposes is one with an aggregated turnover of less than $2 million. The aggregated turnover includes the turnover of the small business entity and certain closely related entities.[13]

1.13 The Australian Bureau of Statistics uses employment to define business size. Under the ABS definition, small businesses employ fewer than 20 people, medium businesses 20 to 199 people, and large business 200 or more people.[14]

1.14 The Reserve Bank of Australia (RBA) advised that the absence of a uniform definition has prompted the RBA to use 'several measures to delineate small and large businesses and the finance flowing to these sectors.' The measures include whether the SME is an unincorporated enterprise, and the size of the business loan, where the RBA assumes 'that loans of less than $2 million are generally provided to small businesses'.[15]

1.15 Treasury stated that 'there is not a clear distinction between what constitutes a small business and what constitutes a medium-sized business'.[16] Similarly, the RBA also stated that the RBA measures do not distinguish between small and medium-sized enterprises.

> No further breakdown of loans about $2 million is available, and hence, it is not possible to provide any further information on financing to medium-sized businesses.[17]

1.16 The Australian Finance Conference (the AFC) raised concerns with the absence of a uniform definition of SMEs:

> Much difficulty and confusion in the discussion and development of SME finance policy is caused by imprecision as to what exactly is the subject of consideration.[18]

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11 *Fair Work Act 2009*, s. 23; Fair Work Australia, *Small Business Fair Dismissal Code*, http://www.fwa.gov.au/index.cfm?pagename=legislationfwdismissalcode (accessed 30 March 2011).

12 Treasury, *Submission 16*, p. 2.

13 Treasury, answer to question on notice, 4 March 2011 (received 29 March 2011).

14 Australian Bureau of Statistics, *Australian industry*, 2008-09, cat.no. 8165.0, http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/F5105AEC0D3E0B11CA257730001839E5/$File/81550_2008-09_1.pdf (accessed 19 April 2011).

15 RBA, *Submission 3*, p. 1.

16 Treasury, *Submission 16*, p. 2.

17 RBA, *Submission 3*, pp. 1–2.

1.17 However, this concern did not appear to be necessarily widely shared. In response to questions on this issue, ACCI noted that lenders' procedures can differ depending on whether the applicant is considered a small business but did not comment on whether the multiple definitions had a positive or negative outcome.[19] Treasury advised that it does not consider that the absence of a settled definition poses regulatory problems.[20] Westpac Group linked the flexibility to define SMEs with increased lending competition: 'Westpac and St George's different approach to the SME market is part of the Westpac Group's multi-branded strategy.'[21]

1.18 The committee is aware that industry-specific definitions can serve regulatory and policy purposes. In the United States, the Small Business Administration delivers small business support programs, including guidelines for government contracting.[22] It maintains different small business size standards for each industry sector, some based on annual receipts and some on numbers of employees. These standards are used to tailor program eligibility to the structure of each business sector.

Committee view

1.19 Evidence before the committee does not indicate that the absence of a uniform definition of SMEs directly restricts SME's access to finance. However, the committee considers that the SME sector would benefit from consistent, sector-wide definitions of 'micro', 'small' and 'medium' business. Consistent definitions would assist analysis of the health of the SME sector and encourage greater use of the analysis by SME stakeholders. A shared understanding of micro, small and medium business would also promote more informed policy and practice and solutions tailored to the challenges faced by each kind of SME.

1.20 For the purposes of this report, the committee notes the definitions used by each submitter to the inquiry.

Recommendation 1

1.21 The committee recommends that the Government assess the value of developing uniform definitions of 'micro', 'small' and 'medium' business to be applied for data gathering, policy development and analysis by Commonwealth and state agencies.

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18 AFC, *Submission 15*, p. 3.

19 Mr Evans, ACCI, *Proof Hansard*, 2 March 2011, p. 16.

20 Mr Ian Beckett, Principal Adviser, Financial Systems Division, Treasury, *Proof Hansard*, 4 March 2011, p. 43.

21 The Westpac Group, *Submission 9*, p. 2.

22 US Small Business Administration, Size standards, http://www.sba.gov/content/size-standards (accessed 21 April 2011).

The importance of access to finance for SMEs

1.22 Small and medium businesses are a fundamental part of Australia's economy. The Australian Bureau of Statistics has calculated that at 30 June 2009 SMEs provided employment for approximately 7.1 million people.[23] For the 2008-09 financial year, SMEs also provided 58% of industry value added; that is, businesses' contribution to the gross domestic product.[24]

1.23 The relevance of SMEs to the Australian economy was noted in submissions to the inquiry. For example, Treasury advised that:

> Small and medium sized enterprises (SMEs) make a significant contribution to employment, productivity, and value added in the Australian economy.[25]

1.24 Several submissions also argued that a strong SME sector is a vital component of a robust economy.[26] Views put to the committee are reflected in ACCI's statement that:

> a healthy small business sector is the key in ensuring the durability and sustainability of private sector-led growth, creating jobs and introducing innovation and productivity growth in the Australian economy.[27]

1.25 Against this background, the committee was informed that SMEs have limited funding options and place considerable reliance on debt funding. The RBA advised that:

> Businesses use a combination of debt and equity to fund their operations. Compared with large companies, smaller businesses tend to make greater use of debt funding and less use of equity funding; the latter is generally limited to the personal capital of the owners. Small businesses rely mainly on loans from banks and other financial institutions for their debt funding, as it is difficult and costly for them to raise funds directly from debt capital markets. Most lending to small businesses is secured against residential property.[28]

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23 Australian Bureau of Statistics, 'Employment by business size', Australian Industry, cat. No. 8155.0.

24 Australian Bureau of Statistics, 'Industry value added by business size (private sector), Australian Industry, cat. No. 8155.0.

25 Treasury, *Submission 16*, p. 1.

26 ACCI, *Submission 6*, p. 6; National Australia Bank, *Submission 19*, p. 5; NSW Business Chamber, *Submission 8*, p. 1; Real Estate Institute of Australia, *Submission 7*, p. 2; Urban Taskforce Australia Ltd, *Submission 1*, p. 2.

27 ACCI, *Submission 6*, p. 6.

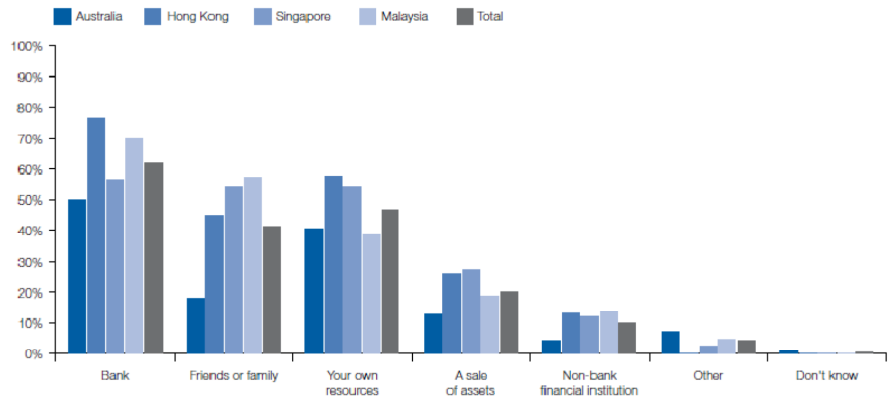
28 RBA, *Submission 3*, p. 1.

1.26 Treasury shared this view, stating that debt funding from banks is essential for SME business:

> SMEs fund their activities from a variety of sources, including internal funding, owner equity, venture capital, secured and unsecured intermediated credit, and bank bills. While larger businesses can issue corporate bonds and equity as alternative sources of finance, small businesses' funding requirements tend to be too small to make such issuance cost-effective. As such, bank credit remains an important funding source for SMEs.[29]

1.27 CPA Australia reported that for the Australian businesses surveyed as part of the Asia Pacific Small Business Survey 2010 (the Asia Pacific Survey), 'the most important source of finance was from a bank'. The data provided indicated that for the Australian respondents bank lending was the primary source of funding followed by internal resources.[30]

Figure 1.1: CPA Australia, Asia Pacific Small Business Survey 2010, 'Source of additional funds'



Question 3-4: And from which of the following sources were those 'required additional funds' obtained? (Multiple response) (Australia n=128, Hong Kong n=85, Malaysia n=96, Singapore n=85)

1.28 It was put to the committee that access to finance, particularly debt funding, is a key part of a strong SME sector. For example, ACCI stated that SMEs 'rely heavily on intermediated finance from financial institutions for their working capital, new capital expenditure...as well as opportunities for overall expansion.'[31] Similarly, CPA Australia reported that the two main reasons for SMEs in Australia to seek finance are increasing business expenses (30.5 per cent) and business growth (28.1 per cent), with the third being business survival (27.3 per cent).[32]

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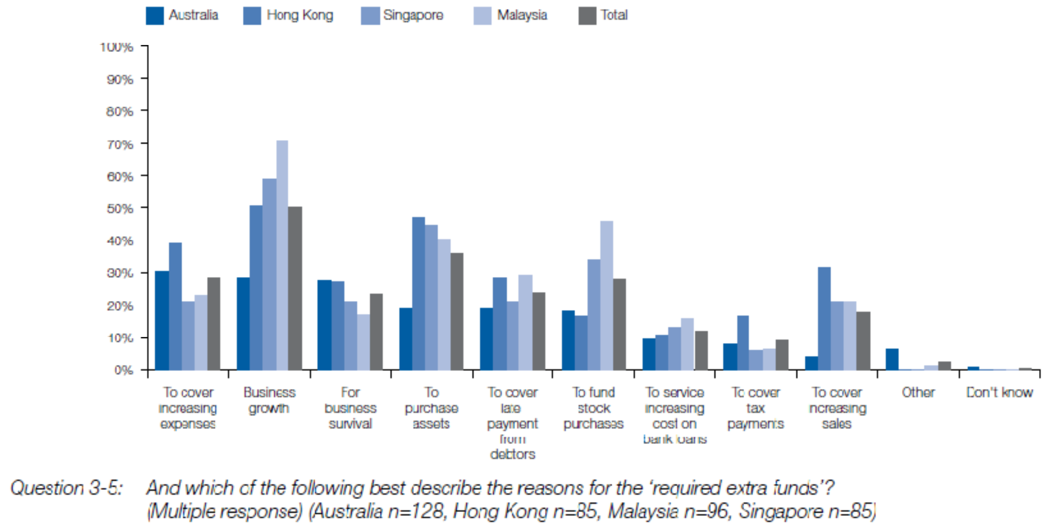
29 Treasury, *Submission 16*, p. 1.

30 CPA Australia, *Submission 10*, p. 4.

31 ACCI, *Submission 6*, p. iii.

32 CPA Australia, *Submission 10*, p. 3.

Figure 1.2: CPA Australia, Asia Pacific Small Business Survey 2010, 'Reasons for seeking additional funds'[33]



1.29 The NAB also linked business lending to business growth, stating that SMEs 'need financial support to grow and thrive. Good quality business lending is critical to a healthy and robust Australian economy.'[34]

1.30 Conversely, difficulties accessing finance were cited as contributing to poor SME performance. For example, ACCI submitted that 'while the economy begins to recover, more businesses are reporting the negative impact of difficulties in obtaining finance on their investment plans as well as their normal operating expenses.'[35] ACCI provided data from Victoria University's 2010 small business survey which found that inadequate access to finance was considered a major obstacle to growth by 16 per cent, and a moderate obstacle by a further 18 per cent, of the 284 businesses surveyed. Similarly, the NSW Business Chamber stated:

> Small businesses will struggle to grow without access to finance. Their lower margins and smaller size means that it is more difficult for them to save; and funding expansions, riding economic downturns, and maintaining the ongoing viability of a small business typically all require access to finance.[36]

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33 CPA Australia, *The CPA Australia Asia-Pacific small business survey 2010: Australia, Hong Kong, Malaysia and Singapore*, 'Figure 4: Reasons for seeking additional funds', p. 12, as cited in CPA Australia, *Submission 10*, p. 4.

34 NAB, *Submission 19*, p. 1.

35 ACCI, *Submission 6*, p. 9.

36 NSW Business Chamber, *Submission 8*, p. 4.

1.31 The Victoria University survey also noted adverse impacts on business productivity, with 30 per cent of respondents indicating that the business had 'passed up' business opportunities due to difficulties accessing finance.[37]

1.32 Evidence presented to the committee also highlighted a connection between access to finance and employment. CPA Australia advised that:

> [A] global survey conducted on behalf of CPA Australia, the Association of Certified Chartered Accountants (United Kingdom) and the Certified General Accountants Association of Canada in 2009...found, not surprisingly, that employment by SMEs is sensitive to the supply of finance. The survey found that SMEs facing tough credit conditions, and SMEs facing severe cash flow problems, are almost three times as likely to lay off staff as those SMEs not so affected.[38]

1.33 Several submissions also stated that SMEs are turning to less appropriate forms of finance due to difficulties obtaining business loans. For example, CPA Australia and the Lismore and District Financial Counselling Service reported that SMEs are sourcing finance from credit cards or family members due to difficulties accessing business loans.[39] CPA Australia advised that the Asia Pacific survey found that 62.6 per cent of Australian small businesses used credit cards as a source of finance.[40] ACCI stated that over-reliance on credit card funding can increase business costs:

> Heavy reliance on credit card finance also means that business owners are paying more than double the interest rate charges for credit card finance than a residentially-secured business loan, which puts significant pressure on small business.[41]

Committee view

1.34 The SME sector is vitally important to the Australian economy. The number of previous inquiries into small business finance is a testament to the need to ensure that SMEs have access to finance to support productivity, growth and innovation. As the main source of finance for SMEs, access to debt funding from lending institutions is an essential part of a healthy, robust SME sector. A properly functioning market economy requires the support of policies that facilitate lending from financial institutions. However, as will be explored, it is equally important for there to be a balanced approach to lending, one that is neither overly restrictive nor imprudent regarding the risks associated with lending.

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37 ACCI, *Submission 6*, p. 11.

38 CPA Australia, *Submission 10*, p. 9.

39 CPA Australia, *Submission* 10, pp 3–4, p.6; Lismore and District Financial Counselling Service Inc., *Submission 2*, p. 1.

40 CPA Australia, *Submission 10*, p. 5.

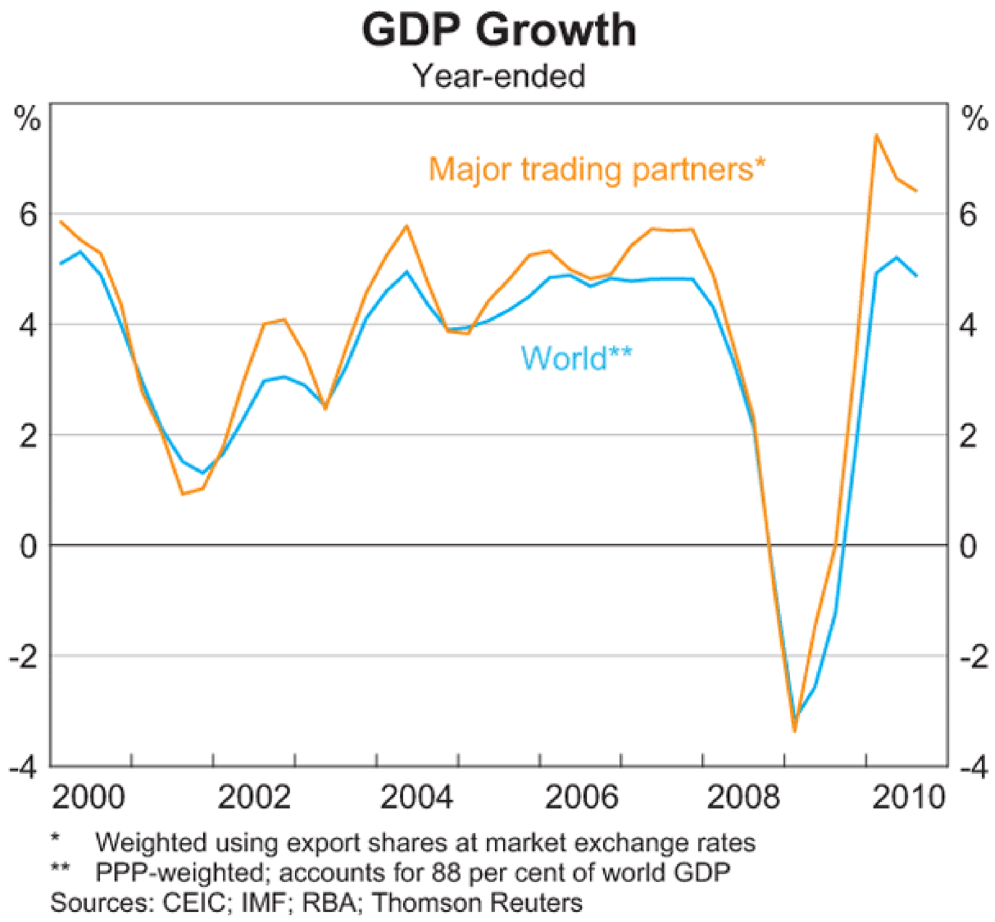
41 ACCI, *Submission 6*, p. 10.

Chapter 2

Business finance and the global financial crisis

2.1 The global financial crisis (GFC) that engulfed the world's economy in 2008 was the 'most serious financial crisis and economic slowdown in decades' (see figure 2.1).[1] Its effects were extraordinary, and the committee emphasises that any discussion of economic conditions and policies, such as in this report, should take its influence into account.

Figure 2.1 The GFC caused a significant global economic contraction[2]



2.2 Australia weathered the GFC far better than most other countries as a result of its fiscal and regulatory strengths. However, it was not immune from its effects, which

1 G-20 Meeting of Ministers and Governors, Communiqué, 9 November 2008, http://www.g20.org/Documents/2008_communique_saopaulo_brazil.pdf (accessed 30 March 2011).

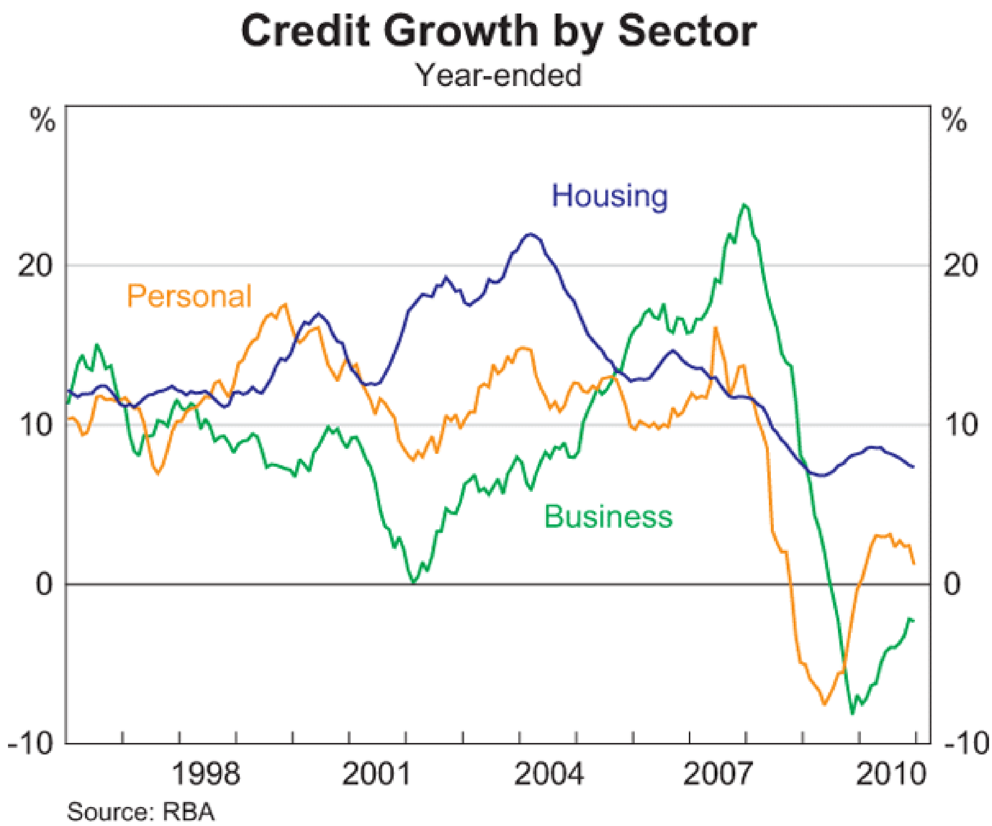
2 RBA, The Australian Economy and Financial Markets, Chart Pack, April 2011, p. 1.

were perhaps nowhere more evident than in access to finance particularly for the SME sector.

The GFC and access to finance

2.3 The GFC saw a massive drop in credit levels for both business and personal lending as well as a more modest slowing of housing finance growth, as figure 2.2, from the Reserve Bank of Australia (RBA), shows.

Figure 2.2 Credit growth by sector, as at March 2011[3]



2.4 Funds available to lenders decreased as a result of the GFC. In the less certain economic environment, the risk appetite of lenders has been reduced. The same is true for the wholesale funders on whom the banks rely.[4] The Australian Finance Conference (AFC) stated that for lenders in Australia the overseas wholesale debt and securitisation markets were inaccessible by the second half of 2008.[5] CPA Australia noted that the GFC caused 'a scarcity of debt funding' and attributed this, in part, to 'a reduction in the number of foreign lenders, changes to the risk profiles of lenders and the increased difficulty of accessing other sources of funding (particularly for larger

3 RBA, The Australian Economy and Financial Markets, Chart Pack, p. 9.

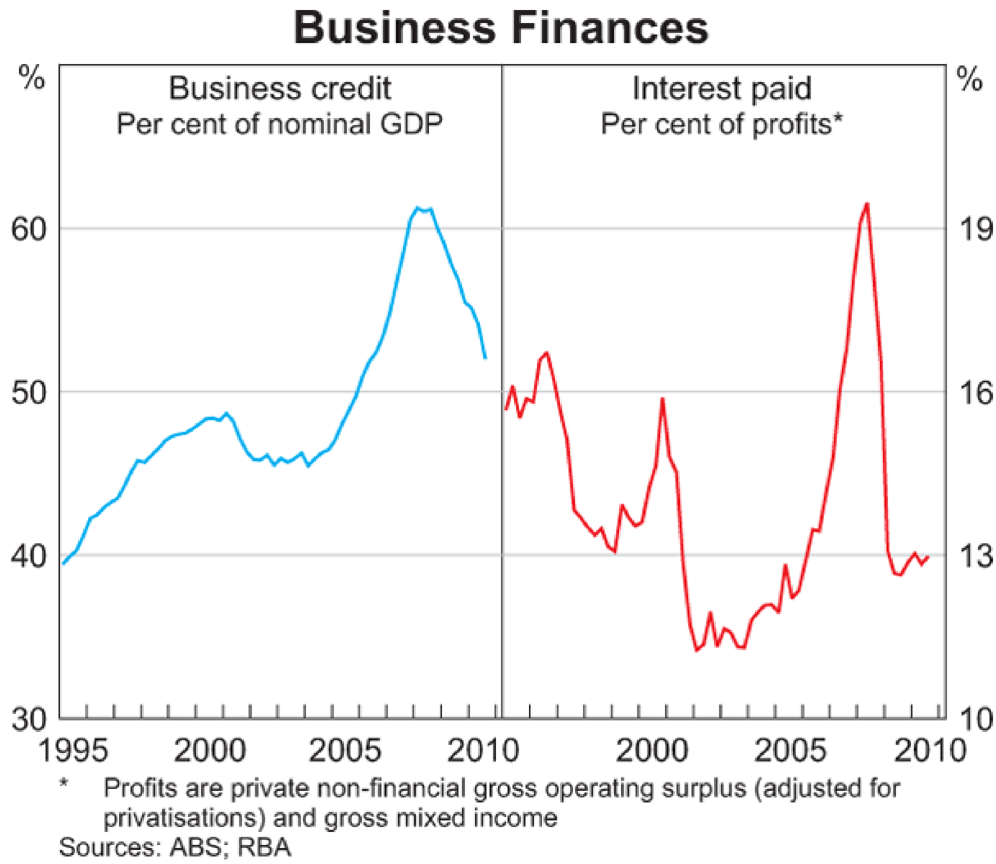
4 RBA *Submission 3*, p. 7.

