

Chapter 10 Summary ...

Mergers and Acquisitions

Overview

- A competitive financial system is in the best interests of Australia. Merger laws and their administration have an important role to play in ensuring a competitive structure for the Australian financial system.
- This chapter considers the laws and policies which should govern mergers in the financial sector, who should administer them and some of the key factors relevant to their assessment. It does not seek to comment on specific merger scenarios. Nor does it consider all of the issues relevant to defining a market or assessing the competitive impact of a merger since this can only be done in the context of a specific merger proposal.

Key Findings

- The cluster of services methodology used by the ACCC in the Westpac/Challenge merger should be closely questioned and at least narrowed.
- Retail transaction accounts and small business products are likely to be central to the competition assessment of future retail banking mergers.
- The market for some retail banking products is moving from being regional to national. The pace of movement varies depending on the product. The market for a limited number of products, such as housing loans and credit cards, may already be national. The

market for some other retail and SME products may be national in the future, but they do not appear to have yet reached that point.

- Regional banks have provided an important competitive pressure in recent years — although there is nothing immutable about their position.
- It is not possible to make findings about the potential efficiency gains from mergers in the abstract.

Key Recommendations

- Section 50 of the *Trade Practices Act 1974* and the administration of competition law by the ACCC should continue to apply to the financial system.
- Banking and insurance laws should be amended to make it clear that the only competition assessment of a merger should be under the *Trade Practices Act 1974*.
- Mergers should be subject to assessment under the *Trade Practices Act 1974* and under banking and insurance laws, but the ‘six pillars’ policy — which separately imposes a government prohibition on mergers among the largest four banks and the largest life companies — should be removed.
- The *Foreign Acquisitions and Takeovers Act 1975* should continue to apply to acquisitions in the financial system but the policy prohibition on the foreign takeover of the four major banks should be revoked.
- A large scale transfer of ownership of the financial system to foreign hands should be considered contrary to the national interest. However, this does not preclude some increase in foreign ownership, including of major participants.

Mergers and Acquisitions

10.1 Introduction

This chapter considers the laws and policies which should govern mergers in the financial system, who should administer them and some of the key factors relevant to their assessment.

The chapter takes as its starting point the view that a competitive financial system is in the best interests of Australia and that merger laws and their administration have an important role to play in ensuring a competitive structure for the Australian financial system.

The Inquiry has adopted the principle that the regulation of mergers in the financial system should not differ from that applied in other sectors unless strong and clear reasons for special treatment can be demonstrated.

10.2 Merger Laws

Laws governing mergers in the financial system are contained in banking and insurance legislation as well as in the *Trade Practices Act 1974*. The appropriateness of the existing laws and who should administer them are discussed in this section.

10.2.1 Application of the Trade Practices Act

The Trade Practices Act provides a set of economy wide competition laws — including provisions governing mergers. An initial issue for the Inquiry was whether the Trade Practices Act should continue to apply to the financial system or whether there should be special provisions governing competition in this sector.

In brief, s. 50 of the Trade Practices Act prohibits mergers and acquisitions which would have the effect, or likely effect, of substantially lessening competition in a substantial market for goods or services.

Whether a specific merger would breach the s. 50 test is a matter for determination on the facts at the time of its proposal. In the first instance, the Australian Competition and Consumer Commission (ACCC) may form a view in relation to a particular merger and advise the parties accordingly. However, any view so formed does not of itself prevent the merger from proceeding. If a merger proceeds in circumstances where the ACCC has formed the view that it would breach s. 50, the Commission may apply to the Federal Court to have the merger declared in breach of the law — in which case penalties may be applied and the merger prevented or overturned.

The Trade Practices Act also provides a process whereby authorisation can be granted, on public benefit grounds, for mergers which would otherwise breach s. 50.

Under s. 90(9) of the Act, the ACCC may grant an authorisation to an applicant if it is satisfied:

in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

10.2.2 Industry Specific versus Economy Wide Law

The Hilmer Committee on National Competition Policy concluded that:

*the general conduct rules of a national competition policy should, in principle, apply to all business activity in Australia, with exemptions for any particular conduct only permitted when a clear public benefit has been demonstrated through an appropriate and transparent process.*¹

This principle has been accepted by all Australian governments. The issue is whether there is any justification for applying to the financial system a set of competition rules different to those applying to the rest of the economy.

For such a case to be made out, it would need to be demonstrated that the test applied under s. 50 of the Trade Practices Act is not appropriate for the financial system — because it is either too strict or not strict enough.

The Inquiry's examination has found no substantive evidence for a different test.

Rather, examination of the Australian financial system suggests quite the opposite. As noted throughout this Report, non-traditional suppliers, such as retailers, telecommunications companies and manufacturers, are presently entering the financial system. This convergence would make the practicality of administering a separate competition regime for the financial system extremely difficult.

Recommendation 79: Section 50 of the Trade Practices Act should continue to apply to the financial system.

Section 50 of the *Trade Practices Act 1974* should continue to apply to the financial system as to other sectors—so that a merger in the financial system is prohibited where, in a substantial market, a substantial lessening of competition would be likely to result.

1 Independent Committee of Inquiry (Hilmer Committee) 1993, p. xxiv.

10.2.3 Role of the ACCC

A related issue is whether the application of competition laws to the financial system should be administered by an industry specific regulator or the ACCC as the economy wide competition regulator.

The Hilmer Committee also considered the possibility of competition policy being administered by industry specific regulators. It was satisfied that all aspects of a national competition policy could be fully and effectively performed by an economy wide body. Factors influencing it against industry specific regulators included:

- the risk of industry capture;
- the resulting lack of consistency with the application of competition policy;
- the lost opportunity to apply insights gained in one industry to analogous issues in other industries;
- the resulting fragmentation of regulatory and analytical skills; and
- the typically greater administrative costs.²

The two arguments usually used to support industry specific regulators are that the economy wide regulator does not devote sufficient resources to the sector and that the economy wide regulator does not have sufficient knowledge and understanding about the sector. Neither of these arguments applies in relation to the financial system.

The Inquiry agrees with the Hilmer Committee's assessment that an economy wide regulator is generally appropriate for competition regulation. Moreover, as new players—such as telecommunications companies, software providers and retailers—become more involved in the financial system, the feasibility of operating a separate competition regulator for the sector diminishes.

2 Independent Committee of Inquiry (Hilmer Committee) 1993, p. xxxv.

Recommendation 80: The ACCC should administer competition laws for the financial system.

The ACCC should continue to administer the competition laws for the financial system as for other sectors.

10.2.4 Mergers under Banking and Insurance Laws

Under existing arrangements, there is a degree of regulatory duplication in the oversight of mergers involving banks and insurance companies. Mergers involving these institutions are required both to pass the competition test under the Trade Practices Act and to receive the consent of the Treasurer (and sometimes the Governor-General) under banking and/or insurance laws. Competition considerations are relevant under both, but the latter also require consideration of prudential and broader national interest criteria.

In relation to competition considerations, there is clearly potential for conflict as well as duplication.

