



Inquiry into Competition in the Australian Financial System

The Australian Government has asked the Productivity Commission to undertake an inquiry into competition in Australia's financial system (attachment A).

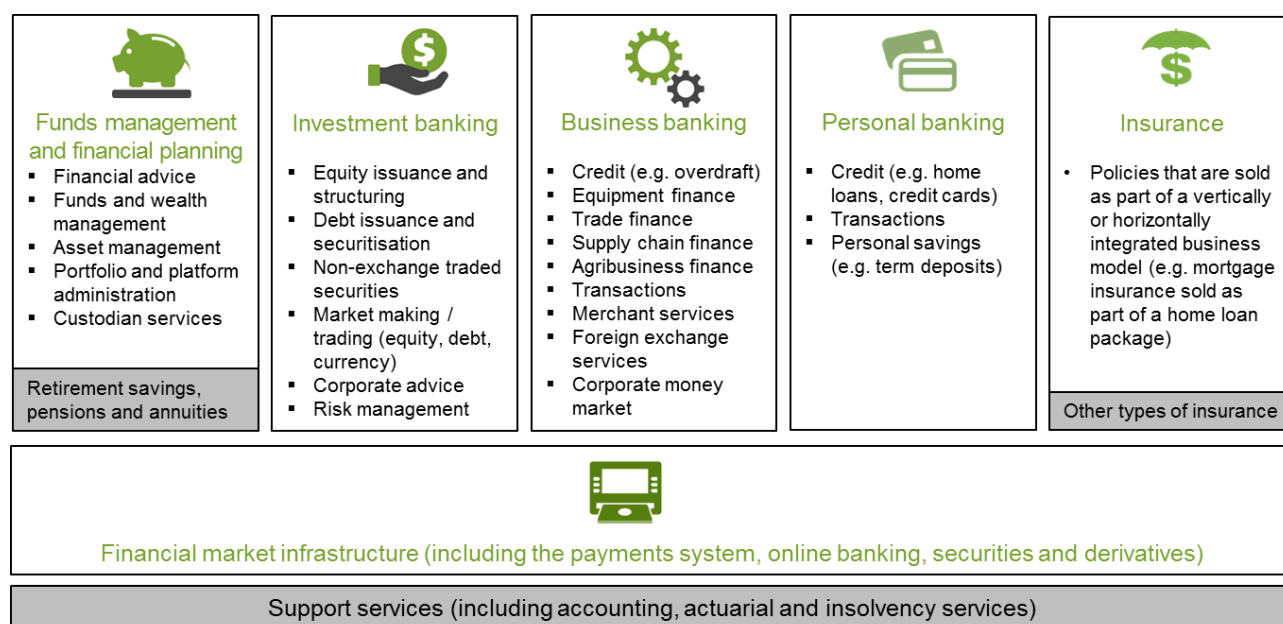
As stated in the terms of reference, this inquiry complements other work by the Commission, which will affect the financial system:

- the recently completed inquiry into Data Availability and Use, and
- the concurrent inquiry into the Competitiveness and Efficiency of the Superannuation System.

These inquiries add to the substantial number of reviews undertaken across government that have assessed competition and contestability in the financial system as a whole, as well as focused on specific parts of the system. These past inquiries and other policies and initiatives have led to the development and implementation of a broad range of potential reforms, and other actions that remain pending or still unaddressed. In undertaking this inquiry, the Commission will take stock of the existing reforms to assess what would constitute a coherent framework for the future operation of Australia's financial system.

This inquiry is broad ranging, and will take a holistic view of the financial system — including products and services provided to households, small businesses and large corporations, as well as financial system infrastructure. To avoid overlap with other active reviews, this inquiry will consider superannuation and insurance products only in so far as they affect competition between banks and other financial service providers, including as part of vertically and horizontally integrated business models (figure 1).

Figure 1 Key segments of the financial system



Segments in grey are out of scope for this inquiry

Source: Adapted from Australian Financial Centre Forum (2009)



The financial system is evolving at a fast pace — new technologies are enabling providers to create different products and changing the ways customers interact with their financial service providers. Competition often spurs desirable innovation in business models. However, this inquiry will seek to establish whether there are barriers to competition through innovation, and — where innovation does occur — whether its benefits are directed towards consumers.

From the point of view of incumbent firms, competition requires them to continuously re-evaluate their product offering; as a result, previous reviews have found that competitive pressure has been increasing for some personal banking products. But the level of competition across different products and markets can vary substantially. For example, other inquiries indicated that the ability of some small businesses to access finance may be hampered by low levels of competition.

