Chapter 5

Regulation of Australian bank mergers

5.1 There are a number of bodies with a role in regulating Australian bank mergers. As for mergers in other industries, the prime responsibility lies with the Australian Competition and Consumer Commission (ACCC). Reflecting the special status of banks, mergers also require the approval of the Treasurer. Banks also need the blessing of their supervisor, the Australian Prudential Regulation Authority (APRA), who also advises the Treasurer. All these approvals may involve conditions being placed on the merging banks.

ACCC approval of mergers

5.2 Mergers which have the effect of 'substantially lessening competition' are prohibited by the *Trade Practices Act* (section 50) unless the Australian Competition Tribunal authorises them on the grounds that they give rise to a public benefit.[1] The ACCC:

> …takes the view that a lessening of competition is substantial if it creates or confers an increase in market power on the merged firm and/or other firms in the relevant market that is significant and sustainable.[2]

5.3 A significant increase in market power is in turn defined as one that enables the merged company to raise prices, or reduce quality of goods or services without lowering sales.

5.4 There has been criticism of the operation of section 50:

> The biggest problem with section 50 is that the substantial lessening of competition test is a very high threshold. It has been equated to the ability of the merged party to raise prices without losing business. Very few corporations have that ability and as a result…you can understand why we have a highly concentrated market.[3]

5.5 Firms contemplating merger may either approach the ACCC for an informal view on whether the merger is likely to breach section 50; ask the ACCC for a formal

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1 When the Martin Report was tabled in 1991, the Trade Practices Act was based on 'market dominance' rather than 'substantial lessening of competition' and that committee was concerned that this was too permissive of bank mergers and may not even be sufficient to prevent the emergence of a duopoly; House of Representatives Standing Committee on Finance and Public Administration (1991, pp 118-28).

2 ACCC, *Submission 4*, p 3.

3 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 10 August 2009, p 71.

clearance (which if granted will provide protection from court action under section 50); or apply to the Australian Competition Tribunal for authorisation. In practice, parties have used the informal process but the other avenues have never been used.[4]

5.6 The ACCC described the informal process as follows:

> So we have essentially constructed a system which incentivises parties to come to us before they merge to seek a view, and in many cases they will get a degree of comfort from our position that we will not intervene. In some cases we will say, 'Yes, we have a problem and we will intervene if you go ahead,' but in the end we actually have to make our case in court.[5]

5.7 The ACCC may authorise a merger subject to the parties giving undertakings under section 87B. One possible undertaking would be to sell some branches to another bank.[6] The ACCC may take court action if undertakings are not kept.

5.8 In merger guidelines issued in 1999 for assessing whether a proposed merger may 'substantially reduce competition', the ACCC had given as an example of where there had not been such a reduction, a market where the post-merger combined market share of the four (or fewer) largest players was under 75 per cent. This was never a rule and the revised guidelines issued in 2008 removed it. Some commentators, but not the ACCC, saw this as the ACCC adopting a more permissive approach.[7]

5.9 The previous chair of the ACCC articulated the 'Fels policy' of preferring at least one regional bank in each market in addition to the big four. The takeovers of BankWest, Adelaide Bank and St George in 2008 could be seen as a move away from this policy.[8]

5.10 Asked about this, the ACCC said:

> …a decision last year in that context might be seen through a different prism than a decision, say, in 1997, where it might have been considered that there was a need to have a regional bank in each state.[9]

5.11 There have been calls for a much stronger section 50:

> The FSU believes there should be an onus on merger parties to demonstrate that a positive outcome will occur rather than simply the absence of a major negative. The FSU strongly supports the adoption of a public benefit test

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4 Australian Competition and Consumer Commission, *Submission 4a*, p 3.

5 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 23.

6 A similar approach is used overseas, for example, in Switzerland during the merger of UBS and SBC.

7 Dr Evan Jones, *Submission 5*, p 3; ACCC, *Submission 4a*, pp 11-12.

8 The approval of Westpac's takeover of Bank of Melbourne was arguably the first step away from the 'Fels policy'.

9 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 25.

> for all bank mergers with the concept of 'public benefit' defined as widely as possible to include employment levels, access to services and impacts on low income and disadvantaged consumers.[10]
>
> There needs to be a demonstrated, specific public benefit, ie customer benefit, in relation to any proposed merger.[11]

5.12 The ACCC rejects this idea of a broader compass for section 50 as it would:

> …really turn section 50 on its head because…section 50 prohibits substantially anticompetitive mergers. In Australia it is possible that an anticompetitive merger can be authorised if that anticompetitive merger is in the net public interest, net public benefit. But it seems to me that what is being proposed is that, even if a merger is not anticompetitive—it might be competitively neutral, it might be pro competitive—there would still need to be some public benefit assessment or social audit conducted, and the commission would be put in a position where it might seek to oppose or have to require conditions to be attached to that conceivably pro-competitive merger because it did not pass some social audit.[12]

