The Parliament of the Commonwealth of Australia

Review of the Reserve Bank of Australia's 1992/93 Annual Report

Report from the House of Representatives Standing Committee on Banking, Finance and Public Administration

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Foreword

This review of the Reserve Bank of Australia's 1992/93 annual report is the first of a series of reviews which the Committee intends to conduct each year.

Through this process the Committee intends to provide an accountability mechanism whereby the role and function of the Reserve Bank in terms of financial surveillance and prudential supervision can be monitored. It will also provide a public forum where concerns arising from changes in the banking and financial services industry can be discussed and debated.

This report focuses primarily on bank interest rate margins which will also be a major consideration in the next review. Other issues that have been examined include the role of the Council of Financial Supervisors, consumer protection, barriers to competition, financial surveillance and prudential supervision, lending to small business and the rural sector and superannuation and insurance.

I thank members of the Committee for their strong and valuable assistance in the conduct of the review and in the preparation of the report. The Committee extends its appreciation to the Governor of the Reserve Bank, Bernie Fraser, for his support during the initial review. The Australian Bankers' Association's assistance is also acknowledged.

Finally I would like to thank the secretariat for their work in the conduct of the review and Mr George Stoyanoff from the Australian National Audit Office for his professional assistance in the course of the review.

THE HON DAVID SIMMONS MP
Chairman

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1 Replaced the Hon R P Elliott, MP as Chairman from 10 February 1994.

2 Replaced Mr A C Rocher, MP as member of Committee from 5 May 1994

3 Replaced Mr E J Fitzgibbon as member of Committee from 10 May 1994 and Mr Fitzgibbon replaced the Hon J C Kerin, MP as member of Committee from 9 February 1994.

4 Replaced the Hon R P Elliott, MP as member of Committee from 9 February 1994.

Terms of Reference of the Committee

The Standing Committee on Banking, Finance and Public Administration is empowered to inquire into and report on any matters referred to it by either the House or a Minister including any pre-legislation proposal, Bill, motion, petition, vote or expenditure, other financial matter, report or paper.

Annual reports of government departments and statutory authorities tabled in the House shall stand referred to the relevant committee for any inquiry the committee may wish to make. Reports shall stand referred to committees in accordance with a schedule tabled by the Speaker to record the areas of responsibility of each committee.

Acronyms and Abbreviations

RBA	Reserve Bank of Australia
ABA	Australian Bankers' Association
US	United States of America
UK	United Kingdom
OECD	Organisation for Economic Co-operation and Development
STATEX	Australian Stock Exchange database
NFF	National Farmers Federation
G30	Group of Thirty
NBFI	Non-Banking Financial Institutions
NCD	Non-Callable Deposits
SME	Small and Medium Enterprises
FCLs	Foreign Currency Loans

CHAPTER ONE

INTRODUCTION

Background

1.1 On 4 October 1990, the then Treasurer, the Hon Paul Keating, MP announced that he intended to refer an inquiry into the Australian banking industry to the Committee. This inquiry provided the Committee with a valuable opportunity to assess the progress and outcomes of financial deregulation. The result of the inquiry was a comprehensive report on the banking industry, *A Pocket Full of Change.*[1] The then Chairman of the Committee, the Hon Steve Martin, MP said of the report:

> This report can be viewed as a balance sheet for the banking industry in its first decade of deregulation. More importantly, though, the Committee, through this report, is looking to the future of the banking industry, as Australia prepares to meet the challenges of a new century.[2]

1.2 The report subsequently became recognised widely as one of the most significant reviews of the banking industry for many years.

1.3 The first recommendation of the report that was implemented was the amendment of the resolution of appointment of the House of Representatives Standing Committee on Finance and Public Administration to include responsibility for reviewing the banking industry. This recommendation also included changing the name of the Committee to its present name, the House of Representatives Standing Committee on Banking, Finance and Public Administration, to reflect the responsibility for banking.

1.4 On 31 March 1992, the then Treasurer, the Hon John Dawkins, MP provided the Committee with a reference to review the implementation of the 25 recommendations specifically directed to the banks. The result of the inquiry was the Committee's second report into the banking industry, *Checking the Changes.*[3]

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1 House of Representatives Standing Committee on Finance and Public Administration, 1991, *A Pocket Full of Change,* Canberra, AGPS.

2 ibid., Foreword.

3 House of Representatives Standing Committee on Banking, Finance and Public Administration, 1992, *Checking the Changes,* Canberra, AGPS.

1.5 In this report,[4] the approach that the Committee took in making its recommendations was to define a view of best banking practice.[5] However, as indicated in the report,[6] the Committee did not consider that the market would always drive banks towards best practice, particularly where the consumer was involved. The Committee considered that pressure would need to be maintained on banks regarding the implementation of those recommendations that were intended to lead to a better and fairer banking system for consumers.

1.6 In addition to the interests of consumers, the Committee is of the view that there is a need for continuing parliamentary oversight of the banking and financial services industries as a means of addressing broader policy issues including the role of the Reserve Bank of Australia (RBA). One of these issues is the need to maintain accountability. The Governor of the Reserve Bank acknowledged the need for accountability with regard to the operation of the RBA:

> the Reserve Bank does operate with a high degree of independence. We choose to exercise that independence in consultation with the government... At the same time, because we do operate with a high degree of independence, we recognise that that has to be accompanied by a high degree of accountability...We have been making considerable efforts over some years now to be more accountable, to put out more information on what we do and why we do those things, not least in the annual report.[7]

1.7 This annual review of the RBA's annual report provides a valuable accountability mechanism through a public forum where concerns arising from changes in the banking and financial services industry can be discussed and debated outside of the supervisory framework between the RBA and the banks. It also provides a means by which the RBA can be held accountable for its policies and decisions, a process which will benefit the RBA, the industry and the community.

1.8 The Governor went on to indicate support for the role of the Committee in this process:

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4 ibid.

5 ibid., p. 3.

6 ibid.

7 Evidence, p. 3.

> Notwithstanding those efforts, I am afraid there still is a good deal of misunderstanding and misinterpretation...It is against that background that we actually welcome the opportunity to come along here today before the committee to clarify and elaborate on some of the issues *that are covered in the annual report.*[8]

1.9 The ability of the Committee to continue to monitor issues in the banking industry was facilitated by amendment to the standing orders, whereby standing order 28B was amended so that annual reports of government agencies were referred to the relevant House standing committee.

1.10 In accordance with standing order 28B(b), the RBA's 1992/93 annual report was referred to the Committee in 1993. The Committee was then able to undertake an inquiry into matters arising from the annual report. This process also forms the basis for the Committee to undertake an annual review of the banking industry to fulfil the Committee's view of the need for continuing parliamentary oversight of banking issues.

1.11 In this review the Committee has taken the opportunity to follow up on matters raised in earlier reports and to examine current concerns and developments that the banking industry, and the customers of the banks are presently facing.

1.12 In conducting the inquiry, the Committee invited the RBA to attend a public hearing and comment on current issues facing the RBA and more generally on developments in the banking industry that have occurred during 1992/93. At the Committee's first hearing, held on 28 October 1993, the RBA provided comment on interest rates and interest rate margins, lending to small business and the rural sector, the proposed changes in financial surveillance and prudential supervision and consumer issues including the operation of the banking industry ombudsman scheme.

1.13 In order to provide the banking industry with an opportunity to respond, the Committee also invited the Australian Bankers' Association (ABA), to attend a public hearing. This hearing was held on 18 May 1994 and the ABA provided comment on the developments in the industry and on many of the issues raised by the RBA.

1.14 In addition to the two hearings, the Committee also received a number of submissions on various aspects of the banking industry. A list of the submissions received is at Appendix 1.

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8 ibid., p. 4.

1.15 The Committee found that the level of bank interest rate margins was one issue which raised considerable public comment and as there were a number of other issues that also needed to be considered when examining bank interest rate margins, a chapter has been devoted to this matter. Other issues which were also considered significant are included in a single chapter. These issues include the role of the Council of Financial Supervisors, consumer protection, barriers to competition, financial surveillance and prudential supervision, lending to small business and the rural sector and superannuation and insurance.

CHAPTER TWO

INTEREST RATES AND BANK MARGINS

Historical Perspective and Public Concern

2.1 *A Pocket Full of Change*[9] indicated that the issue of bank interest rate margins had aroused considerable public concern in 1990 to the point that it was the subject of a report to the then Treasurer and was one of the motivating factors behind the first inquiry into the banking industry. Since 1990, nominal interest rates have tumbled to historically low levels, and 1993 and 1994 have been characterised by these low levels. However public comment over interest rates has continued, but these concerns are now directed, not only at the level, but particularly at interest rate margins applied by the banks.

2.2 The issue of bank interest rate margins is also significant because it provides one means of assessing the extent to which financial deregulation has increased competition in the industry. To ensure that the Committee was well informed on this aspect of the inquiry and as a means of securing advice independent of the RBA and the ABA, the Committee engaged 2 consultants to provide submissions on the issue of margins; Professor Ian Harper, Ian Potter Professor of International Finance at the University of Melbourne and Mr Des Moore, Senior Fellow at the Institute of Public Affairs. These submissions have been authorised for publication.

2.3 In response to both the public concern over margins and to recommendation 2 from *A Pocket Full of Change*,[10] the RBA in its May 1992 Bulletin[11] reported on bank interest rate margins to provide more reliable information and allow informed debate to take place, avoiding reliance on anecdotal evidence.

2.4 The RBA indicated that the concerns over margins are:

> ...often made with reference to a simple comparison of one lending rate and one deposit rate. The most common examples are:

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9 op.cit., p. 88.

10 ibid., p. 101.

11 Reserve Bank of Australia Bulletin, Bank Interest Rate Margins, May 1992, pp. 1-6.

- the difference between the business indicator lending rate and the bank bill/certificate of deposits rate;

- the difference between the business indicator lending rate and the overnight cash rate; and

- the difference between the housing indicator lending rate and a savings account deposit rate e.g. statement savings account.[12]

2.5 The RBA indicated that the measures referred to above have often been used to try to justify claims that bank customers have been disadvantaged by a widening of margins. As indicators of margins, the RBA considered that they are simplistic and misleading.

