

The Senate

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Economics  
References Committee

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Report on Bank Mergers

September 2009

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# Senate Economics References Committee

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# Chapter 1

## Introduction

1.1 The acquisitions of St George Bank by Westpac and Bankwest by the Commonwealth Bank in 2008 increased the market share of the 'big four' banks. Around the same time the global financial crisis weakened the position of some non-bank lenders, who competed with the banks by raising funds in securities markets. These events have led to concerns that increasing concentration from bank mergers may be significantly reducing competition in the Australian market for financial services.

### Referral of the Inquiry

1.2 On 24 November 2008, the Senate referred a number of matters relating to aspect of bank mergers to the Senate Standing Committee on Economics for inquiry and report by 26 February 2009. The Senate later extended the reporting date to 17 September 2009. The terms of reference setting out the matters to be investigated during the inquiry were as follows:

- (a) The economic, social and employment impacts of the recent mergers among Australian banks;
- (b) The measures available to enforce the conditions on the Westpac Banking Corporation/St George Bank Ltd merger and any conditions placed on future bank mergers;
- (c) The capacity for the Australian Competition and Consumer Commission (ACCC) to enforce divestiture in the banking sector if it finds insufficient competition;
- (d) The adequacy of section 50 of the *Trade Practices Act 1974* in preventing further concentration of the Australian banking sector, with specific reference to the merits of a 'public benefits' assessment for mergers;
- (e) The impact of mergers on consumer choice;
- (f) The extent to which Australian banks have 'off-shored' services such as credit card and loan processing, information technology, finance and payroll functions;
- (g) The impact 'off-shoring' has on employment for Australians; and
- (h) Alternative approaches to applying section 50 of the *Trade Practices Act 1974* in respect of future mergers, with a focus on alternative approaches to measuring competition.

## **Conduct of the inquiry**

1.3 The Committee advertised the inquiry in the national press on numerous occasions and on its website. It also wrote to relevant organisations and academics to inform them of the inquiry. The Committee received 21 submissions, which are listed in Appendix 1.

1.4 The Committee held public hearings in Canberra (12 and 13 March and 10 August 2009), Brisbane (1 July 2009) and Perth (2 July 2009). The witnesses who appeared at these hearings are listed in Appendix 2. The Committee thanks those who contributed to the inquiry.

## **Outline of the report**

1.5 The role of mergers in creating the current banking landscape is highlighted in Chapter 2. As further background to the analysis of the recent Australian mergers in Chapter 4, the economics of bank mergers is discussed in Chapter 3. Current and possible alternative regulatory responses to Australian bank mergers form the focus of Chapter 5. The extent of 'offshoring' and its impact on employment is discussed in Chapter 6.

## Chapter 2

### Background - the Australian banking market

#### A history of strong banks in Australia

2.1 Banking in Australia has a history spanning almost two centuries and for at least the latter century the core banking system has proved itself one of the strongest and most resilient in the world.<sup>1</sup> As the Australian Bankers' Association pointed out:

This stands in contrast to many other countries. For example, since the 1890s depression... there is only one example of bank depositors losing money in an Australian bank, and that was a small rural bank in the 1930s when the depositors lost one cent in the dollar. In our research we have found no example of when taxpayers' money has been used to bail out any Australian private bank.<sup>2</sup>

2.2 This long-term strength has owed a lot to the regulation and supervision of the banks by the authorities. It has been notable that the collapses and near-collapses of financial intermediaries have occurred among the unregulated non-bank intermediaries.<sup>3</sup>

2.3 In the current global financial crisis, in a number of countries large banks have had to be 'rescued' by governments injected equity, making emergency loans or even (temporarily) nationalising them. By contrast, none of these measures have been necessary in Australia. The four major Australian banks now constitute four of only eleven among the world's largest 100 banks which are rated AA or better.<sup>4</sup>

2.4 The Government has implemented schemes to guarantee deposits up to \$1 million, and offered to guarantee, for a fee, larger deposits and wholesale funding. This was arguably necessary to match similar measures by foreign governments. Views differ about whether the scheme has helped or hindered the smaller banks. As the guarantees are the subject of a separate inquiry by this Committee, they are not discussed further in this report.<sup>5</sup>

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1 A brief history of banking in Australia can be found in Chapter 2 of House of Representatives Standing Committee on Finance and Public Administration (1991).

2 Mr Nicholas Hossack, ABA, *Committee Hansard*, 12 March 2009, p 1.

3 Examples include 'merchant banks' such as Tricontinental, Nugan Hand, and Rothwells; Pyramid Building Society (in the period before building societies were supervised by APRA), and finance companies such as FCA.

4 Reserve Bank of Australia, *Financial Stability Review*, March 2009, p 25.

5 The report *Government measures to address confidence concerns in the financial sector – The Financial claims Scheme and the Guarantee Scheme for Large Deposits and Wholesale Funding*, was tabled on 17 September 2009.

2.5 Views differ about the reasons for the recent relative strength of the Australian banking system. The banks themselves regard it as a vindication of good management. The supervisors believe it reflects their good work. There is some truth in both these views; Australian banks have largely eschewed the practices such as 'low doc' and 'no recourse' lending which generated large bad debts in the domestic lending of American banks. There was also an element of good luck. As Australia is a net borrower, banks here were concentrating on raising funds overseas to lend in Australia. This meant that unlike countries which generated excess savings, Australian banks were not looking to buy foreign securities, many of which had a complexity which disguised their low quality.<sup>6</sup>

### Concentration in the Australian banking market

2.6 Four large banks now dominate the Australian banking market, accounting for around three-quarters of deposits and assets and a larger share of home loans (Table 2.1, last row). They have each reached this position through a succession of mergers over the past 150 years (see the 'family trees' in Charts 2.1 to 2.5).<sup>7</sup>

**Table 2.1: Measures of concentration in the Australian banking market**

	Assets		Deposits		Home loans	
	Share of 4 largest banks	HH index <sup>1</sup>	Share of 4 largest banks	HH index <sup>1</sup>	Share of 4 largest banks	HH index <sup>1</sup>
1890	0.34	.06				
1913	0.38	.10				
1950	0.63	.14	0.64	.15		
1970	0.68	.16	0.68	.16	0.77 <sup>2</sup>	.21 <sup>2</sup>
1990	0.66	.12	0.65	.12	0.65	.13
Oct 2008 (pre-mergers)	0.65	.11	0.65	.12	0.74	.15
Oct 2008 (post-mergers <sup>3</sup> )	0.73	.14	0.75	.15	0.86	.20
July 2009 <sup>3</sup>	0.74	.15	0.78	.16	0.90	.27

<sup>1</sup>The Herfindahl-Hirschman concentration index (which can vary from 0 representing perfect competition to 1 representing monopoly; a market with X equally-sized competitors will have an index of 1/X). <sup>2</sup>Assuming all owner-occupier housing loans were made by savings banks and accounted for all their loans. <sup>3</sup>Counting Adelaide, BankWest and St George as parts of Bendigo, Commonwealth and Westpac respectively.

Source: Secretariat, calculated from data in APRA, *Monthly Banking Statistics*, October 2008, July 2009; *RBA Bulletin*, June 1990; Butlin et al (1971), White (1973).

6 See Macfarlane (2009) for an elaboration.

7 To keep the trees legible, some small savings banks and building societies have been omitted.

2.7 For example, Westpac was formed from the 1982 merger of the Bank of New South Wales and the Commercial Bank of Australia. Since then, Westpac has acquired the Challenge Bank (1995), the Bank of Melbourne (1997), BT Financial Group (2002) and, in December 2008, St George Bank Ltd (which itself started as a building society and amalgamated with a number of smaller banks, including Advance Bank in 1997 and BankSA).

2.8 Indeed, the big four banks have essentially grown their market share over the past century by successively taking over the various banks and building societies established in the previous century – other than the Commonwealth Bank (only established in 1912), the increases in their market share are more than accounted for by their acquisitions (Table 2.2). There are now few smaller banks left for them to take over, so they will face the novel challenge of having to compete among themselves for market share in coming years.

**Table 2.2: Major banks: increases in market share, role of acquisitions**

	July 2009: % share of total bank assets	1913: % share of total bank assets of predecessor	Change (% points)	1913: % share of total bank assets of banks subsequently acquired
Commonwealth <sup>1</sup>	23	2 (Commonwealth)	+21	11
Westpac <sup>2</sup>	21	13 (Bank of New South Wales)	+8	7
NAB	16	5 (National Bank)	+11	18
ANZ	14	6 (Bank of Australasia)	+8	15
Sum of above	74	26	+48	51

Source: Secretariat, calculated from data in APRA, *Banking Statistics*, July 2009 and Butlin et al (1971).

<sup>1</sup>Counting BankWest as part of Commonwealth. <sup>2</sup>Counting St George as part of Westpac.

2.9 A consequence of these mergers has been a long-run tendency towards increased concentration within the Australian banking industry (Table 2.1). There was a temporary reduction in concentration with the deregulation of the 1980s, mostly reflecting the entry of foreign banks and conversion of the larger building societies, but this has now been overwhelmed by the ongoing mergers. As a result the

Australian banking market is now, by some criteria, the most concentrated it has been for more than a century. This is a greater concern at a time when the global financial crisis has markedly reduced the ability of non-bank financial institutions to compete with the banks.<sup>8</sup>

2.10 There is a long history of concern about inadequate competition in Australian banking, well before the mergers of the past decade. In 1932 former treasurer 'Red Ted' Theodore led a committee which pointed out that a handful of banks possessed 90 per cent of business in 'a virtual money trust'.<sup>9</sup> In 1991, the Martin Report commented:

...the emergence of four major banks in Australia over the past decade has indicated a trend towards greater concentration in the banking industry...The concerns which exist among various sections of the community about the trend towards increased concentration in the banking industry are shared by the Committee.<sup>10</sup>

2.11 The Australian banking market is now quite concentrated by international standards (Tables 2.3 and 2.4).<sup>11</sup> This is likely to be one reason it is more profitable, and has wider interest margins, than banks in most comparable countries, although this also partly reflects that it has fewer non-performing loans. Operating costs are not especially low. An international comparison shown in Table 2.3.

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8 See House of Representatives Standing Committee on Economics (2008).

9 Theodore et al (1932, p 9). A history of Australian banking is given in Chapter Two of House of Representatives Standing Committee on Finance and Public Administration (1991); see especially paragraphs 2.29, 2.41, 2.86, 2.87 and 2.93 on mergers. Chapter Eight is also relevant.

10 House of Representatives Standing Committee on Finance and Public Administration (1991, pp 120, 127).

11 This conclusion is also reached by House of Representatives Standing Committee on Economics (2008, p 26).

**Table 2.3: Aspects of banking markets, 2008**

	Concentration measures, 2008 (based on assets) <sup>1</sup>		Profitability of major banks (per cent of assets)				Major banks' non-performing
	% share of 4 largest banks	HH index <sup>2</sup>	Pre-tax profits	Loan loss provisions	Net interest margin	Operating costs	loans: per cent of total assets
Australia	84	.19	1.0	0.3	1.7	1.5	0.3
Canada	76	.17	0.5	0.2	1.4	2.0	0.4
France	82	.21	0.1	0.2	0.7	1.2	1.0
Germany	47	.10	-0.4	0.2	0.6	1.2	0.4
Japan	57	.10	0.1	0.2	0.5	0.7	1.0
Netherlands	97	.33	-0.8	0.3	1.0	1.3	0.9
Sweden	99	.30	0.7	0.1	1.0	1.0	0.5
Switzerland	82	.32	-1.9	0.1	0.5	2.6	0.3
UK	84	.21	-0.1	0.4	0.8	1.3	1.1
United States	<59	<.10	0.4	1.1	2.2	3.4	1.0

<sup>1</sup>Only includes domestically-headquartered banks which rank in the world's top 1000. In Australia this includes nine banks accounting for 80 per cent of the market. <sup>2</sup>The Herfindahl-Hirschman concentration index (which can vary from 0 representing perfect competition to 1 representing monopoly; a market with X equally-sized competitors will have an index of 1/X). Sources: Secretariat, calculated from data in *The Banker*, July 2009; Bank for International Settlements (2009, p 39).

**Table 2.4: Concentration in banking markets: assets held by 5 largest banks (per cent of total assets)**

	1980	1990	1999
Australia	77	72	74
Belgium	53	48	72
Canada	n.a.	60	77
France	n.a.	52	69
Japan	29	32	30
Netherlands	n.a.	74	82
Spain	38	38	47 <sup>1</sup>
Sweden	n.a.	62	84 <sup>2</sup>
Switzerland	n.a.	53	58 <sup>1</sup>
United Kingdom	n.a.	44	35
United States	14	11	27

Source: Group of Ten (2001), data annex B. <sup>1</sup>1997 <sup>2</sup>1998

***Is Australia overbanked?***

2.12 Mergers make more sense if Australia is currently 'overbanked'; if it now has an excessive number of bank branches. Australia does have more banks and branches relative to its population than many other developed economies (Table 5). But allowance must be made for the dispersed population of Australia: a single branch in Kowloon would be within a reasonable distance for the six million residents of Hong Kong, but a branch in Sydney (or even Perth) is not much use for a customer in Karratha.

**Table 2.5: Deposit-taking institutions\* in advanced economies, c2000**

	DTIs per million persons	DTI branches per million persons
Australia	18	321
Euro area	23	557
Hong Kong	42	261
Japan	5	180
Singapore	69	160
Switzerland	56	471
United Kingdom	9	242
United States	79	288

\*DTIs include commercial, savings and various types of mutual and cooperative banks, and similar intermediaries such as building societies, thrifts, savings and loan associations, credit unions and finance companies, but *excludes* insurance companies, pension and superannuation funds, unit trusts and mutual funds.

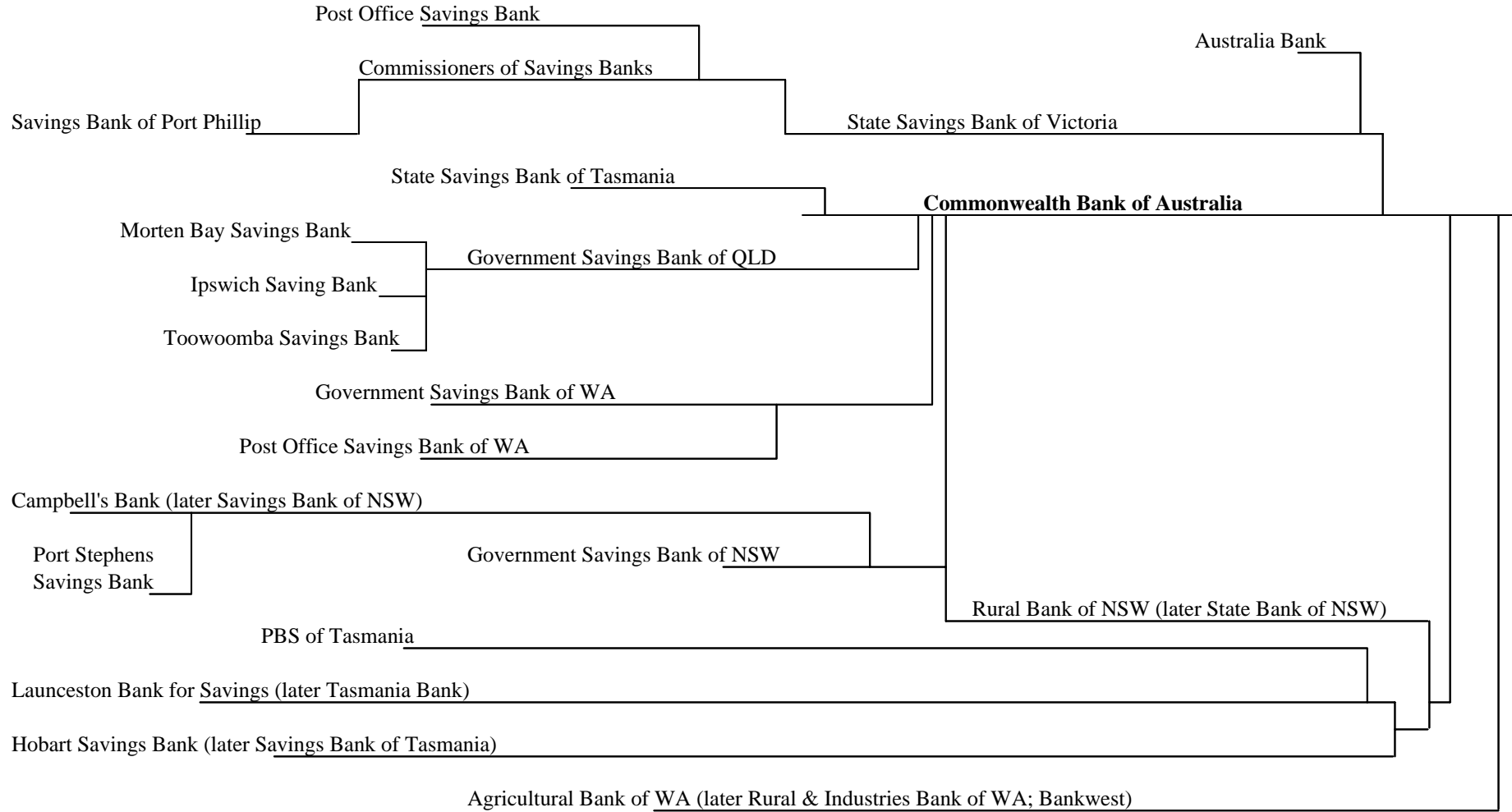
Source: Hawkins and Mihaljek (2001).