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

corporates)'.[6] For lenders, the cost of obtaining funds increased. ANZ reported that prior to the crisis the average cost of five-year term funding was 16 basis points above the Bank Bill Swap Rate, while in early 2011 the cost was between 120 and 150 basis points above this rate. This contributed to an 'an absolute increase' in funding costs.[7] Other lenders (such as mutuals) faced the same issues.

2.5 Notwithstanding the dramatic effects of the GFC, business credit levels remain proportionally high. Figure 2.3 shows that, despite the drop in credit caused by the GFC, credit as a percentage of GDP remains higher than at any time in the period 1995 to 2005, while the interest bills faced by business remain low as a proportion of profits.

Figure 2.3 Business finances[8]



2.6 While the GFC saw a decline in business finance, this was not simply a problem with supply. The RBA explained that there have also been significant constraints on demand:

6 CPA Australia, *Submission 10*, p. 1.

7 ANZ, *Submission 14*, p. 11.

8 RBA, The Australian Economy and Financial Markets, Chart Pack, p. 7.

> Business surveys suggest that the availability of finance is not the most significant factor concerning small businesses at present. According to the PwC/East & Partners Business Barometer, the availability of credit appears to have been less of a constraint than it was a year ago. In September 2010, 37 per cent of businesses expected the availability of credit to be a constraint in the year ahead, compared with 82 per cent of businesses surveyed in late 2009. By comparison, in September 2010, around 60 per cent of businesses cited global economic conditions and a general deterioration in confidence as an impediment on business activity. Likewise, the Sensis Business Index and ACCI Small Business Survey suggest that issues such as lack of sales, economic climate and future cash flows are more of a concern for small businesses than the cost and availability of debt financing. NAB's Quarterly SME Business Survey indicates that cash flows, global economic uncertainty and a lack of demand are significant issues facing around 30 per cent of small and medium businesses, while credit conditions remain a concern for around 15 per cent of businesses.[9]

2.7 Thus an important element of the reduction in business borrowing has been reduced business demand for loans. Nevertheless ACCI indicated that businesses are reporting that 'changes in bank lending criteria negatively affected their capital expenditure plans,'[10] and that 'difficulties in obtaining finance may have been worsened by the declining risk assessment skills within the banks.'[11]

Have SMEs been hit hardest?

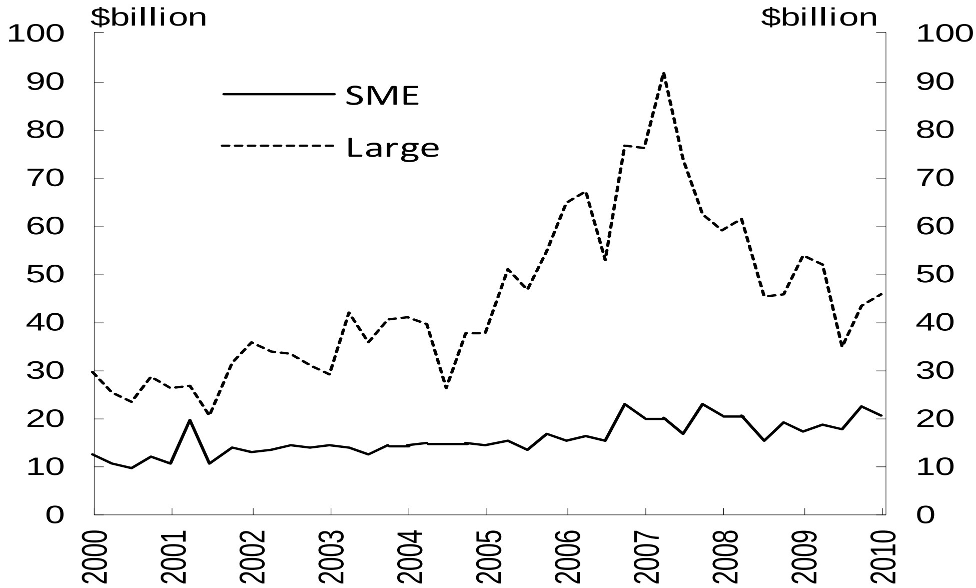
2.8 The GFC affected all areas of the economy, including small and medium business finance. However, SMEs appear to have fared better than large business. Lending to large business has dropped dramatically since 2007. In contrast, lending to SMEs experienced a more modest decline, and may be showing clearer signs of recovery (Figure 2.4).

9 RBA, *Submission 3*, pp 3–4.

10 ACCI, *Submission 6*, p. 8.

11 ACCI, *Submission 6*, p. 13.

Figure 2.4 - Bank lending to business[12]



Source: RBA D7 – Bank lending to business, as included in submission from Treasury.

2.9 The RBA reported a slowdown in SME lending following the GFC, attributing this to 'reduced demand from businesses and a general tightening in bank's lending standards.'[13] However, Treasury indicated that new lending to SMEs increased from $19.8 billion per quarter in September 2007 to $20.6 billion per quarter in September 2010.[14] The ANZ noted that lending to SMEs is beginning to increase, reporting that its '[t]otal lending in Small Business Banking has grown strongly since the GFC.'[15]

2.10 As noted above, demand for finance dropped in the wake of the GFC, and this appears as true for SMEs as for large business. CPA Australia's Asia Pacific Small Business Survey, conducted in October 2010, indicated that 'except only in a small number of cases, lending conditions, loan procedures and the cost of finance were not cited as reasons for not applying for finance.'[16] Rather, the majority of businesses indicated that they did not need additional funds.

Nevertheless, the GFC has meant higher costs

2.11 As the AFC noted, credit pricing was influenced by the cost and scarcity of funds available. Treasury reported that finance has become more expensive for

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12 Treasury, *Submission 16*, p. 5.

13 RBA, *Submission 3*, p. 1.

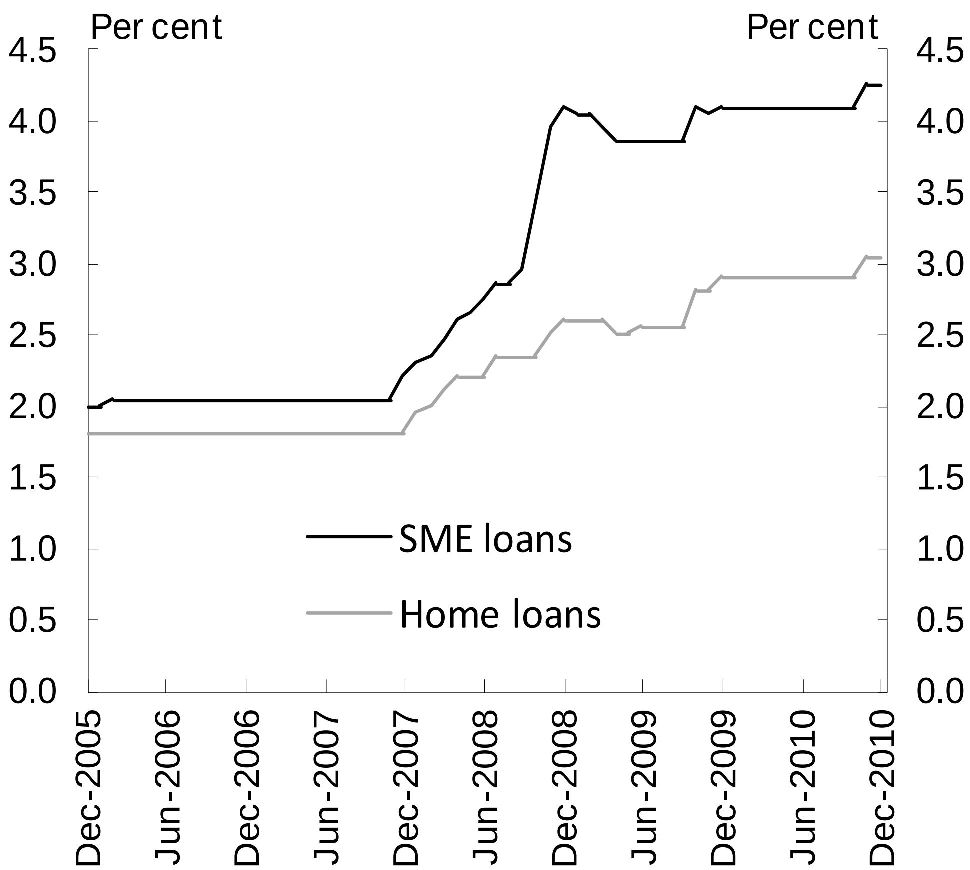
14 Treasury, *Submission 16*, p. 5.

15 ANZ, *Submission 14*, p. 8.

16 CPA Australia, *Submission 10*, p. 3.

SMEs.[17] As figure 2.5 indicates, the margins between the official cash rate and loan interest rates have increased, with the margin for small business loans increasing more than for residential loans. The committee heard concerns from business groups about this, with the NSW Business Chamber noting that '[s]preads on small business loans have blown out from around 200 basis points to more than 400 basis points,'[18] while ACCI submitted that 'the increases in lending rates relative to the cash rate have been much larger for small business loans than housing loans since June 2007.'[19] This matter is further considered in chapter three.

Figure 2.5 – Interest rates compared to the cash rate[20]



Source: RBA F5 – Interest rates, as included in submission from Treasury.

17 Treasury, *Submission 16*, p. 1.

18 NSW Business Chamber, *Submission 8*, p. 1.

19 ACCI, *Submission 6*, p. 1.

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

2.12 The RBA advised that, as of early 2011, the average residentially secured small business loan interest rate is approximately about 180 basis points above the residentially secured housing loan indicator rate. By comparison, at the start of 2008, the small business rate was approximately 95 basis points above the housing rate.[21] Clearly, the cost of finance is higher than immediately prior to the GFC. However, this does not mean that it is at historically high levels.

The good old days?

2.13 On the basis of information provided, the committee does not believe there will be a swift return to the conditions immediately prior to the GFC. Indeed, such conditions probably were unsustainable across all sectors of the economy. When CPA Australia conducted a round table of finance sector corporations, '[m]any corporates admitted that the easy credit days prior to the GFC led them to drop good business practice.'[22] The Australian Bankers Association (ABA) reported that:

> From the late 1990s till 2007...small businesses generally had sufficient access to bank finance. Due to this high availability of funding and competition, margins were contracting on business lending by around 10 basis points per annum, and the risk premiums being charged reduced. Some found lenders eased their credit standards and non-bank lenders made credit available to segments of the market that were not being served by banks due to their risk profile.[23]

2.14 The ABA's Mr Münchenberg confirmed this view at hearings, saying 'I think we will return to an appropriate equilibrium. The situation before the GFC was exceptional.'[24] As figure 2.2 indicates, business credit growth prior to the GFC was at an historically high level. Figure 2.3 likewise shows that business credit as a percentage of GDP had been rising sharply prior to the GFC and even today remains high. Prior to the GFC the cash rate was at its highest level in a decade.[25]

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21 RBA, *Submission 3*, p. 5.

22 CPA Australia, *Submission 10*, p. 5.

23 ABA, *Submission 13*, pp 1–2.

24 Mr Münchenberg, CEO, ABA, *Proof Committee Hansard*, 4 March 2011, p. 50.

25 Reserve Bank of Australia, The Australian Economy and Financial Markets chart pack, March 2011, http://www.rba.gov.au/chart-pack/pdf/chart-pack.pdf, accessed 30 March 2011.

Conclusion

2.15 The OECD has characterised the GFC as 'the severest financial crisis in decades' to affect the global economy.[26] According to the OECD, '[t]he Australian economy has been one of the most resilient in the OECD during the global economic and financial crisis.'[27] This view is shared by Australian stakeholders, for example, RBA Deputy Governor Ric Battellino recently noted that 'no other developed economy has experienced uninterrupted growth over the past 20 years', a comment that includes the period since the onset of the GFC.[28]

2.16 The small and medium business sector has made a significant contribution to this resilience, and this has been reflected in stable borrowing levels. The ABA submitted that 'growth in small business lending...has held up better than the wider business lending market over the last 12 months.'[29]

2.17 Nevertheless, the committee recognises that there have been some specific issues in SME finance, in relation to prudential requirements and competition, and it is to these the committee now turns.

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26 OECD, *OECD strategic response to the financial and economic crisis: Contributions to the global effort*, 2009, p. 3.

27 OECD, *OECD Economic Surveys, Australia: Volume 2010/21, Supplement 3*, November 2010, p. 8.

28 Ric Battellino, 'Twenty Years of Economic Growth', *RBA Bulletin*, September 2010, p. 103.

29 ABA, *Submission 13*, p. 3.

Chapter 3

Regulatory frameworks

Prudential requirements

3.1 The Global Financial Crisis (GFC) demonstrated that a stable, prudent banking sector is an essential part of a stable, productive economy. Lenders, or 'authorised deposit-taking institutions (ADIs)', do not have absolute discretion in setting their lending policies but must comply with the prudential regulatory framework overseen by the Australian Prudential Regulation Authority (APRA). The framework applies to all ADIs, including banks, building societies and credit unions, which cannot provide banking services in Australia without APRA's authorisation.[1] Making a sporting analogy, APRA's Chairman has explained the application of the prudential framework to ADIs as follows:

> We licence financial sector participants — we decide whether each team has the fitness, skills and experience to compete — and then we monitor teams continuously to ensure they are meeting prudential requirements and managing their affairs with appropriate prudence. In other words, we ensure that regulated institutions play within the letter and spirit of the rules and remain match fit.[2]

3.2 Abacus – Australian Mutuals (Abacus) advised that the application of one framework to all ADIs is a feature unique to the Australian prudential system:

> What is unusual about the Australian banking regulatory system is that mutuals, credit unions and building societies are entirely integrated into the same regulatory system. You will find in other markets that mutuals, credit unions, will have their own regulatory system. The banks will be off separately. Our members meet all the requirements that banks meet. We are, I think, the only credit union system anywhere in the world which is fully compliant with the Basel international banking regulatory frameworks.[3]

3.3 The prudential framework promotes financial stability through directing ADIs to appropriately engage with risk. As APRA has previously stated, the framework, which is comprised of legislative requirements, prudential standards and prudential guidance, 'aims to ensure that risk-taking is conducted within reasonable bounds and

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1 *Banking Act 1959*, s. 9; Australian Prudential Regulation Authority, 'Authorised Deposit-taking Institutions Home', http://www.apra.gov.au/adi/ (accessed 1 April 2011).

2 Mr John F. Laker, Chairman, APRA, American Chamber of Commerce Business Briefing, 25 August 2010, p. http://www.apra.gov.au/Speeches/upload/05-AmCham-speech-25-Aug.pdf (accessed 1 April 2011).

3 Mr Luke Lawler, Senior Adviser, Policy and Public Affairs, Abacus, *Proof Committee Hansard*, 4 March 2011, p. 7.

that risks are clearly identified and well managed.'[4] Treasury supported this view, advising that '[t]he purpose of prudential regulation is to protect bank depositors and maintain financial stability.'[5] Westpac Group submitted that the prudential framework promoted financial stability in Australia throughout the GFC:

> We would just like to reinforce that we think the prudential regulation that existed through the crisis stood up well in the great scheme of things, and we are quite supportive of it.[6]

3.4 The regulatory framework adheres to the global capital adequacy regime endorsed by the Basel Committee on Banking Supervision (the Basel II framework), which Australia adopted in 2008.[7] Treasury stated that the Basel II framework 'is based on risk-weighted capital requirements', and further noted that:

> Minimum capital requirements are a core component of prudential regulation [....] The amount of capital required for different types of loans varies in line with differences in the amount of risk they involve. The amount of risk involved in a loan is a function of the probability of default by the borrower and the expected recovery value of any collateral provided to the lender.[8]

3.5 The prudential framework influences conditions attached to the provision of finance, including business lending. Treasury advised that the Basel II framework directs ADIs to 'hold capital requirements proportionate to a loan's riskiness'.[9] APRA advised that the prudential regulations also require the interest rates to reflect the risk-weight, with higher risk-weights attracting higher interest rates:

> APRA [...] expects ADIs to reflect the credit risks to which they are exposed in setting their lending rates, with a higher risk margin on higher risk loans to reflect the greater probability of default and/or the potential for loss if the loans were to default.[10]

3.6 APRA and Treasury stated that the Basel II framework provides two methods for calculating the risk-weight; the standardised approach and the advanced approach.[11] APRA stated that the standardised approach 'is more about [ADIs] putting

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4 APRA, Letter of 18 May 2007 to the Hon Peter Costello MP from Mr John F. Laker AO, Chairman APRA, http://www.apra.gov.au/AboutAPRA/upload/Ltr-to-Treasurer-Statement-of-Intent.pdf (accessed 1 April 2011).

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

6 Mr James Tate, Chief Product Officer, Westpac, *Proof Committee Hansard*, 11 March 2011, p. 22.

7 APRA, *Submission 12*, p. 1.

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

9 Treasury, *Submission 16*, p. 11.

10 APRA, *Submission 12*, p. 1.

11 APRA, *Submission 12*, p. 1; Treasury, *Submission* 16, p. 10.

things into buckets that we have decided.'[12] In contrast, APRA advised that the advanced approach allows the ADI to 'use its own internal modelling, drawing on its actual historical loss experience in the various lending categories, to assist in quantifying, aggregating and managing its credit risks.'[13] At present, the major banks and Macquarie Bank are authorised to use the advanced approach.[14]

3.7 APRA further advised that for SME loans secured by residential property, 'the credit risk-weight under the standardised approach is the same as that applying to an owner-occupied mortgage'. Using the advanced approach the risk-weight is generally higher than the risk-weight for an owner-occupied mortgage. This reflects historical experience that the probability of default for small business loans is higher than the probability of default for residential loans.[15]

3.8 APRA stated that while the prudential regulations distinguish between broad categories of credit, for example personal, residential mortgage and business, the framework 'does not generally distinguish by size of business borrower.'[16] Mr Wayne Byres, Executive General Manager, Diversified Institutions Divisions, APRA, further advised that '[t]he regulatory system is really designed, to the extent possible, to reflect differences in risk rather than differences in type of borrower or the purpose of borrowing.'[17]

3.9 While the prudential framework is intended to apply equally to all categories of lending, it was evident that the prudential requirements have particular consequences for SME finance. It was apparent that the prudential requirements influence the range of ADIs that provide finance to small businesses. Abacus explained that ADIs are required to meet certain standards before entering the SME finance market:

> APRA strongly advises mutual ADI boards not to allow their institution to move into commercial lending without ensuring they have the personnel, expertise and systems to do so prudently. APRA's position is that assessing, pricing and securing commercial exposures requires a set of skills distinct from those required for assessing standard mortgages and personal lending. APRA requires ADIs to have robust product development processes to analyse new lines of business before products are formally endorsed and launched.[18]

12 Mr Graham Johnson, General Manager, Industry Technical Services, APRA, *Proof Committee Hansard*, 11 March 2011, p. 48.

13 APRA, *Submission 12*, p. 2.

14 APRA, *Submission 12*, p. 2.

15 APRA, *Submission 12*, p. 2.

16 APRA, *Submission 12*, p. 1; Mr Wayne Byres, Executive General Manager, Diversified Institutions Divisions, APRA, *Proof Committee Hansard*, 11 March 2011, p. 41.

17 Mr Byres, APRA, *Proof Committee Hansard*, 11 March 2011, p. 42.

18 Abacus, *Submission 18*, p. 3.

3.10 Abacus advised that the prudential framework can constrain second-tier lenders from providing finance to SMEs. Mr Lawler stated that '[i]f our members want to enter into new forms of businesses, they can. They just have to make sure that they have the right level of expertise and capacity and risk management systems to do it.'[19] However, Mr Lawler further stated that these requirements can deter smaller ADIs:

> [I]t is challenging to meet all the prudential regulatory requirements and to meet all the other regulatory compliance issues. We see ongoing consolidation in our sector. The sector itself continues to grow, and our assets are growing, but the number of participants is shrinking because the smaller mutuals either find the regulatory compliance burden too heavy or they see, for good strategic reasons, a case to merge with another institution to become larger and get access to economies of scale. Economies of scale help in the context of entering new lines of business, such as business lending.[20]

3.11 Additionally, Treasury advised that ADIs 'are likely to need to hold more capital against SME loans, relative to residential mortgages.'[21] Similarly, ANZ reported that:

> [t]he higher probability of default and loss given default for small business customers when compared to mortgage customers requires banks to hold a higher level of capital and reserve more for bad debt expenses for small business lending. A requirement to hold three times as much capital for small business customers than residential mortgage customers is typical and is required by APRA.[22]

3.12 NAB also reported greater capital requirements for SME loans, stating that 'the amount of capital required to be held by banks is generally three times higher than for residential loans, and in some instances can be up to seven times higher for certain products.'[23]

Codes of conduct and additional legislative requirements

3.13 In addition to complying with APRA requirements, ADIs may choose to adhere to voluntary, industry-based policies and guidelines. The two key industry codes are the Code of Banking Practice and the Mutual Banking Code of Practice.

3.14 The Code of Banking Practice, developed by the Australian Bankers Association (ABA), directs the banks' interactions with customers.[24] Matters that the

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19 Mr Lawler, Abacus, *Proof Committee Hansard*, 4 March 2011, p. 7.

20 Mr Lawler, Abacus, *Proof Committee Hansard*, 4 March 2011, p. 8.

21 Treasury, *Submission 16*, p. 11.

22 ANZ, *Submission 14*, p. 13; NAB, *Submission 19*, p. 8.

23 NAB, *Submission 19*, p. 8.

24 Mr Steven Münchenberg, Chief Executive Officer, ABA, *Proof Committee Hansard*, 4 March 2011, p. 49.

code covers include disclosure of application fees and notification of changes to terms and conditions such as fees, charges and interest rates.[25]

3.15 The ABA advised that the code applies to small business finance.[26] However, the code is voluntary and therefore may not apply to all bank lenders.[27] A list of banks that have adopted the code is at Appendix 3. For banks that have adopted the code, compliance with the code is monitored by the Code Compliance Monitoring Committee.[28]

3.16 The Mutual Banking Code of Practice (MBCOP) outlines requirements regarding the provision of finance from a second-tier lender. Matters that the MBCOP covers include notification requirements for setting terms and conditions for products and facilities, reviewing fees and charges, and providing notification of increased interest rates.[29] Abacus stated that the MBCOP is designed to build on the prudential framework:

> The MBCOP sets high standards in a range of areas beyond those required by law, as an expression of the value mutual ADIs place on improving the financial wellbeing of their members and communities. The number one promise in the MBCOP is: "We will always act honestly and with integrity, and will treat you fairly and reasonably in all our dealings with you.[30]

3.17 In addition to regulating the provision of finance to individuals for non-commercial purposes, the MBCOP applies to small business members or customers and covers the provision of small business loans and other financial products.[31] However, the MBCOP does not cover the field for mutual lending. Similar to the Code of Banking Practice, the MBCOP only applies to the credit unions or mutual building societies that choose to subscribe.[32] A list of ADIs that have subscribed to the MBCOP is at Appendix 4.

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25 ABA, *Code of Banking Practice*, May 2004, items 15, 18, p. 10.

26 Mr Münchenberg, ABA, *Proof Committee Hansard*, 4 March 2011, p. 49.

27 ABA, *Banking Code of Practice*, May 2004, p. 2.

28 ABA, 'The main feature of the revised code', http://www.bankers.asn.au/Default.aspx?ArticleID=450 (accessed 5 April 2011).