Existing Powers under Banking and Insurance Laws

The Treasurer has powers over bank mergers under the *Banking Act 1959* and the *Banks (Shareholdings) Act 1972*. The Banking Act provides for the authorisation of banks and for the imposition of conditions on bank authorities. It also requires authorised banks to seek the prior consent of the Treasurer to effect a sale, amalgamation or reconstruction, or to form a partnership or association (s. 63). The Act provides no guidance on how the Treasurer is to exercise this discretion beyond stating that the Treasurer's consent shall not be unreasonably withheld. In practice, the Treasurer usually considers:

*any prudential considerations, the potential efficiency gains resulting from any rationalisation, and any potential losses resulting from reduced competition in the financial sector.*³

The Banks (Shareholdings) Act restricts individual shareholdings in banks to 10 per cent or less, subject to exemptions which may be granted by the Treasurer for shareholdings of up to 15 per cent, or by the Governor-General for shareholdings above 15 per cent. A national interest test is applied to determine whether or not an exemption should be granted.

The primary policy rationale for this legislation is prudential: namely, that such restrictions are needed to ensure a wide spread of ownership in order to minimise the likelihood of the stability of a bank being prejudiced by the influence or varying fortunes of a particular shareholder. While the legislation can be used for competition reasons, that is not its main purpose. The broader prudential issues relating to these ownership rules are discussed in Chapter 8.

There are analogous powers in the *Insurance Acquisitions and Takeovers Act 1991*. These give the Treasurer the power to stop the acquisition, or issue, of shares in Australian registered insurance companies which would result in a person controlling 15 per cent or more of the shares. If an unauthorised action is carried out, the Treasurer can make a divestment order. This law states that its objectives are to protect the public interest in a number of ways, including by protecting prudential standards, preventing unsuitable persons from being in a position of influence, and preventing undue concentration of economic power. While the primary focus of these objectives is prudential, this legislation also gives the Treasurer scope to regulate acquisitions in the insurance industry on competition grounds.⁴

3 Department of the Treasury, Submission No. 143, p. 143.

4 Insurance and Superannuation Commission, Submission No. 53, p. 99.

Assessing Non-Competition Issues

As the above brief description of banking and insurance laws shows, a range of non-competition factors are considered in assessing merger proposals under these laws.

Of these factors, the Inquiry considers that, apart from foreign ownership and competition concerns, only prudential considerations have sufficient substance to justify intervention in commercial choices about the amalgamation of banks or insurance companies. Any concern about the concentration of economic power should be more than adequately addressed through the exercise of competition regulation, particularly given the trend towards widening boundaries for the financial system. Concerns about fit and proper persons should be a matter for licence conditions or other prudential regulation unrelated to possible mergers among already established and operating institutions.

The prudential regulator is the body with the greatest experience and expertise in prudential matters. It should therefore be responsible for assessing the prudential aspects of a merger between licensed financial institutions. (This, and the issue of mergers involving an unlicensed institution, are discussed in greater detail in Chapter 8). Prudential considerations would generally not result in mergers being prohibited but could affect their financial or other features, for example, by ensuring that capital adequacy rules were met. The reasoning for this view is set out in Section 10.3.

The prudential regulator should also be vested with adequate powers to ensure that each institution meets prudential requirements, including ‘fit and proper’ person tests, and that any breach of these requirements is remedied, whether it arises from mergers or other events. In this regard, the power to impose licence conditions is an important one which the Inquiry has recommended remain available to the prudential regulator.

To vest these powers over mergers and acquisitions in the regulator rather than the Treasurer would be unlikely to lead to any appreciable difference in decisions on mergers because the Treasurer would normally act upon the advice of the prudential regulator in any event. However, the Inquiry considers that to vest these powers in the prudential regulator would clarify

the respective roles of prudential regulation and competition regulation in the financial system.

The Treasurer's role in assessing the national interest considerations in mergers involving foreign investment and acquisition is discussed in Section 10.5.

Recommendation 81: The prudential regulator should assess the prudential implications of relevant mergers and acquisitions.

The prudential aspects of mergers between licensed financial institutions should be determined by the prudential regulator through its regulation of the merging and merged entities. In general, prudential considerations would be unlikely to prevent mergers but regulatory, capital or other requirements might influence the methods used for giving effect to them.

Assessing Competition Issues

The potential for conflict between the views of the Treasurer and those of the competition regulator is not merely hypothetical. In 1990, the then Treasurer disallowed a merger between a major bank and a major life company on the ground that it would ‘detract more from effective and vigorous competition than is in the national interest’.⁵ This view was taken even though the merger would almost certainly have been approved by the then Trade Practices Commission (now the ACCC).

This current duplication of roles in assessing the competition aspects of a merger is undesirable because it creates both uncertainty and the potential for inconsistency. Parliament has clearly specified the test which is to apply to assessing mergers under the Trade Practices Act. There is no such clarity, however, about the competition test which may be applied under current banking or insurance laws.

This situation should be remedied. Since the Inquiry has recommended that the Trade Practices Act should continue to apply to the financial system, two approaches for doing so suggest themselves. They are not mutually exclusive.

- The Government could adopt a policy position stating that it will accept the views of the ACCC (or, as the case may be, the Australian Competition Tribunal or the Courts) on competition issues.

5 Keating 1990.

- The banking and insurance laws could be amended to clarify that the Treasurer will not have power under these laws to regulate mergers on competition grounds.

The latter approach is consistent with the approach recommended by the Inquiry in Chapter 8. The former approach is available as an alternative or interim approach until the legislation can be amended.

Recommendation 82: The Trade Practices Act should provide the only competition regulation of financial system mergers.

Banking and insurance laws should be amended to clarify that the only competition assessment of a merger should be under the *Trade Practices Act 1974*.

In the meantime, the Government should publicly adopt a policy of accepting the competition assessment of bank and insurance company mergers made by the ACCC (or the Australian Competition Tribunal or Courts), as applicable, under the *Trade Practices Act 1974*.

10.3 The ‘Six Pillars’ Policy

The previous Government stated in May 1990 that mergers would not be permitted among any of the four major banks or two or three major life insurance institutions.⁶ This policy position was reiterated in subsequent years.⁷ The policy is known as the ‘six pillars’ policy.

The ‘six pillars’ policy was framed under the terms of the banking and insurance laws—it has no application under trade practices law. The present Treasurer, the Hon Peter Costello MP, stated that the policy would

6 References in this chapter to the four major banks are to the National Australia Bank, Westpac Banking Corporation, ANZ Banking Group and the Commonwealth Bank of Australia.

7 Keating 1990; and Dawkins 1993. The 1993 statement reiterates the 1990 position.

remain in force at least until the Government had received and considered the Final Report of this Inquiry.

The Inquiry therefore had to consider whether the so-called ‘six pillars’ policy should remain, be abolished or be amended in some way. Clearly, adopting the preceding recommendations would remove the legal underpinnings of the ‘six pillars’ policy.

Two matters need to be addressed.

- First, do competition concerns justify the retention of the current policy, or a new version of it?
- Secondly, are there prudential issues — such as concerns about the creation of institutions which are ‘too big to fail’ — which justify the retention of a government policy in this area?

Competition concerns appear to have been the original justification for the ‘six pillars’ policy. However, as this Report demonstrates, the financial system is dynamic and the pace of change is likely to accelerate, not slow down. Thus, any static policy may become outdated.

Also, as discussed above, the Inquiry has taken the view that the financial system should be subject to the same set of competition rules as the rest of the economy — namely, those contained in the Trade Practices Act and administered by the ACCC — and that no other competition regimes should be applied to the sector.

It follows that on competition grounds the Inquiry does not support continuation of the ‘six pillars’ policy, or a modified version of it.

This position should not be interpreted as representing a view on the desirability or otherwise of mergers among any of the ‘pillars’. Rather, the position simply states that the ACCC should assess the competition implications of any such proposal. It should do this in accordance with the merits of the proposal at the time it is made.