# Chart 1: Australian Banks Family Tree

## I. Commonwealth Bank of Australia

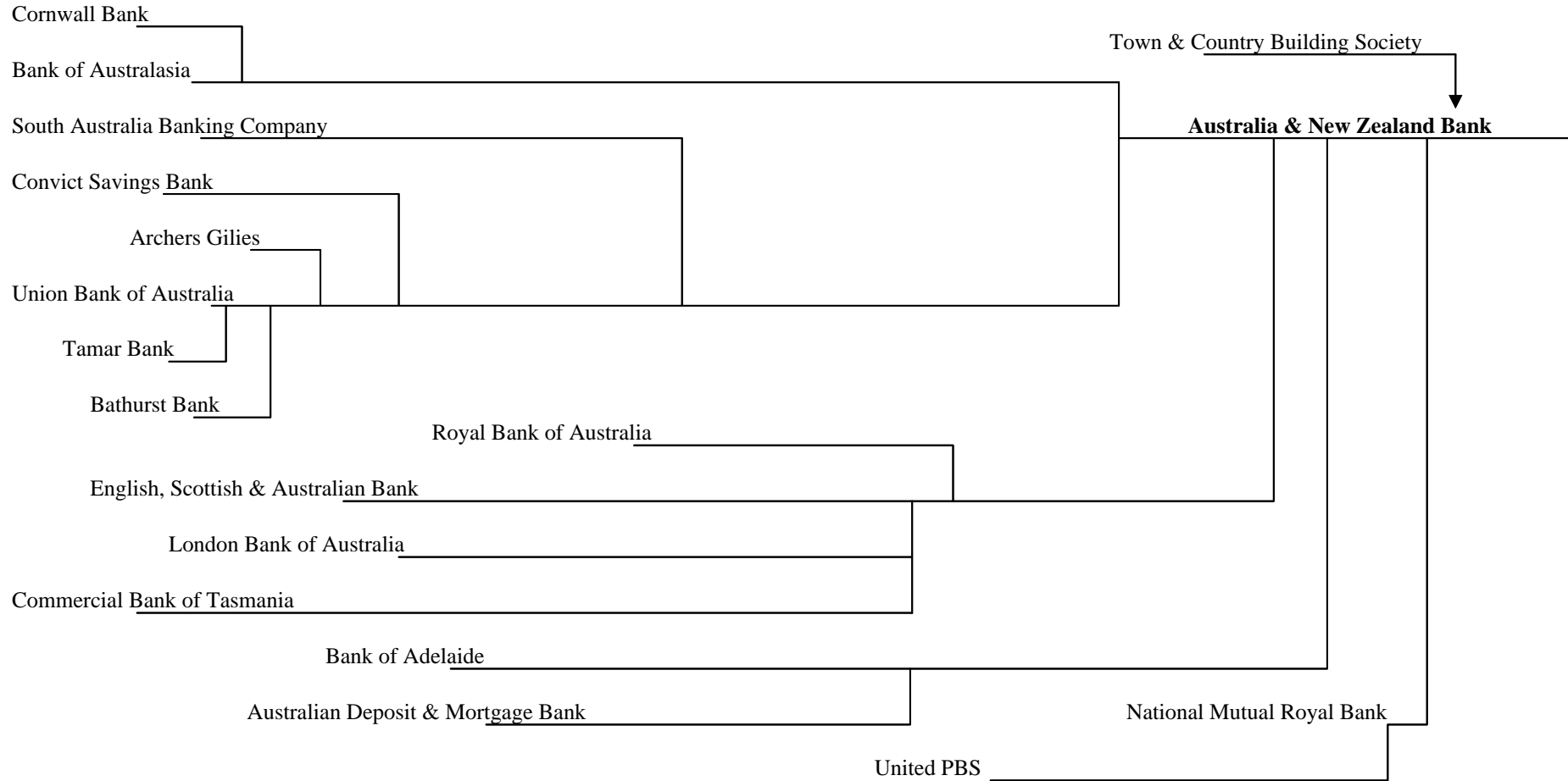
1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's



## Chart 2: Australian Banks Family Tree

## II. ANZ Bank

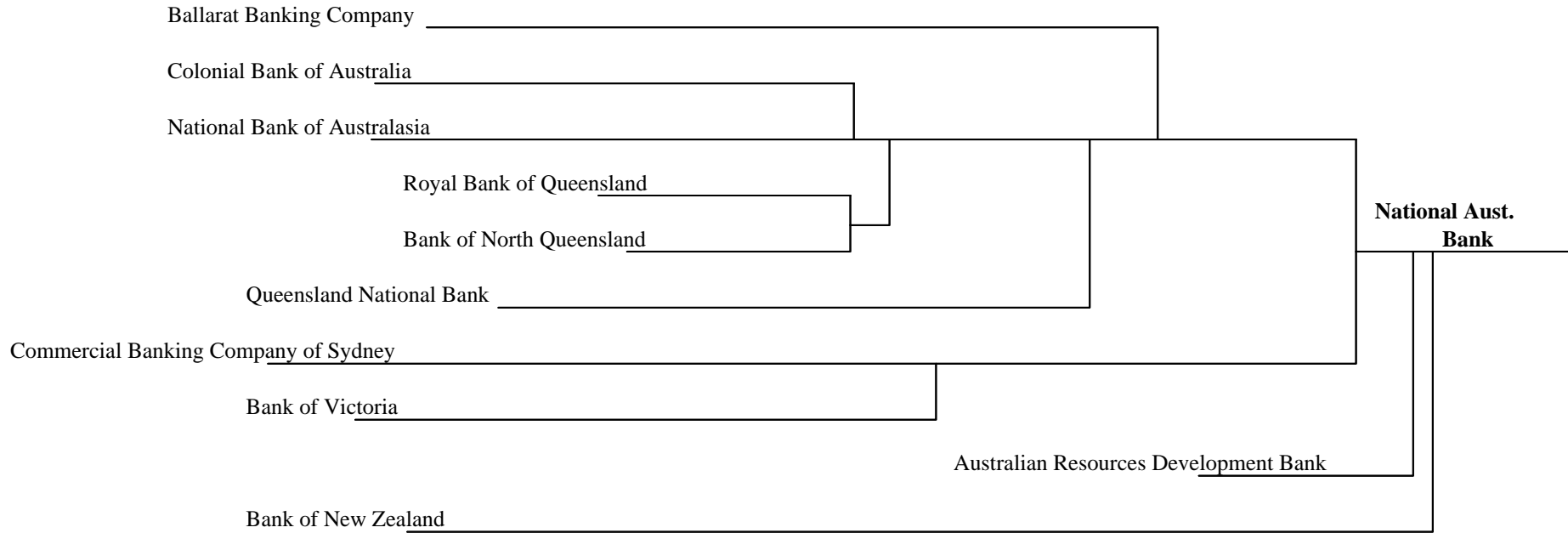
1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's



### Chart 3: Australian Banks Family Tree

### III. NAB

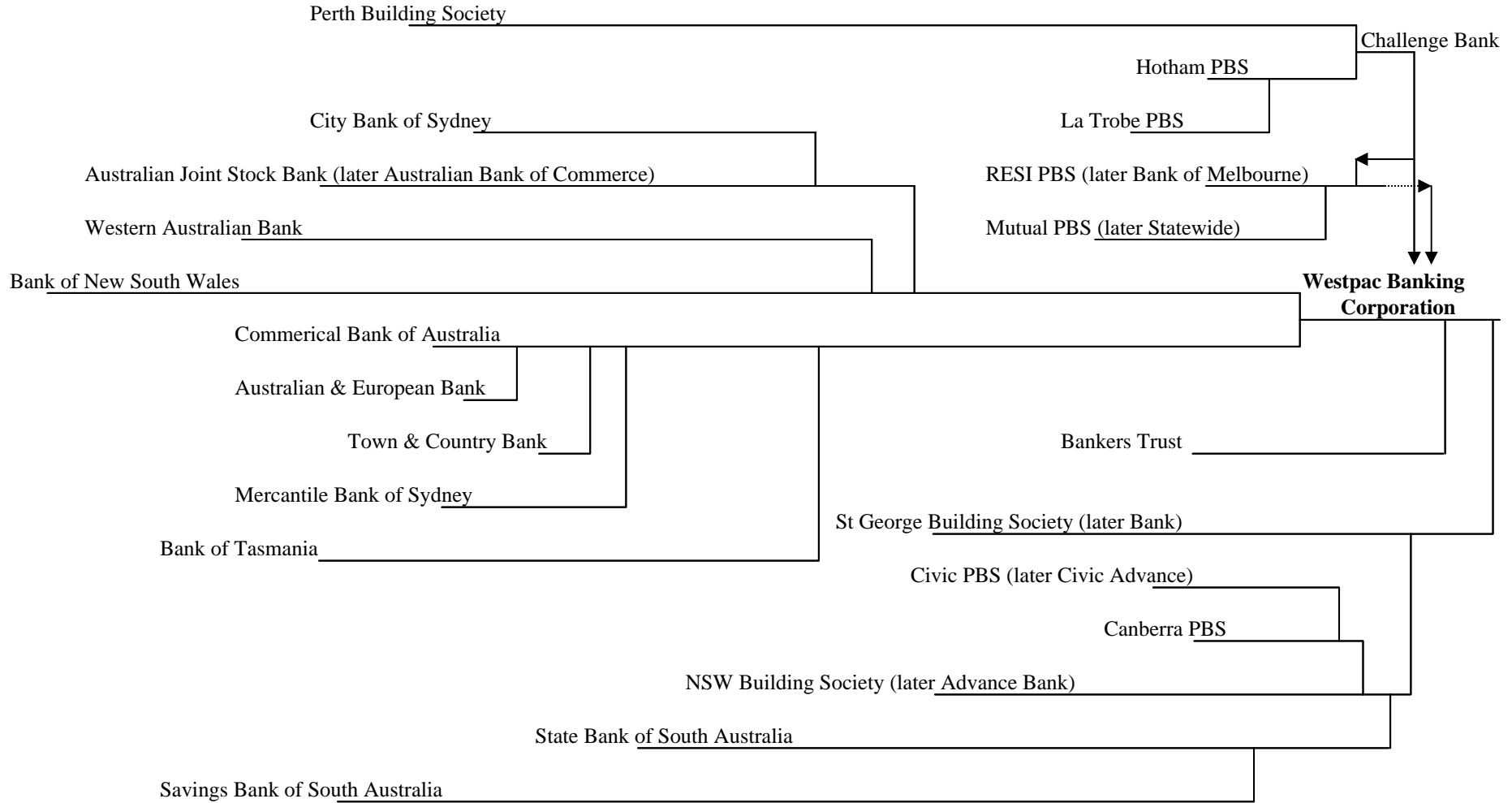
1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's



# Chart 4: Australian Banks Family Tree

## IV. Westpac

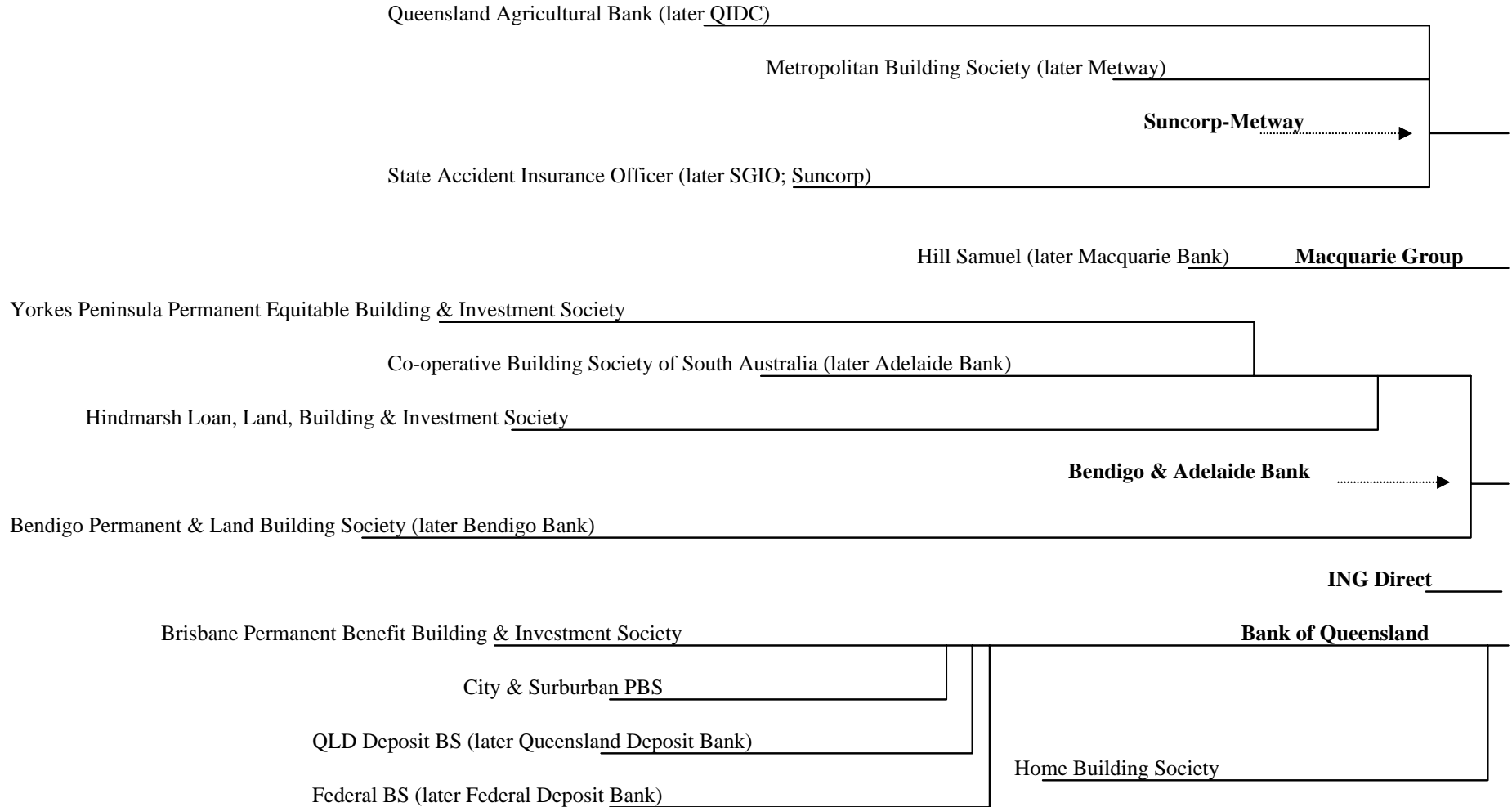
1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's



## Chart 5: Australian Banks Family Tree

### V. Other

1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's





# Chapter 3

## The economics of bank mergers

3.1 There are essentially four main views about the motivations for bank mergers.<sup>1</sup>

- The first is that it is about improving the efficiency of banking by realising economies of scale and economies of scope or allowing banks to meet the borrowing needs of increasingly large corporations.
- The second is that it is motivated by increasing market power (and hence profits), which will be reflected in lower interest rates on deposits and/or higher interest rates on loans.
- The third motivation is that banks may seek to merge in order to reach a size at which they are 'too-big-to-(be-allowed-to)-fail'. There is evidence that ratings agencies and markets believe that large banks are more likely to be assisted in a crisis than small banks.<sup>2</sup>
- The final view is that mergers are largely ego-driven, with bank management seeking the greater prestige and salaries that come from running a larger organisation.<sup>3</sup> (There are also defensive advantages in getting larger. It makes the bank less likely to become a takeover target itself, thereby protecting the CEO's position.)

3.2 It is only if the first reason is dominant that mergers may be in the public interest rather than just in the interests of the bankers. This chapter therefore concentrates on the evidence for economies of scale and scope in the international economics literature. The latter part of it addresses the question of whether a

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1 In addition, in some countries the authorities have driven the merger process under 'master plans' as a means of removing weak banks from the system, preferably before they failed; Mihaljek (2006).

2 Hawkins and Mihaljek (2001) show that the credit ratings of large banks are higher than those for small banks with the same inherent strength.

3 An econometric study by Bliss and Rosen (2001) supported this widely-held impression. 'Compensation generally increases even if mergers cause the acquiring bank's stock price to decline, as is typical after a merger announcement'; Warren Buffet (1993) holds a sceptical view about the benefits of mergers in general (not just banks), having said: 'I've observed that many acquisition-hungry managers were apparently mesmerized by their childhood reading of the story about the frog-kissing princess. Remembering her success, they pay dearly for the right to kiss corporate toads, expecting wondrous transfigurations. Initially, disappointing results only deepen their desire to round up new toads...Ultimately, even the most optimistic manager must face reality. Standing knee-deep in unresponsive toads, he then announces an enormous "restructuring" charge.'

'contestable' banking market allows greater concentration without banks increasing their margins.

### **Economies of scale in banking**

3.3 Very small independent banks may well be inefficient. In terms of costs, it would not be desirable for every suburb or town to have its own bank developing bespoke computer systems (including for internet banking), advertising, training staff and so forth. One response would be for the individual banks to buy these services from specialist providers or form syndicates to provide some of them.<sup>4</sup> But in most cases the model adopted has been for banks to spread these costs across a number of branches around the country. This also has the advantage that if a particular town is struck by a specific problem – a natural disaster or the closure of a large factory – the soundness of its bank will not be affected. Further diversification across different types of banking activity may be a further advantage.

