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# Submission to Productivity Commission on *Competition in the Australian Financial System – Draft Report*

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# Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to comment on the Productivity Commission's Draft Report on *Competition in the Australian Financial System*.

The IPA is one of the three professional accounting bodies in Australia, representing over 35,000 accountants, business advisers, academics and students throughout Australia and internationally. The IPA prides itself in not only representing the interests of accountants but also small business and their advisors. The IPA was first established (in another name) in 1923.

The IPA's submission has been prepared with the assistance of the Faculty of Business and Law, Deakin University, as part of the IPA Deakin SME Research Centre.

We would welcome an opportunity to discuss this submission at your convenience. If you have any queries then please don't hesitate to contact Vicki Stylianou.

Yours faithrfully

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# IPA Submission

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Online submission: See link at https://www.pc.gov.au/inquiries/current/financial-system/make-submission#lodge

The Institute of Public Accountants (IPA) welcomes the opportunity to comment on the Productivity Commission's Draft Report on *Competition in the Australian Financial System*.

The reputation of the banks and other financial service providers has deteriorated, particularly since the Global Financial Crisis (GFC). It is encouraging to see so much attention being given to this sector by the Australian Government. It is hoped that improvements can be made for the benefit of all.

## 1. Creating a culture of competition by the consumers of the financial system

The behaviours of consumers and small businesses in Australia seem to reflect an apparent complacency when it comes to obtaining competitive financial products and services. The perceived inconvenience associated with 'switching' financial provider, coupled with the complex array of products on offer, seem to deter many Australians from making changes that would, in fact, increase competitive behaviour between the providers. Perhaps consumers believe that 'they are all as bad as each other' and that there is little to be gained from shopping around.

The recommendations in the Draft Report deal with various matters designed to stimulate competition in this sector. The IPA will address some of those below. However, on a macro level, the IPA believes that competition in the financial system could be improved by a cultural attitudinal change by Australians. If the behaviour of consumers (including small businesses) changes, for example by 'shopping around' for the best deal and switching providers when a more competitive offering is available, the financial sector will have to respond.

Government has a key role to play here. Wherever possible, government should be calling on consumers and small businesses to seek out better deals. The Open Banking

recommendations[1] should be widely advertised, in simple terms, so consumers and small businesses understand that they have a right to access their data and the significant 'power' this gives them vis-à-vis the financial providers. Customers should be demanding better products and better customer service and, if they don't receive it, they should be switching provider.

The issues of improving transparency and simplicity raised in the Draft Report will be vital to facilitating this change. The ability to compare products and services will equip consumers and small businesses with the information needed to enable choices to be made. We discuss this further below.

[1] Commonwealth of Australia, 2017. *Review into Open Banking: Giving customers choice, convenience and confidence*: Canberra.

## 2. Market concentration

The Draft Report highlights the extent of market concentration currently existing in the financial services sector in Australia. The Productivity Commission does not consider divestment to be the preferred route to increased competition, at least not when there are alternative solutions available[2].

The redundancy of the 'four pillars policy' is unlikely to have any significant impact on the oligopolistic nature of the market. The IPA believes that the financial services market in Australia (with a population of approximately 26 million) is unlikely to support more than four large financial service providers, that have currently positioned themselves historically and collectively into a dominant market position, particularly post the GFC[3]. That status quo is likely to remain, at least to a large extent. What is needed now is:

- More competition ***between*** the four banks;
- Competition from ***innovative smaller financial service providers*** offering new (or better) products and services (such as those provided by St George and BankWest prior to their mergers with Westpac and CBA respectively);
- Continued ***scrutiny*** of their actions by the regulators and enforcement steps taken, as appropriate.

We expand on these ideas below.

### a. How do we deal with market concentration and get competition back into the financial system?

In order to create an environment where consumers and small businesses can drive improved competitive behaviours, the financial system needs to provide:

[2] Harris, Peter (2018). Speech to the Committee for Economic Development of Australia (CEDA), Melbourne, 26 February.