Measurement of Bank Interest Rate Margins

2.6 The Committee notes that there are three measures that can used in measuring margins. They include:

- simple comparison of one lending rate and one deposit rate, referred to above;

- net interest margin; and

- gross and net interest rate spreads.

2.7 It is generally accepted that the best measure of bank interest rate margins is the measure of the gross and net interest rate spreads. The RBA,[13] ABA,[14] Harper[15] and Moore[16] also consider the interest rate spread to be the most useful and reliable measure of bank interest rate margins.

2.8 The net interest margin is considered less useful and reliable as a measure of bank interest rate margins as it is affected by changes in the banks capital structure, ratio of fixed assets to interest-earning assets and ratio of commercial bill acceptances to total assets.

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12 ibid., p. 1.

13 ibid., p. 3.

14 Evidence, p. S26.

15 Evidence, p. S6.

16 Evidence, pp. S112-S114.

Calculation of the Interest Rate Spread

2.9 The net interest rate spread is equivalent to the difference between the average rate of interest earned on the bank's portfolio of interest-bearing assets and the average rate of interest paid to its depositors:[17]

$$\text{net interest rate spread} = \frac{\text{total interest received}}{\text{total earning assets}} - \frac{\text{total interest paid}}{\text{total deposit liabilities}}$$

2.10 This measure is not affected by changes in the bank's commercial bill acceptances nor changes in capital structure that effect the net interest margin. However, the net interest rate spread is effected by those loans where no interest is being earned ie non-accrual. To take into account of the effects of non-accrual loans, the gross interest rate spread is used. The gross interest rate spread is simply the net interest rate spread adjusted to take into account the interest attributable to non-accrual loans.

International Comparison of Margins

2.11 Even with an appropriate measure of bank interest rate margins, such as the interest rate spread referred to above, the Committee noted that it was generally agreed that it was difficult to make reliable or meaningful bank to bank comparisons, let alone international comparisons of bank margins using raw interest rate spread data. This difficulty is highlighted by the RBA,[18] the ABA[19] and Harper.[20]

2.12 The RBA's view was that 'to our knowledge, reliable data permitting such comparisons do not exist.'[21] The ABA supported this view by saying that it was 'sceptical of any international comparisons, not least because there will be a considerable degree of judgement required in making adjustments to ensure *like-with-like* comparisons.'[22] Moore also supported these views, saying that 'All international comparisons have to be approached with considerable caution.'[23]

17 Evidence, p. S6.

18 Evidence, p. S1.

19 Evidence, p. S31.

20 Evidence, p. S7.

21 Evidence, p. S1.

22 Evidence, p. S31.

23 Evidence, p. S115.

2.13 Harper indicated that:

> ...straightforward comparison of published net interest spreads for different countries, without any reference to the types of banks involved or the regulatory circumstances of the countries concerned, is fraught with danger. Without some attempt to ensure that one is comparing *apples with apples*, such comparisons are virtually impossible to interpret.[24]

2.14 The Committee was interested in examining the factors which made the comparison of interest rate spreads so difficult. The ABA explained that to compare bank interest rate margins, or indeed profits, across countries there are a range of factors for which analysts need to adjust.[25] In particular:

- differences in fee income compared to interest income;
- differences in the cost of capital due to different interest rate structures, inflation, regulatory and reporting requirements, or credit ratings;
- extent of on-balance versus off-balance sheet business;
- population, demographic factors, geographic coverage, proximity and access to international markets and country size factors;
- size, scale and structure of the market and the institutions within markets;
- differences in tax structures;
- differences in the stage and reach of deregulation;
- differences in the income and other characteristics of customers across countries, and mix of customer segments;
- extent to which institutions operate in a number, often a large number, of countries;
- mix between fixed and variable lending;

24 Evidence, p. S7.

25 Evidence, pp. S30-S32.

- mix between industry sectors (e.g. extent of agriculture, mining, etc) and the risks in those sectors; and

- differences in accounting and reporting requirements.

2.15 According to Harper[26] the main determinants of the interest rate spread are:

- that the higher operating costs (including the cost of equity capital) and the smaller the proportion of income from fees, the higher will be the interest rate spread so that costs can be absorbed;

- the level of operating costs is dependent on the product mix - a retail network is more costly than a bank whose operations centre on services to large corporate entities; and

- the level of risk inherent in a banks' balance sheet - a bank involved in higher risk activities will require a higher return and therefore achieve a higher interest rate spread to compensate owners.

2.16 Moore[27] identified factors relating to effective competition which would maintain bank interest rate margins at levels higher than they should be. One of the factors identified was the extensive bank branch networks carried over from the period before deregulation when there was little scope for competing on price. The major method of competing at the retail level was through a branch network, which led to the establishment of a considerable number of branches which were uneconomic but whose costs were able to be recovered either through 'excess' spreads or by having higher lending and deposit rates than were necessary. Moore indicated that since deregulation there has been little rationalisation of these networks, citing the relative importance of the Commonwealth Banking Group in the banking system and implications for the policies of the other major banks from the fact that the Commonwealth has not undertaken substantial rationalisation. With regard to this point, the Committee notes that the Commonwealth Bank is undergoing a two year restructuring program and it is reported to be about half way through the process.[28] The Committee is also aware of considerable community debate over branch closures in regional Australia, although the Committee is not aware of the extent of these closures.

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26 Evidence, p. S8.

27 Evidence, pp. S117-S121.

28 Maley, Karen 1994, 'Sleeping giant stirs slowly into life', *Sydney Morning Herald*, 23 July, p. 37.

2.17 Another factor that Moore considered important related to the industrial relations framework and the associated difficulty in ensuring that productivity improvements are reflected in lower costs for the benefit of bank customers and shareholders.

2.18 The final factor identified by Moore was that government involvement had the effect of severely restricting competition, creating a situation which provides reduced incentive for the major banks to effect structural changes. This includes the fact that the existing four major banks are operating in a market in which they are effectively protected from takeover by either foreign banks or each other. In addition, the existence of a situation where a substantial proportion of the assets of the banking industry have been operated under a government guarantee, but with less concern regarding returns, has clearly reduced the capacity for the other major banks to engage in active competition.

2.19 Moore indicated that the combination of the above allows a *follow-the-leader type* approach to develop in both pricing and the introduction of new products. This approach limits sustained competition due to cost and the limited potential for success.

2.20 After emphasising the difficulty in obtaining reliable data on bank interest rate margins for the purpose of comparing one bank to another or for comparison internationally, the RBA then advised the Committee that it would compile data on a selection of banks in the US, Canada, UK, New Zealand and one or two continental European countries which are closest to the Australian majors in terms of size, product mix, branch structure and regulatory environment. The Committee welcomes this constructive assistance and the new data should provide a basis for further informed consideration of this matter.

2.21 The RBA also indicated that the data being compiled will not only examine margins but also broader measures of profitability and efficiency. This will address concerns of the ABA that profitability should also be taken into account in making comparisons between Australian banks and *equivalent* banks in other countries.[29] This study should allow interested parties to provide informed commentary on data which covers not only margins, but also profitability and efficiency.

2.22 While it was agreed that international comparison was difficult to achieve, there have been several international sources that have compared international bank margins, including Australian bank interest rate margins. These sources include the Bank Annual[30] and data published by the OECD.

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29 Evidence, p. S31.

30 Salomon Brothers, Bank Annual, 1991 Edition.

2.23 To assist the Committee, the RBA[31] reviewed these sources and found that in relation to the Bank Annual:

- it relates to selected banks in several countries and does not purport to be comprehensive;

- the data in relation to Australia only covers the major banks. For other countries, the data covers a small number of the largest banks; in the US, for example, only 'money centre' banks are included (the main regional retail banks, which in some ways are more akin to the majors in Australia are not covered);

- the data takes no account of major differences in the structure of banking sectors among countries; and

- a further distortion is that the Bank Annual expresses the margin as a ratio to average interest earning assets, which exclude bank bills from the denominator ie the net interest margin as opposed to the preferred net interest rate spread. This distortion is significant as the use of bank bills is more prevalent in Australia than in other countries.

2.24 Harper[32] had a similar view of the data from the Bank Annual.

2.25 As to the OECD data, the RBA[33] indicated that:

- this was better quality than the Bank Annual in that the coverage is wider, and the total assets used as a denominator; and

- the OECD data was still subject to many qualifications and that the OECD states that international comparisons in the field of income and expenditure accounts of banks are particularly difficult due to considerable differences in OECD countries as regards structural and regulatory features of national banking systems, accounting rules and practices, and reporting methods.

2.26 However, to assist the Committee in making a comparison of like with like, Harper,[34] after correcting the Bank Annual data, and using the RBA's preferred set of OECD data, found that the results place Australia roughly in the middle of the pack.

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31 Evidence, p. S1.

32 Evidence, pp. S7-S8.

33 Evidence, pp. S1-S2.

34 Evidence, p. S8.

2.27 The ABA had a similar view, indicating that 'Based on raw, i.e. unadjusted 1991 OECD data Australian banks are not extraordinarily profitable compared to OECD banks.'[35]

2.28 With the difficulty in comparing bank interest rate margins, the Committee also looked at the levels of profitability as a possible measure to assess whether the claims against the banks were sustainable. While the Committee has not formed a concluded view on this matter, it was interested to note the interpretations placed on bank profitability in evidence provided to the Committee.

2.29 In relation to levels of profitability Harper said 'If one is concerned over the possibility of monopoly pricing by banks, the first statistic to check is the profitability of banks compared with other enterprise in Australia and banks elsewhere in the world.'[36] The ABA takes a similar view that in making comparisons, it is more appropriate that they be on the basis of profitability as this measure at least incorporates all of the features of competition.[37]

2.30 The ABA evidence to support the view that the level of profitability does not indicate monopoly profits was the Return on Average Shareholder's Funds data obtained from the STATEX Database.[38] This data indicated that while the banks exhibited returns well above the All Company Average Return during the early 1980's, these returns have fallen to be much closer to the All Company Average and are in line with those in other industries.

2.31 The ABA referred to a further survey of the 300 largest banks in terms of assets, which after adjusting the 1992 figures indicated that while only including the four major banks, the real profitability scores suggest that Australia's experience is not out of line with that in a number of countries.[39]

2.32 Harper had a similar perspective in that 'It is generally accepted that, certainly since deregulation, banks are not outlandishly more profitable than other Australian firms, including firms in quite competitive industries.[40]

2.33 In contrast to this view, Moore questions whether deregulation has increased competition and moved industry toward more normal returns on capital. Moore makes the point that while declines in bank profitability during and after

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35 Evidence, p. S31.