3.4 It is also argued that, especially with prudential rules limiting large exposures to set proportions of capital, making large loans is only open to large banks. A variant of this argument is that large banks can be 'national champions' able to compete in international commercial markets, or develop a significant retail presence in emerging banking markets such as China. This view has been put by the four major banks in arguing that no restrictions should be placed on their ability to undertake further mergers:

To put it bluntly, the Australian majors need scale to compete with global banks...But the four pillars policy materially constrains us, both domestically and offshore...Westpac often finds itself competing against organisations 10 times our size. So no one should be too surprised when we do not feature in the “mega-deals”. Size does matter when it comes to lead bank roles and taking on the exposures involved.<sup>5</sup>

If Australian banks are to compete internationally, they will need to grow substantially. Scalability is important for operating in global markets, in which Australian banks are relative minnows.<sup>6</sup>

3.5 The four major Australian banks ranked between around 40<sup>th</sup> and 60<sup>th</sup> in the world by size of assets and capital in *The Banker's* 2009 survey.<sup>7</sup> While this is well up on the 75<sup>th</sup> to 105<sup>th</sup> places they held a quarter-century ago, it still leaves them well short of the world's leading banks. A merger between two of the major Australian

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4 For example, the smaller banks in Hong Kong formed a strategic alliance to develop new superannuation and life insurance products; Carse (2001). See also White (1998). Banks have long formed syndicates to make large loans.

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

6 Harper and Skeffington (2006, p. 38).

7 Since the global financial crisis wiped out considerable amounts of capital from many foreign banks, the Australian banks would now rank higher based on capital. As noted above, they also constitute four of only eleven banks within the world's 100 largest rated AA or better.



banks would not create a bank in the global top twenty. Indeed a merger of all four majors, giving virtually a domestic monopoly, would be needed to create a bank in the global top ten, or with a capital base comparable to that of the leading Chinese banks.<sup>8</sup>

3.6 Nor is it obvious that domestic mergers would make Australian banks more effective global competitors:

It has been convincingly argued that, in many cases, domestic rivalry rather than national dominance is more likely to breed businesses that are internationally competitive.<sup>9</sup>

3.7 As Professor Davis points out:

...the ability of a much smaller local bank (Macquarie) to compete in international investment banking, securities and wholesale markets would appear to weaken the argument, and suggest that 'culture' may be a more important issue than domestic commercial banking scale.<sup>10</sup>

3.8 Moreover, there are also disadvantages from banks becoming too large. Many customers believe that large banks lose touch with their communities. Local managers may be transferred interstate and not know their customers and their business. The perception that larger organisations give poorer, or less personal, service may be one reason why there is often a loss of a smaller bank's customers when it is taken over by a larger bank.<sup>11</sup> An industry rule of thumb is that typically about 5 per cent of the target bank's retail customers will transfer their business elsewhere as a result of a takeover.<sup>12</sup> This accords with the experiences of some local bank workers:

Every takeover I have been subjected to has lost business...When Trust Bank was bought out by Colonial, then CBA, we had an enormous amount of clients say, 'Well, if I wanted to bank with the CBA, I would already have been with them,' and they leave—over a period of time, because it takes a fair bit of effort to change banks.<sup>13</sup>

3.9 As banks become larger and more complex, it becomes much harder for head office management to keep control of the risks being undertaken. There have been

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8 Similarly, Harper and Skeffington (2006, pp 38-9) argue 'For example, if all the big four Australian banks merged, the new entity would be less than half the size of large US banks such as Citigroup or Bank of America.

9 Fels (1999, p 4).

10 Davis (2007, p 276).

11 Choice, drawing on results of customer satisfaction surveys by Roy Morgan pollsters, report that larger banks consistently have lower customer satisfaction; *Submission 6*, p 8.

12 Beal and Ralston (1998). Their own analysis of Australian bank mergers suggests a leakage of market share with mergers. It is also consistent with the results in Table 2.2.

13 Ms Carol Gordon, National President, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 6.

high profile cases of 'rogue traders' from large banks operating in complex derivatives markets causing huge losses.

3.10 Furthermore, even when mergers offer the *potential* to reduce costs, these gains may be hard to realise. Incompatibilities in computer systems are a common problem but there can also be significant challenges in reorganising management and dismissing excess staff while maintaining focus and morale, and merging institutional cultures.<sup>14</sup> One Japanese bank, some years after forming from a merger, had *three* HR departments, one for those staff from one of the constituent banks, one for those from the other and a third looking after staff who had joined since the merger.

3.11 The Australian Bankers' Association suggest 'a merger is assumed to offer benefits in terms of economic scale efficiency'.<sup>15</sup> But the available evidence questions this assumption.

### *Evidence on economies of scale*

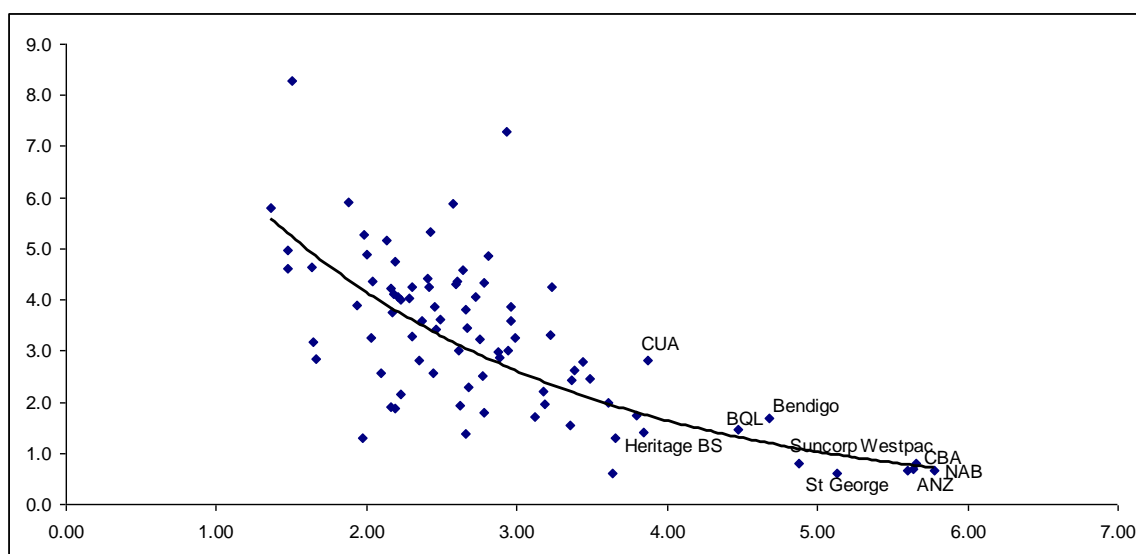
3.12 An indication of the extent of economies of scale is given in Chart 3.1, which summarises data from Australian banks, building societies and credit unions. The horizontal axis shows the size of institutions (measured by assets, on a log-scale so that small credit unions and the large banks both fit) and the vertical axis shows operating (ie excluding interest and write-offs) costs as a percentage to assets. If the operations of financial institutions were dominated by economies of scale the observations should lie around a downward-sloping curve. For the credit unions, this seems to be the case. But for the larger banks, the curve flattens: St George's operating costs were already a similar proportion to assets as the four major banks, even before its merger with Westpac. The chart does not therefore suggest that mergers of large banks are likely to generate significant gains in efficiency.<sup>16</sup>

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14 See Beal and Ralston (1998, p 30), Focarelli and Panetta (2003), Hawkins and Mihaljek (2001), Marcus (2001, p 135) and Rhoades (1998) for further discussion.

15 ABA, *Submission 14*, p 7.

16 When a higher-order polynomial was used to fit the trend line, it curved up towards the end, suggesting there were diseconomies of scale once intermediaries reached the size of the major banks.

**Chart 3.1: Australian financial intermediaries: size vs efficiency**

Source: Secretariat, based on data in KPMG, *Financial Institutions Performance Survey 2008*.

3.13 This result is consistent with empirical studies which have attempted to ascertain at what point the advantages of increasing the size of banks start to become outweighed by the disadvantages. A study by two BIS economists found that in some parts of the world, the average large bank had lower operating costs relative to assets than did the average small bank, but in other regions the small banks actually had lower average costs. However, despite these general results, there were many small banks with costs/assets ratios which compared favourably with the average large bank. In terms of profitability:

...smaller rather than larger banks were more profitable [on average]...mainly because larger banks...included a greater number of loss-making institutions (especially in Asia). Larger banks, however, have an advantage in returns on capital, because they are generally able to operate with smaller capital relative to the size of assets.<sup>17</sup>

3.14 Surveying the literature, they observe:

Recent econometric evidence on gains from mergers is therefore often weaker than the claims of the merging institutions. Some empirical studies found... economies of scale could be exhausted at relatively low levels.<sup>18</sup>

17 Hawkins and Mihaljek (2001, p 17).

18 Hawkins and Mihaljek (2001, p 34). McAllister and McManus (1993) found increasing returns to scale up to about US\$500 million in assets and constant returns thereafter. Berger et al (2000) found that average costs were usually minimised somewhere between US\$100 million and US\$10 billion in assets. IMF (2001) found some evidence of scale economies for banks with assets between US\$1 billion and US\$10 billion. Similarly the Group of Ten (2001, p 253) concluded: 'most research on the existence of scale economies in retail commercial banking finds a relatively flat U-shaped average cost curve, with a minimum somewhere around US\$10 billion of assets, depending on the sample, country and time period analysed.'

3.15 Subsequent studies continue to give at best very weak support to the efficiency gains from mergers, other than those between small banks. Some recent surveys of the literature found:

...findings of previous studies are consistently pessimistic. There is generally a lack of improvement in firm performance as a result of mergers.<sup>19</sup>

...little evidence that there are *significant* economies of scale or scope in banking at the institutional level.<sup>20</sup>

...the evidence for such cost economies arising from mergers in the financial services sector is at best ambivalent. Most studies of financial intermediaries, especially banks, show constant returns to scale over large ranges of output. The evidence for economies of scope is more encouraging but only slightly.<sup>21</sup>

...the bulk of empirical research shows no evidence of efficiency gains from bank mergers.<sup>22</sup>

...although some consolidations improve cost efficiency, others worsen the performance of the combined institutions. The net effect across all institutions is no significant gain in cost performance...many studies conclude that substantial economies of scale exist, but only up to a relatively small size. While there is a wide variation in the exact size of this cut-off point, the largest Australian banks are clearly above this point.<sup>23</sup>

...the available research literature seems to suggest that increasing bank market concentration and consolidation tend to drive loan rates up...<sup>24</sup>

Overall, there appears to be little evidence...that very large banks gain substantial cost savings from increased scale or product diversification...<sup>25</sup>

In general, most studies find only small economies of scale in a [financial] firm's cost structure. In those studies that find evidence of increasing returns to scale, the measured economies of scale seem to be stronger in small to medium-sized firms than for large firms.<sup>26</sup>

...consolidation in the financial sector is beneficial up to a relatively small size in order to reap economies of scale, but there is little evidence that mergers yield economies of scope or gains in managerial efficiency.<sup>27</sup>

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19 Wu (2008, p. 144).

20 Valentine and Ford (2001, p 51).

21 Harper (2000, p 69).

22 Buckley and Rayna (2001, p 205). Houston and Ryngaert (1994) reach similar conclusions.

23 Kent and Debelle (1999, p 18). Similar conclusions were reached by Brown and Brown (1995).

24 Carletti, Hartmann and Spagnolo (2002, p 41).

25 Davis (2007, pp 269-70).

26 Allen and Liu (2005, p 2).

27 Amel, Barnes, Panetta and Salleo (2004).

3.16 Similar results were obtained in two recent econometric studies of Australian banks:

For those four major banks that are found to operate over the range of diseconomies of scale, mergers among them will inevitably result in much lower efficiency in the consolidated banks and the overall banking sector.<sup>28</sup>

Decreasing returns to scale set in very quickly at less than \$10,000 million: almost all medium size and large banks exhibit decreasing returns to scale. This suggests a question mark over the economies of scale claimed at times by the proponents of mergers between the largest banks.<sup>29</sup>

3.17 Another reason why mergers may lead to reduced efficiency is that they may lead to banks that are too big to be allowed to fail. This reduces discipline on the banks. As one regional bank put it:

It is always the case that any institution considered too big to fail will lose internal discipline whilst parties dealing with that institution act as if that institution has a guarantee from the government. This becomes a self-fulfilling prophecy, with that institution gaining an unfair advantage in the risk-return tradeoffs, while its internal disciplines deteriorate until we have a situation like the recent US or UK experience.<sup>30</sup>

3.18 Another indication that bank mergers often fail to generate improved efficiency is the reaction of stock market valuations to them. Here most studies fail to find the market rewarding banks, either at the time the takeover is announced or after it has been realised. For example, Buckley and Rayna (2001) examined Westpac's takeover of Bank of Melbourne and found that while the takeover led to increased returns on Bank of Melbourne shares, it led to *decreased* returns on Westpac shares. Surveys of other studies of bank mergers conclude:

The main finding of the event studies looking at share prices around the time that a deal is announced is that, on average, total shareholder value (ie the combined value of the bidder and the target) is not affected by the announcement of the deal, since, on average, the bidder suffers a loss that offsets the gains of the target.<sup>31</sup>

...traditional studies fail to find conclusive evidence that bank mergers create value.<sup>32</sup>

...[study] finds a strong negative share price reaction following the acquisition.<sup>33</sup>

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28 Wu (2008, p 154).

29 Neal (2004, p 187). An earlier empirical study of Australian banks by Walker (1995, p 114) found 'constant returns to scale for long run costs'.

30 Mr Ram Kangatharan, Chief Financial Officer, Bank of Queensland, *Committee Hansard*, 1 July, p 3.

31 Group of Ten (2001, p 254).

32 Houston, James and Ryngaest (2001).

## **Economies of scope**

3.19 Merging banks with differing foci, or merging a bank with another type of financial institution, may allow cross-selling of products; such as selling insurance to customers with bank accounts. It may allow a reputable brand name to be used to sell more products (albeit at the risk of diluting the value of the brand). A humble bank branch may become a 'one stop financial shop'.

3.20 However, bringing together different types of financial institutions involves more difficulties in blending corporate cultures. It creates organisations which are harder to manage and harder to assess, and may give rise to conflicts of interest which 'Chinese walls' may not always effectively address (e.g. a bank simultaneously lending to a company, underwriting its securities and investing its customers' superannuation in the company's shares). Empirical studies have generally found economies of scope to be relatively small.<sup>34</sup>

3.21 The impact of the formation of financial conglomerates on financial stability is unclear, reflecting conflicting forces:

These are diversification, which will reduce the probability of individual bank failure, and contamination, which can lead to contagion flowing from failures in non-core banking activities.<sup>35</sup>

## **Concentration, contestability and interest margins**

3.22 The empirical literature on the relationship between concentration and interest margins is surveyed in Northcott (2004). There are many studies which suggest that more concentrated banking systems are associated with higher interest rates being charged for loans and lower rates being paid on deposits. In some cases, the results are not robust after controlling for other factors. In particular, low barriers to entry reduce the impact of concentration on interest margins. There do not seem to be any studies arguing that interest margins are *narrower* in more concentrated systems. The survey also refers to studies showing that more competitive banking systems tend to be more efficient.

3.23 Concentration ratios are only one aspect of assessing the competition within the banking market. The similarity of interest rates is not a good guide: while banks generally charge very similar rates for housing loans, this could be a sign either of a cartel or of very strong competition. Looking at how changes in interest rates charged move with the banks' costs of funds might suggest that the housing market is reasonably competitive but not the credit card market. One way the market can be

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33 Madura and Wiant (1994).

34 See, for example, Berger et al (1999).

35 Kent and Debelle (1999, p 33).

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made more competitive is by making it easier for customers to move between banks, and the Government is currently addressing this.<sup>36</sup>

3.24 Bank mergers, even if they lead to high concentration, will not harm consumers if it is easy for new banks to enter the market in response to any high profits observed. This is known as a 'contestable' market, and will mean that high concentration will not be associated with excessive profitability.

3.25 One factor that has made the Australian banking market more contestable is that the authorities no longer artificially restrict the number of banking licences. As Valentine and Ford (2001, p 42) put it, banking licences used to be like taxi licences but are now more like driver's licences.

3.26 Another change is that the rise of internet banking means there is less need to establish a physical 'bricks and mortar' network of branches in order to compete in the retail market. ING Direct is an example of a new bank that primarily operates in Australia via the internet:

Apart from Government obligations, banking is now a much more contestable market. In the past, banks derived considerable advantage from having extensive branch networks that made it expensive for new entrants to duplicate. The emergence of the Internet, electronic banking and emergence of the loan and equipment finance broking industry has eroded this advantage.<sup>37</sup>

3.27 Nonetheless, generally the most successful banks have had both branches *and* an online presence – the 'clicks and mortar' model. This is illustrated by the way the major banks, having reduced their branch networks in the 1990s, are now expanding them again.<sup>38</sup>

3.28 The ACCC's view is that:

...the barriers to large scale national entry for all retail banking products are high and are particularly significant for branch-centric products...current credit conditions have had the effect of raising barriers to entry for lenders. In particular, the closure of securitisation markets and the increase in the cost of credit has meant that many non-bank players have exited lending markets...the high degree of customer 'stickiness' for many retail banking products may further increase entry barriers...it is often difficult and time-consuming for a customer to compare one product with another. In

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36 See House of Representatives Standing Committee on Economics (2008).

