Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO COMPETITION IN THE AUSTRALIAN FINANCIAL SYSTEM

MR P HARRIS, Chairman
MS J ABRAMSON, Commissioner
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TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE
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MR HARRIS: Welcome to the first of a series of roundtables the Productivity Commission is holding for its inquiry into Competition in the Australian Financial System. I'm Peter Harris, Chairman of the Productivity Commission, and with me I have Julie Abramson and Stephen King who are Commissioners on this inquiry, along with me.

This is a public hearing under the Productivity Commission Act and there are various legal obligations that arise from that, which I'm not going to list in any vast detail today. We try very hard to operate informally when we do these hearings, the primary purpose of which is to have the registered participants with a chance to place to the record certain comments they would like to make at the outset of an inquiry like this which can help direct our efforts.

For parties who are present here today that are not registered participants, the way the process operates is we don't tend to take comments from the floor, but there are informal opportunities between each of the rounds of these roundtables for you to either indicate a further interest in contributing to this inquiry, or provide us with information that we can use to follow-up with you separately, and that's the informal nature of things.

As you can tell, we are recording and, for any media representatives present, the use of social media is fine by us, we have no restrictions on that, but we do ask that if you are going to video or photograph you gain permission beforehand from us, which is effectively from the participants, so we will be asking participants if they are comfortable with that, and that is primarily about them rather than us.

We will be undertaking further consultation with interested parties over the next couple of weeks in this initial phase, that will primarily take the form of one-on-one meetings and, for those of you who want to track the progress of the inquiry on our website, we'll tend to put records up, where those records are taken, reasonably soon after each of the meetings so you can follow through that.

Also though, because we are going to take some of those comments with one-on-ones in the next couple of weeks on the record, we won't be adjourning proceedings today. That is a legal, technical matter for me, to actually say we won't be adjourning proceedings, nothing else is relevant to anyone else here, but primarily that's a factor which says we can continue to, as it were, record comments as we go.

The inquiry is calling currently for public submissions, or as indicated, that we are open for public submissions. We will be keen to get them by about the middle part of September in order that they can contribute to a draft report which we hope to put in place by the early part of 2018. Our standard process is the draft report is then the trigger for another round of hearings where the participants respond with the sorts of things we have found and conclusions we can make.

So obviously all the parties who are present here today, we would expect them to be participants again at a subsequent round of hearings on this. Anybody who is registered as a participant gets automatically updated on each of the progress points of the inquiry, that is when publications are made and when hearings are about to be held, so it's always worthwhile registering for that purpose.

We have got three separate roundtables today. The key financial sector regulators are up first, regional and smaller banks are up second, and consumers who have encountered problems in the nature of competition in the financial system are up third. We have deliberately kept these roundtables quite small, so they are not representative obviously of everybody who could participate in any of those forums, but the idea, as I said at the outset, is to start this process off by registering that we are interested in getting views from those particular groups on the nature of the Terms of Reference that have been given to us.

The format we are going to use today, participants will make some opening remarks and then we will take the opportunity to ask what I might call some early stage questions. So certainly at this stage we are not out to delve particularly deeply into any specific topic unless a participant here today invites us to do so, in which case, with the time available, we will try and do that.

As I said, there is a transcript being taken here, so for the purposes of those who will present today can I say it will be great, when you make your opening presentation, to restate your name so we can attribute the comments to the right people, although we will be trying to do that as well through other mechanisms, but it is always good to restate your name. For other participants, I will say that all submissions will be made available on the website and could I ask each participant, when they do make an opening statement, if they are comfortable with providing that to us so we can put that on the website as well. That's open to you, but if you are happy to do so we can put those up on our website.

Finally, there is the standard OH&S and the emergency evacuation thing. So there are green exit signs outside there and there are floor wardens, should alarms sound and you need to follow their instructions. You will be walking down the stairs and assembling in Enterprise Park at the end of William Street down on the banks of the Yarra, and it's miserable weather so let's hope it doesn't happen.

So I'm happy to now start with opening remarks, and who would like to start first? Wayne, what about you start first?

MR BYRES: Okay, I'll lead off. Thank you. For the record, Wayne Byres, Chairman of the Australian Prudential Regulation Authority, and I'm also happy for this statement to go onto the – to be published on the public record.

First of all, thanks for the opportunity to participate in today's roundtable, we are obviously supportive of this inquiry in the same way we have been supportive of other work that the Productivity Commission has done recently and available to assist and contribute where we can.

So to set the scene for my remarks today I thought I would start with APRA's mandate. We are obviously an independent statutory authority, established for the purposes of prudential supervision of certain financial institutions, so that's about providing assurance that institutions have the financial and operational resources to deliver on their financial promises to the community, and we also have a task of promoting financial stability in Australia more generally. In particular we are responsible for protecting the interests of depositors in banks, or of authorised deposit-takers, insurance policyholders and super fund members.

Now, in pursuing financial safety and stability, Parliament was mindful that safety shouldn't be pursued at all costs, so the APRA Act which governs us requires us to balance the objective of financial safety with efficiency, competition, contestability and competitive neutrality, and in balancing those objectives to promote financial stability.

In the context of this inquiry I highlight a couple of points upfront.

Firstly, that we don't, at APRA, have oversight of the entirety of the financial system. Prudential supervision is considered warranted where, in the words of the Wallis Inquiry which led to APRA's establishment, 'the intensity of the promise' is high and information asymmetry impedes the ability of the typical customer to make an informed decision as to the soundness of their financial services provider. So that was included in that net with bank deposits, insurance policyholders and superannuation balances. Now, deposit-takers, insurance companies and super funds do make up a large proportion of the financial system of course, but it is important to bear in mind, particularly in the context of any consideration of competition, that there are a great many financial products and service providers that are free to operate outside APRA's purview.

Second, the various industry Acts from which APRA derives its powers focus more directly on APRA's role to protect and promote the interests of a certain class of liability holder. We do that by maintaining a framework of prudential standards to establish minimum requirements on such things as financial soundness and risk management and governance, and a program of active supervision. Together they are designed to minimise the risk of loss to those classes of liability holders, depositors, policyholders and fund members.

The prudential framework necessarily focuses in the first instance on safety and stability. We have no mandate to create or impose standards in relation to those other balancing considerations that I referred to, that is, efficiency, competition, contestability and competitive neutrality. Rather, those considerations are intended to be taken into account in designing and implementing the prudential requirements. We obviously provide opportunities for industry to provide feedback on competitive implications of our requirements as part of our public consultation process, and we are also giving more prominence to our own consideration of those issues when we issue proposals for consultation.

We primarily seek to fulfil our mandate using a supervision-led approach. Common baseline regulatory standards are important, but a common, one-size-fits-all, prescriptive rulebook, while notionally delivering a level playing field is, in our view, unlikely to be optimal. A focus on supervision provides us with greater ability to tailor requirements to suit individual circumstances, in other words, to be both risk based and outcomes focused, and that in turn is likely to maximise both the efficiency and the effectiveness of the prudential framework.

Our observation is that that approach seems to be a common feature of jurisdictions that emerged, relatively unscathed, from the financial crisis, it was recognised as important in the Financial System Inquiry report and is consistent with the Government's current Statement of Expectations for APRA.

In establishing and implementing the framework, we have tried to take an approach that allows for proportionate supervision, such that smaller institutions are subject to expectations commensurate with the scope and complexity of their business. So, to give a few examples, small deposit-takers are subject to simpler liquidity requirements than larger ADIs, statistical requirements are commonly stratified by size of institution to reduce reporting burden. We have been working, and are currently working, with the mutual ADI industry and ASIC to develop a form of equity capital that can be issued without jeopardising mutual status of these entities and improve their competitive position.

It is sometimes asserted that there must be a trade-off between stability and competition in the financial system. That is not our view. Competition in the financial sector can bring welcome innovation and enhanced outcomes for consumers, and good regulatory settings can deliver financially strong competitors, creating both financial stability and a dynamic and innovative marketplace for financial services.

Our framework has in mind the maintenance of sustainable competition, that is, competitors who are there for the long-term, that is, both in good times and bad. The 2008 financial crisis revealed too many business models that only worked in the good times and ceased to provide service to consumers when adversity arose, and the long-term outcome has unfortunately been a more concentrated financial system.

Having said that, there are times when it's important for APRA to actively temper competitive spirits within the financial sector. Our current interventions in relation to housing lending are a case in point. We have not been concerned with lenders competing on price or on service standards, but we have been concerned that intense competition was leading to a material erosion in lending standards and that was ultimately unhealthy for both the individual institutions and the long run interests of the community as a whole.

Now, just to finish, my comments thus far have been largely focused on competition between different sorts of entities, different sorts of APRA-regulated entities. But the big, competitive shifts in the Australian financial system have tended to come from new entrants, either non-prudentially regulated entities competing against the regulated, or new, regulated entrants arriving with a different business model from that of the incumbents.

With that in mind we are currently reviewing our licensing processes, and as part of that review we are considering the benefits and risks of adopting a two-phased approach to licensing certain types of new entrant. We think such an approach could bring new sources of competition by allowing new entrants time to establish the full complement of resources and systems necessary to be able to comply with all aspects of the prudential framework. At the same time obviously we still need to be able to make sure, or assure, the community that their deposits and insurance policies and super funds are adequately safeguarded, and we also don't want to create competitive advantages for small, new entrants, relative to small incumbents.

Finally, technology has a critical – or will be a critical driver of the future shape of the financial system. We are very keen to see new investment in new technology by financial firms, both incumbents and new players because we think it has the potential to achieve multiple objectives by offering considerable benefit to the soundness, the efficiency and the competitiveness of the financial system.

So with those opening remarks, I'll be happy to take your questions.

MR HARRIS: Thanks very much, Wayne. I should have mentioned at the outset, one thing I should have mentioned is that Julie Abramson is on the Ramsay Inquiry, the inquiry into external dispute resolution, and she would like me to have noted that in the opening remarks, just in case anybody was at all concerned about some vague conflict of interest. Personally, I can't see the conflict, but anyway, we have noted it and I should have said that in the opening.

Wayne, thanks for your comments, what I might do is go around the table and ask everybody to put their sort of initial statements on the record and then I'll come back to some of the more interesting things that you mentioned already, opening statement and interesting things, so that's pretty good. Shall I just keep going around here, to the ACCC?

MR BEZZI: Yes, sure. Thank you. Marcus Bezzi, I'm the Executive General Manager of Competition Enforcement and responsible at the senior management level of the ACCC for the newly established Financial Services Unit. My colleague, Molly Choucair, is with me, she is the General Manager of that unit. I would like to indicate that Rod Sims, the ACCC Chairman, regrets not being able to be here, he had an unavoidable scheduling problem that prevented his attendance.

MR HARRIS: No problem at all.

MR BEZZI: Thanks very much for the opportunity to provide an opening statement. In this year's Budget a number of measures were announced with the aim of improving competition in the banking and financial sector and this included resourcing the ACCC to establish our Financial Services Unit. The task of that unit is to undertake regular, in-depth inquiries into competition issues in Australia's financial system. Our anti-trust, merger and consumer protection responsibilities mean that we are exposed to a range of specific matters in the financial sector. However, until now, we haven't had a broad mandate to regularly examine and report on competition issues in the sector as a whole.

It's still very early stages for the ACCC, but we have received a direction from the Treasurer to undertake a price inquiry into prices charged, or proposed to be charged, on residential mortgage products by the four major banks and Macquarie. This residential mortgage inquiry is the unit's first task, that is, the Financial Services Unit's first task. During and at the conclusion of the inquiry the unit will be considering competition issues in the financial sector more broadly, and we expect that the PC's inquiry will provide useful insights and lines of inquiry that may also be fed into the work of our unit.

I'm going to briefly discuss the work of our residential mortgage inquiry and then talk a little bit about some of our broader competition work in the financial sector.

On 9 May, as I mentioned, we received a direction from the Treasurer. The ACCC, essentially, is expected to ask the five banks to explain any decisions about fees, charges or interest rates in relation to their residential mortgage products, and do that over the course of the year. So the direction, essentially, lasts for a year. That includes decisions to change or not to change prices that may be charged for residential mortgage products. We are required to have regard to the Government's view that banks need to fully and transparently account for their decisions, and how the needs of borrowers, savers, shareholders and the wider community are balanced by the banks.

We see the pricing inquiry as an exercise in transparency. We can't stop the banks from increasing or decreasing their prices as they see fit, provided of course that they do so independently Instead we will see to understand and explain how each bank makes their pricing decisions and report on those decisions over the next year, and also report on the factors considered in making those decisions. We intend to look for evidence that any of the major bank levy is passed through to residential mortgage customers.

I should say we have got no preconceived ideas about what we will learn during the course of our inquiry, we are required to report our findings to the Treasurer at the conclusion of the inquiry, and may do so through the inquiry.

The Financial Services Unit has a broader mandate, as I have mentioned, to examine specific financial system competition issues. The exact scope of this body of work is still being determined, however I expect the unit's work will allow for increased and more regular scrutiny of competition issues in the financial sector, and I should add not just in retail banking.

I see our broader role as very much complimentary to the work of the Productivity Commission in this inquiry. In many ways we will use the findings of your inquiry as a starting point for the ACCC's new functions. In fact, even before you make findings, when you issue draft reports, I expect that we will closely analyse them and use them to feed into the work of our unit.

We will welcome referrals of any issues that you identify, either through the inquiry or at the end of the inquiry, which you think would benefit from the ACCC's forensic, investigative and analytical approach. We can also do deeper dives into issues that the PC may not have time to undertake. So we extend that offer to engage collaboratively through the unit and look forward to doing so.

MR HARRIS: Thank you.

MR BEZZI: The combination of the PC's work, in combination with the ACCC's continuing role, we think, should provide a comprehensive picture of the state of competition in the financial system and highlight potential areas where measures may be taken to improve or increase competition in particular markets.

Turning now to your Terms of Reference. The financial services sector is broad, it has many players, it encompasses many different products and includes many products which are bundled with other financial services products, or with other goods and services. In our view, we think the PC inquiry should focus on particular markets with significant levels of concentration, high barriers to entry, and importantly, high barriers to expansion or high barriers to actually doing business within the sector.

I should say, this is a sector that is characterised by some barriers to entry, but probably more by barriers to expansion than barriers to doing business. Some of those barriers have a sort of, if I could describe them as a dynamic dimension, and perhaps are deeply influenced by the culture of the institutions, by the entrenched behaviours of the institutions, and in fact the longstanding and well-understood behaviour of consumers, and importantly, perceptions of behaviour of consumers.

I want to briefly mention our perspective on the level of competition in the financial sector and the importance of consumer switching and access to data to improve competition. On the level of competition I should say that the ACCC Chairman has commented in the past that, "There seems a lack of very robust competition in banking … We are not seeing as much robust competition as we would like".

A number of businesses have complained to us about the lack of competition in the financial sector. In many cases these complaints don't relate to specific anti-competitive allegations that we can pursue in our enforcement work, but nevertheless, there is a clear perception that is reported to us of a lack of competition. There are many examples that you can think of, or that we can think of, but our perception is that in many product segments there is a cosiness, or even a lack of competitive culture.

Now, that isn't universally the case, there are clearly products and sectors where there is rigorous and quite strong competition, but it is clear that Australia has a very concentrated banking market, particularly when compared with international comparators, and the degree of competition in the financial sector is not just measured by the number of competitors in the market, there are other factors such as the market structure, the ease of customer switching, innovation, contestability, consumer behaviour as I mentioned before, and even industry culture that can determine competition.

As Mr Byres notes, market share for the larger banks has increased over the last few years and this has come at the cost of others in various markets. There are a range of factors that can explain this, and no doubt you will get to the bottom of many of them.

A key interest for the ACCC is whether the major banks are achieving levels of profitability in excess of what we would expect in a competitive market. If they are, this could indicate a lack of competitive constraint, and that is an issue that we think would be worthy of investigation. We would welcome the PC examining why the market is as concentrated and highly profitable as it is, and indeed the level of contestability within different product markets and different segments would also be an area that we think is worth close attention.

There will be a challenge in getting timely and accurate data from participants in the sector that relates to these issues, that has certainly been our experience in many of our investigations, not through any bad faith I should add, just because it's not necessarily kept in an easily transmittable form.

But the collection of data will be very important. We would also urge you to engage with individual market participants and listen to their stories about market behaviour because we think that that may be quite a powerful way of learning about what is going on in the market, in addition to what you might learn from the analysis of data. I should add that our residential mortgage price inquiry may give some insights into some of the issues, and subject to statutory barriers to sharing confidential information, we would be keen to share these insights with you.

On the issue of consumer switching we do think that one way to improve competitiveness is to help consumers to operate as agents of competition by promoting switching. Consumer behaviour can and should have a profound impact on banks' competitive response. It is notable within this market, there isn't as much consumer switching as is desirable. We have seen how account number portability, consumer switching and access to meaningful data have driven changes to competition in other sectors such as telecommunications.

The UK Government, through the Competition and Markets Authority, has put consumer switching and access to data at the heart of its approach to increasing competition in the banking sector, and we would commend their very detailed and helpful report as a good place to look. We have regular engagement with the CMA and we are quite happy to assist in whatever way we can in establishing connections for the PC in that regard.

MR HARRIS: Thank you.

MR BEZZI: If consumers are engaged and have the ability and are willing to switch to another bank which can offer them a better deal, it provides an incentive for banks to compete, whether on price, quality or innovation. When they are not engaged or the barriers to switching are too high and they are locked in, then it reduces the needs for banks to compete. We think this is a very important issue.

So in that context, we are very aware of the PC's reporting on data availability and we are conscious of the independent review on the best approach to implement an open banking regime, which we think is a very important and independent initiative to your inquiry. The proposals about switching may also help more complex products like insurance, loans and credit cards where there can be a reluctance to change.

I should say that the work of the ACCC and the AER, the Australian Energy Regulator, in the energy, telecommunications and private health insurance sectors, has highlighted the difficulties that consumers can experience in trying to meaningfully compare these products.

Also, I should say that experiences in the UK may also be relevant here. We are aware of some products that are being developed over there that take access of greater data availability to enable switching. There's a product, for example, called Flipper, which is an app that consumers can use to enable switching products between competitors in the energy sector in the UK. It's the sort of innovation that we think may well promote greater competition in the energy sector and perhaps is relevant also to the banking and financial services sector.

The level of integration, and particularly vertical integration in the sector, is an issue that we think needs to be closely looked at. The ability, as I say, of customers to compare prices when products are often bundled with other goods or services is difficult, how bundling can impact a consumer's willingness and ability to switch is also a factor which we think is worth analysis, it can lead to stickiness, which may be a disincentive to competition.

Look, I might mention another issue, and I don't want to overstate this issue, but we have been conducting a number of investigations into the financial sector and we are aware of investigations conducted by our international counterparts in benchmark rates and foreign exchange markets. Those investigations indicate that there is a culture of collaboration, even, in some instances, collusion between traders across financial institutions. We consider this culture may arise from systemic issues which warrant further analysis.

We do know that there have been reforms in Australia to benchmark setting procedures and we very much welcome those reforms, but this does remain an area in which further regulatory reform might be warranted. We have considered issues relating to access to digital wallets and fintech acquisitions and we would be pleased to provide information or specific insights from that work.

Finally, I would like to thank you for the opportunity to address the roundtable and we look forward to continued and close engagement during the inquiry. We stand ready to engage with any specific issues that you identify in the course of the inquiry that you think might be just best dealt with by us or in collaboration with us. Thank you.

MR HARRIS: Thank you, Marcus. We appreciate the ACCC's offers and we will have to call upon you, I'm reasonably confident, at some points in the course of this inquiry, so that has been very useful. Peter, are you ready to go next?

MR KELL: Yes. Thanks very much for the opportunity to appear today. We welcome the inquiry, like our colleagues at APRA and the ACCC. I've got some brief opening comments, which I'm happy to send you through a version later on for the website. These comments touch on a few areas that ASIC considers the Commission might consider in response to the Terms of Reference, and we obviously look forward to providing a more detailed response in our submission and through our engagement with you.

So, fundamentally, our starting point is that competition is about enhancing the long-term interests of consumers, and so we believe that an important focus for the inquiry should be around how to improve consumer choice through innovative or new products and services, and there is obviously a very interesting technology dimension to that issue at present. Consumer access such as reduced barriers to switching, improving consumer decision-making through enabling informed and confident choices by consumers. Overall, the focus on consumer outcomes, from our perspective, is a good one, how do we improve that, through lower prices and better products and services.

ASIC's mandate, in simple terms, is to deliver fair and efficient markets and to ensure that there is confidence on the part of consumers and investors, the consumer protection role, we are a market conduct regulator. We don't have an express competition mandate unlike, for example, our counterpart regulator in the UK, nonetheless, ASIC touches on competition in most of the work we do and we fulfil an important role in encouraging competition in the financial system.

So, for example, we led the introduction of competition in the exchange markets, our recently created Innovation Hub helps support start-ups with innovative new business models to navigate a regulatory system, and our work on a wide range of consumer issues helps to address competition failures, a recent example being the work they've done on add-on insurance.

We oversee a very diverse range of players and markets in the financial services arena with different structures and, at times, different competition issues.

Just to give you an example from one end to the other, we regulate the small amount lending market, sometimes called the payday loan sector, that has over 300 lenders providing loans of a couple of hundred dollars, most, on average, for a period as short as 16 days, and in that market we regulate legislative interest rate caps intended to limit the exploitation of vulnerable Australians. In contrast, we also regulate the monopoly clearing market for cash equities, and there you're talking about billions of dollars every day.

So it's a very diverse regulatory arena that we cover, and it ranges from very localised issues to considering these issues that competition impacts at an international level as well. I think that is an area that we would like to follow-up on, that international dimension of competition, down the track.

As a result, I'm not sure that we could make a general assessment of competition in the Australian financial system. There are obviously areas where competition has delivered very significant benefits, I think you look at some of the innovations around online and mobile banking and you can see the way that that is proving to be a very significant way in which consumers now engage with the banks and other transaction providers.

But we have observed, in the context of our regulatory work, also a range of competition problems and at times market failures in the sectors that we regulate, resulting in poor consumer outcomes, poor outcomes for end users, at times a misalignment of risk between those providing the products and those purchasing those products.

So there are a range of themes that we think warrant further consideration and I'd like to touch on two broad themes, just quickly. The first is that, I think more in this market than most other markets that we have observed, there is a lack of effective demand-side pressure. Consumers and small businesses play an important role in placing competitive pressure on suppliers by switching products or services or demanding better treatment, but there are significant barriers to this.

You've got the credence goods nature and complexity of financial products – which makes it difficult for consumers to compare and switch. Consumers must also often contend with the uncertainty of very long-term contracts that give the supplier, at times, universal variation rights, this has been a big issue in the small business lending sector of late.

In addition you have information asymmetries and behavioural biases interacting in ways that affect consumer decision-making that doesn't support competition.