36 Evidence, p. S9.

37 Evidence, p. S31.

38 Evidence, p. S17.

39 Evidence, pp. S32 and S72-S90.

40 Evidence, p. S9.

deregulation did reflect competition, the reductions cited by the ABA for the period 1989-92 do not necessarily reflect competition, they may simply reflect the impact of the recession, bad debts and non-performing loans. Indeed Moore suggests that by 1993 return on average total assets was back to pre-1989 levels.[41]

Steadiness of Bank Interest Rate Margins

2.34 Evidence to the Committee indicated that due to the various factors effecting margins there is a difficulty in making meaningful comparisons of margins. However, the Committee notes that the ABA's submission included details of the net and gross interest rate spreads for the major bank groups for the period 1980 to 1993[42] and is based on the work undertaken by the RBA. An update of the chart to take into account the first half of 1994 is at Appendix 4.[43]

2.35 The ABA's view[44] was that the chart revealed that there was no evidence that the net or gross interest rate spreads, for the banking industry as a whole, have widened to pay for the large bad debts of the 1980's. Rather, the data indicated that the margins have been steady over the last decade. The ABA also indicated that this was contrary to the claims that the banks were not passing on to borrowers the benefits of lower official rates but were instead increasing their margins and profits to help cover their mistakes in the late 1980's.

2.36 A review of the chart while indicating a steadiness of the margins over the decade did reveal some variation. The ABA[45] explained that the spreads vary naturally between years, depending on, for example, the stance of monetary policy and there can be significant swings in spreads over short periods and over the interest rate cycle. The ABA submitted that margins rose slightly in 1988 as a result of inflows of low interest deposits to banks as investors sought security for savings following the fall in the share market. The ABA advised that deposit and loan rates also change at discrete intervals and not always precisely in step. A research discussion paper[46] by the RBA also indicated that there was *stickiness* in movements of deposit and loan rates.

2.37 With deregulation and the increased competition arising between banks and with other financial institutions, the Committee would have expected that

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41 Evidence, p. S110.

42 Evidence, p. S16, Chart 2.

43 Evidence, p. S108a.

44 Evidence, pp. S26-S27.

45 ibid.

46 Research Discussion Paper, Loan Rate Stickiness: Theory and Evidence - Phillip Lowe and Thomas Rohling, RDP 9206, Economic Research Department, RBA, June 1992, pp. 33-34.

pressure on deposit rates would have increased average funding costs and lending rates would have reduced interest indicator rates. The combination of these two factors would have reduced the interest rate spread. Instead, the spread has remained steady over the period.

2.38 With the issue of the 1994 interim results for the major banks it was revealed that contrary to the ABA data concerning the steadiness and to the expectations that the continuation of competition would reduce margins, interest margins have increased for three out of the four major bank groups. Moore supported this view advising that 'whatever may have happened in the case of the market for some particular products does not deny the general proposition that overall gross spreads should have narrowed.'[47] The following table indicating interest spreads and margins for three major banks was prepared by Moore:

Table 2.1 ***Interest Spreads and Margins***

		Half Year to Mar 94 %	Half Year to Sept 93 %	Half Year to Mar 93 %
National				
Interest Spread	- Australia	4.3	4.5	4.0
	- Overseas	3.3	3.0	3.1
Interest Margin	- Australia	6.2	5.6	5.4
	- Overseas	3.7	3.4	3.4
Westpac				
Interest Spread	- Australia	3.1	2.8	2.6
	- Overseas	1.9	1.7	1.8
Interest Margin	- Australia	4.0	3.7	3.6
	- Overseas	2.2	2.1	2.0
ANZ				
Interest Spread	- Australia	3.3	3.3	2.9
	- Overseas	2.1	1.7	1.7
Interest Margin	- Australia	4.1	4.1	3.7
	- Overseas	2.5	2.2	2.1

Source: Evidence, p. S116

47 Evidence, p. S114.

2.39 The increase in margins also comes after the RBA's 1992/93 annual report stated that customer risk margins, which are the margins added to the indicator loan rate to determine the rate applicable to the loan, were reassessed during 1992/93 with a view to applying a consistent risk grading system across all bank customers. This reassessment has resulted in a reduction of risk margins, and therefore rates, for some customers and increases for other customers. The net result was, as estimated by the RBA,[48] a ⅛% overall increase in risk margins. This ⅛% would, while reflecting the risk margin, increase the interest rate spread by a similar amount.

2.40 The ABA explained that:

> ...increases in customer risk margins to smaller businesses have been minimal to date and have generally matched the risk associated with the facility, and had little effect on banks' average interest spreads. Banks will continue with efforts to ensure that prices struck are relevant to the risk of lending to the individual customer. The importance of risk pricing was underlined by the experience of the 1980's.[49]

2.41 The 1994 interim results give a contrary view and there is a perception that the effects of competition have not materialised and that the effect of the reassessment of risk margins was to widen margins overall.

2.42 However, the Committee accepts that there are a number of factors that need to be taken into account when comparing margins over a period of time. No doubt these factors also need to be taken into account in comparing the 1994 interim results.

2.43 One of these factors which is significant and needs to be taken into account when comparing bank interest rate margins relates to the fees and charges applied by banks to their customers. Since deregulation there has been greater use of *user pays* whereby banks have introduced transaction charges for deposit accounts, establishment fees for loans, together with an increased range of other charges.[50] Moore indicated that while the interest rate spreads referred to earlier are 'undoubtedly a more accurate indicator of the extent of competitive pressures', he noted that:

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48 Reserve Bank of Australia 1993, Report and Financial Statements, p. 22.

49 Evidence, p. S29.

50 *A Pocket Full of Change*, op. cit., pp. 103-106.

> However, as it does not include income from fees and charges, it is possible that any change in the interest spread, or any absence of change, could be offset by a relatively higher or lower proportion of income coming from fees and charges.[51]

2.44 The Committee agrees that a comprehensive assessment of changes in competitive pressures would need to include an assessment of changes in fees and charges as well as net interest rate spread on the income side. However, comparisons of fees poses the same difficulty as does comparisons of margins. A table provided by the ABA[52] on non-interest income expressed as a percentage of average total assets for OECD countries is included at Appendix 5. The Committee notes that Australia is at the higher end of the range.

2.45 Pending the availability of the RBA data on margins, the Committee was interested in whether the levels of bank interest rate margins reflected the market power of banks. Harper indicated that when considering the level of bank interest rate margins as a measure of market power they 'must first be considered in light of the costs and risks incurred by banks and their ability to recoup these costs through direct fees and charges.'[53] An example of this effect was the inability to charge fees on bank credit cards which resulted in increased interest rate spreads to recover costs. In addition, the difficulty in attributing costs to a product, and the ability to price that product to charge a fee, will also result in higher spreads.

2.46 Harper added that:

> ...price discrimination, to the extent that it occurs, may simply be a means for banks to recover fixed (as opposed to marginal) costs or to facilitate bundling of services (e.g deposit taking and payment services) which is too expensive to price separately...and...that certain types of bundling and price discrimination are actually efficient.[54]

2.47 Harper also took the view that discriminatory pricing was not necessarily bad in that:

> ...a discriminatory pricing mechanism is the only way in which sufficient revenue can be generated to produce a product consumers have a willingness to pay for but

51 Evidence, p. S114.

52 Evidence, pp. S104-S106.

53 Evidence, p. S8.

54 Evidence, p. S9.

> which is subject to substantial fixed costs of production. An electronic funds transfer system based on a network of point-of-sale terminals may be an example of just such a product.[55]

Conclusion

2.48 Due to the number of factors that need to be taken into account in comparing bank interest rate margins and due to the lack of reliable data, the Committee is not in a position to draw a firm conclusion on the level of bank interest rate margins between banks in Australia or overseas.

2.49 The Committee acknowledges that bank interest rate margins are a concern and while not in a position to draw a definitive conclusion, the Committee is not convinced that current margins reflect a truly competitive banking environment. The Committee is not convinced that margins in Australia are *mid-field.* The evidence suggests that there is scope for a reduction in margins. The Committee considers that further review of this subject, including fees, would be in the community interest.

2.50 These matters will be further considered in the review of the RBA's 1993/94 annual report when it is expected that the RBA will have completed its work on the development of reliable data on margins. The RBA, ABA and other interested parties will then be requested to provide their views on margins.

2.51 The Committee considers that the current review of the RBA's annual report has been beneficial in that it should allow the debate to progress from relying on anecdotal evidence to consideration based on more reliable data.

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55 ibid.

CHAPTER THREE

OTHER ISSUES OF IMPORTANCE

Council of Financial Supervisors

3.1 The Council of Financial Supervisors was established in late 1992, following a recommendation by the Committee in *A Pocket Full of Change*[56] that the Council be established to facilitate closer co-ordination between the supervisors of the Australian financial system. Membership of the Council consists of the RBA, Insurance and Superannuation Commission, Australian Financial Institutions Commission, and Australian Securities Commission.

3.2 While the Council is not a supervisor in its own right, it is a high level coordinating body which provides an avenue to:

- facilitate exchanges of information which bear on the efficiency and well being of the financial system, including the promotion of regular liaison among financial supervisors;
- assist each supervisor to be aware of, and to understand, developments in other parts of the financial system;
- identify issues and trends important to the financial system as a whole; and
- avoid unintended gaps, duplication and inconsistencies in regulation.[57]

3.3 The RBA advised the Committee that:

> ...the council is a forum, an opportunity for the different regulators to come along and to talk about what is happening in their own spheres of responsibility; to make sure that we do not get in one another's way; that we know what is going on; and that there are no bits of the financial system that are being overlooked; and that no gaps are allowed to open up.[58]

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56 op. cit., p. 233.