37 Australian Bankers' Association, *Submission 14*, p 6.

38 See paragraph 6.2 below.

addition,...the inconvenience and, in some cases financial cost (e.g. mortgage exit fees), may deter switching.<sup>39</sup>

3.29 Choice does not regard the Australian banking market as very contestable:

The structure of the Australian banking market is such that there are significant hurdles for new entrants. This includes incumbents' branch network size, a payments system based on bilateral relations and the obstacles to consumer switching only partly alleviated by reforms instigated by the Treasurer in 2008. By its own admission BankWest was only able to enter the market because of the backing of a very powerful parent company (HBOS) and because pricing in the Australian market was uncompetitive. But BankWest has also acknowledged that complex and cumbersome switching procedures make it difficult to gain market share.<sup>40</sup>

3.30 Dr Jones characterises the experience of the foreign bank entrants in the 1980s as illustrating the barriers to entry in Australian retail banking:

The entrants were sizeable entities, but all found entry into retail (and small business/family farming) banking hampered by the expenses of duplicating the extensive branch network (recently compounded by the added capital expense of ATM installation) that characterises trading bank operations in Australia. Most of the entrants declined the prospect and the few who did were burnt.<sup>41</sup>

3.31 A contrasting view is put by the Australian Bankers' Association:

While banking has long been viewed as an industry characterised by high barriers to entry, evidence now shows that these barriers have fallen considerably... In the past, banks derived considerable advantage from having extensive branch networks that made it expensive for new entrants to duplicate. The emergence of the Internet, electronic banking and emergence of the loan and equipment finance broking industry has eroded this advantage. There is clear evidence in the banking market that some foreign-owned subsidiaries with a retail presence have managed to build large deposit and lending books without extensive branch networks...new entrants can purchase off-the-shelf credit scoring software that will enable them to accurately assess credit risk without needing extensive historical information.<sup>42</sup>

3.32 The ABA claims repeatedly in their submission that:

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39 ACCC, Public competition assessment, 'Westpac Banking Corporation – proposed acquisition of St George Bank Limited', 13 August 2008, paras 68 and 71, reproduced in ACCC, *Submission 4*.

40 Choice, *Submission 6*, p 7.

41 Dr Evan Jones, *Submission 5*, p 10.

42 Australian Bankers' Association, *Submission 14*, pp 5-6.



...academic studies have shown that there is no correlation between bank concentration and competition...<sup>43</sup>

3.33 However, there is a distinction between saying that concentration is not the only factor that determines competition in a market, and that increasing concentration will not reduce competition in that market.

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43 Australian Bankers' Association, *Submission 14*, p 16.



# Chapter 4

## Recent Australian bank mergers

### The Westpac takeover of St George Bank

4.1 Westpac (the second-largest bank by market capitalisation) announced its intention to take over St George Bank (the fifth-largest bank, which also operated 100 branches under the BankSA brand in South Australia) in May 2008 and sought informal clearance for the merger from the ACCC.<sup>1</sup> The offer of 1.31 Westpac shares for each St George share was equivalent to around a 25-30 per cent premium on St George's share price. It was not a hostile takeover as the St George board recommended acceptance by its shareholders. In November 2008, around 95 per cent of votes by St George shareholders were cast to accept this advice.

4.2 When the deal was announced, Westpac's share price fell and that of St George rose (as also happened when the deal was sanctioned by the ACCC in August). As noted above, this is not an unusual response to bank mergers.

4.3 Westpac's CEO described the motive for the merger as cost savings:

The increased scale and integration of operations would drive further investment in our back office processes ensuring more reliable, consistent and improved customer service.<sup>2</sup>

4.4 It would also allow St George, currently rated A, to raise funds more cheaply given Westpac's AA rating. This advantage has been increased since the global financial crisis, but it is wrong to suggest that St George was 'in trouble' before the merger:

St George made a stable \$1.17 billion net profit in the financial year 2007-08. Moreover, return on equity remains at over 20 per cent, compared to much lower figures for the ANZ and the NAB. St George was not vulnerable.<sup>3</sup>

4.5 Expected annual cost savings from the merger are around \$400 million, with one-off integration costs of around \$700 million being incurred over three years.<sup>4</sup>

4.6 Most of St George's branches are in NSW (where it emerged as a building society in the eponymous region) and South Australia (mostly from its inheritance of

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1 At various times ANZ and NAB had taken significant shareholdings in St George but did not proceed to making a takeover offer.

2 Gail Kelly, quoted in *The Australian*, 13 May 2008.

3 Dr Evan Jones, *Submission 5*, p 11.

4 *Australian Financial Review*, 18 December 2008.

the former State Bank of South Australia – see Chart 2.4). As Table 4.1 shows, unlike some previous bank mergers, this one is not 'plugging a gap'; Westpac was already strongly represented in these two states, and after the merger has many more branches than the other major banks. For example, in the Belconnen shopping mall (in the ACT) the combined bank now has two branches and four ATMs. In Lane Cove (suburban Sydney) there is a St George branch at 134 Longueville Rd and a Westpac branch at 138 Longueville Rd. A St George branch in Junction St, Nowra (in regional New South Wales) is in the same block as a Westpac branch.

**Table 4.1: Bank 'branches'<sup>5</sup> by state, June 2008**

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
St George	174	37	31	13	118	0	13	4
Westpac	277	190	163	104	51	22	10	9
<i>combined</i>	<i>451</i>	<i>227</i>	<i>194</i>	<i>117</i>	<i>169</i>	<i>22</i>	<i>23</i>	<i>13</i>
Commonwealth	365	293	150	77	60	42	17	5
ANZ	230	217	160	85	81	24	9	10
NAB	241	218	167	73	49	10	11	5

Source: APRA, *ADI Points of Presence*, June 2008.

4.7 As discussed in more detail below, Westpac claims it will continue to operate St George as a distinct retail brand. Initially, Westpac had expected to lose some St George customers as a result of the merger but this has not been happening to any marked extent.<sup>6</sup>

4.8 Scepticism about whether the merger was a fair contest motivated purely by a desire to realise efficiencies was fuelled by Westpac's appointment of the former CEO

5 Strictly speaking, 'points of presence offering a branch level of service', which APRA defines as offering the following services: 'accepts cash and other deposits (including business deposits) and provides change; facilitates the keeping of accounts for customer access, including the provision of account balances; opens and closes accounts; can facilitate or arrange the assessment of the credit risk of existing and potential customers; and offers additional services in the one establishment such as financial services, business banking and specialist lending.'

6 *Australian Financial Review*, 18 December 2008.

of St George, Ms Gail Kelly, as the new Westpac CEO, and her reportedly still being a large shareholder in St George when the takeover was announced.<sup>7</sup>

### ***Public attitudes***

4.9 A national opinion poll of 1 000 people found that:

- 75% believe that the merger would mean less competition;
- 89% do not believe that the merger would result in lower fees; and
- 69% believe that this merger would mean less pressure on banks to reduce fees and charges.<sup>8</sup>

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7 Westpac's Chairman has discussed the 'conflict of interest' arising from Ms Kelly's shares in St George in an interview on ABC's *PM*, 13 May 2008.

Westpac advised the Committee that Ms Kelly has honoured standard confidentiality obligations under her contract with St George; Westpac, answers to questions taken on notice, 27 August 2009. They also said that 'she was kept completely separate to all the dealings around the acquisition. In fact, there was a subcommittee of the board, as you would expect, looking at it and a separate management team looking at that acquisition, and Gail had no role to play in that'; Mr Brad Cooper, Westpac, *Proof Committee Hansard*, 10 August 2009, p 39. They had no comment on her St George shareholdings.

8 The poll of 1,000 people was conducted by McNair-Integrity in June 2008; Finance Sector Union, *Submission 12*, p 3.

## The Commonwealth Bank takeover of BankWest

4.10 The Commonwealth Bank's takeover of BankWest has taken it from having the fourth largest representation (by branches) in Western Australia to by far the largest (Table 4.2).

**Table 4.2: Bank 'branches'<sup>9</sup> by state, June 2008**

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Commonwealth	365	293	150	77	60	42	17	5
BankWest	18	8	4	87	1	0	0	0
<i>combined</i>	<i>383</i>	<i>301</i>	<i>154</i>	<i>164</i>	<i>61</i>	<i>42</i>	<i>17</i>	<i>5</i>
Westpac-St George	451	227	194	117	169	22	23	13
ANZ	230	217	160	85	81	24	9	10
NAB	241	218	167	73	49	10	11	5

Source: APRA, *ADI Points of Presence*, June 2008.

4.11 A clear difference from the St George takeover is that BankWest's ability to compete was under question. As the Commonwealth Bank and BankWest itself put it:

...BankWest would be under increasing pressure as a result of the pressure that its parent company was under, which I think was well known. The ACCC's investigations through its discussions, which obviously we were not able to have, gave it a clear view that BankWest was unsustainable in the form in which it had been.<sup>10</sup>

...there would have been a much greater risk of much higher job losses if the acquisition had not proceeded. The reason I say that is that the parent company, HBOS Plc in the UK, was in extreme difficulty...

4.12 This picture was broadly confirmed by the ACCC:

9 Strictly speaking, 'points of presence offering a branch level of service', which APRA defines as offering the following services: 'accepts cash and other deposits (including business deposits) and provides change; facilitates the keeping of accounts for customer access, including the provision of account balances; opens and closes accounts; can facilitate or arrange the assessment of the credit risk of existing and potential customers; and offers additional services in the one establishment such as financial services, business banking and specialist lending.'

10 Mr Ian Narev, Commonwealth Bank of Australia, *Committee Hansard*, 12 March 2009, p 19.

Unfortunately for competition, Bankwest suffered as a consequence of the impact of the GFC on its UK owner and we found quite convincingly, in our review of Commonwealth Bank-Bankwest, that without the merger Bankwest was not going to be the expansionary, innovative price leader that it had been. In fact, it was quite the opposite. It was, if anything, going to contract.<sup>11</sup>

4.13 One point of contention is whether BankWest's competitive potential had been permanently damaged:

When you dig down a little bit further, the reality is that the parent, HBOS, of Bankwest was bought out by Lloyd's and then Lloyd's was bought out by the government. So I think it was a bit premature to say that Bankwest would not have continued as an effective competitor because of the global financial crisis.<sup>12</sup>

4.14 Another was whether there were preferable ways of supporting BankWest that would not have had a detrimental impact on competition. The ACCC claimed:

We spoke to every firm, every bank, that had expressed any interest in acquiring Bankwest—and that included international banks, all the Australian banks, others—and it was quite apparent from our inquiries that if Commonwealth Bank did not buy Bankwest no-one else was likely to buy it. Essentially, we concluded that without the acquisition HBOS UK and Lloyds would continue to run Bankwest, but not at all in the way Bankwest had previously been run. It would no longer be the price leader. It would no longer be a vigorous or effective competitor.<sup>13</sup>

4.15 In apparent contrast, Bank of Queensland told another inquiry by this committee:

I would dispute the assertion that BankWest needed to be rescued by the Commonwealth Bank in the sense that if that deal had been available to the Bank of Queensland on the same terms, with the funding support and implied support from the regulatory authorities, then we would have been quite happy to take on that business; in fact it had a lot of synergies with us...

CHAIR—Were you offered that opportunity?

No.<sup>14</sup>

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11 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 27.

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

13 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 28.

14 Mr Ram Kangatharan, Chief Financial Officer, Bank of Queensland, *Proof Committee Hansard* (for Bank Funding Guarantees inquiry), 14 August 2009, p 31.

## Branding strategies

4.16 Westpac claims it will continue to operate St George as a distinct retail brand and not close St George branches:

Separate St George and Westpac branch networks and customer relationships will be maintained...no net branch closures. Continuing to invest in separate Westpac and St George brands and branch networks is considered critical to the future success of the merger.<sup>15</sup>

4.17 There have been some doubts expressed about the worth of this assurance:

Westpac has claimed that if the acquisition proceeds it will continue to operate St George as a distinct retail brand. The ACCC notes that even if this is the case, common ownership will remove the incentive for the two organisations to compete on price or on other aspects of the service offering.<sup>16</sup>

Gail Kelly will say that they will not close any St George branches. People will be sceptical about that. They'll obviously, if they can merge the two businesses, they can cut some costs out which of course will mean jobs.<sup>17</sup>

4.18 Similarly, the Commonwealth Bank and BankWest itself both assured the Committee that BankWest will continue to have an independent identity:

...the governance of BankWest remains under a board that is separate from the board of the Commonwealth Bank of Australia, and under a managing director who reports to that board. Decisions regarding the BankWest footprint, the BankWest strategy and the BankWest brand are all made by the managing director, John Sutton, his executive team, and approved by a separate board. From the point of view of the consumer in Western Australia, there is still a choice between two quite separate brands and two quite separate looks and feels that are not coordinated through common governance processes.<sup>18</sup>

Bankwest is a wholly owned subsidiary of the Commonwealth Bank but actually maintains an independent board of directors and has its own business strategy independent of the Commonwealth Bank. Bankwest has its own pricing committee, which sets its own mortgage and deposit rates and prices across all of its products. It remains quite independent from the Commonwealth Bank in those decisions.<sup>19</sup>

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15 Westpac, *Submission 11*, p 2.

16 ACCC, Public competition assessment, 'Westpac Banking Corporation – proposed acquisition of St George Bank Limited', 13 August 2008, para 56, reproduced in ACCC, *Submission 4*.

17 Then shadow treasurer Malcolm Turnbull MP, interviewed 12 May 2008.

18 Mr Ian Narev, Commonwealth Bank of Australia, *Committee Hansard*, 12 March 2009, p 18.

19 Mr Jon Sutton, Managing Director, Bank of Western Australia, *Proof Committee Hansard*, 2 July 2009, p.2.



4.19 When Westpac took over Bank of Melbourne in 1997, it kept the latter's separate identity for a few years but then closed many overlapping branches and the remainder were rebranded. Given this history, Westpac accepts that there is understandable scepticism about their promise to preserve the St George brand:

Senator EGGLESTON -- ...In Western Australia we used to have a bank called Town and Country Bank, which grew out of a building society that was taken over by ANZ. The Town and Country Bank customers were assured that nothing would change, but, of course, it did. In due course, Town and Country disappeared and their mortgages became ANZ mortgages with ANZ rules, which were very different to the kind of rules which had applied under the Town and Country Bank...

Mr Cooper -- ...this merger is very different to mergers that have gone on in the banking industry in the past. I note the example you provided for Western Australia. We have a similar example with the previous merger with the Bank of Melbourne. Of course, that brand does not exist anymore in Melbourne.<sup>20</sup>

Senator PRATT—... You cannot blame the Australian public for being suspicious when in the past commitments to keep separate branding, and therefore competition in the products that are offered, have eventually been phased out.

Mr Cooper—I understand some of that scepticism.<sup>21</sup>

4.20 One interpretation is that it is just about marketing the same product with different labels:

Senator EGGLESTON--...One might suggest it is like marketing of petrol. That all comes from the same refinery, but it is called Caltex, BP and Shell in different locations...What you are offering is finance under this heading of Westpac and St George, but in fact it is the same organisation with the same credit rating setting up different shopfronts.

Mr Cooper—But of course, how the customer experiences that relationship is through the interaction with the staff and the nature of service and quality of service that is provided under each of those brands. So the brand personality and what they stand for is central to why people choose to do business with one bank versus the other.<sup>22</sup>

4.21 This strategy may only work for a limited time. As one regional bank rival put it, the strategy seeks to exploit:

...the value that those brands have in the marketplace, where there are seen as different to the majors. So you are taking advantage of that differentiated brand value for a period of time until the consumer figures out that they are not doing business with Bankwest but they are actually doing business with

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20 Mr Cooper, Westpac, *Proof Committee Hansard*, 10 August 2009, p 36.

21 Mr Cooper, Westpac, *Proof Committee Hansard*, 10 August 2009, p 38.

22 Mr Cooper, Westpac, *Proof Committee Hansard*, 10 August 2009, p 37.

the Commonwealth Bank of Australia; they are not doing business with St. George but with Westpac. It affords the acquirer a period of time where the brand positioning that was built up over a number of years can be exploited...<sup>23</sup>

4.22 Alternatively the strategy may be about appealing to different customers' preferences, such as the extent to which customers are willing to pay a little more for better service:

Indeed, the service propositions, whether it is in call centres and so forth, are different as well. The number of staff per call in a St George call centre would be higher than, for example, in Westpac because the associates there would spend more time on the phone than Westpac.<sup>24</sup>

4.23 Indeed, this strategy would imply that the differences between the banks' images and service qualities should be widened rather than narrowed:

So it is incumbent on us to understand that distinctiveness, and in fact to accentuate it even more so that as a group we can appeal to more customers...<sup>25</sup>

4.24 To the extent that St George will be more focused on appealing to different sorts of customers to Westpac, there is a reduction in the competition for each of these groups.

### **Possible further mergers**

4.25 There is speculation about further mergers.

4.26 Measured by branch representation (Table 4.2) or assets (Table 2.2), the smaller of the four majors are now ANZ and NAB. A merger between them would create the biggest bank in Australia, with a market share of around 30 per cent, and the largest branch networks in New South Wales, Victoria and Queensland. However, mergers between the four majors are prohibited by the Government's 'four pillars' policy (see Chapter 5).