So, for example, there is, I think, some quite good research that shows consumers will often disregard the interest rate in purchasing a credit card because they believe, before the purchase, that they are going to be paying off the full amount every time, even when, in practice, that doesn't occur after the event, and this can be exploited by suppliers through low fee or reward products that actually have high interest rates. So you have a market that has a very wide range of products, but where there is some substantial barriers to competition from the demand side working in the way that it should.

In this context, one theme that we believe would benefit from careful consideration by the PC, and some gathering of some evidence, is the post-sale consumer experience across a range of markets, including issues such as ongoing pricing, exit fees, renewal practices and the like. So this post-sale issue, I think, is one where we have seen numerous examples that indicate potential problems with competition, such as favourable upfront pricing followed by significant increases at the point of renewal, for example, insurance policies, lenders offering new borrowers better discounts than their existing borrowers, or financial advice clients being charged annual fees for advice reviews despite no such reviews being carried out, and yet consumers not switching.

A recent survey found that over 50 per cent of Australian adults have always been with the bank they first opened an account with, which is an interesting indicator of the stickiness that you get in the market. Now, that may be, for many of those people, because they are satisfied, but it is an interesting issue to consider. As a result, suppliers can potentially treat long-standing customers unfairly by denying them access to better prices than terms offered to new customers, there might be a cross-subsidisation issue in play here.

So, one of the areas that we would be interested in discussing with you is how you might obtain data to look at whether the treatment of customers, post-sale across a range of markets, is indicative of competition weaknesses.

In fact, the inquiry may want to examine these restraints on effective demand-side pressure in more detail, and in particular consider whether the disclosure based regulatory regime is achieving outcomes, achieving the appropriate outcomes. Because from ASIC's perspective, while disclosure is important and is one of the key elements of any regime that is going to facilitate competition, it has become apparent that its effectiveness is limited and that there needs to be consideration to other ways of enabling the demand side to help drive competition.

The other theme that I wanted to mention upfront, one that Marcus has just mentioned, is vertical integration, and related to that, the role of competition directed at distribution channels.

This is a debate that occurs in a number of parts of the finance sectors where I think a careful look at the pros and cons is perhaps overdue.

There are some clear, potential benefits from vertical integration, around economies of scale and greater capacity to deal with, say, consumer problems if they arise. But there are also some challenges. Our work on mortgage brokers, and in the wealth management space, suggests vertical integration creates conflicts of interest including misaligned incentives and conflicted remuneration that can detrimentally impact competition.

So, for example, in our recent mortgage broker report, for the two major banks that own intermediary channels there is a clear increase in the proportion of loans being written to the banks when you include the value of white label loans funded by those banks. In this context, multi-brand strategies can, at times, disguise the level of consumer choice and competition that exists.

On this issue we do see, at times, quite vigorous competition but it is product issuers competing for distribution channels, for the ability to gather a larger share of the intermediary instead of doing the selling, rather than directly offering better products, prices, services to the end customer. This can arise from an ownership links or paying higher incentives and has been, at times, a source of poor consumer outcomes, in particular through remuneration that incentivises the sale of products that are inappropriate for consumers.

Now, acknowledgement of this problem has driven a number of recent and current reforms, including FOFA and changes to life insurance advice, and there currently is consultation taking place on the mortgage broker channel. But despite some of those reforms, which we think have made a contribution to raising standards, the vertical integration question, I think, is still one that needs consideration, both on, as I said, in terms of pros and cons.

Our current work on vertical integration and financial advice suggests that the majority of customer funds are still invested in related party products and we expect to have that data available from that project quite soon and we'll obviously look forward to sharing it with you.

MR HARRIS: Thank you.

MR KELL: So, in light of this, the inquiry may want to consider the broader question of how intermediaries and distribution channels mediate consumer access to financial products, including the role of ownership, remuneration and approved product lists, and the impacts there on competition.

So that leads me to the question, and one that you will no doubt be grappling with, what are some of the appropriate responses to some of these issues. One experience that ASIC has had over and over again in this sector is that even with well-acknowledged market failures you get pervasive first mover problems around addressing competition and market failings.

A recent example of that is our experience in looking at flex-commissions in the car finance market. Flex-commissions are a type of commission where, if the car dealer can persuade the consumer to pay a higher interest rate they will get a higher commission from the finance company, and we're not talking here half a percentage point higher, we're talking five, six, seven percentage points higher. You can imagine that the consumers who end up paying that additional amount, typically, are less financially experienced or knowledgeable.

The first mover though in addressing that problem is going to lose market share, and hence ASIC stepped in to come up with a collective solution. So that is – those collective action problems are certainly a feature of competition issues in financial services.

The second issue around responses is that disclosure has its limitations in terms of allowing market forces to drive better outcomes, to drive fairness in the provision of financial products and services, and that was something that David Murray's inquiry also touched on. I think evidence of that in a recent example is the extent to which SME lending contracts are being adjusted to comply with the unfair contract terms law.

The third issue I would just say is how do we encourage new entrants, which is a point raised by my other regulatory colleagues, without comprising consumer protection or other market conduct standards. I am positive that there is the possibility, with new technology, to help us look at that issue in innovative ways.

So in this broad context, we support some of the key recommendations coming out of the Financial System Inquiry that went to expanding ASIC's regulatory mandate and toolkit. We think including an explicit competition objective for ASIC will help flag that we need to have a clear basis to consider competition and promote competition in our regulatory decision-making. It would not make us a competition regulator, that's the ACCC's job, but having that objective is important and that is one the Government is considering.

That secondly, effective reforms around broadly formulated product intervention powers and product design and distribution obligations will help address market failures, so they are important.

I think the final one here is better and more transparent data in a wide variety of the markets that we regulate will, we believe, enhance competition, and it is a distinct issue from just disclosure, it is how can we get the sort of information that is going to allow consumers to make better judgments around the markets that they are dealing in.

Thanks very much again for the opportunity to be here today.

MR HARRIS: Thank you, Peter, thank you for ASIC's contribution. Before we start out with questions it is probably worth me noting on the record, as regulators, of course the ability to regulate for effective competition outcomes for consumers is, at best, a partial one. There are, and you can and should have, regulatory structures which enable markets to function effectively and with good information.

But as regulators, and in terms of our Terms of Reference, that is mechanisms for improving consumer outcomes via competition, you can only, at best, be a partial contributor to that and it is a factor that will stay with us through the course of this.

MR KELL: Agreed.

MR HARRIS: That said, and without attempting to raise expectations, there are some very interesting angles already evident in the sorts of things that you have put forward. I am particularly interested in this ability for competition to arise from consumers' own efforts on their behalf and the ability to ensure that the system can offer them both the information and the convenience, the ease, of being able to take action on their own behalf. Switching of accounts is an example, but clearly when you switch an account you've got so many accreted obligations held by that account that you need to be able to have them addressed at exactly the same time or you will create a very substantial impediment to any switching at all.

Are any of you aware of initiatives, we hear of new payment systems and things like that that are under development, is anybody aware of anything that might be likely to be a contributor, a nascent development that might be able to be a contributor from the regulatory side, to assist consumers in switching accounts, in being able to more readily transfer and therefore to induce pro-competitive behaviour from different suppliers and financial markets?

MR BYRES: A couple of thoughts which are not immediately in any of our bailiwick but are worth you bearing in mind. Things like – and here you need to engage with the Reserve Bank probably, but with the New Payments Platform and the capacity for a more efficient payment system. Probably key to that being really successful in helping people manage their financial affairs and switch will be things like digital identity, and that may make things like account switching, account portability, et cetera, much more effective and feasible. But I don't pretend to be the technical expert to give you the definitive answer on that, but I would encourage you to think about exploring that.

MR KELL: One issue there that has arisen in discussion of late but I don't know that there has been a landing on it, is platforms that potentially offer consumers the ability to aggregate their banking data and to potentially switch. But one of the challenges in that environment is the way in which sharing information between institutions may actually violate your contract with the institution – sharing PIN numbers, for example – so this, I think, is an issue worth considering.

A second issue is to ensure that there is clarity around the multi-brand strategy issue as well. I think that is one where we do receive complaints, typically from competitors, not so much from consumers themselves about, well, there are five brands here but they are all actually the one entity, so people need to be aware if they are considering switching, what the actual degree of competition is in the market.

I don't know whether you wanted to add anything on that first one?

MR KIRK: I guess on that first issue, historically, when the payment system was mostly managed, and the participants were large institutions, it was reasonably easy to get agreement on liability for unauthorised transactions. They tended to – they all had similar roles in relation to the payment system. They needed people to have confidence in it, and there was, it took a period of time, but eventually agreement about terms on which consumers could transact, and when the consumer would be liable for an unauthorised transaction and when the institution, and the institutions took on a lot of that liability, they didn't leave a lot with consumers.

With smaller players coming in who might not have the financial wherewithal to provide that sort of guarantee that is historically provided, the question arises, well, do you change those liability rules, and if you don't, where does the liability fall?

MR BEZZI: I might just add, the UK Government, as I mentioned, through the Competition and Markets Authority, has done a very detailed report on the sort of technology that Peter mentioned, the creation of APIs I think they call them, I'm no technologist but I think that is the expression, they are a technology that is there to facilitate the movement of data from one institution to another. It does require changes to regulatory settings, their report is being implemented in the UK. I'd very much recommend that as a model to look at, and I know that there is consideration in the context of your previous inquiry into data about issues around that going on within Government.

MR HARRIS: That's right. No, the data inquiry seems to have been quite catalytic. But anyway, we're not here to talk about the data inquiry, as much as I'd love to. But just on this question of digital identity and new payment systems that are under consideration between the banking system and the RBA, is the development of this though being done with the concept in mind of improving consumers ability to act in their own interest, that is, does it have a pro-competitive outcome, or is it, if I might call it, a technical efficiency sort of construct that is almost a convenience arrangement, which undoubtedly is therefore not unimportant if it has cost savings and things like that attached to it.

But I think we have found from past inquiries that where new policy or regulatory constructs are being developed, but their objective is slightly different, you can't necessarily rely therefore on the one thing delivering, if you like, the other thing. So it's an open question though, are digital identities being developed for the purpose of pro-competitive outcomes or are they being developed for what I might call technical efficiency reasons?

MR BEZZI: Can I perhaps say that is probably a question that is best addressed to the Reserve Bank.

MR HARRIS: It probably is and we will undoubtedly ask them that, but we have you here today and I just thought, idle speculation, anything at all you would care to put on the record here? Clearly, if you want to take the Fifth, we live with that.

MR BYRES: My guess would be that it's primarily the first purpose, that it's around efficiency costs, speed of processing and reliability of upgrading to new technology, et cetera, rather than the competition issue being the primary objective. But I think it is being designed with the thought of – and part of the reason that there is, I mean it's not a purely industry-led initiative because there is a public sector involvement in it, is to think about what sort of system do you want to have so new entrants can come in, services of the future that we haven't thought about yet aren't precluded in the design. But I come back to Marcus's point, it's probably best to get the gospel from the Reserve Bank.

MR HARRIS: Which we will.

MR KELL: But ASIC has overall responsibility for the payments code and we will be commencing a review of that in the near future, which I think will touch on some of the consumer drivers in this area. I would like to think that both of the issues you have mentioned are drivers and we will talk to our colleagues at the Reserve Bank and elsewhere about that. But you make the point about this.

MR KIRK: Well, certainly on payments, I think at the moment most of the innovation we're seeing still depends on this is a new way to access your existing deposit account, or this is a new way to access the existing payment system. So it's adding a point of entry, and the point of entry may be very convenient but it is still very much built on and dependent on the existing system.

MR HARRIS: Yes. Before I throw it to my colleagues I've got one other sort of generic question. Being an old mortgage holder, that is, first got a mortgage a long time ago, it is very intriguing when you read the nature of the developments that mortgage broking and other intermediaries have created in this market, they appear to be quite a dominant form of information provision and supply of new customers to the financial system, that is, potential borrowers, and they appear to be quite well-rewarded if you look at the financial performance of the relevant firms where they are reported.

As a consequence, one would assume from that that they're quite a notable cost in the origination of mortgages, but once they didn't exist, once upon a time they didn't exist, and indeed, presumably, today still, some people go directly to a financial institution and get a mortgage, therefore saving quite a significant cost to the financial institution. But the pricing of loans doesn't appear to reflect any differentiation between the channel with which you finally achieved your loan, and that is an unusual kind of factor. Usually, intermediaries arise where there is an information provision arrangement that is so opaque and so difficult that an intermediary is required and they get a fee for it.

Am I right in looking at mortgage origination this way or is it just a failure of perception on my part, which I'm often guilty of? So I'm happy to be told, "You've got the wrong end of the stick".

MR KELL: Well, to start with I'd encourage you to read all 240 pages of the ASIC Mortgage Broker Review. But you're right, I mean it is, to give you a sense of the scale, we found that lenders paid 1.42 billion in upfront commissions on home loans in 2015 which was up from 729 million in 2012, and I think the channel is now up to about 57 per cent, it was 54 per cent when we looked at 2015, so it's a very, very significant channel.

Yes, we also found that when we tested the interest rate applied when loans were sold to see if there was a differentiation between the direct channel and the broker channel, that within lenders there was no consistent finding or trend that brokers obtained either cheaper lends or more expensive loans, which I think is interesting when you compare it to some research we did around consumer expectations that they would get a cheaper loan through a broker, of course they may shop around to other lenders, but within lenders there was no differentiation.

So it is a complex issue to sum-up very quickly, but I think you can see brokers potentially performing a role of providing smaller lenders that don't have such a big direct channel, with greater access to the market if that channel is working well and efficiently. Having said that, we found that individual broker businesses typically have around four preferred lenders which receive 80 per cent of loans by value from that business.

Nonetheless, we have tried to set out ways in which we think the current structure of remuneration in that sector could be modified, and it is currently being consulted on these issues, to facilitate the ability of smaller lenders to compete, amongst other things. So there is a lot to talk about there but I think your question is the right one.

MR HARRIS: Yes, because it's an unusual thing, isn't it, that if I'm saving a financial institution a rather large commission by approaching it directly and taking a loan, and that I don't get a benefit out of that, might suggest that is one indication that there is a lack of competition. Because normally, under pressure of competition, you would think a customer would be, as it were, rewarded for saving a cost. Anyway, it's an interesting development. I'm going to drop out now.

MR KING: Can I please just follow-up on that, and perhaps with Marcus of course. The ACCC took action on the basis of the brokers for ANZ passing through part of their fees to customers.

MR BEZZI: They tried to. They were disciplined by the ANZ for seeking to do that. We took action and the Federal Court found that that didn't amount to a breach of the Competition and Consumer Act, or they did find that the ANZ had been engaging in that conduct.

MR KING: So I guess partly from ASIC's as well as the ACCC's perspective, has that tended to be a dampener on the sort of competition that you would expect, that Peter was suggesting, is exactly those sort of pass-backs of fees, their savings in the system, that they should go on to the customer, and obviously that was an attempt to do that which was thwarted by the bank. I mean has that created a legal barrier or a problem that we see more broadly in the mortgage broking, of being able to give discounts to customers, or it hasn't had any effect?

MR BEZZI: I think you are probably – I think ASIC is in the best position to give an up-to-date answer on this, our work in that area was a few years ago now, and your work, ASIC's work, has been very, very detailed and much more recent.

MR KELL: Yes. So it is common for lenders to have a standard variable rate and then provide a margin discount off that to consumers, that has become part of the difficulty of actually comparing rates in this market and part of the difficulty of consumer-driven competition, and the discount is typically fixed for the life of the loan. But we have found that they can occur through either channel, and as a result of this pricing model, lenders do compete at times for market share by varying the level of discount off the standard variable rate for different segments of new borrowers, but not typically in the way that you have just mentioned it, that in terms of returning part of it to the borrower.

So, having said that, I mean that is an interesting question itself that goes to how you deal with upfront customers as distinct from existing customers, and we found that lenders have been offering new borrowers better discounts than existing borrowers. In 2015, for example, two of the largest lenders provided home loans that had, on average, approximately .25 per cent larger discount than loans provided in 2012. So there are some interesting issues that are thrown up around that discounting practice that, again, reflect on the way that competition works in that sector.

MR KING: If you don't mind, just following up on this. I mean one of the other things the financial system – to quote the Murray Inquiry – concluded, it noted the residential mortgage backed security market had collapsed in the GFC and, again, as an outsider, it seemed to me that before 2008 that was an area of blooming competition with independent parties being able to source capital, initial capital, from the major banks, but then being able to package the mortgages with a margin to the market.

It doesn't seem that sector collapsed, there were acquisitions, those that seemed to have survived seem to now be brokers rather than providers of the mortgage backed securities. I was wondering do you have any thoughts on whether that was effective in terms of competition, whether that – something has changed so that competition can't break out again? I guess I'm sitting there sort of waiting for it to break out and I'm not seeing it so I feel like I'm missing something.

MR BYRES: I make a couple of comments. I think the observation you made is right, the market broke down. At the heart of sub-prime lending in the US was this notion of the originate to distribute model, so I write loans and actually, in those extreme cases offshore, I don't care for the quality of them as long as I bundle them up and flog them to someone else before they go wrong, I'm home free. We didn't have that here, thankfully.

But nonetheless, the securitisation activity got a very bad name, and even though Australian mortgage backed securities were actually continuing to perform and very high quality, investors just said, we don't buy that stuff anymore. There was a long period of time where, regardless of the performance of the underlying portfolios, it was very hard to sell those securities. That has, in the last little while, recovered, partly driven by regulatory changes.

So, in response to 2008, regulators around the world, including APRA, had a look at the rules around securitisation, and it's fair to say while those rules were being sorted and settled, that created additional uncertainty of how as the market going to recover again, we're not quite sure of the rules of the game, so if I'm an issuer I don't quite know what I have to comply with yet and I'm a bit wary about doing it.

So we finalised our – in the Australian context, we finalised our rules last year and tried to give some certainty to that. In the last little while, I'd say volumes in that market – and we can probably dig you out some statistics – have taken off again, both non-major banks issuing and also some of the non-ADI, non-prudentially regulated.

Because a product of our intervention in the ADI sector, to temper some of the competitive spirits there that I talked about, has been banks tightening terms and conditions or raising prices, and that has led more customers, naturally, to seek other, alternative forms of finance that aren't constrained by APRA constraints, so a number of the non-ADI lenders who primarily use securitisation as their funding mechanism would be saying they're having a bumpy year this year. But we can probably give you some statistics just to show the trends through time.

MR KING: That would be good, fantastic.

MR BYRES: But I think we're certainly seeing some recovery, exactly how far it goes and how – I think your phrase was burst forth, but whether competition bursts forth or just emerges.

MR KING: Crawls.

MR BYRES: Crawls, we shall see, time will tell. But things are – that particular market is coming back is the very short answer.

MR KING: And it's a (indistinct) thing rather than a regulated thing?

MR BYRES: Well, it's a couple of things. If you're an issuer you want certainty about what are the terms and conditions that you've got to issue. For ADIs who are subject to our regulation, if they want to do it because they want to get capital relief for the assets they've sold, they've got to know what the rules are to get capital relief, get the risk off their balance sheet and therefore not have to hold the capital, that's a big issue for them.

So on the issuer side, knowing what the rules of the game are, both in Australia and also other jurisdictions are important, because on the demand side or the investor side, that is starting to come back now, people are more willing to hold those issues. But a large part of Australian issuance went to offshore investors, so it was not just held within the Australian financial system or economy more broadly, a lot of it went offshore and until that confidence came back in, there was, necessarily, a constraint.

MS ABRAMSON: I just wanted to build on something, Peter, that you said about consumer stickiness – and it's more a question really for Marcus – because you said that when you did the survey or whatever, 50 per cent of consumers actually stayed with their first bank and you made some comments about post-sale. Marcus, I'm quite interested in the comments that you made, looking at other markets like energy and health, and whether there is anything to be gleaned from that, about thinking about even the context of financial products?

MR BEZZI: Yes, so back to that idea of some of the technological solutions, the businesses that are developing in the UK, I think I mentioned a business called Flipper which enables switching very easily. Now, that occurs in a particular regulatory environment where the benefit is being facilitated, but those sorts of things, I think, would be worth looking at closely. They may not be perfectly transferable from the energy sector into the financial sector, but anything that can be done to facilitate the development of those opportunities, I think and we think, would be worth looking at carefully.

MS ABRAMSON: That is different from comparison sites?

MR BEZZI: Yes.

MS ABRAMSON: So this is actually a technological advance to allow the consumer to do it themselves rather than the disclosure issue that Peter was talking about, which is a comparison site issue?

MR BEZZI: As I understood that particular product, it actually does the switching for you, so it looks for the best deal for you and actually does the switch. You pay for the service, but it arranges for the switching to happen without you having to be bothered by where you're getting your energy from, it just happens and they make representations to you about you getting the best deal, whatever that might be for you.

That seems, to me, to be quite an innovative business model, now, whether it would work in the financial sector for particular products in the financial sector, I don't know, but it seems to me that it is a business model that is exploiting the opportunities that great availability of data through this API technology is presenting in the UK.

MR KELL: Just very briefly on that issue, I agree with Marcus, I think there are some practices and structures in other sectors around switching customers that would be very good to look at, and it is too hard to switch standard bank account products in Australia. But having said that, I think it is interesting that in the UK, where they have made switching easier, that has now been in place for a few years, and part of that is by using a different platform to enable that to occur.

I think they've been a bit disappointed about the degree of competitive pressure that has emerged from that greater ease around switching. That is something that we are trying to understand as well, so there seems to be not just an enabling issue, but how do you then incentivise or educate consumers to switch.

MR BEZZI: I think that's what drove the latest CMA report on open banking, because it hadn't been very successful and they wanted to find out, well, what do we do to make it more successful, and that's why they have come up with these new approaches which I understand have only been in place for a very short period.

MR KING: Can I just follow-up on that? Because I think Bernie Fraser did the report which came down in Australia under our existing architecture, it's not worthwhile putting in - - -

MR KELL: A cost benefit.

MR KIRK: Account number portability.

MR KING: Yes, account number portability. But there were changes to the legislation so that there was a 12 month if you change banks then the bank has to forward on automatic credits and debits for the next 12 months and you've got 12 months, has anyone done a follow-up to find out, in Australia, if that reform had any effect? I must confess I pretty much haven't heard of it for the last five years.

MR KELL: I'm not sure whether there's been a formal study, I'd have to check that, but my understanding is that the impact was negligible for the usage.

MR BEZZI: Negligible, yes, that's our understanding as well. Sorry, Peter.

MR HARRIS: Wayne, you mentioned some regulator support for the introduction of new models and giving new business models in the provision of financial service, and I think you said giving some of the newer operators additional time or to allow time for them to adjust, can you explain that a little further and whether you too are doing this in the interests of broader competition or whether you have other objectives? This question of objectives is quite important in design, as I mentioned earlier.

MR BYRES: So, yes, we are looking at our, in a sense, the entry standards and the entry requirements to get authorised. Our first starting point will be for authorised deposit-taking institutions, which is essentially banking activities We have had a process that has sort of been established for the last 20 years on how we process these things, but it probably has a premium on safety and so you don't get to take a dollar of a depositor's money until we are absolutely satisfied you are on top of your game.