5.13 They added that in respect of banking mergers:

> …there already is a separate public interest test applied to banking mergers and it is done under the Financial Services Shareholding Act, under the Treasurer's national interest test.[13]

5.14 The ACCC also cited the Dawson Committee's support for uniform rules across industries and stated:

> The ACCC believes that there are very strong policy reasons for maintaining the same merger test across all sectors of the economy.[14]

5.15 The Australian Bankers' Association and the Law Council also made the point that the provisions requiring the Treasurer's approval of any merger are a de facto public benefit test.[15] The Law Council further argues that now is not the time for reforms:

> …it is premature to seek changes to Australian merger laws and bank mergers laws in particular at this time, while issues from the global

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10 Finance Sector Union, *Submission 12*, p 8.

11 Hon Dr Bob Such MP, *Submission 21*, p 2.

12 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 22.

13 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 22.

14 ACCC, *Submission 4a*, p 3.

15 Australian Bankers' Association, *Submission14*, p 10; Law Council of Australia, *Submission 15*, pp 8, 10.

> financial crisis (although perhaps stabilising), have not yet fully worked through the economy.[16]

5.16 While generally supportive of current arrangements, the Law Council incline towards a more permissive attitude towards mergers:

> …the ACCC has too readily delineated markets as those in Australia only. This approach does not recognise the globalisation of financial service markets…[17]

Divestiture powers

5.17 The courts can order, under section 81 of the *Trade Practices Act*, the divestiture of shares bought in breach of section 50 up to three years after the date of the contravention. This is done by ruling that the acquisition is void and the vendor must refund the payment by the acquirer. There have been calls to use these powers to reverse the Westpac takeover of St George:

> …it is imperative that the ACCC take the opportunity in view of their publicly expressed concerns regarding growing dominance of the 4 major banks. While it may be one thing to have concerns or regrets and not be able to do anything about it, it is entirely a different matter where you have concerns or regrets but can do something about it.[18]

5.18 This provision is only operative at the time of a merger. Some have argued that the ACCC should have a broader, 'trust-busting' power to split up banks (and other companies) that have excessive market power, however obtained:

> …the Committee should review the desirability of providing the ACCC with enhanced powers to review the competitiveness of particular markets including banking markets…[and] providing to the ACCC a power to require divestiture of assets where after review it concludes that a market is not competitive and the divestiture would be likely to be in the public interest.[19]
>
> A divestiture power is a very important power because as markets become more concentrated the only order or remedy you have left is a divestiture to break it up. The Americans have done it for over 100 years and it has been very successful in a number of industries to inject competition... The United Kingdom provides a sophisticated regulatory framework for dealing with divesture where the competition commission there can make an order where the market structure is such that it is detrimental to consumers and competition.[20]

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16 Law Council of Australia, *Submission 15a*, p 2.

17 Law Council of Australia, *Submission 15*, p 7.

18 Associate Professor Frank Zumbo, *Submission 19*, p 8.

19 Choice, *Submission 6*, p 12.

20 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 10 August 2009, pp 73-4.

> …a general power of divestiture resting with the ACCC. So we are not recommending this lightly, but we do agree with the existence of that power and that there should be a good framework for monitoring the accumulation or concentration of market power over a period of time…where those competitive advantages become of such a concentrated nature and where they are used to unfairly restrict competition in certain markets by cross-subsidisation or creating barriers to entry in the way things are bundled, we think the existence of that power would act as a deterrent. So, hopefully, it is one of those things where you have that power but you never have to exercise it. [21]

5.19 The Australian Bankers' Association comment that this 'would represent a very significant increase in the ACCC's powers to intervene in economic markets'.[22]

5.20 The Law Council opposes stronger divestiture powers:

> …complex issues, such as a negative impact on business certainty as to future investment, are raised as a result of this type of power. Additionally, existing prohibitions against misuse of market power, for example, should…provide sufficient safeguard against unlawful behaviour without requiring a general power of divestiture.[23]

Creeping acquisitions

5.21 Choice felt that bank mergers would be better handled if there were provisions in the Trade Practices Act against 'creeping acquisitions':[24]

> Something like creeping acquisition laws will be very useful to accompany this law. We certainly are keen to have those come in. They provide a different approach to looking at a merger. The substantially lessened competition test is a very steep test to meet. Things like creeping acquisition laws are needed to provide a solution where you are not necessarily substantially lessening competition but nevertheless are lessening competition in a particular market.[25]

5.22 The ABA and the Law Council oppose this suggestion:

> …the existing substantial lessening of competition test would be sufficient to capture any participating merger, whether large or any particular smaller state or region or institution. That would almost certainly be captured by the existing section 50. There is no need for an additional so-called creeping

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21 Mr Ram Kangatharan, Chief Financial Officer, Bank of Queensland, *Committee Hansard*, 1 July, p 6.

