Brotherhood of St Laurence
Working for an Australia free of poverty

Submission to

Senate Economics Committee inquiry into competition within the Australian banking sector

Brotherhood of St Laurence

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1 Background into the Brotherhood of St Laurence's interest in competition within the Australian banking sector

The Brotherhood of St Laurence is an independent non-government organisation with strong community links that has been working to reduce poverty in Australia since the 1930s. Based in Melbourne, but with a national profile, the Brotherhood continues to fight for an Australia free of poverty, guided by principles of advocacy, innovation and sustainability. Our work includes direct service provision to people in need, the development of social enterprises to address inequality, research to better understand the causes and effects of poverty in Australia, and the development of policy solutions at both national and local levels.

As part of our wider efforts to promote social inclusion, the Brotherhood is committed to developing and demonstrating effective programs for disadvantaged people to address financial exclusion. Financial exclusion involves being denied access to affordable, appropriate and fair financial products and services, with the result that people's ability to participate fully in social and economic activities is reduced, financial hardship is increased, and poverty (measured by income, debt and assets) is exacerbated (Burkett and Sheehan 2009).

The Brotherhood believes that all Australians have a right to fair and affordable access to basic services, including banking services. Fair and affordable access to essential services helps disadvantaged and low-income people by enabling them to be part of Australia's mainstream society, and by ensuring corporate, government and community sectors all take responsibility for addressing social problems.

The Brotherhood has developed a range of services which help address financial exclusion through capacity building and structural change:

- *Saver Plus*, Australia's largest matched savings and financial education program developed in conjunction with ANZ and delivered in partnership with a number of community agencies. During 2009-11, with Federal Government support, Saver Plus will reach 7,600 participants in 60 communities nationally

- *Progress Loans,* a low repayment, affordable small loan program delivered in partnership with ANZ. During 2009 to 2011, this mainstream and fair loan product will be made available to 800 borrowers

- *MoneyMinded,* a financial literacy education program. The Brotherhood delivers this resource through a 'train the trainer' model and also through professional development for workers in community agencies

- *Financial Health Service,* a pilot one-on-one financial guidance and information service.

The Brotherhood welcomes the Senate Economics Committee's renewed interest in competition in the Australian banking sector as it acknowledges effective competition in this market is crucial to the provision of essential financial services to low income people. We also refer the Committee to our submissions to recent inquiries considering similar matters, in particular the Senate Economics Committee Inquiry into the Banking Amendment Bill 2010 (August 2010), the Senate Economics Committee Inquiry into Aspects of Bank Mergers (January 2009) and the House of Representatives inquiry competition in the banking and non-banking sectors (November 2008).

2 Low income people and the current state of competition in the retail banking sector

In its work with low income people across Australia, the Brotherhood has become aware of the extent to which lower income people are excluded from essential financial services, and some of the causes of this exclusion. The Brotherhood is in support of measures to improve the effectiveness of competition in the Australian banking sector, but notes that competition alone is not enough to address the significant problem of financial exclusion.

The Australian banking sector is comprised of some of the world's safest and most prudently managed banks (ABA 2010), and effective competition in the banking sector has the powerful potential to drive down prices and incentivise innovation as firms seek to service customers. Further, improved competition generally results in better market outcomes for customers: lower prices and improved product and service offerings. However, more is required if fair and affordable essential financial services are to be made accessible to all Australians, particularly low-income and vulnerable groups.

The inquiry raises key issues around the effectiveness of competition in the banking sector, including the availability of products, the prices of the products, and the ease with which one may switch between products. The Brotherhood notes that much of the public debate has centred around important financial products such as mortgages. While effective competition in the mortgage market is important, housing affordability is increasingly inhibiting many lower and moderate income people from purchasing a home. The Housing Industry Association's affordability index demonstrates that affordability has decreased by 18.3 per cent in the twelve months to September 2010 (HIA 2010). Given this reality, the Brotherhood argues that the debate about competition in banking must be broader than the mortgage market, and must consider other financial services that are key to the wellbeing of all Australians.

One financial product that is not adequately provided by the mainstream banking sector is that of short term small-amount credit, which is required by many low-income households to help smooth expenditure and progressively acquire a base of assets. Low income earners are still struggling to access short term small amount unsecured loans, as indicated by the quotes below.