A lot of people have said to us that is costly and not particularly efficient, and sometimes it's actually there's a chicken and egg problem because how do you prove your systems are robust until you can actually do some business and it makes it unnecessary.

So we've had a look at what is being done in the UK in particular, which is more of a – they call it a two-phase model but it's probably got more than two stages in practice, which is designed to allow people, in a sense, to put a toe in the water, or go under P-plates before they get their full license, you can use various analogies about it. There's still an entry hurdle, still a very clear entry hurdle before you can start doing anything, you've got to at least prove you've got a business case and you've got some capital and you've got some expertise, et cetera, but then you might be able to do some activity.

We're still thinking through exactly how this would work so I apologise that this is still necessarily vague, we'll have a discussion paper out on this, hopefully in the near future, which will try and put a bit more meat on the bones of what we're thinking. But essentially allow people to do some small-scale activity to sort of both help them test the viability of their products, and also help us be satisfied that actually their operations are robust, et cetera.

In the UK framework, for example, there's a first stage which is just assessment of business model, et cetera, and then a stage that people can get into where, in the case of deposit-taking, you can take a very small quantum of deposits designed to actually test whether people like your product, whether your product works, whether you can connect with other members of the financial system and make payments between financial institutions, because that's essentially what it's often about, but in sufficiently small scale that if anything goes wrong there's sufficient protections around it that the innocent depositor is not in any way put at risk.

So we're having a think about how do we do that and, as I said, we'll have a consultation paper out on how we might institute a similar sort of framework in Australia shortly.

As to your question about what's the ultimate objective, is it competition, is it efficiency, is it contestability, well, I think it's sort of a bit of all of those things. We think, again, to go back to our mandate, it's safety balanced with these other things, and we think we can probably enhance contestability, efficiency, competition, without really jeopardising safety, and so it's a win for the community, it doesn't jeopardise financial stability, then we should head down this path.

MR HARRIS: And is your current structure in law sufficient to enable you to do these things or might there be a prospect, if you would have to be additionally authorised by the Parliament to do anything?

MR BYRES: At this stage, no. There is one issue which the Treasurer touched on in the Budget, around the Financial Sector Shareholdings Act, which is an Act that limits the potential to have very closely held shareholdings in financial institutions, because there is generally a preference for diversity of ownership and not control of a financial institution by an individual. But that does pose some challenges for, I mean, a start-up entity where there may only be two or three shareholders, or even a single shareholder, at least at the initial stage.

So the Treasurer mentioned in the Budget the need to have a look at that and make sure that wasn't acting as an undue barrier to entry. But we think that that can be – at least as I sit here today, I think that issue can be solved through administrative means rather than through a need to change the legislation itself. There's enough discretion there that I think that can be handled.

MR HARRIS: Good.

MR KING: Can I, just again, sort of following-up on that point. As I understand it you don't – you see stability of the financial system and competition not being in conflict, indeed potentially going together, that seems to be a different view than what came out after the GFC.

I think Ian Macfarlane, for example, came out, probably around 2008 and said, well, one of the reasons why Australia was so successful in the GFC is because we have a concentrated banking system for – I don't want to put words in his mouth but sort of seemed to say, well, less competition may increase stability. I know similar claims have been made about Canada and claims the other way have been made about Europe, so I'd really be interested in your feedback on that.

MR BYRES: I think countries like Australia and Canada did do well in the financial crisis, or relatively well, came through that period well, so did Singapore, so did some other regions. They may or may not have had relatively concentrated financial systems but I don't think that was the defining reason for performance, I think there's a whole range of factors at play.

I do think there is some element of truth. One of Ian's comments was that the four pillars policy had created a dynamic here that didn't exist or – sorry, prevented a dynamic here that existed in some other jurisdictions of just strong competition to gobble one another up, and that didn't exist here and hence there was probably less pressure to get share prices higher to get a premium to do a takeover, et cetera, et cetera. So I think that there may be something in that.

My comment was really, not to really be definitive, but just to make the point that often it is asserted that it’s one, you can have one or the other, you can have stability, you can have competition. I was trying to make the point we think we can have both. If you just have competition without regard to stability you probably end up with the sort of outcome we had, which will be really complicated, really competitive for a period of time, then there will be a period of adversity and you end up with the more concentrated system.

I also said in my comments, we don’t resile from the fact that in some instances, and housing lending is a case in point at present, we are actually intervening because we think the degree of competition, and in particular the nature of the competition – which has not been on price, it’s not been on service standards, it’s not been on product design or anything else, it’s been on basic lending standards – is actually a threat to stability.

So I don’t want to imply that they are always and ever perfectly aligned because they won’t be, but nor do I think that they are mutually exclusive.

MR KING: Yes, it’s sort of getting competition on the right dimensions.

MR BYRES: It’s getting competition on the right dimensions and having, as I said, from our perspective, it’s a business model that says, what do you want in the financial system. You want a financial system that even through wherever you are in the business cycle you’ve still got competitors there providing services to the Australian community in boom times or bust times, and that is actually probably in the long-run, what’s in the interests of the community.

MR HARRIS: I’m noting the time and I’m sure some of you have probably got flights to catch and things like that. I wanted to ask Peter Kell though about a topic that you alluded to which clearly was a hint to us to pay more attention to it, and I need probably a little bit of signposting. You mentioned the international dimension of competition was of significant interest to ASIC. What particular angle of the international dimension should we be most interested in here?

I mean we’ve had the history obviously in the banking system of trying to introduce foreign competition and that still exists and presumably the ability to have foreign competitors hasn’t been seriously impeded, although we’ll be asking that question and we’ll be interested in it, but I don’t think you were alluding to that, you were alluding to something a little different.

MR KELL: Well, I wasn’t alluding, I should be clear, I wasn’t alluding to any particular issue, but it comes into play across a range of ASIC’s responsibilities and we’d be pleased to draw these out. You’ve got the markets regulatory role and inevitably when you’re talking about the way that market infrastructure and various aspects of clearing and whatnot work these days, you have to consider that in an international context.

You’re also talking about issues around, ultimately, Australia is a capital importer, and there’s a fundraising issue as well when it comes to considering how the financial services sector is working, that inevitably has to be considered in the international context. So that was all at this stage, so very happy to sort of explore that issue with you further down the track.

MR HARRIS: I was wondering, obviously it all seems reasonably – from our data inquiry, the ready provision of information, which we're probably not in the perfect position at the moment with the structure of how data is handled in the Australian economy, to say we're around that ready position, but it doesn't seem to be too difficult to create it, would enable someone to borrow from a bank in Singapore just as readily as to borrow from a bank in Martin Place, yet it doesn't seem to happen, and in part can be uncertainties, but information provisions are meant to offset that.

I wonder if you were alluding to the fact that there might be some regulatory barrier that we should look at to say whether particular products – so I'm not actually thinking about being a deposit-taking institution, I was more thinking of being simply a supplier of a product and whether there were regulatory impediments to that from offshore?

MR KELL: Are you talking more about even the ability to provide those products at a retail level or small business?

MR HARRIS: Yes.

MR KELL: Well, there can be very different regulatory regimes which is in part why you have initiatives like the Asian Region Funds Passport Initiative that ASIC is participating in at the moment, and at the retail level often quite bespoke requirements that are not easily transferable, that is correct. The question is, when you're looking at those across jurisdictions you'll inevitably, what is the one that - or our requirements, are they better or do they offer better protection than those from other jurisdictions, how do you get mutual recognition, that's one of the things that ASIC is focusing on in a lot of these markets. So, again, we can come back to you on that issue because it's live, especially in the investment markets.

MR HARRIS: Because as you can tell from our Terms of Reference we're going to be encouraged to look at market segments. So in a sense you can look at the right to enter and take deposits over here, or you can mentally shift and say the ability to provide a particular product over here is a different way of examining the scope of competition. A lot of the commentary that we have noted has really been about the ability to enter, raise a lot of deposits and become a participant in the financial system, regulated in a particular way.

But if you inverted your thinking and said, what does the regulatory structure do for just a simple product, and there are some obviously that are provided from offshore reasonably readily and have got sophisticated investors who can cope with exchange rate risk and things like that.

MR KELL: Yes, that's right.

MR HARRIS: But it is interesting to know whether the regulatory structure is – and by that I mean that's why, as I said, as regulators, I'm saying that in front of you, whether the whole of the regulatory structure does not comprehend the idea of having competition in a particular product from overseas when the ability to supply data which should be able to offset a lot of the risk in so doing, now seems to be reasonably readily available, I won't say readily available to Australia, I'll just say readily available, as in there are models that do so in other countries.

Anyway, I'm interested in that too because of the market segment question, and it does come down to this question, in the end, if this inquiry gets to the point of saying there is a lot of competition that seems to satisfy consumer interests here, here and here, but here, here and here there isn't, then we'll be looking actually more at solutions around products than we would be looking at whole or systemic kind of competition. Anyway, worth noting and I'm interested in that if anybody has got any reactions to it, or indeed anybody else.

MR KELL: No, but we will certainly follow-up on that.

MR HARRIS: I'd like to thank you guys for making the time and effort today to launch this inquiry and new ideas, and thank you for your offers of continued support and assistance which we will of course exploit to the full. I think now we have got a one hour break or so before we start with the set of banking institutions. Marcus, one more point?

MR BEZZI: Can I just mention, I think I forgot to mention that we are happy to make our opening statement available. We don't have it in a form that we can do that right now, but we will at a later stage.

MR HARRIS: Happy to take it from you and then we'll get it uploaded. We're going to have a one hour break I think. Thank you very much.

ADJOURNED [1205]

RESUMED [1301]

MR HARRIS: We've had our one hour break and we are back on the record in roundtables for the financial systems inquiry. At this stage we have a series of representatives in customer owned banking and different CEOs of banks that we have invited along to give us a bit of a perspective on issues that might come up in this inquiry from their perspective.

As I advised people this morning, there are formalities to Productivity Commission hearings of this nature, we record them, we put them up on the website, there are proprieties to be observed by those who are not registered participants at the table in terms of allowing registered participants to get their views out on the record.

We don't prevent social media being used for people to do reporting from the observer level, but we do ask that if anybody wants to take any photographs or video, they seek permission first, its primarily not of concern for us as Commissioners, it's a concern about the participants and they have a right to say whether they are prepared to be photographed or videoed, or not.

I guess being a roundtable, what we tend to do is ask people to see if they want to come along and make some early, prepared remarks and then we will put some questions across, and it tends to be just a relatively free exchange. So at this point I'm going to ask maybe if the Bank of Queensland would like to start us off, and if you've got comments to make that will be great.

MR SUTTON: Great. Thank you, Chair, for the opportunity to be here today and I'll just read a short statement. By way of background, Bank of Queensland has been around for 143 years and has a network of 197 retail branches across Australia. Bank of Queensland's market share of the mortgage and business lending is less than two per cent. Our unique franchise branch network of owner/manager form of two million small businesses contribute to the Australian economy, approximately 50 per cent of our business is in our home State of Queensland.

Bank of Queensland supports the Treasurer's comments that the Australian banking system must be competitive to ensure consumers get the right outcomes. Australia has a highly concentrated financial services sector, the regional banks play an important role in both moderating the market power of the major banks and offering a viable alternative. The market share of the four major banks has increased significantly since the Global Financial Crisis, profitability of the major banks, as referenced by their return on equity, is higher than those of regional banks. This difference cannot be solely attributed to the economies of scale.

In terms of competition, the playing field is not level and this is most evident through four key mechanisms. First of all, changes to capital requirements through the Basel II process implemented in 2008 provided a significant free kick to the major banks through their advanced accreditation status. For example, mortgages are a homogenous product and fundamentally carry the same risks, but as a standardised bank we have to hold $3.50 of capital against every mortgage, the major banks only need to hold $2.

Second, the consequences of the GFC resulted in the Government's implicit support to those banks that it considered too big to fail. This support provided the major banks with a substantial leverage in reducing their wholesale funding costs. This, coupled with the recent Standard & Poor's decision to downgrade our credit rating, has made clear it is a benefit we do not enjoy.

Third, over the longer timeframe there has been consolidation in the financial services sector through M&A, this has encouraged vertical integration in banking. A consequence to retail banking is that a number of the major banks have greater influence on the loans originated by mortgage brokers due to their direct ownership.

Finally, following the GFC there has been a significant increase in the number of regulations implemented across the banking industry. A strengthening of the regulatory framework is understandable given the risks. Nevertheless, the increase in regulation has a greater impact on regional banks that do not have the scale to absorb the rising costs of regulation and compliance.

I believe that the Bank of Queensland history demonstrates that regional banks play a vital role in the Australian banking industry. However, as a result of pace of regulatory change, the industry environment has evolved to the detriment of regional banks. This has inadvertently provided a significant advantage to the major banks to maintain and grow market share.

So the inquiry by the Productivity Commission should, we suggest, seek to redress these structural imbalances so as to enable all consumers of financial services to benefit from a highly competitive market.

I'm happy to elaborate on these issues in greater detail and welcome your questions.

MR HARRIS: Thanks very much, John. Do you want to keep going, Mike, around the table?

MR HIRST: Sure. I've got a lot of commentary that is similar to John's but I'll pick out the pieces that don't double up to make sure that you continue to get the same view. Bendigo and Adelaide Bank is predominantly a retail bank, we operate in 750 locations right across Australia. In more than 300 of those locations our branches are run in partnership with the local community and in 90 of those communities we are the only bank.

In our community bank model, revenue is shared between us and the community, with 80 per cent of the profits of the community company being reinvested for community benefit. Since inception about 18 years ago over 165 million has been invested for community benefit and that amount is currently growing at the rate of about $20 million a year. This model is unique in banking globally and in many Australian communities the retention of branch banking services through a community bank has had positive flow-on effects for commercial activities in those communities.

We have been able to grow our business and achieve these outcomes for local communities despite the uneven playing field that exists in Australian banking. This disadvantage was acknowledged in the Murray Review in Australia's financial system and has arisen for three main reasons.

The Basel II implementation which John has already spoken about, where the different treatments of capital are across the major banks versus everybody else. As John has pointed out, it created an issue in terms of us being able to compete at the same value, or at the same price to get the same return — it's not possible. But it's also resulted in another thing, which is a change in the mix of the major banks' balance sheets, away from business towards housing. So those balance sheets have changed dramatically in their structure over that period so that more of what they do now is finance housing.

The second piece that's led to the uneven playing field is historical, but it was the implementation of the Government guarantee for wholesale funding during the GFC and the inequitable pricing that arose out of that where the majors were charged 75 basis points, and pretty much everybody else was charged 150, there were two that were charged 100, Suncorp and Macquarie.

The change in market share that came about because of that cheaper price for the guarantee, and then the access to funding that that led to, is still in the market today and it moved the mix away from about 75 per cent major bank, 25 per cent everybody else, to well over 80 per cent for the major banks.

The third issue is the implicit guarantee which has been spoken about widely over the last few weeks following the major bank levy, and John has addressed it here already. So if I think about the Australian banking landscape at the moment, there is no doubt that it is intensely competitive, I think everybody would agree with that. However, if the uneven playing field is perpetuated in the banking system, gradually, this will ensure the major banks' dominance is entrenched because smaller players will be unable to continue to effectively compete.

This will likely manifest through sub-optimal returns on capital, directing providers of that capital to the major players, thereby ultimately reducing customer choice. Since the GFC, credit unions and smaller banks have been merging to stay competitive, although overall aggregate market share has been declining for the sector. If the uneven playing field is left unchecked, the Australian banking system could be reduced to just the big four players. Real competition will be gone and genuine customer choice will be a thing of the past.

For all these reasons, I hope the Commission will look at the long-term impact an uneven playing field has and make recommendations, as David Murray did in his report into the financial system, aimed at restoring an opportunity for healthy competition in the system and wide customer choice. I'm happy to take any questions too.

MR HARRIS: Thanks very much, Mike. So, Jamie, are you happy to go on?

MR McPHEE: Yes, sure. I will truncate my comments, but, again, to just show that we are all on the same page. Just for a little bit of history, ME Bank was established in 1994 and we are owned by 29 industry super funds. We got a banking license in 2001, we have about $26 billion in assets, 415,000 customers. We see ourselves as a challengerbrand and we do have growth aspirations, so therefore I'm really pleased that we're having this discussion today and it hopefully demonstrates the Government's commitment to competition.

I think if you think about coming out of the GFC, the focus was all around stability for absolutely logical and rational reasons, because there is not a person in this room that wouldn't want an unquestionably strong banking system in this country because it's in everyone's best interest that we do. But as the other guys, John and Mike, have said, the market now is much more concentrated than it was and we actually do believe that it's a good opportunity now to turn our eye to competition and customer choice.

So that's really the basis of where we sit, so we think competition is really, really important, so therefore [let's identify] where is the playing field not level [so] that we can actually have competitive neutrality. For us, it's in the four areas of: capital that is being talked about, the cost of funding for the too big to fail status, in the vertical integration in relation to the owners of the mortgage broking sector. So these are the areas that we would like the Commission to focus on.

Going forward, can we look at exactly, really identify what/where the unevenness is, what the value of that unevenness is, and then just work towards creating competitive neutrality to enable us all to compete. So, look, that is very much where we are coming from, as I said, we do see ourselves as a challengerbrand, we do have growth aspirations.

The greater the level of competition that's created, I think the two critical benefits the whole community gets is that, first, it de-risks the sector to reduce that, well, I'm too big to fail status, and Mike and John have both talked about the implicit guarantee which is accruing an explicit benefit to the major banks. The first thing, it reduces risk, and the second thing, it increases customer choice, and I would argue that they are both worthy objectives.

So that is very much the camp that we sit in, and thanks for the opportunity to be here today.

MR HARRIS: Appreciate your comments. How are we going to organise it, if we hear from - - -

MR DEGOTARDI: After you, David.

MR HARRIS: Let's look to the left-hand side of the table.

MR CARTER: David Carter from Suncorp, and thank you, as colleagues have said, to the Commission for the invitation to attend today's roundtable. We have been advocating for an inquiry of this kind since it was recommended by David Murray as part of the Financial System Inquiry, and today's hearing is a critical step in developing reforms that will support a productive, competitive and, importantly, sustainable banking sector in this country.

A little bit of background, Suncorp has also had a 100 year-plus history, our main focus is in retail banking, small business, and, importantly, agribusiness, particularly in our home State of Queensland, but also in other parts. I want to state upfront that Suncorp is not seeking special treatment, rather all we want is for banks of all sizes to compete on a level playing field. Improving competitive neutrality will deliver better customer outcomes and drive greater innovation in our sector.

A strong banking system is good for all Australians, and our system is certainly strong when compared to our global peers. However, it is also important to have a fair system where competition is not stifled, nor limited. Smaller banks bring vital competition and choice to the market.

We accept that the larger banks have a scale advantage, our concern is when scale advantage is compounded by a regulatory, prudential or other factors, providing those with scale even further advantage, increasing their market power at the expense of smaller banks. An example of how these factors have impacted the market is evident in the share of the home lending held by major banks which has increased from around 76 per cent in 2007 to around 83 per cent today.

APRA's determination on IRB risk rights and the Federal Government's major bank levy have gone some way to improving competitive neutrality, but they fall short of addressing the significant advantages that come from the current regulatory framework. Policy changes that fail to consider competition can also lead to poor customer outcomes.

For example, while well-intended, the blunt nature of APRA's macroprudential caps have effectively frozen investor and interest only market shares at current levels. This has detrimental consequences as it limits competition and makes it difficult for customers to switch easily. We have seen banks who have the largest investor and interest only lending portfolios increase interest rates since competition has been restricted and start reducing interest rates where competition is strong for owner-occupied mortgages.

In aggregate, these changes have significantly improved the financial position of the major banks. Since December last year the major banks have increased investor interest rates by over 20 basis points and interest only rates by up to 74 basis points by reducing owner-occupier interest rates by five to eight basis points. This has resulted in an average interest rate increase of around 23 basis points across the residential mortgage portfolio, delivering an annualised benefit of a couple of billion dollars.

There are other areas where the regulatory settings continue to disadvantage smaller banks. I would like to highlight the following. The remaining distortion within the two-tiered system of risk weights which still allows the majors to have a disproportionate capital and a pricing advantage on loans with the lowest risk. The implicit Government guarantee, as you have heard, which continued to provide the largest banks with a significant funding cost and accessibility advantage.

The shadow banking sector, which is less regulated and has been able to compete in ways banks can't, for example, by growing their investor and interest only lending book, free from the constraint of APRA's macroprudential caps, and as John highlighted, the unprecedented pace and level of regulatory demands we are experiencing is having a disproportionate impact on smaller banks. I look forward to exploring these issues with the committee.

I would end by saying that while the market is competitive today, it is vital that this competition is fair, productive and sustainable. The bottom-line test must be that which is good for the customers is good for the economy. A more competitively neutral banking sector will deliver this. Thank you.

MR HARRIS: Thanks very much. Keep going left.

MR DEGOTARDI: No worries. Thank you also for the opportunity to be here. COBA is the industry body for Australia's customer owned banking sector and our members are mutual banks, building societies and credit unions.

Customer owned banking institutions have market leading customer satisfaction and highly competitive pricing, they provide the full range of banking products and services, home loans, credit cards, personal loans, transaction accounts and term deposits, but what they don't have is a level playing field. That is why we have welcomed this inquiry and we are hopeful that it will recommend further action to promote competition and choice in the retail banking market.

Our sector has four million customers, total assets of around $106 billion, about 10 per cent of household retail deposits and about five per cent of the home loan market. We have got a strong track record and significant potential to increase competitive pressure and innovation in retail banking but we need a fairer regulatory framework. We look forward to working with this inquiry on improving that framework and measures to empower customers to find the best deal and their best banking services provider.

The Government's position as noted by the Treasurer in a recent speech in Parliament, is that the banking sector is an oligopoly and the largest banks have significant pricing power which they have used to the detriment of everyday Australians. He has also observed that the banking system is highly concentrated and that the major banks would benefit from a regulatory system, including mortgage risk rate settings, that has helped embed their dominant position.

So COBA thinks there are a significant number of areas that we would encourage the Commission to consider, some of which have been raised by our colleagues from the regional banks already. They include the impact of the implicit guarantee on competition, the regulatory advantage gained by the largest institutions in APRA's capital framework, the need for customer owned ADIs to be able to raise capital to compete more effectively, and the need for APRA to be required to consider competition as an explicit secondary objective in addition to its primary objectives of financial safety and stability.

As has been mentioned by my colleagues there is now widespread acceptance that the major banks unfairly benefit from the implicit guarantee and that gives them a significant cost advantage. That cost advantage is getting worse, with one of the major credit rating agencies recently increasing the benefit obtained by the major banks. This advantage is significant and is far higher than the Government's recently announced major bank levy.