22 Australian Bankers' Association, *Submission 14*, p 9.

23 Law Council, *Submission 15*, p 8.

24 'Creeping acquisitions' refers to a series of small takeovers, each of which individually not significantly reducing competition but having that effect when taken together.

25 Elissa Freeman, Choice, *Proof Committee Hansard*, 10 August 2009, p 6.

> acquisition amendment… We think there would be great uncertainty created for the business community in Australia and internationally if the current section 50 were to continually be tweaked to take into account additional changes to material with so-called creeping acquisitions.[26]

5.23 An earlier report by this Committee concluded that:

> …concerns about the impact of 'creeping acquisitions' on competition are valid. It agrees that the current provisions of section 50 of the Trade Practices Act are insufficient to address the problem adequately.[27]

ACCC ruling on Westpac's takeover of St George

5.24 The ACCC announced on 13 August 2008 it would not oppose Westpac's acquisition of St George, as it 'would not be likely to have the effect of substantially lessening competition'.[28] Nor would it require any undertakings.

5.25 While the ACCC initially expressed some concern about reduced competition for 'wrap platforms' (a type of wealth management product offered under the BT brand by Westpac and the Asgard brand by St George), ultimately it reasoned that:

> …while St George Bank was a relatively innovative and dynamic competitor with a strong focus on customer service, other competitors to the merged entity which remain in the market would continue to play a similar role… competition in retail banking markets provided by the other major banks and regional banks along with credit unions, building societies and niche players, would be sufficient to prevent the merged firm significantly increasing its market power after the acquisition, and accordingly would not substantially lessen competition in the relevant markets.[29]

5.26 An important factor was that for most banking products, the ACCC regard the relevant 'market' as a national one (Table 5.1), so St George's market share was relatively small (around 7-9 per cent for most banking products).

5.27 Taking NSW/ACT or South Australia as the relevant market raises St George's market share to around 15-20 per cent for many products. (The merged bank operates around a quarter of ATMs in NSW/ACT and a third of branches and ATMs in SA.[30]) In some individual towns or suburbs, the impact will be greater still. For example, Tanunda in the Barossa Valley currently has three bank branches –

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26 Mr Dave Poddar, Law Council of Australia, *Proof Committee Hansard*, 10 August 2009, p 50; See also Law Council of Australia, *Submission 15a*, Attachments A and B.

27 Senate Standing Committee on Economics (2008).

28 ACCC, Public competition assessment, 'Westpac Banking Corporation – proposed acquisition of St George Bank Limited', 13 August 2008, reproduced in ACCC, *Submission 4*.

29 ACCC, *Submission 4*, pp 10-11.

30 ACCC, Public competition assessment, 'Westpac Banking Corporation – proposed acquisition of St George Bank Limited', 13 August 2008, para 63 and preceding table, reproduced in ACCC, *Submission 4*.

St George (trading as BankSA), Westpac and ANZ – and so will go from three banking groups in the town to two.

5.28 The ACCC's use of national markets to apply tests, supported by the Law Council, has been criticised:

> It is a very simple proposition in competition law that the wider the market definition the less likely a merger is going to substantially lessen competition. Obviously the Law Council has a vested interest in defining market as broadly as it can. If you define the banking market as global, you will never stop any merger in Australia on that basis. Obviously that is where they are headed with that proposition. The reality is that markets are localised…[31]

Table 5.1: ACCC's view of banking markets

Product dimension	*Geographic dimension*	*Functional characteristics*
Personal banking markets		
Transaction accounts	Local but price and service competition is predominantly national	Provide day-to-day deposit and payment functionality in the form of cheque books, debit cards, BPay, internet and phone banking.
Deposit/term products	National	Traditional savings instrument with a focus on growth in the capital value of the deposited funds.
Credit cards	National	Short-term unsecured lending product for individual consumers.
Home loans	National	Mortgage lending to individuals for the purpose of acquiring residential property.
Personal loans	National	Lending to individuals for the purposes of purchasing large personal consumption items.
Hybrid personal loans (margin loans)	National	Flexible lending provided to individuals for the purpose of acquiring shares or investing in funds or for drawing on the equity in assets.
Business banking markets		
SME banking	Local but price and service competition is national	A 'cluster' of banking products encompassing credit products, transaction/cash facilities, merchant acquiring services and banking advice.
Equipment finance	National	Includes lease finance products and hire-purchase products. The lease provider purchases capital equipment and leases it to the business for an agreed term, commonly two to five years.
Agribusiness banking	Local but price and service competition is national	A 'cluster' of banking products for agricultural businesses with a central element being specialised lending products including very long-term credit instruments.

Source: ACCC, *Submission 4*, p 10.

31 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 10 August 2009, p 72.

