

5 December 2013

Mr John Lonsdale  
Head of Secretariat  
Financial System Inquiry  
The Treasury  
PARKES ACT 2600

By email: [fsi@treasury.gov.au](mailto:fsi@treasury.gov.au)

Dear John

### **Financial System Inquiry – Draft Terms of Reference**

The Customer Owned Banking Association (COBA) welcomes the opportunity to comment on the draft Terms of Reference for the Government's Financial System Inquiry. Our members are credit unions, building societies and mutual banks, and collectively, our sector serves around 4.5 million Australians. The customer owned model is the proven alternative to the listed model, delivering competition, choice, and consistently market leading levels of customer satisfaction.

COBA has been a strong and long-standing supporter of the need for a Financial System Inquiry. Earlier this year we ran our "Balance Banking" campaign, drawing attention to the risks posed by a highly concentrated banking market.

COBA supports the overall content of the Terms of Reference, and we note that they have been drafted broadly to provide stakeholders with an appropriate opportunity to have issues of relevance raised.

We are particularly encouraged by the inclusion of "systemic risk," "the performance of financial regulators," and "the philosophies, principles and objectives ... of a well-functioning financial system," in the draft Terms of Reference. These are all important issues for our sector, and are topics that we will be commenting on in detail in our subsequent engagement with the Inquiry.

While the overall scope of the Terms of Reference is sound, we feel they could be further strengthened through some minor changes and additions. Specifically, **COBA recommends that the Terms of Reference be improved through explicit inclusion of:**

- 1. The implicit guarantee currently enjoyed by the four major banks, and the impact of the current regulatory environment in the banking sector on concentration and competitive neutrality.**
- 2. The appropriate treatment and recognition of the 'customer-owned' banking business model in the corporate, prudential and taxation regimes.**

## Explicit focus on the four major banks

It is well recognised that the major banks enjoy implicit government support as a consequence of their systemic importance based on size, interconnectedness, and complexity. The IMF has estimated that this funding cost advantage rose from 80 basis points to 120 basis points during the global financial crisis when government support for the banking system was made more explicit.

The Basel Committee on Banking Supervision says the moral hazard costs associated with implicit government guarantees “may amplify risk-taking, reduce market discipline, create competitive distortions, and further increase the probability of distress in the future.”

“In maximizing their private benefits, individual financial institutions may rationally choose outcomes that, from a system-wide level, are sub-optimal because they do not take into account these externalities,” the Basel Committee says.

Calling for this inquiry in 2010, the Treasurer when he was Shadow Treasurer cited the “too big to fail” problem and proposed the following matters for examination:

- the aggregation of financial services providers into financial conglomerates resulting in the emergence of large and diverse financial institutions;
- the appropriateness of government pledging its balance sheet or providing support to particular entities; and
- the consequences for prudential supervision, confidence, stability and competition of government intervention in guaranteeing financial entities and specific products, and the associated creation of a new risk profile (“moral hazard”) for public sector engagement in financial services.

These are important questions for the inquiry to be asking, and it is disappointing that they are not more specifically covered in the draft Terms of Reference. While we welcome the inclusion of systemic risk, we believe the Terms of Reference would benefit from a more explicit focus on the issues created by concentration in the Australian banking sector.

Our four major banks are among the world’s 20 largest banks. Around 50 per cent of all Australian household deposits are held by just two of the majors – CBA and Westpac. The majors have increased market share and market power significantly since the House of Representatives Economics Committee’s 2008 report on competition in retail banking that 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.”*

In 2011, Parliament attempted to respond to this problem with anti-price signaling laws targeted at the major banks based on “strong evidence of banks signaling their pricing intentions to each other in a bid to undermine competition.”

The regulatory framework itself entrenches the dominant position of the four major banks, for example through the different approaches to calculating risk-weighting of assets for regulatory capital purposes.

A further reason for the Terms of Reference to require the inquiry to explicitly examine the position of the major banks is to reinforce the independence of the inquiry given the major banks’ presence and influence. The FSI is headed by former CEO of a major bank (David Murray, CBA), and major bank boards currently include a former head of

Treasury (Ken Henry, NAB), a former deputy chair of ASIC (Jillian Segal, NAB), and a former RBA Governor (Ian Macfarlane, ANZ). Another former head of Treasury was until recently chair of a major bank (Ted Evans, Westpac). A former deputy secretary of Treasury is currently a policy adviser for a major bank (Jim Murphy, ANZ).

### **Consideration of the customer-owned banking model**

COBA recommends a positive obligation on the inquiry to examine competitive neutrality for different business models, and for the customer-owned model in particular.

While the draft Terms of Reference includes consideration of "corporate governance structures across the financial system", the inquiry should have a specific brief to examine how to better recognise and accommodate the customer-owned model, (as an alternative to the listed model).

Research in the UK, where the customer-owned model has a substantial market share, shows that a diverse range of providers in the banking market results in a more stable financial system.

Appropriate recognition of our sector is essential for a level playing field to maximise competition and choice for consumers. The current lack of recognition means regulatory changes often place our sector at a disadvantage.

Please contact me on (02) 8035 8420 or Luke Lawler, Acting Head of Public Affairs, on (02) 8035 8448 to discuss any aspect of our submission.

Yours sincerely



**LOUISE PETSCHLER**  
Chief Executive Officer