The major banks are also gifted in other funding cost advantage by the regulatory framework because they are permitted to calculate their own risk rates for the amount of regulatory capital they hold against mortgages. This means that those banks hold much less regulatory capital compared to their smaller competitors and that problem is magnified for the very highest quality mortgages, low risk, very low loan to value ratio mortgages. So, in our view, it's a win-win for the major banks, they hold less capital against loans and they pay less for their debt.

Customer owned ADIs raise most of their capital through retained earnings and have limited access to additional forms of capital. This limits our competitiveness and our ability to make strategic investments in a range of areas, including investment in technology. The Government is currently conducting a separate inquiry process to look at capital raising for mutual and cooperative institutions in Australia, not just in the banking sector, and we are working with APRA to develop CET1 capital options for customer banking institutions.

In our view, if there is a genuine commitment to competition, this issue must be resolved as a priority. Regulators need to give more consideration also to the impact of competition on their decisions, the risk rates are an excellent example, but another includes APRA's implementation of its prudential crackdown on investor lending. As has been mentioned by my peers, that cap has entrenched the margin of a bank's market position and undermined competition. Investor lending made up almost 40 per cent of the major bank's home loan portfolios, almost double the proportion of that lending in our sector. There is an issue with the competition and this decision simply embeds the existing problem.

Our sector has got a really strong record of prudent lending and we support APRA's efforts to promote sound lending standards, but this blanket investor lending intervention has harmed our competitive position and enabled the major banks to re-price their investor loan portfolios without fear of losing market share, increasing their profits and further entrenching their dominance.

We think that future problems of this kind could be avoided or minimised if APRA's legislative mandate was changed to include an explicit secondary competition objective. This would require APRA to think more about the impact of competition in pursuing its primary objectives of financial safety and stability, and to be more accountable by reporting annually against that secondary competition objective.

My members of the Customer Owned Banking institutions are nimble and closer to their customers than their larger competitors, they don't have the same economies of scales to keep costs down. Our members often use aggregated structures to achieve scale and are frequently at the forefront of implementing technology innovations for their customers. However, the costs of regulatory compliance are more difficult to mitigate and involve basic fixed costs that larger entities can spread over a much larger asset base. Increasing the focus of regulators and policy-makers on the impact of regulatory compliance costs, and minimising those costs where possible, will promote competition.

Finally, COBA welcomes the Government's announcement that will introduce an open banking regime to increase access to banking product and customer data by consumers and third parties. We support policies that benefit consumers and allow them to find banking products better suited to their needs. Open banking will allow COBA members to offer new services, like tools for their customers to better manage their finances.

However, if participation in open banking is mandatory, and if the implementation timetable is too aggressive, it could harm competition by imposing unacceptable costs on small players, to the detriment of their customers. The same arguments would apply to mandating participation in comprehensive credit reporting and demonstrate why it is critical that competition must be a significant consideration in the determination of the regulatory framework.

I'll just close by noting that often the promotion of competition is portrayed as a threat to stability. Those who promote this idea are the institutions that have a vested interest in maintaining the banking oligopoly. Fairer sustainable competition and financial stability are complimentary aims. A more diverse banking sector will strengthen the resilience of the system and deliver better outcomes for consumers. There is a problem with the way competition in banking works in this country, the only question is what we as a community are prepared to do about it.

Thanks very much for the opportunity to be here, I look forward to the questions.

MR HARRIS: Thanks very much for your time as well. Also, indeed everybody for making the time to come along here today and help us kick this thing off. I think the way we've been doing the roundtables is pretty much that we will ask a few questions, but it becomes a generic, almost free-for-all for response, so anybody who wants to should jump in.

The hardest thing in all of your presentations to directly address, it seems to me in a way, is this cost of capital advantage that has been referred to. Because in a sense, am I wrong in thinking it is a natural feature of the market as well as an advantage that the largest institutions have the greatest access to capital raising. Now, you have referred to Basel II in particular which goes back a way now and we've got Basel III coming along and that sort of thing, and so I can sort of understand a question about holding capital against risk, but there is a natural advantage here in the marketplace in any event, isn't there, or am I wrong on that?

MR HIRST: Maybe if I could have a crack at that to start with. So I think there is a couple of things to draw out of that. The first is to look at the history of Basel II and how it was implemented in Australia. The reality is that in about 2001 or 2002 when it was first discussed with an implementation period of about four years, so I think the majors were accredited in 2006, 2007.

APRA made it very clear to everybody other than the majors and Macquarie that they wouldn't be able to accredit everybody in the industry so they just didn't have the resources to do it so basically said, we're going to do the majors and then once that's done you guys can think about it. The resourcing is one issue, there was concerns in there about whether or not we had the data to be able to actually do it. But even if we wanted to do it we couldn't because it just wasn't able to get done in that period.

So, the assurance that was given at the time was we shouldn't worry too much about that because we'll make sure, through capital overloads and other things, that the amount of capital in the system will stay the same, and effectively, that did happen. What they didn't anticipate though was the swing away from the high risk way, that sense of business loans and SME, to housing in the increasing leverage and profitability that that drove. So even though the amount of capital might have stayed the same, the amount of leverage increased dramatically, which increased the returns.

So that brings you to the point about, well, is there an advantage in capital anyway that is naturally there because of the size of those organisations. To some extent, the answer to that is, well, yes, there is an advantage as there is with size in many things, however the difference in leverage driven by the risk weights means the returns on capital available to us versus the majors are different and can't be breached. So, in a way, the unnatural implement of Basel II turned into a significantly greater advantage in terms of capital than had been intended, which has then led to higher returns, which has put us in the position that we're in.

So, yes, there are certainly advantages in being larger, in fact you could even say the reason they had to get accredited was because they were larger. But there's some systemic issues that wouldn't occur in other industries around capital access with those two qualities.

MR SUTTON: I think it's a good way to put it, in a really simple example, in our case our ROE is 9.8 per cent, the Australian banks, the big four, are averaging around 14 per cent.

MR HARRIS: Fourteen, yes.

MR SUTTON: So if you go back to the time that Mike was talking about when Basel II was first introduced there were some portfolios, mortgage portfolios, that had a capital weighing of six per cent or even less. Now, we're a standardised bank, and sure, we would always aspire to get to advanced accreditation over time, but we are putting aside $3.50 and others – during that period, the capital weighing was so low, and if I'm lending you the money you've got the same probability to default, all it is is basically a view on the systems and risk systems.

A lot of those risk systems were shown to be very poor during the GFC when a number of very large banks that had mortgage portfolios in the US and the UK blew up. So what you did see is that the big banks, because of those significant capital weighting advantages they had piled into mortgages.

MR McPHEE: I think a good question to ask APRA is how often did the risk weighted system indicate that the banks tended to hold more capital? Because my understanding is that that was very rare, they continued to show that the more detailed the modelling the less capital the banks needed to hold.

So I think that's just a good sense check and the point that John makes is, at the end of the day, we're all regulated by the same regulator, we're all operating in the same jurisdiction, Australia, we're all lending on the same assets, housing, to broadly across the population, but one model says you should hold, sort of currently they say 25 per cent of capital, or under advanced models 18 per cent, 17, 18 per cent of capital with a standard model, the rest of us are holding an average of around 39 per cent of capital, there's your issue.

I mean why is it on that ratio when we're in the same market, to the same regulator, on the same asset class, I mean that's the real question I think that we're putting back, and it's created by a regulatory framework, not a business framework. I think the point was made, I mean if the banks build scale, and there's advantage of that scale, then that advantage should accrue back to the business. This one has been provided by regulatory mismanagement.

MR CARTER: I think maybe the other way to think about it is separate the cost of equity which would make scale from the return on equity. Very simplistically, if there's $10 return on offer for a loan, maybe if you're large you can make $11 because of your funding benefit for being big, that's great, but if the capital was a universal $100 it would be 10 per cent return versus 11. But the point that's being made is the capital is not a universal $100, it's $100 for some and $50 for others. The differential is 10 per cent versus 20 per cent.

When things get tight in competition, 10 per cent is a pretty tough threshold to fall below to still attract capital in any industry. So it doesn't require much of a squeeze on the return for the non-advanced banks to find themselves in a challenging position to compete for those very good quality home loans.

MR KING: Can I sort of follow-up on this because I understand when the rules of Basel II were introduced, I understand the issues there and how that, in a sense, set the playing field out of kilter. I would like to understand more, and maybe funding as you mentioned, Mark, the issue of the capital required to get the advanced standing, to get on the individualised rather than the standard risk weights. That presumably can just be done by a capital investment and investment in your risk systems, or is it more than that, and then what is the barrier there?

MR SUTTON: I think all of us have all had individual experiences, and the Bank of Queensland doesn't have an overt program of work to get the advanced accreditation but we're doing a lot of the foundational work. In a previous life at other institutions I've been through advanced accreditation but the bar had been continuously moved higher each time I'd been involved in an advanced accreditation program.

There are incentives provided by the regulator to get a partial accreditation, but in some circumstances – and the others are probably better qualified to talk about recent experience – the bar does move around and it does get higher.

I think, philosophically, you've got to ask yourself, going back to Basel II days when the big four got their advanced accreditations, and then we had the GFC, did all those models perform as they thought they would perform. You can quite easily argue that, particularly on the UK experience, that just did not happen, and that was a combination of liquidity and that was a combination of poor credit underwriting standards that led to some of those failures.

MR HIRST: So I think there is an opportunity for all of us, perhaps not all of us, but certainly for middle ranging ones, to move to that advanced accreditation piece.

MR KING: There are benefits in that.

MR HIRST: It is a significant effort in terms of time and money, and I think John had made a very good point, that the bar continues to shift. So obviously with the majors having this and been doing it for 10 years, they are getting better and better at improving the systems as they go through, whereas we are coming to it fresh, but I think being held to the same level as where the majors are at after 10 years of use, it makes it difficult to get to that point.

The second thing I'd say though is that I would question whether or not the regulator is taking advantage of the option it has within the prudential standards to change that level, or that bar, the height of that bar, relative to the complexity of the businesses that have been accredited. So, clearly, we are far less complex than a major bank, we don't have half the risk that they do around corporate finance and financial markets and a whole lot of systems.

MR McPHEE: Operating on the floor.

MR HIRST: Yes. But I don't get the feeling that there is any variance being applied around that complexity, despite the fact that the Basel rules allow for that to happen.

MR McPHEE: The one other thing I just would add is that we have constantly, as a group, said that we're okay that there's a differential between the standard model and the advanced model, as in there should be some incentive to invest in your risk management capability. It's just what is that advantage, and our collective belief is as I've just quoted back to what we've put into the Financial System Inquiry, is that gap is just far too great and needs to be narrowed and should be narrowed.

MR DEGOTARDI: Absolutely, and from our members' view, and some of my members are considerably smaller than the banks around the table here today and will never be in a position to move to an IRB system, nor would argue do they need to, they have very, very simple balance sheets. For that same reason, you need to narrow that gap between where it was, Murray made that observation in his inquiry report, APRA moved to put a floor into the IRB risk weights. But still, and APRA has acknowledged, yes, that was a temporary measure and so that gap needs to narrow further.

Some of our members, some of my members, have never taken a loss on their home lending in their history, so the notion that they are somehow unable to manage their risks or need to hold more capital against those loan portfolios, for very obvious reasons, rubs them up pretty much the wrong way.

MR HARRIS: So if the problem, at its heart, is the standards that you might aspire to to reduce this gap are ones where the regulator would like you to move to a higher standard of effectiveness, or I don't know if that's not the right term but you know what I mean, in managing risk, is that just a cost problem or is it actually a systems problem as well? In other words, is there something aside from simply investing in a better risk management arrangements that prevents this happening?

MR SUTTON: I would argue it's not necessarily better risk management arrangements, we're not advanced accredited and we are running very sophisticated systems, we actually have our models, arguably they are models as good as anybody else's. We run the same sorts of processes throughout the bank as what you'd find at a big four bank in terms of mortgage management.

What it is, there is no doubt that there is considerable cost to getting an advanced accreditation, the timetable is indefinite when you deal with the regulator, it can be quite opaque at times. I do believe that, to Mike's comment, that we are probably being held to a standard that is held at a much higher level for a less sophisticated business. Our business is pretty simple, we've got mortgages and we do small business loans and we're not corporate finance, we're not vertically integrated, we don't have brokers, we don't do financial planning, we don't have all of those sorts of things.

So I do believe that there is always a benefit for improving your risk systems and part of what you do under advanced accreditation and you have operational risk and you have market risk and you have all sorts of different aspects to that, but it is a cost and it does take considerable amounts of time, but there is a huge gap between advanced and standardised.

I feel that, at times over the last few years, that that directs a lot of lending into the mortgage market, and you've got this huge SME market which is powering the Australia economy, the Australian economy is making a significant transition. If I take one of my businesses at the moment, it's leasing, it's a hundred per cent risk weighted. Our leasing book, average size typical for leasing is $80,000 to $90,000, it's basically to trucks, to supply capital to small businesses that go about their – they are creating jobs every day in the Australian economy. Advanced accredited banks are at 75 per cent for that particular product.

So if I could be at 75 per cent I could actually be a bit more competitive and grow a little bit more market share in that. That's an example of how I would think about it.

MR CARTER: So we're fairly well-advanced on that journey. So to answer, yes, it is a big investment. I would say I'd like place on the record, APRA is a very good, constructive regulator and deserves a lot of credit for why this system went through the GFC in reasonable way.

But it is a significant investment, and not just of money, though it is a big financial investment. It is a big investment of time, so it's a multi-year program of work, it is a significant investment in acquisition of data in changing, and that can be a little bit more challenging if you're a smaller bank who doesn't play in all segments of the market for long periods of time because you need longitudinal data as well as today's volume of current data.

That is where some of the tension arises, so I suspect in modelling mortgage performance it's relatively generic because my risk is the same whether my loan comes from one of five or six or 10 different banks. Where it gets more challenging is once you have to move outside of basic mortgages and you have to bring in the depth and breadth of data that a smaller player may not have access to. We as an organisation feel very strongly that we have benefitted from the work we have done to become a stronger bank in terms of risk management systems and processes and practices, it's been borne out in our financial results.

It does feel that it is more challenging to achieve that outcome though to be officially accredited than maybe it once was. So we are certainly very pleased with having invested in it, but it does seem difficult to try and get to that final bar.

MR HARRIS: Just one further comment on this, so that's it's to try and get this, effectively, in my head. Because in a public policy sense, challenging the regulator over the risk weights that it chooses to apply is a big call. But addressing directly the cost of getting to satisfy those weights is less of a big call.

But given we are public policy design people, that's what we do, I'm just trying to work out what the target is and, conceptually, it looks to me like if – therefore that's why I was trying to get that on the record, it is not just money, it is time and it is data and therefore there's a big, non-dollar investment, but if a substantial part of it is cost then there are ways in our economic system where we assist people with bridging the gap and costs that may apply with different tax advantages, for example, when making investment and things like that.

That's not unheard of, it's not necessarily considered to be first best kind of public policy making, but if there is no other way of addressing that, a cost issue, then you do need those sorts of things. That's what I was trying to work out whether – which this is the purpose of having these roundtables, is to find out where should be go and look.

The question is, should we go and look at the cost for you of meeting that higher standard of accreditation, or is that in fact likely to lead us to only discover that it's much more than cost and therefore it isn't really a productive place to go.

MR CARTER: In my view, in our view, the time is almost the greater cost. In an environment where, in our day-to-day business activity, it is very competitive in the trenches for the business that we're actually all able to compete for without us choosing to go into what, for us, would be riskier segment, which would be corporate, multi-national lending, because we don't have that capability today, that's why we don't do it.

So if it's three to four years for someone who starts today on that journey, it may not be that taxpayer assistance, financially, will help with the competition aspects that you are seeking to look at.

MR McPHEE: I would say that - - -

MR HIRST: Sorry, Jamie. I think one of the areas though is around the approach of the regulator – and I agree with David, the regulator has done a terrific job, et cetera, et cetera, but I think the different between when the majors are accredited and when everyone else is trying to accredit now, actually the regulator was keen for those people to be accredited and that seemed to enable them all to get accredited at the same time and they went across the line together, et cetera, et cetera.

Now that that has been done it's very much a, well, you can give it a shot if you want, but see how it goes, it is a little bit of a black box in terms of what you're trying to do, you're trying to guess where you get to. I think if there was a more prescribed approach for people to follow then that would certainly assist in being able to get it done. Because one of the systemic issues you talk about is this is a very specific area of knowledge and there is only handfuls of people that work in this space, they're all at the major banks.

MR McPHEE: So, Peter, if I summarise, you say where to look, I think what we're saying is time, cost, data, it's a bit opaque and the benchmark has been increased since 2006/2007. I would say if you're trying to find where to look, I reckon they're the five areas. Is that fair?

MR HARRIS: It's useful to know, to get it summarised.

MR McPHEE: I know we requested tariffs so you can actually – because then - - -

MR HARRIS: Because then we've got targets.

MR McPHEE: Yes, and clearly we're having these conversations with the regulator too about what is the right risk ratings, and that's obviously the conversation with APRA so I completely understand why that's a bigger challenge from this committee's perspective, I completely understand.

MR HARRIS: We don't resile from that, it's just that we're just trying to compare the two and say, this one [is the] path of lesser resistance.

MR McPHEE: No, the point is well made, yes.

MR DEGOTARDI: Look, we actually support what has been said in terms of making it more simple, some of my larger members, at some stage, will want to be looking at this as an option for them. But many of my smaller members will never go to IRB so can I ask you to not take the competitive issue off the table when talking about risk weights with the regulators because we've got to do both, you have to address both of those issues.

MR HARRIS: I was really just going through the four basic points which then became three points and dealing with what seemed a larger and most consistent to everybody and just trying to think, well, where do we go.

MR DEGOTARDI: In terms of data load, many of my smaller members will never have that data to enable either accreditation.

MR KING: Can I just follow-up, just in the sense of how far you go down a path and which path you want to follow. I mean one of the things I always find useful, is there anywhere we can say, well, look, under the Basel II set of frameworks, different countries implement it through their regulators in a different way, is there anywhere we can say, well, look, APRA has gone down a certain path, but can you have a look at Canada or Norway or somewhere else and sort of say they've actually done it in a slightly better way, and if you look at that outcome it's been more of that level playing field.

MR SUTTON: I think that's a really interesting question and part of that, part of why that doesn't sort of get a lot of prominence is the fact too that, systemically, Australia imports significant amounts.

MR KING: Wholesale fundings.

MR SUTTON: Wholesale fundings. So if I'm talking to an investor in Asia, they still can't wrap their mind around the fact that since Federation, that we have been importing 25 per cent. Then if you go across to the UK they've probably gone the other way and significantly tightened up on everything to the point of where there is not a great deal of competition, and in fact there is probably capital being staffed to businesses to actually fund themselves.

MR McPHEE: Do you know, Mike, or you're a fair way down this path yourself, David, where there's other jurisdictions that have done it differently?

MR HIRST: There's some nuances to the Canadian system that are helpful for small players, but other than that I must admit I am not looking for it, not in any - - -

MR CARTER: I think each country, or each major, mature banking jurisdiction has done things so differently from each other and from the broad principles in Basel to actually add height, another comparable one with enough consistency in other things where you go, yes, this is a comparable system unfortunately.

MR SUTTON: Harmonisation has been very fraught.

MR CARTER: Yes. The Canadian Government, effectively, guarantees all higher risk mortgages in a way and gives people a zero risk weighting if they're insured by the Government insurer. We simply just don't have that model here, for example.

MR HARRIS: Julie, do you have anything?

MS ABRAMSON: Yes, I wanted to change the topic if I may and ask you about the demand side, or in other words the customers. ASIC said to us this morning that 50 per cent of customers are with the bank that they first started with so I'm interested on your views about why, given the nature of your business models, why people don't switch and what are some of the things that we might look at which would open up the ability of customers to switch. So I'm happy to start wherever.

MR DEGOTARDI: I'm happy to start. Look, lack of awareness in terms of our sector is certainly a problem, that's an issue that we continue to address and that is our responsibility. But we have certainly done research internally that indicates about one in three customers think about switching and about one in 10 of those who think about it actually do, so that is a problem. The reasons that they put up to us is, in that research, indicate first of all they think it's too hard, and secondly, they're not convinced that there is any difference between all the institutions on offer.

So that is a fundamental lack of awareness and I would say an issue around financial literacy in the community, the fact that they simply don't understand many of the institutions in this room, and certainly my members, are offering products at substantial discounts to what is on offer from the major banks. I mean take a credit card for instance, our members offer credit cards approximately five per cent lower than the average of the four major banks and yet it's not a significant product line for me. I don't understand why someone would take a credit card at 16 when they could have one at 11 or 10 or less. But that is an issue for us.

Now, that obviously raises the question of what can we do to make switching more easy, and there has been a couple of attempts at this, I would say that they have been helpful without being fabulous, and at the moment it is certainly easier to switch than it used to be. But it's also important that I think people understand that, they think of switching, about there's my gym membership, there's my health fund payments, and yes, if you want to switch your main transaction account all of those things have to be dealt with, but you can switch your credit card or you can switch your mortgage pretty easily in the marketplace, and people do.

So I think you've actually got to be a bit more sophisticated in looking at that data and say, well, where are they switching, what are they switching, and draw the distinction between switching main financial relationship transaction accounts versus the range of other products you might have, and see if there is differences in those product sets.

MR SUTTON: I actually am not privy to what that piece of research that ASIC had done, but in my 22 years of banking I've never seen more intense competition, say in the mortgage market, and what you are seeing in consumer behaviour, particularly around certain products, is that there is a greater propensity to switch. So the mortgage market, certainly with the advent of brokers, and brokers certainly understand their customers very well, but they know that every three years there's different sort of honeymoon products or discounted products out on offer for different customers, that there is a challenge to switch.

You're certainly seeing lots of switching on products, whether it's credit cards or mortgages, traditional savings accounts with all of the debits and credits is probably less so. But from my perspective, in competition day-to-day, there is intense competition, particularly across some of those retail products, and key products such as mortgages where there's a lot of switching.

MR HIRST: I think all that is true, but I think at the most basic level, people just aren't engaged with their banking. I mean not too many people jump out of bed in the morning and go, you beauty, I'm going to do my banking today, and unless they get to a point where there's a moment of friction or frustration or whatever, they really don't have the motivation to make that change. Switching is much easier today than what it has been in the past, once the New Payments Platform comes in it will be even easier again.

So I think if someone is dedicated to doing it they can do it pretty easily, and with the exception of perhaps mortgages or lending where there's going to be costs associated with making that move, there's nothing stopping you from doing it. The clearing house that we have operating looks after all direct debits and direct credits, et cetera, it's fair to say that some people don't adhere to the timetables that they should that is associated with that, and in fact I have a sneaking suspicion they use that time to try and retain the customer if they can. But, by and large, it's a motivation issue.

MR CARTER: I think each of the businesses represented around this table all consistently have higher customer satisfaction and higher net promoted scores.

MS ABRAMSON: I thought someone might say that.