57 Council of Financial Supervisors Annual Report 1993, p. 5.

58 Evidence, pp. 47-48.

3.4 The Council's first annual report[59] outlined the developments in financial surveillance and supervision:

- regulatory agencies are being given additional resources and powers;
- minimum entry and operating standards are being discussed;
- information available to supervisors is being increased;
- supervisory roles are being clarified;
- disclosure is being enhanced to facilitate informed decision making;
- directors and auditors of financial institutions are being made more accountable;
- professional and industry bodies have taken steps to improve industry self-regulation and to develop 'best practice' guidelines;
- the payments system is being reformed; and
- regulatory agencies are cooperating more closely on an international basis.

3.5 The Committee supports the role and the actions of the Council in improving the co-ordination between the respective supervisors to ensure that each regulator is aware of developments and issues in order that a more comprehensive approach develops towards supervision.

3.6 The successful establishment of the Council has justified the initiative of the Committee in making the original recommendation for the establishment of the Council.

3.7 The establishment of the Council is also timely given the prominence that financial conglomerates are gaining in Australia's financial system. This parallels their role in the US non-bank financial sector where they have grown due to changes in the savings patterns of US households. This sector has overtaken banks as the major repository of household wealth and supplier of capital to small and medium sized business.

3.8 The ABA's view on this development was that 'It is very important that you do not put in a situation where, by regulation, funds are forced out of their

59 Council of Financial Supervisors, op cit., pp. 27-33

natural place in the market, which might be with the banks, to these trusts and other institutions which may not have the same standing in terms of the security and prudential regulation.'[60]

3.9 With this in mind the Committee will continue to monitor developments in this area and raise with the RBA, as a member of the Council, the issue of the regulation and supervision of financial conglomerates and the growth of the non-banking financial sector.

Consumer Protection: The Code of Banking Practice and the Australian Banking Industry Ombudsman

3.10 The Committee has indicated that a major role exists for government in a deregulated environment to ensure that the markets work efficiently and competitively and that the financial system remains safe and sound.[61] The relationship between banks and their customers was an issue in the Committee's first report and continues to be a matter of concern to the Committee.

3.11 The RBA's view on the relationship between banks and customers was that while it:

> ...does not have a specific 'consumer protection' role. It is, however, keen to see improvements in bank/customer relationships. It is concerned also that measures to 'protect' consumers are not inimical to either the efficiency of the banking system or the best interests of the people they are intended to help.[62]

3.12 The RBA also indicated that 'It was clear from public debate that the banks' relationship with many of their retail (and other) customers leave a good deal to be desired.'[63]

3.13 The Committee views improvements in the bank and customer relationship to be an important development. The RBA offered the view that 'the task of improving relationships without creating unintended - even perverse - effects needs to be pursued at several levels.'[64] The levels that the RBA referred to were the Code of Banking Practice and the Australian Banking Industry Ombudsman Scheme.

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60 Evidence, p. 90.

61 *A Pocket Full of Change*, op. cit., pp. 458-459.

62 Reserve Bank of Australia, op. cit., p. 34.

63 ibid.

64 ibid.

Code of Banking Practice

3.14 The development of the Code of Banking Practice arose from the Committee recommendation that banking law and practice should be codified.[65] In *Checking the Changes* the Committee indicated that:

> The development of the Code of Banking Practice should enable the market to work more effectively and more fairly than has been the case. It should address many of the areas of concern about the relationship between banks and customers which were highlighted in the Committee's earlier report.[66]

3.15 On 3 November 1993, the Federal Government and the banking industry released the agreed Code of Banking Practice. The Code is designed to set industry standards of disclosure, conduct and dispute resolution, thereby increasing the confidence of customers in their personal banking relationships. While the Code has been released, the Committee is concerned to note that it has not yet been fully implemented.

3.16 The Code addresses two principal objectives:

- to improve the quality and timeliness of the contractual and other information that banks disclose to their customers before, during and subsequent to the time at which they enter into contracts; and

- to require better and more comprehensive documentation of pricing and other contractual terms and conditions by banks.[67]

3.17 These objectives are emphasised in the preamble to the Code which states that:

> The Code of Banking Practice (the Code) seeks to foster good relations between Banks and their Customers (as defined below) and to promote good banking practice by formalising standards of disclosure and conduct which Banks that adopt the Code agree to observe when dealing with their Customers.[68]

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65 *A Pocket Full of Change*, op. cit., pp. 383-391.

66 *Checking the Changes*, op. cit., p. 71.

67 Economic Round-up, Dept of Treasury, Summer 1993/94, p. 25.

68 Code of Banking Practice, Australian Bankers' Association, 3 November 1993, p. 1.

3.18 While the Code is a major step in improving the relationship between banks and customers, a criticism of the Code[69] is that it is too narrow in application. The 'definition' of customers only includes individuals utilising a Banking Service for private or domestic purposes and excludes small business and the rural sector. The Committee notes that schemes in New Zealand, Ireland and the UK allow (or soon will allow) access to small business and the rural sector.

3.19 The ABA indicated that a reason for this exclusion from the Code is that:

> One of the great difficulties we have is that businesses incorporate and complex themselves deliberately, and it becomes very difficult then to handle situations associated with complex financial arrangements through a scheme as simple as the ombudsman scheme, or overlaying a code of practice which, in a sense, would pretend to overlay case law which unfortunately - or fortunately, whichever way you look at it - is the best way our society has found to unravel complex arrangements.[70]

3.20 The ABA also indicated that:

> We have ongoing dialogue with the business community in Australia. At this point in time, a code of practice is not a particular issue that is on the agenda of issues that are concerning the business community.[71]

3.21 While the Committee acknowledges the Code is not the best way to unravel complex arrangements, the two principal objectives of the Code, as emphasised in the preamble to the Code, are not intended to do this. Rather, they are intended to promote good banking practice by formalising standards of disclosure and conduct which banks that adopt the Code agree to observe when dealing with their customers.

3.22 The Committee also acknowledges that the issues of concern to farmers and small business, and the potential remedies available to these groups, are in many ways quite distinct from those of personal customers. However, there is potential for application of the Code to farmers and small business in relation to the disclosure and conduct which banks observe when dealing with their customers. The underlying concept that should be adopted in the bank's business is 'truth-in-lending'. This truth comes from complete and full disclosure.

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69 Economic Round-up, op. cit., p. 26.

70 Evidence, p. 97.

71 Evidence, p. 96.

3.23 By adopting this approach in dealing with bank customers, the Code would then deal with the issue of whether there was complete and full disclosure in the bank's dealings with its customers and not with the complexity or otherwise of the business structure, and would be irrespective of the size of the transaction. This would alleviate the concerns of the ABA regarding the Code trying to unravel complex issues. The Committee considers this approach to be reasonable given that a bank's product, such as a term loan, whether provided to an individual sole trader or to an incorporated entity, would still require the same disclosure and conduct.

3.24 The Code is a significant step in the process of 'truth-in-lending' and should not exclude any customer.

3.25 With regard to the application of the Code of Banking Practice to other customers, the ABA indicated that a number of years ago, and in co-operation with the farming industry, a farming code was developed.[72] This code was reviewed in *Checking the Changes*[73] and became known as the *ABA Farm Code*. The Committee noted that the Code, launched in November 1991 at an NFF Conference[74] received a scathing reception from the delegates. It was clear to the Committee at that time that the resolution mechanisms delineated in the Code were not working.[75] Further concerns were that the Code was a voluntary agreement, it could not be enforced legally nor was any body monitoring adherence to its provisions.[76]

3.26 The Committee reaffirms the view that the Farm Code should be incorporated in the Code of Banking Practice.[77]

Extending the Code of Banking Practice

3.27 With deregulation, the range of products offered by the banks or by their subsidiaries has increased considerably. The range now includes derivatives, provision of investment advice, fixed interest loans, insurance and superannuation and recently the National Australia Bank issued a National Sharemarket Bond which is effectively a term deposit with the rate of return linked to the share price index.

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72 ibid.

73 op. cit., pp. 34-36.

74 ibid.

75 ibid.

76 ibid.

77 ibid., p. 36.

3.28 The Committee considers that the Code should not be static, but rather reflect changes in the banking environment and take into account the development of new banking products. The Committee considers that the Code should cover new developments, particularly those aimed at small business or consumers and those which are subject to various charges and penalties, and are complex or require judgement or management. The inclusion of these products in the Code would promote *truth in dealing* concept raised earlier.

3.29 There is a precedent for this approach. The Code does, at Part B, Clause 11.0, cover a specific product, namely Foreign Exchange Services and specifies a standard of conduct in the granting of foreign currency loans (FCLs). While this reference is admirable, its origin lies in the serious problems associated with FCLs. The Committee takes the view that it is better to avoid such potential problems through full and complete disclosure rather than to resolve the situation through the media or through litigation, as was the case with the FCLs.

3.30 The ABA[78] indicated that the definition of 'Banking Service' includes the products referred to above. It also indicated that insurance products will be covered by the proposed 'Life Insurance Code of Practice'. Investment advice is covered by existing legislation.

Australian Banking Industry Ombudsman Scheme

3.31 The Scheme provides a free service for the independent resolution of consumer complaints about the provision of banking services. The RBA has one representative on the board of the Scheme. As with the Code of Banking Practice, the Scheme's jurisdiction is limited to the consideration of disputes about banking services in Australia between individuals (including partnerships) and member banks. In addition, there is a financial limit of $100,000. The limit relates to the loss that the customer has suffered and not the size of the loan or facility.

3.32 In *Checking the Changes*[79] the Committee indicated that lifting the financial limit from $100,000 to $200,000 would be desirable. This higher limit would match the comparable United Kingdom Scheme which has a limit of approximately $220,000.

3.33 The Committee noted that similar schemes in other countries are able to deal with the complexities in dealing with small business. The ABA had a contrary view.[80]

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78 Evidence, pp. S100-S101

79 ibid., p. 50.

80 Evidence, p. 98.

3.34 The Committee noted that some 40%[81] of cases were rejected as they fell outside the terms of reference. The report indicated that there has been a constant increase in the number of cases outside the terms of reference since the scheme began in 1990. The Committee is concerned at the level of the rejections.