4.27 More likely are one of the majors taking over one of the remaining regional banks:

Westpac's takeover of St George was preceded by the merger of Bendigo Bank and Adelaide Bank, and there now suggestions that both Bank of Queensland and Suncorp-Metway are for sale.<sup>26</sup>

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23 Mr Ram Kangatharan, Chief Financial Officer, Bank of Queensland, *Committee Hansard*, 1 July 2009, p 4.

24 Mr Cooper, Westpac, *Proof Committee Hansard*, 10 August 2009, p 37.

25 Mr Cooper, Westpac, *Proof Committee Hansard*, 10 August 2009, p 37.

26 Abacus, *Submission 18*, p 2.

There are three reasonable size regional banks that remain in the marketplace. If majors want to pursue growth domestically then that would be one of the alternatives that they would look at.<sup>27</sup>

4.28 In terms of share of national market shares, the largest of the regional banks is Suncorp-Metway with 3 per cent of bank assets, followed by Bendigo-Adelaide with 2 per cent and Bank of Queensland with 1 per cent. On a national basis, a takeover of one – or even all – of these by ANZ would still leave it smaller than the Commonwealth Bank or Westpac. The impact by region would be more significant: ANZ combined with the three regional banks would have about half the branches in Queensland and over a third in Victoria.

### **Impact on consumer choice**

4.29 Bank customers may lose if mergers reduce competitive pressures in markets. Choice believes that there is now excessive market power held by the four largest banks, and that risks the following outcomes:

...crowding out new entrants, poor customer service, poor employee satisfaction, excessive fees and interest rates, low rates of customer switching, poor product innovation, reduced access to essential banking services, and reduced diversity in local areas.<sup>28</sup>

4.30 Particularly at risk may be the poor:

Previous mergers have been associated with branch closures which can disadvantage people on low incomes, as they often prefer to conduct their banking in-branch. This preference is partly due to limited access to other modes of banking, in particular online banking which requires a secure computer and internet connection.<sup>29</sup>

[Mergers motivated by cost-cutting are] ... particularly troubling when it applies to an essential service such as banking where some consumers and areas may not be 'profitable' and therefore not attractive to companies primarily focussed on the economic bottom line.<sup>30</sup>

4.31 In rural areas, bank mergers may intensify the pattern of closures of rural branches in small towns. This leads to customers going to larger towns for banking

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27 Mr David Foster, Group Executive, Suncorp Bank, *Proof Committee Hansard*, 10 August 2009, p 57.

28 Choice, *Submission 6*, p 5.

29 Brotherhood of St Laurence, *Submission 8*, pp 3-4.

30 Finance Sector Union, *Submission 12*, p 1.

business and then doing their other shopping there too, which adversely affects other stores in the small town.<sup>31</sup>

4.32 There is mixed evidence about whether larger banks are more likely to neglect small business customers once they are better placed to lend to large companies:

...the static effects of consolidation reduce small business lending, but are mostly offset by the reactions of other banks, and in some cases also be refocusing efforts of the consolidating institutions them selves.<sup>32</sup>

...large banks are found to lower the probability of obtaining credit for small businesses...<sup>33</sup>

...acquirers tend to recast the target in their own image [so that mergers between small banks have no impact, but a large bank taking over a small bank could reduce credit to small business]...<sup>34</sup>

4.33 Treasury agreed that smaller banks may be more prepared to lend to small business, particularly in difficult conditions:

Senator EGGLESTON—Do you suppose that the local banks might have a better perception of local economic circumstances and be more prepared to consider propositions because they better understand the local economy?

Mr Murphy—Yes.<sup>35</sup>

4.34 There remains plenty of competition in terms of numbers of products:

...125 mortgage providers are providing over 2,000 mortgage products in Australia and 78 card providers provide over 330 types of credit cards. We have 114 providers of deposit accounts and there are 900 or more types of accounts. There are 32 providers of 39 different small business commercial loans, which represent a lot of different products.<sup>36</sup>

4.35 However, these numbers are inflated by large numbers of small credit unions offering the same basic products. There are concerns that bank mergers will reduce *innovative* or more keenly priced products:

Senator EGGLESTON—...In personal banking, the smaller banks, the provincial banks and the building societies offered a wider variety of innovative products than the big four do. The loss of various building

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31 Ralston and Beal (1997) report that a survey showed that 88 per cent of people shopped less in the local town after the bank branch closed. See also the discussion in Joint Committee on Corporations and Financial Services (2004, pp 35-7), who remark 'the loss of a bank branch threatens to undermine the economic life and confidence of the community'.

32 Berger et al (1998).

33 Craig and Hardee (2007).

34 Peek and Rosengren (1998).

35 Mr Jim Murphy, Executive Director, Treasury, *Committee Hansard*, 12 March 2009, p 30.

36 Mr Jim Murphy, Treasury, *Committee Hansard*, 12 March 2009, p 28.

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societies has lessened the range of products available to the public, as a matter of fact, in personal banking.

Mr Grimwade—I think that is correct.<sup>37</sup>

4.36 One major criticism of the industry is that, while there may be plenty of organisations offering services, the services offered are 'plain vanilla':

Part of my job is comparing competitors' products with our products and the four major banks' products. Every one tweaks a little bit. They will muck around with an ongoing fee or the up-front fee or they will shave an extra 0.1 per cent off a rate or something like that. There is no fabulously sexy product that one of them offers that the other three do not, in my experience, and the minute anyone comes up with a new version of something, the others just copy it anyway... they are all pretty well variations on a theme and, to be honest, everyone in the entire industry has got a similar suite of products.<sup>38</sup>

4.37 A regional rival bank emphasised that it not just bank deposits and loans for which the mergers are increasing concentration, but also wealth management services:

...all four of the major banks have very, very significant wealth management businesses that seek to access and control the superannuation related savings of Australians. When we define the market and the products in the constructs we have had in the past, I think there is a tendency to miss how the advantages gained from another subsegment of the financial services business can cross-subsidise and give the majors a competitive advantage that they can use to clear the field of the smaller competitors.....if you control 30 per cent of the financial planners in the country because you are in the wealth management business and they are tied advisers, it gives you a unique opportunity to bundle those services with banking products and to price it in a manner that effectively excludes competition in the banking market.<sup>39</sup>

4.38 The Law Council of Australia asserted that mergers led to benefits for consumers:

Mergers... are an important aspect of a fully functioning and efficient economy. Mergers enable efficiencies to be achieved, ineffective competitors to exit the market and product and service innovation to occur.<sup>40</sup>

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37 Mr Tim Grimwade, ACCC, *Committee Hansard*, 13 March 2009, p 27.

38 Ms Carol Gordon, National President, Finance Sector Union, *Proof Committee Hansard*, 13 March 2009, p 10.

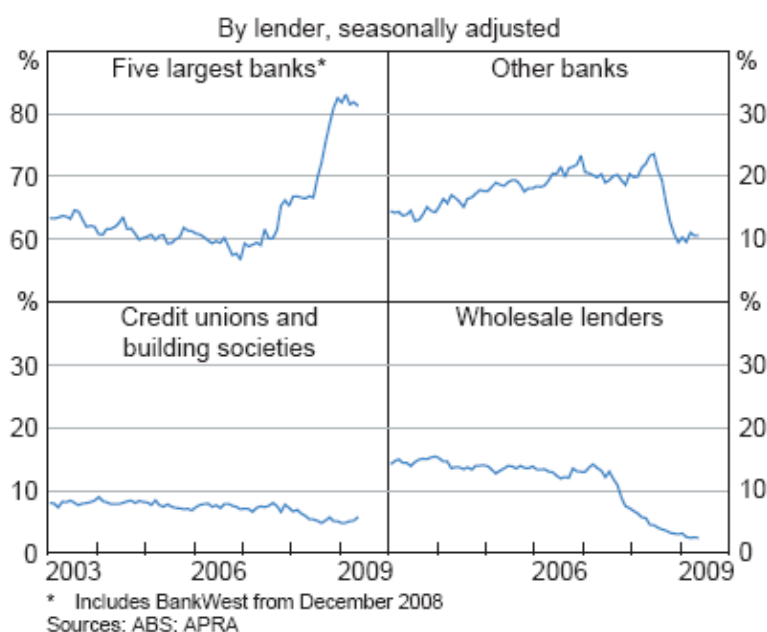
39 Mr Ram Kangatharan, Chief Financial Officer, Bank of Queensland, *Committee Hansard*, 1 July, pp 4-5.

40 Law Council of Australia, *Submission 15*, p 2.

4.39 Asked about what benefits St George customers might expect from the Westpac takeover, the only tangible example Westpac gave was access to a larger ATM network without fees. They also claimed Westpac was 'a much safer and more highly rated financial services provider', but did not explain in what way Westpac was safer than the equally supervised and the traditionally more conservative, retail-focused St George.<sup>41</sup>

4.40 Arguably the main area of concern about consumer choice is that of housing loans. The effective closure of securitisation markets and cutbacks in other sources of wholesale funding hit non-bank entities particularly hard. This has seen the major banks increase their share of this business. Following the Westpac-St George merger, four banking groups now account for over 80 per cent of new lending for home purchases (Chart 4.1).

**Chart 4.1: Share of owner-occupier loan approvals**



Source: Reserve Bank of Australia, *Statement on Monetary Policy*, August 2009, p 60; update of chart in APRA, *Submission 16*.

### Impact of mergers on system stability

4.41 Mergers may have adverse impacts on system stability, although studies are inconclusive:

41 Westpac, answers to questions taken on notice, 27 August 2009.

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A more consolidated system has fewer banks, therefore we expect to see fewer bank failures. However, in a more consolidated system the banks are bigger, so that a single bank failure has a much greater impact.<sup>42</sup>

...on the basis of this literature one cannot ascertain a clear-cut relation between the effects of consolidation and bank or systemic risk.<sup>43</sup>

There has thus been a view (often unstated) that there is a trade-off between the efficiency benefits of increased competition and the risk of instability in the financial sector arising from reduced concentration. There have been a number of arguments advanced in support of that view. First, larger banks may tend to be more diversified ...Second, larger banks may be better able to implement sophisticated risk management systems...Third, higher profitability arising from lessened competition generates a franchise or charter value exceeding book value...[which] acts as a disincentive to excessive risk-taking...Fourth, a small number of larger banks may be easier for regulatory authorities to effectively monitor and may involve less risk of contagion...there are equally plausible counter-arguments. The systemic importance of large banks may induce a too-big-to-fail attitude...leading to excessive risk-taking. Market power may also enable banks to charge higher interest rates on loans, possibly inducing greater risk-taking by their borrowers. Big banks may be more opaque, and internal control systems may become less effective with large scale... The empirical literature has produced mixed results...<sup>44</sup>

## Impact on interest margins

4.42 Mergers increase concentration in banking markets and this allows greater scope for explicit collusion, or just a less keen approach to competition. Both can lead to wider interest margins. Associate Professor Zumbo submitted:

There is no doubt that the greater the levels of market concentration, the greater the likelihood that consumers will be price gouged. The reason for this is quite simple. As markets become more concentrated, the opportunities for either collusion or parallel conduct with respect to pricing and related matters grow considerably. Within this context, banking mergers, as with other mergers across the economy, present a real and very serious risk to competition and consumers... the danger of mergers is that any efficiencies or reduction in costs that may be realised through a merger will not be passed onto consumers for the simple reason that as mergers remove competitors from the market, there will be fewer competitors left to take an independent stance to drive down prices to consumers.<sup>45</sup>

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42 Kent and Debelle (1999, p 31).

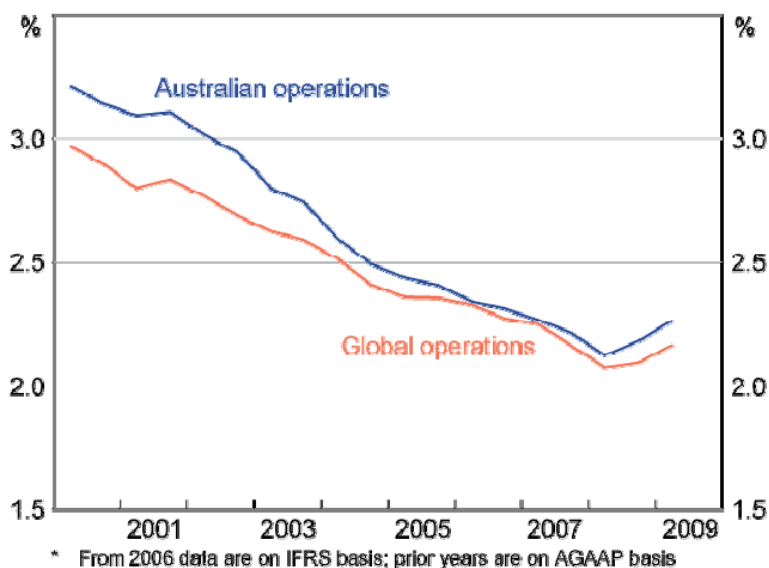
43 Carletti, Hartmann and Spagnolo (2002, p 44).

44 Dvairs (2007, pp 270-1).

45 Associate Professor Frank Zumbo, Submission 19, p 1.

4.43 After a long period when increased competition put pressure on bank interest margins to narrow, they have recently widened (Chart 4.2).

**Chart 4.2: Major banks' net interest margin**



Source: Reserve Bank of Australia (2009, p 4), reproduced in Associate Professor Frank Zumbo, *Submission 19*, p 4.

4.44 This is mainly attributable to the global financial crisis which reduced the capacity of non-bank lenders to compete by offering loans funded from international securities markets. It is hard to tell the extent to which recent mergers have also contributed.

4.45 Associate Professor Frank Zumbo commented:

...the four major banks have increased their market share in home lending and in deposits significantly—certainly in the previous 18 months. We have seen increases in fees over a period of time; we have seen an increase in interest margins over a period of time... That is very troubling because all of those are indicia of a competition that is weakening and perhaps failing... in the space of 18 months, we have lost two vigorous competitors—the Commonwealth Bank has taken out Bankwest. Bankwest has been a significant, vigorous and independent player in the market. The Commonwealth Bank previously took ownership stakes in Aussie Home Loans and Wizard. Those two—Aussie Home Loans and Wizard—were significant non-bank mortgage providers. Westpac took out St George and previously RAMS Home Loans... the net interest margins started to increase after Bankwest, St George and those non-bank providers were taken out of the picture.<sup>46</sup>

46 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 10 August 2009, pp 69- 70.



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## The global financial crisis and bank mergers

4.46 According to the ACCC, the global financial crisis may have reduced the impact on competition from takeovers of second tier banks by the four majors. Commonwealth Bank comment that in approving their takeover of BankWest, the ACCC held that:

... in the face of the global financial crisis and the financial situation of BankWest's UK parent company, HBOS plc, BankWest's operating model would be significantly scaled back given the parent company's reduced risk appetite. Under these circumstances, the BankWest business would no longer continue to grow and competitive pricing would cease.<sup>47</sup>

4.47 However, it could be argued that the crisis is a temporary phenomenon but any reduction in competition from a merger would be permanent.

4.48 Choice reaches the opposite conclusion about the implication of the financial crisis, arguing:

The crisis has already reduced competition and will continue to alter the nature of markets for some time. If the recent mergers were being proposed during a period of robust competition, there would at least be non-bank competitors able to keep rates and fees in check in the lending markets. But at this time, in this environment, competition cannot sufficiently constrain excessive market power... the global financial crisis has impacted directly on the competitive dynamics of the Australian financial system. The RBA's specific concerns were in the collapse of non-ADI mortgage originators in the owner-occupied home loan market and the corresponding sharply rising dominance of the Big Four banks... In recent months interest rate margins on credit cards, home loans and personal [loans] have all crept above their long term average.<sup>48</sup>

4.49 Were the crisis to lead to distressed banks in Australia, as it has overseas, there would be a stronger case for being more lenient towards takeovers. There is arguably no more reduction in competition from a bank being taken over than from it failing, and there are advantages in terms of financial stability and preserving jobs.

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47 Commonwealth Bank, *Submission 2*, p 2.

48 Choice, *Submission 6*, pp 5-6. A similar view has been expressed by Professor Allan Fels, ABC News, 13 May 2008.



# 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.<sup>1</sup> 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.<sup>2</sup>

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.<sup>3</sup>

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.<sup>4</sup>

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.<sup>5</sup>

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.<sup>6</sup> 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.<sup>7</sup>

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.<sup>8</sup>

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.<sup>9</sup>

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.<sup>10</sup>

There needs to be a demonstrated, specific public benefit, ie customer benefit, in relation to any proposed merger.<sup>11</sup>

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.<sup>12</sup>

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.<sup>13</sup>

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.<sup>14</sup>

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.<sup>15</sup> 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, *Submission 14*, p 10; Law Council of Australia, *Submission 15*, pp 8, 10.

financial crisis (although perhaps stabilising), have not yet fully worked through the economy.<sup>16</sup>

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...<sup>17</sup>

### ***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.<sup>18</sup>

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.<sup>19</sup>

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 divestiture where the competition commission there can make an order where the market structure is such that it is detrimental to consumers and competition.<sup>20</sup>

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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.<sup>21</sup>

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'.<sup>22</sup>

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.<sup>23</sup>

### ***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':<sup>24</sup>

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.<sup>25</sup>

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.<sup>26</sup>

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.<sup>27</sup>

### ***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'.<sup>28</sup> 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.<sup>29</sup>

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.<sup>30</sup>) 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...<sup>31</sup>

**Table 5.1: ACCC's view of banking markets**

<i>Product dimension</i>	<i>Geographic dimension</i>	<i>Functional characteristics</i>
<b>Personal banking markets</b>		
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.
<b>Business banking markets</b>		
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.<sup>32</sup>

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.<sup>33</sup>

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.<sup>34</sup>

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.<sup>35</sup>

### ***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.<sup>36</sup> The Finance Sector Union goes further, arguing 'the ACCC should publish all information associated with merger reviews unless there are compelling reasons otherwise'.<sup>37</sup>

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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.

