The Senate

Economics
Legislation Committee

Banking Amendment (Keeping Banks Accountable) Bill 2009

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Senate Economics Legislation Committee

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Introduction

Background

1.1 The Banking Amendment (Keeping Banks Accountable) Bill 2009 seeks to amend the *Banking Act 1959*. It aims to encourage banks to set mortgage interest rates in line with movements in official interest rates (defined as the Reserve Bank's overnight cash rate).

1.2 The mechanism by which this is done is that if a bank moves interest rates contrary to movements in official interest rates, it must explain to the treasurer why it is doing so. If the treasurer considers that the bank's action (or inaction) is 'contrary to the public interest', and the bank persists, then the treasurer may revoke the guarantee applying to the bank's deposits under the Financial Claims Scheme.

Conduct of the inquiry

1.3 On 12 August 2009, the Senate referred the Banking Amendment (Keeping Banks Accountable) Bill 2009 to the Economics Legislation Committee for inquiry and report by 24 November 2009.

1.4 The committee advertised the inquiry on its website and in a national newspaper. A number of organisations, commentators, academics and stakeholders were also invited to make submissions to the inquiry.

1.5 The committee received 7 submissions. These are listed in Appendix 1. A public hearing was held in Melbourne on 5 October 2009. The witnesses appearing are listed in Appendix 2. The committee thanks those who participated in the inquiry.

Outline of the report

1.6 The issue of whether it is reasonable to expect banks to move (and only move) their home loan interest rates in line with movements in the official cash rate is discussed in Chapter 2. Whether the bill represents an appropriate response is discussed in Chapter 3, which concludes that the bill should *not* be passed.

Chapter 2

Banks' adjustment of home loan interest rates

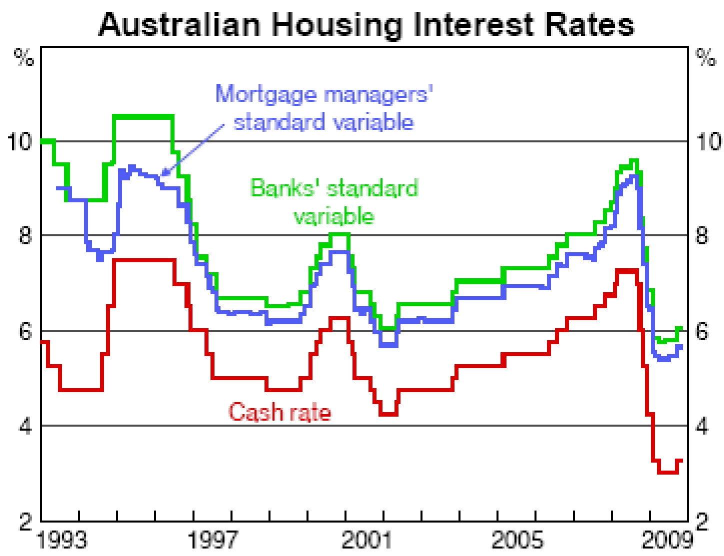
The official rate and banks' cost of funding

2.1 In recent years, banks have tended to move the interest rate charged on their variable home loans closely in line with movements in the Reserve Bank's official target overnight 'cash' rate (see Chart 2.1, the thick line in Chart 2.2 and the left hand half of Chart 2.3). This has led to an expectation developing that this is the 'usual' or 'fair' way of setting home loan interest rates.

2.2 However, the Reserve Bank recently observed:

> …while the cash rate still has a large influence on banks' funding costs, changes in risk premia in markets over the past two years have weakened this relationship. In turn, this has also weakened the close relationship that has been experienced in the previous decade between the cash rate and banks' interest rates on loans.[1]