The second issue is whether the policy, or a modified version, is justified on prudential grounds. In its submission, the Reserve Bank of Australia (RBA) stated that it did not think that the reduction of four major banks to three would present particular prudential problems. However, it noted that, if this

happened, there may be pressures for a further move to two major banks. It went on to say:

If this were to occur, it would give Australia the most concentrated banking industry in the industrialised world, and would take us into uncharted prudential waters.⁸

The types of prudential concerns implicitly being referred to here are issues such as how failure would be managed and what the Government's responsibility would be. For example, the resulting bank may be too large for any single Australian financial institution to purchase should it subsequently fail. Also, there would be major consequences for the economy if such a large financial institution were to fail and consequently considerable pressure on the Government of the day to intervene to keep the bank solvent.

The Inquiry does not consider these arguments are persuasive from a prudential perspective. It is unlikely that the management of failure task would differ appreciably from that which would already confront a regulator if one of the existing majors failed. This is because the majors are already of a size which would limit the options for organised takeovers within Australia. If a large domestic institution fails, the options for resolution include joint ventures, foreign acquisition, partial acquisition by non-financial institutions, management by the regulator, recapitalisation or break-up prior to sale.

Another argument supporting restrictions on mergers is that one of the inevitable consequences of vastly increased concentration is vastly increased regulation. This is because of the legitimate concern the Government would have about failure. However, this differs little from the situation which already prevails in the banking sector in Australia, as in many other countries.

Australia's life insurance industry is less concentrated than its banking industry, and the firms in the industry are relatively smaller than the major banks. Accordingly, the prudential grounds for restricting mergers in this sector because of the possible creation of large firms are weaker.

8 Reserve Bank of Australia, Submission No. 111, p. 76.

In forming these judgments on prudential issues, regard must also be had to the fact that even the largest Australian financial institutions are relatively small in regional and global terms. Firms may perceive commercial advantages in growth by acquisition, and such growth should be restricted only on the grounds of strongly demonstrated domestic market considerations — such as competition concerns.

Recommendation 83: The ‘six pillars’ policy should be removed.

Mergers should be subject to assessment under the *Trade Practices Act 1974* and under banking and insurance laws, but the ‘six pillars’ policy — which separately imposes a government prohibition on mergers among the largest four banks and the largest life companies — should be removed.

10.4 The Competition Effects of Mergers

The main task of the Inquiry was to make recommendations on the overall regulatory framework for the financial system, including the appropriate framework for the determination of merger proposals.

The Inquiry did not address individual merger possibilities. This was not sought in the submissions and it is not appropriate for the Inquiry to comment on specific commercial matters. Merger proposals must be assessed case by case on the facts at the time by an appropriately constituted authority — the ACCC. This is especially so in a sector undergoing rapid change.

The Inquiry wishes, however, to comment on trends occurring in the financial system which are of relevance to the process of assessing mergers. Its focus is on retail banking since it is generally agreed that the wholesale sector is competitive and because possible mergers in retail banking are an area of controversy at present. A range of pressures on banks are leading some to consider mergers. These pressures include threats to the revenue

side of traditional banking, opportunities for scale economies and ‘the need to reinvigorate the retail franchise’.⁹ Retail banking is defined here to include the household and small to medium sized enterprise (SME) sectors. Many farms are included in this sector.

In noting the trends occurring in the financial system, the Inquiry is conscious of the fact that markets cannot be defined, nor mergers assessed, in the abstract. That is, these tasks can only be performed in the context of a specific proposal. The Inquiry has therefore not commented on all aspects of the merger assessment process. Instead, it has confined itself to those areas where it believes it can usefully make observations and impart information.

While much of the rest of this Report concentrates on how financial services business will be undertaken over the next decade, this section focuses more on where we are today on the continuum of progress and where we are likely to be in the next year or two.

10.4.1 Current Process of Assessment

As noted above, the ACCC has the role of assessing mergers for compliance with the Trade Practices Act. The methodology adopted by the ACCC to help it assess the likely impact of mergers on competition in a market involves five stages:

- defining the market;
- establishing concentration thresholds to filter out mergers which are unlikely to result in a substantial lessening of competition;
- assessing the level of import competition;
- looking at barriers to entry; and
- considering other structural and behavioural market features.

This methodology was used by the Trade Practices Commission (now the ACCC) in its assessment of the Westpac/Challenge merger in

9 First Manhattan Consulting Group and the Bank Administration Institute 1995, p. 1. See also Maloney 1996.

September 1995. In the course of approving the merger, the Commission made its position clear on three key issues:

- each merger must be assessed on its merits in accordance with the circumstances prevailing at the time;
- at that time, it considered that there was a regional, not a national, market for retail banking products, as opposed to financial services; and
- the presence of a regional bank in a region is important for competition and therefore the ACCC will closely scrutinise any merger involving a major trading bank and the last major regional bank in a State or region.¹⁰

These last two propositions have attracted both vociferous supporters and detractors.

In its more recent approval of the merger between St George Bank and Advance Bank, the ACCC reiterated its 'long held view on the importance of having a strong regional bank in each State'.¹¹

10.4.2 Factors Relevant to Assessing Merger Proposals

Market Definition

The first step in assessing any merger proposal is to define the relevant market. This is because a merger is prohibited only if it substantially lessens competition in a relevant substantial market. Defining markets can be viewed as:

establishing that area of product, functional and geographic space within which a hypothetical current and future profit maximising monopolist would

¹⁰ TPC 1995, p. 3.

¹¹ ACCC 1996, Media Release 149/96.

*impose a small but significant and non-transitory increase in price (SSNIP) above the level that would prevail absent the merger.*¹²

Defining markets, however, is not an exact science and is thus not without controversy. As one Australian expert has argued:

*substitutability, competition and market power are all matters of degree, requiring the exercise of some judgement in the delineation of relevant markets. Essentially that judgment must turn on what quantum of market power is worth worrying about.*¹³

Two main controversies surround market definitions in mergers involving Australian retail banks:

- the appropriate methodology for analysing and specifying the product dimension of the market; and
- whether the geographic element of the market is regional or national.

The Product Dimension of Market Definition

Delineation of the relevant product market requires identification of the goods and services supplied by the merged firm and the sources and potential sources of substitute products.

In both Australia and the United States, there is currently a debate occurring as to whether the appropriate approach in banking mergers is to consider substitutes for a cluster of services or individual products.¹⁴

In the Westpac/Challenge decision, a cluster of services approach was adopted. Only those institutions which offered all of the products in the

12 ACCC 1996, *Merger Guidelines: A Guide to the Commission's Administration of the Merger Provisions (ss. 50, 50A) of the Trade Practices Act*, pp. 31-32.

13 Brunt 1990, p. 107.

14 The cluster of services approach was first adopted by the United States Supreme Court in *US v Philadelphia National Bank [1963] Trade Cases 70,812 at 78,265* and is still used by the US Federal Reserve. The US Department of Justice, which also has a role in assessing bank mergers, has, however, abandoned the cluster approach in favour of a multi-product analysis approach. See Fels 1996, Woodward 1996, Fell 1996, Davis 1996; Guerin-Calvert and Ordovery 1992; Guerin-Calvert 1996; Blinder 1996; Greenspan and Colclough 1996.

cluster (deposits, loans, transactions) were included in the market. Those who disagree with this approach argue that substitutes should be separately identified for each of the major products.

