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Association of Building Societies and Credit Unions

13 March 2009

Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Mr Hawkins

Inquiry into Aspects of Bank Mergers

This submission to the Committee's inquiry into aspects of bank mergers will limit its focus to the impact of mergers on consumer choice.

Abacus – Australian Mutuals is the industry body for credit unions, mutual building societies and friendly societies. Collectively, Abacus member institutions have more than $70 billion in assets and serve more than 6 million members.

Mutual, or member-owned, financial institutions in Australia play a critical role in delivering competition and consumer choice. Australia has a strong mutual financial services sector, including one of the largest credit union sectors in the world.

Credit unions and mutual building societies are Authorised Deposit-taking Institutions (ADIs) regulated by APRA under the *Banking Act 1959*. Mutual ADIs have more than 4.5 million members and the third largest share of household deposits in the Australian market, behind the Commonwealth Bank and Westpac but ahead of ANZ and NAB.

Total assets of credit unions grew by 10.8 per cent last financial year while mutual building societies expanded their asset base by 13.3 per cent.

The mutual ADI sector is prudently managed, with very strong capital and liquidity ratios.

Ratings agency Moody's observed recently that credit unions and building societies have low-risk loan books, predominantly comprised of residential mortgages with significant levels of mortgage insurance cover, and generally no exposure to 'toxic' investments or large bad loans.

There are 120 credit unions and 9 mutual building societies.[1] Ongoing merger activity is a feature of the credit union sector as credit unions take advantage of strategic opportunities. The credit union sector has grown strongly for many years while the number of credit unions is falling.

Credit unions and building societies have 1,240 branches. The total number of credit unions and building society employees increased by 7.4 per cent last year to 10,522 employees.

[1] Two other building societies are listed companies and are not Abacus members.

Mutual ADIs strongly and consistently outperform the major banks in customer satisfaction, as reported in monthly Roy Morgan banking customer satisfaction surveys.

The sector's market leading customer satisfaction will be further enhanced after 1 July 2009 when the Mutual Banking Code of Practice is implemented. The new Code sets high standards in a range of areas beyond those required by law, as an expression of the value mutual ADIs place on improving the financial wellbeing of their members and communities.

Bank mergers are clearly causing a reduction in consumer choice.

Mutual ADIs are becoming increasingly important in delivering competition and choice in retail banking.

In this submission, Abacus makes the following recommendations to promote the capacity of mutual ADIs to continue to provide effective competition and choice for retail banking consumers:

- promote public understanding of the prudential regulatory framework and the status of mutual ADIs;
- amend anti-competitive aspects of the Government's optional guarantee for high value deposits;
- engage with mutual ADI sector aggregators to improve access to wholesale funding; and
- weigh up new regulatory proposals against the need to reduce the regulatory compliance burden on mutual ADIs.

Bank mergers and consumer choice

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. Non-ADI lenders have exited the market. Foreign banks are not filling these gaps.

Only mutual ADIs compete with the major banks across the full range of consumer banking products and services, such as transaction accounts, deposits, home and personal loans, debit and credit cards, and branch and ATM networks.

CBA's takeover of BankWest gives the merged entity 46 per cent of the market for deposits in Western Australia, as well as 38 per cent of the ATMs. According to the ACCC's December 2008 assessment, the merged entity's national market share of deposits is almost 31 per cent and for home loans it is almost 22 per cent.

CBA has also taken a one-third stake in Aussie Home Loans and Aussie Home Loans and CBA have jointly acquired Wizard Home Loans from GE Money.

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. (An illustration of the possible future impact of these trends on the household deposits market is shown on Attachment.)

Last year's inquiry into competition in the retail banking market by the House of Representatives Economics Committee observed:

> "While there is no doubt that the big four [banks] aggressively compete with the other players in the market, including foreign-owned banks, the credit unions, building societies and the non-banking sector, there is some uncertainty as to whether the big four are actively competing with each other."

Real consumer choice?

In an increasingly concentrated market dominated by four big banks, it is essential that consumers are informed about alternative providers.

As ADIs, credit unions and mutual building societies are subject to strict prudential regulation by APRA under the Commonwealth *Banking Act 1959*.

Mutual ADIs are subject to the same, legally-enforceable prudential standards as banks, including standards on capital, liquidity, risk management and governance.

However, the global financial crisis highlighted widespread community ignorance about the prudential regulatory framework and ADIs.

In media coverage of the global financial crisis before and after the Government's announcement of the guarantee of ADI deposits, many leading and presumably trusted commentators displayed little understanding of the prudential regulatory framework for deposit-taking. There has been a failure of communication about Australia's prudential regulatory system and the only beneficiaries are the four major banks.