29 Abacus, *Mutual Banking Code of Practice*, January 2010, items 4, 6, 17, pp 11, 17.

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

31 Abacus, *Mutual Banking Code of Practice*, p. 6.

32 Abacus, *Mutual Banking Code of Practice*, p. 5.

3.18 As noted in the MBCOP, regulatory requirements that can impact SME finance are also contained in:

- the *Corporations Act* 2001 and requirements set by the Australian Securities and Investment Commission;
- Commonwealth, State and Territory privacy legislation; and
- fair trading laws.[33]

3.19 At present, the National Consumer Credit Code does not regulate the provision of finance to SMEs. However, the ABA advised that while not officially applying to SME loans, banks may be choosing to apply the Code to SME customers:

> While they apply to individual customers, for a small business, whether it is doing individual banking or small business banking is quite blurred. We will find that certainly for small operations the banks will err on the side of caution and treat them as small customers.[34]

3.20 In July 2010, Treasury sought public feedback on a proposal to extend the consumer credit code to apply to small business finance.[35] Three options were outlined. Option one proposes limited application of the consumer credit regulations, under which '[m]inimum standards of conduct and competencies could also be developed for small business lending'. Option two proposes full application of the National Consumer Credit Code to small business lending. Option three proposes the development of industry standards, which could be enacted in legislation, to address current regulatory gaps.[36] The committee understands that if the proposal is endorsed, it is intended that legislative measures be in place by mid 2012.[37] Treasury advised that 'there has not yet been any decision or outcome arising from the consultations following the release of the Green Paper.'[38]

SME concerns with the regulatory framework

3.21 APRA stated that SMEs have benefitted from the Basel II framework:

> The second point I want to make is that, although the capital adequacy requirements for banks, building societies and credit unions were changed in 2008 with the introduction of the Basel II framework into Australia, we

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33 Abacus, *Mutual Banking Code of Practice*, p. 5.

34 Mr Münchenberg, ABA, *Proof Committee Hansard*, 4 March 2011, p. 55.

35 Treasury, *National credit reform, enhancing confidence and fairness in Australia's credit laws: Green Paper*, July 2010, p. 1.

36 Treasury, *National credit reform, enhancing confidence and fairness in Australia's credit laws: Green Paper*, July 2010, pp 12–14.

37 The Hon Chris Bowen, Minister for Financial Services, Superannuation and Corporate Law, 'Release of green paper on phase two of the COAG national credit reforms', media release no. 085, 7/7/10.

38 Treasury, answers to question on notice, 25 March 2011 (received 8 March 2011).

> would say those changes were, if anything, marginally favourable towards SME lending and certainly we do not see anything in those which would materially disadvantage SME lending relative to other sorts of lending that a bank might choose to do.[39]

3.22 In contrast, evidence presented to the committee highlighted three main concerns with the regulatory framework's impact on SME access to finance, namely,

- Increased lending costs;
- The introduction of Basel III requirements;
- Changes to the conditions of existing loans following the GFC.

Increased lending costs

3.23 The RBA informed the committee that interest rates are determined taking into account the cost of obtaining funds to lend and the 'perceived riskiness of the borrower.'[40] As the RBA explained, and as explored elsewhere in this report, the GFC prompted ADIs to re-evaluate the risk of lending:

> One of the things you have seen as to why interest rates have gone up over the subsequent few years was that the banks repriced that risk, which saw lending rates rise.[41]

3.24 Similarly, Treasury advised:

> Lenders' perception of the risk associated with a loan are also significant drivers. Just as the risk appetites of the banks' wholesale funders have decreased since the financial crisis, so too have the risk appetites of lenders themselves.[42]

3.25 The RBA reported that the variable interest rate for residentially secured loans increased 220 basis points relative to the cash rate from mid 2007, and further advised that '[o]ver the same period, the spread between the actual variable rate paid by small businesses and the cash rate also rose by about 175 basis points.'[43]

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39 Mr Byres, APRA, *Proof Committee Hansard*, 11 March 2011, p. 41.

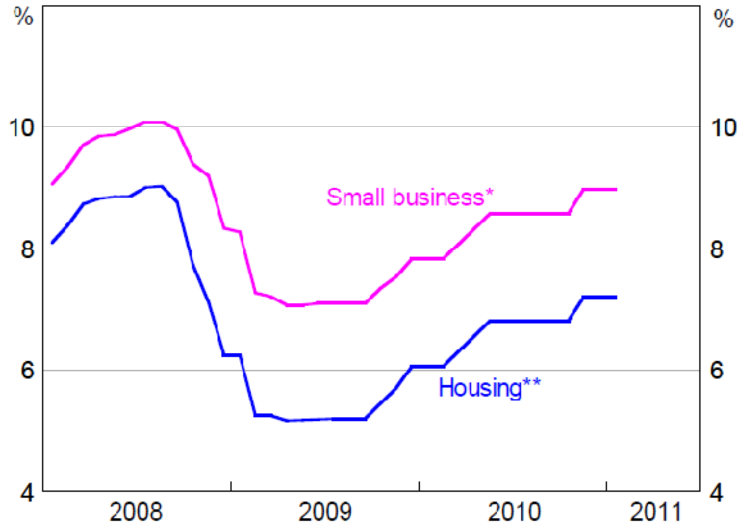
40 RBA, *Submission* 3, p. 4.

41 Mr Guy Debelle, Assistant Governor, Financial Markets, RBA, *Proof Committee Hansard*, 11 March 2011, p. 3.

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

43 RBA, *Submission 3*, p. 5.

Figure 3.1 Variable lending rates, residentially-secured term loans[44]



3.26 Submissions from SME representatives recognised that lenders must assess the level of risk and offer credit accordingly. However, it was disputed whether the interest rates accurately reflect the cost of, and the risks associated with, providing SME loans. For example, the NSW Business Chamber argued that:

> [W]ith the worst of the crisis now behind us, lending conditions should have improved, and small businesses should now be able to access the funding they need to expand and support the economic recovery. Unfortunately, it appears that banks are reluctant to move away from the high levels of risk aversion adopted during the height of the crisis.[45]

3.27 The Council of Small Business Organizations Australia (COSBOA) questioned the disparity between the interest rates for SME loans and residential mortgages, particularly for business loans secured by residential property: '[i]t still seems wrong. It is the same house, the same person and the same business earning them money.'[46] ACCI stated:

> Data from the Reserve Bank indicates that small businesses were paying a margin of 4.17 percentage points above the cash rate on average for bank finance, compared to a margin of 2.23 percentage points for large businesses and 2.47 percentage points for mortgage customers as of 2 February 2011, despite most of these small business loans being residentially secured.[47]

44 RBA, *Submission 3*, p. 5.

45 NSW Business Chamber, *Submission 8*, p. 10.

46 Mr Peter Strong, COSBOA, *Proof Committee Hansard*, 4 March 2011, p. 66.

47 ACCI, *Submission 6*, p. 1.

3.28 It appeared there were three causes for the higher interest rates for SME loans. First, it was submitted that the higher interest rates resulted from the increased cost to ADIs in obtaining funds to lend. The ABA explained:

> [The GFC] had two major impacts on lending to small business. The first was that the cost of funds to lender increased dramatically. For many lenders, particularly smaller lenders, even access to funds became a real issue. In other words, money became less available and much more expensive. This inevitably affected bank lending.[48]

3.29 The ANZ also noted the impact of rising costs on interest rates, stating:

> In setting interest rates, ANZ considers our funding costs and the inherent risk profile of the lending portfolio. The GFC impacted on both these fronts and required us to consider all interest rates, including those to small businesses, to ensure they adequately reflected the cost and risk of lending.[49]

3.30 Second, it was argued that the higher costs are an appropriate response to the higher default rates, and therefore the higher risk, of SME loans. The RBA submitted:

> One common concern of small businesses is that interest rates on residentially secured small business loans are priced at a premium to residentially secured housing rates. However this pricing results from higher expected losses on small business loans...[50]

3.31 The RBA advised that non-performing small business loans have increased from approximately 1 per cent during 2005-07 to approximately 2.5 per cent of banks' total small business loan portfolios as of September 2010. Figure 3.2 shows that the growth in the number of non-performing assets on the banks' books in the business sector now far exceeds those in the housing sector.

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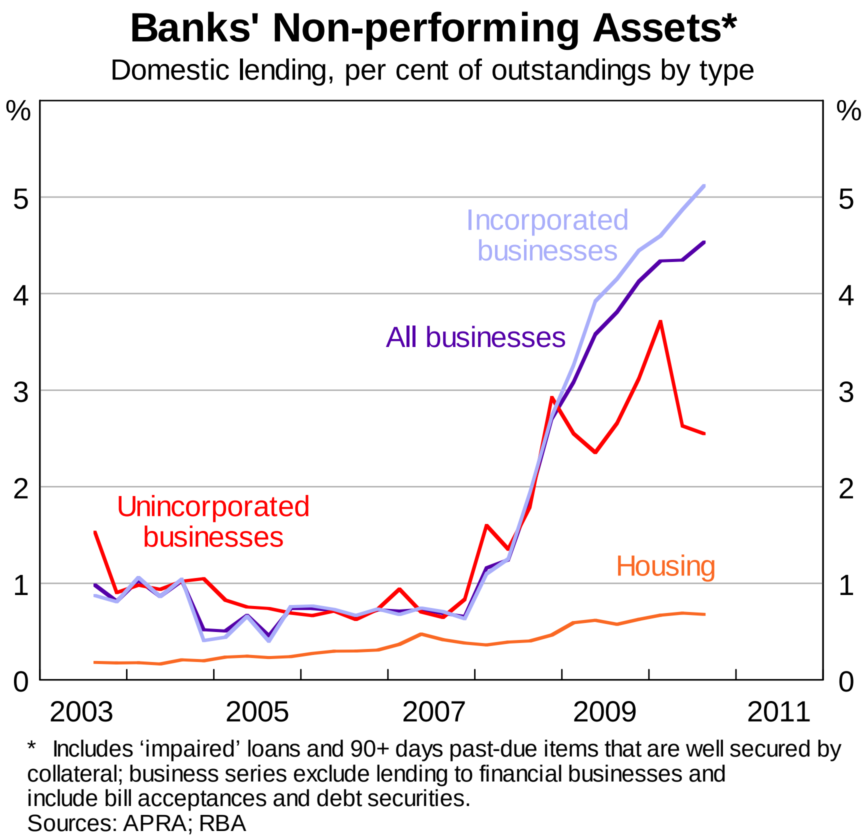
48 Mr Münchenberg, *Proof Committee Hansard*, 4 March 2011, p. 48.

49 ANZ, *Submission 14*, p. 10.

50 RBA, *Submission 3*, p. 4.

Figure 3.2 Bank's Non-performing assets[51]



3.32 Westpac Group also submitted that the higher interest rates were an appropriate response to the default rate of SME loans:

> [S]lightly higher interest rates for SME lending when compared to residential mortgage lending is consistent with the performance of SME loans across Westpac Group portfolios. Currently, small business '90 days+' delinquency rates are approximately two-and-a-half to three times greater than that of residential mortgages. Further, SME borrowers have a significantly higher net bad debt rate when compared to the consumer mortgage portfolio.[52]

3.33 Treasury also argued that the higher costs were a proportionate response to the probability of SME loans defaulting, stating that:

> While the Australian economy performed well during the financial crisis, it is likely that loans were re-priced by lenders to reflect the higher probability of default on SME loans.
>
> While many loans to SMEs are secured by residential property, banks take into account several factors, in addition to the type of collateral used, when pricing a loan. The average probability of default on small business loans is

51 RBA, *Submission 3*, p. 5.

52 Westpac Group, *Submission 9*, p. 4.

> around 2.4 per cent. This compares to residential mortgages, whose probability of default is less than half that, at around 1.1 per cent. Further, once a borrower has defaulted, banks stand to lose different amounts on different loans. The loss given default on loans to small business is approximately 30 per cent of the loan's value. This figure is around 20 per cent for housing loans.[53]

3.34 Third, the ANZ submitted that the higher capital requirements for SME loans increased the cost of providing SME loans relative to residential mortgages.[54] This was confirmed by the RBA, which also stated that the higher interest rates result from 'the larger amount of capital that banks hold as a buffer against unexpected losses.'[55] The CBA supported the additional capital requirements, stating that 'there are legitimate reasons why APRA requires additional capital be held for small and medium business lending, which carries a higher risk than mortgage lending.'[56]

3.35 NAB argued that the prudential framework contains 'an inherent bias in favour of residential mortgage lending', and further stated:

> The operational impact of such prudential settings is that Australia's commercial banks can do significantly more residential mortgage lending relative to business lending in terms of capital management.[57]

3.36 However, this did not appear to be a view widely shared by other lenders or oversight bodies. As previously explored in this report, it appears that risk was less rigorously priced prior to the GFC. On this point, Treasury stated:

> We think that the banks themselves or the lenders have become—maybe you could call them—risk adverse, but at the same time it is more likely than not that they are pricing in risk much better post-GFC than they probably were beforehand.[58]

3.37 The CBA argued that 'the GFC is the most recent reminder of why higher risk lending must be priced accordingly.'[59] Australia's response to the GFC, including the actions of ADIs, has received international approval. For example, the Organisation for Economic Cooperation and Development (OECD) has concluded:

> Australia’s financial system has proved very resilient during the global crisis. This is partly due to solid domestic banking supervision, which was substantially reinforced after sizeable banking sector losses in the early

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

54 ANZ, *Submission 14*, p. 13.

55 RBA, *Submission 3*, p. 4.

56 CBA Australia, *Submission 17*, p. 9.

57 NAB, *Submission 19*, p. 8.

58 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 4 March 2011, p. 35.

59 CBA, *Submission 17*, p. 9.

> 1990s, and low exposure to toxic assets...Banks have remained profitable with stable capital ratios, and the largest Australian banks are now among the soundest in the world.[60]

3.38 The OECD has further stated:

> The good performance of the financial sector has improved the ranking of Australian institutions by international standards. Reviews of Basel II implementation and stress tests give good marks to the solidity of the system.[61]

Committee view

3.39 On the basis of the evidence submitted to the committee, it appears there are sound reasons for the higher interest rates for SME loans compared to residential loans, and the increased cost of SME lending that resulted from the GFC. It would be of significant concern were the prudential framework misapplied to attempt to justify inappropriately high interest rates or other charges. However, the committee has not received evidence of inappropriate application of the prudential framework. On the contrary it appears that the prudential framework has served Australia well throughout the GFC.

Basel III requirements

3.40 In its report to the G20[62] in October 2010, the Basel Committee on Banking Supervision announced the introduction of the Basel III regulatory framework.[63] The new regulatory framework was developed in response to the GFC, and is intended to 'strengthen the regulation, supervision and risk management of the banking sector.'[64] APRA stated that 'Basel III remedies a number of weaknesses which were highlighted in previous global capital standards, highlighted by the GFC.'[65] As the RBA noted during an address at the Basel III Conference 2011, the new requirements are 'about applying the lessons learned from the crisis to the way we regulate banks.'[66]

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60 OECD, *OECD Economic Surveys, Australia: Volume 2010/21, Supplement 3*, p. 12.

61 OECD, *OECD Economic Surveys, Australia: Volume 2010/21, Supplement 3*, p. 27.

62 The Group of Twenty Finance Ministers and Central Bank Ministers. It was established in 1999 to promote international dialogue among key emerging market countries.

63 Bank for International Settlements, 'The Basel Committee's response to the financial crisis: report to the G20, http://www.bis.org/publ/bcbs179.htm (accessed 5 April 2011).

64 Bank for International Settlements, 'International regulatory framework for banks (Basel III), http://www.bis.org/bcbs/basel3.htm (accessed 5 April 2011).

65 Mr Byres, APRA, *Proof Committee Hansard*, 11 March 2011, pp 42–43.

66 Dr Malcolm Edey, Assistant Governor (Financial Systems), RBA, 'Basel III and Beyond', Basel III Conference 2001, 24 March 2001, http://www.rba.gov.au/speeches/2011/sp-ag-240311.html (accessed 5 April 2011).

3.41 The Basel Committee has advised that Basel III aims to 'improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, improve risk management and governance and strengthen banks' transparency and disclosures.'[67] The new requirement include the Liquidity Coverage Ratio, which will require ADIs to 'have sufficient high-quality liquid assets to survive an acute stress scenario lasting one month', and the Net Stable Funding Ratio, which will encourage ADIs to access 'more stable sources of funding (e.g. deposits or long-term debt).'[68]

3.42 On 17 December 2010, it was announced that Australia will comply with the new Basel III framework.[69] APRA stated that staggered phase-in arrangements will apply in Australia, advising that 'for the purpose of this discussion we can say it is coming in a couple of years' time.'[70]

3.43 The *Australian Financial Review* has reported that banks are concerned that the new requirements will lead ADIs to raise mortgage rates faster than changes to the official cash rate.[71] However, these concerns were not raised in the evidence banks provided this inquiry. Referring to Basel III, CBA Australia noted the bank 'accepts the scope to further improve the framework and the global agreements to do so (such as the implementation of Basel III).'[72]

3.44 In contrast, ACCI submitted that the new requirements may increase the cost of SME finance:

> ...ACCI is concerned that the Basel III requirements will put small business borrowers at a substantial disadvantage compared to mortgage borrowers and larger corporates, with the flow on impact of higher funding costs and bank charges as well as further tightening in non-price lending requirements imposed on the small business sector.[73]

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67 Bank for International Settlements, 'International regulatory framework for banks (Basel III), http://www.bis.org/bcbs/basel3.htm (accessed 5 April 2011).

68 APRA, 'Letter to All Authorised Deposit-taking Institutions (ADIs), Basel III Reform Package', 17 December 2010, http://www.apra.gov.au/ADI/upload/20101217-Ltr-to-all-ADIs-re-Basel-III-package.pdf (accessed 5 April 2011).

69 The Hon Wayne Swan MP, Treasurer, 'Release of Basel III Global Banking Standards', Press release, 17 December 2010.

70 Mr Byres, APRA, *Proof Committee Hansard*, 11 March 2011, p. 42.

71 Geoff Winestock, 'No escape from new bank rules', *Australian Financial Review*, 6 January 2011, p. 1.

72 CBA, *Submission 17*, p. 7.

73 ACCI, *Submission 6*, p. 22.

3.45 This view was not shared by the RBA and APRA, both members of the Basel Committee.[74] APRA has advised ADIs that '[a]s a member of the Basel Committee, APRA has been actively involved in developing these global reforms and it fully supports the package.'[75] In evidence to the committee, APRA stated that transitioning to the Basel III framework was 'quite manageable without particular disruption', and further advised that 'most of our banks have been quite happy to say quite publicly that they are quite well placed and already very close to compliance with the new requirements.' [76] APRA further stated that the regulator does not consider that Basel III will trigger significant changes in lending conditions:

> The impact of Basel III on our ADI sector will be far less than on many other similar sectors around the world, in other jurisdictions. We see the Australian ADI sector as quite well placed to be able to meet these new requirements without the need for large-scale capital raisings or substantial changes to balance sheet structures. The point being made is simply to say that we do not see it as being particularly disruptive or costly from the position the banks are in today.[77]

3.46 Mr Guy Debelle, Assistant Governor, Financial Markets, RBA, stated that '[f]rom my point of view, no, I do not think that should have any particular impact. Certainly I do not see it having a disproportionate impact on small business lending.'[78] Similarly, in announcing Australia's commitment to Basel III, the Treasurer stated that 'no Australian bank will be able to cite them [the Basel III requirements] as justification for stinging customers with any additional costs.'[79]

Committee view

3.47 It appears from the evidence provided to the inquiry that there is overall support for the introduction of Basel III. Even where concerns were raised no evidence was provided, nor were there any suggestions that Australia should not be part of Basel III. However, it would be a significant concern were the new requirements to result in imposing further barriers to finance for SMEs. The committee is of the view that it would be improper for ADIs to use the introduction of Basel III as an opportunity for 'price-gouging'. Given the serious negative impact that

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74 Dr Malcolm Edey, Assistant Governor (Financial Systems), RBA, 'Basel III and Beyond', Basel III Conference 2001, 24 March 2001, http://www.rba.gov.au/speeches/2011/sp-ag-240311.html (accessed 5 April 2011).

75 APRA, 'Letter to All Authorised Deposit-taking Institutions (ADIs), Basel III Reform Package', 17 December 2010, http://www.apra.gov.au/ADI/upload/20101217-Ltr-to-all-ADIs-re-Basel-III-package.pdf (accessed 5 April 2011).

76 Mr Byres, APRA, *Proof Committee Hansard*, 11 March 2011, p.43.

77 Mr Byres, APRA, *Proof Committee Hansard*, 11 March 2011, p.43.

78 Mr Debelle, RBA, *Proof Committee Hansard*, 11 March 2011, p. 6.

79 The Hon Wayne Swan MP, Treasurer, 'Release of Basel III Global Banking Standards', Press release, 17 December 2010.

this could have for the SME financial market, the committee recommends that the impact of Basel III in Australia be closely monitored. While not provided to the committee, it is noted that similar concerns could be raised regarding the cost of residential mortgages. The committee sees merit in also monitoring the impact of Basel III on Australian residential mortgages.

Recommendation 2

3.48 The committee recommends that the Reserve Bank of Australia specifically track the impact of the introduction of Basel III on the cost of small and medium business finance and residential mortgages.

Changes to the conditions of existing loans following the GFC

3.49 Business representatives reported that the GFC prompted significant changes to lending conditions not only for new but also for existing SME loans. For example, CPA Australia stated:

> From the beginning of the GFC, the banks were acutely aware that the fallout from this crisis would change the risk profile of most businesses. One step they undertook to mitigate their risks was to review their loan portfolios with additional rigour. The result was that many businesses were required to agree to changed loan conditions.[80]

3.50 Similarly, the NSW Business Chamber reported that '[r]isk aversion during the GFC saw small business lending conditions tighten significantly, both in terms of tightening lending criteria and relative costs of funds.'[81] The reported changes to lending conditions included increased security requirements, a reduction in the kinds of security accepted, a decrease in the loan-to-valuation ratio and increased reporting requirements that included requirements outside the scope of the original loan agreement.[82] CPA Australia also reported member feedback that ADIs are requesting personal and directors' guarantees, and key man insurance.[83]

3.51 It appeared that the changes were prompted by prudential considerations. Commenting on the impact of the GFC on the lending market, the ABA reported that 'the banks and non-bank lenders took steps to re-evaluate risks associated with business lending.'[84] The ANZ stated that:

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80 CPA Australia, *Submission 10*, p. 8.

81 NSW Business Chamber, *Submission 8*, p. 10.

82 CPA Australia, *Submission 10*, pp 8 – 9, Appendix A, p. 16; NSW Business Chamber, *Submission 8*, pp 11–12.

83 CPA Australia, *Submission 10*, Appendix A, p. 15. 'Key man insurance' is defined as 'insurance that covers the key personnel in the business and provides the banks with some certainty that the business will continue to operate under the current management.'

84 ABA, *Submission 13*, p. 2.

> It is prudent for all banks to review their lending criteria on a regular basis in response to the broader economic climate. In early 2009, ANZ implemented moderately tighter business lending standards in response to adverse economic conditions impacting certain segments of the portfolio.[85]

3.52 CPA Australia noted member feedback that the increased reporting requirements may be appropriate as 'the banks are now doing what perhaps they should have always been doing.'[86] It was also noted that tighter lending conditions may ease as the economy improves. For example, the RBA stated that 'you do get this tightening across a range of standards and then, as the economy comes back into recovery, general easing in the conditions as well.'[87]

3.53 However, evidence presented to the committee indicates three main concerns with the changed lending conditions. First, it was put to the committee that the new conditions may restrict SME's access to finance. NSW Business Chamber stated that 'generally speaking the banks appear to be unwilling to lend without very high levels of cash flow and security.'[88] Participants in Victoria University's small business survey argued: '[T]he Banks are not interested in you if you have no security' and '[i]f you have equity in your house you can get finance – if not good luck.'[89] APESMA Connect stated that there is an 'unwillingness of banks to lend where there is limited non-personal collateral.'[90] CPA Australia argued that the new requirements could impact business growth, noting that 'the security required for such [additional] lending may not be available as it is already pledged as security.'[91]

3.54 Second, CPA Australia raised concerns with the manner in which the conditions were altered. The organisation reported:

> Changed lending conditions (including implementing additional reporting requirements) were, at times, imposed with great speed and (often) lack of warning. In our view, the inadequate time many businesses had to adjust their systems to meet the new conditions added to the pressure many businesses felt during the GFC; the banks could have handled this better.[92]

3.55 Under the MBCOP, mutual ADIs undertake to provide 'clear and effective communication' with customers.[93] The Banking Code of Practice directs banks to

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85 ANZ, *Submission 14*, p. 10.