5.29 The ACCC's approach has also been criticised for ignoring some important market segments. The Brotherhood of St Laurence regards it as:

> …inadequate, as it does not demonstrate the very limited levels of competition to service people on low incomes. We are concerned that the ACCC's assessment only segments the market into 'retail banking' and 'business banking', without specifically considering low-income or disadvantaged consumers, to understand how the banks are actually competing.[32]

5.30 The Brotherhood also suggests that information should be published on the following variables, and that the impact on them could be considered by the ACCC in assessing future merger proposals:

- numbers and percentage of consumers using basic bank accounts
- availability of fair, appropriate credit for people on low incomes.[33]

5.31 The Finance Sector Union argued:

> …there needs to be a much more vigorous public interest test that takes into account employment and other community issues.[34]

5.32 The ACCC may now take a harder line on future merger proposals, given the impact of the global financial crisis on competitive pressures:

> …the global financial crisis has seen a vacation from Australia of some foreign lenders and a diminution in competition from, say, non-bank lenders and, importantly, a potential diminution in the threat of international competition. The structure of the market is a bit different now and we would have regard to the lessening of those constraints if and when another merger comes across our desks.[35]

Transparency of ACCC processes

5.33 The approval process could also be made more transparent. Choice suggests that unless submitters to ACCC inquiries indicate that their submissions contain confidential information, they should be made publicly available on the ACCC website.[36] The Finance Sector Union goes further, arguing 'the ACCC should publish all information associated with merger reviews unless there are compelling reasons otherwise'.[37]

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32 Brotherhood of St Laurence, *Submission 8*, p 4.

33 Brotherhood of St Laurence, *Submission 8*, p 5.

34 Mr Leon Carter, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 3.

35 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 26.

36 Ms Elissa Freeman, Choice, *Proof Committee Hansard*, 10 August 2009, p 2; Choice, *Submission 6*, pp 10-11.

37 FSU, *Submission 12*, p 2.

5.34 Associate Professor Frank Zumbo supported these calls:

> I think those public assessment documents— that is competition assessment documents—that the ACCC brings out are a step forward. I think they could be more comprehensive. I certainly believe that submissions, when they are not confidential, should be made available on the ACCC website. I believe transparency leads to a greater debate, and we need to have a greater debate.[38]

5.35 In response, the ACCC defended maintaining a degree of confidentiality:

> …the success and the reputation of the commission's informal merger review process is critically dependent on the ability of merger parties and interested parties being able to submit their views to us in confidence. We have a policy in the informal merger review process that we do not reveal any communications made to us, to the extent that they are confidential. There are a number of reasons for this. One is that often information that is put to us does contain commercially sensitive information—that is obvious. But we often have people talking to us who are concerned about possible retribution by merger parties, we have people talking to us who might be subject to influence by merger parties or other parties if their submissions or identities are known, and we have a general policy that submissions made to us in that process are confidential.[39]

5.36 However, the ACCC argued that they were more open than they had previously been:

> Further, over the last five years the ACCC has significantly increased the transparency of its merger review process with three important elements of its procedure. The first of these is the "Statement of Issues" which the ACCC publishes where competition concerns arise in the course of its merger review. Its purpose is to alert the market to the ACCC's need for further information. Secondly, the ACCC publishes the reason for its decision in all public matters. And finally, the ACCC releases a "Public Competition Assessment", which comprehensively details the ACCC's reasons for decision in matters of significant public interest.[40]

5.37 In the specific case of the Westpac-St George merger, the ACCC pointed out:

> The ACCC sent out a market enquiry letter providing an overview of the market, areas of overlap between the parties' activities and questions about competition to ensure that interested parties had an opportunity to provide comments, and also had relevant information about the parties and the merger proposal. This market enquiry letter was sent to over 120 organisations and posted on the ACCC's website. In addition, the ACCC issued a media release to raise awareness of the process, and the

38 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 10 August 2009, p 72.

39 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, pp 19-20.

40 Australian Competition and Consumer Commission, *Submission 4a*, pp 4-5.

> opportunities available to any person wishing to comment. ACCC staff met or engaged in telephone conversations with more than 30 third parties, to discuss and explore the issues raised in their submissions, and to test the reliability and completeness of other information before the ACCC (having regard to the confidentiality of submissions).[41]

5.38 It was put to the ACCC, that they could publish submissions unless the submitter explicitly requests they be kept confidential — essentially the practice of Senate committees. The ACCC were not keen on this:

> …there is nothing stopping anyone who makes a submission to the commission from publishing or publicising their submission themselves, but as a policy we do not do that.[42]

> The operation of the ACCC's merger review process would be substantially jeopardised if it were required to publish submissions made to it in the course of an investigation - even if there were provision made to keep some elements of a submission confidential.[43]

5.39 The Law Council do not believe that the ACCC should be more transparent:

> …the ACCC and the merger processes under the current ACCC administration are very transparent, that the informal merger reviews for both the CBA and Bankwest and Westpac and St George were very public. They are very transparent. They were more so than…mergers that have occurred in the United Kingdom…[44]

5.40 A particular case of secrecy by the ACCC that did not appear justifiable on confidentiality grounds was a 'survey' of the public used when assessing the Westpac-St George merger. Choice argued:

> We also believe that any primary research undertaken by the ACCC during the course of its investigations and subsequently used to inform its decision to allow or reject a merger should also be available to the public. During the Westpac and St George merger, for example, the ACCC undertook a customer survey but to date has refused to publish the results of the survey, despite using the survey results to inform its decision to allow the merger to proceed.[45]

5.41 The ACCC described it as a 'market inquiry' rather than a 'survey':

> I regret now that it was called 'a survey', because really it was a mechanism by which we were trying to get consumers and small businesses to engage with us in our usual market inquiry process. So instead of sending out 250

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41 ACCC, *Submission 4a*, p 9.