The following examples illustrate the problem:

- The deputy chairman of financial advisory firm Dixon Advisory, Max Walsh, in an "analysis" column in the *Canberra Times* on 20 September 2008 said "credit unions and building societies do not have the same deposit protection" as banks. Further, Mr Walsh advised *Canberra Times* readers that the "Goldman Sachs JB Were CMT" was safer than regional banks and credit unions and building societies.[2]

- The *Sydney Morning Herald* editorialised on 27 October 2008 that: "It is absurd that nondescript credit unions should enjoy government backing while well-run cash management trusts and mortgage trusts – bearing some of the most respected names in Australian finance – should not."[3]

- *Herald Sun* columnist Terry McCrann wrote on 12 November 2008: "Institutions which shouldn't even be borrowing triple-C, like building societies and credit unions are borrowing triple-A."[4]

- *The Australian* editorialised on 7 January 2009 that "banks are subject to more rigorous requirements than other deposit takers."[5]

Given that "experts" don't understand the prudential status of ADIs, the general public's level of understanding is a matter of significant concern. If consumers are not informed they can't make informed choices.

Abacus believes there is a strong case for Government spending on a public information campaign to promote the prudential regulatory framework for deposit-taking and the ADI concept.

Informing consumers about the ADI concept and the prudential regulatory system will empower consumers to make effective choices and increase the competitiveness of the retail banking market.

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[2] Crisis emphasises importance of following fundamental investment rules, *Canberra Times* 20 Sep 2008, p4.
[3] Extend the guarantees, *SMH* 27 Oct 2008, p12.
[4] Defining the risk, *Herald Sun* 12 Nov 2008, p67.
[5] Bank on trouble with deposit guarantees, *The Australian* 7 Jan 2009, p13.

Given the enormous advantage major banks already have in terms of size and marketing power, and the impact of the global financial crisis on competition, there is a pressing need to educate consumers to promote real choice.

In our Pre-Budget submission to Treasury, Abacus has recommended the allocation of funding for a public information campaign explaining the ADI concept and encouraging retail banking consumers to "shop around" with confidence in the ADI sector.

Ideally, such a public information campaign should be delivered by the key regulators, APRA and ASIC, though neither regulator has given priority to such an initiative to date.

APRA is not a high-profile, consumer-facing agency and its chairman, Dr John Laker, commented recently that: "We have no mandate for market conduct or consumer matters so we can be single-minded in pursuing our prudential objectives."[6]

Government Guarantee of Deposits

Abacus supports continuation of the deposit guarantee for deposits of up to $1 million and looks forward to engaging with Government on transitional arrangements after the initial three year operation of the guarantee.

However, to better balance stability and competition objectives, we seek refinements to the arrangements applying to deposits of more than $1 million.

We strongly object to the differential pricing for optional guarantees for deposits or more than $1 million. The differential fee arrangements make it impossible for mutual ADIs to compete effectively in the market for deposits from depositors who want the guarantee. Mutual ADIs must pay a fee of 150 basis points compared to the fee for major banks of 70 basis points.

The use of ratings by credit ratings agencies to determine the fee increases the competitive advantage of major banks by effectively equating the ratings system with the prudential regulatory framework.

The implication, quite damaging to competition and choice, is that there are three tiers of ADIs.

The record of the ratings agencies in the lead up to the global financial crisis does not justify giving them status as arbiter of the prudential standing of Australian deposit-takers. Unrated Australian mutual ADIs have proven themselves to be prudentially stronger than highly rated global banks.

Mutual ADIs, with a small number of exceptions, do not have credit ratings because they have never needed a credit rating for their deposit-taking activities. A credit rating – being an opinion, purchased from an external agency, about a company's creditworthiness for debt instruments – has to date only been necessary for gaining access to capital and wholesale debt markets.

There is now a growing risk that an agency rating will become a requirement for ADIs competing in the high value deposits market. In our view this is a worrying development for competition in retail banking and will serve only to benefit the major banks.

A better balance of stability and competition objectives could be achieved by imposing the same fee on all ADIs for high value deposit guarantees. A single fee would reflect the fact that ADI deposits are subject to the same level of prudential protection across the ADI sector and are distinct from non-deposit wholesale funding.

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[6] APRA: The Year Ahead, Dr John Laker 26 February 2009

Imposing the same fee on all ADIs for high value deposits will also better facilitate the ultimate removal of all guarantees in due course by reinforcing and deepening public perceptions about the ADI concept and hence lowering the risk of disruption and instability.