86 CPA Australia, *Submission 10*, Appendix A, p. 17.

87 Mr John Broadbent, Head of Domestic Markets Department, RBA, *Proof Committee Hansard*, 11 March 2011, p. 4.

88 NSW Business Chamber, *Submission 8*, p. 11.

89 NSW Business Chamber, *Submission 8*, pp 11–12.

90 APESMA Connect, *Submission 4*, p. 3.

91 CPA Australia, *Submission 8*, p. 8, Appendix A, p. 15.

92 CPA Australia, *Submission 8*, p. 7.

93 Abacus, Mutual Banking Code of Practice, p. 16.

notify customers of changes to terms and conditions, including standard fees and charges, no later than the day on which the changed conditions take effect. Notification may occur either in writing or through advertising in the media.[94] However, it is unclear whether changed lending conditions such as increased security and reporting requirements are covered by the Code of Banking Practice or the MBCOP. In response to the concerns, the ABA advised '[w]ithout having heard the precise circumstances, I am not sure. I cannot tell you precisely whether the code or the legislation would cover that sort of behaviour.'[95]

3.56 Third, submissions also questioned whether the changed lending conditions, particularly the reporting requirements, were appropriate. CPA Australia reported members' concerns that the reporting requirements are unnecessary, arguing that 'the lack of experience and skills of many business bankers is in fact counterproductive to accessing finance and is leading to unnecessary information requirements.'[96] The organisation further stated that members believe ADI staff request unnecessary information 'as they do not have the skills to make a professional judgement on what is necessary and not necessary to make an informed decision.'[97]

3.57 It seemed that underlying this is a concern about the quality of service ADIs provide. A participant at CPA Australia's small business roundtable questioned whether ADI staff have the technical expertise to understand the information requested:

> They don't seem to understand what is in the forecast, because they keep asking questions – they just don't seem to get it. I don't think they know what they are looking at, especially for a mining company, unless they have a background in mining.[98]

3.58 Similar concerns were noted in the Victoria University small business survey.[99] ACCI reported that its March 2010 survey found that 34 per cent of the 215 respondents considered that business bankers 'do not have adequate understanding of their business' cash flows and its ability to service any current or prospective loan obligations.'[100] The Real Estate Institute of Australia (REIA) stated:

> Many respondents to the March 2010 REIA survey in their comments felt that the financial sector did not understand the small business sector and furthermore tended to group all small businesses in the one basket without

94 ABA, Banking Code of Practice, p. 10.

95 Mr Münchenberg, ABA, *Proof Committee Hansard*, 4 March 2011, p. 55.

96 CPA Australia, *Submission 8*, p. 8.

97 CPA Australia, *Submission 8*, p. 9.

98 CPA Australia, *Submission 8*, Appendix A, p. 16.

99 NSW Business Chamber, *Submission 8*, p. 13.

100 ACCI, *Submission 6*, p. 13.

> any differentiation, neither of the factors affecting a particular segment nor of the outlook for that segment.[101]

3.59 It appeared that there was a disconnect between the views of some SMEs and the evidence submitted by ADIs. For example, ANZ stated that it provides SMEs with 'dedicated specialists, who are trained to help small business customers experiencing financial difficulty.'[102] ANZ further advised:

> In the small-business space, our team does not make assessments, in the sense of the actual credit decision. They certainly work with customers to put together the best possible submission for a loan...We hire a lot of people from small business or who have had family working in small business, so they really understand and have empathy with small business. They go through significant induction training and significant credit training.[103]

3.60 Westpac Group reported that Westpac Business Assist 'provides personalised support to SME customers.'[104] The CBA stated that '[s]ince 2006, CBA has achieved a fast growth rate in business customer satisfaction.'[105] The Code of Banking Practice also directs bank ADIs to ensure staff are 'trained so that they can competently and efficiently discharge their functions and provide the banking services they are authorised to provide.'[106]

3.61 To address these concerns, CPA Australia advocated for the introduction of a dedicated code of conduct for SME lending.[107] The ABA advised, and the Code of Banking Practice states, that that Code applies to small business lending.[108] However, CPA Australia argued:

> There are significant gaps that could be corrected in an expansion of the ABA Code of Banking Practice or in a separate code of practice. Such a specific Code would provide the framework for banks to improve their relationship with small business and more clearly set out the rights and responsibilities of banks and borrowers and enable banks "*to get closer than ever to business*". This would no doubt lead to improved outcomes in small business lending.[109]

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101 REIA, *Submission 7*, p. 5.

102 ANZ, *Submission 14*, p. 6.

103 Mr Nick Reade, General Manager, Small Business Banking, ANZ, *Proof Committee Hansard*, 11 March 2011, p. 36.

104 Westpac Group, *Submission 9*, p. 4.

105 CBA, *Submission 17*, p. 2.

106 ABA, Code of Banking Practice, p. 5.

107 CPA Australia, *Submission 10*, p. 9.

108 Mr Münchenberg, ABA, *Proof Committee Hansard*, 4 March 2011, p. 49; ABA, Code of Banking Practice, p. 2.

109 CPA Australia, *Submission 10*, pp 9–10.

3.62 The organisation stated that gaps exist in the areas of explaining the requirements needed to obtain bank credit, estimating the time to process credit applications, informing the SME that further information is needed to process the loan, and informing the SME about the reasons for declining an application.[110] On the basis of requirements of banking codes in the United Kingdom and Canada, CPA Australia recommended that a minimum of 15 days notice should be provided of changes to lending terms and conditions, such as reporting requirements.[111] The ABA informed the committee that the ABA and CPA Australia are discussing 'getting together to talk about a lot of these small business issues.'[112]

3.63 CPA Australia also recommended additional technical training for business banking staff 'so that such staff have a reasonable understanding of financial matters and the industries in which their clients work.'[113] The NSW Business Chamber stated 'we think there is room for improvement on the part of credit providers; they could do more to evaluate individual loan applications than simply applying a sectoral or regional template that they have developed as part of their credit systems.'[114]

3.64 SME representatives also stated that there is scope for additional training for SMEs. CPA Australia acknowledged that 'some businesses are finding it difficult to meet the information requirements imposed by lenders for new loans partly because of poor record keeping.'[115] The NSW Business Chamber noted:

> We find information deficiencies and differing rates of capability are issues on both sides of lending transactions. There is always more that can be done to improve the ability of small business to get across their business opportunity and prospects to a prospective credit provider. There is always room for that.[116]

Committee view

3.65 The committee notes the concern expressed by some stakeholders that ADIs, and in particular banking staff, do not fully appreciate the conditions peculiar to the SME sector and the nuances of SME finance. The committee considers that a uniform definition of micro, small and medium business can facilitate better policy analysis and development. Timely dissemination to financial sector participants and business organisation of data about the SME sector could assist lenders to more fully

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110 CPA Australia, *Submission 10*, Appendix B, pp 23–38.

111 CPA Australia, *Submission 10*, Appendix B, p. 31.

112 Mr Münchenberg, ABA, *Proof Committee Hansard*, 4 March 2011, p. 51.

113 CPA Australia, *Submission 10*, p. 9.

114 Mr Paul Orton, Director, Policy and Advocacy, NSW Business Chamber, *Proof Committee Hansard*, 4 March 2011, pp 28–29.

115 CPA Australia, *Submission 10*, p. 8.

116 Mr Orton, NSW Business Chamber, *Proof Committee Hansard*, 4 March 2011, pp 28–29.

understand their clients' circumstances and to develop lending practices that are tailored to each client's needs.

3.66 It would be of concern were significant changes to lending conditions introduced without providing SMEs sufficient opportunity to adjust to the new requirements. The committee accepts advice from Abacus and the ABA that the MBCOP and the Code of Banking Practice apply to SME products. However, the codes should be amended to make clear the service standards required for ADIs when altering lending conditions. In this regard, the committee notes CPA Australia's advice that 15 days is the minimum lead time required under banking codes in the United Kingdom and Canada.

3.67 The committee approves the measures many ADIs have taken to improve services to SMEs. While evidence is inconclusive, the committee notes the substantial anecdotal evidence of SMEs concerns with the skills and training of business bankers. The committee encourages the ADI sector to take on board these concerns, and to prioritise staff training in this area.

Recommendation 3

3.68 The committee recommends that the Code of Banking Practice and the Mutual Banking Code of Practice be amended to include a standardised notice period for notifying business borrowers of changes to loan terms and conditions that may be materially adverse for them.

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.
>
> • 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:
>
> • Mergers and acquisitions in the banking sector
>
> • Higher bank's funding costs
>
> • Closure of securitisation markets and constraints in other funding markets.
>
> 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*.

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.

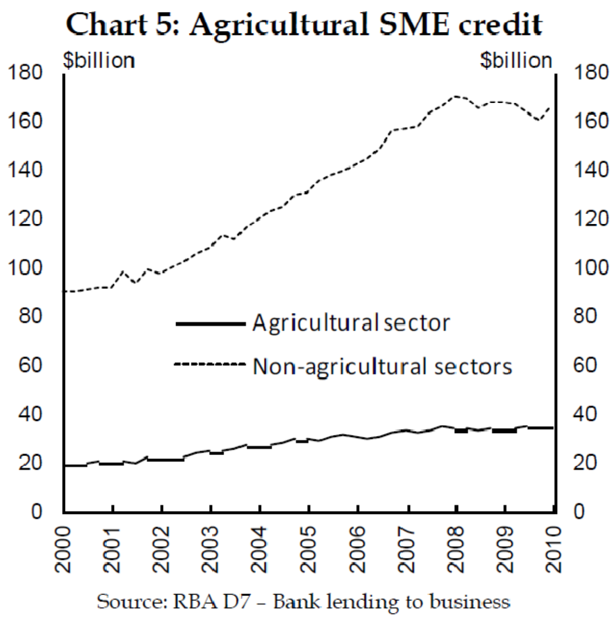
Chapter 5

Finance for regional SMEs

5.1 The committee was asked to make a 'comparison between the credit options available to SMEs located in regional Australia and metropolitan areas.'

5.2 Treasury reports that between June 2007 and September 2010, 'the stock of outstanding credit to SMEs in the agricultural sector increased in nominal terms by around 75 per cent between September 2009 and September 2010'. Comparatively, for the same period the stock of outstanding credit for SMEs in other sectors increased approximately 85 per cent.[1]

Figure 5.1 Stock of outstanding credit[2]



5.3 Treasury further reported that credit outstanding to SMEs in the agricultural sector rose by approximately 8 percent from June 2007 to September 2010, compared with a 7 per cent growth across other SME sectors.[3]

5.4 None of the ADIs presenting evidence to the inquiry informed the committee that their lending policies differed between SMEs in regional and rural areas and

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

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

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

SMEs in metropolitan areas. ANZ and NAB stated that the same lending polices applied to rural and regional SMEs and SMEs in metropolitan areas.[4]

5.5 In addition to finance that does not differentiate between industries, rural and regional SME may have access to financial products tailored to the agribusiness sector. ANZ, BankSA, BankWest, CBA, NAB and Westpac are among the providers of 'agri banks' specialising in loans to rural SMEs.[5] ANZ stated that its Regional Commercial Banking service offers many of the mainstream SME products and services, as well as 'specific products for farming business.'[6] Westpac Group explained that '[a]gribusiness lending products and bankers focus almost exclusively on the specialised lending needs of agricultural-based businesses.'[7]

5.6 Data from Canstar Cannex indicates that there are approximately 69 agribusiness finance options from nine 'agri banks' (Appendix 5). The kinds of finance available include residentially secured business overdrafts, residential secured variable business loans and commercially secured variable business loans. The interest rates for agribusiness loans are in most cases comparable to the interest rates attached to mainstream business loans. For example, one bank's commercially secured variable business loan has an interest rate of 7.94 to 9.74, which is the same as the interest rates applying to the equivalent agribusiness product. However, agribusiness products may also attract a higher interest rate. For example, the interest rate for one bank's residentially secured agribusiness overdraft is slightly higher than the equivalent mainstream business overdraft. The residentially secured business overdraft has an interest rate of is 9.81 per cent while the rate for the agribusiness residentially secured business overdraft varies from 9.81 per cent to 11.71 per cent.

5.7 The committee did not receive evidence that clearly indicated a lack of banking competition in regional areas. It did hear that there had been a move out of regional banking in the past, but that there were signs of that trend being reversed.[8] ANZ stated:

> We believe that, despite the retreat of some finance providers during the GFC, the market for small business banking remains competitive with a range of lending and deposit products targeting this segment across both metropolitan and regional geographies.[9]

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4 ANZ, *Submission* 14, p. 10; NAB, *Submission 19*, p. 11.

5 Canstar Cannex, 'Business Banking – Compare Interest Rates and Star Ratings', http://www.canstar.com.au/business-loans/ (viewed 11 April 2011).

6 ANZ, *Submission 14*, p. 5.

7 Westpac Group, *Submission 9*, p. 3.

8 Mr Paul Orton, Director, Policy and Advocacy, New South Wales Business Chamber, *Proof Committee Hansard*, 4 March 2011, p. 29.

9 ANZ, *Submission 14*, p. 4.

5.8 The ABA argued:

> We are seeing, particularly in regional and rural areas, more and more of the decision making being devolved down to people in the branches or the subregional managers for the very reason that they are the people who can make the soundest judgments about what is going on in that region.[10]

5.9 In some regional markets, individual lenders – often mutuals rather than major banks – may have a strong presence:

> We have at least two regional members where almost a third of their lending is commercial, which is highly unusual. It just goes to show that in those regional markets they are very well established, they know those markets very well.[11]

5.10 Overall, the mutual sector is particularly well-represented in regional Australia:

> Mr Lawler—I think the fact that we have such a big footprint in regional Australia reflects the fact that there is demand for institutions, and historically there has been demand for institutions like ours. People want to have access to banking services. They want to be able to retain their capital locally. They want to be able to speak to lenders who understand them, understand their business and understand the local community.[12]

5.11 There are also intermediaries, such as brokers, stepping in to address the gap created by a lack of bank branches at the regional level:

> The commercial asset finance broker is a vital distribution network that provides small and medium businesses located in regional Australia an increased level of access to finance. Many regional towns or areas no longer have a bank branch physically present or, if they are one of the lucky ones, they might have one of the big branches represented. Outside of the big four, there are many lenders who provide asset finance to small and medium businesses—Capital Finance, the Bank of Queensland and Macquarie—but they do not have an extensive branch network in regional Australia. This is where the commercial asset finance broker provides access to finance for businesses located outside of major cities.[13]

5.12 Representatives of CAFBA demonstrated that what is important to successful regional lending is not an on-the-ground presence of the lender, but of someone who understands the business that is seeking funds. CAFBA gave an example of successfully assisting businesses to borrow funds from banks that did not have a

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10 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers Association, *Proof Committee Hansard*, 4 March 2011, p. 58.

11 Mr Luke Lawler, Abacus, *Proof Committee Hansard*, 4 March 2011, p. 6.

12 Mr Luke Lawler, Abacus, *Proof Committee Hansard*, 4 March 2011, p. 7.

13 Mrs Kathryn Bordonaro, Committee Member, CAFBA, *Proof Committee Hansard*, 4 March 2011, pp 17–18.

regional presence, and contrasted this to the inability of the business to borrow from a local bank, because despite having local staff, 'they just did not understand the goods.'[14]

5.13 The committee notes concerns that the loss of some funding sources, following the GFC, may have disproportionately affected regional institutions. The government is taking steps to address these concerns:

> We have been particularly concerned with the demise of the securitisation market, and that was a good funder of small business. The regional lenders especially—lots of representations have been made to us by institutions such as the Bank of Queensland and Suncorp and smaller lenders which may be closer to the market—have been affected by the demise of the securitisation market. That is why in the banking package we are pushing to try to revive the securitisation market and to try to get a corporate bond market going, because we think, again, that will provide funding.[15]

5.14 The committee also understands that the National Farmers Federation, in conjunction with Canstar Cannex, is developing an 'NFF Agribusiness Monitor'. In announcing the new service, Mr Jock Laurie of the National Farmers' Federation argued that at present:

> It is virtually impossible to know, with any certainty, how your farm loan compared with others in the market, what the interest rate are and how they compare across various loan products...This makes the decision about changing your bank difficult and, ultimately, thwarts competition.[16]

5.15 The NFF Agribusiness Monitor is intended to 'shed new light on bank rates and products',[17] to assist agribusinesses to make an informed decision when selecting a finance option.

5.16 Evidence indicates that the SME agribusiness shares the challenges of all SMEs and others largely unique to the agribusiness sector. Treasury stated that rural debt outstanding has increased in recent years and reported that '[c]ash flows to rural sector businesses can often be volatile, particularly as a result of extreme weather events, such as droughts and floods.'[18]

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14 Mrs Kathryn Bordonaro, Committee Member, CAFBA, *Proof Committee Hansard*, 4 March 2011, p. 18.

15 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 4 March 2011, p. 36.

16 Mr Jock Laurie, National Farmers Federation, 'Lifting the lid on bank interest rates for farmers', Media Release, 14 December 2010.

17 Mr Jock Laurie, National Farmers Federation, 'Lifting the lid on bank interest rates for farmers', Media Release, 14 December 2010.

18 Treasury, *Submission 16*, p. 9.

5.17 It appeared that there is a range of measures in place to assist SMEs affected by extreme weather events. Treasury advised that the Australian Government is providing the following assistance:

- Farmers and agriculture-dependent small businesses experiencing drought may be able to access interest rate subsidies of 50 per cent of the interest on loans for the first year of an Exceptional Circumstances declaration, and 80 per cent for second and subsequent years. These subsidies provide recipients with up to $100,000 per year, and up to $500,000 over 5 years.
- Affected farmers may also access professional advice and financial planning assistance that helps them develop business plans and identify ways to improve their farm management practices.
- Employees, small businesses and farmers who have lost income as a direct result of the extreme weather events since November 2010 may be able to access the 'Disaster Income Recovery Subsidy' announced on 10 January 2011, which provides a fortnightly payment of up to the maximum rate of existing Newstart Allowance for 13 weeks.[19]

5.18 ADIs also indicated that there are measures in place to address cash flow concerns resulting from recent natural disasters. ANZ and CBA have advised that the ADIs are providing loan assistance to SMEs affected by the extreme weather events in recent months.[20] Abacus advised that its members are providing affected SMEs hardship relief, which includes deferred loan repayments.[21] ANZ also stated that cash flow concerns are factored into the bank's agribusiness loans:

> This segment...offers specific products for farming business, such as revolving lines of credit which are specifically structured to account for typical (i.e. infrequent) agribusiness cash flows as interest can be charged in accordance with the customer’s income (i.e. monthly, quarterly, half yearly or yearly).[22]

5.19 Overall, Treasury reported that the regional banks 'have done reasonably well,'[23] while the ABA considered that the 'outlook from the banking sector is very positive for regional areas because of where commodity prices are.'[24]

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19 Treasury, *Submission 16*, pp 9–10.

20 ANZ, *Submission 14*, p. 7; CBA, *Submission 17*, p. 2.

21 Mr Lawler, Abacus, *Proof Committee Hansard*, 4 March 2011, p. 8.

22 ANZ, *Submission 14*, p. 5.

23 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 4 March 2011, p. 38.

24 Mr Stephen Carroll, Policy Director, Australian Bankers Association, *Proof Committee Hansard*, 4 March 2011, p. 52.

Chapter 6

Conclusion

6.1 In chapter one, this committee acknowledged the previous efforts of parliamentary committees and governments in examining important issues that concern Australia's SMEs. These efforts are testament to the ongoing commitment of governments and parliaments to this business sector that provides employment for over seven million Australians.

6.2 Australia has in place a strong economy and a robust, highly effective system of financial regulation. These factors have meant that it weathered the global financial crisis relatively well, and is recovering strongly. All Australians, including those in SMEs, have benefitted from these circumstances.

6.3 Nevertheless the GFC has presented great challenges, particularly on the financial front, for all businesses including SMEs. The committee was given evidence that some of the major issues are starting to be resolved, but that there are still measures that can be taken to improve the productivity and resilience of the SME sector.

6.4 The committee believes that better information about SMEs and about business finance could contribute to better policy processes and lending. The committee noted in chapter one that there is no coherent approach across government agencies or major stakeholders in defining different business categories. A lack of standard definitions means a lack of standardised data. It can also lead to misunderstandings when interpreting that data. In listening to stakeholders, there appeared to be at times significantly diverging understandings of what was happening in the lending environment, with some data gaps.

6.5 The dissemination of accurate, timely and relevant information about economic conditions can help governments in policy development and implementation. It can also help ensure lenders adopt lending practices that reflect current economic conditions and issues. Good communication can also help stakeholders understand the issues they each face. The committee formed the impression that this was not always the case following the onset of the GFC.

6.6 The committee hopes that implementation of its recommendations, particularly in relation to information gathering and dissemination, will help improve the financial environment for SMEs in Australia.

Mr Bernie Ripoll MP

Chairman

Appendix 1

Submissions

1 Urban Taskforce Australia Ltd

2 Mr Steve Snelgrove, Lismore and District Financial Counselling Service Inc

3 Reserve Bank of Australia

4 APESMA Connect

5 Commercial Asset Finance Brokers Association

6 Australian Chamber of Commerce and Industry

7 Real Estate Institute of Australia

8 NSW Business Chamber

9 Westpac Banking Corporation

10 CPA Australia

11 Name Withheld

12 Australian Prudential Regulation Authority

13 Australian Bankers' Association

14 ANZ

15 Australian Finance Conference

16 The Treasury

17 Commonwealth Bank of Australia

18 Abacus

19 National Australia Bank

Appendix 2

Public hearings

Wednesday, 2 March 2011 – Canberra

Real Estate Institute of Australia

Mr Jock Kreitals, Manager Policy

Australian Chamber of Commerce and Industry

Mr Greg Evans, Director of Economics and Industry Policy

Friday, 4 March 2011 – Canberra

Abacus Mutuals

Mr Luke Lawler, Senior Adviser, Policy and Public Affairs

Commercial Asset Finance Brokers Association

Mrs Kathryn Bordonaro, Committee member

Mr David Gandolfo, Committee member

NSW Business Chamber

Mr Paul Orton, Director Policy & Advocacy

Mr Micah Green, Economist

The Treasury

Mr Ian Beckett,Principal Adviser, Financial Systems Division

Mr Andrew Deitz, Manager, Infrastructure, Competition & Consumer Division

Mr John Lonsdale, General Manager, Financial Systems Division

Mr Jim Murphy, Deputy Secretary, Markets Group

Australian Bankers' Association

Mr Stephen Carroll, Policy Director

Mr Steven Münchenberg, CEO

Council of Small Business Organizations Australia

Mr Peter Strong, Executive Director

Friday, 11 March 2011 – Sydney

Reserve Bank Australia

Mr John Broadbent, Head, Domestic Markets Department

Dr Guy Debelle, Assistant Governor, Financial Markets

Urban Taskforce Australia

Aaron Gadiel, Chief Executive Officer

Westpac

Mr James Tate, Chief Product Officer, Westpac Banking Corporation

Mr Andrew Moore, Chief Operating Officer, St George Bank

ANZ

Mr Nick Reade, General Manager, Small Business Banking

Ms Tania Motton, General Manager, Regional Commercial Banking

Mr Michael Johnston, Head of Government & Regulatory Affairs

Australian Prudential Regulation Authority

Mr Graham Johnson, General Manager, Industry Technical Services

Mr Wayne Byres, Executive General Manager, Diversified Institutions Division

Appendix 3

Banks that have adopted the Code of Banking Practice[1]

Adelaide Bank Limited

AMP Bank Limited

Arab Bank Australia Limited

Australia and New Zealand Banking Group

Bank of China

BankSA (A division of St George Bank Limited)

Bank of Queensland Limited

Bank of Western Australia

Bendigo Bank

Citibank Australia

Commonwealth Bank of Australia

HSBC Bank Australia Limited

ING Bank (Australia) Limited

Macquarie Bank Limited

National Australia Bank Limited

Rabobank Australia Limited (formerly Primary Industry Bank of Australia Limited)

St George Bank Limited

Suncorp Metway Limited

Westpac Banking Corporation

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1 ABA, 'Banks that have adopted the Code of Banking Practice', 10 December 2010, http://www.bankers.asn.au/Default.aspx?ArticleID=460 (viewed 21 April 2011).