> I suppose you have less options, it's less options obviously because your income is low. Many people like for example an unemployed person, pension people, if they approach the bank, the bank will say 'Sorry, you're not entitled because your income is less than $15,000', and Centrelink payment is between $12,000 and $13,000.
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> Banks are very, very dominant over you. You feel very intimidated … You feel as though you shouldn't be in there. You're in this ivory tower, you shouldn't go near it. In the old days before they became globalised you could walk into a bank and you talk to the bank manager, and he would make a decision there. There was more leeway. But now they say 'the book says no'. (Sheehan et al. 2008, p.15).

Despite low income earners displaying strong demand for small-amount personal loans, they are far less likely to hold any form of mainstream debt (Kohler et al. 2004), as most banks do not offer small personal loans to low income earners. Where providers do advance small amount credit to lower income households, it is often in the form of credit cards or expensive options promoted by fringe and payday lenders. For many on low incomes, credit cards are a debt trap – they are a product designed to encourage immediate expenditure, without provision for a clear and realistic payment arrangement.

Fringe banking services, including payday lenders and the like, have also proliferated in Australia over recent years, exploiting the lack of mainstream providers in the market for small amount loans (CALC 2010). Many low income earners who require small loans (less than $5,000) borrow from payday lenders and other fringe lenders at exorbitant rates as, in many cases, it is their only viable option. Others turn to credit cards and amass debt that way. In both cases, the borrower is often slugged with exorbitant fees and/or interest rates.

Community organisations, with support of the Federal Government, and in partnership with mainstream banks including the ANZ and NAB, do offer small amount loans to low income earners at fair rates. These initiatives help improve the availability of small amount short-term credit to low income earners. Through these initiatives and other tools, lower income earners can gain access to fair and affordable financial services. Further support needs to be provided by governments and banks to expand these initiatives to reach more people.

Improved access to financial services does not pertain only to improved access to small amount loans, but also to superannuation, insurance and transactions accounts. In relation to transaction accounts, competition in the marketplace relating to ATMs may not have positive outcomes for all in the community. While increased transparency in terms of fees charged for ATMs being displayed on ATM screens is good, many low income and marginalised groups still find themselves incurring significant ATM fees. In particular, many low income consumers who generally have lower account balances check their balances at ATMs in order to see if their income has been credited to their account. For many, each time a balance is checked, this may incur a fee. Further, disabled people or those living in rural areas may have limited access to the ATM of their choice, meaning that they could have to use another bank's ATM facility and, in doing so, incur a fee. These outcomes underscore our submission that measures other than enhancements to competition must be used to ensure that marginalised people have access to fair and affordable financial services.

3 Ease of moving between providers of banking services

Switching by customers is crucial to competition in many markets, including those for financial products and services, because it forces providers to price more keenly to avoid losing customers (UK OFT 2010). There are various costs associated with switching between product/service providers, and these can hinder effective competition.

Customers' reluctance to switch financial service providers is evident in markets for mortgages and superannuation services, but extends into range of essential financial services. Forthcoming research from the Brotherhood around awareness and uptake of basic (low/no fee) transactions accounts shows that despite at least 75% of those surveyed standing to gain from switching, not even 30% had made that switch. This is despite the fact that many of those surveyed had participated in financial literacy education which emphasised the benefits of basic accounts and switching providers.

This reluctance by customers to switch something as simple as a transaction account can be explained by a number of factors relating to behavioural economics, financial literacy levels, and the various costs associated with switching, which are not limited to monetary costs, but also include risk, time and costs of other resources (e.g. cost of phone calls or internet costs). More specifically, these costs may include:

- The time and resources spent in the information search phase of the switch, and the inherent risk that this information search may be of no utility to the customer if they were to find themselves to already have the preferred deal
- The time taken to make enquiries into the advantages/disadvantages of the switch
- The time taken to enter the bank branch where the new account is to be opened and provide the necessary identification and complete the necessary paperwork
- The time taken to transfer the funds balance, as well as the monetary cost of any penalty fees, lost interest or transfer fees
- The time and resources required to cancel or amend any direct debit arrangements existing with the original account
- The various risks (such as failure to cancel a direct debit leading to an overdrawn account fee)

The effects of these costs may be understood to induce even further reluctance toward switching when viewed in the context of the situations of lower income Australians, who may have limited access to information (many save money by forgoing landline phones, but this can render phone communication with banks too expensive), limited time (many work and/or are responsible for one or more children or dependants) and lower levels of financial literacy required to fully interpret and understand the impacts of entering into new financial arrangements.