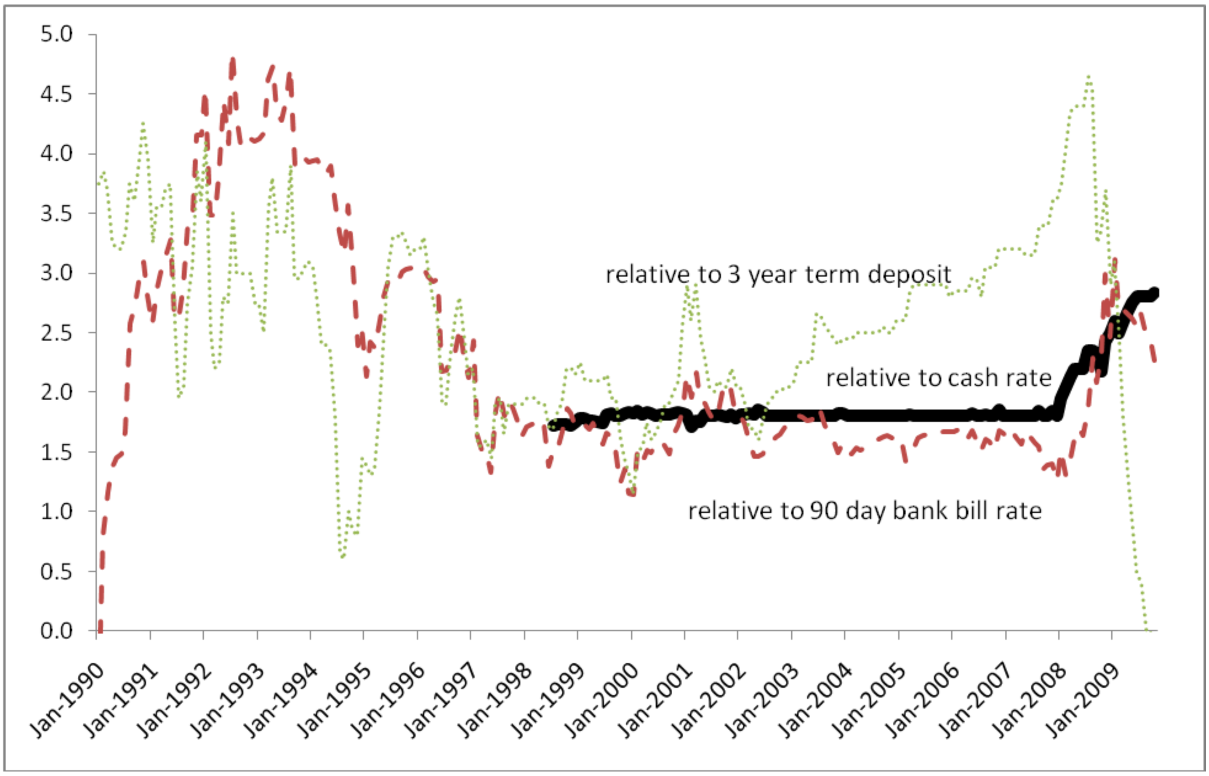
Chart 2.1



Source: Reserve Bank of Australia, www.rba.gov.au

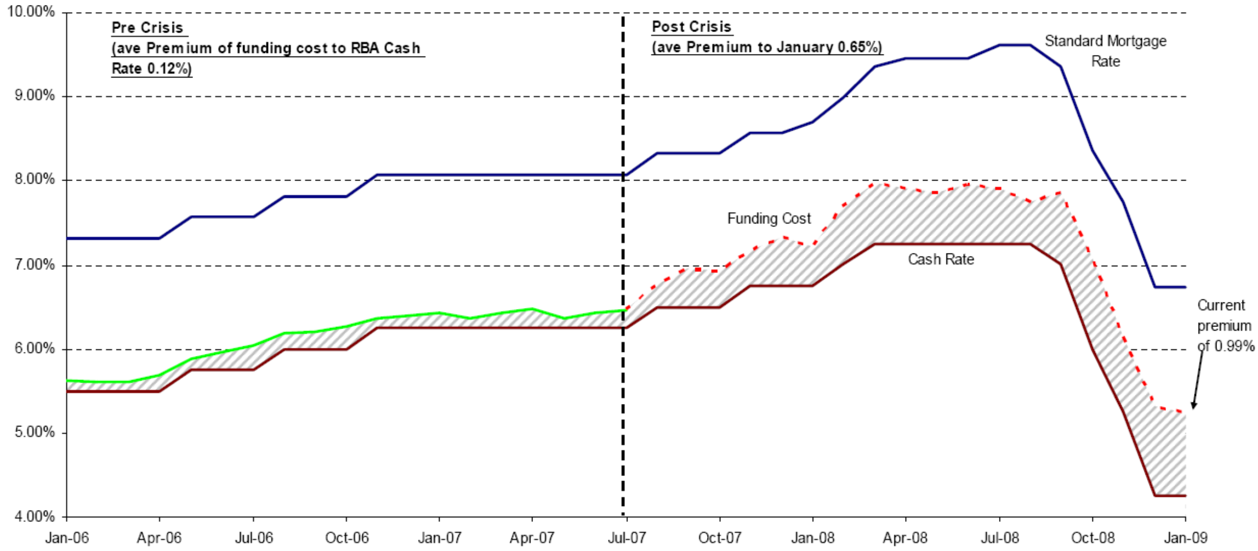
1 Reserve Bank of Australia, 'The impact of the capital market turbulence on banks' funding costs', *Reserve Bank Bulletin*, June 2009, p 1.

Chart 2.2: Difference between home loan variable interest rate and other rates



Source: Secretariat, based on data from Reserve Bank of Australia, www.rba.gov.au

Chart 2.3: NAB's standard variable mortgage rate, funding costs and cash rate



Source: National Australia Bank, *Submission 5*, attachment 2.

2.3 The recent breakdown in the relationship between the variable home loan interest rate and the cash rate is shown in Charts 2.2 and 2.3.

2.4 Rather than the norm, the close relationship between the cash rate and lending rates had been an *unusual* feature of the 2000s:

> The relationship between the cash rate and the rate on standard housing loans was particularly close from 1999 to 2007, though in the longer sweep of history this period looks unusual.[2]
>
> The presumption that their lending rates would and should move only in line with the cash rate, which had arisen in an earlier period when all these rates were much more closely related, has not been a realistic one in the recent environment.[3]

2.5 Chart 2.2 shows that while the home loan interest rate is currently higher than usual when compared to the cash rate, it is around its long-term average when compared to the 90 day bank bill rate and is currently very low compared to term deposit rates.

2.6 A number of lenders made the point that the interest rate paid on a significant proportion of funds raised by lenders does not move with the official cash rate and so it is not reasonable to expect lending rates to move in line with the official cash rate:

> The fact is that roughly half of the money that banks borrow to lend to people here in Australia is sourced from outside depositors. It is sourced from the wholesale markets both here in Australia and overseas; it is sourced both long term and short term. That means, as I said before, that the cash rate has little if any effect on the costs that banks have to pay to source their money to lend to people.[4]
>
> There are really three factors that we take into account when determining the mortgage rate. They are the actual cost of our funds, the risk that we perceive in the environment we are lending into and also, obviously, we are looking at remaining competitive with other providers of credit. The main factor within that would be the cost of funds, and that in itself is broken down into three areas. About half of our funding, like most major banks in Australia, comes from depositors; about half of the remaining 50 per cent comes from short-term wholesale funding; and the final 25 per cent comes from long-term wholesale funding.[5]

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2 Reserve Bank of Australia, 'The impact of the capital market turbulence on banks' funding costs', *Reserve Bank Bulletin*, June 2009, p 9.