3.35 The ABA explained that the 40% rejection rate:

> ...is a figure that has been picked out, and bandied about, of a whole set of statistics and includes complaints to the Ombudsman which are totally outside the ambit of banks. If you in fact recast those statistics, there are a very small proportion of those complaints that actually come back to, say, specific sectors such as small business.[82]

3.36 The Committee reviewed the statistics contained in the annual report,[83] which indicated that in 1992-93 of the 3,399 cases received, 1,341 were outside the terms of reference. The reasons for rejection included:

- 283 (21%) due to the complaint being from incorporated bodies;
- 84 (6%) due to the complaint relating prior to events occurring prior to the commencement of scheme;
- 63 (5%) were for amounts greater than the $100,000 limit to the scheme; and
- 911 (68%) of the other reasons included policy issues, bank commercial judgements, non-bank financial institution, non-banking service, non-member bank, other jurisdiction, general complaints and non-specific problems.

3.37 The Committee reaffirms its earlier proposal that the limit should be lifted to $200,000. The ABA 'rejects this proposal on the grounds that only a very small proportion of matters coming before the Ombudsmen are excluded because of the monetary ceiling'.[84] However, the 5% rejection rate may simply reflect the fact that customers with losses greater then $100,000, being aware of the limits simply do not apply. If the ABA is correct then it is not obvious why they are so opposed to giving these few customers the benefit of recourse to the scheme.

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81 The Australian Banking Industry Ombudsman Limited's 1992/93 Annual Report, p.11.

82 Evidence, p. 98.

83 Australian Banking Industry Ombudsman, op. cit., p. 45.

84 Evidence, p. S106.

Member Banks of the Scheme

3.38 The Scheme's jurisdiction is limited to disputes between individuals (including partnerships) and member banks. Not all banks are members.[85] The major exclusions being:

- Metway Bank which left the Scheme;
- Bank of South Australia;
- Bank of Queensland; and
- a number of foreign owned banks.

3.39 While the lack of involvement of the foreign owned banks can be explained by their lack of retail business, the non-membership of the three retail banks is a concern and reduces the opportunities for customers of these banks to avail themselves of the Scheme. The ABA[86] supported the view that all retail banks should be members. The Committee endorses the ABA's view and has written to banks who are currently not members of the scheme seeking their cooperation.

Barriers to Competition

3.40 One of the terms of reference of the first banking inquiry was to inquire into and report on the benefits of competition to different sections of the community including access to financial services, product innovation, choice and quality of financial services and information to users.

3.41 The Committee's assessment was that:

> ...much of what was envisaged of deregulation has occurred. The efficiency of banks has increased and they have taken market share from other financial intermediaries that had benefited from regulation. Finance has become more widely available, though customers have had to pay a market price for it, including a component to reflect risk. Product range has increased and banks have increased their responsiveness to customers.[87]

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85 Australian Banking Industry Ombudsman, op. cit., p. 2.

86 Evidence, p. 99.

87 *A Pocket Full of Change*, op. cit., p. 457.

3.42 However, views vary on how effectively competition among the banks has increased. Many believe that an oligopoly now exists rather than a truly competitive system. The ABA's view was that 'The substantial changes that have occurred in market shares between sectors, and among individual institutions, is further evidence of strong competition.'[88]

3.43 The Committee questioned whether the competition was across all sectors or just limited to housing finance and re-finance. The ABA responded by noting that:

> ...there is a lot of mobility caused by competition that has been occurring and caused by the fact that banks are placed differently...it is not just limited to housing finance. There has been quite a lot of market share shift.[89]

3.44 The ABA cited a number of initiatives[90] that are the result of competition:

- special products, packages and special offers tailored to the needs of small to medium business (eg capped rates);
- substantially greater choice in the credit card market, and significantly lower interest rates, following deregulation in August 1993;
- special offers and new products for home buyers (including, for example, a facility to roll-up other loans at home loan rates);
- customer relations officers and continuous improvement programs. There is increased use of relationship officers and relationship banking, especially in the business banking middle market;
- customer service programs and guides to customer service;
- longer and more flexible operating hours;
- substantial further innovation in deposit products (eg flexible term deposits); and
- enhanced use of customer information systems to evaluate customer needs.

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88 Evidence, p. 63.

89 Evidence, p. 95.

90 Evidence, p. S14.

3.45 The RBA also indicated that deregulation had increased in competition saying:

> ...there is an awful lot of competition in the banking system already...it is hard to see how more competition could be introduced into the banking system as the banking system when, as of now, our banking system is open to any bank anywhere in the world that wants to come in and establish a banking operation.[91]

3.46 However, the ABA identified two barriers that foreign banks face in establishing branches in Australia. These barriers restrict competition.

3.47 The first barrier is the issue of non-resident interest withholding tax. In February 1992, it was announced that, subject to compliance with the RBA prudential guidelines, the Banking Act would be amended to alter the conditions under which foreign banks can operate in Australia. This amendment would allow foreign bank operations to be undertaken through branches rather than as subsidiaries. However, foreign banks that establish branches are subject to 10% withholding tax in respect to 50% of the tax deductible intra-bank interest charge on borrowings from head office. This concession effectively operates as a 5% withholding tax. Domestic banks, including foreign owned bank subsidiaries, on the other hand, are able to obtain exemption from all withholding tax under s.128F of the *Income Tax Assessment Act 1936*. The effect of this is to make the operations of branches less profitable than similar operations conducted by a subsidiary. Accordingly, the number of branches that have been established has been minimal.

3.48 To alleviate this discrepancy, it was recently announced that foreign banks would be able to undertake part of the activities through their branches and borrow money from their parents through the subsidiaries. These changes mean that foreign banks will be able to raise funds offshore through a non-bank subsidiary, free of withholding tax, while at the same time conduct treasury activities through a branch leveraged off its parents balance sheet.[92] While the changes alleviate the problem, the ABA's view was that 'the non-resident interest withholding tax forces up the costs of accessing offshore markets and that removal of this tax would, as a result, enhance efficiency in the Australian markets.'[93] The ABA indicated that it would be putting a detailed submission to government on this matter.

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91 Evidence, p. 36.

92 Australian Financial Review, 14 December 1993, p. 1.

93 Evidence, p. S24

3.49 The other barrier that the ABA[94] identified was the Government's decision on depositor protection on foreign bank branches. In effect this decision will require foreign banks to have both a branch and subsidiary if they wish to compete for the whole Australian market. The ABA claimed that this has forced up the costs of foreign bank participation in Australia and that, as a result the competitive benefits to the Australian system have not been maximised. The ABA has also indicated that it was conducting appropriate research on this issue with a view to demonstrating that a branch structure is appropriate in these circumstances, and whether any legislative change is necessary for that purpose.

3.50 While the Committee supports any initiatives to increase the efficiency of bank operations, the issue of the non-resident withholding tax and depositor protection will be reviewed once the ABA has completed its research in this area.

3.51 The Committee was concerned as to whether there were any further barriers to competition. Harper indicated that there were still barriers to competition in that:

> If there are remaining obstacles to enhanced competitiveness of banking in Australia, they have to do with inertia on the part of consumers. It seems clear that consumers are less willing to change banks in order to accept a superior offer than might have been thought either likely or healthy.[95]

3.52 There are at least two factors which may explain why consumers of banking services may be reluctant or unwilling to take advantage of competition. The first source relates to the costs incurred by customers in closing one account and opening another. The second is described by Harper as the inertia of customers themselves.

3.53 The issue of transfer costs faced by customers was noted in a *Pocket Full of Change*[96] where it was indicated that competition would be limited if consumers faced difficulties in moving from one bank to another. The Committee indicated that consumers face large cost barriers if they move a secured loan, such as a mortgage, from one bank to another. The costs identified included:

- costs of establishing a mortgage - bank charges, including application and establishment fees as well as legal and valuation fees;

- government charges including stamp duty and registration fees for the registration of mortgage documents;

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94 ibid.

95 Evidence, p. S9.

96 op. cit., p. 371.

- costs of exiting a mortgage, including legal fees and in some cases an early repayment penalty; and

- government charges for executing the discharge of the mortgage.

3.54 This view was supported by Harper where he indicated that:

> To some extent, this reluctance may have a rational foundation in the impact of State government stamp duties (which can be substantial), the difficulty of transferring accumulated 'reputation capital' from bank to bank and the cost of informing oneself.[97]

3.55 The ABA took a similar view where it indicated that:

> The main costs that impact on mobility, particularly in relation to variable rate lending, are government costs. One of things that we have constantly talked about is ensuring that stamp duty and registration fees for new mortgages do not impede people changing. If you have got a secured loan and if, when you change it, the government is going to slug you, then that decreases mobility - these costs are not bank costs. We would take the proposition that it is not bank costs that stop people from moving; it is government costs.[98]

3.56 The Committee considers that the effects of banks fees and state government charges and their effects on competition, particularly in mobility, need to be considered and the Committee will further examine these issues in a future review.

3.57 The Committee has indicated that it was concerned with making recommendations which were directed to the banks so as to define a view of best banking practice.[99] This 'best banking practice' would allow the banking industry to meet the challenges of a new century.

3.58 With this in mind, the Committee was interested in whether competition has reduced costs or will further reduce costs. The ABA indicated that there has been strong competition from banks and non-banks, both domestic and international, and that the recent recession added a particular urgency to efforts

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97 Evidence, p. S9.

98 Evidence, p. 95.

99 *Checking the Changes*, op. cit., p. 3.

aimed at lowering costs and improving productivity.[100] The ABA noted that in Australia there are now 43 banks, including 31 newly licensed since the deregulation, 740 registered financial corporations, including 32 building societies and 253 credit unions.[101]

3.59 To support this claim the ABA submission provided a chart[102] which details operating expense as % of average assets for OECD banks in 1991. This chart indicated that Australian banks are in about the middle of the field compared with those in other OECD countries.

3.60 The ABA[103] also provided details of measures taken by the banks to reduce costs. A number of these measures include; staff reductions, award restructuring, user-pays, new technology, review of processes, re-focus or reduced involvement in some areas, rationalisation of product ranges, and a re-focus of business profitability. According to the ABA the measures have reduced operating costs from around 78% of operating income in 1990 to around 62% in 1993.[104]

3.61 Moore indicated that the this contrasts with KPMG figures indicating that the ratio in 1993 was not noticeably different to pre-recession levels, adding that there now appears to be a considerable difference between the best practice Australian bank (National) and the other major banks. Moore noted that if the other three banks were to have achieved the same 1993 operating expense/operating income ratio as the National, their operating expenses would have been about $1.5 billion lower in total.