Wholesale funding measures

Abacus is supportive, in principle, of Government initiatives to enhance wholesale liquidity and access by Australian ADIs to wholesale funding, in light of current market conditions.

Most mutual ADIs will rely on their industry aggregators to gain access to these initiatives.

Abacus encourages Government engagement with these aggregators (Cuscal Limited, Indue and Australian Settlements Limited) to enhance the capacity of mutual ADIs to access affordable sources of wholesale funds.

Abacus also encourages Government consideration of the Canadian Mortgage Bonds Program as a model for facilitating access to liquidity for a range of ADIs and market participants. Canadian credit unions access the CMB program through their central aggregator (the equivalent of Cuscal Limited in Australia) and have advised that the CMB has proven to be a very effective tool in easing liquidity concerns and supporting competition by credit unions in the concentrated Canadian banking market.

Regulatory compliance burden

The regulatory compliance burden is a significant factor in determining the capacity of mutual ADIs to compete with major banks and provide consumer choice.

As noted above, mutual ADIs are subject to the some prudential regulatory regime as major banks.

Each and every mutuals ADI is also subject to oversight by ASIC as Australian Financial Services Licensees and by AUSTRAC as reporting entities under the Anti Money Laundering and Counter Terrorism Financing (AML/CTF) Act. New AML/CTF obligations have been a significant and costly regulatory compliance challenge over the past two years.

Regulatory compliance has fixed costs that disproportionately affect smaller ADIs. Each new or revamped regulatory regime adds to these costs. A report[7] on compliance costs released by ASIC and the Finance Industry Council of Australia found that the main concerns of the financial sector with regulation are:

- poor implementation of some legislation;
- some regulation is seen to be unnecessary; and
- the volume of regulatory requirements is difficult to manage.

Major cost components were: staff costs; training; documentation; IT; outsourcing (legal, audit, consultants); procedures; monitoring and recording; and, opportunity cost. The opportunity cost of regulatory compliance includes staff time and the impact on business expansion and new product development.

The FSR laws introduced in 2001 were intended to benefit industry participants by “reducing administrative and compliance costs”[8], but this good intention was not delivered and the FSR regime has been subject to significant and ongoing revision.

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7 A Report on Costs of Financial Services 2007 Chant Link & Associates. ASIC. December 2007.
8 Explanatory Memorandum to FSR Bill 2001.

Abacus is currently concerned about the risk of an unnecessary increase in the regulatory compliance burden on responsible lenders, such as mutual ADIs, arising from the transfer of credit regulation from the States to the Commonwealth.

Abacus supports the Federal Government taking responsibility for the Uniform Consumer Credit Code but this should be achieved in a process that minimises disruption to responsible lenders.

Conclusion
Credit unions and mutual building societies continue to be an important competitive force in retail banking in Australia. The bank mergers that have occurred and those that are likely in the foreseeable future will leave our sector as one of the few viable competitors to the large banks.

Any reduction of competition will hurt Australian consumers. For this reason, we urge the Committee to recommend measures that will foster competition – measures such as improved wholesale funding opportunities for smaller ADIs, promotion of ADIs to better inform Australian consumers and sensible assessment of regulation to ensure that regulatory compliance costs do not force smaller competitors out of the marketplace.

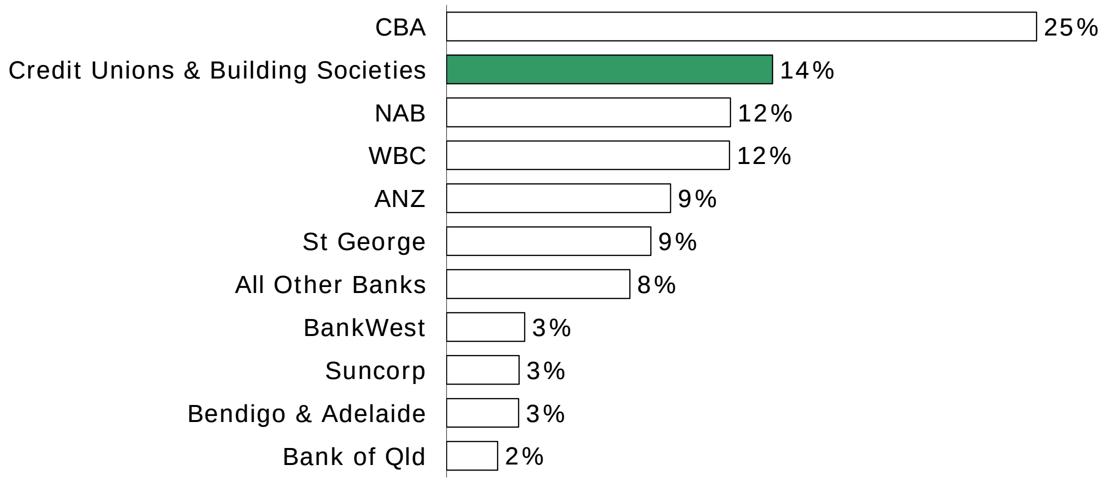
We would be delighted to discuss this issue further with the Committee at an appropriate time.