3 Mr Glenn Stevens, Governor, Reserve Bank of Australia, Address to Smart Capital 2008: The Euromoney Australian Financial Markets Innovation Congress, Sydney - 27 March 2008, cited by Australian Bankers' Association, *Submission 3*, p 1.

4 Mr David Bell, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 5 October 2009, p 9.

5 Mr Munchenberg, National Australia Bank, *Committee Hansard*, 5 October 2009, p 17. NAB elaborated on the factors driving their cost of funds in their Supplementary *Submission 5*.

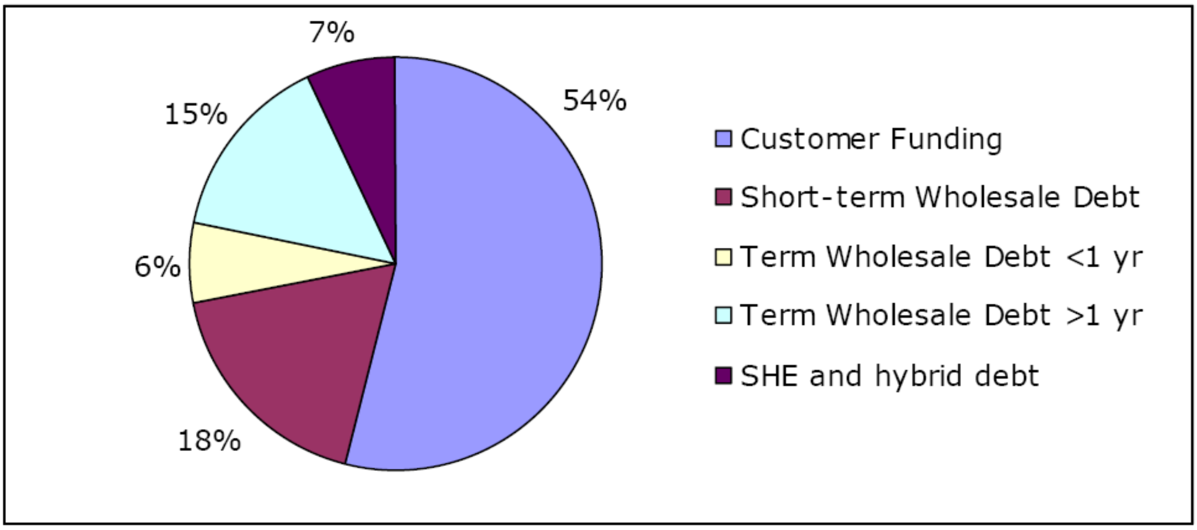
> Mortgage rates are determined by the cost of funds to institutions – that is, the cost of raising funds through either retail deposits or wholesale funds. The cost of these funds has no direct link to the RBA cash rate.[6]

> The current Bill attempts to bring back a system of setting rates that were inefficient and do not reflect how funds are raised and costed today… The big four do not rely on the RBA cash rate; the international market governs the costs of funds.[7]

2.7 As an example, the ANZ comments that over half their funding comes from customer deposits (Chart 2.4), and that the cost of these has not dropped commensurately with the official cash rate:

> …the cost of deposits has fallen more slowly than the cash rate over the past year. This reflects the current strong competition between financial institutions for deposits. Since early September 2008, rates on savings deposits have fallen by an average of 380 basis points, less than the 425 basis point decrease in the official cash rate.[8]

Chart 2.4: Composition of ANZ's funding (March 2009)



Source: ANZ Bank, *Submission 4*, p 4.

2.8 The Reserve Bank have compiled data showing only around a quarter of banks' funding is priced directly off the official cash rate (Table 2.1).

6 Abacus, *Submission 6*, p 1.

7 Michael Peters, *Submission 7*, p 2.

8 ANZ Bank, *Submission 4*, p 5.

Table 2.1: Major banks' funding mix (as at April 2009)

Funding source	Per cent of funding liabilities	Pricing benchmark	Additional costs
Domestic deposits	53		
Transaction	9	Rates do not change	..
Savings	26	Cash rate	..
Term	18	Bank bills	..
Capital markets	47		
Short-term domestic	13	Bank bills	..
Short-term foreign	7	Bank bills	Hedging
Long-term domestic	5	Bank bills/swap rate	Spread
Long-term foreign	19	Bank bills/swap rate	Spread + hedging
RMBS	2	Bank bills	Spread + hedging

Source: Reserve Bank of Australia, 'The impact of the capital market turbulence on banks' funding costs', *Reserve Bank Bulletin*, June 2009, p 3.