In order to reduce barriers to switching and drive effective competition, the Brotherhood supports the measure proposed by the Consumer Action Law Centre (CALC 2010) to have the Australian Government develop an effective scheme that would allow bank account portability. This would see customers own their bank account numbers and allow them to switch between institutions without having to change credit or debit instructions.

4 Interest rates and cost of capital

The Brotherhood supports measures which improve transparency in banks' setting of loan interest rates, and how this relates to banks' costs of capital. Transparency and clarity would provide consumers, including those that are economically and socially marginalised, to have confidence that the banking sector is delivering competitive and efficient products and services.

The Brotherhood would encourage the Reserve Bank of Australia to research and publish the average cost of capital of Australian banks. This would see customers become better informed and enable them to make well informed decisions when selecting between lenders, particularly in relation to mortgages. It would else help ensure customers understand movements in interest rates, and bring about confidence that movements reflect actual cost pressures rather than banks' gouging of customers. Without more clear and transparent information about the average cost of funds for banks, Australians are rightly suspicious that banks are setting interest rates at a level that is not efficient or competitive.

Further consideration needs to be given to how banks could be more transparent in the pricing of unsecured credit, such as personal loans and credit cards. It is not clear to many consumers why interest rates on credit cards in particular are so high in comparison with other forms of credit.

5 Policies, practices and strategies to enhance competition

While the Brotherhood supports measures to enhance competition in the banking sector, it also acknowledges that competition and the free market cannot deliver the essential financial services required by all Australians, and that other measures must be taken to ensure that every Australian has fair and affordable access to essential financial services.

In addition to measures to encouraging competition and ease of switching, and the publishing of banks’ costs of capital, there are numerous other policies, practices and strategies which are crucial in enhancing outcomes for consumers. Listed below are a number of policies that need to be considered further to ensure competitive outcomes are delivered for the whole community.

Monitoring and accountability

The Brotherhood notes that performance monitoring in the United Kingdom and the United States has created accountability among financial institutions to develop affordable, appropriate products to address financial exclusion. In the United Kingdom, the United Kingdom Treasury Department has measurable objectives including a goal that affordable credit, saving accounts and simple insurance products be available to all who require them. In the United States, financial institutions are rated on their performance under the Community Reinvestment Act.

Reputation

Banks may be incentivised to service all citizens by way of reputational rewards (from Government initiatives such as ratings schemes) in accordance with their contribution toward financial inclusion. In the United States, banks’ ratings under the Community Reinvestment Act give the public an indication of the banks’ performance in meeting the needs of marginalised borrowers. Any favourable ratings achieved could then be used by banks in subsequent media releases to enhance their reputation.

Tax incentives

Tax incentives can be useful in rewarding firms who participate in and contribute toward building financial inclusion. This could involve increasing tax incentives for firms to invest in Community Development Finance Institutions (CDFIs). This would encourage financial investment from firms into CDFIs which help to provide financial services to underserved markets, helping to overcome social exclusion.

Community and service obligation

There may be the case for further regulation to ensure that financial institutions provide accessible basic services to all customers. This can be necessary in markets where policy makers recognise conflict between the profit motive of firms and the social policy goals of the industry. For instance, privatised telecommunications, gas and electricity companies are not able to deny access to less profitable rural or low-income consumers.

Funding

Governments can provide funding for the development of affordable, appropriate products. The Federal Government did provide funding to this end, in response to the global financial crisis. For example $44 million was provided to NILS, Saver Plus, Progress Loans and Step Up programs (Rudd 2009), while $7 million has been committed to support community development finance institutions

(Macklin 2010). Government support can help establish business cases, or identify where service will not be delivered without government subsidy.

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