Submission to the banking royal commission

This is intended to be an overall (with some specific examples included) assessment of the financial system in relation into banking practises and the impacts of these for individuals and business across Australia. The suggestions included are for further consideration of transition or change from our (possibly) outdated financial system to a new more effective system intended to support the Federal government's economic objectives of. Institutional change is required so that the banks play an appropriate role that will assist Australia achieving its economic goals. Not just be profit making factories that do not have the nation's economic interest at heart. Ideally a fair go for all!

1. The objective of price stability
2. The objective of sustainable economic growth
3. The objective of full employment of the labour force
4. The objective of external stability
5. The objective of efficiency in resource allocation
6. The objective of equity in personal income distribution.

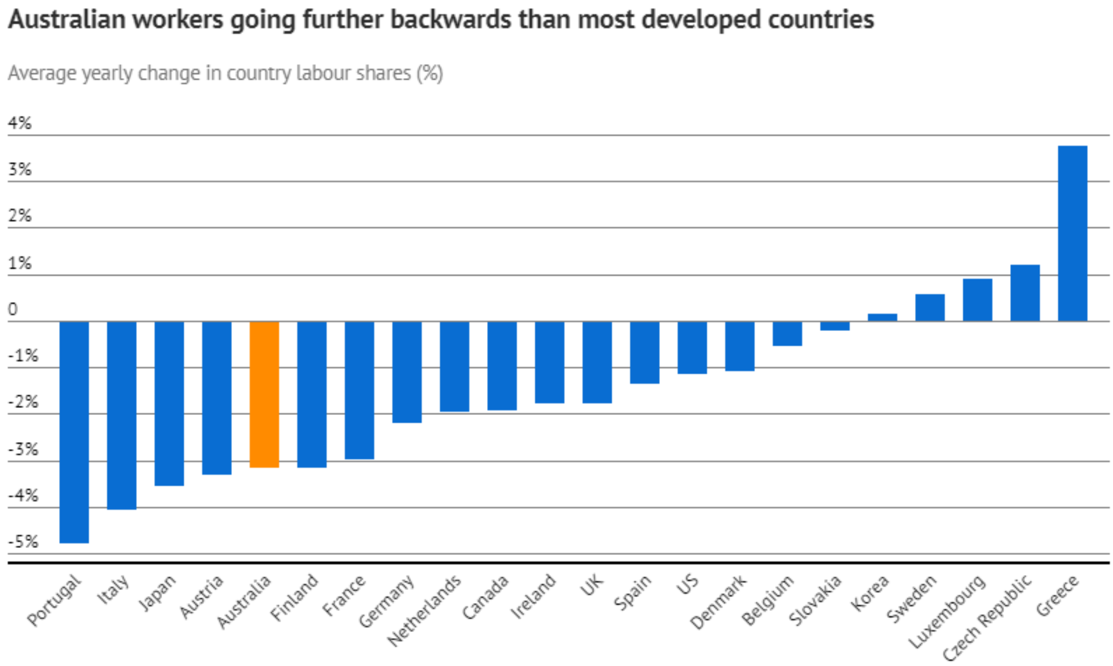
The objectives of the federal government must align with the policies the government uses to control the economy to achieve them. It must be stated that there could be some incongruences in the federal government in achieving these objectives as stated in relation to our financial system at the moment.

The banks recently have been luring customers in with widely advertised rates that are relatively low and then pushing up rates when they have been established as a customer. Customers unfortunately have no recourse but to pay the new rate the bank changes it to. The bank without any supervision (independent, external watchdog) can justify any change to a customer's interest rate. This is for the banks to maximise and protect their profit margins from being compromised whatsoever. More about this protecting profit margins later. This practise must cast doubt as to the validity of the initial rate published to attract customers in the first place. Banks are moving to raise these sweetener rates not long after they have customers signed up. This is a questionably practice.