2.9 NAB added about the use of foreign funding:

> Structurally, it is true that Australians are borrowing more than they save. Hence, the National Bank is reasonably typical in only being able to obtain half the money we wish to loan from the depositors in the bank.[9]

2.10 Looking at the recent period, the Reserve Bank observe:

> It is estimated that the major banks have reduced their variable housing lending rate by an average of 385 basis points since September 2008. This is less than the reduction in the cash rate of 425 basis points, but more than the reduction in their average funding costs of 330 basis points.[10]

Competition and bank margins

2.11 Calls for a degree of re-regulation of bank loan interest rates have been fuelled by concerns that there is reduced competitive pressure on banks. For example, former ACCC head Allan Fels has commented:

> We are now back to where we were in the 1970s and I fear a similar prolonged period of limited competition…[11]

2.12 Bank margins narrowed as competition (most notably from non-bank home lenders such as Aussie, RAMS and Wizard) increased over the past decade (Charts 2.1 and 2.5).[12] More recently, the global financial crisis has seen a drying up of the

9 Mr Salamito, National Australia Bank, *Committee Hansard*, 5 October 2009, p 19.

10 Reserve Bank of Australia, 'The impact of the capital market turbulence on banks' funding costs', *Reserve Bank Bulletin*, June 2009, p 9.

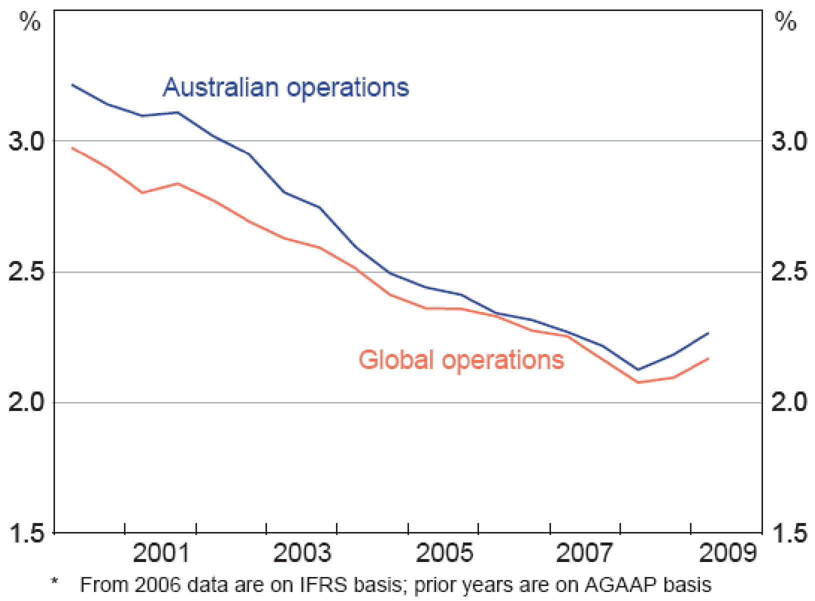
11 Quoted in *The Australian*, 1 August 2009.

12 A similar chart in ANZ Bank, *Submission 4*, p 3, shows the downward trend in the margin started in the mid-1990s.

securitisation markets used by the competitors to banks and a reduction in the competitive pressure exerted by these non-bank lenders. There has also been some consolidation within the banking industry.[13] The combined effect has been that the four major banks have gone from accounting for around 60 per cent of new home loans in 2007 to approaching 90 per cent now.

2.13 There has been an expansion in bank margins recently (Chart 2.5).[14] However, as noted above it has been in their loans to business rather than households that the expansion in margins has occurred.

Chart 2.5: Major banks' net interest margin



Source: Reserve Bank of Australia, 'The impact of the capital market turbulence on banks' funding costs', *Reserve Bank Bulletin*, June 2009, p 11.

Accountability and transparency

2.14 National Australia Bank's submission emphasises their efforts to explain the relationship between their cost of funds and lending rates:

> With each adjustment in our variable mortgage interest rate NAB has publicised and made widely available detailed information on our over-all funding costs and how these have impacted our decisions on rates.[15]

2.15 At the hearing they reiterated their support for transparency:

13 Westpac took over St George Bank and the Commonwealth Bank took over BankWest. The impact of bank mergers is discussed in the Senate Economics References Committee's *Report on Bank Mergers* (September 2009).

14 A similar chart is included in ANZ Bank, *Submission 4*, p 3.

15 National Australia Bank, *Submission 5*, p 3.

> NAB supports the need for greater transparency around the commercial setting of interest rates. We believe that NAB customers and the wider community should hear directly from us about the factors that influence their home loan repayments…We also believe that better public information and understanding of the full range of factors affecting commercial interest rates is in the interests of all stakeholders: customers, the media, government and the banks themselves.[16]

2.16 They explained the measures they were taking:

> Since August last year, National Australia Bank has provided detailed information on funding costs to our customers, the media and other stakeholders. This means that each time the NAB has adjusted its variable mortgage rate we have made available details of how our overall funding costs have impacted our decision. [17]

2.17 Critics of the banks may always be sceptical of information provided by them. This has led to calls for independent authorities to publish information as well:

> Senator PRATT—… who has the most substantive body of knowledge that compares what is going on with both official interest rates and what banks are actually doing?
>
> Prof. Sathye—I would say that APRA and the Reserve Bank of Australia are the best organisations to do that kind of research and get that kind of information…I would like that kind of information [on interest rate margins] to be generated by these agencies and put forward to people.[18]
>
> We would also like to suggest that the RBA itself continue to play a role in increasing information and education on the factors affecting interest rates, as it did with its analysis published in its June bulletin on the costs of funds…We believe that more of this type of information from the RBA would make a significant and positive contribution to public transparency and understanding of the factors affecting interest rates.[19]

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16 Mr Steven Munchenberg, National Australia Bank, *Proof Committee Hansard*, 5 October 2009, p 14.