Appendix 4

Mutuals that have subscribed to the Mutual Banking Code of Practice[1]

ABS Building Society Ltd. Alliance One Credit Union Ltd. Australian Central Credit Union Ltd .Australian Defence Credit Union Ltd. AWA Credit Union Ltd .Bankstown City Credit Union Ltd.

Berrima District Credit Union Ltd. Big Sky Credit Union Ltd. Broken Hill Community Credit Union Ltd.

CAPE Credit Union Ltd. Central Murray Credit Union Ltd. Central West Credit Union Ltd. Circle Credit Co-Operative Ltd. Coastline Credit Union Ltd. Collie Miners Credit Union Ltd. Community CPS Australia Ltd. Community First Credit Union Ltd. Comtax Credit Union. Country First Credit Union Ltd. Credit Union Australia Ltd. Credit Union SA Ltd.

Defence Force Credit Union Ltd.

ECU Australia Limited .EECU Limited. Encompass Credit Union Ltd.

Family First Credit Union Ltd. Fire Brigades Employees' Credit Union Ltd. Fire Service Credit Union Ltd. Firefighters & Affiliates Credit Co-Operative Ltd. First Choice Credit Union Ltd. First Option Credit Union Ltd. Fitzroy & Carlton Community Credit Co-Op Ltd. Ford Co-Operative Credit Society Ltd.

Gateway Credit Union Ltd. Geelong & District Credit Co-Operative Ltd. Goldfields Credit Union Ltd. Goulburn Murray Credit Union Co-Operative Ltd. Greater Building Society Ltd.

Heritage Building Society Ltd. Heritage Isle Credit Union Ltd. Holiday Coast Credit Union Ltd. Horizon Credit Union Ltd. Hume Building Society Ltd.

Illawarra Credit Union. Industries Mutual Credit Union Ltd. Intech Credit Union Ltd.

La Trobe University Credit Union Co-Operative Ltd. Laboratories Credit Union Ltd. Latvian Australian Credit Co-Operative Society Ltd. Lysaght Credit Union Ltd.

Macarthur Credit Union Ltd. Macquarie Credit Union Ltd. Maitland Mutual Building Society Ltd. Manly Warringah Credit Union Ltd. Maritime, Mining & Power Credit Union Ltd. Maroondah Credit Union. MCU Ltd. mecu Limited. Melbourne University Credit Union Ltd. Memberfirst Credit Union Ltd.

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1 Abacus, MBCOP Subscribers, http://www.abacus.org.au/consumers/mutual-banking-code-of-practice/mbcop-subscribers/nodes (viewed 21 April 2011).

Newcom Colliery Employees Credit Union Ltd. Northern Inland Credit Union Ltd. Nova Credit Union Ltd.

Old Gold Credit Union Co-Operative Ltd. Orange Credit Union Ltd.

Police & Nurses Credit Society Ltd. Police Association Credit Co-Operative Ltd. Police Credit Union Ltd. Pulse Credit Union Ltd.

Qantas Staff Credit Union Ltd. Quay Credit Union Ltd. Queensland Country Credit Union Ltd. Queensland Police Credit Union Ltd. Queensland Professional Credit Union Ltd. Queensland Teachers' Credit Union Ltd. Queenslanders Credit Union Ltd.

Railways Credit Union Ltd. Resources Credit Union Ltd. RTA Staff Credit Union Ltd.

Savings and Loans Credit Union. Security Credit Union. Select Credit Union Ltd. Service One Credit Union Ltd. SGE Credit Union Ltd. Shell Employees' Credit Union Ltd. Shoalhaven Community Credit Union. South West Slopes Credit Union Ltd. South-West Credit Union Co-Operative Ltd. Southern Cross Credit Union Ltd.l Summerland Credit Union Ltd. Sutherland Credit Union Ltd. Swan Hill Credit Union Ltd.

Tartan Credit Union Ltd .Teachers Credit Union Ltd. The Capricornian Ltd. The Community Mutual Group. The Police Department Employees' Credit Union Ltd. The University Credit Society Ltd. Traditional Credit Union Ltd. Transcomm Credit Co-Operative Ltd.

Unicom Credit Union.

Victoria Teachers Credit Union Ltd.

Wagga Mutual Credit Union Ltd. Warwick Credit Union Ltd. WAW Credit Union Cooperative Ltd. Western City Credit Union. Woolworths Employees' Credit Union Ltd. Wyong Council Credit Union Ltd.

Appendix 5

Agribusiness finance

1. Residential Secured Business Overdrafts[1]

Company	Product	Odraft Residential Star rating	Rate	Minimum loan amount	Unused Limit fee	Overdrawn Service Fee	No. of Free Transactions allowed	EFTPOS transaction fee	Internet transaction fee	BPAY transaction fee	Cheque Fee
ANZ Agribusiness	Revolving Agri Line	Not rated	9.51 to 14.72	2000.00	Nil	37.70	28	Nil	Nil	Nil	0.80
BankSA Agribusiness	Agri Business Maximiser	Not rated	9.57	20000.00	Nil	9.00	15	N/A	Nil	Nil	0.50
	Agri Business OD	Not rated	10.30 to 13.75	20000.00	Nil	9.00	15	N/A	Nil	Nil	0.50
	Agri Commercial LOC	Not rated	10.27 to 12.47	20000.00	Nil	9.00	8	2.00	2.00	2.00	2.00

1 Data sourced from Canstar Cannex, http://www.canstar.com.au/ (viewed 11 April 2011).

Company	Product	Odraft Residential Star rating	Rate	Minimum loan amount	Unused Limit fee	Overdrawn Service Fee	No. of Free Transactions allowed	EFTPOS transaction fee	Internet transaction fee	BPAY transaction fee	Cheque Fee
BankWest Agribusiness	AgriOne Overdraft	Not rated	8.15 and higher	100000.00	Nil	38.00	N/A	Nil	Nil	Nil	Nil
Commonwealth Bank Agri	Agribusiness Line of Credit	Not rated	7.35 to 9.74	0.00	Nil	10.00	8	2.00	2.00	2.00	2.00
	Agribusiness Overdraft	Not rated	9.01 to 9.21	0.00	Nil	10.00	330	Nil	Nil	Nil	Nil
nab Agribusiness	Farm Management Overdrft	Not rated	9.76 to 13.33	20000.00	N/A	N/A	Nil	0.10	0.10	0.10	0.40
	Farmers Choice OD	Not rated	8.76 and higher	20000.00	N/A	N/A	Nil	0.10	0.10	0.10	0.40
Rabobank Agribusiness	Rural Overdraft	Not rated	6.75 and higher	250000.00	0.25%	40.00	N/A	Nil	Nil	Nil	0.60
Suncorp Agri	Business	Not rated	10.84	10000.00	N/A	10.00	30	Nil	Nil	Nil	0.60

Company	Product	Odraft Residential Star rating	Rate	Minimum loan amount	Unused Limit fee	Overdrawn Service Fee	No. of Free Transactions allowed	EFTPOS transaction fee	Internet transaction fee	BPAY transaction fee	Cheque Fee
	O/D (Res Sec)										
Westpac Agribusiness	Agribusiness One LOC	Not rated	6.83 to 9.33	100000.00	N/A	9.00	N/A	0.14	0.14	0.14	0.50
	Agribusiness Overdraft	Not rated	9.81 to 11.71	0.00	N/A	9.00	N/A	0.14	0.14	0.14	0.50

2. Residential Secured Variable Business Loans[2]

Company	Product	Term Residential Star rating	Rate	Minimum loan amount	Maximum loan amount	Maximum facility term (years)	Interest only maximum years	Payment frequencies allowed	PI, IO, Both or Revolving
ANZ Agribusiness	Bus Loan Var (Bus Asset)	Not rated	8.94	50000.00	99999999.99	30 yrs	10	w f m q s a	Both
Bananacoast Comm CU Agri	Bus Ln Var Base Rate	Not rated	8.55 to 9.30	500.00	7000000.00	25 yrs	5	w f m q s a	Both
	Business Flexi	Not rated	8.15 to	150000.00	249999.99	25 yrs	5	w f m	Both

2 Data sourced from Canstar Cannex, http://www.canstar.com.au/ (viewed 11 April 2011).

Company	Product	Term Residential Star rating	Rate	Minimum loan amount	Maximum loan amount	Maximum facility term (years)	Interest only maximum years	Payment frequencies allowed	PI, IO, Both or Revolving
	Rate		8.90						
	Business Premier Rate	Not rated	7.85 to 8.60	250000.00	7000000.00	25 yrs	5	w f m	Both
	Business Loan Base Rate	* * *	8.55 to 9.30	500.00	7000000.00	25 yrs	5	w f m	Both
BankSA Agribusiness	Agri Bus Loan Variable	Not rated	8.72	30000.00	99999999.99	15 yrs	5	m	Both
	Agri Commercial Loan Var	Not rated	9.75 to 13.70	20000.00	99999999.99	15 yrs	5	m	Both
Commonwealth Bank Agri	Agribusiness Variable Loan	Not rated	7.94 to 9.74	0.00	99999999.99	30 yrs	No max	m q s a	Both
nab Agribusiness	Bus Opts Instal Var Std	Not rated	7.76 and higher	20000.00	99999999.99	15 yrs	N/A	m q s a	P+I
	Bus Opts IO Var Standard	Not rated	7.76 and higher	20000.00	99999999.99	15 yrs	15	m q s a	IO
Rabobank Agribusiness	RuralPrime floating rate	Not rated	6.85 and higher	250000.00	99999999.99	15 yrs	15	m q s a	Revolving
Suncorp Agri	Business Ln Var (res)	Not rated	9.34	10000.00	99999999.99	25 yrs	15	m q s a	Both

3. Residential Secured 5 year Fixed Term Business Loans[3]

Company	Product	Term Residential Star rating	Rate	Minimum loan amount	Maximum loan amount	Maximum facility term (years)	Interest only maximum years	Payment frequencies allowed	PI, IO, Both or Revolving
ANZ Agribusiness	Agri Business Loan - Fixed	Not rated	8.17 to 10.09	10000.00	99999999.99	30 yrs	10	w f m q s a	Both
Bananacoast Comm CU Agri	Business Loan Fixed	Not rated	8.04 to 8.98	500.00	7000000.00	25 yrs	5	w f m q s a	Both
BankSA Agribusiness	Agri Business Loan - Fixed	Not rated	7.89 to 8.54	30000.00	99999999.99	15 yrs	5	m	Both
Commonwealth Bank Agri	Agribusiness Fixed Loan	Not rated	6.60 and higher	0.00	1000000.00	30 yrs	7	m q s a	Both
nab Agribusiness	Bus Options IO Standard - Fixed	Not rated	8.05 and higher	20000.00	99999999.99	15 yrs	15	m q s a	IO
	Bus Opts Instal Standard - Fixed	Not rated	7.95 and higher	20000.00	99999999.99	15 yrs	N/A	m q s a	P+I
Rabobank Agribusiness	Rural Loan - Fixed	Not rated	6.70 and higher	250000.00	99999999.99	15 yrs	15	m q s a	Revolving
Suncorp Agri	Business Loan (res sec) - Fixed	Not rated	7.60 to 9.25	10000.00	99999999.99	25 yrs	5	m	Both

3 Data sourced from Canstar Cannex, http://www.canstar.com.au/ (viewed 11 April 2011).

Company	Product	Term Residential Star rating	Rate	Minimum loan amount	Maximum loan amount	Maximum facility term (years)	Interest only maximum years	Payment frequencies allowed	PI, IO, Both or Revolving
Westpac Agribusiness	Agri Finance Loan-Fixed	Not rated	7.82 to 9.73	250000.00	99999999.99	No max	No max	w f m q s a	Both

4. Commercial Secured Business Overdrafts[4]

Company	Product	Overdraft Commercial Star rating	Rate	Minimum loan amount	Overdrawn Service Fee	No. of Free Transactions allowed	EFTPOS transaction fee	OTC transaction fee	Internet transaction fee	BPAY transaction fee	Cheque Fee
ANZ Agribusiness	Revolving Agri Line	Not rated	9.51 to 14.72	2000.00	37.70	28	Nil	0.80	Nil	Nil	0.80
Bananacoast Comm CU Agri	Bus O/Draft Secured	Not rated	9.75 to 15.05	500.00	25.00	40	Nil	Nil	Nil	Nil	Nil
BankSA Agribusiness	Agri Business OD	Not rated	10.30 to 13.75	20000.00	9.00	15	N/A	1.00	Nil	Nil	0.50
	Agri Commercial LOC	Not rated	10.27 to 12.47	20000.00	9.00	8	2.00	2.00	2.00	2.00	2.00
BankWest	AgriOne	Not rated	8.15	100000.00	38.00	N/A	Nil	Nil	Nil	Nil	Nil

4 Data sourced from Canstar Cannex, http://www.canstar.com.au/ (viewed 11 April 2011).

Company	Product	Overdraft Commercial Star rating	Rate	Minimum loan amount	Overdrawn Service Fee	No. of Free Transactions allowed	EFTPOS transaction fee	OTC transaction fee	Internet transaction fee	BPAY transaction fee	Cheque Fee
Agribusiness	Overdraft		and higher								
Commonwealth Bank Agri	Agribusiness Line of Credit	Not rated	7.35 to 9.74	0.00	10.00	8	2.00	2.00	2.00	2.00	2.00
nab Agribusiness	Farm Management Overdrft	Not rated	9.76 to 13.33	20000.00	N/A	Nil	0.10	0.60	0.10	0.10	0.40
	Farmers Choice OD	Not rated	8.76 and higher	20000.00	N/A	Nil	0.10	0.60	0.10	0.10	0.40
Rabobank Agribusiness	Rural Overdraft	Not rated	6.75 and higher	250000.00	40.00	N/A	Nil	Nil	Nil	Nil	0.60
Suncorp Agri	Business O/D (Comm Sec)	Not rated	10.99 and higher	10000.00	10.00	30	Nil	1.00	Nil	Nil	0.60
	Line of Credit (Com Sec)	Not rated	9.59 and higher	10000.00	10.00	10	0.20	0.70	Nil	0.20	0.60
Westpac Agribusiness	Agribusiness One LOC	Not rated	6.83 to 9.33	100000.00	9.00	N/A	0.14	1.00	0.14	0.14	0.50
	Agribusiness Overdraft	Not rated	9.81 to	0.00	9.00	N/A	0.14	1.00	0.14	0.14	0.50

Company	Product	Overdraft Commercial Star rating	Rate	Minimum loan amount	Overdrawn Service Fee	No. of Free Transactions allowed	EFTPOS transaction fee	OTC transaction fee	Internet transaction fee	BPAY transaction fee	Cheque Fee
			11.71								

5. Commercial Secured Variable Business Loans[5]

Company	Product	Term Commercial Star rating	Rate	Minimum loan amount	Maximum loan amount	Maximum facility term (years)	Interest only maximum years	Payment frequencies allowed	PI, IO, Both or Revolving
ANZ Agribusiness	Bus Loan Var (Bus Asset)	Not rated	8.94	50000.00	99999999.99	30 yrs	10	w f m q s a	Both
Bananacoast Comm CU Agri	Bus Ln Var Base Rate	Not rated	8.55 to 9.30	500.00	7000000.00	25 yrs	5	w f m q s a	Both
	Business Flexi Rate	Not rated	8.15 to 8.90	150000.00	249999.99	25 yrs	5	w f m	Both
	Business Premier Rate	Not rated	7.85 to 8.60	250000.00	7000000.00	25 yrs	5	w f m	Both
Bananacoast Community CU	Business Flexi Rate	Not rated	8.15 to 8.90	150000.00	249999.99	25 yrs	5	w f m	Both
	Business Loan Base Rate	* * *	8.55 to 9.30	500.00	7000000.00	25 yrs	5	w f m	Both
	Business Premier Rate	Not rated	7.85 to 8.60	250000.00	7000000.00	25 yrs	5	w f m	Both

5 Data sourced from Canstar Cannex, http://www.canstar.com.au/ (viewed 11 April 2011).

Company	Product	Term Commercial Star rating	Rate	Minimum loan amount	Maximum loan amount	Maximum facility term (years)	Interest only maximum years	Payment frequencies allowed	PI, IO, Both or Revolving
BankSA Agribusiness	Agri Commercial Loan Var	Not rated	9.75 to 13.70	20000.00	99999999.99	15 yrs	5	m	Both
Commonwealth Bank Agri	Agribusiness Variable Loan	Not rated	7.94 to 9.74	0.00	99999999.99	30 yrs	No max	m q s a	Both
nab Agribusiness	Bus Opts Instal Var Std	Not rated	7.76 and higher	20000.00	99999999.99	15 yrs	N/A	m q s a	P+I
	Bus Opts IO Var Standard	Not rated	7.76 and higher	20000.00	99999999.99	15 yrs	15	m q s a	IO
Rabobank Agribusiness	RuralPrime floating rate	Not rated	6.85 and higher	250000.00	99999999.99	15 yrs	15	m q s a	Revolving
Suncorp Agri	Business Lns Var (com)	Not rated	9.49 and higher	10000.00	99999999.99	20 yrs	5	d w f m	Both
Westpac Agribusiness	Agribusiness One Loan	Not rated	6.83 to 9.33	100000.00	99999999.99	No max	No max	w f m q s a	Both

6. Commercial Secured 5 year Fixed Term Business Loans[6]

6 Data sourced from Canstar Cannex, http://www.canstar.com.au/ (viewed 11 April 2011).

Company	Product	Term Commercial Star rating	Rate	Minimum loan amount	Maximum loan amount	Maximum facility term (years)	Interest only maximum years	Payment frequencies allowed	PI, IO, Both or Revolving
ANZ Agribusiness	Agri Business Loan - Fixed	Not rated	8.17 to 10.09	10000.00	99999999.99	30 yrs	10	w f m q s a	Both
Bananacoast Comm CU Agri	Business Loan Fixed	Not rated	8.04 to 8.98	500.00	7000000.00	25 yrs	5	w f m q s a	Both
Commonwealth Bank Agri	Agribusiness Fixed Loan	Not rated	6.60 and higher	0.00	1000000.00	30 yrs	7	m q s a	Both
nab Agribusiness	Bus Options IO Standard - Fixed	Not rated	8.05 and higher	20000.00	99999999.99	15 yrs	15	m q s a	IO
	Bus Opts Instal Standard - Fixed	Not rated	7.95 and higher	20000.00	99999999.99	15 yrs	N/A	m q s a	P+I
Rabobank Agribusiness	Rural Loan - Fixed	Not rated	6.70 and higher	250000.00	99999999.99	15 yrs	15	m q s a	Revolving
Suncorp Agri	Business Ln(com/oth sec) - Fixed	Not rated	7.75 and higher	10000.00	99999999.99	15 yrs	5	m q s a	Both
Westpac Agribusiness	Agri Finance Loan-Fixed	Not rated	7.82 to 9.73	250000.00	99999999.99	No max	No max	w f m q s a	Both

Appendix 6

Answers to Questions on Notice

Abacus

Public Hearing 4 March, 2011

Proof Hansard, p. 12

Topic: Representations regarding term 'Authorised Banking Institution'

Mr Lawler—We are not entirely sure. There is a discussion now with APRA about their administration of section 66 of the Banking Act, which is where they protect the terms ‘bank’ and ‘banking’, and ‘credit union’ and ‘building society’. So that discussion is unfolding at the moment. That might shed a bit of light on where the regulator sees what these terms mean to the public and how it thinks they should be used. But at this point we certainly do not have a totally positive response to the suggestion of changing the Banking Act to get rid of ‘ADI’.

Mr ANTHONY SMITH—To the extent that you have made public representations and the rest, would you be able to provide the committee with that?

Mr Lawler—Yes.

From: Luke Lawler [llawler@abacus.org.au]

Sent: Friday, 25 March 2011 4:32 PM

To: Holland, Ian (SEN)

Cc: Edwards, Ruth (SEN)

Subject: RE:

Dear Mr Holland,

I gave an undertaking to provide further information to the committee on our representations proposing a change in the *Banking Act 1959* term "Authorised Deposit-taking Institution" to "Authorised Banking Institution".

Here is a link to a 2 July 2010 submission by Abacus to the Treasurer which was recently publicly released as part of a Freedom of Information request. This document includes our case for the change from "ADI" to "ABI".
http://www.treasury.gov.au/documents/1970/PDF/6_letter_from_ABACUS.pdf

Earlier and subsequent representations on this matter, covering the same ground, were made in our January 2010 Pre Budget submission to Treasury, March 2010 submission to the Productivity Commission, April 2010 submission to the Senate Economics Committee, November 2010 submission to the Senate Economics Committee and January 2011 Pre Budget submission to Treasury.

Yours sincerely,

Luke Lawler
Senior Manager, Public Affairs
Abacus - Australian Mutuals
T: 02 6232 6666
M: 0418 213 025
F: 02 6232 6089
llawler@abacus.org.au

1 Margaret St
Sydney NSW 2000

GPO Box 4720
Sydney NSW 2001

TEL (02) 8299 9000
FAX (02) 8299 9607

Association of Building Societies and Credit Unions

Abacus
Australian Mutuals

2 July 2010

Correspondence Received - Office of the Treasurer
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Treasurer | Contact Advisor - ....
Chief of Staff | Other Adviser - ....
Deputy Chief of Staff | DLOs - ....

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Departmental Action
Acknowledge | Briefing
Substantive Response | Speech
Appropriate Action | Refer to ....
Information | No Further Action
Constituent Response | URGENT
Signatory ....

The Hon Wayne Swan MP
Deputy Prime Minister
Treasurer
Parliament House
CANBERRA 2600

Dear Deputy Prime Minister

We appreciate your ongoing support for the mutual banking sector and our sector's capacity to provide competition and choice in the Australian retail banking market.

Our sector's role has become more important due to the diminution of competition caused by the global financial crisis and exit of non-ADI lenders.

Credit unions and building societies have 4.5 million members, $72 billion in assets, around 9 per cent of the new home loan market and around 11 per cent of the household deposits market.

I seek your support for some measures to enhance our sector's competitive potential by delivering genuine regulatory neutrality among regulated banking institutions.

I understand that the Council of Financial Regulators is currently considering the future of the Financial Claims Scheme (FCS), including transitional arrangements and the appropriate cap for the deposit guarantee.

We propose:

- Maintaining the FCS cap for deposits at $1 million beyond October 2011, and at least until the prudential standing all authorised banking institutions is better understood;
- An effective public awareness campaign about the prudential regulatory framework and the FCS;
- Changing the Banking Act term 'Authorised Deposit-taking Institution' to 'Authorised Banking Institution'; and,
- Allowing all regulated banking institutions unrestricted use of the terms 'bank' and 'banking'.

These proposals are consistent with the *Core Principles for Effective Deposit Insurance Systems.*[1] The principal objectives of the FCS are to contribute to the stability of the financial system and protect deposits but the FCS is also an important factor in promoting competition.

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[1] *Core Principles for Effective Deposit Insurance Systems* Bank for International Settlements & International Association of Deposit Insurers, June 2009

Changes to the language of banking regulation are far from merely cosmetic. Consumer perceptions about security and prudential standing are critical factors in the banking market. The changes we propose increase the capacity of smaller banking institutions to deliver simple, cut-through messages to the market that they are subject to the same regulatory standards as major banks and that their depositors are covered by the FCS.

These changes will help smaller banking institutions to continue to deliver competition and choice and a vibrant, diverse retail banking market.

These changes would also improve APRA's capacity to meet its statutory obligation "to balance the objectives of financial safety and efficiency, *competition, contestability and competitive neutrality*".[2]

The attached submission sets out our proposals in more detail.