MR CARTER: So I think to Mike's point, people aren't thinking about doing this all of the time. I did hear the ASIC in fact this morning, but I'm unclear what the benchmark should be, I'm not sure how many people are actually interested in switching, I know that some people think about it, but it's not for lack of satisfaction or net promoted, people being advocates of the smaller players. Perhaps the other way of thinking about it, I think negative towards the larger players, they consistently have the least satisfaction, so is something else playing, whether people just really need something material.

The one segment of the market where there is a higher incidence of switching, a higher propensity, is the mortgage market and also in small business lending. That's where, again, without wanting to go back to where we've spent some time already, that ability to compete fairly and squarely in the lending market, where risk weights are a factor and too big to fail funding costs are a factor, which is mortgages and small business secured by a home, becomes quite important for enabling that sector of the market to be more competitive.

MR McPHEE: I suppose too, from our perspective, how we look at it internally, if you've got to create a benefit that overcomes the friction or the hassles of switching, that the consumer then says it's in their better interests to do so. So there's two way, you could remove the hassle of switching or making it as easy as practical, and increase the benefit. We look at trying to do both.

The ex-chairman of the bank, Bernie Fraser, there was obviously the review done on switching and making that easier, I share Mike’s view, I think it would be great to have it quite prescriptive and actually have people have to operate inside that and make the community aware that it’s not as big an issue as it can be.

So that sort of removes the friction part and I think that’s up to all of us to build into the customer value proposition part and what are those products and services or those ancillary benefits that you build into whatever offering it may be that actually then gives that individual consumer the motivation to make the effort to go and switch. Because I’m with Mike, I’m yet to say to my kids, come on kids, let’s have a ripper day today, let’s go and do some family banking together, that hasn’t happened in my family.

MR HIRST: My family left because I tried to.

MR KING: Can I just follow-up on that because there are a couple of things there I want to know, I guess two in mortgages. Because a couple of you, in your introductory comments, mentioned the vertical integration there for the majors and the mortgage brokers and we understand that where that integration occurs, the parent company tends to get a fair bit of business opportunity including the right labelling of products, so I’d be interested in getting more feedback on how that affects the market, whether that vertical integration is an annoyance or it’s really affecting competition.

Then I think there was a statement that competition is pretty intense in the mortgage market. So I’d like to understand what we’re seeing there, is it that the majors are – it’s sort of two separate markets where the majors are competing very hard with each other at one level, you guys are competing hard with each other but it’s sort of for a different customer, or is it the case that, from your perspective, the majors are competing hard but they compete up to you guys, so they get such a good return on equity.

MR SUTTON: Two questions, so maybe I’ll deal with those two questions. Upfront brokers can play an important, incredibly important, role, they provide consumers with a choice. It’s how they provide that choice that I’m worried about and it’s also the transparency of the choice, particularly when they are bank-owned.

So at the moment it is pretty difficult to see, if you get a loan from a major bank that owns a broker, that that major bank is powering that loan. So if you think about choice and the consumer being informed, perhaps that needs to be upfront, on the piece of paper, that says we are owned by such and such institution and this loan that we’re recommending comes from this institution. So that’s the first thing.

I think, in terms of competition for mortgages, we’re out there competing with everyone around this table and the four majors. What you want to be careful of is that you don’t end up with disproportionate outcomes over time, so where you find that it can quite easily happen, at the moment with the macroprudentials, so everybody is chasing owner-occupier, 80 per cent LVR or lower, or 60 LVR, you will find risk-based pricing coming into the market really, really quickly, it’s starting to evolve as we speak.

But if you're a big bank and that particular risk weighting is at less than 25 per cent and I'm at 30, 40 per cent, they decide that they want to go after that market, they can literally pretty much just blow us all out of the water here.

MR HIRST: Well, I think the way to think about it is, majors have got more than 80 per cent of the market, if we're wanting to grow our businesses we've got to be competing against them, simple as that. In terms of competing up or competing down, we all have our different value propositions which I'm sure we all think we can charge a little bit more for because we're providing different value and that comes through in the customer satisfaction and the advocacy and other things, but that differential isn't enough to make a difference on pricing in terms of return. So where you were going with do they compete up to you or do you compete down to them, we compete at about the same level because we've got to be competitive, it's just the returns that are different.

MR McPHEE: Yes, that's right.

MR HIRST: We get 10 and they get 15.

MR McPHEE: That's right, outplays itself.

MR CARTER: What we'd observe on new business pricing is that typically, at the published rates anyway, the main brand of the majors tends to advertise a higher rate than smaller banks, but the regional brand of the majors tends to be priced on both deposits and loans at around about the same price point. In the broker market which is less transparent, it's not advertised. We tend to find, for the higher quality mortgages, that brokers are able to obtain some very good pricing, they can from us, they can from the majors.

So I think mortgage pricing competition is intense at the moment. I agree with some of the comments made, I just want to state a different point of view, but mainly by Mr Byres when he was here earlier, that some of the lending standards were being used as a basis for competition, we modified a lot of our standards and tightened them up, became more conservative and we watched a lot of business not come our way for a period of time

MR SUTTON: We were exactly the same.

MR KING: That is at close 2008?

MR CARTER: Yes. So again, certainly the regulator has been active in talking to people behind closed doors, it's been surprising how long some have taken to adjust. The tension for us in the mortgage market, 100 per cent of the mortgage market, 40 per cent of today's investor, we are all constrained with the growth cap of 10 per cent, even if you wanted to refinance someone else's existing loan, so not add to the stock of investor lending, you just want to keep it neutral, you are constrained by growing your own book by 10 per cent.

So you've got 85 per cent of the market, if those customers aren't happy they can't come to the other 15 in droves because none of us can write it, we can only write up to 10 per cent greater than where we were a year ago. You're then left with the balance, which is 60 per cent of the market, take off the interest only component of owner-occupiers, and they are maybe about 50 per cent of the market, that is where the intense competition is at the moment.

Capital advantage on low loan to value ratio mortgages with good quality borrowers is where the action is in terms of competition, it's very, very sensitive to competition.

MR McPHEE: Stephen, if I could just add, just on a couple of points Stephen said. I'm in the camp that we all compete in the same market, there's not this we're competing in one level and they're competing another, and I'm just so endorsing Mike's point, it just plays itself out in return, a 9 per cent return, an average of a 9 per cent return compared to an average of 14 per cent return, that's how you're seeing that play out.

The second point about the brokers is that the broker market is now 53 per cent of the mortgage distribution so it's clearly a significant portion of the market. So my test is just go and look at who owns which aggregated group and just go and look at the flows, because then you can just have a database, but that's just a facts-based discussion, it's not subjective. If more flow flows through to the banks products who own that aggregated group, then why is only CBA better here but NAB better here and someone else better there, so I would just say that is an opportunity to go and just actually get some visibility.

The last point that would be good if we maybe pick up the discussion at some stage is this macroprudential policy that David just alluded to. Because to some degree it's almost mandating current market shares and I think that is a really big issue for competition. One of the things that I would suggest is it's interesting where you've got 80 per cent of the market share and four players, why wouldn't you potentially put certain caps and controls around that. Then as long as it's done appropriately from a risk perspective, et cetera, et cetera, why are you putting the cap on the other 20 per cent of the market.

So the point is, if you can't grow your new business flows of interest only more than 30 per cent, I know Mark mentioned some of his participants started from a much lower base, so by definition they're capped at a lower base, you can't grow your investment rate at more than 10 per cent, et cetera, et cetera. So the more we do about macroprudential policy, I think we all absolutely acknowledge what it's trying to achieve and support its core purpose.

Just a question that I would have, well, my belief, is what it's doing is going some way to mandating current market share going forward. So they would be my observations to your questions.

MR HIRST: I have a slightly different view on that last point though, Jamie, and that is macroprudential intervention or any intervention of that nature by a regulator is intended to be temporary. So they chose the Government guarantee, what we're going through now, et cetera, et cetera. I think one of the aims of any temporary intervention should be that it doesn't disrupt the market during that period, so it should start and end with pretty much the same market dynamics in place.

Otherwise, you get what happened during the GFC where they intervened, didn't think about the market share, and because of the way they intervened it just went up. They would have charged everybody the same price and said no one can grow it more than three per cent, growth of your debt at three per cent, we wouldn't have gone from 75 per cent to 83 per cent.

So I think you've got to be careful about the impact that any regulatory intervention has on the market dynamics, unless it's aimed at changing those market dynamics, which I think is what you're promoting that it should help at changing those market dynamics.

MR McPHEE: Yes, well, I'm going back to you've got an oligopoly and because the market dynamic has changed out from say 65 per cent to 80 per cent during the GFC, I mean how do you, to some degree, revert that more to what I'd call – which is more aligned with other jurisdictions, so outside Canada, that's all my point is.

MR HIRST: I think the other thing is, thinking about the mortgage base which is probably the most contested presence in the market. I think there are some things that could be looked at there from a system-wide point of view that would assist the smaller players in terms of their costs and other things. That, for instance, would be something like a standardised mortgage.

So when I started in banking in – a long time ago, nearly 40 years ago, if you wrote a loan, the mortgage, you'd go to the cupboard, you'd get out a pre-printed form, you'd put the person's name in it, you'd put the volume and folio number of the land in it, everyone would sign it and everyone had the same mortgage.

If we, as an industry, could agree a standard mortgage for everybody, and what do you reckon, 80 per cent of mortgages are pretty stock-standard, then you could actually set it up as a register rather than what it is today, which every time you swap you've got to do a new mortgage, et cetera, et cetera, if you just had that one mortgage, someone signs it once when they get their first loan, when they want to swap you just cross out Bendigo and you put in Suncorp, it just acts like a register, like Austraclear or the Stock Exchange or whatever. The cost savings, to not just the banks but to consumers, would be enormous.

MR SUTTON: I mean technology will change a lot of that over time, I mean if you think about blockchain and things like that, blockchain could have enormous profound changes in the way you do securitisation, in the way that – even to Mike's point on s registry of mortgages and those sort of things, we're probably some way away from that technology, but that could be quite profound.

MR HIRST: The first thing we've got to do is just agree a standard mortgage, that would probably help, wouldn't it.

UNIDENTIFIED SPEAKER: Yes, that's right.

MS ABRAMSON: Well, just picking up that point, how much of a percentage of the mortgage market is what you would call a vanilla mortgage, so that type of solution or how much, I mean in small business the mortgages are going to be different because they're going to be bespoke and held against other assets?

MR HIRST: Maybe. A lot of small business is actually funded by residential housing. So if you take residential housing as the only – or a loan for residential housing as the only piece of security and ignore what the purpose is, what do you reckon, 80 per cent (indistinct)?

MR CARTER: Easy. I'm not quite the veteran Mike is, but nearly. But we had two documents, one was a registered mortgage and the other was a registered guarantee mortgage and that would cater for 99 per cent of what we do, where the guarantee mortgage is where the borrower is not necessarily the owner of the property, which you often find in small business because assets are being protected to some degree.

So the mortgage itself over a residential house is the same thing, it's the terms and conditions, maybe in a small business it's harder to have, although we are being encouraged to do so as a result of the Carnell Inquiry. But residential consumer credit laws are universal so it's actually hard to differentiate too much, so it should be quite easy to standardise.

MS ABRAMSON: Can I ask a point about small business lending, and I don't want you to think I haven't listened very carefully to what you've all said before about risk weighting, et cetera, but how competitive do you think the small business lending market is, because we hear a lot, anecdotally, about, well, it's hard to get a loan, blah, blah, blah, blah, so I'm just interested in what your experiences are?

MR SUTTON: I think from our experience it's small lending secured by residential, it's very competitive. Probably the area where it varies significantly is probably just straight cash flow lending, and that's really down to individual institutions' risk appetites. But from my perspective, at the SME part of the world, it's pretty competitive out there if it's secured by a residential mortgage.

MR CARTER: Yes, I tend to agree and I would suggest sometimes the feedback people give is because they're not sufficient creditworthy to obtain the loan as opposed to there isn't enough. I mean I actually think the small business market at the moment, because it tends to come with good deposit balances, which is important for the regulatory settings that start from January, as well as lending, I think that is almost equal to owner-occupied home loans at the moment in terms of intensity of competition.

I do wonder whether the middle business market and the corporate market is getting the access to credit it needs to really grow and invest into the economy because there is so much of the capital of this system that is being directed at home loans and small business lending in recent times.

MR HIRST: That's right. I think the major complaint in small business isn't that they can't necessarily get the finance, although that might be true in the property development space, the major complaint is around service, ongoing service, and can they get to talk to the people who make decision, and can they get service at the level they want, how much access have they got. But they seem to be the major complaints that I hear.

MR SUTTON: I concur with that.

MS ABRAMSON: So just a very general question, I mean I have my own view but what do you regard as small business, because different banks have different market segmentation?

MR SUTTON: Well, my perspective of it would be just residentially secured, so that, for me, that's small business lending. But if it's cash flow lending you're into another jurisdiction.

MR HIRST: We'd probably look at under two million.

MS ABRAMSON: Sorry, under?

MR HIRST: Two million.

MR CARTER: Yes, I'd be in a very similar place. I think we need to encourage people to think more than just about the lending and think about banking. So I think it's the sophistication and nature of the customer, a small business, to us, would probably have 10 or less employees, often dominated by family members running a fairly – without being disrespectful, relatively unsophisticated businesses, not systems and processes and people, we can picture those types of businesses, and in an lending sense they probably go up to towards $2 million, they might turn over anything up to 10.

MR HARRIS: In the case of mortgage brokers is it true that smaller financial institutions find themselves with less leverage with brokers, it's rumoured that is the case, it's hard to find?

MR SUTTON: I think the way I look at it, there's a couple of things that, over the last few years, which I've found as quite interesting. One in particular, or one, I won't name it, but a mortgage broker, when we approached a mortgage broker and said, "Would you please consider BOQ products on your consideration set as a bank?" we were politely told, no, we're full up, or (2) you need to mature and improve your service standards. Now, obviously we get that so we always are willing towards that, but we were also told that we had to make contributions to IT system changes, which I found rather interesting.

I think that probably the other part, and I think a lot of the other side over the last few years, we certainly could not spend the sorts of money that others would spend, or large institutions would spend in terms of marketing towards some of the brokers. On the other hand though, some of the brokers that we do work with have been incredibly supportive and understand the need to be able to have regional banks or banks such as Bank of Queensland on their panel.

Look, brokers play an incredibly important role in customer choice, and customers choose to deal with brokers and we will always deal with brokers.

MR DEGOTARDI: I think it's an important point to bring out, I mean particularly for small institutions, even smaller than the regional banks here, it's a distribution channel that gives us access that we wouldn't normally have. So many of our members are active users of broker channels for that very reason.

I do think though it's important that consumers know what they're getting and what their service is they're getting from that broker, I think many would feel that they are going to a broker and they're going to have a wide access of lenders and that they're going to get the best possible deal, and I would say that that's not always, certainly not always the case in terms of the breadth of lenders.

Arguably, the ASIC report that was out last month or so would suggest that they're not necessarily getting the best rates in the market and that there is interesting flows of mortgages to businesses that are investors in the broker model. So I think this is a worthy – to your earlier point, Stephen, I would start with that ASIC report and have a bit of a look at the findings there, there may well be reasons for why the flows match up with the investor profiles, but I think it's worthy of exploring. We would certainly hope that consumers are better informed about what they're getting when they approach a broker.

I would actually say that's true of comparison websites too, I think most consumers probably think that a comparison website gives you the best of the best from the entire lending market comparison websites are paid for, and that's not what they do. So I think these are also issues that are worthy of addressing.

MR McPHEE: But I think, from our perspective, completely support complete transparency. However, we re-entered the mortgage broker market back in November 2011 and I've got to be honest, I probably sit in the camp that we haven't found too many hurdles or impediments as to working with that channel to help us distribute our mortgage products. But I would love to see absolute transparency through that vertical integration ownership structure.

MR CARTER: They play an important role for us in interstate origination which helps us diversify our balance sheet, which is an important part of managing the risk geographic diversification important to investors, important to the regulator, important to me as the accountable person for the balance sheet.

So the industry average is about 53 per cent originated through brokers, you will find those of the smaller players who were using brokers that number is greater, on average. Certainly, for us, it's more than two-thirds of our new business, partly because two-thirds of the mortgage market in this country is in New South Wales and Victoria and our strongest State is Queensland.

So we tend to find it reasonably easy to work with most brokers and it's a good viable channel for us. We apply the same criteria to the way we think about the credit risk and the assessment of risk, I think that's really important to understand, that they don't present a higher risk, it's your processes that present the risk to you. So if you are universal in your application of them you will achieve the right outcomes in terms of the quality of your book and that customer.

MS ABRAMSON: Can you actually correct me if I'm wrong, but it's a two stage process normally, isn't it, that's the introduction where the broker does the paperwork and then you actually do your own due diligence?

MR CARTER: That's right. ASIC has been very helpful with the responsible lending regulation, just to reinforce that over the last 18 months, that that is our responsibility to assess the credit. So that is exactly the way it lies.

MR SUTTON: We assess a hundred per cent of every one of our mortgages.

MR HARRIS: Now, I wouldn't want to divert too much to the recent application of a banking levy from large institutions, but I did note that a couple of you did make comments on the implied guarantee and there's now, relatively recently, emerged that the levy should appear to be a charge for the guarantee. Now, I'm not going to rest on that, obviously as this inquiry goes on I'm sure there will be many iterative elements to this levy.

But in the sense that the guarantee was raised by some of you as being one of the advantages that large banks had that assisted them, that I didn't want you to comment so much, although I'm happy for you to comment on what or however you would like on the levy, but it is a curiosity then, isn't it, that it appears that the levy is not meant to influence the price of mortgages and yet if it were to offset an advantage that larger institutions have, I would have expected that you would want it to influence the price of mortgages, as in they should go up because we're now paying a levy.

I haven't read anywhere, anyone drawing that linkage, and this is what happens when you get people like us [thinking], banking experts will apply principles from every market and just think, hmm, but if that's the intention, if the levy was intended to offset some of the advantage that comes from a guarantee one assumes it could only do that by actually feeding into the price in the marketplace, but apparently it is not meant to do so.

MR HIRST: No, it can also do it by narrowing the difference in the cost to capital because the returns, their returns could fall down.

MR HARRIS: I can understand the returns argument, the argument would simply be as you have made many times, you've made the difference between costs and returns, but it still is a question then of saying, okay, if the idea is the larger banks will simply see their return on equity fall to a degree as a result of this levy, it's logical. But from our perspective you see, we're in the game of competition and is this actually going to shift competition and tenureship for competition in favour of consumers by saying, yes, how does that happen, it happens through price and quality of service.

So I'm thinking here that a levy may be actually a matter in which, for the purposes of this inquiry, we would be then completely indifferent, do you know what I mean, it would no longer be an issue for us. I'm happy to take things away from this inquiry because there's lots and lots and lots.

MR CARTER: I think there's a couple of elements to it, there's possibly a political answer in part of the question.

MR HARRIS: That's why I've been tap-dancing a little.

MR CARTER: Yes, I'm sure, as probably we will as well.

MR HARRIS: And you should too.

MR CARTER: I think if you look at the maths, around about a third of their funding book is subject to a six point levy, so it's going to translate to three or four basis points across the asset portfolio if it was to be passed on, and you'd have to ask the banks involved whether they have passed it on. I would observe there has been a series of significant interest rate rises for interest only borrowers and investors in the last few weeks, I am not suggesting that's because of the levy because the increases have been much greater than the levy.

MR HIRST: I think, when they've been announced, they have said this is not clerical and it's not - - -

MR CARTER: Yes, it's not because of the levy. So I think it's a question for the five involved as to how they're thinking about it, to Mike's point, and in fairness to the points made by the five concerned, it has to be borne either through a reduction in costs which would mean less people employed, the shareholders receiving a lower return or the customers paying a higher price one way or another, or some sort of combination of those three.

MR HARRIS: But you see my point is, in an inquiry into the nature of competition and the impact on consumers, if the levy were totally absorbed as a reduction in costs then it would have no competitive effect.

MR CARTER: No competitive effect, yes.

MR HIRST: So I think that if you're only interested in competition for consumers, I think given the way that these have been framed to date, you could well say it's got no competitive effect. Does it help with the evening of the playing field, I think it does, because we compete for capital. If it narrows that turn that has been unnatural, then that assists us in that competing for capital. Whether or not you're interested in that side of it?

MR HARRIS: No, no, we obviously are because you have made an allusion to it, I'm just trying to get the linkage established so I know why I would be interested in a levy you see, that's what I'm trying to ascertain here.

MR McPHEE: Yes, so by the way, I'm more than happy not to dance around this and give you exactly what we think about it because we've been pretty much saying it from day dot. But in relation to it, I'd just turn around and come right back to the initial comments that we made in relation to competition, so all we want is competitive neutrality and I would argue that competitive neutrality is fundamental to competition. So where are the areas where competitive neutrality does not exist, remediate those, you've now got a level playing field and allow the competition, or people to get out there and compete.

So I do think it's fundamental to the input into competition. How it plays out, well, that's for the institution, but you can't have someone getting explicit benefit from an implicit guarantee and then have a level playing field that's enabling competition to prosper over the longer term. For me, I just come back to those basic First Principles.

MR KING: Can I just follow-up on something that was said. I just want to check to the degree that it affects the funds and competition in the market for capital, would you expect the bank levy to make it easier for you to access capital or to lower your cost of capital, or is it - - -

MR SUTTON: Well, the unintended consequence we used to play out with the S&P a few weeks ago where, literally what happened, S&P took a view on a systemic risk-building in the Australian economy, and like a rating agency they had many different ways that they construct a company rating and a bank rating, and they downgraded that aspect of the rating for all the banks. But as a consequence of that they actually gave a further notch of support which neutralised that aspect of the downgrading to the big four and Macquarie. So hence they kept their rating as a consequence.

MR KING: And your rating went down.

MR SUTTON: Our rating went down. So how does that amount - - -

MR KING: So your cost to capital is actually the funding.

MR SUTTON: So our cost to funding has increased. Now, how does that play out, it plays out, like all of us that sit around the table, we actually access deposits from middle market customers, so that might be churches, it might be universities or it might be an earner, but because we're now BBB+, therefore the limit that they can ascribe to feeding us money, probably has gone from fixed to something else.

MR CARTER: Just we're not crowing about it, we weren't downgraded, but I just wanted to back up the example that John was using, because we can see the flip of this. I made mention in my opening statement that it's not just the price, it's the accessibility of the funding. So we retained our rating at A+ and we have seen increased inquiry from these customers because there are less people now in that rating space where they can place funds, and because they have got different limits now, that we have now got a pool of issuers who have gone into that lower rating. So it has actually played out that way, and just to support John's comments.

MR HARRIS: Well, that's a perverse effect, what you've described is a reverse effect.