17 Mr Steven Munchenberg, National Australia Bank, *Proof Committee Hansard*, 5 October 2009, p 14.

18 Professor Milind Sathye, *Proof Committee Hansard*, 5 October 2009, p 4.

19 Mr Steven Munchenberg, National Australia Bank, *Proof Committee Hansard*, 5 October 2009, p 14.

Committee view

2.18 The committee regards it as helpful for the public debate for banks to explain the relationship between the official cash rate, their own cost of funds and the rates they charge on loans, especially for variable rate housing loans. It commends those banks which do so.

2.19 It would further enable informed opinions to be made around this issue if the relevant authorities made more data available.

Recommendation 1

2.20 The committee recommends that the Reserve Bank and the Australian Prudential Regulation Authority regularly publish estimates of the costs of funds for the banking sector as a whole and bank interest margins.

Chapter 3
The bill

Background - the Financial Claims Scheme

3.1 The Financial Claims Scheme, or 'deposit guarantee' as it is more commonly known, has been the subject of a recent report by the Economics References Committee.[1]

3.2 At present the Scheme offers a 'free' guarantee on all deposits up to $1 million. There is an optional guarantee (under the 'Large Deposits Guarantee Scheme') for larger deposits at a fee equivalent to that charged for the guarantee on wholesale funding. However, this broad coverage reflects the extraordinary circumstances of the current global financial crisis. The Government has announced it will only operate until October 2011.

3.3 The scheme envisaged before the crisis struck, originally known as an 'early access facility', was to only apply to deposits up to $20,000.[2] It has not yet been decided to what level of deposits the permanent scheme will apply.

3.4 Such 'deposit insurance' schemes are common around the world. It has been noted that:

> An IMF survey has referred to average coverage levels in (pre-crisis) deposit insurance schemes being around one to two times per capita GDP… Given Australia's GDP of over $1 trillion and population of over 20 million, in round terms, one to two times per capita GDP would translate into a range of $50 000 to $100 000 as a coverage limit.[3]

Should the banks face obligations in exchange for the deposit guarantee?

3.5 It has been suggested that the bank funding guarantees provide a substantial benefit to the banks at a potential cost to the public purse and that it is therefore reasonable to expect the banks to provide something in return. For example, the Finance Sector Union suggest:

> …such conditions should include measures to safeguard Australian jobs against practices such as off-shoring, maximise Australian employment, lend responsibly and effectively to all market segments and require the

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1 *Government measures to address confidence concerns in the financial sector - The Financial Claims Scheme and the Guarantee Scheme for Large Deposits and Wholesale Funding*, 17 September 2009.

2 Reserve Bank of Australia, *Financial Stability Review*, March 2008, p 65.

3 *Government measures to address confidence concerns in the financial sector - The Financial Claims Scheme and the Guarantee Scheme for Large Deposits and Wholesale Funding*, 17 September 2009, p 50.

> observation of social obligations ensuring that banks do not withdraw services to disadvantaged communities or groups.[4]

3.6 Another example of a possible obligation is to accept some restraint on their mortgage interest rates as envisaged by this bill.

3.7 On the other hand, the banks argue that no obligation should arise as the deposit guarantee is underwritten by the banks collectively rather than taxpayers.[5] This is presumably a reference to the industry levy proposed for the original financial claims scheme with the $20,000 cap.

3.8 Professor Sathye was the only witness to give (qualified) support to the bill. However, he argued the requirements should be tied to the temporary wholesale funding guarantee rather than to the ongoing Financial Claims Scheme:

> …I support the bill where the public wholesale funding guarantee is provided. This means that there needs to be a full pass-through of the quantum of the OCR [official cash rate] reduction.[6]

Impact on monetary policy effectiveness

3.9 An argument for tying movements in bank lending rates to those in the official interest rate is that it makes monetary policy more effective. The bill would mean that the Reserve Bank would know that the movement it chooses to make in its official rate will be fully reflected in the interest rate affecting household spending decisions (although deposit rates which also affect households' decisions to spend or save, credit card interest rates and business loan rates would still not be tied to the official rate).

3.10 This is the basis for Professor Sathye's qualified support for the bill:

> The OCR, the official cash rate, is reduced to push more credit into the economy and raised to curb credit expansion. I would particularly support the bill when the OCR is being reduced to kick-start the economy. When banks do not do a full pass-through, the monetary policy, in my opinion, gets stunted…[7]

3.11 However, Professor Sathye is less supportive of the bill in an environment where the Reserve Bank is increasing interest rates, which most commentators expect to be the case for the foreseeable future:

> However if it is the other way around and the OCR [official cash rate] is being raised in order to curb credit expansion in the market and the banks end up trying to raise their lending rates above the OCR, then probably the

4 Finance Sector Union, *Submission 11* to Economics References Committee inquiry on bank funding guarantees, p 2.

5 Australian Bankers' Association, *Submission 24* to Economics References Committee inquiry on bank funding guarantees, pp 6-7.

6 Professor Milind Sathye, *Committee Hansard*, 5 October 2009, p 2.

7 Professor Milind Sathye, *Committee Hansard*, 5 October 2009, p 2.

> monetary policy objective is being achieved through the banks' actions…. [when interest rates are rising the bill] is probably not very desirable in the sense that we do not want to go to a system of prescribed interest rates.[8]

3.12 Under section 18F a bank *cutting* mortgage interest rates in the absence of a cut in official rates, or failing to pass on (in full) an increase in official rates would not have to send an explanation to the treasurer, even though this is also going against the policy intentions of the Reserve Bank.

3.13 The Reserve Bank itself does not seem particularly perturbed about banks not always exactly following its movements in official interest rates.