Is the intended advertised low rate (usually new customers only/why is there a difference in interest rates between these two groups?) a sweetener for the bank to attract customers to initially think that they will be paying the advertised rate until the reserve bank cash rate is changed sometime into the future. With this in mind the RBA has stated in its board meeting minutes that the RBA won't change for at least another year! Customers as a result don't expect the banks to change rates anytime soon and will sign up for a low interest rate financial product that reflects their financial position and servicing. This is very close to a bait and switch type of selling approach which is not ideal for consumers who want to make the best decision financially. Customers when they sign on to the product will think that they will pay the advertised rate, that they signed on to, until official interest rates have changed some time into the future.

This comment is based on the information contained in the RBAs most recent monetary policy report and the information contained in the RBAs decision is reported widely in the media. This does create in the consumer's mind a perception
that they will be able to plan from a financial point of view their ability to budget and meet the families or businesses financial needs without having a change in the initial rate being changed by the banks to deal with. This can reduce stress and provide a predictable/stable environment in which businesses and families can better plan in relation to their savings.

The rate rises coupled with a lack of wages growth for most families is making things very tight indeed. Most areas of the retail sector are finding it tough going and the small rise in consumer spending (consumption) that was reported in last quarter was through the use of household savings rather than an increase in wages growth. This is not sustainable into the short to medium term. Expenses such as increase in power costs health and transport have already eroded the purchasing power of people's stagnant incomes as can be seen in the following chart.



Another area of concern is the banks funding costs impacting on business and individuals. All of these factors combined makes it really difficult for a normal household to plan ahead with the banks raising rates outside of the official cash rate as set by the RBA. When banks operate outside of the official cash rate it makes it much harder for the RBA to make appropriate decisions to achieve its goals to adequately promote the best economic environment to assist all Australians have the best opportunities in the economy. At the moment the level of funding required by banks relies on significant amounts of capital to be raised overseas and are therefore exposed to changes in interest rates and changes in currency valuations. This flows through our financial markets in a way where if interest rates and extra funds are obtained from by the banks are higher than in Australia the costs are transferred straight on to consumers. Rates are expected to increase further overseas which suggested that these extra costs will be transferred on to consumers again. This is happening at the moment. We need to reconsider the current approaches for banks to raise their funds so that banking costs are minimised.

If the official rate stays the same during these increases the RBA lost control over the amount of movement that rates are raised on loans due to the needs of the banks have to finance their operations overseas. Government policy needs to be rethought to make sure that their reliance on overseas funding is reduced to as small as possible. This could be realised through a change in policy from the government ensuring that our banks do not have to lift rates outside of our system here and consumers can be protected to a lesser degree than they are exposed the moment. This would provide the opportunity for structural change in the market, that would give the government through its various agencies more control to achieve its economic goals. The financial system we have currently needs to be changed to adequately reflect the practises of the banks and the impact of new thinking and technological improvements to doing business. The reliance of banks to finance their operations in the way they do currently is creating the need for rates to rise for consumers unnecessarily.

Is this the best approach to run our financial system with all of the knowledge and the ability to change policies to achieve the economic goals we are striving for?

What changes are necessary for our financial system to operate in a manner that our government and its agencies can effectively control the variables within the system to achieve the overriding objectives it has for economic wellbeing that helps everyone in our society?

Lets talk about the profit margins of the banks

The protection of the profit margin has recently manifest itself for Westpac as a 4.2billion profit for the first half of this year!

As a guide multiply this figure by approximately the same amount with the big four banks this half yearly figure becomes 16.8 billion for the half year and then 33.6 billion for the full year! How does this leakage of funds from the wider economy help the Federal government achieve its economic goals? The RBA is concerned with the focus or funds going into the housing market and has changed policy to limit this in the short to medium term.

I would suggest the banks are hardly struggling to make ends meet. The profit that the banks have generated in recent years clearly relates to the amount of concentrated market power these institutions have. The concentration of power the banks have is largely as a result of the rationalisation of financial institutions that occurred after the GFC. Most institutions who didn't have access to funds through customer deposits found the price of capital go through the roof. The cost of funds got to a point where they went higher in percentage terms than those being offered by the other institutions who had funds coming in over the counter. Therefore they could not compete and most did not survive as a result of not having the ability to continue lending to customers in the market (their core business). This rationalisation of lenders in the Australian market led the way for those that survived (our big 4 banks) had more power than they have before the GFC. The result of this is that the remaining players have a much reduced number of alternatives in the marketplace. This does not encourage competition in the marketplace and can lead to the players being able to set the price for their products/services offered.

for those that Is it time that the government has a higher level of involvement and possibly regulate more in this marketplace so that a more equitable distribution of power still provides a good profit for these institutions but not in the skewed manner that is happening at the moment because of the lack of regulation in terms of market power.