The academic literature on cluster markets suggests that clustering will be appropriate only when most consumers purchase all items in a group from an individual supplier because of the transaction costs they would incur were they to purchase them separately. A comparison of the costs of unbundling with the cost savings available from bundling—including convenience—will be relevant to determining whether a cluster market exists. Similarly, evidence that suppliers market their services on the basis of joint prices, although not definitive, can constitute evidence of a cluster.¹⁵

The Inquiry examined both demand-side issues, such as consumer purchasing behaviour, and supply-side factors to assess whether the cluster approach is appropriate. This evidence is set out below and throughout the Report.

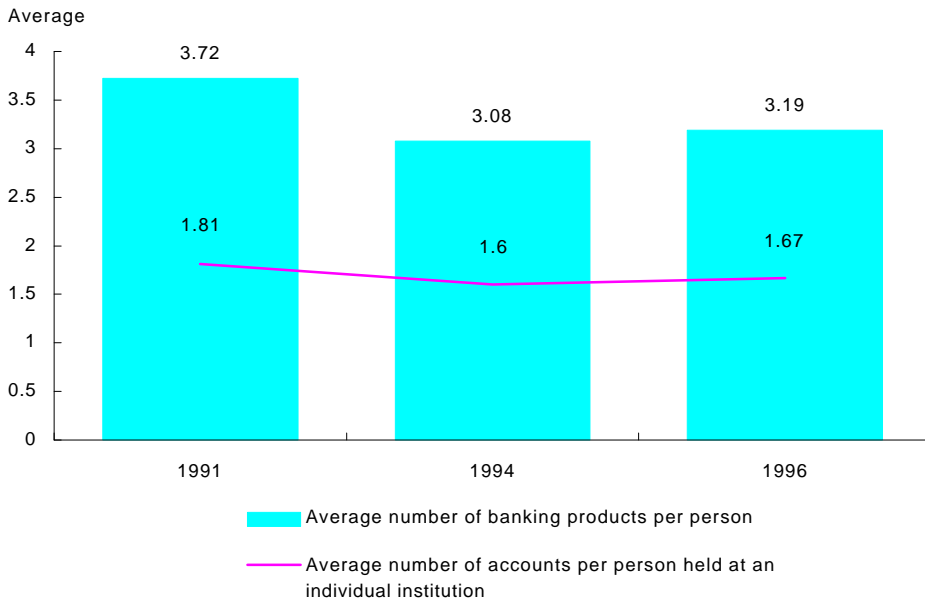
Extent of Clustering

On the demand side, the evidence suggests that, although consumers continue to bundle some of their financial products, a large percentage of consumer banking-type products are not bundled. Figure 10.1 compares the average number of banking-type products per person with the average number of accounts a person holds with an individual institution. It shows that many products are not bundled.

Many Products not Bundled . . .

¹⁵ See Ergas 1996 and Ayres 1985.

Figure 10.1: Average Number of Banking-type Products per Person Compared with Average Number of Accounts per Person per Institution



Note: Includes all accounts, credit/charge cards and loans. (The likely explanation for the drop in product numbers between 1991 and 1994 is the introduction of fees on credit cards during that time which led many consumers to rationalise the number of cards they had.)

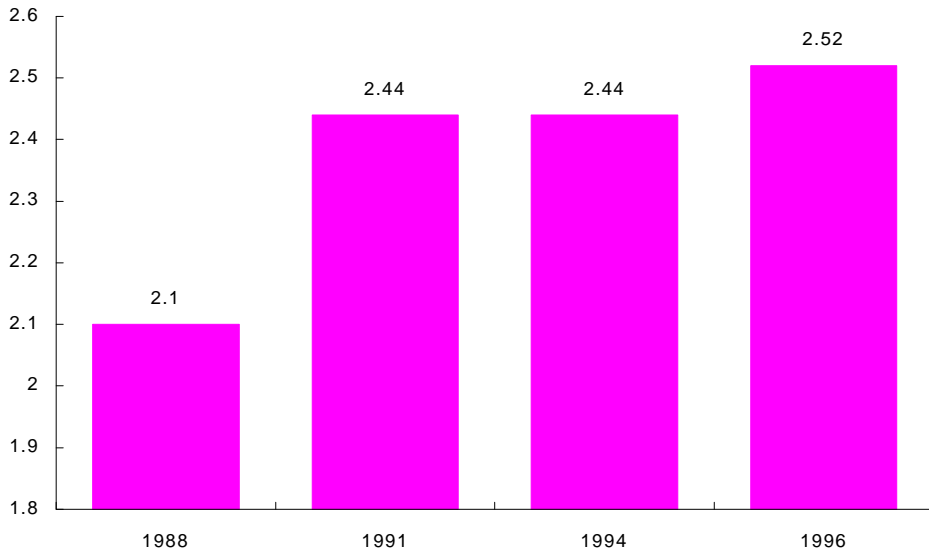
Source: Data provided to the Inquiry by Roy Morgan Research.¹⁶

Figure 10.2 also suggests that many products are not bundled. It shows that the number of financial institutions with which consumers have a relationship for ‘banking-type products’ is increasing — though only very slightly. This suggests that some unbundling is occurring.

¹⁶ The research compiled by Roy Morgan Research for the Inquiry was based on data collected via face to face interviewing of a random sample of people aged 14 and over throughout Australia. The sample size for the years included in this Report were: 1988 — 28,676; 1991 — 31,595; 1993 — 32,860; 1994 — 36,556; 1995 — 60,423; and 1996 — 55,852. Interviews were conducted every weekend throughout the year and all data relate to the 12 months ended September for each of the above years.

Consumers Dealing with more Institutions . . .

Figure 10.2: Average Number of Institutions with which Consumers have a Relationship for Banking-Type Products

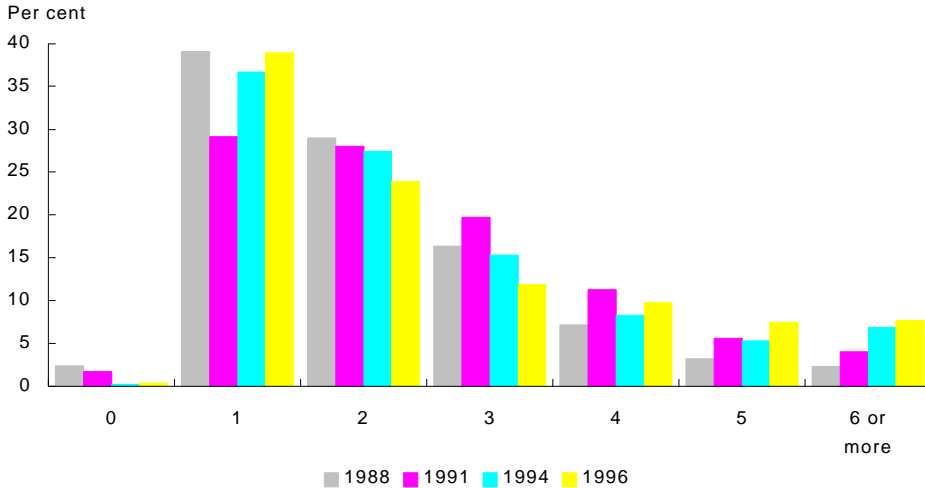


Source: Data provided to the Inquiry by Roy Morgan Research.

Figure 10.3 shows that if a breakdown of these figures is examined, however, a polarisation of behaviour can be seen — with some consumers rebundling their financial dealings with one supplier while a smaller percentage of consumers would appear to be unbundling and shopping around more frequently than in the past.