Thank you for the opportunity to provide our views to the Committee. Please contact me on 02 8299 9053 or Luke Lawler, Senior Adviser, on 02 6232 6666, should you wish to discuss any aspect of this submission.

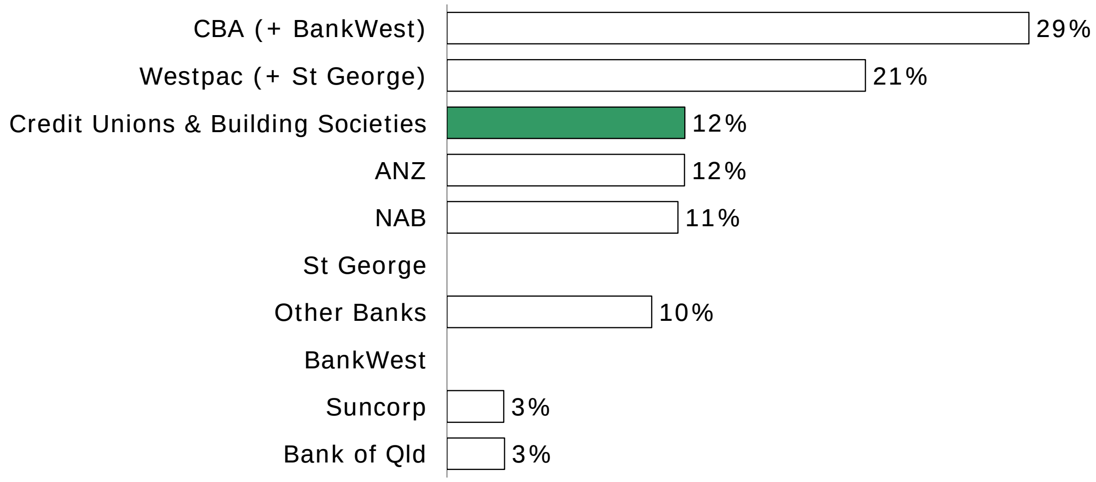
Yours sincerely,

MARK DEGOTARDI
Head of Public Affairs

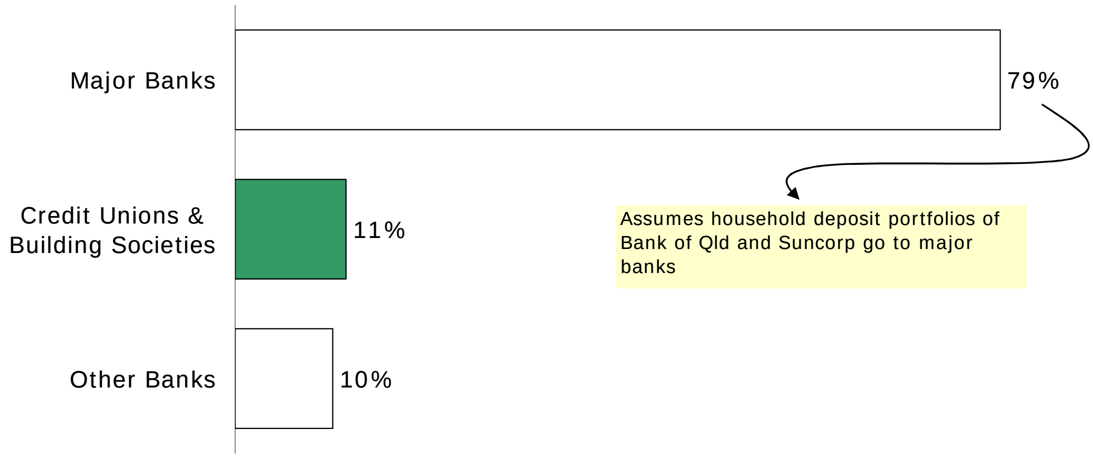
Share of Household Deposits 2007



Share of Household Deposits 2008



Share of Household Deposits 2009 ?



Sources : APRA; RBA; Abacus analysis. Data as at Dec

Abacus Australian Mutuals