42 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 21.

43 ACCC, *Submission 4a*, p 11.

44 Mr Dave Poddar, Law Council of Australia, *Proof Committee Hansard*, 10 August 2009, p 45.

45 Ms Ellissa Freeman, Choice, *Committee Hansard*, 10 August 2009, p 2.

> letters to consumers with a list of questions, we devised a survey with a number of questions and opportunities for them to make comments online…We appreciated that this so-called survey was going to be biased. Those who would self-select into giving us their responses had a reason to engage with us on the merger. We had never intended to portray it as a survey from which you could infer to the general population some empirical findings.[46]

Recommendation 1

5.42 The Committee recommends that the ACCC increase the transparency of their merger inquiries by publishing commissioned research and submissions unless the submitter explicitly asks that they be confidential.

Competition report

5.43 Choice, the Brotherhood of St Laurence and the FSU recommended that the ACCC contribute to an annual report to parliament on retail banking competition.[47]

5.44 Choice recommended that:

> The ACCC together with the Reserve Bank of Australia establish an annual report to Parliament on retail banking competition which (at a minimum) documents the following aspects of retail banking markets:
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> - number of providers
> - rates of customer switching
> - customer satisfaction
> - interest rate margins
> - concentration ratios and disaggregated market share data
> - local points of service.[48]

5.45 The ACCC felt able to do so if directed:

> We can clearly monitor anything that the minister formally directs us to. It would have to be consistent with our roles and functions under the act, and competition is clearly one of our functions under the act.[49]

5.46 Abacus gave guarded support to the idea:

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46 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 20. See also ACCC, Submission 4a, pp 9-10.

47 Ms Elissa Freeman, Choice, *Proof Committee Hansard*, 10 August 2009, pp 8-9; Mr Gerard Brody, Brotherhood of St Laurence, *Proof Committee Hansard*, 10 August 2009, p 22.

48 Choice, *Submission 6*, p 3.

49 Mr Wing, ACCC, *Committee Hansard*, 13 March 2009, p 29.

> If indeed the process is about an institution being responsible for considering the question of competition while using information that is already held by those regulators, that may well be a worthwhile process.[50]

5.47 The Brotherhood of St Laurence suggested some particular aspects which such a report could include:

> …any such analysis must consider how the banking sector is servicing people on low incomes. In particular, it could determine the numbers and percentage of eligible consumers accessing basic bank accounts, the availability of fair, appropriate credit for people on low incomes, and the geographic areas in which banks maintain a physical presence. This analysis would tell us whether banks are living up to the promise of appropriately servicing everyone in the community.[51]

Recommendation 2

5.48 The Committee recommends that the Government request the ACCC, APRA and the Reserve Bank to provide a joint annual report to parliament on competition in the retail banking market in Australia, and the provision of affordable banking facilities to those on low incomes, but taking care not to increase unduly the reporting burden on financial institutions.

The 'four pillars' policy

5.49 A 'six pillars' policy was initiated in 1990 by the Keating Government when it blocked the proposed merger of ANZ and National Mutual and said it would not allow mergers between the big four domestic banks and the two largest insurance companies.

5.50 The Wallis Inquiry's recommendation that the six pillars policy be abolished was rejected by the Howard Government in 1997.[52] While not opposed to a bank-insurance merger, the Howard Government would not allow a merger between the big four banks; giving rise to a 'four pillars' policy. This policy has been continued by the Rudd Government.[53]

5.51 The government's power to maintain the four pillars policy derives from the *Banking Act 1959*. Section 63 of the latter requires the Treasurer's prior written consent for a restructuring of an authorised deposit-taking institution, taking into

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50 Mr Mark Degotardi, Abacus, *Proof Committee Hansard*, 10 August 2009, p 16.

51 Mr Gerard Brody, Brotherhood of St Laurence, *Proof Committee Hansard*, 10 August 2009, p 23.

52 Bakir (2005) notes it was the only recommendation rejected, and he was surprised as he thought 'arguably one of the government's initial aims [in setting up the inquiry] was to legitimize the repeal of the six pillars policy'.

53 Hon Wayne Swan MP, 'Rudd Government committed to four pillars policy', Treasurer's Press Release, no 062, 2 June 2008.

account the national interest but not unreasonably withholding approval. Section 64 allows the Treasurer to impose conditions as part of an approval. Similarly, the *Financial Sector (Shareholdings) Act 1998* requires the Treasurer's approval for an application to take more than a 15 per cent stake in a financial sector company, and also allows conditions to be imposed.