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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.<sup>38</sup>

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.<sup>39</sup>

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.<sup>40</sup>

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

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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).<sup>41</sup>

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.<sup>42</sup>

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.<sup>43</sup>

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...<sup>44</sup>

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.<sup>45</sup>

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.<sup>46</sup>

## 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.<sup>47</sup>

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:

- number of providers
- rates of customer switching
- customer satisfaction
- interest rate margins
- concentration ratios and disaggregated market share data
- local points of service.<sup>48</sup>

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.<sup>49</sup>

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.<sup>50</sup>

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.<sup>51</sup>

## **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.<sup>52</sup> 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.<sup>53</sup>

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.

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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.<sup>54</sup>

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.<sup>55</sup>

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.<sup>56</sup>

5.56 A 1998 opinion poll found that two-thirds of those surveyed oppose a merger between the four major banks.<sup>57</sup>

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.<sup>58</sup>

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.<sup>59</sup>

...the policy is an anachronism, a woolly mammoth dug from the Siberian tundra and shipped still frozen to Australia as a structure for banking.<sup>60</sup>

5.58 While a similar veto exists in Canada, bank mergers do not need government permission in France, Germany, the UK or the US.<sup>61</sup> 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.<sup>62</sup>

5.63 The Treasurer imposed a number of conditions.<sup>63</sup> *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.<sup>64</sup>)

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.<sup>65</sup>

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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.<sup>66</sup>

5.67 Treasury will be 'monitoring' compliance, but only by looking at six-monthly reports by Westpac, not verifying them.<sup>67</sup>

5.68 The ABA breezily assured the Committee there was 'no realistic scenario in which the conditions will not be fully met'.<sup>68</sup> 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.<sup>69</sup>

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'.<sup>70</sup> 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'.<sup>71</sup>

5.71 The Brotherhood of St Laurence was also concerned about 'the lack of any appropriate monitoring and enforcement of these conditions'.<sup>72</sup>

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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.<sup>73</sup> A similar suggestion is made by the Finance Sector Union.<sup>74</sup>

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.<sup>75</sup>

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.<sup>76</sup>

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.<sup>77</sup>

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.<sup>78</sup>

### *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

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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.<sup>79</sup>

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.<sup>80</sup>

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...<sup>81</sup>

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.



# Chapter 6

## Employment and 'offshoring'

### Employment in banking

6.1 The Australian Bankers' Association report their members employed 138 000 Australians at end-2007, an increase of 10 000 from end-2005 which they attribute to opening of new branches in fast-growing areas.

6.2 This represents a reversal after the 1990s, when banks were generally reducing their staffing. The Australian Bankers' Association described the experience as follows:

Banks had not had competition from non-deposit taking institutions before in housing lending. They used to pay for their branch networks by charging the customer where it was in the interest margin. In a sense, those who had a home loan were paying a higher interest rate to cover the costs of these extensive branch networks. When Aussie Home Loans and other non-bank lenders came into the market, they did not have massive branch networks that they had to support so they could offer lower interest rates. The banks found themselves in a situation where they had extremely large and costly branch networks, but they were now facing competition in the lending portfolio from these new players who could offer much lower rates.

We saw a dynamic situation in the 1990s which took a lot of adjustment in the community. The banks started reducing some of those costs, closing some of the branches, and introducing fees to compete, if you like, against the non-bank lenders. That process worked its way out. If you look at the statistics over the past three or four years you will find that branch numbers are starting to increase again, in some banks at reasonably fast rates. We have, if you like, a heightened recognition in the banks now that the branches are providing good services. That is also helped by the fact that there is more of an acceptance in the community that they can charge fees for those services. You can start paying for branches through the imposition of fees.<sup>1</sup>

6.3 The ABS report a broader category of 'finance', which employed 210 000 Australians in November 2008, unchanged from a year earlier and about the same as two decades ago.

6.4 The global financial crisis might have been expected to have affected banking more than other industries. The ABS' seasonally adjusted data on employment in 'financial and insurance services' showed an almost 5 per cent drop in late 2008, but has since steadied.

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1 Mr Nicholas Hossack, Australian Bankers' Association, *Committee Hansard*, 12 March 2009, p 17.

6.5 Mergers almost invariably lead to a loss of jobs. However, the Australian Bankers' Association argue:

In banking, two features of the employment market have historically assisted in reducing the difficulties caused by redundancies. Firstly, banks pay above average redundancy benefits which – all other things being equal - afford redundant staff a longer period to find alternative employment. Secondly, unemployment in financial services is low compared to other industries...<sup>2</sup>

6.6 A concern for banking workers, particularly in call centres, is that job security is being eroded by increasing use of part-time and casual workers, and mergers raise further doubts:

At the contact centre where I work in Parramatta, probably for the last six months or so we have no longer been employing full-time staff. Everybody that is coming through now is a temp, which leaves us a bit out in the air as to the future of our jobs and what is going to happen.<sup>3</sup>

6.7 Currently, about 96 per cent of men in finance work full-time and 74 per cent of women. Twenty years ago, the proportions were 98 and 77 per cent.

6.8 An FSU official told of her own disruptive experiences of multiple takeovers:

The first one is that when the announcement was made that Tasmania Bank was going to be taken over by the SBT...most of our staff found out that we were being sold to someone else in a newsflash about nine o'clock that night. I turned up to work the next morning to a branch that was full of people who looked shell-shocked. They looked ashen-faced. They looked like they had been kicked in the guts and, I can tell you, that is exactly what it felt like. Another merger on, we had been sold off to Colonial. Before we even knew what jobs we had under the Colonial structure, we found out that Colonial was being bought out by CBA, so no matter what people were feeling not knowing what jobs they had under Colonial, it was doubled when they realised that they were going to get maybe a job in the Colonial structure and then have to go through the same thing again in six months time with the CBA... There is a human cost to this. We are not just collateral damage.<sup>4</sup>

## **Employment impact of mergers**

6.9 Westpac told the Committee:

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2 ABA, *Submission 14*, p 8.

3 Ms Linda Blackmore, Member, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 4.

4 Ms Carol Gordon, National President, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 6.



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...no customer-facing jobs have been lost through the merger process...<sup>5</sup>

6.10 The qualification is necessary as the merger will lead to losses of back office jobs. Westpac elaborated:

It is true, though, that we have during the early period of the merger looked to consolidate some of our group functions, most notably around our financial, human resources and risk functions. People affected by those consolidations have been offered alternative employment. Where that has been able to be satisfied, we have been able to move those people into the roles; where not, then those people have been offered and received redundancy packages.<sup>6</sup>

6.11 The St George chairman commented:

Unfortunately there may well be some job losses, mainly in the back office and head office functions, which are inevitable with any merger but Westpac have given a commitment to minimise job losses through natural attrition and redeployment wherever possible.<sup>7</sup>

6.12 The Finance Sector Union expects the merger to lead to a loss of 5 000 jobs.<sup>8</sup> Press reports suggest about 2 000 jobs will go.<sup>9</sup>

### **'Offshoring' of jobs by banks**

6.13 'Offshoring' refers to firms moving jobs to their overseas posts. (It is therefore distinguished from 'outsourcing'; contracting out the work to a specialist company which may operate domestically or overseas.) The main areas of 'offshoring' in banking are call centres and 'back office' processing. India, where educated English-speakers are common and wages only around a quarter those in Australia, is a popular destination for offshoring by Australian banks.

6.14 Consumers often prefer dealing with local call centre operators, but the offshore centres make efforts to disguise their location.<sup>10</sup> The FSU believe they should

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5 Mr Brad Cooper, Westpac, *Proof Committee Hansard*, 10 August 2009, p 30.

6 Mr Brad Cooper, Westpac, *Proof Committee Hansard*, 10 August 2009, pp 31-2.

7 Mr John Curtis, quoted in *Business Spectator*, 13 November 2008.

8 FSU *Submission 12*, p 5. They estimate that 8,000 jobs were lost when the Commonwealth Bank merged with the State Bank of Victoria; 1,400 when Westpac took over Bank of Melbourne and 4,500 when Commonwealth took over Colonial.

9 For example, *The Australian*, 18 December 2008.

10 FSU, *Submission 12*, Attachment 9, gives an example of bank employees being instructed not to tell customers that files are being processed in Pune (western India).

be forced to disclose their location, as has been legislated in France, and they report polling suggesting that 85 per cent of bank customers agree.<sup>11</sup>

6.15 Offshore call centres may not be subject to as stringent data security procedures as domestic centres. Some unions suggest that information should not be sent offshore without customers' consent:

...before any personal or banking data is sent overseas, that should require the express written permission of the consumer.<sup>12</sup>

6.16 The FSU also questions whether offshoring is good for the Indian workers, who are often required to affect western accents and work night shifts (due to the time zone difference with Australia) in what may amount to 'white-collar sweatshops'.<sup>13</sup> But presumably they regard these jobs as better than the alternatives available in India or they would not be working there.

### **The extent of offshoring**

6.17 The Finance Sector Union suggests over 160 000 jobs in the finance industry could potentially be shifted offshore, along with 110 000 in the related areas of insurance and 'services to banking and insurance'.<sup>14</sup> An OECD (2005) study suggested that over 70 per cent of jobs in these areas could be 'potentially affected by offshoring'. Of course, this is *not* a forecast that this number of jobs *will be* offshored.

6.18 APRA does not collect data on offshoring.<sup>15</sup> There have been reports of significant offshoring by banks in recent years. Examples include ANZ shifting 1,100 software development and IT positions to Bangalore in November 2005; Citigroup replacing the 150 jobs in its Brisbane call centre with positions in Manila; NAB shifting 220 IT and accounts processing positions to Bangalore in 2005 and 2006 and a further 500 jobs to India in 2008; St George shifting 100 jobs involving credit cards to India in September 2006 and a further 30 in May 2007 and Westpac moving over 500 back office processing and retail administration jobs to India in September 2006.<sup>16</sup>

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11 Finance Sector Union, *Submission 12*, p 12. Similarly, the Hon Dr Bob Such MP has suggested 'bank customers should be advised in simple terms of the extent to which services have been 'off-shored' so that they can decide whether to do business with the bank or not'; *Submission 21*, p 2.

12 Mr Leon Carter, National Secretary, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 4; Finance Sector Union et al 2006, p 4, reproduced as Appendix 8 in FSU, *Submission 12*.

13 Finance Sector Union et al 2006, p 6, reproduced as Appendix 8 in FSU, *Submission 12*.

14 Finance Sector Union et al 2006, p 8, reproduced as Appendix 8 in FSU, *Submission 12*.

15 APRA, *Submission 16*, p 5.

16 Finance Sector Union et al 2006, p 9, reproduced as Appendix 8 in FSU, *Submission 12*; *Brisbane Times*, 24 June 2008; Finance Sector Union media release, 16 May 2007,

6.19 The Finance Sector Union told the Committee:

So far, by our count—and we believe it is a conservative estimate—over 4,900 jobs have been offshored out of the Australian finance industry.<sup>17</sup>

6.20 According to media reports, the ANZ is considering replacing 620 Australian back office positions with places in Bangalore during 2009, although it claims it will be retaining its call centres in Australia.<sup>18</sup>

6.21 The ABA estimates that:

...around 3,200 full-time employment positions have been impacted by services being sourced offshore over the past few years, equivalent to about 2.4% of the total workforce of ABA member banks.<sup>19</sup>

6.22 Moreover it argues that by increasing bank profits offshoring creates more jobs in Australia. The ABA also argued:

...there is an insufficient supply of suitably qualified Australian-based workers to fill the demand by banks.<sup>20</sup>

6.23 The Australian Bankers' Association told the Committee:

...I do not think any of the Australian-owned banks have call centres located outside Australia and New Zealand. The offshoring we have seen has mainly been in back office, IT, computer software development, and essentially in Bangalore, India.<sup>21</sup>

6.24 A number of submissions by individual bank employees referred to their concerns about past or pending offshoring:

...the loss of jobs will have the effect of increasing unemployment levels within Australia which is particularly worrying in the current economic climate...The current financial crisis may mean that the employees made redundant find it difficult to obtain new positions. There is also a large emotional cost involved which doesn't seem to concern the decision makers. A large number of these employees were long standing and loyal workers who feel that their services have not been appreciated...The level of customer service provided will never be the same when roles are completed overseas so the general Australian public also suffer due to offshoring.<sup>22</sup>

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17 Mr Leon Carter, National Secretary, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 7.

18 *The Age*, 17 December 2008.

19 ABA, *Submission 14*, p 13.

20 ABA, *Submission 14*, p 13.

21 Mr Nicholas Hossack, ABA, *Committee Hansard*, p 8.

22 Ms Elizabeth Harvey, *Submission 1*, p 1.

...it appears that slashing employee and premises costs was the main driver behind the decision to centralise/outsourced/offshore practically all of [Lending Services Queensland, a regional back office loan processing centre]...service and quality levels are already suffering or will suffer, which could ultimately result in the bank losing market share/profitability as a result...[as] we're also wiping out a great deal of our corporate "memory" or "knowledge", as experienced and dedicated staff are forced out of these lending centres and can no longer be a "point of reference" for less experienced branch staff.<sup>23</sup>

NAB is now in the process of off-shoring another 1500 Lending Services positions for what they say is to improve efficiency. I believe efficiency will not improve and further more, customer service to our bankers will deteriorate. I also believe the only reason NAB is off-shoring any jobs they can is primarily to cut costs...that is the bottom line!<sup>24</sup>

This is not a move made to increase customer service levels but a short-sighted attempt to cut costs at the expense of hard-working and decent people. The fact is that our jobs are being moved to a country where industry working standards and wage levels are significantly less than what they are in Australia.<sup>25</sup>

6.25 Some bank workers told their story to the Committee at a public hearing:

I have been employed on a full-time basis by the National Australia Bank for the last 15 years...My duties include pre-processing of loan applications to ensure bankers' submissions are adherent to policy and procedure; preparing documentation such as loan contracts, mortgages and releases; and providing breakthrough customer service to bankers to ensure delivery of documentation is both timely and efficient...last year, I was advised that my position was to be outsourced to India... By June this year, Lending Services Queensland will dramatically shrink from 300 employees to 60, and there are further reviews taking place at the moment... In recent weeks I have seen firsthand the problems the bank is already having with lending services in Jaipur in India. There is a lack of customer service in comparison to our centre and there are also language and communication barriers that have become apparent.<sup>26</sup>

My role was cash balancing, which is balancing all the cash that comes into and goes out of the branches every day...Our jobs were offshored...The way that I have seen it, it certainly has not been working. We have had a lot of complaints. We have a language barrier. We have all sorts of problems. Westpac are not interested in doing anything to alleviate that problem. The

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23 A bank employee, *Confidential Submission 7*, pp 1-2.

23 A bank employee, *Confidential Submission 7*, pp 1-2.

24 Mr Mark Wilkins, *Submission 9*, p 1.

25 Mr John Minuti, *Submission 10*, p 1.

26 Mr Mark Wilkins, Member, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 4.

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staff morale is very bad. More people are going to be retrenched at the end of this month.<sup>27</sup>

6.26 The Commonwealth Bank assured the Committee that it makes little use of off-shoring:

...the Group retains all customer information onshore and has a strict privacy code in place to protect the integrity of that information. The Group does not off-shore any of its Australian processing or call centre operations, maintaining a dedicated and efficient workforce in Australia to undertake these duties.<sup>28</sup>

6.27 The Finance Sector Union reports that it has:

...won commitments from the major banks that no customer call centre jobs will be off-shored. In some companies, they have also won undertakings that anyone affected by off-shoring can remain in the employ of the company – however, there are no guarantees about the nature of the role or whether it matches their skill set and abilities.<sup>29</sup>

6.28 With the global financial crisis, this argument is a weaker one, at least in the short term.

6.29 The ABA claim:

Looking ahead, and even factoring in the global financial crisis, Australian education institutions are not likely to be able to produce the deep pool of highly skilled labour, and in the numbers and specialties required, in order to run bank operations in the decades ahead.<sup>30</sup>

## **The impact of offshoring**

6.30 A study by the OECD of offshoring in general (covering manufacturing and services, not just banking) concluded its overall net effects were benign, as it lowered prices for consumers and improved productivity for firms, allowing them to expand domestic employment. However, the jobs lost were visible while those created diffuse and not perceived as related to offshoring. But while this may make offshoring unpopular, no country has taken coercive measures against it.<sup>31</sup>

6.31 To the Business Council of Australia (2004), offshoring is just another form of international trade and therefore a good thing for both Australia, where it will

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27 Ms Carmel Bourke, Member, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 5.