[3] For the economic theory, see Dick., A. A. (2007) Market Size, Service Quality, and Competition in Banking. *Journal of Money, Credit and Banking*, Vol. 39, No. 1 (February 2007). For current issues, see Australian Government – Senate: Economics References Committee 'Competition within the Australian banking sector' Commonwealth of Australia 2011 (Chapter 4)

- ***Increased transparency*** of the products and services available from financial institutions. This will allow comparisons to be made (with the flow-on benefits recognised in the Draft Report) in relation to matters such as mortgage rates, broker relationships and commissions, and use of consumer data.

  It is concerning that 70% of the so called independent 'mortgage brokers' have been captured by the 'big four'. This raises considerable transparency issues as well as issues of independence and conflict of interest. Customers seeking the best loan or switching their current loans on the basis of advice from the captured brokers, are in fact being misled if the relationship between the broker and any of the 'big four' is not adequately disclosed.

  However, adequate and sufficient disclosure remains elusive. Under the *Financial Services reform Act 2001* (which became chapter 7 of the Corporations Act) the intention was to improve consumer protection and market integrity, within the framework of one piece of legislation. This was to be achieved, at least in part, by improved disclosure for the benefit of all consumers. Subsequent amendments were introduced in an attempt to make the disclosure more accessible, streamlined and meaningful by including summaries and other reduced forms of the disclosed information (such as combining the Financial Services Guide with the Product Disclosure Statement), as well as reducing the amount of legalese. In addition, the Australian Securities and Investments Commission (ASIC) has since released and published a plethora of regulations and policy statements. Amendments were also introduced in 2003 to reduce the administrative burden on trustees of self-managed superannuation funds by removing the need for a Product Disclosure Statement where the trustee reasonably believed that the client had the relevant information.

- ***Simplicity*** in the products and services offered.

  In its *Inquiry into small business loans* (2016), the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) found that customers were provided loan documentation in a volume that was 'overwhelming'[4]. Evidence submitted to the *Parliamentary Joint Committee on Corporations and Financial Services – Impairment of Customer Loans* included a submitter stating:

  > "that his loan document was 53 pages long, and contained obligations on the borrower that included positive undertakings, negative undertakings, default conditions and standard terms. In the submitter's view, the banks have perfected loan contract documents so that is virtually impossible for a small to medium enterprise to challenge a bank in a court."[5]

[4] ASBFEO, 2016. *Inquiry into small business lending*, Commonwealth of Australia: Canberra, p 33

[5] Parliamentary Joint Committee (2016), *Corporations and Financial Services—Impairment of Customer Loans Report*, Commonwealth of Australia: Canberra p 31

This results in a substantial information asymmetry, making it almost impossible for most small businesses to challenge the terms and conditions offered by financial providers. Even if they had the time and financial resources to do so (and very few small businesses do), there is little point when loans are offered on a 'take it or leave it' basis[6].

Against this backdrop, ASBFEO gave a recommendation that: "For loans below $5 million, banks must put in place a new small business standard form contract that is short and written in plain English. Implementation by December 2017" (Recommendation 7)[7]. Changes to some terms that were considered unfair have been made by the 'big four' in relation to small business loans up to $3million[8].

It is likely that complex insurance contracts pose many of the same drawbacks for consumers and small businesses. Unlike loans, insurance contracts are not currently covered by the unfair contract term provisions (see discussion below).

A reduction in the number and complexity of products offered by banks and insurers would provide benefits to both the financial institution and the consumers/small businesses. A market advantage may even be gained by the offering of a simple loan or insurance product, with 'add-ons' that the consumer or small business could choose. Innovation!

- ***A better understanding*** by consumers and small businesses of their financial information and the uses to which that information can be put.

  In its Inquiry Report on *Data Availability and Use*, the Productivity Commission recommended that Australian consumers and SMEs be granted a right to use their digital data. Importantly in this context, the Productivity Commission recognised that this right "would afford individuals and SMEs more choice about the products and

[6] Ibid, n. 4, p 32

[7] See http://www.asbfeo.gov.au/sites/default/files/030217-ASBFEO_Report.pdf

[8] ASIC, Media Releases 17-278MR "Big four banks change loan contracts to eliminate unfair terms", 24 August 2017, 17-139MR "ASIC and ASBFEO hold banks to account on unfair contract terms", 16 May 2017 and 17-056MR "ASIC and ASBFEO join forces to ensure bank lenders meet unfair contract laws", 9 March 2017.

services they consume and the providers of those, and be an avenue to improve market competitiveness and innovation"[9].