MR SUTTON: Well, I've spent a lot of time, as Mike probably did as well, talking to the head of S&P about that perverse effect, because when you think about it, we are a Queensland based bank, and a lot of the systemic risk that they were referring to was building up in the market, so we did not have a great deal of share in that again, and I was quite perplexed by the decision. Whereas the other rating agencies have just recently reaffirmed our rating at the equivalent rate for where we were before, the equivalent rate, so we have split ratings now. But it's made our – it's made it a little bit more difficult, that's all, but I still compete in the market.

MR McPHEE: Peter, can I just go back to a previous comment that you made in relation to – but if you like effort is absorbed in the bank's costs it does have a competitive impact.

MR HARRIS: Well, I'm asking the question.

MR McPHEE: Yes. So I'm just saying, previously, David made the point about one of the issues of getting to the advanced model was actually resources and I think the point was made that it's very intense, the day-to-day business is very intense, so are these additional resources. So these additional resources, so any bank that's removing – or doesn't have to remove those resources, it's competition playing out a different way, it's not purely, overtly through price but it will flow through to that, but you know for the reason. So I just, shortly, wanted to - - -

MR HARRIS: It's an entirely different way of looking at it but it's still relevant.

MR DEGOTARDI: No, that's all right, Jamie. I guess I would also observe, without following the non-tap dancing lead of Mr McPhee, look, you can't affect the competitive landscape unless you do something to one party or the other. So if a group of institutions have an advantage to affect the competitive landscape, you have to take that advantage away or give a similar advantage to everybody else in the system.

What disturbs me sometimes about the competition debate is we take a very short-term view, so we say, well, if you do this today then tomorrow prices will rise, and we never think about the long-term gain. I think that's one of the things I would hope that this Commission is certainly in the position to be able to do more effectively, and think about the long-term costs of doing nothing in the competitive environment.

I think, Mike, you pointed out earlier, the long-term costs of this, of not doing enough in competition, is that we will have a market of four major banks and not too many others. The long-term risks and costs of that need to be weighed up against some of the transitional issues that might occur when you take away the current competitive advantages. We would certainly like to see that, more sophisticated discussion occur.

MR KING: I'd just like to – still following-up on the exclusive interpretation of the bank levy. If there is an implicit guarantee in there for the majors and for the funding under a too big to fail, would it be a good thing, a bad thing or irrelevant if that was made explicit, with an explicit insurance payment by those banks who are getting that guarantee.

MR McPHEE: So the benefit is explicit, right, because they get a three notch rating improvement from SMP in the standalone credit rating. So everyone argues the nuances of whether it's called explicit or implicit, you know my care factor on that, because the fact is there's an explicit benefit.

So this is what I would do, and I know this view is probably not universally shared in this room. That if the benefit is calculable, and we can calculate a lot of things, if we can calculate advance risk models that we get advanced accreditation, I reckon we could calculate this. So I would calculate it and I actually think, wholesomely, that's what the levy should be charged, over time, to make sure that the unquestionably strong banking system, that is not put at the slightest element of risk.

In my personal view, all that is doing is taking explicit benefit and giving it back to where that benefit is being created, and in this context that is by the taxpayer. But if you want to call it implicit or explicit or, to be honest, some other name, I don't really care, what I do though is that that actual calculation is done and, to me, that is actually what should be charged, because it's explicit in the rating agencies.

Now, the Government could come out and basically say there is no big to fail, there's no D-SIBs and all these sorts of things, but then you've got all the unintended consequences coming from that about this whole system, about an unquestionably strong banking system when we've got such a concentrated banking system in this market. So I think it needs to be - - -

MR KING: I'm not sure anyone would believe (indistinct)

MR McPHEE: Yes, well, that's right. And you know, when push comes to shove, that it's in the better interests of the Australian economy. Ultimately, what is going to happen is that – which I believe as it should. I think the decision made through the GFC, whether it was executed optimally or not I think is questionable, but the way this country got through the GFC was the right thing to do.

MR CARTER: I think maybe there's an analogous item which is called the Committed Liquidity Facility that the Reserve Bank offers all of us and we all put in a bid every year and we all get allocated, and it's a contingent limit, that if liquidity goes bad globally, which is really what it's for, there's a backstop that's fantastic.

We all pay the same fee, and so if you choose to hold a different level of high quality assets you have a lower CLF, good luck to you, you pay a lower fee as an insurance premium. That is not discriminated, based on rating, too big to fail, too small to fail or anything else, it is just the number times the percentage. I think that works very fairly, the taxpayer is being paid an insurance premium for the low probability that it will be called, but the taxpayer has still got to stand behind them, it works quite well.

MR DEGOTARDI: I guess our comment would be if the Government would want to make an explicit guarantee, and I probably concur with Jamie a bit here, it's the most explicitly implicit guarantee I've ever seen, but we would hope that – we would say that to be fair to competition, that has to be accessible to all, price attached to it, sure, but that is accessible to all. Some of the experience we've had as a sector certainly is that some of the facilities of Government and others aren't always accessible to the smallest of our members.

MR KING: On the sort of basis like RBA's liquidity facility where it depends on your loan.

MR DEGOTARDI: As an example.

MR McPHEE: If I extend David's point, and I did say this in the inquiry, that if the three notch rating upgrade is extended to ME Bank, we'll more than gladly pay six basis points.

MR KING: And a bit more.

MR McPHEE: No, I'm actually not being sarcastic, I mean I'm being absolutely legitimate about that.

MR KING: Yes. No, I'm thinking of the analysis today after the levy came in where a few people, a few journalists were saying how much it was worth, and it was worth a lot more than six basis points.

MR CARTER: We fund in the same markets the majors do, one notch behind them, and they are bigger banks, they're very well-run banks and they're very well-known by overseas markets. But the gap that we pay for the same type of funding is greater than six points and some of these guys fund in similar markets to us, it's like they were rating – the gap between them and us is not the same as the gap between us and the majors in those markets. So I think the journalists and the RBA and others have been quite good at coming up with some numbers, and all of them are greater than six points.

MR HIRST: So if we take the time where the Government guarantee was explicit, then it was 75 basis points, so a minimum of 75 basis points.

MR CARTER: That's right, yes.

MR HIRST: Jamie indicated that there wouldn't be universal support for his view in the room, and I'm not one of those supporting. I think that, yes, while the explicit or the implicit guarantee creates a lot of disadvantage and we should try and open things up as much as we can, we also need to have an eye to the broader Australian economy and the role that those banks play in importing capital, et cetera.

The wanting to be very, very precise in how you might muck around with that depending on the impacts that that could have, I'm not sure anyone could foresee where that may or may not end up, and I think there's a lot of risk involved in that.

MR McPHEE: No, so I did caveat mine with that you can't put at risk, the only question is from the banking system, and therefore it would need to be done over time, making sure that that wasn't first. So I have no issue with that as an underlying, a guiding principle.

MR SUTTON: I think the point around this is, when we think about some of these things, is to really get down to what can be the unintended consequences. Australia is in a very unique position in that we have been importing capital for a long, long period of time and so I know it's not for the Productivity Commission to look at, but to get savings rates to match lending rates would go a long way to changing the different dynamics in the banking system as well.

MR HARRIS: It would be a big stretch, I mean to our economy.

MR SUTTON: Well, it is. So therefore, when we talk about a lot of these things around competitive neutrality and all of them, we've put a lot of valid points on the table, but it is also the long-term economic health of the economy as well, we'd need to put that over the top as well.

MR HIRST: But I think one of the reasons that we do import capital is the basic reason for banking, Australia has got more opportunity to invest money than we've got money and so that's what comes in, but it's always been a growth economy and that's the reason.

UNIDENTIFIED SPEAKER: Twenty-five years long.

MR CARTER: We do have a big pool of money, some of which heads offshore to invest in opportunities offshore, in superannuation. That kind of distorts our savings ratios a little bit because that money doesn't get necessarily put to work in funding the machinations of credit markets, but not directly at least.

MR HARRIS: Well, I think I'm at the point where - - -

MR KING: I have one more, sorry.

MR HARRIS: You have one more, we'll keep going. No, you've got time, I'm just making sure.

MR KING: Securitisation, we talked very briefly this morning about the collapse of the mortgage securitisation, how did that affect you all, your institutions, is that an area that was beneficial to you prior to the GFC or another source of competition, and what do you see, if anything, happening in that space and how do you think it will affect competition going forward? So very broad, sorry.

MR CARTER: No, I heard the conversation earlier so I might start, if that's all right. So it's true that 12 to 18 months ago that market lost a lot of liquidity very quickly for a period of time, and I think that was as much about events offshore as it was domestic, so it is a bit sensitive.

Typically, the RMBS issued by smaller players is reasonably dependent on the four major banks buying a share of it and the prudential rules associated with that when they are uncertain or unclear, do affect demand. I think you've seen a bit of that play out and I think there are some ongoing risks for that for those who rely on those bank balance sheets to buy.

We issue into that space, less reliant on those balance sheets perhaps, but we saw that last year where it suddenly dried up. It is quite liquid at the moment, it's actually probably the best it's been in some time. I think it's a very important market. I do think the international perspective on the Australian housing market however, at the moment, is being certainly influenced by regular stories of house price bubbles in Sydney and Melbourne and debt bubbles and things, so whether that sustains or not is a little bit unclear, I think it's a very effective vehicle for those who have less access to global capital markets.

MR DEGOTARDI: Yes. Look, that is probably a good segue to my members. So before the GFC, securitisation for our sector was not a significant part but an important part of the way we, in particular, manage capital requirements. As I said, most of our institutions, pre-GFC, were predominantly raising capital through retained earnings. So the variations in your growth patterns are hard to manage with just a retained earnings as your capital base, securitisation was therefore an immediate and effective tool for capital management.

Like all other institutions that pretty much disappeared at the time of the GFC and really hasn't come back in any significant way for our sector. Some are still having some dealings with the securitisation market, but for us it raises that as it's not the same sort of certain tool that we used to have for capital management and it's one of the reasons now that we are pushing, certainly Government and regulators, for a more effective ability to issue capital into the market, because we need to have greater certainty in that space. It's certainly why we're working on a CET1 capital instrument with both APRA and the Government at the moment.

MR SUTTON: I'd endorse David's comments. It's part of the funding mix that we all – that BOQ uses, and just [through] the experience of the GFC, intimately understand that that market can ebb and flow. Running and having a well-run bank from a capital perspective and being funded, it is part of the funding mix, that's not something we solely rely on, and I think all of us understand that. But to see that market dry up would certainly slow down some of the growth aspirations of the participants.

MR McPHEE: Yes, I totally endorse that with one additional comment, which is just from our perspective where we raise it, is the course with securitisation, it's the assets that get rated rather than the institution. So that gives the availability that lower rated institutions – it's just this whole access to markets and it just increases our access to market.

What does that – to dovetail back into John's point – it just gives you the growth more than if you don't have access to that, knowing that it can only be part of your funding mix and you've got to be very disciplined around making sure that should that market close, it doesn't sort of – it will impact your growth rate as long as it doesn't impact the overall bank, your viability of the bank. I think that's the distinction that I would draw.

MR HARRIS: Okay, good. Done? Anything that we haven't asked you that you would like to still answer? If that's all right, David, because this is just the start, we will be going on and you are on our list as it were, so we will be back in touch with you and your organisations as we keep going. Still, this is very good at this right at the start kind of stage of the inquiry for you to have made the time. I particularly appreciate that chief executives have got a lot of other things to do so it's very good of you to help out in this way, and hopefully we can rely upon further communication perhaps forward of this inquiry.

I think we're going to have a big of a break until we start out with the consumers.

ADJOURNED [1445]

RESUMED [1534]

MR KING: Thank you for coming along. We'll start again, so get the transcript going again. Just continuing the roundtable public hearings. Just a couple of formalities to remind people of before we start again. It is being recorded and there will be a transcript created from this. The objective here is to have the invited participants give their views and so on, so for other audience members who might wish to put their views, if they can refrain in this hearing, there will be plenty of other times of consultation during the inquiry process, but this isn't the time, other than for the invited participants.

For anyone from the media who is here, we're happy with social media, so if you want to Tweet or whatever happens on social media, I'm a Luddite, I have no Twitter account or anything, so you can do all of that stuff. If you wish to take video though, please, ask permission, not from our perspective, it's so that we can ask the participants whether they're happy about that. I think that's it, isn't it, Julie?

MS ABRAMSON: Just a couple of other matters. There is just a legal matter, we won't close the hearings at the end of today, and that is to do with our own process because we'll come back and have some hearings later. You didn't tell these poor participants that if the emergency siren sounds they're all to make their way to the exit point, which presumably our staff know where the exit point is.

MR KING: Follow, Ros. Don't follow Ros. In that case, follow Julie and myself, straight to the stairs, straight out through the exits, don't use the lifts. The way we would like to organise this is some opening statements from each of our participants, so thank you for coming and, if you don't mind, we can start now.

MS ABRAMSON: If you could just state your name for the transcript.

MR KING: Yes, please, at each stage state your name so that the transcript knows who is speaking at each.

MR LEVEY: Thanks, Stephen. Matthew Levey, I'm the Director of Content, Campaigns and Communications with Choice. Thank you very much to the Commission for the opportunity to provide this statement on behalf of Choice.

We're Australia's largest, independent advocacy group and we're really pleased, I think, with the inquiry's Terms of Reference, particularly that they begin with reviewing competition in Australia's financial system, with a view to improving consumer outcomes. I think Choice always approaches competition as a means to an end, just as the Competition and Consumer Act does, and that's about advancing consumer welfare.

We believe that you can't have genuine competition without focusing on the demand side, and for us the demand side means active, engaged consumers who are able to choose between meaningfully differentiated products with the confidence of being protected. If consumers are not confident and protected then we think that works against competition.

Most importantly, we think it means approaching competition based on how consumers behave in the real world, and that's a real world that's full of behavioural biases and limits to processing information, it's a world where very few of us read the fine print and want to, or are capable of being super-engaged with every financial decision that we have to make. This isn't a new area of focus for Choice, during the recent Financial System Inquiry in 2014 we responded to the interim report by asking that the inquiry reassess its interim conclusion that Australia's banking sector was competitive. I won't go into that discussion in detail, I'm happy to elaborate through questions.

But one bit I did want to mention was an interim conclusion around household bank fees and there was an observation in the interim report about the levelling off that had happened in bank fees since 2010 was an indicator of competition. We suggest that that was probably more likely a result of the law firm, Maurice Blackburn, launching a series of class actions in 2010, and prior to that some joint campaigning from the Consumer Action Law Centre and Choice in what was called the Fair Fees Campaign.

It's interesting looking back on that now, the Reserve Bank's June 2017 Bulletin did provide an update on banking fees. You know, on the one hand, consumers might be grateful that fees only increased 1.5 per cent last year, on the other hand they might be concerned that 16 institutions charged them a total of $4.4 billion in 2016. We don't think that's an acceptable amount, especially when many of these institutions very likely hold substantial amounts of consumer savings in accounts that earn uncompetitive, or in fact negligible interest rates.

As a starting point we would really encourage the Commission to have a look at some of the work done by the UK's Competition and Markets Authority in their Retail Banking Market Investigation that was published in August last year. As part of that work the CMA determined that, for all types of personal current accounts held by consumers, the average revenue to banks in 2014 was 177 Pounds a year. Around half of that revenue came from banks' lending out consumers' credit balances rather than direct charges. From that it was possible for the CMA to actually estimate the potential savings from different customer types of moving to cheaper products.

We are not aware of similar research having been done in Australia, but if there is the capacity, we would really encourage the Commission to consider a methodology like that in some of its work because it actually puts a cost on what we believe is a lack of competition in Australia's retail banking sector, it's the cost of interest that is foregone on savings, it's the cost of excessive credit card interest rates, it's the cost of above average fees and charges compared to the cheapest products on the market.

Getting back to the FSI, thankfully, the final report did reassess its interim conclusion and talked about reviewing the state of competition every three years, and we find ourselves here. We would also say that three years seems about the right amount of time for reviewing competition in banking, it was three years previous that Choice released our better banking report, that picked up on a lot of public outrage following the Melbourne Cup Day interest rate rises of 2010 where we saw the Commonwealth Bank, I think, increase its variable home loan rate 25 basis points above the Reserve Bank's.

We put out a large report in 2011 called Better Banking and in part of that we actually reflected on decades of interventions and promoting competition with major banks. In the 1970s there was an emphasis on the rise of building societies and credit unions, in the '80s it was very much about deregulation and the expected entrance of foreign banks, and more recently, regional banks and mortgage originators. I think right now you're seeing proponents of fintech selling the same prospect of new entrants.

The reason for this recollect of history is to observe that we don't think it's enough to look at the promise of new entrants on the supply side, we think we have to have a look at whether consumers will be engaged, capable and confident of embracing those new entrants.

So turning to, I guess, the main message that Choice has put out there through multiple reviews, and that is why don't people switch, it's that customer stickiness. Since 2010 we've partnered with a comparison site called Mozo to provide a completely independent and comprehensive comparison of banking products, it's called Compare, Ditch and Switch.

I checked that website today and found that of the 10 lowest rate credit cards, the 10 lowest rate variable home loans, the 10 lowest fee transaction accounts, the 10 highest rate one year term deposits, and the nine highest rate savings accounts, with the exception of UBank that is owned by NAB, none of them were from a big four bank, and that has been the case since that site, more or less, was launched in 2010. Yet the vast majority of Australians, around 80 per cent depending on the product category obviously, bank with one of those four major institutions.

In 2014, around the FSI, we did a bit of work surveying consumers on their reasons for not doing what politicians and consumer groups regularly implore them to do, which is walk down the street and find a better deal, across all products the top reason given for not switching was that it would be a hassle to move just one product. Not far behind that was something similar, which was a desire to keep all products with the one institution.

When we looked across that nationally representative sample we saw that 48 per cent of people had a transaction account, a home loan and a credit card with the same institution. Again, across all products, around a third of consumers had faced an issue when trying to switch. With credit cards and transaction accounts it was very often about direct debits.

We drew a few conclusions from this research at the time, one obvious one is that home loans are the product that tends to anchor a consumer to an institution and this can cause detriment. In the June Reserve Bank Bulletin that I referred to it had noted in fact that the fastest growing component of household bank fees is credit cards because they are being bundled with home loan packages, they are the highest fee cards and that is what is driving the increasing fees.

Of course, related to this, bundling itself is a huge barrier, customers clearly want to see and manage all of their banking products in one place, it is also clear to us that the switching process itself is far from seamless despite repeated attempts to encourage and streamline that process. For all the moves towards it it's still very manual, it's still very difficult, especially when you bring direct debits into it.

Obviously there is a New Payments Platform on the way and I know there has been some flagging of how that will streamline the process even further, and we would obviously urge those responsible to look at that as a priority. But in the meantime we think there are some technical barriers to consumers, with direct debits and credit cards in particular, around who is responsible in the system, looking at the schemes like MasterCard and Visa and looking at the banks, and understanding why some consumers seem to keep accumulating payments on cards they believe they had cancelled.

The final thing I wanted to touch on is around vertical integration, and that is, I suppose, more of the structural side of competition than the demand side. Obviously, the major banks are vertically integrated into mortgage broking and wealth management to different degrees and these channels feed customers directly into their banking businesses.

It was highlighted in ASIC's recent research that NAB owns 100 per cent of three large aggregators accounting for around 30 per cent of brokers in Australia. They also found that NAB-owned aggregators directed 22 per cent of home loans to NAB branded or white label loans, yet NAB's overall market share was just 13.2 per cent. We think it is a problem, if consumers are using brokers thinking they're receiving an independent service, one that will act in their best interests and recommend the best loan for their needs, if that is not the case.

ASIC's nationally representative survey which went with that research found that 86 per cent of people with an experience or an intention of using a mortgage broker thought the broker would put the client's needs either entirely first, or first most of the time. We think this does create an illusion of choice at a key point in the customer's interaction with the financial system, it's probably the biggest transaction they will make in their life and it's certainly the one that seems to anchor many other financial transactions that follow.

Vertically integrated wealth management is another sales pipeline for major institutions, and it's not just about getting customers but it's about getting customers with more products, more add-ons. This, by definition, encourages bundling, which, as I've said, we think is a key barrier to switching and increases the risk of mis-selling. We would urge the Commission to consider whether the major banks vertical integration is promoting genuine competition on the supply side.

There is obviously plenty to look at in the sector and plenty that has already been attempted and tried. The last thing I would say is I hope you can bring some fresh eyes to that and a sharp lens on what has worked and what hasn't, and what you believe needs to change. Thank you.

MR KING: Thanks, Matt.

MR BRODY: Thank you, good afternoon, my name is Gerard Brody, I'm the Chief Executive Officer for the Consumer Action Law Centre. I thank you for the opportunity to be here today on behalf of Consumer Action. Like Choice, we are really pleased to see consumer outcomes are the key focus of the Terms of Reference for this inquiry, and just to echo Matt, competition, we believe, is not an end in itself but should be seen about improving consumer outcomes.

Competition policy which empowers and encourages consumers to exert influence on the financial services markets must be based on a real understanding of how consumers make decisions. Too often a traditional economic view of consumer choice and competition is adopted. One that focuses on whether users can make decisions, whether information is available and a level of expertise required to consider alternatives.

While these are obviously important factors, equally important are the behavioural factors affecting choice which can inhibit decision-making. For example, we know that as the number of choices or the amount of information increases, decision-making deteriorates. We note the Productivity Commission has done some good work on this previously and we strongly encourage you to reconsider those findings in this inquiry.

Further, while empowering consumers is key to promoting effective competition in the financial system, empowered consumers depends on the availability of safe products and fair sales practices. In this way, effective consumer protection supports healthy competition and shouldn't be seen as an inhibitor. This was recognised in the Financial System Inquiry which recommended new product design and distribution obligations on financial service providers. We strongly support both reforms and will continue to advocate for their implementation.

As part of this inquiry we encourage the Commission to focus on the competitive behaviours, in particular the credit card and home loan markets. In relation to credit card lending, we have seen a wholesale failure of mass competition. Credit card interest rates have been unresponsive to reductions in the cash rate, analysis conducted by the Treasury in 2015 showed that effective spreads earned by credit card providers have actually increased over the past decade. Instead, we see credit card providers competing over the generosity of balance transfer offers, interest free periods and reward programs.

Credit card providers have clearly designed their products to take advantage of our inherent biases which see most people optimistically believing, at the time they apply for a card, that they will always pay off the balance in full, this is known as optimism bias. Complexity is used to bamboozle, and teaser offers used to distract us from the true cost of our credit cards. Similarly, we have seen home loan interest rates rise and fall out of cycle with the Reserve Bank Cash Rate, reducing community confidence in banks in the financial sector.

There is no well-accepted benchmark to compare headline home loan interest rates to assess whether those out of cycle rate changes are competitive. Many people can also access interest rate discounts from their lender yet many people do not know how to do that. There is a lack of transparency when it comes to home loan pricing which isn't helped by the hefty upfront commissions being paid to mortgage brokers, which totalled 1.24 billion in 2015 alone.