Polarisation of Behaviour...

Figure 10.3: Breakdown of Number of Institutions Which Consumers have a Relationship with for Banking-Type Products



Source: Data provided to the Inquiry by Roy Morgan Research. (Calculation includes all accounts, credit/charge cards and loans.)

Other survey evidence similarly suggests that a sizeable minority prefer to deal with more than one institution for their banking needs.¹⁷ A 1996 survey found that while 64 per cent of consumers *prefer* to deal with one institution (43 per cent because it is easier and 17 per cent because they thought that those who dealt with one institution were likely to be given good loyalty deals), 36 per cent of consumers *prefer* to deal with several institutions (7 per cent because they like to shop around for rates, 13 per cent to divide money for goals and 6 per cent to avoid putting all their eggs in one basket).

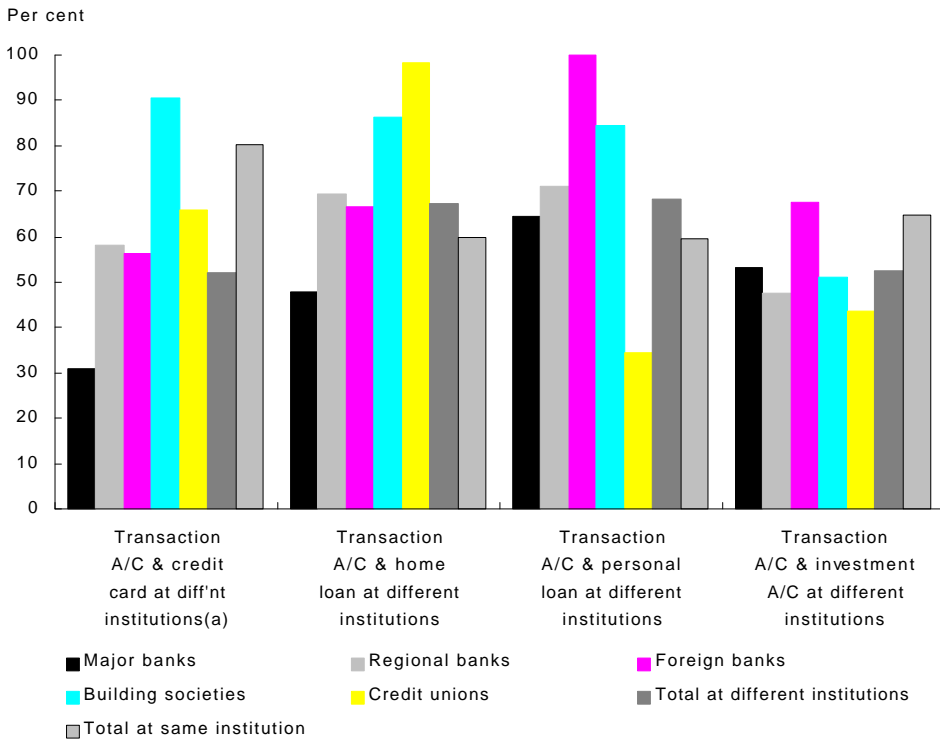
17 Leading Edge and AGB McNair 1996, p. 11.

The most popular banking product is the transaction account, with 95.3 per cent of those who deal with financial institutions having at least one such account.¹⁸ Figure 10.4 takes as its base all consumers who have a transaction account and a credit card, a transaction account and a home loan, etc. It records the percentage of consumers who do not bundle these accounts but have their transaction account and the other product at different financial institutions. As with Figures 10.1 to 10.3, Figure 10.4 shows that a significant amount of business is not bundled. The data also illustrate that the larger the potential dollar savings available from shopping around, the greater the likelihood that consumers will not bundle. For comparison purposes, the percentage of consumers who have these accounts at the same institution is also recorded.

¹⁸ Data provided to the Inquiry by Roy Morgan Research. As at September 1996, 24.1 per cent of consumers who dealt with a financial institution had a housing loan, 14.6 per cent had a personal loan, 53.2 per cent had a credit card and 23.4 per cent had a savings/investment account.

Large Numbers of Consumers do not Bundle their Major Banking Products . . .

Figure 10.4: Percentage of Consumers who hold Transaction Accounts and other Major Banking Products with Different Institutions — 1996



(a) Only includes cards offered by financial institutions. (That is, does not include credit cards offered by retailers).

Note: Figures add up to more than 100 per cent as some consumers have several accounts of the same type.

Source: Data provided to the Inquiry by Roy Morgan Research.

Price Sensitivity

Another demand-side argument used to justify the cluster approach is that consumers are relatively insensitive to pricing variations for banking products. Price elasticity is influenced by the availability of close substitutes for the product as well as such matters as product differentiation, customer loyalty and the transaction costs of switching (eg the time and difficulty of comparing products and the actual time and energy involved in making the change).

Non-business retail banking customers have traditionally been considered to be quite insensitive to pricing issues. This has especially been the case for transaction accounts, which the Prices Surveillance Authority (PSA) found in 1995 to be likely to be 'in aggregate . . . relatively insensitive to price'.¹⁹

This is not the case, however, for home mortgages, with 22.7 per cent of financing of dwellings in the 12 months to October 1996 representing refinancing.²⁰ This suggests that consumers are quite sensitive to price when vigorous price competition and large sums of money are involved.

Roy Morgan Research estimates that, in the 12 months to September 1996, 5.7 per cent of consumers changed their main financial institution.²¹ In previous surveys of this type, service issues, rather than price, were often the main reasons given for changing. While care must be taken in comparing surveys, the fact that the main reason for switching given in Table 10.1 is high fees and charges suggests that perhaps consumers are becoming slightly more price sensitive about transaction accounts as well as for the more expensive financial products. (Whether this will continue to be the case remains to be seen since it has been suggested that consumers now expect that all institutions will have fees soon, if they do not already, and are thus less motivated to change institutions on the basis of fees and charges and the feeling that they are being overcharged.)

The view that the greater the savings involved the more likely customers are to be price sensitive is backed up by data on SMEs. In its survey of members the Australian Chamber of Commerce and Industry (ACCI) found that 59.3 per cent had sought a different lender during the three years prior to the survey. Pricing issues were the main explanation given for looking for a different institution. Only about 1 per cent had not thought about changing their lender in that three-year period.²²

19 PSA 1995, p. 31.

20 ABS 1996, Cat. no. 5609.0, p. 12.

21 This figure may seem out of kilter with surveys which have consistently found that around 10 to 11 per cent change financial institutions each year. The reason is that the Roy Morgan data only measures those who have changed their *main* financial institution whereas many other surveys measure a change in any financial institution.

22 Australian Chamber of Commerce and Industry, Supplementary Submission No. 121, pp. 5 & 17.

Pricing and Service Issues Main Reasons for Switching Institutions . . .