This change in rates will be the thin end of the wedge with banks looking to increase rates further outside of the official cash rate offered by the RBA as interest rates rise further (it is predicted) in the US and funding costs increase further. Rates for home owners and others will continue to be increased in Australia as a result. Ideally where the banks get their funds from should reflect the official rate that the RBA sets so that the overriding goals of the economy can be adequately managed so that policy can be decided to benefit all Australians. Currently the banks are offering most products with a guaranteed profit figure that they *alone* determine.

This part of an article from Ross Gittens sums up my concerns about the state of play and seemingly its motivating factors

Ross Gitens article smh 4/9/18
https://www.smh.com.au/business/banking-and-finance/why-the-banks-will-ignore-customer-anger-and-match-westpac-s-rate-rise-20180904-p501lh.html

In other words, there's a big *economic* dimension to the banks' misconduct. Neglect that and we'll still have much to complain of.

The strange thing about banking is that it's ruthlessly competitive and uncompetitive at the same time. The banks' bosses are obsessed by a game in which they compete to achieve the highest percentage increase in their profits and share prices.

It's *this* competition that's kept bankers in their bubble of unreality, urging their minions on with KPIs and commissions and bonuses, and turning a blind eye to the rule-bending they lead to.
This is why Westpac has moved to protect its profit margin by passing a small increase in its costs on to customers, even though our banks are already among the most profitable in the world. And this is why its competitors are likely to follow suit, whatever their customers think.

It's the lack of *price* competition at the retail level that makes it possible for the banks as a group to raise their prices whenever they see fit. The others could hang Westpac out to dry, but it's a safe bet they won't.

It's only effective measures to increase price competition that will stop the banks overcharging us. There are no easy answers. But the banks are so influential that, to date, neither the two parties nor their bureaucratic advisers in Treasury, the Reserve Bank and the Australian Prudential Regulation Authority have shown much enthusiasm for the challenge.

That's what we must hope all the voter anger generated by the royal commission is about to change.

This article shows that these institutions are able to charge virtually what they want with fees and charges to customers and also adjust interest rates outside of the official rate – at the moment the banks source their funds from a number of different sources over the counter, and through interbank lending (some of this from overseas). This coupled with the devaluing of the Australian dollar and the cost of funds rising overseas an increase in mortgage rates has been passed directly on to consumers. The Australian dollar has reduced 13% in relation to the US dollar so far this year!

This is all to protect the profit margin as determined by the banks not by the market through competition as is traditionally the case in many other industries . It's largely determined by the banks themselves as Ross Gittens puts it within their "Bubble of unreality". How have the regulators allowed this to happen within the economic goals stated? Clearly institutional change and government policy change needs to be considered for efficiencies to return to the marketplace. Something needs to change in the thinking here. We have to ask the question, What is not working within the existing banking/financial system we have and what is needed to ensure that competition returns to the marketplace as quickly as possible.

Unfortunately the banks and their approaches in recent years have reflected this as well with the market power they have. We need to have a rethink of the financial system so that it is not disproportionately taking this much money out of the economic system for a select few. Currently there is talk about how skewed the level of investment is in the housing sector and how it needs to be corrected. The way that banks are operating at the moment there is an imbalance here as well. I am not suggesting that the banks make no profit however to take out billions of dollars in profit through having a lack of diverse alternatives available to consumers in the marketplace is not manifesting itself in a competitive market manner. This means that well all pay more for the same service.

So a possible solution to this could be that the RBA have the power to control access to funds so that banks do not have to access funds overseas in the way that they do currently. Therefore the funding costs in this market where economies are increasing rates higher than our cash rate is that consumers don't have to pay the difference in the higher rates from overseas. Conversely if rates are higher here in Australia and banks funding costs are lower if they get them from overseas that these lower costs should be offered to customers in a timely and appropriate manner.