28 Commonwealth Bank, *Submission 2*, p 3.

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

30 ABA, *Submission 14*, p 14.

31 OECD (2007, p 8).

'enhance the competitiveness and ongoing viability of business operations', and the country providing the service. They refer to:

...net job creation that stems from shifting resources towards more productive areas where Australia has stronger competitive advantage.<sup>32</sup>

6.32 They even give examples of banking jobs being offshored to Australia.<sup>33</sup> The only caveat they make is that businesses should implement it carefully:

...businesses must also have certainty regarding the reliability of delivery (in terms of quality and timeliness).. These are not insignificant factors, and comprehensive analysis is undertaken so these risks do not outweigh the potential benefits of offshoring. At the micro level, offshoring brings with it the potential for additional costs and challenges in the management of operations, and in terms of travel, training and communication. These additional costs can offset as much as 60 per cent of the initial savings associated with offshoring.<sup>34</sup>

6.33 The ABA also argue:

...business continuity planning can be made more resilient in the event of major incidents by having operations activities in multiple locations.<sup>35</sup>

6.34 They assured the Committee that:

...should a customer breach or complaint emerge then it will be managed by banks in the same way as if it had occurred in Australia giving the customer recourse to the independent Financial Ombudsman Service.<sup>36</sup>

6.35 There have been criticisms that the banks have not been helpful towards employees whose jobs are offshored:

The NAB is not helping us into new roles, the NAB is not retraining us for other roles...<sup>37</sup>

## **Policy responses to offshoring**

6.36 Some individual submitters have called for a government policy response to limit or discourage offshoring:

It is time for the Federal Government to impose an off-shoring tax ...<sup>38</sup>

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32 Business Council of Australia (2004, p 11).

33 Deutsche Bank in 2004 made Sydney one of two global processing hubs for foreign exchange and UBS selected Sydney for its global IT support centre; Business Council of Australia (2004, p 11).

34 Business Council of Australia (2004, p 10).

35 ABA, *Submission 14*, p 15.

36 ABA, *Submission 14*, p 15.

37 A bank employee, *Submission 13*, p 1.

I strongly believe that the Federal and State Governments need to put a cutoff limit on all companies wanting to offshore our Australian jobs. I believe that a figure of something like no more than 10 per cent of jobs with each company should be allowed to be sent overseas for the good of our overall economic state of affairs.<sup>39</sup>

6.37 The Finance Sector Union believes that:

In return for the considerable Government assistance received by the banking sector in recent months there should be conditions attached including an immediate cessation of off-shoring Australian jobs.<sup>40</sup>

We cannot imagine the federal government giving that sort of money to Toyota and then saying, 'We don't mind if you take the assembly line over to China.'<sup>41</sup>

6.38 The Australian Prudential Regulatory Authority has a prudential standard (APS 231) which:

...requires that all risks arising from outsourcing material business activities be appropriately managed to ensure that the authorised deposit-taking institution is able to meet both its financial and service obligations to its depositors.<sup>42</sup>

6.39 APRA requires ADIs to notify it in advance of any material offshoring. Reflecting APRA's responsibilities, their rules only seek to ensure that outsourcing and offshoring do not endanger the bank's solvency, not that levels of customer service are maintained. Not are APRA charged with the welfare of bank employees.

**Senator Alan Eggleston  
Chair**

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38 Mr Mark Wilkins, *Submission 9*, p 1.

39 Ms Julie Franks, *Submission 3*, p 1.

40 Finance Sector Union, *Submission 12*, p 12.

41 Mr Leon Carter, National Secretary, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 9.

42 Cited in ABA, *Submission 14*, p 13. See also APRA, *Submission 16*, pp 4-5.





# Labor Senators' Dissenting Report

## Competition in the Banking Sector

Labor members agree with ongoing concerns regarding the concentration of the banking sector and the market power held by the big four banks. We believe there is value in encouraging competition to maintain downward pressure on fees and charges, and promote continual innovation in products and services. It seems clear also that the 'four pillars policy' of not allowing the big four to merge unless there is evidence of increased competition has proved its merit over a range of financial cycles.

In light of recent mergers and acquisitions in the banking sector it is apparent that government should review policies to promote vigorous competition. The government should be vigilant that the barriers for new entrants are as low as possible within regulatory guidelines. In developing policies the government should also ensure that all participants in the contemporary financial environment are allowed to compete vigorously.

An example of a policy initiative to promote competition is the support the Government has directed the Australian Office of Financial Management to provide to the residential mortgage-backed securities market. Issuance of these securities has been an important means of funding for home loan lenders competing with the major banks, but the market had dried up following the global financial crisis.<sup>1</sup>

Labor members are extremely concerned about the implications of the remaining majority report recommendations. We believe that the requirement of more reporting by regulators will not result in increased competition in the sector, but will add costs to financial institutions which will then be passed on to their customers.

Alternatively we believe that stimulating competition by adopting measures to encourage new entrants into the market is a better approach than the addition of more onerous reporting requirements.

During the Senate inquiry the Australian Bankers' Association were questioned regarding measures the Government or industry could undertake to foster more competition in the financial service sector:

If there were any restrictions or impediments on banks coming into the market, they really are the province of governments these days. There are no obvious things that the banks do to impede entry at all. It is the government which imposes, if you like, licensing on banks.<sup>2</sup>

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1 The measures are discussed more fully in the committee's report, *Government measures to address confidence concerns in the financial sector - The Financial Claims Scheme and the Guarantee Scheme for Large Deposits and Wholesale Funding*.

2 Mr Nicholas Hossack, *Proof Committee Hansard*, 12 March 2009, p 4.

However this was later qualified when asked specifically what regulations the Government should relax in order to encourage further entrants into the market:

I suppose the irony is that the regulations that are in place are all soundly placed. If you want to operate a bank or certainly a deposit-taking institution, there are very good reasons as to why you should be prudentially sound and meet APRA's prudential standards, which it requires. You need that [but] that could be a difficult exercise for someone wanting to come into the market.<sup>3</sup>

This highlights the delicate balance that is needed to ensure stability and security for our financial sector but not discourage vibrant competition through over regulation.

### **Recommendation 1**

**The government should examine all possible opportunities to foster new competitors in the banking industry. The government should monitor regulation of the financial services market to ensure it achieves stability and security for the sector but does not impose any unnecessary barriers to entry for possible new entrants.**

### **Member owned financial institutions**

The committee also received evidence about the critical role that mutual or member-owned financial intermediaries play in delivering competition and consumer choice in the banking sector. Credit unions and mutual banking societies are ADIs registered by APRA and have more than 4.5 million members and the third largest share of deposits in the Australian market behind the Commonwealth and Westpac.<sup>4</sup>

Labor Senators are disappointed that the majority report does not address any of the issues raised by member-owned financial intermediaries in their submissions to the inquiry.

Labor Senators recognise that mutual financial institutions play a vital and important role in Australia's financial sector. We also agree with calls from the sector that regulatory compliance costs should not force smaller competitors out of the marketplace.

### **Recommendation 2**

**Given the vital role that mutual financial institutions contribute to competition in the financial sector, the Government should engage with the mutual ADI sector to ensure legislation and regulation is consistent with assisting the sector to**

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3 Mr Nicholas Hossack, *Proof Committee Hansard*, 12 March 2009, p 5.

4 Abacus, *Submission 18*, p 1.

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**continue to grow and remain on a competitive and even playing field with the "big four" banks.**

### **Increased transparency of the ACCC**

Labor Senators do not agree with the position put to the inquiry by Choice and the subsequent majority report recommendation that the ACCC should publish all research and submissions in regards to their merger inquiries.

The ACCC are a regulator and as such should be able to conduct their investigations in a manner than will not jeopardise the eventual outcomes of such investigations. A requirement that all submissions, market inquiries and information gathered in the course of an inquiry into a proposed merger be publicly available, would draw an ongoing commentary that would seriously hamper the ability of the regulator to make independent evidence based judgements. The ACCC gave the following evidence in their opening remarks to the committee:

I would like to comment that 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.<sup>5</sup>

Labor Senators believe that given the nature of bank merger investigations, any submissions containing commercial in confident material would be accompanied with a request of confidentiality. This means that the submissions available for public scrutiny would only reflect a part of the evidence garnered by the investigation and would therefore be misleading.

### **ACCC, APRA and the Reserve Bank – Joint Annual Report**

Labor Senators are concerned that additional reporting to Parliament by the ACCC, APRA and the Reserve Bank on competition in the retail banking market and the provision of affordable banking facilities to those on low incomes will increase the reporting burden of financial institutions.

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5 Mr Tim Grimwade, *Proof Committee Hansard*, 13 March 2009, p 19.

It is difficult to comprehend how the regulators would be able to report on these matters without financial institutions compiling and submitting the relevant data. Labor Senators believe that this would require additional resources in a sector that already has significant reporting requirements. If this had the unintended consequence of financial institutions raising fees or charges to customers this would be a serious adverse outcome. Despite the majority report noting in the recommendation that care should be taken "not to increase unduly the reporting burden on financial institutions" Labor Senators are concerned this would be an unrealistic expectation.

Furthermore although further reporting would provide additional transparency on the issue of competition in the sector, it would do nothing to address high market concentration or attract new entrants into the financial services market.

### **Monitoring and enforcing conditions**

Labor Senators share the concerns of the full committee regarding the enforcement of conditions set by the Treasurer when approving a bank merger. Labor Senators agree there is also merit in the application of monetary penalties for banks failing to comply with the conditions.

However we do not agree with the recommendation to nominate a unit within Treasury or APRA for the purposes of monitoring, verifying and imposing penalties. Given the conditions are set by the Treasurer it is appropriate that Treasury monitor them.

Currently Treasury monitor not only conditions imposed upon banks by the Treasurer but also monitor the financial sector more broadly. At a public hearing in Canberra Mr. James Murphy from Treasury said the following:

As a matter of policy, in Treasury we are continually monitoring the delivery of financial services to the community. My colleagues can talk to you and explain to you how we do that. Recently, in the life of this government, there have been issues relating to switching that has enabled individuals to switch from one bank account to another. The government has been strong in trying to ensure that the majors fully pass on interest rate cuts or to the greatest extent possible. The government is also engaged in moral suasion and putting forward into the marketplace issues relating especially to bank fees.<sup>6</sup>

Treasury consider a well functioning financial sector to be a part of their core business:

The goal of policy in this area and the goal of this government and the previous government are, in effect, to have a well-functioning financial services market. You might ask, 'How would you define that?' and we

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6 Mr James Murphy, *Proof Committee Hansard*, 12 March 2009, p 26.

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would say, 'It is vibrant, it is dynamic, it is competitive, and it has been diverse.'<sup>7</sup>

It is difficult to see how nominating a unit within Treasury to monitor and verify conditions placed on banks in the event of a merger would result in more scrutiny than is currently already being undertaken.

Furthermore whilst the committee heard evidence from consumer groups that expressed concern banks may not be complying with conditions, we did not receive any clear evidence of examples where this has actually occurred. In fact the Australian Bankers' Association explained the process by which conditions are monitored in their submission to the inquiry.

Given the conditions formed part of the Treasurer's approvals, the conditions are publicly documented, and the banks themselves have committed to them, there is, in the ABA's view, no realistic scenario in which the conditions will not be fully met.

Furthermore, the conditions documented in the Treasurer's media [release] are worded specifically enough to easily evaluate whether or not they have been achieved, particularly those relating to ATM and branch numbers, maintenance of brands, and availability of ATM networks to customers of the acquired entity.

Where the conditions relate to human resource management, there is less specificity but the role of the Financial Sector Union (FSU), media and bank reputations will ensure staffing changes, redeployment, retraining and general assistance to affected staff will be managed appropriately, meeting the Treasurer's obligations and the intent of those obligations.

The ABA understands both the Commonwealth Bank and Westpac have established internal controls and reporting arrangements with the Government to ensure the conditions are met in the same way as legal obligations are met.<sup>8</sup>

Labor members believe that the current scrutiny by Treasury of conditions set by the Treasurer and the broader operation of the financial services market generally is sufficient and that the nomination of a specific unit is unnecessary.

## **Employment and offshoring**

Labor Senators are extremely disappointed that the majority committee report provided no committee view on employment and 'offshoring' as a result of bank mergers. This is despite estimates being provided to the committee that more than

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7 Mr James Murphy, *Proof Committee Hansard*, 12 March 2009, p 26.

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

4,900 jobs have been offshored from the Australian finance industry.<sup>9</sup> It appears that 'back office' jobs are particularly vulnerable to offshoring after a bank merger.

Labor Senators welcome the recent conditions applied to the Commonwealth Bank and BankWest mergers to assist employees by the Treasurer.

- a) CBA will maximise internal redeployment opportunities available for affected staff, support external job placement where employee redundancies occur, and ensure that staff affected by the acquisition have timely access to their full entitlements under CBA or BankWest (as applicable) retrenchment arrangements;
- b) CBA will work through the implications for employees as quickly and sensitively as possible, in consultation with employees, the Finance Sector Union and other affected stakeholders; and
- c) CBA will provide specialist resources to assist staff affected by the acquisition.

Labor Senators also note similar conditions were required by the Treasurer for the Westpac and St. George merger with the additional requirement that the banks:

- d) 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.

Labor Senators note with concern evidence given to the committee by consumer organisations that despite this condition being in place contact did not occur until some six months after the merger. For this reason we concur with the majority report that monetary penalties be considered by the Government if Treasury monitoring demonstrates a failure to comply with conditions imposed on the merger.

The majority report also notes submissions that called for increased transparency in the location of banking call centres. Legislation in France requires call centres to disclose their location so that customers can be informed what services have been offshored when dealing with their financial institution. Labor Senators note that currently no Australian banks have offshored their customer call centres at this stage.

The committee also heard concerns that some 'back office' offshoring involved customer information being handled in locations that may not have as stringent privacy legislation as Australia. The scope of this inquiry was not sufficient to fully appreciate the depth of this issue however Labor Senators believe it is reasonable that financial institutions should be transparent in their dealings with customers – in particular when it involves either their personal information or customer service provision.

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9 Mr Leon Carter, National Secretary, Finance Sector Union, *Committee Hansard*, 13 March 2009, p 7.

**Recommendation 3**

**The Government should consider legislation to require banks to disclose in their annual reports if any customer service call centres are located overseas to increase transparency of offshoring. The Government should also consider legislation to require financial institutions to disclose in their annual report if any customer information is handled offshore.**

**Senator Annette Hurley  
Deputy Chair**

**Senator Louise Pratt**





# Minority Report by Senator Xenophon

## Introduction

1.1 The inquiry into aspects of bank mergers was established to investigate the economic, social and employment impacts of the recent mergers among Australian banks, what measures are in place to ensure sufficient choice for consumers, and whether section 50 of the Trade Practices Act 1974 is adequate to prevent further concentration of the Australian banking sector.

1.2 Australia's big four banks, Commonwealth Bank, Westpac, ANZ and National Australia Bank, dominate the Australian banking sector, holding 73 percent of the national banking market.<sup>1</sup> These major banks are a result of a series of bank mergers over the past 150 years, however there are concerns that any greater concentration of the sector, especially as a result of acquisitions of second-tier banks by any of the Big Four, will result with less consumer choice, reduced competition and job losses.

## Background

1.3 There are four main views about the motivations behind bank mergers; that it improves the efficacy of banking; that it's aimed at increasing market power; that it enables banks to grow in size and share; and, also, corporate ego.

Interestingly, only one of the four intents of a merger appears to be in the interests of customers.

In fact, the Finance Sector Union stated in its submission to the Committee that "some bank mergers may be necessary to ensure that financial institutions survive, however most major mergers appear to be motivated by profit with no guarantee of any public benefits"<sup>2</sup>.

1.4 Since the late 1990's, Australia's banking systems has operated according to the 'four pillars policy', which the Reserve Bank of Australia explains is:

"... an Australian Government policy that there should be no fewer than four major banks to maintain appropriate levels of competition in the banking sector."<sup>3</sup>

The reason four banking institutions is based on the notion that a merger between any two of the four would likely be followed by a merger of the other two which would result in an effective duopoly of the market.

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<sup>1</sup> Australian Prudential Regulation Authority, *Banking Statistics*, October 2008

<sup>2</sup> Finance Sector Union, *Submission 12*, pg 13

<sup>3</sup> Reserve Bank of Australia, Glossary,  
<http://www.rba.gov.au/Glossary/detail.asp?term=Four%20Pillars%20Policy>

1.5 However, the Finance Sector Union asserted in its submission to the Committee its concerns of mergers between any of the four major banks and medium-sized banks, which it believes has flow on effects, namely increased pressure for the other big banks to also acquire ‘second tier’ banks.<sup>4</sup>

Indeed, the role of ‘second tier’ banks plays a crucial role in ensuring competition in the banking sector.

In a paper authored by Garry Goddard and Greg Walker, *Competition Analysis of Bank Mergers in Australia*, medium-sized banks were considered to:

“... be efficient, innovative, geographically focused, close to their customers and sufficiently differentiated from the ‘look-a-like majors’ to provide an incentive for the major banks to remain competitive.”<sup>5</sup>

1.6 Mergers can be considered by the Australian Competition and Consumer Commission (ACCC) under a formal or informal process, however, to date, all banking mergers considered by the ACCC have been under the informal process.<sup>6</sup>

“The ACCC’s approach in assessing a merger is to compare the likely state of competition in future with the merger (the factual) and the likely state of competition in the absence of the merger occurring (the counterfactual).”<sup>7</sup>

In its capacity to review and make an assessment on proposals of acquisition, the ACCC gives consideration to section 50 of the Trade Practices Act, which states that:

- (1) A corporation must not directly or indirectly:
  - (a) acquire shares in the capital of a body corporate; or
  - (b) acquire any assets of a person;if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

And, in determining whether the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the following matters must be taken into account:

- (a) the actual and potential level of import competition in the market;
- (b) the height of barriers to entry to the market;
- (c) the level of concentration in the market;
- (d) the degree of countervailing power in the market;

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<sup>4</sup> Finance Sector Union, *Submission 12*, pg 3

<sup>5</sup> Garry Goodard and Greg Walker, *Competition Analysis of Bank Mergers in Australia*, Journal of Law and Financial Management, 2002

<sup>6</sup> Australian Competition and Consumer Commission, *Submission 4*, pg 5

<sup>7</sup> Australian Competition and Consumer Commission, *Submission 4*, pg 3

- (e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
- (f) the extent to which substitutes are available in the market or are likely to be available in the market;
- (g) the dynamic characteristics of the market, including growth, innovation and product differentiation;
- (h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and,
- (i) the nature and extent of vertical integration in the market.