Table 10.1: Reasons for Switching from Main Financial Institution Within Last 12 Months (per cent)

Reasons for Switching (from) Main Financial Institution (MFI)	Major Banks n=1401	Regional Banks n=601	Building Societies n=116	Credit Unions n=185	Total(a) n=2336
High fees and charges	39.0	32.0	9.2	7.9	32.3
Poor service	24.4	13.7	3.7	7.3	18.7
Didn't care about loyal customers	21.1	11.8	7.9	5.0	16.2
Poor interest rates	15.8	11.3	7.5	4.7	13.3
Took out a new loan with new MFI	14.4	11.3	9.0	14.4	12.9
Staff not interested in customers	13.6	9.4	10.8	3.4	11.4
Too many mistakes	12.9	9.9	0.9	8.4	10.9
Not conveniently located	6.4	14.3	14.4	24.1	10.3
Staff didn't understand my circumstances	7.4	6.4	7.3	3.5	6.8
Wanted to consolidate with one financial institution	5.7	6.9	7.9	9.8	6.4
Couldn't get options for my financial problems	6.4	7.4	4.0	5.3	6.1
Staff couldn't explain product options well	5.1	3.0	-	3.0	4.1
Took out investments with my new MFI	3.1	3.4	1.8	2.9	3.2
Poor range of investment products	2.3	1.5	4.8	1.8	2.2
Advertising by new MFI appealed to me	2.3	1.5	2.5	1.5	2.1
Bad publicity	2.1	1.5	1.2	-	1.8
Old financial institution was taken over/changed name	1.0	2.0	1.0	2.1	1.5
Other	11.7	15.3	31.3	22.4	15.4
Can't say	8.8	7.4	9.4	13.2	9.3
Total(b)	203.5	170.0	134.6	140.7	184.9

(a) Includes foreign and other banks.

(b) Adds to more than 100 per cent due to multiple reasons given.

Source: Data provided to the Inquiry by Roy Morgan Research.

The foregoing demand-side evidence suggests that while many consumers choose to bundle their banking products, many do not. In particular, it suggests that consumers are unbundling where sufficient price incentive exists.

Supply Substitutes

In determining the extent of clustering, the Inquiry also examined two key issues on the supply side. These were the sources of competition for individual products and the current marketing approaches of the financial institutions.

Figure 10.5 shows current and potential sources of competition for traditional banking products. For most traditional banking products, there are now also non-bank providers. In addition, there is a range of possible future providers.

New providers take a variety of forms, including new institutions which cherry-pick the most profitable segments—such as mortgage originators, established financial institutions which are expanding their product range and established non-financial institutions.

Many of these new providers offer only a single product or a limited range. Their recent growth is evidence that some consumers are prepared to unbundle their purchases to a degree. For traditional banks to compete with these new players, they must encourage customers to bundle or, where this cannot be achieved, they must unbundle their pricing as is starting to happen. (The issue of greater choice and new providers is discussed in more detail in Chapter 15.)

Increasing Number of Supply Sources . . .

Figure 10.5: Competition Map of Traditional Banking Products

	Consumer products										Small business products				
	Home Loans	Retail Transaction A/Cs	High value Transaction A/Cs(a)	Investment or Deposit A/Cs	Personal Loans	Stored Value Cards(b)	Bill Payments/Agency Services	Credit Cards or Charge Cards	Debit Cards	Transaction Banking	Overdrafts	Commercial Bills	Term Loans	Leasing	Credit Card Merchant Facilities
Major Banks	Currently	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Regional Banks	Currently	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Foreign Banks Subsidiaries.	Currently	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Building Societies & Credit Unions	Currently	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Possible future provider
Life Companies	Currently	(c)	Currently	Currently	Possible future provider	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Super Funds	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Collective Investments	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Securitisers-includes Mtg Origs	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Finance Cos-includes Priority 1	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Utilities-Telstra, Aust Post, Elec.	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Credit Card Specialists	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Equipment Manufacturers	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Other/Specialist Providers	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently
Merchant Banks - includes AIDC	Currently	Currently	Currently	Currently	Possible future provider	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently	Currently

(a) Accounts with minimum balances such as those offered by mutual funds in the US.
 (b) Many banks and credit unions have already been involved with trials of SVCs and Telstra already offers them to cover the costs of phone calls.
 (c) May only allow limited transactions.
 Source: Adapted from St George Bank, Supplementary Submission No. 99, p. 15.

For some products, however, the range of suppliers remains limited. A clear example is retail transaction accounts. The only competitors to banks offering these products at this point in time are building societies and credit unions. Research suggests that at present many consumers do not consider these institutions to be an adequate substitute for banks because they are not considered to be as secure and stable or because of concerns about their capacity to deliver a full range of services or to provide accessibility interstate.²³

While other potential suppliers of transaction accounts are mooted in Figure 10.5, it is not clear when they will emerge or to what extent they will be full substitutes for traditional transaction accounts.

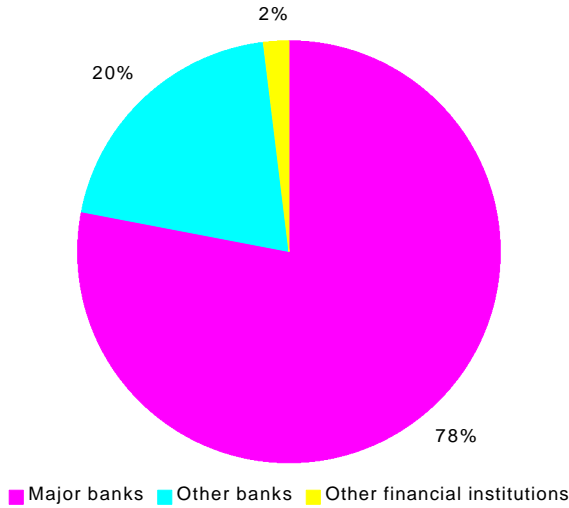
The other area for which there is presently little effective competition to banks is small business banking products. Figure 10.6 illustrates this with respect to small businesses' choice of main financial institution. (Most small business proprietors use a single financial institution, with only 15 per cent operating accounts with more than one financial institution.)²⁴

23 Leading Edge & AGB McNair, 1996, p. 8; Credit Union Services Corporation (Australia) Limited, Submission No. 162, p. 7 Appendix D; and Australian Chamber of Commerce and Industry, Supplementary Submission No. 121, p. 22.

24 Yellow Pages™ 1995, p. 18.

Banks are the Main Financial Institution for Almost All Small Businesses . . .

Figure 10.6: Small Businesses' Main Financial Institution

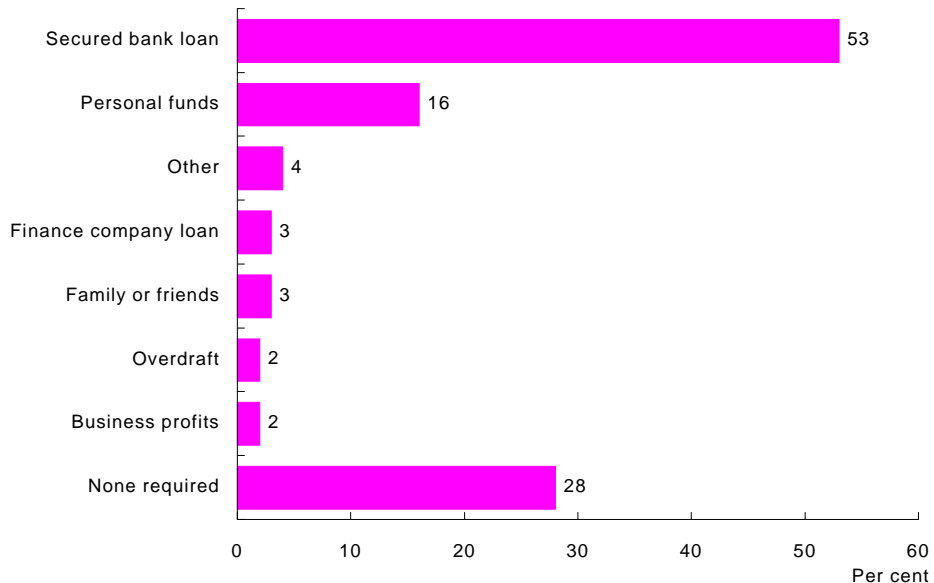


Source: Brian Sweeney & Associates in Yellow Pages™, September 1995, p. 18.