As discussed above, the Government needs to assist in spreading awareness and understanding of this key issue.

### b. Competition from innovative smaller financial service providers

From the supply side, the 'big four' will have an incentive to compete if they face genuine (even if only potential) competition from other financial service providers (as well as each other). In addition to the initiatives mentioned above, this could be achieved through:

- ***Lower regulatory barriers to entry***. This has been suggested in the Deloitte Access Economics Report (2012) and The Senate: Economics References Committee 'Competition within the Australian banking sector' Report (2011)[10]. Note though that there are significant other barriers to entry which would be extremely difficult to overcome[11].

- ***A fifth pillar?*** Government should consider a mechanism to allow smaller ADIs (credit unions, building societies and mutuals) a greater share of the banking pie. Their position and competitiveness in the banking market was significantly weakened post-GFC due to increasing funding costs, and the ability of the 'big four' to more ably absorb fixed costs with little change to pricing (i.e. the economies of scale argument). However, the economies of scale argument posited by the big banks as justification for industry concentration, (i.e. more able to absorb costs resulting from the stronger capital adequacy requirements imposed by a more conservative application of Basel III) is not supported in the literature - the research results are inconclusive. The IPA Deakin SME Research Centre can provide further information if required.

### c. Scrutiny from regulators and appropriate enforcement actions

Both ASIC and the ACCC have a number of legislative provisions available to them to address potential anti-competitive behaviour of the 'big four'.

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[9] Productivity Commission, 2017. *Data Availability and Use*, Commonwealth of Australia: Canberra, p 15

[10] Available at https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Completed_inquiries/2010-13/bankingcomp2010/index

[11] Ibid, n.9, pp 63-66

### *Consumer law provisions*

ASIC has power to investigate conduct in relation to financial services and financial products that breaches the consumer law provisions as set out in the *ASIC Act (Part 2, Division 2*). These include unconscionable conduct, misleading and deceptive conduct and unfair contract terms[12]. Questions about whether ASIC is appropriately funded to pursue all of its obligations are raised below.

#### (a) Unfair contract terms and unconscionable conduct

The unfair contract term provisions do not currently apply to insurance contracts. The Australian Consumer Law Review Final Report ("ACL Final Report") recommended that this be changed based largely on a "2012 Australian Government estimate [that] placed the cost to consumers of unfair contract terms in general insurance at up to $10 million per annum"[13]. This was considered a conservative estimate.

The IPA considers that this recommendation should be implemented and notes it was not included in the *Exposure Draft Treasury Laws Amendment (Australian Consumer Law Review) Bill 2018*. The Ministers for Consumer Affairs have asked for a regulatory impact assessment to be completed on this proposal to inform future decision making[14]. It is hoped that this indicates an intention to introduce this amendment sooner rather than later.

In a submission to the Competition Policy Review in 2014, the IPA recommended amending the unconscionable conduct and unfair contract term provisions to make it clear that "it is unconscionable conduct for a firm to use its superior bargaining power to force a customer (or supplier) to accept an unfair price and to make void a contractual term specifying an unfair price"[15]. It was suggested this could be achieved by:

(i) including 'price' in the list of matters to which the court may have regard under section 22 ACL (unconscionable conduct);
(ii) deleting section 26(1)(b) (unfair contract terms).

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[12] For a recent example of the use of these provisions by ASIC, see ASIC, Media Release 18-061MR "ASIC takes action against Rio Tinto and its former CEO and CFO for misleading and deceptive conduct"
[13] Commonwealth of Australia, 2017. *Australian Consumer Law Review Final Report*: Canberra, p 53.

[14] Legislative and Governance Forum on Consumer Affairs, *Joint Communique of Meeting of Ministers for Consumer Affairs*, Melbourne, Victoria, 31 August 2017

[15] IPA, *Submission to Competition Policy Review*, June 2014, p 4

To date, these submissions have not been accepted by the Government.