This will reduce the dislocation of funds in our economy that are allocated for banks to currently make that end up with profits. These funds could be used to consume or invest in different ways and not just end up in the reported profit figures for the years trading for the banks. We need to ask the question, how can regulation and the level of controls through policy change help this to work much better for individuals and business in Australia? Are we doing enough so that financial stress is minimised at an acceptable level within our society so that banks can make a profit and the rest of society does not wear the brunt of the market power these institutions have. Do we have the economic objectives in mind when this happens?

We should also consider the possibility as a nation for the role of the RBA to provide housing loans to consumers directly. This would take a change in thinking and policy for the government to consider and would have the potential to provide a significant (cheaper) alternative for consumers and satisfy their funding needs in the marketplace and for consumers not just to be at be at the discretion of the big four and their significant market power they have. This extra competition will make organisations become more efficient and help to drive process down. This can be seen in the super industry and is highlighted with the difference in industry and private superannuation products in the marketplace. The royal commission has highlighted some less than ideal practises that some companies have engaged in to further disadvantage individuals in our society. This does not help to achieve the economic goals of the federal government. We as a nation can do better than this, as long as we consider institutional and policy change.

The concentration of market power the banks currently have is shown in the lack of product differentiation and in most customer heavy financial products within the marketplace. This is highlighted by the example shown below. An example of the frustration individuals has with the products banks offer is below and clearly highlights the lack of competition in the industry. This is not a typical situation for a loan however, it will show the lack of financial products and alternatives being provided by the big 4 banks.

A person I know is looking to buy a unit for their retirement.
They were told by the bank that they have to meet the following criteria and conditions to qualify for a loan.

The property they were looking at was to be auctioned. The people involved have just received a lot of money through an inheritance, so were cashed up. They were to provide the deposit for the purchase which is normal requirement of a purchase. The rest of the funds, which are to be provided for the purchase of the unit, would then needed to be assessed further (through a bank valuation) after the deposit has already been paid to purchase the unit.

It is only at that point after the unit had been purchased that the bank were willing to provide the extra funds but thus was based on a valuation of the property. This is an incredibly risky option for any would be purchaser to have to consider. The LVR was around 52% based on the ballpark price for the unit to be sold in a slightly dropping market. Even less risk for the bank to provide the funds. The people went around to a few other banks and found that all of the banks are offering exactly the same deal. It would be a big

coincidence that all of the banks contacted had the same deal. The banks watching what the others are doing and offering no real alternatives for consumers to be able to find an appropriate financial product to satisfy their needs. This is replicated for the banks mum and dad customers in mortgage rates, credit card rates, personal lending rates etc. The banks could possibly show me where there are differences in the marketplace with some of the products they offer however there is a sameness about what id being differed to consumers across the board.
Where is the competition in the marketplace here?

The banks don't have to try too hard because they know that there is nowhere else for consumers to go once they signed on to a loan there have been recent changes in the lending criteria, making it much harder for individuals to qualify for a loan. There is the however the strange anomaly in the products the banks offer new customers with the interest rates being offered being much lower than what their loyal customers are being offered. Surely the cost of funds for the bank should be the same? This, it could be suggested, relates to the attraction of new customers at the advertised lower rate and when consumers commit themselves to the product, the rates being changed at a later time without any real alternative but to just wear it. With lending criteria tightening significantly the banks know that individuals will not qualify to refund these loans elsewhere and therefore do need to try as hard to look after customers that may happen in a more competitive marketplace.

There needs to be the ability for the rates charged on a loan (mortgage) to be more in line with the cash rate as published by the RBA and for other funding costs to be limited in their ability to change the economic landscape in the way they currently do. Some households are experiencing heightened levels of mortgage stress but in a different way than in the past. Historical levels of low interest rates have driven household debt to record levels. This combined with the lack of income growth and increased costs in the bills households need to cover, is leading to a reduced level of consumption in our economy. Less consumption leads to less being output and the possibility of businesses needing less workers needed, unemployment going up and having to wait even longer period before wage rises kick in to help service that debt. This approach doesn't achieve too many of the economic objectives the federal government is aiming for. Why is it appropriate for us to continue with this system that has led to the issues already raised? We need to consider full systematic and policy change for Australia to achieve it economic goals?