5.52 The argument for the 'four pillars' policy is that a merger between any two of the four major banks would likely be followed by a merger of the remaining two, giving rise to an effective duopoly.

5.53 Choice felt that the four pillars policy was in the interests of consumers:

> Following the recent mergers the market share of the four largest banks has reached critically high concentration levels in transaction, savings, wealth services and lending markets. CHOICE supports the four pillars policy, which acts to prevent the banking market being a duopoly or even monopoly. However, given the recent consolidation in the market, it may be time to consider revisiting the policy to extend its reach further.[54]

5.54 Associate Professor Frank Zumbo wants the 'four pillars' policy strengthened:

> Yes, there is a four-pillar policy. But I am concerned that that is only a policy. I think if the government is truly committed to the four-pillar policy, it should enact its regulatory framework and the four-pillar policy should be codified as a law to lock in those four banks, the major banks.[55]

5.55 Former RBA Governor Ian Macfarlane credits the policy with helping Australia avoid the worst of the global financial crisis:

> It's hard to avoid the conclusion that the difference was there was no competition for corporate control in Australia. That saved us from the worst excesses that characterised banking systems overseas. Why was there no competition for corporate control? It was not permitted by that curious creature: the 'four pillars' policy… the quiet irony in my view is that the policy has made a positive contribution to improving the stability of our financial system, but not because it increased competition, but because it reduced it to manageable levels.[56]

5.56 A 1998 opinion poll found that two-thirds of those surveyed oppose a merger between the four major banks.[57]

5.57 On the other hand, there are also critics of the 'four pillars' policy. The Wallis Report argued that the ACCC assessment provides appropriate protection for

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54 Choice, *Submission 6*, p 5.

55 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 10 August 2009, p 70.

56 Macfarlane (2009), cited by Dr David Morrison, *Submission 17*, p 2.

57 Cited by Bakir (2005, p 252). More recently, former RBA Governor Ian Macfarlane (2009) said of the 'four pillars' policy, that it 'is supported by the general public as far as we can tell'.

consumers and so there is no need for a separate 'four pillars' rule. This (unsurprisingly) is also the unanimous view of the major banks, and is supported by the Law Council.

> …we agree with the principle of Wallis and that is that banking mergers should be assessed on the basis of all other industries on a competition basis, and that is by the ACCC.[58]
>
> Australia's existing legislative regulatory framework for examining bank mergers provides the appropriate level of scrutiny to prevent any anticompetitive mergers from occurring. Bank mergers should not be subject to bespoke, legislative, or additional framework.[59]
>
> …the policy is an anachronism, a woolly mammoth dug from the Siberian tundra and shipped still frozen to Australia as a structure for banking.[60]

5.58 While a similar veto exists in Canada, bank mergers do not need government permission in France, Germany, the UK or the US.[61] As Macfarlane (2009) notes, Canada stands out as the other OECD economy that has not had to call on the taxpayer to keep its banks afloat.

Committee view

5.59 It would be neater for any proposed merger between the four major banks to just be handled by the ACCC in terms of the provisions of the *Trade Practices Act*, rather than being treated as a special case. However, the Committee is concerned that the Act sets such a high bar that the ACCC may not have grounds to prevent such a merger, which the Committee would regard as not being in the national interest.

Recommendation 3

5.60 The Committee recommends that the Government retain the 'four pillars' policy of not allowing a merger between any of the four major banks.

Approval by the Treasurer for other bank takeovers

5.61 The Treasurer's approval is also required under the *Banking Act 1959* and the *Financial Sector (Shareholdings) Act 1998* for a takeover by one of the major banks of another bank, or a merger between smaller banks.

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58 Mr Nick Hossack, ABA, *Committee Hansard*, 12 March 2009, p 6.

59 Mr Dave Poddar, Law Council, *Proof Committee Hansard*. See also Law Council, *Submission* 15, p 11.

60 Then CEO of Westpac, David Morgan (2007, p 3).

61 Bakir (2005).

5.62 The Treasurer was therefore required to rule on the Westpac-St George merger. His approval was announced on 23 October 2008. His reasoning was that:

> The merged entity will have a larger balance sheet and capital base, as well as broader access to funding markets, making it better placed to withstand systemic shocks. The St George banking brand will also benefit from Westpac's lower funding costs, helping it to offer lower interest rates on loans.[62]

5.63 The Treasurer imposed a number of conditions.[63] *For three years*, the merged entity is required to:

> maintain (in net terms) branches and ATMs…;
>
> remove foreign ATM fees for Westpac customers using St George ATMs and vice−versa;
>
> continue to provide a comprehensive range of affordable banking products to low-income consumers and others … with special needs;
>
> retain all Westpac and St George retail banking brands including Bank SA;
>
> maintain dedicated management teams for St George and Westpac retail banking distribution; and
>
> retain a corporate presence in Kogarah.