3.62 The Committee acknowledges that the banking industry has taken up the challenge to improve individual competitiveness. However, the Committee considers that the banks must continue the effort to enhance competitiveness as it appears that there is still scope for more efficiency gains to be realised for the benefit of the community as a whole. The Committee also notes that there are still barriers to competition in respect to foreign banks from establishing branches in Australia and on the mobility of bank customers.

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100 Evidence, p. 63.

101 Evidence, p. 62.

102 Evidence, p. S22

103 Evidence, p. S23.

104 ibid.

Financial Surveillance and Prudential Supervision

3.63 The RBA has responsibility for promoting stability in the banking system, and a more general responsibility for the financial system as a whole.[105] The RBA in its prudential supervisory role indicated that:

> The Bank's prudential supervisory role has come under considerable scrutiny in recent years, prompted largely by the difficulties experienced by some State banks and their subsidiaries, and the general slump in bank profitability.[106]

3.64 The RBA also indicated that its approach to prudential supervision was that:

> The Bank is against highly intrusive prudential supervision, which it sees as inhibiting efficiency and innovation in banking without guaranteeing the safety of banks. It is, however, in favour of modifying and strengthening supervisory arrangements in the light of changes in banking practices and conditions.[107]

3.65 One of the areas that the RBA has focussed on in its supervision was the work that has been carried out to achieve more consistency in banks' reporting of problem loans, to encourage banks to install systems to track changes in the quality of their entire asset portfolio, and to establish appropriate loan-grading systems.[108] The RBA indicated that 'Standardising the approach to the identification of problem loans will benefit both the Bank and financial markets in making comparisons of banks' performance.'[109]

3.66 Another area in which this approach has been applied is the adoption by the RBA of the Committee's recommendation in *A Pocket Full of Change*[110] that the role of auditors and the relationship with the RBA needs to be improved. As a result the RBA has met with the external auditors to discuss possibilities for improving their reporting requirements with the RBA.

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105 Reserve Bank of Australia, op. cit., p. 24.

106 ibid., p. 26

107 ibid.

108 ibid., p. 27.

109 ibid.

110 op. cit., p. 209.

3.67 The RBA advised that there had been several meetings with external auditors where the state of the banking industry was reviewed. Issues relating to improving the reports that the external auditors provide to the RBA were examined and developments overseas which bear on the duties that the external auditors have in reporting to the RBA were discussed.[111] The RBA told the Committee that 'the relationship with the auditors has deepened and grown a great deal since the Martin Committee took evidence.'[112]

3.68 Other developments have included:

- amendment to the risk weighting applied to certain housing loans under the capital adequacy guidelines;

- preparation of a response to the consultative papers prepared by the Basle Committee on Banking Supervision on market risk;

- canvassing the issue of whether the Basle Committee's current guidelines should be amended to extend the forms 'netting' of obligations which might be recognised as reducing credit risk for capital adequacy purposes; and

- the prominence of financial conglomerates and the issues faced by financial supervisors.

3.69 A further area that the RBA assessed was the implication of the strong growth in financial products known as derivatives. While the use of derivatives is not a recent phenomena, the growth experienced and the large gross values of the outstanding obligations and seemingly complex nature of some of the derivative products, has resulted in a number of concerns amongst regulators and within the legal and accounting professions.

3.70 As the derivatives market is an international market it is being closely monitored by supervisory authorities around the world. The RBA has focussed on the nature and measurement of the risks and on the analysis of new products and risk-management techniques.

3.71 The RBA[113] reported that the banks' derivative obligations are large in gross terms and have grown rapidly in recent years. The growth in the banks' derivatives activity has been around 20 percent on average over the last three

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111 Reserve Bank of Australia, op. cit., p. 41.

112 Evidence, p. 41.

113 Reserve Bank of Australia Bulletin, August 1993, Supervision of Banks Derivatives Activity, pp. 7-12

years.[114] As of March 1993, the aggregate derivative obligations of Australian banks were just below $2,000 billion. To put the figure into perspective, the RBA, noted that it equates to about 5 times the Australian dollar assets of the banks.

3.72 The RBA defined[115] derivatives as financial contracts where the value is dependent on the value of some other asset. The RBA also noted that derivatives come in three generic forms:

- those which involve an obligation to acquire or sell an asset at a given price in the future (this category would include forward contracts and futures);

- those that involve the right (but not the obligation) to acquire or sell an asset in the future (options); and

- those involving the exchange of income streams without necessarily involving an exchange of principal (interest rate or foreign currency swaps)

3.73 The RBA told the Committee that 'the risks are broken up basically into credit risk, market risk and operations risk.'[116] The RBA described credit risk as the risk that a counter party fails and does not carry out its side of the obligation. The RBA's view of credit risk was that it 'has already been taken into account in the supervision framework in that the capital adequacy standards we introduced in 1988, the risk based one, brought into the capital calculation off balance sheet business for the first time.'[117]

3.74 As to market risk, the RBA described it as the risk that a bank will face a loss if prices in the market move against a position it has taken. The RBA indicated that market risk is 'the risk that a bank will face loss if prices in the market move against a position it has taken...and...those risks are not currently covered in the capital framework.'[118]

3.75 The Basle Committee on Banking Supervision has prepared consultative papers on market risk and the RBA has sought comment from the banks on the papers. A response has been forwarded to the Basle Committee for consideration. Under the Basle Committee proposals, banks would be required to

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114 ibid., p. 8.

115 ibid., p. 7.

116 Evidence, p. 46.

117 ibid.

118 ibid.

hold a minimum level of capital to cover risks associated with changes in interest rates, share prices and exchange rates, similar to the way that the existing risk-based capital adequacy guidelines focus on credit risk.

3.76 Formal guidelines on market risk will be issued in late 1994 with the implementation expected towards the end of 1996. The RBA anticipates the impact of these proposals on the banks to be small relative to their existing levels of capital.[119]

3.77 A number of banks provided detailed responses to the Basle proposals on market and interest rate risk. These responses included sensitive competition information on the extent to which individual bank systems aligned with the Basle proposal and it was not therefore appropriate for the ABA to respond on behalf of the industry to the Basle market risk proposal.

3.78 As to operational risks, they were described as the risks associated with the banks having inadequate systems and procedures and that the banks do not understand fully how they work in order to properly manage the risks involved. The RBA told the Committee that it has been talking to the banks, on a case by case basis, about the sorts of things that they do and the risks that they run.[120]

3.79 RBA finished by saying that:

> All of these issues have been covered in quite a number of studies and international reports, including the G30 report which came out most recently. So the derivatives are a focus of debate internationally and here, and I think will continue to be a focus of debate. We have not heard the last word on that topic by any means. It is very important for us to keep in touch with that debate.[121]

3.80 The Committee agrees with the RBA's view that derivatives will continue to be a focus of debate as they continue to grow in both use and volume. The debate has also focused on the legislative control over derivatives, both in Australia and internationally. Recent evidence given to a US Congressional House Banking Committee indicated that concern about the stability of financial markets was well founded. The evidence indicated that concern related to the use of derivatives by financial institutions all re-hedging their portfolios in the same direction thereby amplifying the change. The recent selling climax in the US bond market on 4 April 1994 was an example of the consequence of the use of derivatives by financial institutions in the dynamic hedging of their portfolios.

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119 Reserve Bank of Australia, op. cit., p. 28.

120 Evidence, p. 47.

121 ibid.

3.81 A further concern that the evidence raised was in the derivatives themselves in that there were so many derivative instruments that the risks involved in their use was not properly understood, even by the sophisticated investor.

3.82 Following the Congressional hearing, the committee chairman indicated that legislation would be introduced to cover derivatives. While no details were provided, it was indicated earlier that the proposed legislation would require banks to disclose more about their derivatives trading and provide bank regulators with greater powers to gather information on the banks activities. It was also indicated that another Bill would create a Federal Derivatives Commission.

3.83 The Committee considers that developments in the US further highlight the need for the RBA to be in touch with what is being done in this area and the Committee supports the RBA's focus on the nature and the measurement of risk.

3.84 The ABA's view on the developments in the US regarding derivatives trading and disclosure was sought. The ABA advised that:

> the RBA is using the survey data to expand its knowledge of the market and market practices, and to get a feel for how risk management systems used by banks in Australia compared with standards recommended internationally, for example, in the Group of Thirty (G30) Study. If new forms of supervision or regulation are to be considered, it is appropriate that they be subject to cost-benefit analysis to ensure there is a demonstrated need for the particular regulation proposed and to ensure it does not interfere unduly with the competitiveness and efficiency of markets.[122]

3.85 Given the complexity and the risks involved in the use of derivatives by business, large and small, the Committee is concerned that users may encounter difficulty due to a lack of adequate knowledge and understanding. The Committee recalls the issue of foreign currency loans (FCLs) dealt with in the earlier banking inquiry, where the Committee noted that while the product was not considered to be an inherently risky product, it was a separate question as to whether it may be considered to be an inappropriate product to provide to some borrowers who did not fully understand the associated risks. While the various derivatives available are able to be well controlled by institutions, in the hands of the unsophisticated they could result in significant losses.

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122 Evidence, pp. S99-S100.

3.86 The ABA was asked for their point of view as to whether the situation that arose with FCLs could occur with the use of derivatives by those uninformed of the associated risks and costs associated. The ABA responded that 'The major users of derivatives are very financially aware, typically bankers, NBFIs, Government instrumentalities and large corporates who use derivatives as a risk minimisation tool.'[123]

3.87 To support the Committee's view that when a product is provided to retail customers, whether FCLs, derivatives or other products which possess various risks, there is a need for complete and full disclosure, the RBA indicated that:

> The Bank also contributed to a review by the Australian Securities Commission of the regulation of the 'over-the-counter' market for derivatives; the Bank generally favours relatively light regulation of transactions in professional or wholesale markets but acknowledges the need for more protection where institutions are offering retail products.[124]

Lending to Small Business and the Rural Sector

3.88 The Committee is of the view that the banks can and should play a more pivotal role in assisting small business and the rural sector to take advantage of the opportunities flowing from Australia's improved international competitiveness.[125] For many businesses, and especially small business and those in the early stages of establishment, the banking system is likely to be the main source of debt finance. This has been particularly so since deregulation of the financial market during the 1980's.