Some other points…..

The new restrictive lending criteria placed on loans in most cases does not allow customers to consider switching between loan providers because they don't qualify for a new loan from another lender. This means that banks have a monopoly like level of power over customers because they cannot qualify for the alternate product. This limits customers' ability to be able to shop around for a loan. This means that there will not be a lot of motivation for banks to have a level of competition in the marketplace that should have and the ACCC should try to provide for consumers out there. This can lead to higher levels of fees being charged and relative levels of inflated interest rates being charged compared without achieving a more competitive marketplace in this sector. This leads to profits being higher. The banks are experiencing record profits already – one example being Westpac announcing recently a half year profit of $4,200 million.

These institutions are able to charge virtually what they want with fees and charges to customers and also adjust interest rates outside of the official rate – at the moment the banks source their funds from a number of different sources over the counter, and through interbank lending. With the devaluing of the Australian dollar and the cost of funds rising overseas an increase in mortgage rates has been passed on to consumers. This will be the thin end of the wedge with banks looking to increase rates further outside of the official cash rate offered by the RBA as interest rates rise in the US and funding costs increase further. Ideally where the banks get their funds from should reflect the official rate that the RBA sets so that the goals of the economy can be adequately considered so that policy can be decided to benefit all Australians.

Also we should consider the possibility as a nation for the role of the RBA to provide housing loans to consumers directly. This would take a change in policy for the government however will provide a significant alternative for consumers and their funding needs in the marketplace and not just be at the discretion of the big four and their significant market power they have.

With the lack of consumption happening now (accept for those using their savings to support it), there is a dislocation of funds within the economy that will slow economic growth because they are ending up at the banks as profit, not being used to invest or being used for consumption of goods and services. The government has focussed on the housing sector being overheated and has moved to slow this growth by introducing lots of systematic and policy change to become more aligned with its economic objectives.
This has not happened within the financial industry and is creating a monopolistic environment in which the banks can be their own boss. The banks still seem to have the same market power as they had before the royal commission!

There seems to be a level of sameness in the market place that we have had in Australia since the consolidation of financial alternatives were mostly gobbled up or did not continue to trade after the GFC. This concentration of players in the market place along with the tighter lending restrictions the banks are now using to assess a persons suitability for a loan provides the financial sector that has possibly unintentionally created an environment in our financial markets that is even worse than before the royal commission in the banking sector was!

The deposit rates the home loan rates are all just about the same product
The way banks are assessing the suitability of consumers applications in very similar ways.
There in little or no difference in the alternatives present to consumers in the market.
This could be construed as an oligopoly market. That definitely has a lack of competition.
The policy makers need to acknowledge this and start to reformulating our financial markets through appropriate ways to do this.

In the bigger scheme of things it has become really difficult for a normal person to plan for their retirement with the amount of changes that have been happening in relation to policy. There have been a number of policy changes made recently that are constantly effecting individuals approaches to invest and provide for their families retirement. Recent changes in the financial system have been the biggest and most sweeping in Australia's history. The changes to investment properties, foreign investment, changes in share market portfolios, lending criteria, ability to qualify for a loan, etc. have made it nearly impossible for an individual to try and work towards financial independence and not be able to rely only on the existing superannuation system we have for our retirement. The examples that the royal commission have identified recently have shown that if this is the only option for many individuals for their retirement savings, it's a very disappointing and potentially very short sighted system we now have.

Through the banking royal commissions findings and a relatively new Federal government that is open to what is fairness for all individuals we do have an opportunity for real systematic and policy change to happen.

Just think of the possibilities for Australians if we firstly identified the need to change and then got it right!

Wow!

An external factor to consider.
The trade war between China and the US has intensified and there will be some fall out for the Australian economy. With this impact the rate of growth will slow down which will take longer for our economy to recover. We should be looking at the opportunities for the Australian companies to take advantage and fill the gaps that the US goods could have filled. Oy will take time to establish new trade relationships at all levels with Chinese markets and companies. This is a once in a lifetime opportunity for our industries to further engage with not just China but others as well. This will assist in our economic growth at in a sustainable way into the future.