On commissions, we have seen the bundling of what we would argue as useless add-on products, like consumer credit insurance, having a significant detrimental impact on consumer outcomes and competitiveness. This is evidenced not only by our clients' experience, but endemically low claims ratios for these products. Purchase of insurance is secondary to purchase of the loan and there can be a reverse competition between insurers competing for access to the lending sales channel.

This is supposedly dealt with by the National Credit Code capping the amount of commissions paid by insurers to lenders at 20 per cent, however we note that in relation to a related distributor channel, motor vehicle dealerships, the ACCC recently found that a similar proposal to capped commissions would produce a net public detriment.

Commission based selling sees outcomes align when the interests of the sales person, perhaps to maximise their commission, rather than with good customer outcomes. Not only are people being sold products that don't suit their needs, but they also aren't being shown the true value of these products. Commissions can obscure the true cost, shielding them from competition and almost certainly keeping the price of the product inefficiently high.

Just touching on bank switching packages which have been designed to encourage people to shop around and find a better deal. We agree that they haven't worked. Previous attempts at encouraging bank switching have gently failed. The 2012 tick and flick reforms only applied to transaction accounts and that was a key failing, it didn't apply to credit cards or other accounts and, as Matt has explained, the nature of people, bundling products, means there was little take-up.

Consumers still consider it too difficult to switch, and the program was not broadly promoted by the banks. It also didn't fix the many problems associated with trying to switch credit card providers and to cancel ongoing direct debits. We would suggest that the Commission give detailed consideration to the idea of account number portability and the opportunities presented by the New Payments Platform for bank switching and competition.

Finally, we note proposals to introduce mandatory consumer credit reporting which appears to be in the name of improving competitiveness in lending. We have two concerns here. First, there is a lack of agreement about how to report repayment history information on credit reports, particularly when someone has come to a hardship arrangement with their lender. We can provide further details of this. But our concern is that the practice will only discourage people from seeking assistance and will not enhance lending decisions.

Second, the primary driver of this reform appears to be about driving efficiency in pricing, we believe that this will result in those in more precarious financial positions being unfairly charged higher amounts of credit, or being pushed to second tier or high cost fringe lenders. There are serious fairness considerations at play here. We're happy to take questions as well.

MR KING: Thank you.

MS GUTHRIE: Lucky last. Thank you, Stephen. I'm Fiona Guthrie, I'm the CEO of Financial Counselling Australia. So our comments are informed by the work we do, which is to assist people in financial hardship. Financial counsellors deal, day to day, with people in really vulnerable circumstances who sometimes can be suicidal, who have got mental health issues or are close to homelessness.

We wanted to begin by acknowledging just a couple of things by the way of context, which the first is that it's so important to have a stable and strong banking system, I think we all accept that, and also the good work that the bank industry has done in addressing financial hardship over the last few years, which is really significant.

Our overall observation in terms of where we fit in is that the poor pay more for financial services. So I'm going to make three points around that issue, and it goes to the issue of fairness in your Terms of Reference, and I'll overlap a little bit with what Gerard and Matt have said, not surprisingly.

The first point is about credit cards. So just about every financial counselling client is going to have credit card debt that they are struggling to pay, it would be very unusual to not see a client with credit card debt. One of the reasons for that is inappropriate lending practices, when people are given debt that is unaffordable.

It's almost, I think, a first outcome of competition, because as banks automate processes to try and cut costs, they also are less likely to take into account someone's individual capacity to actually repay loans, and that leads, later on down the track, to people with large levels of debt which they can't repay. That is exacerbated then, once you're in that situation, because credit card interest rates are so high, and as we talked about before, are so sticky, so people are being trapped with persistent debt.

My second point is that if the poor are paying more now then it's only going to get worse, and it builds on what Gerard mentioned a moment ago about comprehensive credit reporting. Under CCI we will soon see much more risk-based pricing, it hasn't really come into the Australian marketplace yet, but it is not far away.

So every economic downturn is going to create a new group of people who will pay more. You will lose your job and that won't be your fault, but that will happen to you and, as a result, your credit report will become impaired and you'll have to pay higher rates and you'll be in a cycle which is self-perpetuating. That is a really perverse outcome of a system that is supposed to improve consumer outcomes.

So risk-based pricing, credit reporting and credit score are just not transparent, people don't understand the system and they're being gamed at the moment where there has been a huge industry, an explosive industry, around credit repair agencies trying to take advantage of this new system already.

Then my third point, and this one has distressed me the whole time I have been in this job, which is for seven years, is that the poor continue to pay more because there is still too many exploitative products and exploitative sales practices in financial services. I could give you lots and lots and lots and lots of examples, but I am just going to give you one from Alice Springs and Indigenous communities just recently.

So there are Aboriginal people in that area, who might live in Alice Springs or in remote communities, who are being signed up in a store selling household goods to what they think is free money. It's actually a Latitude GO MasterCard, and it's not free money. But we are dealing with people for whom English, if they're lucky, it might be a second language, it might be a third or fourth language, and they think the card is very similar to their CommBank key card or their Basics card because there's income management in the Northern Territory. They are being caught and not able to get out of that debt, they are being exploited.

But that's just one example. There's payday loans, there's consumer lease providers, there's the debt consolidation companies, and they are all targeting people who are in financial hardship, and what they have in common is that they often leave people in worse financial situations.

But to bring that back to competition, the problem is that they are exploited if products and practices continue to exist. So competition in this sense doesn't drive down prices or improve products, all it does is bring more of these players into the market because there is a buck to be made.

So to finish up, what needs to change. In relation to credit cards we need a proper assessment of ability to repay, we need a fundamental redesign of a product itself so it doesn't trap people into persistent debt, and we need to make it easier to switch. In relation to comprehensive credit reporting there is huge things that should change there, but at the very least, we need some transparency about how this system works so that it works for consumers and not for the people who are making money out of it.

Finally, in relation to the continued exploitation of low income Australians and Indigenous Australians, we should not shy away from regulation, it is the only thing that is ever going to work. I wanted to finish with a quote from Nelson Mandela which I think sums it up beautifully, he said, "Morality cannot be legislated but behaviour can be regulated. Judicial decrees may not change the heart but they can restrain the heartless". Thank you.

MR KING: Thanks, Fiona. Did you want to kick off, Julie?

MS ABRAMSON: I did. Thank you very much to you all for making time available, I know you're all busy. I wanted to start, Matt, with you, and I wanted to spend a bit of time on the demand side, or consumer switching. So I know that in your FSI submission I think you did a survey of why people don't switch and, Gerard, you also referred to that as well, so I'm interested in understanding a bit more about that and what type of policy interventions you would think might make a difference.

If I can give you a triple-barrel question. I understand in the UK there have been some reforms about switching, so any comments that you might have on that would be very useful.

MR LEVEY: Sure. Thanks, Julie. I'm happy to kick off and then hand over.

MS ABRAMSON: Others might contribute too.

MR LEVEY: Yes, of course. Look, it's something we've looked at consistently and the last time, as you say, was as part of the Financial System Inquiry in 2014. Our approach was really to look at the major retail banking products and ask people whether they had switched or thought about switching in the previous two years, and if not, why not. In doing that we were able to, I guess, segment people who hadn't even thought about it, people who had thought about it and not done it, then people who had done it and had potentially encountered some sort of issue in doing so.

The purpose of that was, I guess, to try and dig deeper into that gap between where all the good products seems to be in the 20 per cent and where all the people seem to be in the four banks who have the 80 per cent. As I said, I think there's something around home loans that we think is the anchor product for people who have them, it seems to be the one that defines other product choices, particularly the bundling with credit cards. But more than that, I think there's a quite natural consumer desire to not have different products with different institutions, to have a single view of their transactions, to have a single view of their products, and to not put things in different places. That was certainly the key reason that people gave for not switching.

I think we see potential in the Government's Open Data initiatives which the Productivity Commission has done so much work to advance, to actually, I guess, take that data out of the wall gardens of individual providers and let people, for example, have some kind of third party interface, an APRA website where they would be able to see everything together in a secure and useful way. We think there is potential in that, we think making sure that happens as a result of the Open Data agenda will be really important.

I think an observation we'd make is that the reason people in the past haven't wanted to move transaction accounts has traditionally been around who has got the most bank branches, then over time it became who had the most ATMs and maybe now it's who has got the best app. That's, I think, an interesting transition. Because obviously the Commonwealth Bank can and does spend millions of dollars on its app and that's not necessarily a capacity that a regional bank or a mutual credit union, customer-owned bank, is going to have. So I think you're seeing versions of the anchoring as technology moves on.

I think one of your questions was around account switching and what hasn't worked, or looking to the UK, was that right?

MS ABRAMSON: Well, two parts, I'm sorry I gave you three at the one time.

MR LEVEY: No, that's all right.

MS ABRAMSON: It's, first of all, what type of policy intervention did you think would make a difference on this, because we've tried a few things on the switching front if we took the proposition that that's an important part, and then I think it was your submission that referred to the UK switching service I think, is it called CASS or something?

MR LEVEY: Yes, so I could probably give you a brief answer to both of those and I'm sure my colleagues can expand. I think that our observation, based on what's been tried and what hasn't worked, is that it needs to be seamless from a consumer perspective, and that means, ideally, a single conversation with the new provider puts everything in train, not getting a printout of your direct debits and going back to your old bank and having a conversation, not finding out that you'd forgot to cancel a certain payment with a provider and that, for that reason, your previous credit card couldn't be cancelled and was continuing to accumulate your gym membership or whatever it might be.

So that's, I think, a learning from the first phase as well of the UK's My Data program, where they were compelling people to give data to consumers and you had to be highly motivated, we'd suggest, to sort of download an Excel spreadsheet, take it off somewhere else, upload it and then gain some insight about how your credit card had been going. So we think the more that that sort of experience can be integrated through open APIs, or whatever the technical solution might be, it's just got to be as seamless as possible. So that would be our sort of policy suggestion.

MR KING: Do you see it sort of, I guess the analogy I'd do with the old days of mobile phones where you had to go into your current provider and they'd say, "What do you want to switch for?" he will start offering you a discount now if you don't switch even though we've been screwing you for the last how many years, "No, I want to switch", and all that.

So you would see it almost, whether physically or on an app or through the internet, if the data is available you can simply go to, look, I've compared these sites or I've had someone help me compare these sites and that looks like it, I want to be able to, in a sense, press the button and I get a package and I don't have to deal with the guys I'm leaving. Is that sort of where you'd like to head?

MR LEVEY: Yes, that's a nice way of putting it. I guess it's probably part of a system really, ideally, where you're comparing your credit card based on how you actually used it over the last 12 months, including all the months where you didn't pay off your balance in full, and the rewards that you thought were sending you on holiday weren't really worth an arm.

You can actually see how much cheaper it would be to move to a nine per cent credit card rather than stay on your 22 per cent one and you're then able to undertake that transaction and have your payments switched over. I think, technically, there's no theoretical barrier to any of that happening, but part of it is, I guess, whether the market is going to enable that.

MR KING: I think there's technical barriers at the moment, the New Payments system is meant to be getting around them.

MR LEVEY: Yes. I don't think it would happen right now, but the data is out there and if it can be sort of communicated in a way.

MS ABRAMSON: There's probably also some technical barriers, so whether it's in contract law, your bank precludes you from giving your PIN number too, so there would be some add-on things in terms of the way we regulate at the moment, even if it's just contract law.

MR LEVEY: I imagine that's going to be the case. To your final point, there's not a huge amount I can add about how the UK experience has gone, other than to say that the Competition and Markets Authority, Retail Banking Market Study that I referred to, the one that came out that put the cost on interest foregone, made a series of recommendations to improve that service. I know it did that in August 2016, and there's a whole series of documents about how that is going and how stakeholders have responded to it. So I think there's probably – well, I don't have it at hand, but there's plenty of info on it, it was obviously something that they thought could be improved.

MS ABRAMSON: Thank you. Gerard, you mentioned before, account portability, so that is part of that conversation.

MR BRODY: Sure. I mean I think that our experience is that it's the practical issues that can be a barrier for people. Just on the previous account switching packages, they were limited to transaction accounts, it didn't even apply to credit cards, so I don't think that would – because people do have their banking bundle, but it didn't really solve the problem.

MR LEVEY: That makes good sense, yes.

MR BRODY: In terms of the practical challenges, one of the key ones is direct debits and there are some technicalities about how direct debits work that make it challenging for consumers. So consumers generally, if you set up a direct debit arrangement with your bank on your transaction account using your BSB and account number, you have the right under the Code of Banking Practice to cancel that arrangement directly with your bank.

If you set up the arrangement on a scheme platform, Visa or MasterCard, so whether it's your credit card or whether it's your credit card using the scheme numbers, because they all are linked to a scheme, you don't have such a right. That means that you actually have to go individually to each merchant that you have recurrent payment arrangements with, your insurer, your gym and so on, and actually try and negotiate that cancellation separately, sometimes that can be very challenging to actually get them to stop doing that.

So those practical barriers of actually having to stop all that and restart it again is, I think, a particular problem to switching. I think anybody who has had credit cards, when their credit card expires the date expires and you have to re-establish all those direct debits, can imagine the frustration that can happen in re-establishing those things.

Another concern that we have around, we see, people switching in credit cards, is that they can be tempted by teaser offers, balance transfer offers, come to us if you're having trouble with your credit card debt, we'll give you zero per cent for the first 12 months. What tends to happen in practice is the person doesn't close the previous account, there's no requirement to close the previous account, and suddenly they've got – again, the optimism buyer come to the play and they're tempted to use that, so then they've got two debts rather than one.

So we see, particularly through our financial counselling service, that people end up with four or five credit cards to different providers because they've done that over time. One of the difficulties there is actually closing bank accounts, I know there's some work being done by the banks at the moment on that point to try and improve it. I think what's interesting in that work has been the extent of win-back incentives and sales incentives by banks to stop you closing them and call depends – within banks, to make those conversations with people.

MS ABRAMSON: Usually you have to go in to the bank itself to cancel the credit card, where you can actually apply for it online.

MR BRODY: Yes, that's right, that's exactly right. I mean, in terms of solutions, I do think that some of these product designs need to be looked at, I think the balance transfer products are really problematic, and if they were to be in the market then I think they need to be over a period that's reasonable to pay down the full amount of the debt within the low interest rate period, which it tends not to be at the moment, and there needs to be processes to cancel the previous card otherwise the risk of over-indebtedness rises.

We are also interested, as Choice is, about what can be done in open banking and the New Payments Platform in particular, we don't have full details about how that is going to operate but what we hear about the possibility to make your banking more portable through the use of phone numbers and so you can just transfer your banking package like the phone number, seems to off-put us.

MS ABRAMSON: Can I also – it's probably a good question for – and Fiona, if there is something you wanted to add?

MS GUTHRIE: No, Matt and Gerard covered it all.

MS ABRAMSON: Just in terms of one of the things that Matt said and other people have said it to us as well, is that the home loan is often the anchor, but you would see a lot of customers who don't have home loans so what is it that is the anchor, is it just this factor of it's all too hard?

MR BRODY: I think it is. The survey results that are out there about why people don't switch, it is the hassle factor, then I think there's, when it comes down to it, these practical issues around direct debits and so on that make it really, really difficult.

MS ABRAMSON: There was some reform work on direct debits, but did that only go to the bank direct debits as opposed to credit cards?

MR BRODY: So on bank direct debits you can cancel that arrangement, an ongoing direct debit directly with the bank, so if it's through the BSB and account number, but if it's using the scheme cards you can't. We have tried to address that issue with the industry a number of times, both with the banks and with the scheme providers and each of them point the finger at the other one, saying it's their responsibility. Apparently, the scheme providers do have the capacity to cancel those arrangements on the request of a customer, but that comes with a fee that is payable by the bank. So there's some barriers in there that means they actually don't want to sort of cooperate to have that outcome.

MS ABRAMSON: Can I ask a broader question to all of you too about bundling of products. In a bundle of products are there some products that consumers value more, so that's kind of why they would go with that particular institution, or I'm thinking of things like ASIC did a lot of work recently around insurance and things like that, so just how contestable is that market? I think, Gerard, you mentioned the bundling issue so I'm quite interested in understanding a bit more about that.

MR BRODY: The bundling issue that I was referring to was when lenders, banks in particular, bundle an adult insurance product, a consumer credit insurance product, with a loan, and that is quite common throughout the industry. You're not offered choice at that stage, it's the one that comes with the loan, it's one that they've got an arrangement with a particular insurer and that they get a commission for placing you in that product.

MR KING: So just to make it clear, this is not just mortgage insurance, so I take out a car loan and I get – yes.

MR BRODY: Car loans, personal loans, credit cards, but also mortgage insurance as well.

MR KING: Well, with mortgage insurance, that becomes a regulatory issue as well because there's a requirement to get it.

MR BRODY: Well, there are two types of mortgage insurance, there's lenders mortgage insurance which covers the lender if you've got - - -

MR KING: Less than a certain deposit?

MR BRODY: That's right. But there is mortgage insurance protection as well which covers the borrower, which is very much like an add-on product, like the CCI products.

MS GUTHRIE: This is another factor I think, just explaining this, financial products are really complex and a lot of people just don't understand them. So trying to expect that consumers are going to enliven competition and understand the nitty-gritty of all these product features, we're asking too much.

MS ABRAMSON: What's interesting, Fiona, is I think that Matt was saying, and certainly Gerard said it before, just the consumer even having the interest to learn about the product, so this kind of – from what I understand you've said to us – it's a behavioural bias to start with, it's, well, it's all too hard and I want the destination point.

MS GUTHRIE: Well, it is too hard, that's why the comparison sites have sprung up, that's a symptom of that marketplace.

MR BRODY: Well, even the documentation that goes with some of these products is so dense and non-transparent. We came across an example recently, actually it was a Toyota Finance product whereby they offered insurance with the car loan. After we met with them they put in some changes to their product disclosure, they used a supplementary product disclosure that actually said, quite clearly, this is a more expensive insurance product than you would get elsewhere and it said probably not, basically, it's probably not suitable for you. That was put on product disclosure statements after signing, but people don't read that so it made no difference to their actual practices of people taking out that product.

MS ABRAMSON: In fact one of the things that was said to us this morning that we really should look at, and I'm interested in the work that you've done and your experience, is really looking at the post-sale consumer experience, and just interested in the work that you're doing there, any areas where you think in particular would be of benefit for us to have a look at?

MR BRODY: Yes, where do I start. I mean I guess the whole area of disputes and customer complaints is an area that needs continued focus I think, and I think there is an intention at the moment to better require banks to better report on internal dispute resolution. Our experience is it's very variable, and it's variable within a bank and between banks, and over time.

So a bank might change some processes and the system works reasonably well, but then there's some cost-cutting initiatives, amount sourcing, the system breaks down and people can find themselves stuck in loops just trying to resolve particular issues within banks. I think that it's hard to know exactly why that happens, but I sense it's because more of the effort in a bank is put on the sale process within the bank, rather than that after-sales experience.

MS GUTHRIE: Do you want to talk about fees?

MR KING: You can talk about it.

MS GUTHRIE: Well, the other obvious place that, of course, people don't make decisions about banking products based on fees, they might pay for not paying back their debts at the time, but then of course that's why we had all this issue about penalty fees and dishonours.

MR BRODY: I mean one thing I would say about penalty fees, and I read the same report that Matt did from the Reserve Bank, that the fees have gone up marginally in the last 12 months. But we have noticed that the quantum fee is increasing, so this is a credit card late payment fee, for example, I think it's National Australia Bank that has gone up 200 per cent in the last two years, so from $5 to now $15, and similarly just this year, Westpac's has gone up, from $9 to $15. It's hard to escape the conclusion that a successful, or the unsuccessful High Court class action around bank penalty fees has given the banks license to push up those fees.

MR KING: Opened the door, yes.

MR LEVEY: I think to answer the previous question about bundling, I guess in addition to the sorts of products that Gerard and Fiona talked about, it is an issue that we see with credit cards when they're part of a package, when they're bundled with a home loan, that was clearly the single biggest factor driving up credit card fees in that later set of Reserve Bank figures.

We've surveyed consumers previously and half of credit card holders didn't know their credit card interest rate. I think that's symptomatic of the product design, as Gerard was saying earlier, and that's going to be even more submerged if it's part of package where what you're probably focusing on is the mortgage, and along with that, potentially, comes an offset account and a credit card and you're not assessing those features individually on their merits, asking if they're the right ones for you, you're taking them as a package and getting stuck in them over time.

MS TEMPLE: I think though the lack of understanding about how credit card interest rates are applied as well, so they will be focused on making the home loan repayment and not understanding how the interest-free periods work or how balance transfer offers really work, so that complexity.

MS ABRAMSON: One of the comments that was made to us this morning too was looking at reforms in energy and health markets in terms of competition, I'm not putting that this is a great market, look at this, but are there things about those markets in terms of consumer choice that you think would be interesting to look at in our inquiry?

MR LEVEY: Having just gone through several months of the Federal Government's Health Insurance Working Group, I think it might - - -

MS ABRAMSON: I'm not trying to cause you additional - - -

MR LEVEY: No, no, that's all right, I'd almost say it's the other way around. But look, I think one thing that I guess we would observe – it's not a direct answer to your question, Julie – but there is a few of these processes going on at the moment in different markets, and a lot of the consumer detriment and consumer behaviour, in some senses, is quite similar.

They're markets where people are being given very complex products with lengthy bits of disclosure that they're not reading, they're markets where you've kind of got, to some degree, an essential service or one where it's a grudge purchase, and where people aren't really engaging with the design features of that product.

So certainly health insurance is an example where the Government's publicly announced agenda is looking at radically simplifying that product by moving to a sort of gold, silver, bronze tiering so that people can sift through the 40,000 products in the marketplace and hopefully know what they're covered for before they're about to go into the operating theatre.

I guess our encouragement would be for, at some level, Government to not look at these markets in isolation. So if you're going to redesign disclosure in health insurance to actually test what really works and what's impactful, to apply those learnings across into banking and across into energy because I think there's a lot of (indistinct) stuff.

I guess the final point I'd finish on is that I think the one thing that struck us I suppose is that the example I gave before around credit cards and open data could so easily be applied to extras in health insurance, because it's not hospital cover, right, it's essentially a budgeting product, you pay a certain amount and at the end of each year you figure out if you used enough physio or went to Specsavers enough to make it back, it's not about something that you don't foresee, it's in fact about trying to use those services enough to get value and it's really hard for consumers to judge that, just as it's probably hard for them to judge whether the rewards point they got on their Platinum Amex was worth the upfront fee.

MR BRODY: I mean we would say that, in terms of energy, it also might not be a good one, a good example, of how competition should work, there is also an ACCC inquiry on foot on that industry. Our, I guess, indicator for us is that not only do there seem to be very high margins that energy retailers earn, but some of the pricing strategies and practices leave a lot to be desired. In fact it looked like they intended to confuse people into discounts and so forth, which don't actually tell you the nature of the price you're paying but focus on an upfront discount that only lasts a certain period, which we think is problematic.