3.89 However, since deregulation, there has been, and still is concern by small business and the rural sector that banking policies and practices have not passed on the benefits of deregulation, particularly those benefits that would be expected from increased competition.

3.90 In *Checking the Changes,*[126] the Committee identified that there was a need for the RBA to enhance its capacity to monitor and report on trends in bank lending to small business and the rural sector. This was further reinforced by

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123 Evidence, p. S100.

124 Reserve Bank of Australia, op. cit., p. 28.

125 *3rd Annual Review of Small Business in Australia*, Department of Industry, Technology and Regional Development, December 1993, p. 32.

126 op. cit., p. 15

Investing in the Nation,[127] which re-emphasised the recommendation of the Committee, as well as adding other measures to assist small business and the rural sector.

3.91 In response the RBA established the Small Business Finance Advisory Panel. The RBA took the view that the Panel:

> ...will improve our knowledge of the problems of small business...rather than have to rely upon the odd anecdotal report...and...is quite a significant improvement in the knowledge base about small business and their problems.[128]

3.92 The ABA was asked for the banking industry's view of the Panel. The ABA indicated that 'it was not privy to the deliberations of the Small Business Finance Advisory Panel so it is difficult to comment on its effectiveness.'[129] The ABA added that 'the ABA or banks would welcome representation on the Panel should the Government consider that is appropriate.'[130] The Committee will take this matter up with the RBA in the review of the RBA's 1993/94 Annual Report.

3.93 The Committee is encouraged that there has been improvement in the understanding of small business and their problems. This gives opportunity for the banks, and the Committee, to use more reliable evidence, rather than the anecdotal evidence used to date.

3.94 In order to monitor and report on the trends in bank lending to small business, the RBA requested the banks to provide statistics on their lending to small business. As a result, the RBA's April 1994 Bulletin, reported, for the first time, the results of the first quarterly collection of statistics from the banks on their lending to small business in relation to loan size, interest rates and purpose.

3.95 For the purposes of collection of the statistics, which are as at December 1993, small business was defined as being any business with borrowings up to $500,000. It was also found that the level of borrowings closely correlated with turnover, and that the greater the borrowings the greater the turnover, such that small business generally had turnover up to $5 million.

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127 *Investing in the Nation*, Statement by the Prime Minister, The Honourable P J Keating, MP, 9 February 1993, pp. 53-57.

128 Evidence, p. 27.

129 Evidence, p. S98.

130 ibid.

3.96 The main feature of the statistical collection, which will now be undertaken quarterly, is the classification of the loans by:

- size and by the average interest rate charged;
- type (whether variable interest rate loans, fixed interest rate loans or bill facilities);
- sector; and
- purpose.

3.97 Based on this information, the RBA indicated that:

> ...for the first time in a long while we should, over the course of the next year or so, start to build up some hard information on lending by size of loan.[131]

3.98 The RBA also reported on the results of a survey of small and medium sized businesses in metropolitan areas to provide information on their attitudes to and experiences with banks. This was supplemented by results from a survey of rural business. The Committee intends to pursue the issue of lending to small business and the rural sector during the course of the Committee's review of the RBA's 1993/94 annual report in order to ascertain whether the survey requires further refinement.

3.99 The Committee commends the work undertaken by the RBA and the support provided by the banks to provide the information as a step towards improved relations between banks and their customers. The Committee considers that the December 1993 statistics will form a base to build upon. These statistics will, as indicated above, provide more reliable evidence for analysis rather than reliance on anecdotal evidence.

3.100 The general observations of the survey data to date indicate that-

1. Small business loans account for some one third of total *business credit provided and for the majority in number.*

2. Small business rely more heavily on variable interest rate loans (which include overdrafts and fully drawn loans where the interest rate is adjusted in line with indicator rates) than do larger businesses in that 39% of all small business loans were at variable interest rates while only 15% of all large business loans were at variable interest rates.

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131 Evidence, p. 28

The RBA explained that a reason for the large use of variable interest rate loans by small business is the use of overdraft facilities as the most common form of borrowing by small business. A survey into small business banking needs indicated that 63% of respondents said that the overdraft predictability was the most important priority for the facility.

3. Small business makes a slightly greater use of fixed interest rate loans than large business, however, the variation is less marked.

4. Small business makes much less use of bill finance with only 29% of small business loans as compared to 62% for large business.

The RBA explained that small business make less use of bill facilities than large business due to bill facilities lacking the flexibility of overdrafts and the simplicity of leases.

5. In relation to the cost of the respective types of finance used by small business, it was found that:

- variable interest rate loans tend to be more expensive than the other facilities;

- average cost of variable interest rate loans was 10.9%, compared to indicator rates for variable interest rate business loans of between 8.95% and 9.5%, implying an average risk margin of between 1.4 and 1.9%;

- the average cost for fixed interest rate loans was 10.0% and bill financing was 8.2%;

- in each case, the average rates were the highest where the loan was the smallest. Small borrowings tend to have higher interest rates, however, the margin is not large. The average rate paid on a $100,000 variable interest rate loan is 1.3% higher than the average paid on loans over $2 million. For fixed interest rate loans the difference is 2.1% and for bill finance the difference is 1.7%. The differences were explained as being due to higher risks associated with small business, and economies of scale in lending ie costs associated with the establishment and monitoring of small loans tend to be similar to those for larger loans;

- higher cost of overdrafts in part reflects the fact that these facilities incorporate an option to draw down (within approved limits) and repay at will. Such options are valuable to borrowers, but also involve higher costs to lenders, and result in a higher interest rate on such loans;

- for variable interest rate loans, only 3% of loans were at interest rates higher than 13%. Some of these were overdrafts drawn down in excess of approved limits thereby attracting penalty rates; and

- for fixed interest rate loans, a similar percentage of loans were greater than 14%, but this is due to the existence of many fixed interest rate loans which may have been taken out at much higher prevailing rates in the late 1980's or early 1990's.

3.101 One conclusion that can be drawn from the RBA statistics is the preference by small business and the rural sector to use more costly forms of lending, namely overdraft facilities. This has resulted in a perception that the banks are taking advantage of this preference and charging a premium for the privilege of having an overdraft facility. The ABA response was that 'Banks endeavour to provide the right type of facility for the purpose required by small business, be it working capital or investment.'[132] As to the cost of the overdraft, the ABA advised that 'the actual interest cost to a smaller business with fluctuating finance needs (which would be the majority of cases) will usually be lower with an overdraft than with a fully drawn advance at a lower rate because with the overdraft the customer is only charged for the amount of credit needed.'[133]

3.102 The ABA also highlighted that what appears from a 'simplistic analysis to be the cheapest product is not always the most effective way of satisfying a particular need; all of the required features of the credit facility have to be taken into account when selecting the appropriate bank product.'[134]

3.103 A further Government initiative to improve lending to small business was a policy announcement in *Investing in the Nation*[135] which recommended that the RBA, from 1 July 1993, pay a market interest rate (equal to the yield on 13 week Treasury Notes) on the non-callable deposits (NCD) of the banks with the RBA. This would increase the gross revenue of the banks by about $140 million on a continuing basis. The banks were asked to utilise this benefit to increase their lending to small and medium sized business to the maximum extent possible.

3.104 As part of the initiative, the RBA was to report to the Government on progress of the banks in utilising the gain. The Committee wrote to the RBA for advice on the progress that the banks have made in utilising the $140 million gain

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132 Evidence, p. S98.

133 Evidence, p. S97.

134 Evidence, p. S99.

135 op. cit., p. 5.

to benefit small and medium sized business. The RBA indicated that 'it is not possible to quantify the specific impact of the change to NCD arrangements on banks' lending to small businesses.'[136] However, the RBA added that since the change was announced, 'there is considerable qualitative material suggesting that the banks have competed more vigorously for the small business market by offering price discounts and new services, and the volume of lending has increased.'[137]

3.105 Another initiative by the Government was the recent White Paper on Employment and Growth, *'Working Nation'*, which indicated, that:

> ...the financing problems of small business have continued to feature prominently in industry submissions to government...and...part of the solution lies with improving the communication between lenders and borrowers.[138]

3.106 To address this, *Working Nation*[139] contained a number of measures to assist:

- establishment of a model of best practice for a range of industry sectors to assist banks to understand and assess the future prospects of SME's (small and medium enterprises) and to standardise their loan application and approval processes;

- provision of improved training for accountants, business advisers and bankers to enhance their knowledge of the special needs of SME's and particular types of lending such as cash-flow lending and export finance;

- provision of assistance directly to SME's to obtain expert advice on export finance facilities and on the preparation of applications for finance facilities;

- promotion of the role of the Commonwealth Development Bank in lending to small business through a major advertising campaign; and

- facilitation, in consultation with the ABA and small business representatives, of constructive dialogue between banks and small business to address the concerns of SME's.

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136 Evidence, p. S93.

137 ibid.

138 op. cit., p. 74.

139 ibid.

3.107 The ABA's views on these measures was that 'Individual banks will take cognisance of what the White Paper says and match it against their own processes to see the extent to which it has validity for them.'[140] The Committee will follow with great interest the approach of the banking industry in addressing these measures.

3.108 The Committee concludes that the RBA should now review the information that has been collated in respect to lending to small business and report the results.

Superannuation and Insurance

3.109 As in the rest of the world, banks in Australia have moved away from their traditional deposit-taking and lending activities to include other activities through diversifying into insurance, superannuation, funds management, investment advice, foreign exchange trading and stockbroking. The RBA reported that 'financial *conglomerates are becoming a more prominent feature of the financial system.*'[141]

3.110 The diversification that has occurred has been attributable in part to the competitive forces at work. The Committee will continue to monitor these important developments.

3.111 Superannuation is one area which has experienced considerable growth. At the hearing with the ABA, concern was raised regarding the restrictions imposed on banks from offering superannuation products direct. However, as Government policy on this matter is now clear, the Committee has chosen not to pursue it further.

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140 Evidence, p. 81.

141 Reserve Bank of Australia, op.cit., p. 28.

CHAPTER FOUR

CONCLUSION

4.1 The review of the RBA's 1992/93 annual report is the first such inquiry into matters arising from the RBA annual report. The Committee views this as an important development in the relationship between Parliament and the RBA. This process also forms the basis for the Committee to undertake an annual review of the banking industry to fulfil the need for parliamentary oversight of banking issues. This provides an opportunity to examine current concerns and developments in the banking industry.