5.64 In addition, the bank is required during the transition period to maximise internal redeployment opportunities; assist staff made redundant during the merger process and work with consumer advocates and community stakeholders to minimise community concerns about the merger and its impact on customers and the community, and address any concerns as sensitively and quickly as possible. (Similar conditions were later imposed in the approval of Commonwealth Bank's takeover of BankWest.[64])

5.65 The Australian Bankers' Association comments:

> …the conditions were not forced upon the two banks against their advice. The ABA understands that in respect of both the Westpac merger and the Commonwealth Bank acquisition, the conditions were either offered or mutually agreed.[65]

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62 Treasurer's press release 08/116.

63 Treasurer's press release 08/116; reproduced in Westpac, *Submission 11,* p 4 and ABA *Submission 14,* pp 20-21.

64 Treasurer's press release 08/144, 18 December 2008, attachment A, reproduced in Commonwealth Bank, *Submission 2,* pp 5-6 and ABA *Submission 14,* p 20.

65 ABA, *Submission 14,* p 9.

Monitoring and enforcing the conditions

5.66 These conditions are not 'undertakings' in the ACCC sense. Indeed, the ACCC has explicitly stated that:

> …these conditions are not monitored or enforced by the ACCC.[66]

5.67 Treasury will be 'monitoring' compliance, but only by looking at six-monthly reports by Westpac, not verifying them.[67]

5.68 The ABA breezily assured the Committee there was 'no realistic scenario in which the conditions will not be fully met'.[68] Others were not so sure.

5.69 The Finance Sector Union argued:

> …the Treasurer has imposed conditions on that merger. But there is no proper process to monitor whether those conditions are met, there is no formal process through which that is independently monitored and, even more importantly from our point of view, there is no enforcement capacity at the moment, including penalties if those conditions are not adhered to. If mergers are to happen—and we certainly do not believe that they should—and conditions are to be imposed, we think it is absolutely critical that those conditions are monitored very rigorously and, where they are breached, action is taken.[69]

5.70 Choice raised some doubts about the extent to which Westpac is complying with the conditions and the extent to which there is any enforcement. In particular, one of the Treasurer's conditions is that Westpac 'work with consumer advocates and community stakeholders to minimise community concerns about the merger and its impact on customers and the community, and address any concerns as sensitively and quickly as possible'.[70] Choice was apparently not contacted until nearly six months after the merger took place. Furthermore, they had 'contacted a series of other state-based consumer advocates operating in the retail banking sector who, similarly, have confirmed no contact from the banks'.[71]

5.71 The Brotherhood of St Laurence was also concerned about 'the lack of any appropriate monitoring and enforcement of these conditions'.[72]

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66 ACCC, *Submission 4*, p 11.

67 Finance Sector Union, *Submission 12*, p 6.

68 Australian Bankers' Association, *Submission 14*, p 9.

69 Mr Leon Carter, National Secretary, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 3.

70 Treasurer's press release 08/116; reproduced in Westpac, *Submission 11*, p 4.

71 Choice, *Submission 6*, p 4.

72 Brotherhood of St Laurence, *Submission 8*, p 4.

5.72 In response to this problem, Choice suggest that the ACCC be given responsibility for reporting on compliance with conditions placed on banks under the *Financial Sector (Shareholdings) Act 1998*, and that some penalty provisions be placed in the Act for cases of non-compliance.[73] A similar suggestion is made by the Finance Sector Union.[74]

5.73 The ACCC opposes being given this responsibility:

> …that might confuse the commission's independent role in terms of its competition enforcement and review of the merger, or any merger that comes before it. We have a process where we might reach a view that we will impose our own conditions, and we think it might be inconsistent and inappropriate for us to then be monitoring and enforcing a set of potentially separate and potentially inconsistent conditions that we were not involved in making.[75]

5.74 APRA does not regard it as part of their current responsibilities:

> APRA would monitor, and enforce compliance with, any conditions imposed by the Treasurer on a bank merger approval that are prudential in nature. However, it does not have the responsibility or authority to monitor or enforce compliance with conditions that are imposed to meet competition or other non-prudential objectives: that is the role of other regulatory agencies.[76]

5.75 There were also concerns that if a bank was found to be breaching the undertakings, the only penalty appears to be rescinding approval for the takeover and requiring it to be reversed. This seems both impractical, and too severe a penalty for many breaches. It may imply that all but the largest breaches of the conditions would go unpunished. Choice suggested:

> The sorts of penalties that we envisage would be broadly in line with the penalties that apply under the *Trade Practices Act*—so a range of civil penalties rather than just the divestiture, the complete revocation of the merger…We need an approach where the penalty fits the breach. Not all breaches will necessarily require complete revocation; nevertheless, it should carry some penalty if they are not compliant.[77]

5.76 The Law Council gave some support:

> Senator XENOPHON—Finally, at the moment it is either revoke the merger—goodness knows how that will happen in a practical sense—or, secondly, get an injunction. Should there not be a third option of financial

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73 Choice, *Submission 6*, p 4.