> …the banks' overall funding costs have not come down quite as much as the cash rate has, so the overall rates that they have to earn off the whole portfolio of loans were not going to come down as much as the cash rate did. Of course, we took account of that in deciding how far down to go on the cash rate.[9]
>
> Of course, in setting the cash rate, the Reserve Bank has taken account of these shifting relationships, just as it does shifts in other relationships in the monetary transmission mechanism.[10]

3.14 Home loan lenders believe the bill would not be helpful to monetary policy as by requiring the treasurer's assent to some bank decisions it would 'politicise' interest rates:

> The bill politicises interest rate setting by giving the Treasurer the power to determine bank product prices through interest rate control. This is a form of price control which is inconsistent with a market based economy and has been rejected by the last two major inquiries into Australia's financial system, the Wallis inquiry in 1997 and the Campbell inquiry in 1980. One of the reasons why the Campbell inquiry rejected price control was that it ultimately proves unfair to low-income earners. Politicisation of interest rate setting is inconsistent with sound monetary policy, whereby it is recognised that interest rate setting should be independent of the political arm of government. This is why the government has exchanged letters with the Reserve Bank assuring the central bank that it should act independently in setting official interest rates. The same principle should apply to retail rates.[11]
>
> Price intervention in response to a highly political and public issue will compromise the Reserve Bank's ability to act independently and sets a very dangerous precedent for the wider community. It has always been

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8 Professor Milind Sathye, *Committee Hansard*, 5 October 2009, p 3.

9 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *House Economics Committee Hansard*, 20 February 2009, p 8.

10 Mr Glenn Stevens, Governor, Reserve Bank of Australia, Address to Smart Capital 2008: The Euromoney Australian Financial Markets Innovation Congress, Sydney - 27 March 2008, cited by Australian Bankers' Association, *Submission 3*, p 1.

11 Mr David Bell, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 5 October 2009, p 7.

> government policy that interest rates are set independent of government. We do not support government intervention in rate setting in the manner proposed in the Bill.[12]

Coverage and definitions in the bill

3.15 The bill only covers standard variable rate mortgages, which are the majority of home loans. It would have caused a problem if it also referred to the rate charged on new fixed rate mortgages as these rates are generally set based on deposit rates of a corresponding maturity, which reflect the *expected* official rates over the term, rather than the *current* official rates.

3.16 The bill uses the term "bank" to refer to 'an authorised deposit-taking institution to which Division 2AAA applies'. As their industry body, Abacus, notes, this means it covers building societies and credit unions as well as banks.[13] This could prove an administrative problem if a large number of credit unions wanted to move rates around the same time (in the absence of a move in official interest rates) as there are over 100 credit unions.

3.17 Under section 18D, 'movements in official interest rates' are those announced 'following meetings of the Reserve Bank board'. It might be argued that the bill would not apply to cases where the board had given the Governor limited discretion to act between meetings, or decisions were taken by a more informal contact between board members.

3.18 Under section 18F, the bill applies to three cases;

- a bank not making a corresponding cut to its mortgage rate (within five business days) when the Reserve Bank cuts the official rate[14];
- a bank increasing its mortgage rate when the Reserve Bank has not moved the official rate; and
- a bank increasing its mortgage rate by more than the Reserve Bank has increased its official rate.

3.19 The bill is unclear whether a bank making such a move must automatically send an explanation to the treasurer (as implied by s18B(2)(b)) or whether it is up to the treasurer to request in writing such an explanation (as implied by s18G(1)).

3.20 If the bank fails to provide a satisfactory explanation to the treasurer, the treasurer can tell the bank to set its mortgage rate at a different level and/or declare that the bank's decision is 'contrary to the public interest'. This term has been criticised by a submitter:

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12 Abacus, *Submission 6*, p 2.

13 Abacus, *Submission 6*, p 1.

14 The exact wording is 'within 5 business days of a reduction in official interest rates, the bank fails to reduce its standard variable rate by at least the same amount, **or at all**'[emphasis added]. Professor Sathye would like 'or at all' dropped, as he is concerned that a bank can meet the requirement by cutting its interest rate by 0.001 per cent; *Submission 1*, p 4.

> I find the term public interest too vague and that it will give ample occasion for greediness to find a way through.[15]

3.21 If the bank fails to comply with the treasurer's direction, then the treasurer can determine that the Financial Claims Scheme will cease to apply to that bank. (The treasurer can later revoke such a determination.)

3.22 It is not clear whether this would mean that the Scheme would not apply to new deposits or also to existing deposits. It may be argued that it is unfair to depositors that have placed funds in a term deposit on the understanding that they would be covered for that guarantee to be withdrawn before the deposit matures. It could also undermine the aim of the scheme which is to support confidence in bank deposits:

> …when you give a guarantee and then you withdraw the guarantee, the decision of the investor who invested the money at the time when the guarantee was in place is now affected because of the withdrawal of the guarantee. The investor will not know at the time when he invests the money how the bank will comply with the requirements of the government. Another thing that can happen is that it will impact the fundraising by other banks, because investors may then be wary as they may not know whether these banks will also be complying with the government rules or not and whether there is a risk of the guarantee being withdrawn. So in my opinion this is likely to affect the investor decisions. And from that perspective I feel that, instead of giving the signal to the market, it is always useful to keep it internal and impose a financial penalty rather than a withdrawal of the guarantee itself.[16]

3.23 It is also unclear whether the bill applies to deposits of over $1 million, for which a fee is being paid for the guarantee. Professor Sathye has commented that the reference to 'funds' in s18B(1) of the bill needs to be clarified.[17]

Is the penalty credible?