The importance of banks to small business is also illustrated in Figure 10.7, which shows that banks are the main source of finance for small businesses. This situation may change somewhat with mortgage originators having announced their intention to provide small business loans against the security of a house. However, the difficulties involved with establishing the credit risk associated with small business lending (see Chapter 11) make it questionable whether effective alternative suppliers will emerge for large portions of this sector in the immediate future.

Small Businesses Rely on Bank Debt . . .

Figure 10.7: Sources of Additional Small Business Capital



Note: Sources of new capital accessed in prior two years by 1,100 small businesses employing fewer than 20 people. These data do not refer to start-up capital. The totals add to more than 100 per cent due to more than one source of capital being used in some instances.

Source: Brian Sweeney and Associates in Yellow Pages™, Small Business Index™, September 1995, p. 6.

Marketing Practices

Another area of supply-side evidence relevant to the debate on the cluster of services methodology is the marketing practices of the institutions. Different competitors will pursue alternative product bundling and unbundling strategies at different times. As well as the bundling options formally promoted, institutions will offer customised deals to individuals—including informal requirements for bundling if favoured conditions are to be received. Even given these factors, it is possible to make certain generalisations about current bundling trends.²⁵

²⁵ These conclusions are drawn from an examination of 127 brochures collected by the Inquiry from eight financial institutions (four major banks, three regionals and a credit union) in Canberra in the week commencing 3 November 1996.

- There is clear evidence that institutions continue to bundle some, though not all, products. Some institutions bundle more than others.
- Bundling appears to take two main forms:
 - rewards based bundling where, for example, fees are waived or more competitive interest rates are offered; and
 - convenience based bundling where the convenience of linking, say, credit cards, transaction facilities and cheque accounts is emphasised.
- Rewards based bundling is not linked to all products and seems to be used as a marketing technique to retain the business of more profitable customers — primarily those with a home loan and, to a lesser extent, those with a quality credit card or personal loan. These products are notably the ones for which a larger range of alternative suppliers exists and which are thus subject to the greatest competitive pressure.
- Only two examples of rewards based bundling were noted for small business products.
- Rewards based bundling now reaches beyond financial services products as a result of ‘loyalty schemes’ which bundle, say, credit cards with such non-financial products and services as petrol, groceries, air travel and telephone calls.
- While convenience bundling is used in conjunction with transaction accounts by most institutions, only one institution surveyed strongly promoted rewards bundling targeted at transaction accounts and this was designed to encourage consumers to choose a transaction account incorporating fees. One other offered discounted personal loans to those who had its transaction account; another discounted credit card fees.
- Finally, there are now several new products on the market which bundle all financial services into a single product. However, these products, which may offer tax advantages, are available only to those with a home loan.

The above supply-side evidence suggests that it may be time to move to narrower clusters or from the cluster approach to one of multi-product analysis.

Conclusions on Product Dimension Issues.

The totality of the demand and supply-side evidence presented above on the product dimension of the market definition has led the Inquiry to the view that the cluster of services approach adopted in the Westpac/Challenge merger — where the majority of commonly used retail banking products were included in the cluster — should be closely questioned and at least narrowed.

The products likely to be the focus of future bank merger assessments are transaction accounts and small business products, especially small business finance. This is because of the limited number of effective substitute suppliers to the banks for these products at this time.

The Geographic Dimension of Market Definition

The issue in dispute in relation to the geographic dimension of the market definition is whether it is regional or national. At this point in time, there are few who argue strongly that the appropriate geographic element is global, although some believe that this will be the case in a few years' time.

Delineation of the relevant geographic market (or markets) involves:

the identification of the area or areas over which the merged firm and its rivals currently supply, or could supply, the relevant product and to which consumers can practically turn.²⁶

As noted, in the Westpac/Challenge merger, the ACCC was of the view that it was a regional market. It reached this conclusion because, at the time of that merger, it believed that retail customers were unlikely to seek out interstate suppliers of banking products in response to a moderate price rise and, similarly, potential interstate suppliers were unlikely to respond to a moderate price increase in another State.

26 ACCC 1996, *Merger Guidelines: A Guide to the Commission's Administration of the Merger Provisions (ss. 50, 50A) of the Trade Practices Act*, p. 35.

In examining this issue, the Inquiry examined both demand and supply side considerations. The key issue would seem to be how important having a physical branch presence is to doing business in a region. In brief, the findings were that:

- new delivery mechanisms on the supply side make traditional branches less important and a national marketplace a feasibility if the problems associated with price and brand awareness can be overcome;
- on the demand side, consumers do not yet choose to utilise these new delivery mechanisms to their full potential — for at least some financial products, consumers do not look beyond suppliers with a physical local presence when selecting their provider;
- one of the most important factors for making the market national will be reducing the transaction costs involved in switching accounts — especially by improving access to affordable and comparable national pricing information; and
- the market will become national for some products before others.

[Importance of a Branch Presence to Attracting New Business](#)

While new technologies and new distribution mechanisms have the potential to make branches less relevant and the marketplace national, this has not yet happened in Australia for most retail banking products.

Evidence suggests that, at this point in time, new technologies and distribution mechanisms are primarily used for servicing existing customers. Consumers do not yet utilise them in any significant numbers to establish new relationships. That is, on the demand side, new technologies have not led retail customers to seek out interstate suppliers of banking products in response to a moderate price rise.

For example, a recent innovation which holds considerable potential for creating a national market, is giroPost, with its approximately 2,600 outlets Australia wide. Inquiries to the nine banks which are presently members of giroPost, however, showed that, at the time of writing, the number of new accounts opened through giroPost — especially in States where the financial institution does not have a strong physical presence — was still so small as

to be insignificant. Nonetheless, there is potential for giroPost to play an increasingly important role in creating a national market.

By contrast, mobile lending services, and agency arrangements with institutions in other States, appear to have been successful in ensuring that a branch presence is no longer essential to initiating home loans. (Although it should be noted that there are administrative complications — such as titles and valuation administration — for institutions providing housing loans in States or Territories in which they do not have any form of presence).

The Inquiry also sought to determine the percentage of business banks do in various categories of products in States where they do not have branches. Unfortunately, only a small number of banks record their figures on the basis of the domicile of the account holder.²⁷ Each of these is a regional bank. (All others base their figures on the branch where the account is held.) In 1996, RBA data showed that of the banks which record on the basis of domicile:

- all reported having zero per cent of their transaction account business in States where they did not have any branches; but
- one bank had 5 per cent of its term deposit business in States in which it did not have any branches and two banks each had 1 per cent of their non-financial sector loans (which include commercial loans) in such States. (Whether this business was attracted from interstate or the account holders moved States is not known.)²⁸

Small business lending is an area where a branch presence has traditionally been considered to be very important to establishing new business. This would still seem to be the case in Australia although there is some evidence that this may change. For example, at least one Australian regional bank has started a centralised assessment process for its small business loans which may make branch access less essential for attracting small business clientele. Similarly, in the US, at least one major bank lends to small business on the

²⁷ Advance Bank, Bank of WA and Bendigo Bank record loans based on the domicile of the account holder. Bank of Melbourne records loans according to the location of the security.