74 Finance Sector Union, *Submission 12*, p 2.

75 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, pp 21-2.

76 APRA, *Submission 16*, p 4.

77 Ms Elissa Freeman, Choice, *Proof Committee Hansard*, 10 August 2009, p 10.

> penalties as well as an alternative remedy? Would that not make sense as an extra tool in the toolbox to ensure compliance?...
>
> Senator HURLEY—…Previous witnesses…were calling for intermediate measures that could be imposed on merged companies as a penalty…
>
> Ms Roseman—…I think it would be reasonable to impose those kind of intermediate penalties. It would also make the *Banking Act* then more consistent with other commonwealth statutes, like the *Corporations Act*, that has those kind of mid-range and tiered penalties as well.[78]

Committee view

5.77 The Committee regards it as reasonable for the Treasurer to impose conditions on banks before approving a merger. Once conditions are imposed, there should be independent verification and appropriate penalties if the bank is not complying.

Recommendation 4

5.78 The Committee recommends that an appropriate unit within APRA or Treasury be charged with examining whether banks given conditional approval for mergers are complying with these conditions.

Recommendation 5

5.79 The Committee recommends that the *Banking Act 1959* or the *Financial Sector (Shareholdings) Act 1998* be amended to allow monetary penalties to be imposed on banks for failure to comply with conditions placed on them by the Treasurer when mergers are approved.

The role of the Australian Prudential Regulation Authority (APRA)

5.80 Section 51(xiii) of the Constitution gives the Commonwealth the power to make laws relating to "banking, other than State banking; also State banking extending beyond the limits of the State concerned, the incorporation of banks, and the issue of paper money." Between the mid 1920s and 1959, the role of Central Bank was played by the Commonwealth Bank of Australia. In 1959, the Reserve Bank of Australia (RBA) was created to take over this function (leaving the Commonwealth Bank to operate on a purely commercial basis). The RBA was responsible for prudential supervision until, as a result of the recommendations made in a 1997 report by the Financial System Inquiry (known as the 'Wallis inquiry'), the Australian Prudential Regulation Authority (APRA), was formed.

5.81 On the basis of this constitutional power and as a result of the Wallis inquiry recommendations, the Australian Securities and Investment Commission (ASIC) now has responsibility for establishing and enforcing rules of conduct and disclosure, APRA has responsibility for prudential standards and regulations in the finance sector

78 Ms Roseman, Law Council of Australia, *Proof Committee Hansard*, 10 August 2009, p 50.

and the Payments System Board (PSB), a quasi-independent entity within the Reserve Bank, has responsibility for payments systems.

5.82 APRA described its role in regard to bank mergers as follows:

> APRA provides advice to the Treasurer on whether proposed mergers of larger prudentially regulated financial institutions under the *Financial Sector (Shareholdings) Act 1998* are in the 'national interest'. (APRA has delegation to approve applications under this Act for smaller institutions.) In the absence of any definition or guidelines regarding 'national interest', APRA prepares its advice based on the public interest criteria set out in section 5(1) of the *Insurance Acquisition and Takeovers Act 1991*. The test is whether the change in ownership is:
>
> (i) likely to adversely affect the prudential conduct of the affairs of the companies; or
>
> (ii) likely to result in an unsuitable person being in a position of influence over the companies; or
>
> (iii) likely to unduly concentrate economic power in the industry or the Australian financial system: or
>
> (iv) contrary to the national interest.[79]

5.83 This amounts to fairly narrow grounds for APRA to reject a merger proposal. The fourth criterion is circular. APRA does not regard the third criterion as coming within its purview:

> APRA's main focus is naturally on terms (i) and (ii). It does not, in the normal course, offer advice on whether the proposed merger is likely to unduly concentrate economic power (item (iii)). Rather it relies on the Australian Competition and Consumer Commission to provide that advice separately to the Treasurer.[80]

5.84 The APRA Chair, when asked about recent merger proposals, commented:

> …our focus is to ensure that the resulting entity, the merged entity, is robust, well-capitalised and well-governed and has a strong board, strong fit and proper standards within the institution. We also place considerable emphasis on the actual integration process itself because that can expose the entities to considerable operational risk and distraction of management time and resources while a merger, or takeover, is being implemented. …This possible merger on the scale of St George and Westpac is clearly quite resource intensive for us. But we need to ensure that, when we allow institutions to run onto the field, they are fit and they are strong, and they know the rules of the game and they are capable of playing it as hard as they need to in the marketplace...[81]

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79 APRA, *Submission 16*, p 1.

80 APRA, *Submission 16*, p 1.

81 Dr John Laker, APRA Chair, *Estimates Hansard*, 4 June 2008, p 179.