3.24 Doubts have been raised about whether removing the deposit guarantee from a bank is a credible threat:

> Such a power in my opinion would be hard to exercise in practice. Withdrawal of deposit guarantee for whatever reason would result in a run on that financial institution which the government could ill afford. A bank may *not* set mortgage interest rates in line with the official cash rate as it knows that the government can't revoke guarantee due to financial stability considerations. The proposed Amendment then is ineffective and is only a paper tiger![18]

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15 Ms Irene Schardijn, *Submission 2*, p 1.

16 Professor Milind Sathye, *Committee Hansard*, 5 October 2009, p 2.

17 Professor Milind Sathye, *Submission 1*, p 3.

18 Professor Milind Sathye, *Submission 1*, p 3.

3.25 As the Professor argues, the withdrawal of the guarantee from one bank may remove the confidence-inspiring effect of the guarantee on other banks. He suggests as an alternative:

> An alternative could be to insert a penalty provision which could require erring banks to pay to the government a penalty equivalent to (official cash rate minus the actual rate charged by the bank) multiplied by the total loans and advances outstanding.[19]

Impact on banks' rate setting

3.26 It is possible that the bill could discourage lenders cutting mortgage interest rates in the absence of a cut in official rates, as the bill would prevent them later (even partially) reversing such decreases. Similarly, the bill may discourage a lender refraining from passing on (in full) an increase in official rates, as if they leave it more than five days the bill would not allow them to 'catch up'.

> Mutual ADIs have frequently reduced their interest rates outside of changes to the RBA cash rate for the benefit of their members. This Bill would place pressure on institutions to limit their mortgage rate changes to movements in the cash rate – this would not necessarily be of benefit to consumers.[20]

3.27 Home mortgages amount to about half of banks' loans. If banks are restricted from raising interest rates on these loans, it might be argued this would put upward pressure on interest rates on personal and business loans:

> The proposed Bill applies only to mortgage rates and therefore poses the risk that other forms of credit will become more expensive or that fees will rise. Younger people, who rely on personal loans and credit card debt, will find themselves subsidising those who hold a mortgage; a poor outcome for consumers.[21]

3.28 Alternatively, there is a risk that the bill will make mortgage lending less profitable than other forms of lending and so lead to a return to the credit rationing that occurred when interest rates were heavily regulated in the 1950s and 1960s. There were also 'hidden charges' such as banks only lending to customers who had shown 'loyalty' (some would say 'fealty') by placing funds for a long period in low-interest deposit accounts:

> The Australian financial market was substantially deregulated in the 1980s. Before this the interest rate which a bank could charge for a home loan was controlled. Quantitative lending controls placed ceilings on interest rates that could be charged to borrowers. In this period, access to housing finance for many consumers was limited. The regulatory restrictions on the price of credit caused a restricted credit supply. As a result, only customers with a

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19 Professor Milind Sathye, *Submission 1*, p 4.

20 Abacus, *Submission 6*, p 2.

21 Abacus, *Submission 6*, p 2.

> very good credit record and high income or savings were able to obtain a home loan without needing to resort to supplementary forms of finance.[22]

3.29 When the ABA appeared at the hearing, they referred to the Campbell inquiry, which found that interest rate controls disadvantaged low-income earners:

> …if you have a control and you are restricting the bank in recovering costs then the bank looks for other ways to cover those costs, such as doing more business with those who have got high levels of collateral or who have got higher offsetting balances in deposit accounts. These tend to be people who are wealthier.[23]

Confidentiality of bank affairs

3.30 Under section 18I of the bill, the treasurer can require APRA, ASIC or the Reserve Bank to provide information 'including a matter relating to the affairs of a bank'. This could involve the disclosure of commercial-in-confidence information.

Committee's conclusions

3.31 The committee is not convinced of the merits of the bill. In particular, it is concerned that the bill may discourage banks from competing in reducing interest rates, could lead to higher bank fees and/or reduced lending to homebuyers, could raise doubts about the deposit guarantees and so reduce confidence in the safety of bank deposits and could be perceived as politicising the setting of bank interest rates.

3.32 The goal of increasing the accountability of banks could be better achieved by increasing information as addressed in the first recommendation. The goal of discouraging banks from unduly increasing interest rate margins at the expense of homebuyers can be better achieved by measures to make the market more competitive, such as the recent initiative by the Government to facilitate customers moving between banks.

Recommendation 2

3.33 The Committee recommends that the Senate not pass the bill.

Senator Annette Hurley

Chair

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22 ANZ Bank, *Submission 4*, p 2.

23 Mr Nicholas Hossack, ABA, *Committee Hansard*, 5 October 2009, p 12.

FAMILY FIRST
DISSENTING REPORT

Australia has some of the highest interest rates in the world.

One of the reasons Australians are paying higher interest rates is because the major banks have been greedy in withholding official interest rate cuts and lifting their rates above the official rate rises.

During the Senate inquiry Professor Milind Sathye revealed that homeowners are being slugged an additional 2.8% above the official cash rate on their standard variable loans. This is outrageous and something must be done to bring the banks into line.

The Rudd Government is as weak as water and refuses to stand up to the big banks – it hides behind saying if customers aren't happy they should switch banks.

Unfortunately, ordinary Australians have little ability to do anything about their predicament because of ineffective competition in the banking sector. The big four banks continue to dominate the Australian market and follow one another in regards to interest rates – that's why most Australians believe there is no use switching banks because they are all just as bad as each other in regards to interest rates and fees.