### (b) Unfair business practices

The ACL Review Final Report also stated that Consumer Affairs Australia and New Zealand (CAANZ) should examine the potential need for a general prohibition against 'unfair trading practices':

> "Noting the evidence of persistent unfair business practices, CAANZ is committed to investigating further whether a prohibition of unfair trading would provide additional protections beyond those currently in the ACL, and how it could be implemented in Australia."[16]

Examples of unfair business practices commonly arise in the banking sector. The ASBFEO *Inquiry into small business lending* provides excellent examples of small business owners being treated unfairly by the banks, for example in relation to the initial mortgage terms, loan rollovers and in circumstances of (technical) default.

Although some of this conduct may be considered 'unconscionable', it is often difficult for small business to identify this, especially given that there is "some uncertainty in how the provisions will apply, and whether particular conduct is unconscionable according to the principles used by the courts"[17]. Commencing an action for unconscionable conduct is likely to be out of the reach of most small business owners in any case.

#### *Competition law provisions*

ACCC has power to investigate anti-competitive behaviour under the *Competition and Consumer Act 2010*. Of particular relevance in this context are:

- Misuse of market power (section 46)
- Concerted practices (section 45)
- Mergers and acquisitions (section 50).

[16] Commonwealth of Australia, *Australian Consumer Law Review Final Report,* 2017, p 51

[17] Commonwealth of Australia, *Australian Consumer Law Review Final Report,* 2017, p 49

### *(a) Misuse of market power*

From 6 November 2017, the ACCC can utilise the amended section 46 (misuse of market power) provision which prohibits a player with substantial market power from using that market power in a way that has the purpose, effect or likely effect of substantially lessening competition.

The ACCC *Interim guidelines on misuse of market power* were released for consultation late last year. The Guidelines set out clear examples of the types of exclusionary behaviour that are prohibited (exclusionary behaviour *excludes* a competitor from a market) but do not address exploitative practices (where a strong player exploits its market position). The IPA has called for the ACCC to apply section 46 to exploitative practices[18]. Any behaviour of the 'big four' that results in charging high fees or imposing unfair conditions may be exploitative and a misuse of market power.

### *(b) Concerted practices*

In addition, from 6 November 2017, the ACCC can utilise amended section 45 which now applies to 'concerted practices'. A 'concerted practice' was defined in the *Explanatory Memorandum to the Competition and Consumer Act (Competition Policy Review) Act* 2017 as:

> "any form of cooperation between two or more firms (or people) or conduct that would be likely to establish such cooperation, where this conduct substitutes, or would be likely to substitute, cooperation in place of the uncertainty of competition."

This is of particular relevance in oligopolistic markets.

The price signalling provisions introduced in 2012 which were applicable only to the banking sector have been removed as they are now considered unnecessary with the introduction of a prohibition against concerted practices.

[18] IPA, *Response to ACCC Guidance and Guidelines*, 24 November 2017

### *(c) Mergers*

The ACCC continues to have the ability to assess anti-competitive mergers and acquisitions under section 50. Mergers in the post-GFC environment may be assessed more cautiously than in the late 2000s.

## 3. Issues specific to SMEs

### *What is a 'small business'?*

The IPA notes the Productivity Commission's reference to inconsistent definitions of 'small business' as between the ABS, ATO, APRA, RBA and lenders (page 250).

In its forthcoming Small Business White Paper 2.0, the IPA identifies further inconsistent definitions of small business that exist within the *Competition and Consumer Act 2010*. Based on extensive definitional work by the IPA Deakin SME Research Centre, the IPA is of the view that one definition of 'small business' should be used as far as possible. Ideally, a definition that is consistent with the ATO and ABS commonly used classifications would be helpful to small business.

### *Better representation for small business*

In its forthcoming Small Business White Paper 2.0, the IPA argues that the small business community will feel better represented and understood by regulators if there is a representative from the small business community holding a significant office.