Yours sincerely,

LOUISE PETSCHLER
Chief Executive Officer

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[2] *Australian Prudential Regulation Authority Act 1998*, Section 8(2).

PROMOTING COMPETITION AND COMPETITIVE NEUTRALITY IN RETAIL BANKING AND FINANCIAL SYSTEM STABILITY

SUBMISSION BY *ABACUS – AUSTRALIAN MUTUALS*

Retail banking market

A major bank CEO recently described Australia's banking industry as an "oligopoly"[3]. An oligopoly occurs when a particular market is controlled by a small group of firms. The Australian banking market is an oligopoly, where barriers to entry are high[4], and the market is "now, by some criteria, the most concentrated it has been for a century"[5].

Major banks had by late 2009 lifted their net interest margins 20-25 basis points above pre-crisis levels.[6]

More competition is needed to drive down retail banking prices, and to promote innovation and real choice.

As the Treasurer recently noted[7], credit unions and building societies meet the same high standards of prudential regulation as banks, as they are supervised by APRA in the same way.

> "All deposits held with a credit union or building society are backed by the Government's Financial Claims Scheme up to $1 million – just like bank deposits – with this cap being reviewed for all in October 2011. So Australians can have absolute confidence in the safety of their money wherever their deposit is held."

However, there is persistent evidence that major banks continue to benefit from entrenched misconceptions about the regulatory framework and the scope of the FCS.

<u>*Consumer perceptions*</u>
Recent research by Brand Central[8] confirms that major banks are seen as stronger and more reliable than smaller banking institutions.

The survey found that bank customers believe credit unions and building societies behave more responsibly than the major banks, but they are still more likely to take their business to the big four lenders because customers think the major players will be around longer. (This is despite the fact building societies have been around for more than 100 years and credit unions for more than 60 years.)

Consumers can make judgements about security and stability only if they are informed.

A key finding of a June 2009 survey[9] of consumer attitudes about the guarantee of "bank deposits" was that 15 per cent of adults were not aware of the guarantee.

The other key findings of the IFSA survey provided to the Senate Economics Committee into the deposit and wholesale funding guarantees were:

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[3] *Clyne warns of risks in refusing to change* The Australian, 8 April 2010.
[4] Public competition assessment, 'Westpac Banking Corporation – proposed acquisition of St George Bank Limited', ACCC, 13 August 2008
[5] Senate Economics References Committee, Report on Bank Mergers, September 2009
[6] *Recent developments in Banks' Funding Costs and Lending Rates* RBA Bulletin March Quarter 2010
[7] Australian Mutuals Safe and Competitive, 28 Mar 2010
[8] *Stability attracts customers* Australian Financial Review 16 April 2009
[9] *IFSA: The Government's Guarantee on Bank Deposits* Investment Trends, June 2009

- When asked how long the guarantee would last, only 8 per cent stated it would last 2.5 to 3 years, 50 per cent for a shorter duration, 6 per cent thought it would last longer and 18 per cent said they didn't know;

- Only about a quarter (28 per cent) correctly said that the guarantee covers $1 million, 29 per cent thought it covered a smaller amount and 14 per cent a larger amount; and

- 30 per cent say they would feel comfortable investing money in banks with no guarantee after the global financial crisis has passed.

Research by CoreData[10] reported in March 2010 indicated that "mutuals are considered the least secure segment for retail deposits in Australia". The research indicated that only 13.7 per cent of respondents consider deposits held by credit unions and building societies to be 'very secure' while 13.9 per cent considered mutual deposits to be 'somewhat not secure'. In contrast, 49.5 per cent of respondents considered a deposit with a big four bank as 'very secure' and only 4.5 per cent considered deposits with the big four 'somewhat not secure'.

"It's clear from these results that Australians have not understood the deposit guarantee, perceiving safety based on the size and awareness of a banking brand," CoreData said.

According to findings by Sweeney Research[11] for the current national industry promotion campaign for credit unions and building societies, negative associations for credit unions and building societies include the perception that they are not backed by the Federal Government guarantee. Key barriers to switching to a credit union or building society include "many consumers are hesitant to move beyond the security of the Big 4 banks" and "overcoming the perception that credit unions and building societies are not being backed by the Federal Government guarantee."

"Credit unions and building societies are generally better regarded than banks on most of the attitudinal measures included for testing. However, perceptions of accessibility, financial expertise and the security of credit unions and building societies are clearly inferior to banking institutions," according to the Sweeney Research work.

According to a Datamonitor survey[12] of depositors' reasons for choosing their main account provider, depositors rank safety and stability ahead of other factors such as service, location of branches, and recommendations by friends and colleagues.

These findings, consistently appearing across a range of consumer surveys, indicate a clear need to raise public awareness about the prudential regulatory framework and the FCS.

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[10] *Misunderstood Mutuals* Burningpants, CoreData, March 2010 http://www.burning-pants.com/2010/03/misunderstood-mutuals/

[11] *Advertising Concept Testing – Credit union and building society group.* Sweeney Research, October 2009

[12] Datamonitor survey, Market Scan 2010, Abacus, March 2010

Financial Claims Scheme

The guarantee of deposits of up to $1 million under the FCS was a decisive and welcome intervention by the Government in 2008 and remains a pro-competitive measure that has delivered peace of mind to depositors and stability to the core of the financial system.

Public misunderstanding about the institutional scope of the guarantee probably contributed to the slower growth of deposits in credit unions and building societies compared to major banks in the September-November period of 2008. Public nervousness and perceptions of safety and security clearly also played a role in the major banks managing to capture the bulk of funds redirected from higher risk investments over the course of the most unstable period of the global financial crisis.

While credit unions and building societies grew their deposit balances steadily over 2009, the much stronger performance of the major banks has seen the mutual banking sector's market share slip from third place (behind CBA and Westpac) a year ago to fifth place (just behind ANZ and NAB) in December 2009. (See **Appendix A** for more detail on deposit trends.)

Westpac has commented that "in the absence of a guarantee, it is more likely that a greater share of deposit funds would have flowed to larger ADIs (with relatively higher credit ratings) on the basis of the perceived greater security of these funds."[13]

The 'flight to quality' in the deposits market was accompanied by a similar trend in lending. One of the factors behind the 'flight to quality' by borrowers was the performance of "non-bank lenders" – the category of lender financed entirely from wholesale markets – that were unable to lower mortgage rates in line with moves in official rates. Mutual ADIs suffer collateral reputational damage when identified in the "non-bank lender" category by borrowers opting for the perceived security of "banks".

Westpac's chairman Ted Evans commented recently that Westpac's out-of-cycle rate rise in December 2009 was partly because the bank was attracting too many mortgages.[14] Consumers are paying dearly for their misconceptions about the banking market, as indicated by research by InfoChoice.com.au published in the *Sunday Telegraph*: "Assuming a $300,000 home loan, $10,000 in an instant access savings account, a $25,000 car loan and $3,000 on a credit card, a customer with Westpac is $4615 a year worse off than a consumer with the best value products."[15]

Abacus recognises that our own industry needs to work more effectively and co-operatively to increase our market recognition and consumer awareness. That is why credit unions and building societies have embarked on their largest ever industry promotion campaign. However, we are competing against enormous businesses with colossal marketing budgets that benefit from entrenched misconceptions about the prudential regulatory framework. CBA's 2009 advertising budget was estimated to be $65-70 million, Westpac's $55-60 million and ANZ's $45-50 million.[16]

[13] Westpac submission to Senate Inquiry into banking funding guarantees, 13 July 2009

[14] *Rate rises tipped for five years* Australian Financial Review 23 March 2010

[15] *How the banks rank* Sunday Telegraph 7 February 2010

[16] *Plenty of pruning among top 25* Australian Financial Review 29 March 2010

One of the *Core Principles for Effective Deposit Insurance Systems* is that it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system. (See **Appendix B** for comparison of the FCS and the Australian prudential framework with the *Core Principles*.)

Abacus recommends the per-depositor cap for FCS should be maintained at $1 million beyond October 2011, and at least until the prudential standing and competitive offering of non-major banking institutions is better understood. The $1 million per depositor cap, guaranteed by the Government, poses no risk to the taxpayer because:

1. the prudential regulatory framework ensures that it is highly likely that the remaining assets of a failed institution will be sufficient to recover funds paid out under the FCS to depositors; and

2. in the unlikely event of there being a shortfall, banking institutions will be levied to make up the difference.

The FCS reduces the risk of a 'run' on a banking institution by unsophisticated depositors on the basis of often uninformed market rumours. The price of entry to the FCS for the banking institution is an extremely tough prudential regulatory regime. Entities that wish to compete on a level playing field with banking institutions are welcome to submit to the same requirements on capital, liquidity, risk-management, reporting, auditing and governance.

Prudentially-regulated banking institutions also meet the cost of this "first line" of depositor protection because they pay the costs of regulation via ordinary industry levies.

The perception that major banks are too big to fail is an anti-competitive factor in the banking market. This perception has been strengthened as a result of the GFC because, internationally, there have been many real examples of governments bailing out large banks. The FCS levels the playing field for large and small banking institutions and is a pro-competitive factor. Any reduction in the FCS cap from $1 million will benefit the four major banks to the competitive detriment of other regulated banking institutions. Rather than being seen as a risk to the taxpayer, the FCS should be seen for what it is – a no cost reassurance to depositors and an early access facility for depositors' funds in the event of an institution failing.

Importantly for competition in retail banking, the $1m cap is reassuring for larger depositors, e.g. local governments and non-government organisations, that are important sources of funding for smaller banking institutions. APRA and others have noted from recent experience that 'runs' are generally not caused by depositors with very small amounts.[17]

A $1 million cap does not appear excessive when compared to the median house price in Sydney in the March quarter 2010 of $609,300.[18] Average amounts held in deposits are much lower than $1 million but households, i.e. unsophisticated investors, will from time to time have much larger amounts held in regulated banking institutions. The vast majority of these depositors are extremely unlikely to have the skills and capacity to be able to assess and monitor the prudential standing of a financial institution.

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[17] Evidence by APRA executive Keith Chapman, 28 July 2009, and FSI member Ian Harper, 14 August 2009, Senate Economics Committee inquiry into bank funding guarantees.
[18] http://news.domain.com.au/domain/real-estate-news/sydney-still-top-of-the-property-ladder-but-rivals-are-closing-gap-20100429-tu7e.html

Investors with more than $1 million to deposit are more likely to be able to contribute to the market discipline necessary for an effective deposit insurance scheme. Setting the cap at that level, though relatively high by international standards, gives credibility to the limits of the scheme.

Market discipline will also continue to be imposed by other creditors outside the FCS and by shareholders. Excessive risk taking by profit-maximising banking institutions is constrained by a combination of market discipline and prudential regulation. Unlisted mutual banking institutions do not have the same motivation to maximise profits as listed banks, so there is not the same incentive to take excessive risk in our sector. The focus of mutual banking institutions is demonstrated by their market-leading customer satisfaction ratings and their long track record of responsible lending.

A cap lower than $1 million is less likely to be taken seriously as a genuine limit. This is particularly valid in the Australian context because of the long-standing 'implicit' deposit guarantee arrangements that applied until October 2008. The Council of Financial Regulators took the view prior to the global financial crisis that this system, rather than an explicit FCS, was more likely to be subject to moral hazard.[19]

RBA research in 2006 showed that 60 per cent of respondents were of the view that there was a guarantee of deposits or that it was likely (or highly likely) that the Government would step in to ensure either full or partial repayment of the funds in their main deposit account. Only 10 percent were of the opinion that their main deposit account was not guaranteed and that, in the event of a failure, the government was unlikely to step in.[20]

Setting the cap at a credibly high level is important to a successful permanent transition from the pre-existing implicit blanket guarantee.

The RBA's 2006 survey asked respondents to identify the supervisor of banks, building societies and credit unions from a multiple choice list. Only 14 per cent correctly said that APRA was the supervisor, slightly more than the 10 per cent who thought it was the Australian Bankers' Association.

The OECD has observed that effective consumer protection requires that the public properly understand existing arrangements and is aware of the extent of and limits to existing compensation arrangements and that simplicity is valuable in promoting public understanding.[21]

A relatively high cap of $1 million for the FCS is not only stark and simple, it is also a credible limit on the 'early access' dimension of the depositor safety net.

A 2009 Senate Economics Committee report referred to an IMF survey showing average coverage levels in pre-crisis deposit insurance schemes at around one to two times per capita GDP (around $100,000 in the Australian context). However, the IMF noted that this "is only a statistical description of deposit insurance systems and is not meant to be considered as a desired design feature."[22]

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[19] *Financial Stability Review* RBA Sep 2006

[20] *Financial Stability Review* RBA Mar 2006

[21] *Financial Turbulence: Some Lessons Regarding Deposit Insurance* Sebastian Schich OECD 2008

[22] *Government measures to address confidence concerns in the financial sector - The Financial Claims Scheme and the Guarantee Scheme for Large Deposits and Wholesale Funding* Senate Economics Committee Sep 2009

Abacus notes that major banks and non-ADI industry bodies have argued for a lower cap.

Major banks are seeking to preserve the competitive advantage they obtain from depositor misconceptions that they are safer simpler because they bigger than their competitors.

Non-ADI industry bodies have argued that financial products that are "close substitutes" to deposits are disadvantaged by being outside the FCS. However, such products are not direct competitors with deposits if issuers of such products are not subject to prudential supervision and requirements on capital, liquidity, risk-management, reporting, auditing and governance.

Any reduction of the $1 million cap, eg. to $500,000, should be implemented only with safeguards to minimise negative impacts on stability and competition. These would include a transition period with an effective public awareness campaign about the prudential regulatory framework and the scope of the FCS.

Under the *Core Principles for Effective Deposit Insurance Systems,* public awareness of deposit insurance, its existence and how it works (including the level and scope of coverage and how the claims process operates), plays a significant role in underpinning a sound deposit insurance system.

> "All deposit insurers should promote public awareness about the deposit insurance system on an ongoing basis to maintain and strengthen public confidence. The objectives of the public awareness program should be clearly set out and consistent with the public policy objectives and mandate of a deposit insurer. When designing a public awareness program, deposit insurers should clearly define the principal target audience groups and subgroups (eg the general public, depositors, member banks etc). Employing a wide variety of tools and channels of communication can help ensure that the deposit insurers' messages are conveyed to the target audience.
>
> "In general, the deposit insurer should be the primary party responsible for promoting public awareness about deposit insurance and should work closely with member banks and other safety net participants to ensure consistency in the information provided and maximise synergies. All these bodies and their staff have a role to play.
>
> "Budgets for public awareness programs should be determined on the basis of the desired level of visibility and awareness about deposit insurance among the target audience. And, it is an effective practice for a deposit insurer to conduct a regular independent evaluation of awareness levels."

Competition is needed in retail banking to drive efficiency, innovation and productivity but competition depends on effective consumer choice. Informed consumers are empowered and motivated consumers.

The creation of a single licensing regime for banking institutions a decade ago was aimed at promoting competition and choice. It is time for a renewed effort at explaining the prudential regulatory system, including by making some changes to the language of regulation, to achieve a genuine level playing field.

Promoting the prudential regulatory framework

"Authorised Banking Institutions"
All ADIs - credit unions, building societies and banks - are subject to the same strict prudential regulatory regime, with the same set of strict, legally-enforceable prudential standards covering capital, liquidity, risk management and governance.

ADIs are subject to rigorous and close supervision by APRA, which requires the ADI to comply with a range of requirements contained in Prudential Standards and provide comprehensive data to APRA under Reporting Standards. APRA has a range of powers it can exercise should an ADI not comply with any of the requirements imposed by APRA.[23]

"Banking business" is defined in the *Banking Act 1959* as both taking money on deposit (otherwise than as part-payment for identified goods or services) and making advances of money.

This is what all ADIs do.

However, using its powers under s66 of the Banking Act, APRA restricts use of the terms 'bank' and 'banking' to a minority of ADIs. ADIs that have at least $50 million in Tier 1 capital can apply to call themselves banks.[24]

The $50 million hurdle has been in place since 1992 and was seen by the RBA, APRA's predecessor as banking prudential regulator, as a "means of discouraging unsuitable shareholders from attempting to gain a banking authority."[25] The RBA's 1996 submission to the Financial System Inquiry (FSI) said that in "a world where financial institutions of doubtful pedigree are always scouting for opportunities, the minimum capital requirement for a bank is an excellent screening device."

The RBA at that time also took the view that to "provide the relatively broad range of services expected of banks requires sufficient capital to acquire the necessary expertise and technology, and to generate the required degree of confidence."

The FSI's final report in 1997 adopted the position that a "continuing distinction between banks and other DTIs remains relevant in an international setting and in distinguishing those entities large enough to maintain an exchange settlement account with the RBA from other, smaller DTIs."[26]The FSI said "authority to use the word 'bank' in its brand should be reserved for licensed DTIs which meet two additional conditions: satisfy a minimum capital requirement as prescribed by the [APRA] from time to time (the Committee suggests retention of the current $50 million): and, have an exchange settlement account with the RBA."

Abacus argues that in 2010 the continuing restrictions around the term 'bank' and 'banking' that exclude the majority of regulated banking institutions have long outlived their original rationale. Allowing only a minority of regulated banking institutions free use of the terms 'bank' and 'banking' is unjustified and anti-competitive.

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[23] *How to apply for ADI authority* APRA website http://www.apra.gov.au/ADI/ADI-authorisation-applications.cfm
[24] *ADI authorisation guidelines* APRA website http://www.apra.gov.au/ADI/upload/ADI-Guidelines-11-4-08.pdf
[25] RBA submission to Financial System (Wallis) Inquiry, 1996
[26] Financial System Inquiry Final Report March 1997 (Wallis Report).

The original distinction between 'banks' and other deposit-taking institutions, based on an arbitrary level of capital and a vague concept that a 'relatively broad range of services [is] expected of banks', was never well-founded and is now clearly anachronistic.

The RBA's successor as prudential regulator, APRA, has a much wider and stronger array of powers to screen out "doubtful" and "unsuitable" applicants for a banking licence. These include prudential standards on governance and 'fit and proper' requirements for directors and senior managers. APRA's powers have been strengthened and extended since it was established in 1999 and will be further enhanced under measures proposed in the Financial Sector Legislation Amendment (Prudential Refinements and Other Measures) Bill 2010.

With regard to exchange settlement accounts (ESAs), smaller banking institutions, such as credit unions and building societies, do not need to hold an ESA with the RBA because they can access settlement services and the payments system through providers such as Cuscal, Indue and ASL. However, a number of Abacus member banking institutions have exercised their option to become ESA holders.[27]

Credit unions and mutual building societies, as customer-owned institutions, obviously value their distinct identity from banks but the reality is the terms "bank" and "banking" are well understood in the community. The term "ADI" is not well understood a decade after it entered the statute books. The term is barely used even in Government publications:

- the Report on Australia's Future Tax System released on 2 May 2010 recommends a tax cut for interest income but refers to "*bank* accounts" and "*bank* deposits";[28] and
- ASIC's June 2010 updated regulatory guide on advertising of debentures and unsecured notes refers throughout to *"bank deposits"*[29].

ADIs that do not have the option of marketing themselves as "banks" are at a competitive disadvantage. They must comply with an intrusive, constantly-evolving, burdensome regulatory regime to engage in the business of banking but they are denied the full competitive benefit of achieving compliance.

A simple step to improving market awareness of the prudential standing of all regulated banking institutions - and therefore contestability, competition and choice – would be to replace the term "Authorised Deposit-taking Institution" with "Authorised Banking Institution".

<u>"Mutual Banks"</u>

There are 27 mutual ADIs that have at least $50 million in Tier 1 capital (though as far as Abacus is aware, none have to date opted to apply to call themselves a "bank"). The majority of mutual ADIs are currently ineligible, due to APRA policy, to apply to use the term "bank". Credit unions and building societies have APRA's express consent to use the term "banking". They may use the term "banking" in relation to "the banking activities of the building society or credit union if the word is not used in a misleading or deceptive way."[30]

However, new uncertainty about the scope of this consent was raised last year when APRA indicated to one Abacus member ADI that a complaint had been lodged about the

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[27] Greater Building Society, Heritage Building Society, IMB Ltd, Police Department Employees Credit Union.
[28] Australia's Future Tax System, Report to theTreasurer, Part One, Overview, December 2009
[29] ASIC Regulatory Guide 156
[30] Guidelines – Implementation of Section 66 of the Banking Act 1959. APRA January 2006. http://www.apra.gov.au/ADI/upload/Guidelines-Implementation-of-Section-66-of-the-Banking-Act-1959.pdf

ADI's use of the word "banking" in its marketing material and that the ADI could be in breach of section 66.

APRA should allow all ADIs the non-compulsory option of marketing themselves as "banks". This would enable Abacus members to exercise the option of marketing themselves as "mutual banks" to the market generally or to market segments where the terms "credit union" or "building society" are less effective.

These changes to the Banking Act and APRA's approach would give mutual banking institutions greater capacity to cut through misconceptions that they are not as safe as listed banks and that they are not covered by the FCS.

It is unlikely that all mutual banking institutions will embrace the term "mutual bank". Abacus members with very strong brand strength in their regional areas and other market niches have no need or desire to use the term bank in their core markets.

The objective of the change is to enable all regulated banking institutions, whether listed or customer-owned, to effectively promote their status as prudentially-regulated entities covered by the FCS.

Genuine regulatory neutrality does not mean any loss of diversity in the banking market. The key distinguishing factor of mutual banking institutions is their strong customer focus, as demonstrated by their consistent market-leading performance in customer satisfaction surveys.

Prior to 1998, building societies seeking to become "banks" were required to demutualise. Most building societies that converted to banks in the 1980s and 90s have since merged with other banks and disappeared completely or continue to exist only as part of a major bank's brand strategy. These include St George Bank, Advance Bank, Challenge Bank, Bank of Melbourne, Tasmania Bank, Metway Bank, and Adelaide Bank.

The Productivity Commission's June 2010 Draft Report on regulatory burdens on business and consumer services discusses this issue in a section entitled 'Bank – what's in a name.'

> "Historically banks in Australia have usually been larger businesses than building societies or credit unions and might, therefore, be thought to offer a greater level of security and a wider range of services. But that is not always the case. The largest building societies and credit unions (such as Credit Union Australia, Heritage Building Society, Newcastle Permanent Building Society and IMB) are larger than, or of similar size to, the smallest Australian owned banks (Members Equity Bank and AMP Bank).
>
> "It would seem, *prima facie*, that there is little beyond the name 'bank' to distinguish some credit unions and building societies from banks. It would be useful to remove any unnecessary restrictions which limit the ability of building societies and credit unions to compete with banks on a level playing field. The current restrictions on the use of terms such as 'bank' by other ADIs could be reconsidered."

Conclusion

The FCS is generally consistent with the Core Principles for Effective Deposit Insurance Systems, though there is a need for a public awareness campaign in line with Principle 12.

The FCS cap for deposits should be retained at the credible, stark and easily understood level of $1 million to promote stability and mitigate moral hazard.

Retaining the cap at $1 million is also pro-competitive because it helps level the playing field for smaller banking institutions and new entrants.

The dominant position of the major banks in Australia's highly concentrated banking market has become even more entrenched due to the global financial crisis.

Abacus acknowledges the critically important role of the now-closed *Guarantee Scheme for Large Deposits and Wholesale Funding* in ensuring the flow of credit in the Australian economy during the global financial crisis.

However, the scheme's unfair fee structure meant that the scheme disproportionately benefited the major banks. The fee for major banks was 70 basis points compared to 150 basis points for the vast majority of regulated banking institutions. The RBA has confirmed that the differential in the fee structure was "relatively large by international standards" and that the fee paid by the major banks was "at the low end of the international range."[31]

Fees flowing to the Government from the scheme are estimated to total $5.5 billion. As argued in previous submissions by Abacus, diverting a small fraction of this windfall revenue to a pro-competitive public awareness campaign about the prudential regulatory framework and the FCS would help level the playing field in banking.