For new financial service providers looking to enter into a market, limited contestability and barriers to entry may curtail their ability to compete. Some regulation of new entrants — as well as existing firms — may be warranted to manage risks and ensure desirable outcomes for the community are maintained. Nonetheless, some regulators have taken innovative approaches to enable new entrants. Regulatory “sandboxes”, for example, allow some fintech companies to test innovative products with lower administrative burdens. But even apart from such specific arrangements, the regulatory structures faced by some market participants can be quite different to others offering similar products: payday lenders and issuers of credit cards can both lend money to individuals, but they do so facing different regulatory requirements.

For consumers, a competitive financial system should deliver products that fit individual needs, and are accessible and flexible. Competition is likely to be higher if consumers can easily switch between products and providers. The Commission’s recommendations in its Data Availability and Use report would, if implemented, make switching easier for consumers. And while there are other initiatives in the financial system (such as crowdfunding and numerous apps for mobile devices) intended to facilitate greater choice of financial products, the benefits to consumers — individuals or businesses — remain elusive in some areas.

Competition in the financial system should work in concert with stability and the smooth operation of financial markets. This is particularly the case in times of global uncertainty, given the interconnected nature of global financial markets. Faced with ongoing change, regulators are accountable to the community to ensure regulatory approaches remain fit for purpose, while not impeding competition unnecessarily. Some regulation may indeed limit competition, but it is essential to maintain community trust and confidence in the financial system, protect consumers’ rights and offer avenues to address grievances.

In conducting this inquiry, the Commission will examine competition across different products and markets. It will consider the outcomes that consumers (individuals and businesses) expect in their interactions with the financial system, including with providers, intermediaries and regulators, and whether these expectations are met. It will seek to establish what competition in Australia’s financial system should be like, and what challenges need to be overcome in order to achieve the benefits of competition in the future.

The Commission invites interested individuals and organisations to make a written submission addressing the issues raised in the terms of reference. Submissions are requested by **15 September 2017**. Further information on the inquiry and how to provide a submission is available at <http://www.pc.gov.au/inquiries/current/financial-system> or by contacting Tracey Horsfall on 02 6240 3261.



Attachment A Inquiry Terms of Reference

I, Scott Morrison, Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby request that the Productivity Commission (the Commission) undertake an inquiry into competition in Australia's financial system.

Background

The financial system undertakes a number of key functions both directly for households and in support of the operation of the whole economy. These include allocating capital, aiding the smoothing of consumption, helping manage risks, and providing payment services. The financial sector itself is the largest sector in Australia - accounting for around 10 per cent of our economy.

The 2014 Financial System Inquiry (the Murray Inquiry) considered that although competition generally appears adequate, the high concentration and degree of vertical integration in some parts of the Australian financial system has the potential to limit the benefits of competition in the future and should be proactively monitored over time.

The Murray Inquiry recommended that the Government strengthen the focus on competition in the financial system, including by reviewing the state of competition in the sector every three years. In response, the Government agreed to implement periodic reviews of competition in the financial system, and to tasking the Productivity Commission in 2017.

Following other recommendations of the Murray Inquiry, the Government has already commissioned other Productivity Commission work of direct relevance to furthering competition in the financial system, which this inquiry is intended to build on and complement. That work concerns data availability and use, and the efficiency and competitiveness of the superannuation system.

Scope of the Inquiry

The Commission is to review competition in Australia's financial system with a view to improving consumer outcomes, the productivity and international competitiveness of the financial system and economy more broadly, and supporting ongoing financial system innovation, while balancing financial stability objectives.

Without limiting related matters on which the Commission may report, its report to the Government should:

1. consider the level of contestability and concentration in key segments of the financial system (including the degree of vertical and horizontal integration, and the related business models of major firms), and its implications for competition and consumer outcomes
2. examine the degree and nature of competition in the provision of personal deposit accounts and mortgages for households and of credit and financial services for small and medium sized enterprises
3. compare the competitiveness and productivity of Australia's financial system, and consequent consumer outcomes, with that of comparable countries



4. examine barriers to and enablers of innovation and competition in the system, including policy and regulation
5. prioritise any potential policy changes with reference to existing pro-competition policies to which the Government is already committed or considering in light of other inquiries.

The Commission should have regard to the Government's existing wide-ranging financial system reform agenda and its aims to:

- strengthen the resilience of the financial system
- improve the efficiency of the superannuation system
- stimulate innovation in the financial system
- support consumers of financial products being treated fairly
- strengthen regulator capabilities and accountability.

Process

The Commission will commence the inquiry on 1 July 2017.

The Commission should undertake appropriate public consultation processes, including holding hearings and inviting public submissions.

It should consult widely, including with consumers, financial institutions and the agencies that regulate the financial system, in particular the Australian Prudential Regulation Authority, the Australian Securities and Investments Commission and the Reserve Bank of Australia. The Government has asked the regulators to consider making submissions on matters that relate to their areas of expertise.

The final report should be provided to the Government within 12 months of commencement.

Scott Morrison
Treasurer

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