Since 2008, one of the two ACCC Deputy Chairpersons has been required to have small business expertise (section 10(1B) CCA). The introduction of this expertise has resulted in a significant improvement to the focus on, and information available to, small businesses in relation to competition and consumer law. For example, the ACCC has published a *Small Business in Focus* report twice yearly since 1 July 2010, a range of publications targeted at small business such as *Small business & the Competition and Consumer Act* (https://www.accc.gov.au/publications/small-business-the-competition-and-consumer-act) and *The benefits of working with other small businesses: collective bargaining and collective boycotts* (see https://www.accc.gov.au/publications/the-benefits-of-working-with-other-small-businesses-collective-bargaining-and-collective-boycotts) and has a Small Business and Franchising Consultative Committee chaired by the ACCC Deputy Chair responsible for small business.

Other regulatory bodies that could benefit from having a similar arrangement in the context of the financial system include ASIC and the Reserve Bank of Australia (RBA). An SME representative on these bodies would also provide valuable input to the Council of Financial Regulators (discussed below).

## 4. Issues specific to Regulators

### *Council of Financial Regulators (CFR)*

The Productivity Commission has suggested that an independent body should provide an objective competition assessment of proposed interventions to the CFR. The Commission has suggested either the ACCC or ASIC fulfil this role.

The IPA believes the ACCC is more suitable to fulfil this role:

- The ACCC has a dedicated Financial Services Unit which "[i]n addition to examining anticompetitive conduct, … will proactively identify competition issues in the sector and conduct market studies.[19] This places the ACCC in a strong position to provide independent expert advice in relation to a complex industry. The ACCC also included "competition issues in the financial services sector" as one of its 2018 compliance and enforcement priorities[20].
- The ACCC has the in-house expertise to fully evaluate the impact of proposed interventions on competition.
- The ACCC appears to be better resourced to take on this role. The IPA has a number of concerns about the resourcing and capabilities of ASIC (discussed below).
- Although ASIC has jurisdiction in relation to potential consumer law breaches relating to financial products and services (including misleading and deceptive conduct, unconscionable conduct and unfair contract terms), it does not have jurisdiction in relation to potential competition law breaches. In the context of a proposed market intervention, it is the ***competition*** law issues that are likely to be of greatest relevance, rather than the *consumer* law issues.

[19] Rod Sims, *Speech to launch ACCC's 2018 Compliance and Enforcement policy*, CEDA, Sydney, 20 February 2018

[20] ACCC, 2018 Compliance and Enforcement Policy, available at https://www.accc.gov.au/publications/compliance-and-enforcement-policy

- The ACCC already has an SME representative as one of two Deputy Chairpersons. This ensures a valuable contribution to a debate about the potential effects of interventions on SMEs and SME banking issues.

### *APRA*

The IPA notes the comments made in the draft report referring to APRA and the impact on banking risk models resulting from the application of the Basel capital requirements. Specifically, IPA believes that greater examination is required of the impact on competition of APRA's objective of making Australia's banking system 'unquestionably strong'. We support any recommendations to rebalance the regulatory pendulum toward consumers of banking and financial service products and away from shareholders of banks and other financial institutions.

### *ASIC*

As noted above, the IPA has concerns about the current capacity of ASIC which, it believes, is substantially due to being inadequately funded and resourced.

In 2016-17, ASIC raised $920.24 million for the Commonwealth in fees and charges, an increase of 5% from the previous year. This was driven by net company growth and fee indexation[21]. The breakdown of ASIC's total revenue was $801.72 million from fees; and $118.53 million from fines[22]. This money goes directly to the Commonwealth.

In the same year 2016-17, ASIC received approximately $349 million in appropriation revenue ($342 million) and 'own source' revenue ($7 million). ASIC's expenses were $392.46 million, leaving a deficit of over $43.5 million[23]. In other words, even though ASIC is making significant income for the Government, it is not even able to cover its own costs from the budget it receives from the Government. IPA has previously made submissions to the Government on the inadequate funding of ASIC and KPI metrics of ASIC. We have referred in those submissions to the 2013 Productivity Commission report on *Regulator Engagement with Small Business*. The IPA has been a long standing advocate of more funding being allocated to ASIC.

[21] ASIC, *Annual Report 2016-17*, p 26

[22] Id. p139 Table 2.2

[23] Id, p 26