I mean I agree with Matt, there's probably an opportunity to look at what are the indicators of a healthy, competitive market in all these markets. We would like to urge consideration of indicators that are beyond, I guess, the traditional ones around switching matrix and things like that, we'd put forward sort of three indicators, and they probably need a bit of work to work out exactly what they are.

But the first one is, if you like, the proportion of people not getting a bad deal, so actually doing a deal. Maybe that's through surveying, and you're not looking at the whole market, but just an understanding of if people are being – if a large proportion of people that seem to be getting a bad deal, that's a bad outcome.

The second one is around the comprehensibility of information. We do think information is really important to make markets work and it has its role to play. But where information is really difficult or challenging to understand, then that is going to be an indicator that the health of competition is unhealthy.

The third one we would say is the after-sales experience. An example of that, as we were just talking about, is how the particular provider deals with the complaints.

We wonder whether, if further measures were put around those three areas, that might help us determine the health of competition in markets, in health insurance, in banking, in energy.

MS ABRAMSON: What of course, Gerard, would you regard as a bad deal?

MR BRODY: Well, I guess just in comparison to the best deals out there. I'm not saying everyone is going to be on the best deal, that's obviously not going to happen. But if you see in the marketplace that a proportion of people are on this price and that some people are way up here, that's a bad deal.

MS TEMPLE: There's been some work done on this when we were looking at the product design and distribution obligations, they looked at the UK experience of making – of designing suitable products and marketing them at suitable target markets and then assessing whether the post-sale process had been appropriate or not. So I think there are some learnings there from the UK where they have already got those obligations and the world hasn't ended.

MR KING: But just on the first one, I mean a simple starting point, and it comes back to credit cards, would be to simply say, well, if you've got products that are, functionally, pretty similar to each other and you notice that, well, when – the market – you can say it might be working is, well, everyone seems to be on pretty much the same rate. When there is a big price variation, when you've got people paying 25 per cent, down to 14 per cent or 9 per cent, and then of course the ability of some people to go to a lower level, personal loan or whatever, and you've got this big spread of otherwise people who look for same, that tends to suggest there's a problem.

MR BRODY: I think that's right. But I encourage you to think about it, not just about what the label of the product says in terms of the fees and charges, but what people are actually being charged over a 12 month period say.

MR KING: It's got to be, yes.

MR BRODY: Because somebody who is on a 25 per cent card may actually be paying less for that product than a 9 per cent card. So it isn't challenging to work that out, but I think there are probably ways to do it.

MR KING: Can I just, on a couple of points, sort of from other areas. I mean electricity has come up a few times and you said it was a bad comparison and I must confess I tend to agree. There has been comparison websites on electricity and other energy products for an awful long time and they don't seem to be effective, they're usually incomprehensible. Can you give us any examples of the complex product, where we have a comparison website or some sort of intervention, which may be private or it may be by a regulator, that actually works and so that consumers can go on there and say, hey, I can actually get a better deal and it's fair?

MR LEVEY: I'm happy to put in a plug for Choice's new Health Insurance Comparison which launched yesterday and is in fact the most comprehensive and unbiased one in the market.

MR KING: We'll see how many hits you get.

MR LEVEY: We'll see, yes. Look, in seriousness, it's a fair point, because if you look at where most consumers get their information in that market, outside of getting it direct from the product provider, it's really from iSelect and Compare the Market, I think that, combined, it's sort of close to 30 per cent of people going through those channels or at least touching them on their way to the product.

Obviously, they have the same issues that many of the energy sites have, and the banking sites, in fact they're often the same site, which is that they only show you products that they earn a commission for. There's not necessarily any obligation on them once you sort of get off their website into a phone call, which is how 90 per cent, I understand, of those sales are closed, in health insurance at least, you're really out of comparison, we'd say, and into a sales pitch.

So I'm actually giving you more bad examples rather than giving you good ones and I might stop there because it's not what you're looking for.

MR LEVEY: I can't think of one either. But one that – I'm not sure, this is not my area of specialisation, but I do think the telco market, particularly things like, say, a broadband dealer, it's much easier to compare.

MR KING: Easier now, go back.

MR LEVEY: Sure. That's right, yes.

MR KING: It would be interesting to know what happened, because you in fact used to be confuse-opoly, I can remember people – that's where the term came from, the telco industry.

MR LEVEY: I mean there are issues in that market with some of the disclosures about speeds and so forth like that. But in terms of the price you pay, you don't get the pricing strategies in, say, the electricity market, that after 12 months the price jumps up if you do nothing, sort of the lazy tax if you like. I think that's something that is different in that market to connect to electricity.

MR KING: Yes. Although I've never been able to work out what $1000 worth of calls actually means. In Germany they require the advertising to be in your number of minutes of call, which I pushed for.

MR LEVEY: I was probably thinking more, say, a home broadband package than a telco.

MR KING: Yes, you sort of get a much better idea. But in terms of the sort of comparison websites, because as soon as you get into something like a financial area, one of the first things that tends to come up, well, you need a website or something where consumers can compare and I'm afraid I've become very jaded about those over time.

The other bit that I was keen to understand is with these products there is – and again this is coming from completely different areas, but it's in the Consumer Law about clear pricing and the requirement to have clear pricing. When you were running through, I think it was the insurance product example, my immediate reaction was, well, is that satisfying the clear pricing laws if you're able to, in a sense, get someone when they're about to sign on the dotted line and you say, by the way, this is add-on that I haven't quite told you about which is going to be – and by that stage the consumer is sort of, in a sense, committed to the product. Is there something that needs to be done in that space with financial products, are the current clear pricing laws just not strong enough to deal with those, or is just you need the ACCC to go out and talk to them?

MS GUTHRIE: It's the product design.

MR BRODY: I don't think the clear pricing laws go to that issue, I mean the clear pricing laws are about ensuring that if there is one price for a product, the total price and you don't have add-ons. But these are two different products I guess if you like, the sales process that's bundled, and there's evidence that shows that when you do that consumers experience fatigue over time, they could have poor references, so it looks like a low price compared to the big loan I just got so it doesn't look very much but in fact – so it discourages them from checking to see if it's a good price, so it's those sales practices.

One of things that we have advocated for in bundled insurance add-on sales is to separate the sales process, so have sort of what we're calling a deferred sales mechanism. Whereby a lender could perhaps, when you've got breaches of credit card or a loan, tell you that there is availability of insurance, but then there's three or four clear days and then it's your obligation, the customer.

MS GUTHRIE: Like a cooling off period.

MR KING: So a cooling off period.

MR BRODY: In opposite though. So it's a consumer says, actually I've looked at this and it seems useful to me, I'll recontact the provider and say I want the product.

MR KING: So it's got to be a positive obligation on the consumer to re-engage. That's interesting.

MS TEMPLE: I think what we have seen is that many people who buy these add-on products, they don't know that they even have the products, or they thought that buying the product was a condition of getting the loan.

MR BRODY: We're happy to share more information about this, about 12 months ago we built a website called DemandARefund.com to deal with these products. What this website does is if you've bought it and you find that you've got an add-on product, an insurance product, you can enter details in the website and the experience that you had when you purchased it and it generates a complaint letter, referencing misleading conduct or other breaches of law directly to the insurer.

Since we've established that website we've had over 300 people go through the entire process and over $600,000 worth of premiums claims back. We're unable to get the full details about how often people actually get a refund, but in the vast majority it seems that they are, and that's just on the back of one complaint letter. I think there's a lot of poor practices in the industry about sort of misleading conduct to be honest during that sales practice that it makes them more willing to offer a refund when a complaint is raised.

MR KING: Yes, the fact that they're willing to give it on one complaint letter tends to suggest that they know there's lots of misleading conduct going on and they really would prefer not to know.

MS ABRAMSON: Can I ask a question of all of you, though, Fiona, it might sit more with you, is about people who are disadvantaged. So we've been talking about competition and about consumers who are misled, in a generic sort of form, but the people who have difficulty even accessing the financial system, what competition might look for those people?

MS GUTHRIE: Well, people get trapped into terrible products, that was the point I was trying to make in my opening statement. So there's competition for providers to get into those markets because it's highly profitable to sell products to people in financial hardship, they make a lot of money out of them. But once people are trapped they can't get back out. Then that's why all of us keep coming back to credit cards, it's a product that also attracts people and that is offered by our major banks. So at one end we've got the really exploitative products, pay day lending, some of the second tier lenders, then you've got what is a mainstream product, but because of its design, can be actually quite dangerous.

MS ABRAMSON: I thought at one stage – and you all correct me if I've got this wrong – that the banks did actually start offering, like a vanilla package product, that was one of the reports a number of years ago and it was, I think, a credit card with it, a low interest on it?

MR LEVEY: This is one of the great curiosities of the credit card market, which is that you've got relatively low interest products at one end of the scale and then very high ones at the other, and the majority of people are on the very high ones.

MS ABRAMSON: COBA made that point to us, that a number of the community-owned banking actually have quite low rates, say 5 per cent below, but don't have the same take-up.

MS TEMPLE: A lot of the banks also have basic bank accounts which are fee free.

MS ABRAMSON: That's exactly what I was thinking about to be honest, it was branded as a vanilla product.

MS TEMPLE: They're out there but they're not offered to people and they're squirreled away in websites [so] you can't really find them.

MS ABRAMSON: Is that because a customer has to actually ask for them?

MR BRODY: Yes, I mean, potentially. I mean there is obligations for banks to inform you about them, and then that sits in the banking code at the moment actually, proposals to strengthen that more proactively which we're really supportive of in the review of the banking code that has just happened, but we do think there's much opportunity to go further there.

We were talking about data before, so banks will know who of their customers receive Centrelink income because it will be part of the data code, that if the money hits the account. It seems to us that it should be entirely possible for the banks to identify those people and proactively tell them, you're in the wrong bank account, there's availability of this fee-free bank account, can we shift you over, and that doesn't happen.

MS GUTHRIE: That's a really good product if we can get people into it, but there is no really good low interest credit card, a moderate amount of credit, then people get trapped into these really expensive products where it's no longer credit, it's long-term, persistent debt, and nothing is being done to address that.

MR BRODY: One of the problems there is that banks, in the main – it might be different with some of the second tiers and mutuals, but the minimum amount of a personal loan these days starts at around $7000, so if you only want $1000 or $2000, the product you get sold is a credit card and it comes with all the danger we're talking about.

MR KING: On credit cards in particular, how do we fix the problems there? I mean I know, I think it's either being introduced or going to be introduced, that you won't get the, "Your limit has been increased by another 10,000, congratulations, tick here if you really don't want it", so I think that is being eliminated. But what else should we be looking for in a credit card? From my perspective, it also just seems quite an odd – it's not a functional market, let's put it that way.

MS GUTHRIE: It's definitely not a functional market. So the first thing, and I said this before, is that affordability assessments have got to be accurate in the first so we don't trap people into debt that they can't afford. So they're the most profitable actually if you think about it from a banking point of view, you want people who can just keep on paying the minimum or somewhere in between, so you want to grab them. But we don't want that to happen, it's not good for the economy in the long-run. You know we've got household debt at the highest levels it's been ever, that's not a good position for Australia to be in.

The second thing we have to do is we have to address the debt overhang we've got now, so we've got this product which is supposed to be short-term cash flow management which has turned into long-term persistent debt, so there's got to be a way of bringing people back out, of getting people out of what's turned into a dangerous product for them, there's a role for the banks to play in that.

Then the third thing is something about making it easier to switch because the direct debit issue is really difficult. If someone is in financial hardship one of the first things you want to do is cancel the direct debits, you can't do it when they're coming out of your credit card, that makes it really difficult. Then we've got to have a low rate credit card with a small amount of credit, and we don't, those products are not available, so people have got cash.

There's all sorts of problems in the broader about the level of income support, which you can't solve, that's one of the reasons, but having a product that would actually work for the clients that we see because some of them do want access to credit, not everyone does but some people do, and it's just not there.

MR BRODY: It's worth saying that the Government is proposing some reforms about affordability assessments, so there's this strengthening and responsible lending rules when it comes to credit cards. At the moment the legal obligation is responsible lending, as to whether you can repay without causing financial hardship. Now, when the minimum repayment is 1 or 2 per cent of the balance outstanding, that's pretty easy to satisfy.

So the obligation is going to be, when they provide you the credit, can you repay it, the full limit over – the Government is saying a reasonable period and the debate will be, well, how long is a reasonable period? We think that it should be a maximum three years, anything longer than that and it turns into a long-term debt product which is unsuitable for credit cards, but we'll see where that ends up.

I guess the other issue I wouldn't mind saying with the credit cards is I think it's a hidden problem. So we hear about some people, or that come to our centre, who are in default, they've got debt collectors chasing them. But I think there's a huge hidden problem for people, for example, who may have a $10,000 limit credit card, which is probably most people, and yet every month they're paying back $5000, but then during the month they are using it again to spend, so at the end of the month they've got $10,000 at the end of the month, on which they're paying 20 per cent interest on every month.

That doesn't show up in hardship statistics because they're complying with their obligations. I think that would be really useful if you can get information about the extent of that problem because I think it's quite significant that a lot of people are paying a lot of interest on those cards, that if they would just change some a little bit they might be in a position to be paying that off each month.

MS ABRAMSON: How could you get it – sorry, after you.

MR LEVEY: Just really briefly, we would absolutely agree with what Gerard and Fiona have said. I think one thing, and it won't work for everyone, but one thing that has been effective in credit cards in a really simple way was changing the way that institutions communicated the minimum monthly repayment, because there was clearly a very large group of people who assumed that if they paid that they wouldn't be charged any interest.

You can actually see, in what's happened in some of the statistics over time, that changing that to actually indicate what it will really mean and the fact it might take 70 years for you to pay down that debt if you only pay the minimum, does seem to have had a real effect. I guess what's interesting about that is that if you start extending that way of thinking, of actually testing what really works for some groups of consumers, it won't address certainly some of what has been spoken about, but you could potentially extend that to messages about saying, we actually have a card that has a much lower interest rate and did you know you could save this much if you moved to it. I think that would be an interesting sort of approach.

MS GUTHRIE: Can I just make one other point. I think it's become harder to manage your money since when my grandma was around, because with passbooks you could see how much money you had and if you've got credit cards you actually don't know. You've got a number of small transactions happening over the period of a month, and if you ask people in this room what their credit card balance was, most of us would underestimate it, when we wouldn't know.

So as we improve technology so that we can actually get real time notification of what our balances are, I think that will help the population at large. The trouble is that might be bundled with things like, you look like you've overspent, click here to get a payday loan, or click here for more credit, it could be used for good as well as evil. But it is, I think, definitely, it's a more complex world, financial products are difficult and they are hard to manage, and credit cards are a really good example.

MS ABRAMSON: While I don't have, do you have other questions, Stephen?

MR KING: I'll just have a quick look through my notes.

MS ABRAMSON: I should ask, is there anything else that you would like to raise that we haven't traversed or you think it's important for us to look at?

MR BRODY: Well, one, I'm not sure how much this is in your Terms of Reference, is the insurance industry.

MR KING: It's not.

MR BRODY: Because it's part of the financial system and I guess our assessment is that when widespread reviews of the financial system are done, insurance is often forgotten about, and I think we would encourage a bit of a spotlight on competition in insurance.

MS ABRAMSON: Particular types of insurance, Gerard?

MR BRODY: I'm talking about things like home insurance and car insurance, so your basic insurance products. The issues that we see is that there is a level of price competition in that market so that they're all – car insurance, you see their adverts, low price, it's very, very low, Coles Insurance is one, but what that hides is that the cover that you will get buying is actually not very good cover.

MR KING: Is not great cover, yes.

MR BRODY: That's really hidden from customers when that marketing is going on. So when consumers come to us when it's claim time and they've bought a product, the budget product, but they didn't realise and they thought it was just a good deal, they've realised that they actually purchased a worthless product because it's not going to cover them because of some exclusion in the insurance policy.

So I guess there's a couple of things in that issue. One is, firstly, we are very supportive of proposals to apply the unfair contract terms and phrasing into insurance, so at the moment they're excluded, the only product that is excluded from the unfair contracts regime.

MR KING: There you go, you've gone to the bit that I had an arrow next to because I wanted to ask. I'll come back to unfair contracts because I'd like to ask more about that. But, please, sorry.

MR BRODY: Because we do think that, sometimes, exclusions are drafted that are unrelated to the underlying risks that the exclusion is trying to deal with and they're very widely drawn. We think unfair contract terms could help solve that problem.

Our second thing, we're doing some more research on this at the moment, but I guess better suitability markers or product standard markers in insurance would be better. So, for example, it could be a star rating system that they're applying to health insurance, something that, you know, five star versus a one star product that, in advertising, that would be very upfront. So that if you were buying the Coles cover because it's cheap, you might see that it's also a one star product, we think those sort of markers could be really helpful for people.

Also, we're looking at what's called standard cover regime, so under insurance contracts at the moment there is what is called a standard cover regime and it's sort of a minimum benchmark of what an insurance product should cover, and in fact know the products in the market meet the standard cover regime, because the way you can not comply with it is to disclose it in the product disclosure statement.

So that regime has fundamentally failed to work and we'd like to see that re-examined, about what is a better way to ensure that the product is a safe one.

MS ABRAMSON: I suppose the insurance market really functions at, just generically, at two different levels because you've been talking about the consumer experience of the product, but of course there's another issue about the concentration at the back end. I mean, how many - as you know, we looked at this in other contexts, but how many insurers are there really because the underwriters are actually a very small pool, so it's that too.

MR BRODY: That's a problem even at the retail level, I mean I think that the two major insurance companies in Australia, they've got about a dozen brands between them, 13 maybe, so people think they're different companies but it's actually two major insurers that have got most of the marketplace.

MS ABRAMSON: That was raised this morning as well in banking products, so actually it's the same financial institution, it's just badged as a different product.

MR KING: Can I come back to the unfair contracts, because you've already partly answered the question I had. So all insurance contracts are not covered by the unfair contracts rule?

MS GUTHRIE: I think certain exemptions are the law.

MR KING: I didn't realise that.

MS GUTHRIE: Yes, it's an exemption.

MR KING: I should have realised. I sort of feel guilty now, I'm meant to know those sort of things.

MS GUTHRIE: It's not the sort of thing that people know.

MS ABRAMSON: Well, I don't know that you'd be reading the unfair contracts legislation, it's light bedtime reading, everyone is different.

MR KING: I was on the ACCC, but before that law came in. So I now feel guilty that I haven't kept up-to-date.

MR LEVEY: There is a recommendation from the review of the Australian Consumer Law to remove that exemption, which will go to Government in August I think.

MR KING: On other financial products, I mean we've talked about a range of issues on other financial products, is the unfair contracts law strong enough in terms of these financial products, I mean you've mentioned things like the fine print for behavioural biases that are in there in people's behaviour, do we actually need something stronger, actually dealing with contracts, or is that the wrong way to go in the different distinctions?

MR LEVEY: One thing that we've argued for at Choice is actually extending the definition for a contract to be considered unfair due to undue length and complexity. So I think an example we gave was we hired an actor to read the terms and conditions of the Amazon Kindle.

MS ABRAMSON: I remember that, I do remember that.

MR LEVEY: It took them a few days. We packaged it up as a book. But I mean obviously the idea was to sort of make a point, but we thought it was an important point, which is there's nothing particularly fair about burying quite important information in a very long and impenetrable document.

MR KING: My own story of that is that a few years ago I needed to get a phone from a company that will remain nameless, went into the dealer and I thought I'd better read the terms and conditions, first sort of looked at me and I said, "Can I see the terms and condition?", he just looks at me, reaches below the counter and pulled out a book that was about that thick and said, "If you're reading that, I'm going to lunch". I said, "Has anyone ever actually read it?" and he said, "No one has even asked for it before".

So, any other thoughts on the actual contracts and the way to deal with that?

MR BRODY: I mean the only other thing I would say, I think there is opportunity to make contracts simpler through model contracts in industry. I don't see why they have to be that different between providers when it's a, certainly, a clear type of product like a basic transaction account, what you're getting is the same, why can't there be model contracts.

MS ABRAMSON: What's interesting, Gerard, somebody mentioned that to us earlier about mortgages, there's no reason why a residential standard mortgage shouldn't actually. Which, if you took it to its conclusion, would help portability, because actually it's just the same contract.

MR BRODY: That's right.

MR KING: They were thinking about it from the provider side and the fact that that would make it much easier from the providers and then much easier.

MS ABRAMSON: They'd just change the names on the documentation.

MR KING: Reduce switching costs and so on. Because I think it was Holland, about 10 years ago, they actually had a regime and a whole number of products where there were standard contracts which were agreed to, I think, by industry and the regulators – I don't know if they extended to financial products, I suspect this is, again, telcos and energy – then if a provider wanted to move away from the standard contract they had to make that very clear and actually provide it.

So it meant that providers were, in a sense, in general, for the vast majority of transactions, pulled towards those standard contracts, because as soon as they wanted to move away, for your average consumer, their alarm bells started ringing, hang on, what are you doing here?

MR BRODY: I think that that sort of thing is actually pro-competitive because it encourages then competition around service and price which is really important to the customers, rather than presenting there's competition about the detail.

MR KING: Hiding things in contracts.

MS ABRAMSON: It comes back to what we originally spoke about, which is disclosure, meaningful disclosure that enables a consumer to make a choice, then you'd say the competitive forces should actually want people to be clear about what it is, the product that they're offering.

MS GUTHRIE: Except for really disadvantaged people, Julie, because their choices are so limited.

MS ABRAMSON: I understand about that.

MS TEMPLE: We do see products that compete on access rather than price, so payday loans, rent to buy and that's when people get in a lot of trouble.

MS ABRAMSON: I understood Fiona's point too because you're talking about also a segment of the market where people have poor numeracy and literacy skills, or none of them.

MR KING: Language skills, yes.

MS ABRAMSON: There's a whole range of consumers for whom disclosure is not going to be an answer to competition, I understand that.

MS GUTHRIE: I also think that having lots and lots of products is a deliberate strategy, so having lots, how many credit cards do each of the banks have, I think that's done on purpose in a way because it's really hard to choose between them and so you just go, all right, well, that one or whatever comes up.

MR KING: There's big benefits on both sides, I mean on the customer side, also on the merchant side, because if you're a merchant and accept credit cards you have absolutely no idea what fees you are paying on a particular credit card because every different credit card, even if it's got "Visa" written on it and it's got the same bank, the bank will have 20 different sorts of credit cards, all with different merchant service fees. So the merchants have no idea what on earth they're actually paying when they accept these cards. I think that's being fixed up actually.

MS TEMPLE: They should be getting statements, apparently.

MR KING: Yes. Anything else that you would like to run through at this stage? I've found that very helpful I must say.

MS ABRAMSON: That was terrific. Thank you for making the time available for us. It's just the start of our consultative process. Very interested in the work that you've done around some of the surveys and of your follow-up work, that's really of interest as well. So thank you for making the time.

MR KING: Thank you very much. We'll officially adjourn for the day.

MS ABRAMSON: No, we're not.

MR KING: Yes, we're adjourning, we're not closing.

ADJOURNED [1653]