Louise Petschler, CEO, 02 8299 9036
Mark Degotardi, Head of Public Affairs, 02 8299 9053
Luke Lawler, Senior Adviser – Policy & Public Affairs, 02 6232 6666

2 July 2010

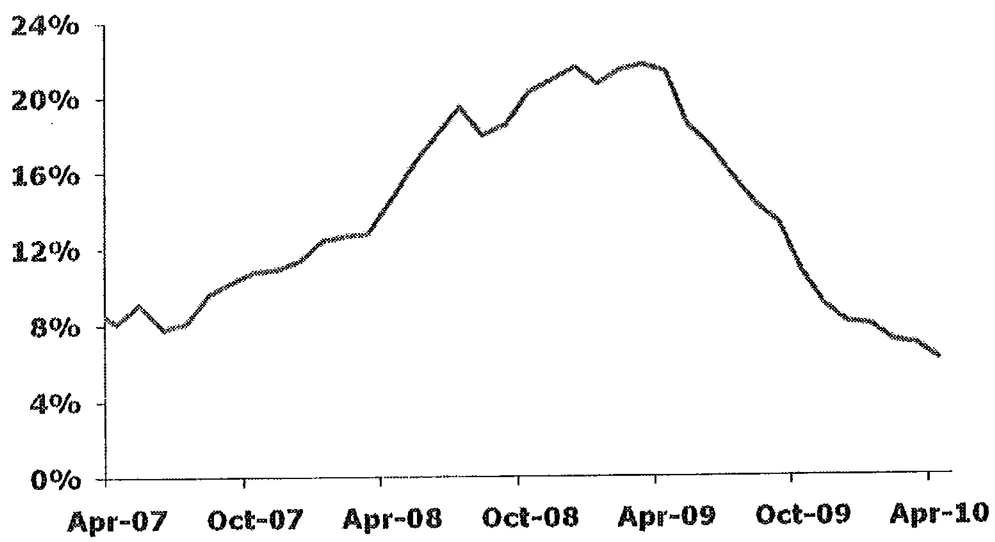
[31] RBA Bulletin, March Quarter 2010

APPENDIX A

Deposit market trends

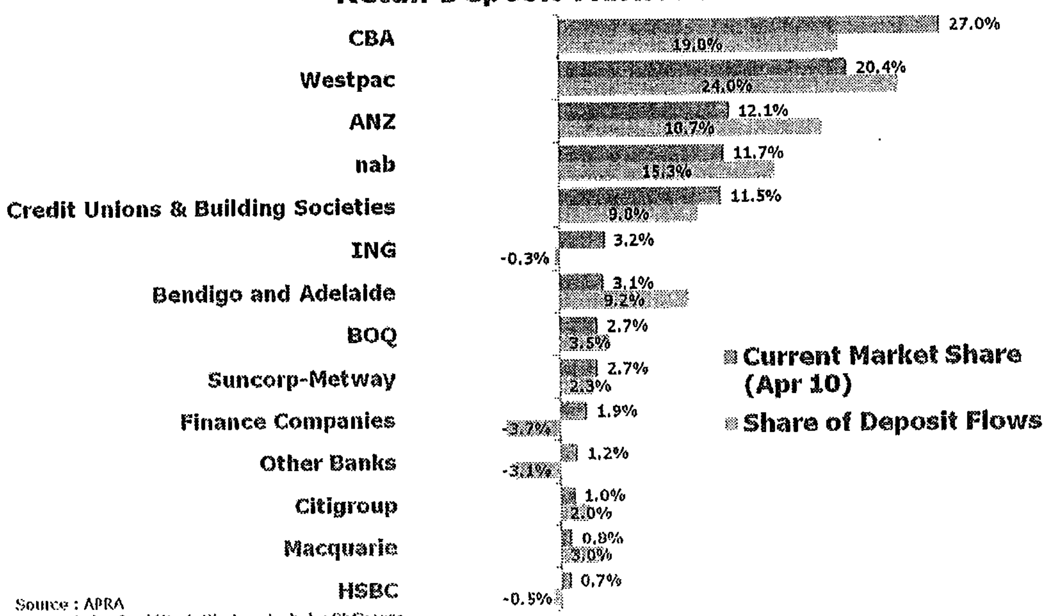
A flight to safety was already evident in the lead up to the announcement of the deposit guarantee. Growth rates of 20% pa continued through 2009 and have sharply fallen back to normal levels.

Overall Growth in Household Deposits



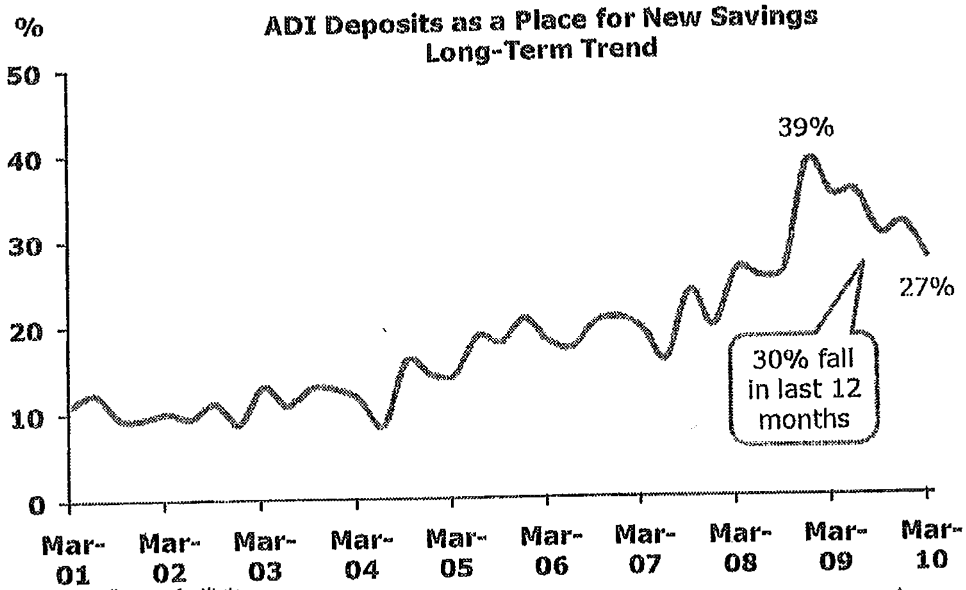
All major banks except CBA attracted deposits in excess of their market share. Credit unions and building societies have grown at close to the rate expected by reference to their market share.

Retail Deposit Market Trends



Source : APRA
CBA includes BankWest; Westpac includes St George
Deposit flows are for the period Sep 08 to Apr 2010

Consumers have more recently re-appraised their risk profiles and are again looking at other asset classes, despite abnormally high deposit rates.



Source: Melbourne Institute

Credit unions and building societies in aggregate have expanded their deposit portfolios by 13% from September 2008, before the deposit guarantee was announced, to the present. The retail deposit market has grown by 16% over the same period, so market share of credit unions and building societies has fallen from 11.6% to 11.4% as a consequence. This below system growth indicates that, at industry level, credit unions and building societies have managed their liquidity and funding risks by building deposits, but have not done better than the market overall as would have been the case if outlier high interest rates had been on offer.

Further evidence that this growth has been achieved in the context of sensible risk management principles lies in trends for interest expense. Over the period that deposit balances rose by 13%, total interest expense fell by 24% between September 2008 and March 2010 as official and market rates were reduced significantly.

Paragraph 47 (1) (b)
(commericially valuable information)

Paragraph 47(1)(b)
(commercially valuable information)

Conclusions

The deposit market grew at unprecedented rates through the GFC, leading up to and after the deposit guarantee was announced. This growth has now returned to normal levels.

Major banks were the real winners in this environment, with most extending their market shares. If moral hazard of having the guarantee was in evidence, a broader spread of deposit takers would have been using price to build deposits.

Credit unions and building societies have benefited from these deposit market dynamics, adding over $7.5bn in balances or an increase of 13%. While credit unions and building societies have a strong reputation for offering better rates to members compared with banks, these are offered in the context of prudential approaches to liquidity, funding and financial performance risk.

Confidential data held by Abacus shows credit unions have seen growth across a range of different sized deposits with only a slight change in the mix across the portfolio when comparing pre and post retail deposit guarantee data.

Close to 90% of all deposits held by credit unions are under $1m.

APPENDIX B

Core Principles for Effective Deposit Insurance Systems
Bank for International Settlements
International Association of Deposit Insurers

1. Public policy objectives: the first step in adopting a deposit insurance system or reforming an existing system is to specify appropriate public policy objectives that it is expected to achieve. These objectives should be formally specified and well integrated into the design of the deposit insurance system. The principal objectives for deposit insurance systems are to contribute to the stability of the financial system and protect depositors.	FCS legislation second reading speech: ensure confidence in Australian financial institutions is maintained; in the event an institution fails, will provide deposits in ADIs with timely access to their funds
2. Mitigating moral hazard: Moral hazard should be mitigated by ensuring that the deposit insurance system contains appropriate design features and through other elements of the financial system safety net.	Limited to ADI deposits of up to $1m. Large depositors, i.e. more than $1m, outside FCS have incentive to impose market discipline on ADIs, along with other creditors and shareholders who are also outside the FCS. Relatively high cap, i.e. $1m, is credible, so large depositors are convinced the FCS is limited. Setting the cap at a credibly high level is important to a successful permanent transition from the pre-existing implicit blanket guarantee. Strong prudential regulatory framework, regularly strengthened and enhanced (APRA, Treasury) Strong financial stability regulator and central banker (RBA) Strong corporate regulatory and disclosure framework (ASIC, ASX) Unlisted mutual banking institutions are not motivated to take excessive risks to generate excessive returns.
3. Mandate: It is critical that the mandate selected for a deposit insurer be clear and formally specified and that there be consistency between the stated public policy objectives and the powers and responsibilities given to the deposit insurer.	APRA is scheme administrator; APRA has strong prudential regulation and crisis management powers and specific powers to administer the FCS

4. Powers: A deposit insurer should have all the powers necessary to fulfil its mandate and these powers should be formally specified. All deposit insurers require the power to finance reimbursements, enter into contracts, set internal operating budgets and procedures, and access timely and accurate information to ensure that they can meet their obligations.	APRA is scheme administrator; APRA has strong prudential regulation and crisis management powers and specific powers to administer the FCS
5. Governance: The deposit insurer should be operationally independent, transparent, accountable and insulated from undue political and industry influence.	APRA is an operational independent statutory authority with 3-member executive group responsible for determining APRA's goals, priorities and strategies.
6. Relationship with other safety-net participants: A framework should be in place for the close coordination and information sharing, on a routine basis as well as in relation to particular banks, among the deposit insurer and other financial system safety net participants. Such information should be accurate and timely (subject to confidentiality when required). Information sharing and co-ordination arrangements should be formalised.	APRA has formalised frameworks in place with other safety net participants - RBA, ASIC and Treasury – including as members of the Council of Financial Regulators
7. Cross-border issues: Provided confidentiality is ensured, all relevant information should be exchanged between deposit insurers in different jurisdictions and possibly between deposit insurers and other foreign safety-net participants when appropriate. In circumstances where more than one deposit insurer will be responsible for coverage, it is important to determine which deposit insurer or insurers will be responsible for the reimbursement process. The deposit insurance already provided by the home country system should be recognised in the determination of levies and premiums.	APRA is a member of the International Association of Deposit Insurers. APRA is active internationally and has memoranda of understanding with many of its counterpart prudential regulators.

8. Compulsory membership: Membership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (eg. retail and small business depositors) to avoid adverse selection.	All ADIs are 'members' of FCS
9. Coverage: Policymakers should define clearly in law, prudential regulations or by-laws what an insurable deposit is. The level of coverage should be limited but credible and be capable of being quickly determined. It should cover adequately the large majority of depositors to meet the public policy objectives of the system and be internally consistent with other deposit insurance system design features.	The FCS applies to ADI deposits of up to $1 million on a per-account holder, per-ADI basis. Protected deposits are defined in the Banking Act and regulations
10. Transitioning from blanket guarantee to a limited coverage deposit insurance system: When a country decides to transition from a blanket guarantee to a limited coverage deposit insurance system, or to change a given blanket guarantee, the transition should be as rapid as a country's circumstances permit. Blanket guarantees can have a number of adverse effects if retained too long, notably an increase in moral hazard. Policymakers should pay particular attention to public attitudes and expectations during the transition period.	Transition was achieved in less than two weeks; 12 Oct 2008 announcement of guarantee of all deposits; 24 Oct 2008 announcement fee-free guarantee applies only to deposits up to $1 million from 28 Nov 2010; 7 Feb 2010 announcement of closure of large deposits and wholesale funding guarantee from 31 Mar 2010.

11. Funding: A deposit insurance system should have available all funding mechanisms necessary to ensure the prompt reimbursement of depositors' claims including a means of obtaining supplementary back-up funding for liquidity purposes when required. Primary responsibility for paying the cost of deposit insurance should be borne by banks since they and their clients directly benefit from having an effective deposit insurance system. For deposit insurance systems (whether ex-ante, ex-post or hybrid) utilising risk adjusted differential premium systems, the criteria used in the risk-adjusted differential premium system should be transparent to all participants. As well, all necessary resources should be in place to administer the risk-adjusted differential premium system appropriately.	APRA is funded by industry levies on ADIs and other supervised entities. As part of the FCS arrangements, the Government has made a standing appropriation for funds to be available for FCS purposes. From October 2011, the appropriation is for a maximum amount of $20 billion for payouts to account-holders at any one time and $100 million for expenses relating to the administration of the FCS. The former amount would be used to pay account-holders in the first instance, with this amount to be repaid to the Government from the liquidation of the ADI. Payments made under the FCS are covered by the depositor preference provisions in the Banking Act, such that the assets in Australia of the ADI in winding up must first be applied to repay amounts paid under the FCS. If the assets of the ADI are insufficient to meet the amounts paid under the FCS (including expenses incurred in administering the FCS), an industry levy may be imposed to cover any shortfall.
12. Public awareness: In order for a deposit insurance system to be effective it is essential that the public be informed on an ongoing basis about the benefits and limitations of the depositor insurance system.	As argued in this submission, there is strong case for action on this principle.
13. Legal protection: The deposit insurer and individuals working for the deposit insurer should be protected against lawsuits for their decisions and actions taken in "good faith" while discharging their mandates. However, individuals must be required to follow appropriate conflict-of-interest rules and codes of conduct to ensure they remain accountable. Legal protection should be defined in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified.	APRA is scheme administrator; APRA has strong prudential regulation and crisis management powers and specific powers to administer the FCS

14. Dealing with parties at fault in a bank failure: A deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in a bank failure.	APRA is scheme administrator; APRA has strong prudential regulation and crisis management powers and specific powers to administer the FCS
15. Early detection and timely intervention and resolution: The deposit insurer should be part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks. The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well defined criteria by safety-net participants with the operational independence and power to act.	APRA is scheme administrator; APRA has strong prudential regulation and crisis management powers and specific powers to administer the FCS
16. Effective resolution processes: Effective failure-resolution processes should: facilitate the ability of the deposit insurer to meet its obligations including reimbursement of depositors promptly and accurately and on an equitable basis; minimise resolution costs and disruption of markets; maximise recoveries on assets; and, reinforce discipline through legal actions in cases of negligence or other wrongdoings. In addition, the deposit insurer or other relevant financial system safety-net participant should have the authority to establish a flexible mechanism to help preserve critical banking functions by facilitating the acquisition by an appropriate body of the assets and the assumption of the liabilities of a failed bank (eg. providing depositors with continuous access to their funds and maintaining clearing and settlement activities).	APRA is scheme administrator; APRA has strong prudential regulation and crisis management powers and specific powers to administer the FCS. APRA works closely with the RBA. RBA has responsibility for stability of financial system.

17. Reimbursing depositors: The deposit insurance system should give depositors prompt access to their insured funds. Therefore, the deposit insurer should be notified or informed sufficiently in advance of the conditions under which a reimbursement may be required and be provided with access to depositor information in advance. Depositors should have a legal right to reimbursement up to the coverage limit and should know when and under what conditions the deposit insurer will start the payment process, the time frame over which payments will take place, whether any advance or interim payments will be made as well as the applicable coverage limits.	APRA is scheme administrator; APRA has strong prudential regulation and crisis management powers and specific powers to administer the FCS. APRA's intention is to provide accountholders with access to their deposits up to the FCS limit as soon as possible following the declaration of the FCS.
18. Recoveries: The deposit insurer should share in the proceeds of recoveries from the estate of the failed bank. The management of the assets of the failed bank and the recovery process (by the deposit insurer or other party carrying out this role) should be guided by commercial considerations and their economic merits.	APRA is scheme administrator; APRA has strong prudential regulation and crisis management powers and specific powers to administer the FCS

NSW Business Chamber

Public Hearing 4 March, 2011

Question 1 – Proof Hansard, p. 31

Topic: Effectiveness of Small Business Loan Guarantees in other countries

Mr Green—Yes, in response to the GFC. I am not sure exactly what the overall perception is, but certainly our communication with fellow chambers in the US and the UK has indicated that, as far as they are concerned, the view of their members is that these arrangements have been helpful in assisting the securing of funds.

Senator STEPHENS—It would be helpful if you were able to put your hands on some sort of evaluation or reporting on the impact and effectiveness of those arrangements. That would be helpful.

Mr Green—We can certainly take that on notice.

Question 2 – Proof Hansard, p. 31

Topic: Victoria University Survey

Senator STEPHENS—You mentioned the Victoria University survey?

Mr Orton—Yes.

Senator STEPHENS—It would be helpful if you could provide the questions in that survey. They would be quite interesting.

Mr Green—I will have to get back to you on that. I certainly should be able to track that down...

Question 3 – Proof Hansard, p. 32

Topic: Reasons why small businesses choose not to apply for finance

CHAIRMAN—Do you know of any cases where businesses have decided not to reapply for funds or not to apply for further funds they need through fear of being reassessed and re-evaluated and having all their assets revalued?

Mr Orton—Certainly one of the responses from the Victoria Uni survey is that quite a large number have had applications rejected. I am not sure whether we obtained data on applications not made in anticipation of being unsuccessful.

Mr Green—We did get a number of respondents indicating that they were not looking at the moment because they thought they would be unsuccessful and that it is too hard. But I do not have specific case studies illustrating that point—the fear that they will turn up and the bank will then show attention to them and tighten their criteria.

CHAIRMAN—I would be interested if you could go back to your membership during this inquiry and report back to us as soon as you could—

Mr Orton—Yes.

CHAIRMAN—on that issue, but also on whether there are any instances of businesses that have actually gone to their bank, looking either to adjust their finance or to refinance, and found that, through doing that, they have damaged their business—whether they found that their assets had been revalued lower and that that has caused them hardship. If you have an example now and you could tell us a little bit about it, that would be great. If not, we are certainly keen to hear from you.

Mr Orton—We will come back to you, yes.

31 March 2011

Dr Ian Holland
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

RE: Access for Small and Medium Business to Finance – Questions on Notice

Thank you for providing the NSW Business Chamber with the opportunity to appear before the Parliamentary Joint Committee on Corporations and Financial Services as witnesses in the access to finance hearing on 4 March.

Over the course of the hearing, we took several questions on notice, and committed to provide the Senators with responses to these questions in a timely fashion.

Q1/ Do we have any information that would assist in evaluating the effectiveness of small business loan guarantees in other countries?

The British Government has completed several reviews of its small business loan guarantee (previously called the *Small Firms Loan Guarantee Scheme* and now titled the *Enterprise Finance Guarantee*).

These reviews have consistently found that there is a real need for a scheme of this kind to exist, and that it has been effective in supporting lending to small businesses. In January 2010, the Institute of Employment Studies completed an economic evaluation of the Small Firms Loan Guarantee Scheme (the SFLG) on behalf of the Department of Business Innovation and Skills.[1] This review found that:

- *"The rationale for SFLG is still valid. There remains a need for supporting viable small businesses with a lack of security and/or track record."*
- *"The scheme is well targeted with high levels of self-reported additionality."*
- *"A conservative cost benefit analysis of SFLG covering the first two years benefits of loans obtained in 2006 show the overall benefits outweigh the cost to the economy in terms of GVA."*
- *"There are other economic benefits attributable to SFLG supported lending, particularly in terms of sales growth, exports and jobs. The scheme appears to be a particularly cost effective way of creating additional employment. Further benefits may also accrue in the future as supported businesses appear to be more orientated towards growth, and many are seeking to develop new products and services."*

[1] Institute for Employment Studies, *Economic Evaluation of the SFLG Scheme*, January 2010.

In February 2011, the UK House of Commons Business Innovation and Skills Committee completed a report into Government Assistance to Industry.[2] Among other things, this report considered the effectiveness of the Enterprise Finance Guarantee Scheme (the EFGS). The report found that:

> *"It is clear that the Enterprise Finance Guarantee Scheme represents a positive intervention by the Department and that in general it is now running efficiently. We note that there were significant problems when it was launched but accept that, to some extent, these were caused by the need to bring the Scheme to market before it was fully ready. We welcome the Government's commitment to the Scheme and the extension to its lifespan..."*

We note that Treasury's submission to the Joint Committee expressed a number of concerns about the merits of a guarantee scheme. We address these concerns below:

Treasury suggests that the UK schemes were not effective because business credit fell in the UK following the crisis. We believe that this is a flawed assessment, as the global financial crisis had a dramatic impact on all developed economies, and the level of lending to small businesses would have declined irrespective of the level of support provided by Government. We would contend that the decline in business lending would have been more significant had the guarantee not been available, and that it was effective in cushioning the decline in business lending.

Treasury then puts forward four reasons why loan guarantees are not effective:

1. *They do not address reductions in demand for small business finance.* NSW Business Chamber agrees with this proposition, but do not believe that this demonstrates that small business guarantees are poor policy. Guarantees do not target the demand side, but they are effective in improving the supply of finance to small businesses. Business surveys continue to indicate that small businesses that wish to access finance are unable to do so – this is a supply side issue which could be addressed by a guarantee.

2. *They do not stimulate demand in the economy.* Again, NSW Business Chamber agrees with this statement, but do not believe this in any way undermines the merits of a guarantee. The purpose of the guarantee is to help address the shortfall in the supply of finance, which small businesses need to meet the existing level of demand in the economy.

3. *They can lead to adverse selection.* We would agree that a poorly designed guarantee scheme could result in adverse selection and an excessive level of risk being transferred onto the Government's balance sheet. Our proposed model (detailed in our submission) suggests two separate mechanisms that could be used to ensure that banks still have "skin in the game." This would ensure that

[2] UK House of Commons, Business Innovation and Skills Committee, *Government Assistance to Industry – Third Report of Session 2010-11*, February 2011, p. 26.

appropriate risk assessments are still completed before loans are approved, and that finance does not flow to businesses with no capacity to make repayments.

4. *They can crowd out private providers.* Under our proposed model, the private sector would be responsible for assessing eligibility for the loan guarantee. Under this model there could not be any crowding out of the private sector, as the Government would not be providing any loan products. In addition, all indications are that there is currently insufficient supply to meet demand – it is hard to see how any crowding out could occur in such an environment.

In summary, we maintain that a carefully developed Government guarantee of small business loans can be an effective temporary tool to help support lending until greater levels of competition have returned to the Australian banking sector.

Q2/ Can we provide the Committee with the full set of questions raised by the Victoria University survey regarding access to finance?

The complete set of survey questions has been attached along with this letter.

If any findings regarding specific questions are of particular interest to Committee members, Victoria University has indicated that it may have the capacity to provide some of these findings to the Committee to assist them with their inquiry.

Q3/ Can we provide further information regarding the reasons why small businesses choose not to apply for finance?

Victoria Unversity's access to finance survey asked respondents whether they had sought external finance in the last two years to fund business expansion. In response to this question, 18.7 per cent of small businesses indicated that they had not sought finance because they did not believe their application would be successful.

Respondents were invited to set out why they felt an application for finance would be unsucessful. Many stated that banks had tightened their lending criteria, that it was too hard to get finance following the global financial crisis, and that they would not have enough collateral to secure funds.