4.2 With this in mind, the Committee's approach was aimed at maintaining the pressure on banks regarding the implementation of recommendations of previous inquiries intended to lead to a better, fairer and more competitive banking system.

4.3 A central aspect of the review was bank interest rate margins due to general concerns over their levels. While the Committee found that there was a commonly accepted measure of bank interest rate margins which was considered reliable,[142] there was great difficultly in making any reliable and meaningful comparisons due to the number of factors that need to be considered when comparing banks and their margins. As a result the Committee did not draw a definitive conclusion, however, the Committee is not convinced that margins as they currently stand reflect a truly competitive banking environment. These matters, including fees, will be further considered in the review of the RBA's 1993/94 annual report, when it is expected that the RBA will have completed its work on the development of more useful data on margins which will allow comparison of *like with like.*

4.4 This review included a number of other issues -

- Establishment of the Council of Financial Supervisors - the Committee considers the establishment of the Council as having had a significant benefit as a result of closer coordination between the supervisors of the Australian financial system. It is also considered that the establishment is timely given the growing significance financial conglomerates in Australia's financial system. This matter will be examined further in the review of the RBA's 1993/94 annual report.

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142 interest rate spread

- The relationship between banks and their customers - improvements have come from the development of the Code of Banking Practice and the operation of the Australian Banking Industry Ombudsman Scheme. While the Committee acknowledges that the Code and the Scheme are major steps in improving the relationship between banks and customers, the Committee considers that they should be broader in their application as they exclude small business and the rural sector. The Committee also considers that the monetary limit applied under the Ombudsman Scheme is too restrictive. The Committee does not accept that widening the application and increasing the limit would reduce the effectiveness of the Scheme to the genuine consumer. The Committee will also be seeking to encourage all retail banks to become members of the Ombudsman Scheme.

- Effectiveness of competition amongst Australian banks and from foreign banks - evidence revealed several barriers to competition including: a reluctance on the part of bank customers to take advantage of the competition due to transfer costs; the withholding tax arrangements for foreign bank branches; and the level of depositor protection on deposits with foreign bank branches. The maximisation of competition in the provision of banking services will be pursued in the review of the RBA's 1993/94 annual report.

- Financial surveillance and prudential supervision by the RBA - the RBA provided details of its approach to financial surveillance and prudential supervision, particularly in the area of derivatives. The Committee endorses the current focus on measurement of risk and the analysis of new products and risk management techniques. The Committee will continue to monitor developments with regard to derivatives.

- Lending to small business and the rural sector - the Committee views the provision of reliable data on bank lending to small business and the rural sector as an important issue and endorses the RBA's work in this regard. The Committee concludes that the RBA should now review the information that has been collated in respect to lending to small business and report the results.

- The Small Business Finance Advisory Panel - the Committee will take up the matter of representation on the panel by the ABA.

4.5 The Committee will follow up these issues with the RBA in its review of the Reserve Bank's 1993/94 annual report. The Committee will also look at other issues that have arisen since this review with a view to ensuring that there is continued public discussion of developments in the banking industry and parliamentary oversight of the role and function of the RBA.

THE HON DAVID SIMMONS MP
Chairman
17 August 1994

Appendix 1

List of submissions

No.	Name of person/organisation
1	Reserve Bank of Australia
2	Professor Ian Harper Ian Potter Professor of International Finance University of Melbourne
3	Australian Bankers' Association
4	Reserve Bank of Australia
5	Australian Bankers' Association
6	Mr Des Moore Senior Fellow Institute of Public Affairs Ltd

Appendix 2

Program of activities undertaken by the Committee

Public hearings

Sydney	28 October 1993
Melbourne	18 May 1994

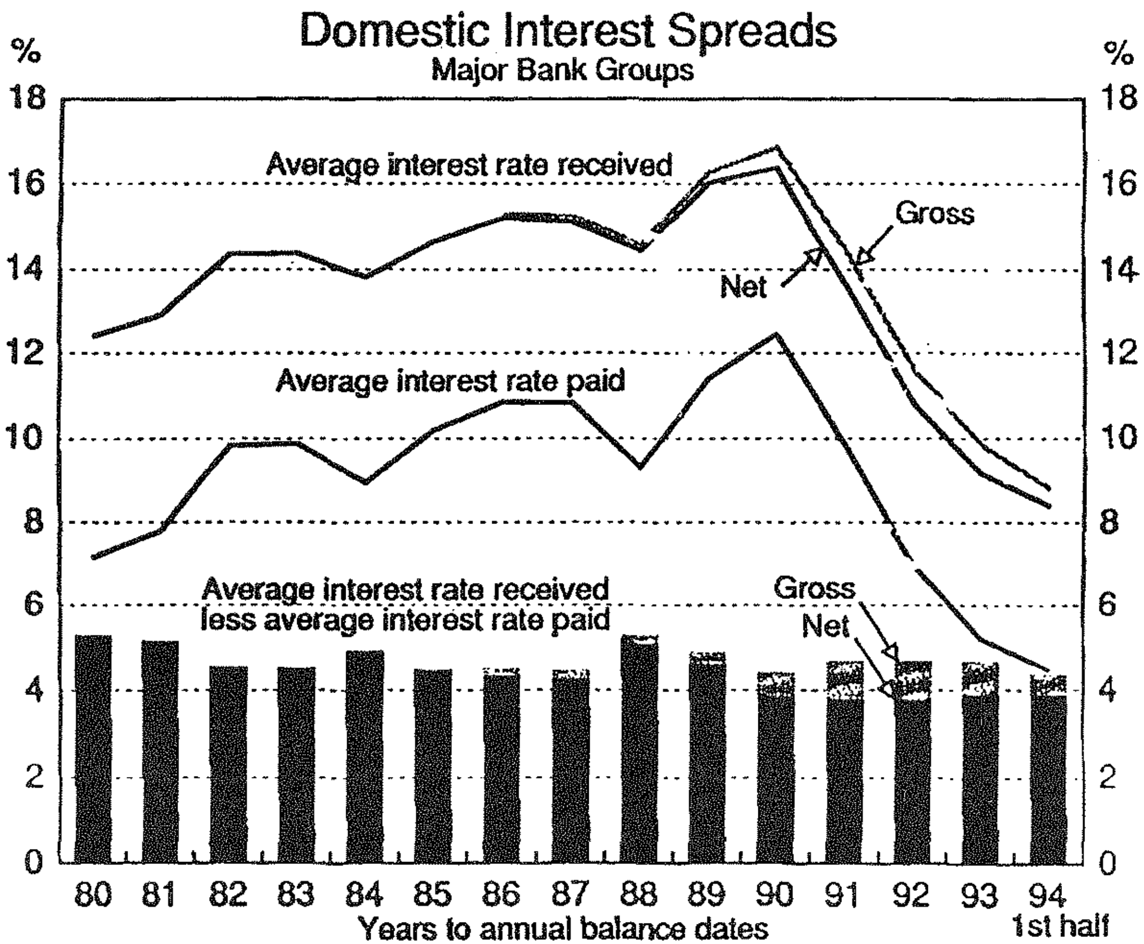
Appendix 3

List of witnesses appearing at public hearings

Witness/organisation	Date(s) of appearance
Reserve Bank of Australia	
Mr Bernie Fraser Governor of the Reserve Bank of Australia	28 October 1993
Australian Bankers' Association	18 May 1994
Mr Glenn Barnes Chairman Executive Committee Australian Bankers' Association	
Mr Alan Cullen Executive Director Australian Bankers' Association	
Mr Gary Healey Director Research Australian Bankers' Association	
Mr Alan Oster Chief Economist National Australia Bank	

Appendix 4

Domestic interest spreads - major bank groups



Source: Evidence, p. S108a.

Appendix 5

OECD figures on non-interest income

(These figures are based on 1991 data and are expressed as a percentage of average total assets)

	Non-interest income (net)
AUSTRALIA	
• All banks	2.37
AUSTRIA	
• All banks	0.86
BELGIUM	
• Commercial banks	0.44
• Savings banks	0.30
CANADA	
• Commercial banks (consolidated world-wide)	1.36
• Foreign commercial banks	1.58
DENMARK	
• Commercial & Savings banks	NA
FINLAND	
• All banks	1.44
• Commercial banks	1.24
• Post office bank	NA
• Foreign commercial banks	0.62
• Savings banks	1.84
• Co-operative banks	1.97
FRANCE	
• Commercial banks & credit co-operatives	0.61
• Large commercial banks	0.66
GERMANY	
• All Banks	0.65
• Commercial banks	0.95
• Large Commercial banks	0.98
• Regional giro institutions	0.21
• Savings banks	0.56
• Regional institutions of co-operative banks	0.63
• Co-operative banks	0.73

	Non-interest income (net)
GREECE	
• Commercial banks	2.77
• Large commercial banks	2.74
ITALY	
• Commercial banks	1.25
• Large commercial banks	1.27
• Savings banks	1.41
JAPAN	
• Commercial banks	0.14
• Large commercial banks	0.19
LUXEMBOURG	
• Commercial banks	0.30
NETHERLANDS	
• All banks	0.73
NORWAY	
• All banks	0.58
• Commercial banks	0.59
• Savings banks	0.57
PORTUGAL	
• Commercial banks	1.13
SPAIN	
• All banks	1.00
• Commercial banks	1.29
• Savings banks	0.55
• Co-operative banks	0.27
SWEDEN	
• Commercial banks	0.71
• Foreign commercial banks	0.97
• Savings banks	2.25
• Co-operative banks	1.70
SWITZERLAND	
• All banks	1.61
• Large commercial banks	1.60
• Other Swiss & foreign commercial banks	3.60
• Other Swiss commercial banks	
• Foreign commercial banks	2.92
• Cantonal banks	4.18
• Regional & savings banks	0.81
	0.48

	Non-interest income (net)
TURKEY	
• Commercial banks	-0.93
UNITED KINGDOM	
• Commercial banks	2.03
UNITED STATES	
• Commercial banks	1.86
• Large commercial banks	2.18
• Mutual savings banks	0.67

Source: Evidence, pp. S105-106.