Competition in the banking sector has become worse under the Rudd Government. Even the Chairman of the ACCC, Graeme Samuel has recently conceded that competition in the banking sector was not intense or vigorous enough.

The way in which the Rudd Government granted the 4 major banks access to a Commonwealth Government Guarantee has seen the big banks increase their market share even further. **The wholesale funding guarantee has helped the four major banks to increase their market share in home loans from 57% to 72%.**

The big banks have enjoyed a windfall profit gain under the Rudd Governments bank guarantee. Under the guarantee the big banks have enjoyed lower borrowing costs and according to Professor Sathye's estimate,

> **…banks would make a profit of $1.34 billion over a three year period from the public wholesale funding guarantee.**

The Commonwealth Government Guarantee is being underwritten by all Australian tax payers for the benefit of the big banks. It is appalling that tax payers should be asked to help prop up the banks with the government's bank guarantee and then be slugged again with higher than necessary interest rates. It is a slap in the face to every Australian family.

It is for these reasons that Family First believes the *Banking Amendment (Keeping Banks Accountable) Bill 2009* is necessary.

The *Banking Amendment (Keeping Banks Accountable) Bill 2009* will keep the banks accountable for the movements in their standard variable home loan interest rate. The major banks will no longer be able to withhold an interest rate cut or put up interest rates beyond the Reserve Bank's official interest rate changes **without** having to justify their actions. This bill will force the banks to satisfy to the Treasurer that their decision is not contrary to the public interest and should not warrant the loss of their commonwealth guarantee. Banks need to understand that government assistance comes with responsibility.

During the Senate inquiry the National Australia Bank claimed that the increasing gap between the official cash rate and the standard variable loan rate was not a result of greedy profiteering by the banks but was due to the global financial crisis which had pushed up the cost of offshore wholesale borrowing.

However, according to Professor Saythe,

> …the argument appears to be weak.

The chart provided by Professor Sathye in his supplementary submission demonstrates that this excuse is just a smokescreen for the great rip-off being carried out by the major banks.

Professor Sathye's chart clearly shows that the gap between the official cash rate and the standard variable loan rate began to increase already in January 2008, well before September 2008 when the global financial crisis took full effect. He stated further,

> …the OCR-SVR difference continued to widen even after January 2009, the month from which the LIBOR substantially declined.

Moreover, former chief executive of Westpac, David Morgan, recently admitted that rising funding costs have been offset by rising lending rates for businesses and home loans. In fact, the increased costs have been more than offset as the graph provided by Professor Sathye indicates.

Banks are making $450 a year more from each average home mortgage than they did before the global financial crisis, while at the same time crying poor that they can't afford to pass on the full rate cuts of the Reserve Bank.

Australian banks continue to record bumper profits of the back of hard working Australians. The world has experienced the biggest economic downturns since the great depression, a downturn which hit the finance industry the hardest, and yet none of the major Australian banks recorded a loss for the previous financial year because of the higher than necessary interest rates which were being charged to Australian families.

This Bill will remedy this injustice. It will send a clear message to the major banks that they can't have their cake and eat it too. If they want the Australian people to help them through providing them with a tax payer backed Commonwealth Government Guarantee, they must be willing to help the Australian people in return.

Family First welcomes the recommendation of the committee that the Reserve Bank and the Australian Prudential Regulation Authority regularly publish estimates of the cost of funds for the banking sector as a whole and bank interest margins, however this recommendation does not go far enough. Simply publishing these estimates will not succeed in holding the banks accountable because there are no repercussions for those banks which increase their margins. Only by passing this bill and enacting measures such as the ability of the Treasurer to withdraw the Commonwealth Government Guarantee will real change be achieved.

During the inquiry, Professor Sathye also commented that by not making the banks accountable for the movements in their interest rates, this gave rise to the possibility that the Australian monetary policy could be "stunted". This is a serious concern for Family First as this could have enormous ramifications on the Australian economy.

All of the above reasons provide a compelling case for why the Senate should pass this bill without further delay.

Recommendation 1

Family First recommends that the bill be passed.

Senator Steve Fielding
Leader of the Family First Party

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Professor Milind Sathye
2	Ms Irene Schardijn
3	Australian Bankers' Association
4	ANZ
5	National Australia Bank
6	Abacus – Australian Mutuals
7	Mr Michael Peters

Additional Information Received

- Received 7 October, 2009 from the National Australia Bank. Additional information:
  - Australian banks cost of funds
    NAB overview
    As at 7 April 2009
  - Global Credit Crisis
    Impact on Australian banks cost of funds
    As at Tuesday, 3 February 2009
  - Global Credit Crisis
    Impact on Australian banks cost of funds
    Wednesday, 5 November 2008
  - Global Credit Crisis
    Impact on Australian banks cost of funds
    Tuesday, 7 October 2008
  - Media Update
    Thursday 21 August 2008
- Received 15th October, 2009 and 16th October 2009 from the National Australia Bank. Answers to Questions on Notice taken on notice on Monday 5th October 2009.

APPENDIX 2

Public Hearing and Witnesses

MELBOURNE, MONDAY 5 OCTOBER 2009

BELL, Mr David, Chief Executive Officer
Australian Bankers' Association Inc

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

MUNCHENBERG, Mr Steven, Group Manager, Government Affairs and Public Policy, National Australia Bank

SALAMITO, Mr John, Executive General Manager, Consumer Production Solutions, National Australia Bank

SATHYE, Prof. Milind
Private capacity

WARD, Ms Sarah, Manager, Government and Regulatory Affairs
National Australia Bank