1.7 The Senate inquiry was spurred by the Westpac/St George Bank merger which was approved by the Australian Competition and Consumer Commission (ACCC) in December 2008 and also the Commonwealth Bank/BankWest merger announced earlier in 2008.

In an interview with the *Australian Financial Review*, ACCC Chairman, Mr Graeme Samuel admitted:

"... the ACCC had been "very uncomfortable" last December when troubled British lender HBOS sold BankWest to Commonwealth Bank of Australia. But the ACCC let it through after being advised by the RBA and the Australian Prudential Regulation Authority that the deal was necessary for the stability of the financial system."<sup>8</sup>

It was also deemed that "the proposed acquisition would not be likely to have the effect of substantially lessening competition in any relevant market"<sup>9</sup>.

### **The economic, social and employment impacts of the recent mergers**

1.8 However, one of the key disadvantages to a bank merger from a consumer's perspective is that large banks have a tendency to lose touch with their communities and customers, unlike their medium-sized counterparts.

In its submission to the Committee, consumer organisation, CHOICE, stated that it has considered the impact of excessive market power held by the banking oligopoly.

"We have formed the view that such excessive market power risks the following outcomes:

- Crowding out new entrants;
- Poor customer service;
- Poor employee satisfaction;
- Excessive fees and interest rates;
- Low rates of customer switching;
- Poor product innovation;
- Reduced access to essential banking services; and,
- Reduced diversity in local areas.<sup>10</sup>

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<sup>8</sup> Matthew Drummond, *Australian Financial Review*, *Samuel warns on bank mergers*, 14 April 2009

<sup>9</sup> Australian Competition and Consumer Commission, *Submission 4*, pg 9

<sup>10</sup> CHOICE, *Submission 6*, pg 5

1.9 In its submission to the Committee, the Finance Sector Union called for a broader 'public interest' test to be incorporated into section 50 of the Trade Practices Act, to take into account these impacts.

"At present mergers assessed under section 50 of the Trade Practices Act 1974 do not consider job losses, for example; however the Finance Sector Union believes that they are a significant consequence of any merger and should be included when considering any merger for regulatory approval."<sup>11</sup>

However, this was contrasted by the Law Council of Australia's introductory statement during the Senate Committee hearing that they:

"... can see no economic or legal justification for the introduction of an alternative regime for assessing bank mergers, or for the introduction of differ way of measuring competition in the banking sector. Rather, the Committees support the continued operation of the existing merger, prudential and public benefit regulatory frameworks for the assessment of bank mergers."<sup>12</sup>

1.10 Currently, there is room for the Treasurer to impose conditions on institutions seeking to merge with another bank, to minimise the impact of a merger on the community and employees, however it has been argued to the Committee that these do not go far enough and are often not enforced.

### **The measures available to enforce conditions on future bank mergers**

1.11 In approving the merger between Westpac and St George Bank, the Treasurer imposed a number of conditions whereby, 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 terms for St George and Westpac retail banking distribution; and,
- Retain a corporate presence in Kogarah.<sup>13</sup>

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<sup>11</sup> Finance Sector Union, *Submission 12*, pg 5

<sup>12</sup> Law Council of Australia, *Proof Committee Hansard*, pg 43 (10 August 2009)

<sup>13</sup> Treasury's Press Release 08/144 (18 December 2008), reproduced in *Submission 14 (Australian Banker's Association)*, pg 20

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 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 positively.

1.12 However, the ACCC in its submission to the Committee did concede that “these conditions are not monitored or enforced by the ACCC”<sup>14</sup>, but stated that:

“If the undertaking is breached, the ACCC may seek orders from the court directing compliance with the undertaking, the giving up of any financial benefit gained from the breach, compensation for any other loss or damage as a result of the breach, or any other appropriate orders.”<sup>15</sup>

1.13 In response to the Westpac/St George merger conditions, the Brotherhood of St Laurence, which represents those in the community living in poverty, stated in its submission that it “is concerned about the lack of any appropriate monitoring and enforcement of these conditions,”<sup>16</sup> and the impact this would have on the community.

1.14 Indeed, it seems contrary to its intent that the Treasurer will impose undertakings upon a merger but not ensure that these conditions are met. Penalties do exist for breach of these conditions, such as “the giving up of financial benefit gained from the breach, compensation for any other loss or damage as a result of the breach or any other appropriate orders”<sup>17</sup>, but it has been recommended that more effective penalties should be introduced, such as a forced de-merger of assets, to ensure the banking institutions abide by the regulations set down.

### **The capacity for the ACCC to enforce divestiture in the banking sector**

1.15 Currently, if the ACCC considers that an acquisition contravenes section 50 of the Trade Practices Act and the parties do not agree to modify or abandon the acquisition, the ACCC can apply to the Federal Court for an injunction, divestiture or penalties to remedy any competition issues.<sup>18</sup>

1.16 Divestiture can be sought either

- By accepting binding undertakings from the notifying party to divest the relevant asset or business line within a specified period; or,

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<sup>14</sup> Australian Competition and Consumer Commission, *Submission 4*, pg 11

<sup>15</sup> Australian Competition and Consumer Commission, *Submission 4*, pg 6

<sup>16</sup> Brotherhood of St Laurence, *Submission 8*, pg 4

<sup>17</sup> Australian Competition and Consumer Commission, *Submission 4*, pg 6

<sup>18</sup> Australian Competition and Consumer Commission, *Submission 4*, pg 6

- By applying to the Federal Court pursuant to section 81 of the Trade Practices Act.<sup>19</sup>

However, according to the Law Council of Australia, “there is no general divestiture power in the Trade Practices Act which would allow the ACCC to seek divestment of assets or business lines by merging parties. Consequently, the ACCC does not have the power to seek divestiture other than in the context of a merger review.”<sup>20</sup>

1.17 As the national regulator for competition, fair trading and consumer protection laws, it should be in the capacity of the ACCC to enforce divestiture in the banking sector where contraventions of section 50 of the Trade Practices Act have occurred.

1.18 While it may seem extreme, the penalties for breaches of merger conditions must be strong to ensure banks don't benefit from the merger without considering the impact the acquisition will have on the community.

1.19 Consumer organisation, CHOICE, also highlighted in its submission to the Committee that:

“... mergers are not the only way in which concentration and consequent harm to consumer welfare can occur. Creeping acquisitions, failure of competitors, organic growth and potentially other market developments can also result in excessive competition over time.”<sup>21</sup>

## **Consumer choice and competition**

1.20 A national poll by McNair Ingenuity of 1000 people in response to the Westpac/St George merger found that 75 percent believed that the merger would mean less competition. It also found that 72 percent already think that there is not enough competition between banks.<sup>22</sup>

1.21 The ACCC admitted in its submission that:

“In some cases, however, mergers have anti-competitive effects. By altering the structure of markets and the incentives for firms to behave in a competitive manner, some mergers can result in significant consumer detriment.”<sup>23</sup>

1.22 Indeed, there are growing concerns that consumer choice as a result of bank mergers is being increasingly limited to the four major banks.

Abacus-Australian Mutuals, the industry body for credit unions, mutual building societies and friendly societies, stated in its submission:

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<sup>19</sup> Law Council of Australia, *Submission 15*, pg 7

<sup>20</sup> Law Council of Australia, *Submission 15*, pg 7

<sup>21</sup> CHOICE, *Submission 6*, pg 12

<sup>22</sup> Finance Sector Union, *Submission 12*, pg 3

<sup>23</sup> Australian Competition and Consumer Commission, *Submission 4*, pg 3

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“Consumer choice is being squeezed in banking. Major banks have taken over the two largest regional banks and there is speculation some of the remaining regional banks are for sale.”<sup>24</sup>

This concern was also detailed by Associate Professor Frank Zumbo from the University of New South Wales, who stated that:

“As markets become more concentrated, the opportunities for either collusion or parallel conduct with respect to pricing and related matters grow considerably. Within this context, banking mergers, as with other mergers across the economy, present a real and very serious risk to competition and consumers.”<sup>25</sup>

1.23 During the recent considerations of the Westpac/St George and Commonwealth/BankWest mergers, CHOICE explained in its submission that it had called on the ACCC to “undertake more thorough research into consumer’s experiences of and attitudes towards competition in the retail banking sector”<sup>26</sup>.

“Despite such requests being made, the ACCC did not believe it was necessary or appropriate to conduct its own research into the market.”<sup>27</sup>

## Off-shoring

1.24 Another growing community concern is the issue of off-shoring. Increasingly, banks, and other sectors, are sending jobs overseas in order to reduce costs.

In its submission to the Committee, the Finance Sector Union gave examples of the ANZ, which shifted 1,100 software development and IT positions to Bangalore in November 2005; Citigroup replacing the 150 jobs in its Brisbane call centre with positions in Manila; NAB shifting 220 IT and accounts processing positions to Bangalore in 2005 and 2006 and a further 500 jobs to India in 2008; St George shifting 100 jobs involving credit cards to India in September 2006 and a further 30 in May 2007 and Westpac moving over 500 back office processing and retail administration jobs in India in September 2006.<sup>28</sup>

1.25 The Australian Bankers Association advised that it “estimates that around 3,200 full-time employment positions have been impacted by services being sourced offshore over the past few years, equivalent to about 2.4 percent of the total workforce of ABA member banks.”<sup>29</sup>

1.26 But, as the Finance Sector Union of Australia argued in its submission:

“... mergers and off-shoring in the finance sector are generally not in the public interest and have often had detrimental outcomes such as:

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<sup>24</sup> Abacus-Australian Mutuals, *Submission 18*, pg 2

<sup>25</sup> Associate Professor Frank Zumbo, *Submission 19*, pg 2

<sup>26</sup> CHOICE, *Submission 6*, pg 12

<sup>27</sup> CHOICE, *Submission 6*, pg 12

<sup>28</sup> Finance Sector Union, *Submission 12, Appendix 8*, pg 9

<sup>29</sup> Australian Banker's Association, *Submission 14*, pg 13

- Employment losses;
- Negative impacts on communities;
- Reduced consumer choice and service; and,
- Loss of skills and investment in Australia.<sup>30</sup>

1.27 Further to this, there remains a lack of consent by customers to have confidential data held by persons other than the bank with whom the information was provided.

When applying for a loan, information about one's salary, debts, marital status, other banking arrangements, address, is provided, to name a few. Sometimes even a Passport is required for verification or a Driver's Licence.

Given the increase in off-shoring by banking institutions, it is imperative that consumers are consulted on this and provide their written consent to allow this to occur.

## **Conclusion**

1.28 Bank mergers may come with corporate benefits, especially if it's as a result of 'rescuing' a bank that may have otherwise had to close, however with acquisitions comes a raft of other issues that must be considered to ensure that Australia's banking system remains competitive and in the community's best interests.

### **Recommendation 1**

**That the Banking Act is amended to provide for an outright prohibition against any merger between the four major banks, so as to ensure that the 'four pillar' policy is given the force of law and can only be altered by Parliament.**

### **Recommendation 2**

**That all bank merger requests be subject to a formal process of approval by the ACCC.**

### **Recommendation 3**

**That section 50 of the Trade Practices Act incorporates a broader 'public interest' test to include the impact of the merger on community access, costs and jobs, and that there be extensive and transparent community consultation as part of the approval process.**

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<sup>30</sup> Finance Sector Union, *Submission 12*, pg 2



#### **Recommendation 4**

**That section 50 of the Trade Practices Act is amended to prohibit any merger or acquisition that "materially" lessens competition.**

#### **Recommendation 5**

**That conditions set down by the Treasurer in respect to mergers are monitored and enforced and that breaches of these undertakings are subject to effective penalties, including the acquiring company being forced to de-merge.**

**Further, that the Trade Practices Act is amended to provide for a general divestiture power whereby a Court can, on the application of the ACCC, order the break up of companies (i) having substantial market share; and (ii) where either the characteristics of the market prevent, restrict or distort competition; or the companies have engaged in patterns of conduct that are detrimental to competition and consumers.**

#### **Recommendation 6**

**That the ACCC consider applying for a divestiture order pursuant to section 81 of the Trade Practices Act in relation to both the Commonwealth Bank's acquisition of BankWest and Westpac's acquisition of St George Bank.**

#### **Recommendation 7**

**That all banks be required to seek written consent from customers to provide their banking data and private information to a third-party off-shore company.**



**Nick Xenophon  
Independent Senator for South Australia**



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# APPENDIX 1

## Submissions Received

<b>Submission Number</b>	<b>Submitter</b>
1	Ms Elizabeth Harvey
2	Commonwealth Bank
3	Ms Julie Franks
4	Australian Competition and Consumer Commission (ACCC)
4a	Australian Competition and Consumer Commission (ACCC)
5	Confidential
6	CHOICE
6a	CHOICE supplementary submission
7	Confidential
8	Brotherhood of St Laurence
9	Mr Mark Wilkins
10	Mr John Minuti
11	Westpac
12	Finance Sector Union (FSU)
12a	Finance Sector Union (FSU) supplementary submission
13	Name Withheld
14	Australia Bankers' Association
15	Law Council of Australia
15a	Law Council of Australia supplementary submission
16	Australian Prudential Regulation Authority (APRA)
17	Dr David Morrison
18	Abacus-Australian Mutuals
19	Associate Professor Frank Zumbo
20	Suncorp Bank
21	Hon Dr Bob Such MP

## **Additional Information Received**

- Received from Treasury, answers to Questions on Notice taken at a public hearing on 13 March 2009.
- Received from Westpac on 30 August 2009, answers to Questions on Notice taken at a public hearing on 10 August 2009.



## **APPENDIX 2**

### **Public Hearings and Witnesses**

#### **Canberra, Thursday 12 March 2009**

HOSSACK, Mr Nicholas, Director, Prudential, Payments and Competition Policy,  
Australian Bankers Association

MARTINE, Mr David, General Manager, Financial System Division,  
Department of the Treasury

McLENAGHAN, Mr John, Head of Government and Industry Affairs,  
Commonwealth Bank of Australia

MURPHY, Mr James Andrew, Executive Director, Markets Group,  
Department of the Treasury

NAREV, Mr Ian Mark, Group Executive, Business and Private Banking,  
Commonwealth Bank of Australia

ROGERS, Mr Scott, Acting Manager, Competition Policy Framework Unit,  
Department of the Treasury

WIJEYWARDENE, Ms Kerstin, Manager, Banking Unit,  
Department of the Treasury

#### **Canberra, Friday 13 March 2009**

BENNETT, Mr James, Senior Policy and Research Officer,  
Finance Sector Union

BLACKMORE, Ms Linda, Member,  
Finance Sector Union

BOURKE, Ms Carmel, Member,  
Finance Sector Union

CARTER, Mr Leon, National Secretary,  
Finance Sector Union

GORDON, Ms Carol, National President,  
Finance Sector Union

GRIMWADE, Mr Tim, Acting Executive General Manager, Mergers and Acquisitions Group, Australian Competition and Consumer Commission

HARVEY, Ms Elizabeth, Member,  
Finance Sector Union

HOLLAND, Mr Tim, General Manager, Merger Investigations Branch,  
Australian Competition and Consumer Commission

MASSON, Mr Rod, Director, Policy and Communications,  
Finance Sector Union

WILKINS, Mr Mark, Member,  
Finance Sector Union

WING, Mr Anthony, General Manager, Transport and General Prices Oversight,  
Australian Competition and Consumer Commission

WOOD, Ms Danielle, Director, Mergers and Asset Sales Branch,  
Australian Competition and Consumer Commission

### **Brisbane, Wednesday 1 July 2009**

KANGATHARAN, Mr Ram, Group Executive and Chief Financial Officer,  
Bank of Queensland Ltd

### **Perth, Thursday 2 July 2009**

CORFIELD, Mr Ian, Chief Executive, Retail,  
Bank of Western Australia

SUTTON, Mr Jon Earle, Managing Director,  
Bank of Western Australia

**Canberra, Monday 10 August 2009**

BRODY, Mr Gerard Gavan, Senior Manager, Financial Inclusion,  
Brotherhood of St Laurence

BUTTSWORTH, Mr Andrew Mark, Head of Government and Industry Affairs,  
Westpac Banking Corporation

COOPER, Mr Bradley John, Group Chief Transformation Officer,  
Westpac Banking Corporation

DEGOTARDI, Mr Mark, Head of Public Affairs,  
Abacus Australian Mutuals

FOSTER, Mr David, Group Executive,  
Suncorp Bank

FREEMAN, Ms Elissa, Senior Policy Officer,  
CHOICE

LAWLER, Mr Luke, Senior Adviser, Policy and Public Affairs,  
Abacus Australian Mutuals

PODDAR, Mr Dave, Chairman, Trade Practices Committee, Business Law Section,  
Law Council of Australia

ROSEMAN, Ms Justi, National Chair, Financial Services Committee, Business Law  
Section, Law Council of Australia

ZUMBO, Associate Professor Frank,  
Private capacity