Others noted that banks were being more selective, and that it was harder to satify banks that they had a strong trading record. For example, one respondent stated that *"even though our business has grown every year over 25 years, the bank is not willing to invest in a proven small business."*

For many small businesses, they believed that the likelihood of success was so low that they felt their time was better spent in other areas. One respondent noted that *"lenders have tightened to a point where a preferred position is to forge ahead rather than continue to waste energy that would likely prove to be fruitless."*

The following comment summarised one small business's frustration with the overall system:

> *"In the past we have provided company tax returns etc for the last 2 years or so in order to get finance. Even when this is done there seems to be other hidden rules and criteria that keep comming out of nowhere in order to progress the application. Then it all becomes too hard and the guarantees too large to continue."*

Overall, the strong anecdotal evidence was that many small businesses had stuggled to get finance following the global financial crisis, and their belief that lending conditions had not improved meant they were no longer looking for funds.

Should you require further information or clarification on any of these matters, then please do not hesitate to contact Mr Micah Green, Economist on (02) 9458 7259 or via e-mail at micah.green@nswbc.com.au.

Yours sincerely,

Paul Orton
Director, Policy and Advocacy

Dear business owner or manager,

Welcome to the Survey of Business Finance in South Australia being carried out by Business SA (link) and the Centre for Strategic Economic Studies (Victoria University).

This survey requests the opinion of firm owners and managers about the difficulties they face as they seek to grow their firms. In particular, we are interested to hear about your firm's ability to access external credit.

Your participation will contribute to a better understanding of the obstacles facing South Australian firms, which will inform policy recommendations. The survey will take between 5-15 minutes, depending on your responses. You can withdraw from the survey at anytime and choose not to respond to certain questions. At the completion of the survey, you can request that the results of the study be emailed to you when they are published. Those who complete the survey can enter the draw for an Apple iPod Classic (160GB) .

Please note that none of the information collected will be used for commercial purposes or shared with outside institutions. All data will be stored securely on premises at the Centre for Strategic Economic Studies, Victoria University. The privacy of participants is protected by the Privacy Act and Victoria University's Research Ethics guidelines, which follows the national framework . When the research is complete, only aggregate statistics will be published so that confidentiality is protected. If you have any queries please contact Dr. Andrew van Hulten, the lead investigator for this research, via email. If you have any concerns or complaints about the way you have been treated, you may contact the Ethics and Biosafety Coordinator, Victoria University Human Research Ethics Committee, Victoria University, PO Box 14428, Melbourne, VIC, 8001 phone (03) 9919 4148.

Do you consent to participate in this research? (please tick box)

Yes
No

What is the legal status of this firm?

Sole proprietorship (Sole Trader)
Partnership
Incorporated company (e.g. PTY LTD)
Publicly-listed company
Other (please specify)

What industry is your firm engaged in? (e.g. manufacturing, financial services)

Entered manually and coded

Firm size

- How many people does this firm employ?
- What is the firm's approximate annual revenue?

Accounting and auditing

- Does your firm employ a professional accountant?
- Does an external auditor review to prepare firm's financial accounts?
- Does your firm have a formal business plan?

What best describes the debt level of the firm?

Has no debt

Has low levels of debt
Has moderate levels of debt
Has high levels of debt
Is close to insolvency
Do not know
Prefer not to say

Does the firm need access to external finance in order to survive in the next 12 months?

Ownership characteristics

- Is this a family-owned business?
- Does this firm operate as a franchise?
- What percentage of this firm is foreign-owned?

Importing and exporting

- Does this firm specialise in importing goods and services?
- Does this firm sell goods or services inter-state within Australia?
- What percentage of total firm revenue comes from exports overseas?

Business characteristics

- How many business premises does this firm operate?(including international subsidiaries)
- Is this firm home-based? (i.e. operate from a personal residence)
- How old is the firm?

Which best describes your position?

I am an owner-manager responsible for investment and borrowing decisions (including partners and part-owners)
I am a manager involved in investment and borrowing decisions
I am filling this survey out on behalf of an owner-manager
I am filling this survey out on behalf of a firm manager
Other (please specify)

Owner/Manager characteristics.

- Were you born in Australia?
- Did you arrive in Australia to live in the last 10 years?
- Is English your second language?
- Gender?
- Age?
- How many years experience do you have as a business *manager*?
- How many years experience do you have as a business *owner*?
- What is the highest level of formal education that you have completed?
- Do you have a formal qualification related to business management (e.g. management, accounting, finance)?
- Have you used your personal assets (e.g. family home) as collateral to get a business loan for this firm? *(Owner-managers only)*
- Do you own your own home? *(Owner-managers only)*
- Have you ever declared bankruptcy? *(Owner-managers only)*

Does your firm have a line of credit (or overdraft facility) with a financial institution?

Credit history of the firm

- Has the firm been late to make debt repayments in the last 5 years?
- Has the firm renegotiated debt repayments in the last five years?
- Does the firm have a debt with the Australian Taxation Office?

Over the last 2 years, did this firm pass up attractive business opportunities because it could not access external finance? (Tick ALL boxes that apply)

No
Yes, because attempts to access external finance were unsuccessful.
Yes, because credit was not available in sufficient quantities
Yes, because credit/finance was too expensive (e.g.interest rates were too high)
Yes, because lender conditions were too strict (e.g. collateral requirements).

Innovation

Please indicate your level of agreement with the following statements.
Strongly/Moderately Agree/Disagree

- The firm must constantly invest in high-tech equipment and new processes to remain competitive.
- The firm must invest heavily in research and development or intellectual property to grow.

What factors are obstacles to the GROWTH of this firm?

No obstacle
Minor obstacle
Moderate obstacle
Major obstacle

- Transport and communication costs Inadequate infrastructure (roads, rail, utilities)
- Inadequate access to finance
- Recruiting and retaining skilled labour
- Recruiting and retaining low cost labour
- Labour market regulations
- Reliable supplies of inputs and products
- Foreign competition
- The exchange rate
- Other MAJOR firm obstacle not listed above (please specify).

Which best describes the priority given to growing this firm?

The firm wants to scale-back operations
Firm growth is not a priority
Firm growth is a minor priority
Firm growth is an important priority
Firm growth is the most important priority

Importance of access to finance

- Access to external finance is ESSENTIAL if this firm is to achieve its long-term goals.
  Strongly/Moderately Agree/Disagree

Credit history of the firm

- Has the firm been late to make debt repayments in the last 5 years?
- Has the firm renegotiated debt repayments in the last five years?
- Does the firm have a debt with the Australian Taxation Office?

Over the last 2 years, did this firm pass up attractive business opportunities because it could not access external finance? (Tick ALL boxes that apply)

No
Yes, because attempts to access external finance were unsuccessful.
Yes, because credit was not available in sufficient quantities
Yes, because credit/finance was too expensive (e.g.interest rates were too high)
Yes, because lender conditions were too strict (e.g. collateral requirements).

Innovation

Please indicate your level of agreement with the following statements.
Strongly/Moderately Agree/Disagree

- The firm must constantly invest in high-tech equipment and new processes to remain competitive.
- The firm must invest heavily in research and development or intellectual property to grow.

What factors are obstacles to the GROWTH of this firm?

No obstacle
Minor obstacle
Moderate obstacle
Major obstacle

- Transport and communication costs Inadequate infrastructure (roads, rail, utilities)
- Inadequate access to finance
- Recruiting and retaining skilled labour
- Recruiting and retaining low cost labour
- Labour market regulations
- Reliable supplies of inputs and products
- Foreign competition
- The exchange rate
- Other MAJOR firm obstacle not listed above (please specify).

Which best describes the priority given to growing this firm?

The firm wants to scale-back operations
Firm growth is not a priority
Firm growth is a minor priority
Firm growth is an important priority
Firm growth is the most important priority

Importance of access to finance

- Access to external finance is ESSENTIAL if this firm is to achieve its long-term goals.
  Strongly/Moderately Agree/Disagree

Did the firm seek external finance in the last 2 years to fund BUSINESS EXPANSION?

Yes
No, the firm did not need external finance
No, because it was assumed than an attempt to raise external finance would be unsuccessful.

In the previous question, you indicated that you thought an application for external finance would not have been successful. Why do you think this? (please specify)

In the last 2 years, how many attempts to raise external finance were SUCCESSFUL? Including bank loans, sale of equities and bonds, trade finance etc.

Details of the MOST IMPORTANT loan application in the last 2 years that was SUCCESSFUL

- Loan maturity
- Length of firm's relationship with lender (at time of application)
- Did an accountant or financial advisor assist in the application for external finance?
- What was the MOST IMPORTANT use for the finance raised?
    - *Increase cash reserves/working capital*
    - *Acquisition of another business*
    - *Purchase of land/buildings*
    - *Maintaining/Refurbishing existing buildings, equipment Investment in new production equipment (excl. IT)*
    - *New computing/IT systems*
    - *Research and development*
    - *Purchase of new intellectual property (patents, licenses etc)*
    - *Other*
    - *Do not know*
    - *Prefer not to say*
- Type of finance raised?
    - *Loan from Big Four Banks (NAB, ANZ etc)*
    - *Loan from other banks or financial companies*
    - *Loan from family/friends*
    - *Loan from owners*
    - *Line of credit or overdraft facility*
    - *Trade credit (inc. factoring)*
    - *Equity investment from existing owners*
    - *Equity investment from new owners/partners*
    - *Issue of equity or bonds on capital markets*
    - *Lease agreement*
    - *Loan from government or not-for-profit agency*
    - *Government grant*
    - *Other*
    - *Do not know*
    - *Prefer not to say*
- What interest rate are you currently paying on this loan (%)?

In the last 2 years, how many attempts to access external finance were UNSUCCESSFUL? Including bank loans, sale of equities and bonds, trade finance etc.

Details of the MOST IMPORTANT application for external finance that was UNSUCCESSFUL in the last 2 years

- Loan maturity
- Length of firm's relationship with lender (at time of application)
- Did an accountant or financial advisor assist in the application for external finance?
- What was the MOST IMPORTANT intended use for the finance raised?
  - *Increase cash reserves/working capital*
  - *Acquisition of another business*
  - *Purchase of land/buildings*
  - *Maintaining/Refurbishing existing buildings, equipment Investment in new production equipment (excl. IT)*
  - *New computing/IT systems*
  - *Research and development*
  - *Purchase of new intellectual property (patents, licenses etc)*
  - *Other*
  - *Do not know*
  - *Prefer not to say*
- Type of finance applied for?
  - *Loan from Big Four Banks (NAB, ANZ etc)*
  - *Loan from other banks or financial companies*
  - *Loan from family/friends*
  - *Loan from owners*
  - *Line of credit or overdraft facility*
  - *Trade credit (inc. factoring)*
  - *Equity investment from existing owners*
  - *Equity investment from new owners/partners*
  - *Issue of equity or bonds on capital markets*
  - *Lease agreement*
  - *Loan from government or not-for-profit agency*
  - *Government grant*
  - *Other*
  - *Do not know*
  - *Prefer not to say*
- What reasons were given by lenders for why the application was unsuccessful? Please
  - *No reason given by lender*
  - *Lender thought firm was already too indebted*
  - *Insufficient collateral*
  - *Poor credit history/rating*
  - *Proposed project was not viable*
  - *Lender did not have funds available*
  - *Equity or bond raising was deemed unlikely to succeed*
  - *Don't know*
  - *Prefer not to say*
  - *Other (please specify)*
- What were the consequences of the unsuccessful attempt(s) to raise external finance?
  - Firm growth has been constrained significantly *(Strongly/Moderately Agree/Disagree)*

- The chances of firm bankruptcy have increased significantly *(Strongly/Moderately Agree/Disagree)*

Firm profitability

- Was the firm profitable for the 3 financial years prior to the recently completed financial year (i.e. 2006-07, 2007-08, 2008-09)
- Was the firm profitable for the recently completed financial year (2009-10)
- Do you expect the firm to be profitable this coming financial year (2010-2011)?

Balance sheet items

- Approximately, what are the total assets of your firm ($AU)?
- Approximately what are the total liabilities of your firm ($AU)?
- Approximately, what percentage of the firms total assets are 'hard assets'such as land, buildings and vehicles? (%)

Has the firm recently declared bankruptcy or gone into voluntary administration or receivership?

How long does it take to visit your primary business banker in person?

0-5 minutes
6-15 minutes
16-30 minutes
31-60 minutes
More than an hour
They usually come to our premises
We have no face-to-face contact with our business banker
Other (please specify)

Please enter the post-code of the physical location of the firm.
If the firm has multiple locations, please list the post-code of the main office.

The survey is now complete. Thank you for your participation.

If you wish to provide additional feedback on some of the issues raised by the survey, please let us know here.

The Treasury

Public Hearing 4 March, 2011

Question 1 – Proof Hansard, p. 39

Topic: History of US small business guarantee

Mr ANTHONY SMITH—I would not mind getting your perspective, Mr Lonsdale, because I know you have worked in this area. I read in one of the submissions, particularly on the history, that the US has had something since the 1950s. Let me be blunt. Can you fill in some of our gaps in knowledge, like what I think the Bush administration, I suppose initially, did in terms of boosting up in this area? Where are some of them at now?

Mr Lonsdale—I think we can come back on the chronology. We are happy to do that. To be honest, I cannot take you through the chronology from 1950 but I can certainly come back.

Response

Information on the history of US small business assistance (particularly, lending programs and loan guarantee schemes) can be found on the US Small Business Administration at http://www.sba.gov/about-sba-services/198.

The Treasury

Question 2 – Proof Hansard, p. 44

Topic: Definition of Small Business

Mr Murphy—With SMEs, it is not an exclusive definition. It is just a guide.

Mr Lonsdale—When designing policy typically, whether it is tax policy or regulatory policy or whatever it is, you always take a broader view—it is not so much the definition but whom it is that you want to direct something to.

Mr ANTHONY SMITH—You might remind me—how do the capital gains tax small business-specific measures work?

Mr Lonsdale—We would take advice from our revenue group people on that. A lot of work has been done on the tax side to try to streamline the definition of small business.

Mr ANTHONY SMITH—Yes. Could you send us something on that—not that it is going to be a big focus. I think the chair raised it. Ultimately, in any report we will have to address this issue.

Response

Broadly, a small business entity for taxation purposes is one with an aggregated turnover of less than $2 million. The aggravated turnover includes the turnover of the small business entity and certain closely related entities.

The Treasury

Question 3 – Proof Hansard, p. 44

Topic: Banking reform community awareness campaign – timeframe

Senator STEPHENS—On a slightly tangential issue, we had evidence this morning from the mutuals and credit unions representative around the government's undertaking in relation to the Bank on a Better Deal campaign. We had a discussion then about who might be overseeing that campaign, the authority with which the campaign would operate and the importance of consumer education around financial literacy and these issues. Does Treasury have a view? Would it be APRA? Would it be the Financial Literacy Foundation? Where do you think it would be most potently driven?

Mr Lonsdale—On the last one, I am not sure at this stage, but I can give you a sense of where the thinking is up to in terms of the broader campaign. The government announced in the statement it issued on 12 December that it wanted to look at a campaign approach. Some preliminary research has been done—market testing. Some preliminary results have come through, but it is very partial at this stage because it is quite qualitative. I have not yet seen the quantitative results of surveying, but the idea is that when that comes together—which has not yet happened—advice would be put to government on the form of the campaign. So whether that is advertising or a website approach—there are different forms that could take. No decision has been made on that. There is an established government process where that research would go and decisions would be made.

Senator STEPHENS—Is there a time frame involved? Do we know a target date and when it might start?

Mr Lonsdale—I can come back to you on that target date.

Response

The Campaign commenced on 15 March 2011 with the launch of ASIC's new personal finance website called MoneySmart (www.moneysmart.gov.au). Timeframes for future elements of the campaign have not been finalised at this stage.

8 April, 2011

Dr Ian Holland
Secretary
Senate Joint Committee on Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Dr Holland

COMMITTEE INQUIRY INTO ACCESS FOR SMALL AND MEDIUM BUSINESS TO FINANCE

Thank you for your letter of 25 March 2011 originally directed to Secretary of the Treasury, Dr Martin Parkinson, regarding of the National Credit Reforms and lending to Small Business. I am pleased to be able to provide responses to your questions on his behalf.

1. Consultation on the topic whether the provision of credit to small businesses should be regulated

The issue of the provision of credit to small business is one of a number of topics that are being considered as part of a review of credit generally (following the 2008 COAG decision to refer power from the States to the Commonwealth in respect of credit). COAG specified that a number of topics be considered within the National Credit Reform Agenda, with different delivery timetables, according to the nature of the topic. Small business is one of a number of topics where the complexity of the issue requires more time for consideration and therefore there has not yet been any decision or outcome arising from the consultations following the release of the Green Paper.

The National Consumer Credit Phase 2 Green Paper, *National Credit Reform: Enhancing confidence and fairness in Australia's credit law,* was released in July 2010 and covered all topics within Phase Two of the COAG National Credit Reform Agenda. Chapter One of the Green Paper sought views on a range of questions relating to whether or not there should be additional regulation for lending to small businesses. Submissions on this issue were received from major banks, other lenders, lender and broker industry bodies, small businesses, and small business associations.

In general terms, lenders and brokers remained cautious about further regulation except where market failure could be demonstrated. Some small businesses considered there were no significant differences between the way they borrowed money as consumers and as small business borrowers, and that similar issues could arise in relation to, for example, information asymmetries or lack of competition.

Small business was discussed at the meeting of the Industry and Consumer Representatives Consultation Group on 18 October 2010, in the context of a review of the outcomes of the Green Paper generally, with a representative of the Council of Small Business of Australia (COSBOA) outlining their views. Since that time this broader group has been focussed on issues other than small business that have a more immediate priority because of the COAG timetable.

Treasury intends to use these submissions as a useful starting point for a more detailed examination of the issues, as this model has proved effective in consultation on other topics in the National Credit Reform Agenda. It is proposed to use the information provided, and other evidence gathered by Treasury, to enable a more sophisticated analysis of the issues, and the consequences of particular options, to be developed.

2. The roles of the industry consultation groups

The Industry and Consumer Representatives Consultation Group was initially convened in 2008 to consider Phase One of the National Credit Reforms. It is the main vehicle for consulting with stakeholders and has a broad membership (apart from COSBOA) comprising:

- lender and finance industry bodies (the Australian Bankers' Association, ABACUS, the Australian Finance Conference and the National Financial Services Federation);
- broker and intermediary industry bodies (the Mortgage and Finance Association of Australia, Finance Brokers Association of Australia (MFAA), the Financial Services Council, and the Financial Planning Association (FPA));
- both external dispute resolution bodies, the Credit Ombudsman Service Limited and the Financial Ombudsman Service; and
- legal and consumer group representatives from the Law Council of Australia, CHOICE, Legal Aid NSW the Consumer Action Law Centre and the Consumer Credit Legal Centre (NSW).

Consultation on Phase Two commenced shortly after the end of the 2010 election caretaker period. Meetings with the Implementation Group in which these reforms were discussed have been held in Sydney on:

- 10 September 2010;
- 18 October 2010;
- 3 November 2010; and
- 1 December 2010.

These meetings have concentrated on topics where the COAG timetable requires decisions to be made relatively soon and before any decision needs to be made in respect of small business lending. These topics include reforms in relation to credit cards, reverse mortgages and consumer leases.

The Equity Release Consultation Working Group (ERCWG) is the forum for consultation in respect of reforms to the regulation of equity release products (that is, products that enable persons who have retired or are approaching retirement age to access funds through the equity in their home). The nature of these products means that the consultations needed to include persons with specific specialist knowledge, in order to ensure the reforms were practical and effective.

The ERCWG has held 6 meetings since February 2010. The membership of this group consists of SEQUAL (the main industry body for reverse mortgages and home reversion scheme products), major industry bodies such as the MFAA and the FPA, as well as seniors, legal and consumer groups. This group provides feedback to Government on the various options for reform of reverse mortgages and equity release products.

The Point of Sale Working Group (POSWG) is a consultation group brought together to discuss the specific issue of whether or not there should be regulation of vendor introducers who can arrange finance for the purchase of their goods or services (such as car dealerships or retail stores). This class of persons are currently exempt from the national credit regime.

Its membership comprises key stakeholders with specialist knowledge, including persons from major financiers in the retail sector, representatives from the two main retail areas (stores and vehicle dealerships), industry bodies, and consumer representatives. Again, it was considered the issues raised by this topic required more detailed consultation with key stakeholders with specialist knowledge.

The POSWG met approximately monthly (usually face to face but also by teleconferences) between December 2009 and June 2010, and developed proposals for a more refined approach to the regulation of point of sale vendor introducers. Treasury is now looking to consult more broadly on those proposals, and intends to release a Discussion Paper on this topic.

Treasury also delivered reports to the Industry and Consumer Representatives Consultation Group on the outcomes of the ERCWG and the POSWG.

3. Small business involvement in Phase 2 consultation

During Phase One of the National Credit Reforms the Industry and Consumer Representatives Consultation Group did not include small business representatives. Treasury recognises that small businesses need to be involved in the Phase Two consultations and COSBOA has become a member of this group. In addition Treasury has met directly with representatives of COSBOA on two occasions to discuss their specific issues in relation to small business' access to credit.

Treasury will continue to seek the views of small business as part of the Phase Two consultations.

Once again, I thank you for your letter and look forward to the release of the Committee's report. Please do not hesitate to contact me if you require any further information.

Yours sincerely

Geoff Miller

Geoff Miller
General Manager
Corporations & Financial Services Division
The Treasury

Australian Prudential Regulation Authority

Public Hearing 11 March, 2011

Proof Hansard, p. 45

Topic: Regulatory Framework

CHAIRMAN—It is a complex area, but I ask APRA, as the regulator, perhaps to consider that and write to the committee with some thoughts—if this is just not possible, fair enough—on whether there is some consideration of how regulation works on the treatment of specific financial arrangements.

Mr Johnson—You are looking at something similar to the hardship loans that the LGA has put in place?

CHAIRMAN—Yes, that is one example....

I have heard of—and as I said this is anecdotal, but I know there are such cases—of a business which was operating well, was viable and managing itself although things might have been tight, for which their bank, having reassessed a number of things and suggested a number of courses of action, actually created a problem resulting in the business failing because the new terms and conditions just were not possible to meet.

Mr Byres—I think we certainly understand the issue. The challenge is what to do about it because, as I said, what is someone's reasonable risk based pricing is someone else's unreasonable request and excessive margin. They are often in the eye of the beholder, but I understand the issue and we will have a think about it.

CHAIRMAN—Can you take it on board?

Mr Byres—Yes.

Australian Prudential Regulation Authority

400 George Street (Level 26)
Sydney NSW 2000

GPO Box 9836
Sydney NSW 2001

T 02 9210 3000
F 02 9210 3411
W www.apra.gov.au

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11 APR 2011

APRA

8 April 2011

Committee Secretary
Parliamentary Joint Committee on Corporations
and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Sir

ACCESS FOR SMALL AND MEDIUM BUSINESS TO FINANCE

During APRA's appearance before the Committee's hearing on 11 March 2011, the Committee asked APRA officers to consider if the regulatory framework could or should be amended in respect of how authorised deposit-taking institutions (ADIs) renegotiate loan arrangements with small and medium enterprise borrowers.

As our officers noted at the hearings, APRA's primary objective is to ensure that ADIs manage the risks associated with their lending activities on an ongoing basis, and take appropriate measures to address these risks as they change. In some cases, these measures may involve the renegotiation of loan arrangements of the risks associated with an ADI's exposure to a particular borrower are assessed to have increased. This is simply prudent banking and APRA does not see a role for prudential regulation in this area.

APRA's mandate does not extend to consumer protection or business conduct issues and, hence, it does not intrude into dealings between an ADI and its customers. These matters are the domain of the Australian Securities and Investments Commission (ASIC).

The most appropriate forum for the resolution of disputes of the type the Committee alluded to during APRA's appearance appears to largely exist in the form of the Financial Ombudsman Service (FOS). The FOS was established to independently resolve disputes between consumers – including small businesses – and member financial services providers. It is approved by ASIC under Regulatory Guide 139 and operates as the primary consumer external dispute resolution scheme in the financial sector.

Yours sincerely

Thea Rosenbaum
Secretary