²⁸ Data provided to the Inquiry by the RBA.

basis of a credit scoring system which does not require personal visits. The bank consequently undertakes lending in States where it does not have a branch presence.

The above limited findings argue that a physical branch presence is still important to initiating some forms of new business—including, at this time, transaction accounts.

The Importance of Information

A linked issue in determining the geographic boundaries of markets is the importance of information. Consumers need to be aware of more competitive products before they can purchase them. This is related to the issue of branches because, on the whole, institutions do not advertise in regions where they do not have branches. Research undertaken by one bank clearly shows that the lower the branch density, the lower the brand awareness and thus, presumably, knowledge of the institution's products.²⁹

While brand awareness is always likely to be a factor in customer choice, information problems may be overcome to some extent in the near future with the increasing prevalence of services designed to assist consumers to find the cheapest financial product for their needs. Several of these services already exist in Australia, although their cost is such that consumers are likely to use them only to select their more expensive financial products. The media are also increasingly providing useful comparative information.

Many predict that the availability of so-called 'intelligent agents' to perform this function will expand (see Chapters 1 and 2). If this occurs, and is coupled with increased access to computers with modem connections, the transaction costs involved for consumers in finding the lowest priced provider are likely to drop considerably. This is likely to provide a spur for consumers looking to out-of-State institutions for products. As well as hastening a national market it may help establish an international market for some products.

29 St. George Bank, Supplementary Submission No. 99, p. 4.

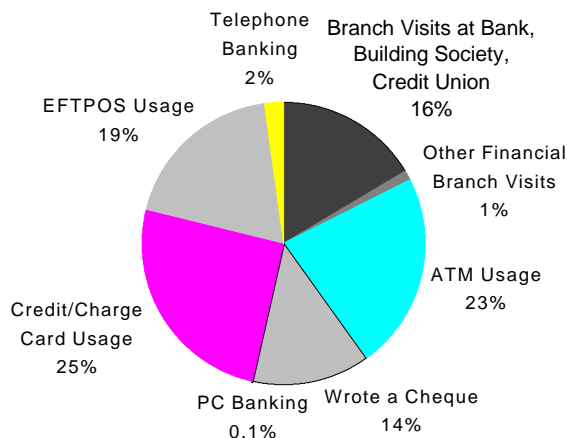
Consumer Take-up Rates for New Technologies

In their submissions, some financial institutions pointed to a range of new electronic delivery mechanisms to argue that branches are no longer as important as they once were and that the market is now national.

As Figure 10.8 shows, a significant proportion of banking transactions are now carried out electronically. Trend information suggests that the proportion of transactions carried out electronically will continue to grow (see Chapter 2). All predictions, though, seem to be that this trend will not make branches redundant in the foreseeable future. People still want to visit banks for a range of reasons, including to discuss their more complex decisions, open accounts, make deposits and pay their credit card bills. A more likely outcome is that traditional branches will reduce in number and take a variety of new forms such as kiosk banks located within supermarkets and, in a smaller number of instances, personalised bankers in concentrated areas of high net worth customers. Overall, the number of points of representation may even increase.

Large Percentage of Transactions Now Done Electronically . . .

Figure 10.8: Percentage of Transactions using Specific Financial Channels in September 1996



Note: (Base = Volume of Transactions/visits. September 1996.)
Source: Data provided to the Inquiry by Roy Morgan Research.

The above prediction that branches will remain in one form or another remains true even though access to a branch is already not essential to utilise some products. This is because branchless banking is yet to achieve widespread consumer acceptance. For example, a 1996 consumer survey found that 93 per cent of customers desire or require access to a branch some or all of the time. The same survey showed, however, that younger consumers are more willing to use a bank without a branch (12 per cent of 18 to 24 year-olds).³⁰ Roy Morgan Research found in September 1996 that 62.8 per cent of people surveyed had visited a bank, building society or credit union branch in the previous month.³¹ Table 10.1 showed that 10.3 per cent of those who changed their main financial institution did so because it was not conveniently located. Similarly, 84 per cent of businesses surveyed by ACCI rated convenient location as moderately to extremely important in their choice of financial institution.³²

Another factor relevant to the continued importance of branches is that some consumers are not prepared to use electronic delivery mechanisms and therefore continue to be dependent upon branches. Figure 10.9 shows the percentage of consumers who have never used various delivery channels. While mechanisms such as pricing signals can help change such behaviour, resistance to new technologies among at least some segments of the community is likely to continue for some time. Also, different technologies and functions are likely to enjoy different success rates. This can be seen from Citibank's recent decision to cease offering video banking services in Australia due to lack of use. It is also evident from the fact that the vast majority of consumers have shown a marked reluctance to deposit money through automated teller machines (ATMs) even though they are happy to make withdrawals from them.³³

30 Leading Edge & AGB McNair 1996, p. 9.

31 Data provided to the Inquiry by Roy Morgan Research. (The research also showed that 54.9 per cent of people had used an ATM in the previous month; 39.2 per cent had written a cheque, 47.4 per cent had used a credit or charge card, 45 per cent had used EFTPOS, 9.2 per cent had used telephone banking and 0.6 per cent had used PC Banking).

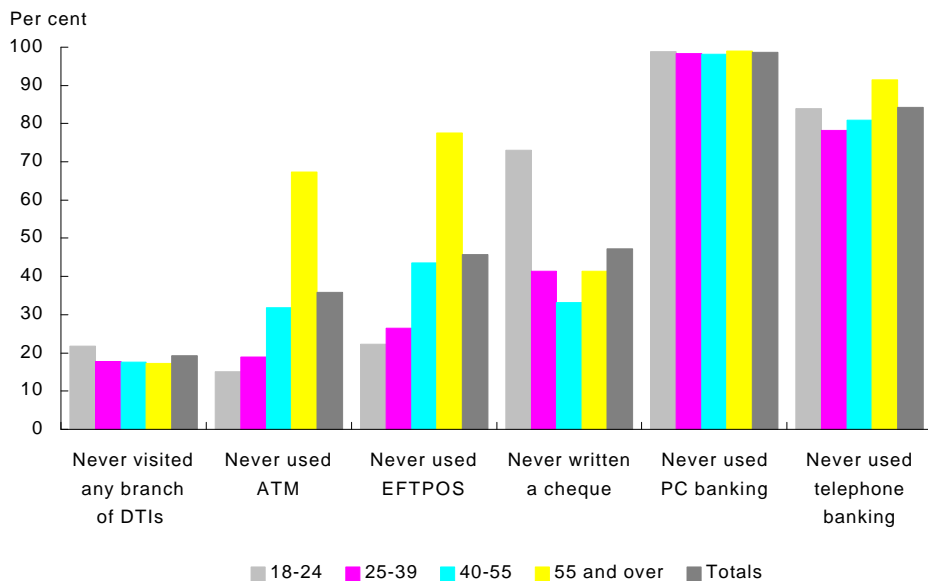
32 Australian Chamber of Commerce and Industry, Supplementary Submission No. 121, p. 12.

33 Research conducted by RDA Research for Citibank in October 1996 shows that over three quarters of consumers prefer to use branches for making deposits and nearly half prefer to use them for making a credit card payment.

Nonetheless, it is worth noting that, in both the UK and the US, there are now very popular ‘branchless’ banks which use the telephone, mail and electronic delivery mechanisms to interact with their customers. Such banks, however, are not yet truly branchless, since they all have agency arrangements so that their customers can use the branches of other institutions when necessary.

Some People still not Using Electronic Delivery Channels . . .

Figure 10.9: Percentage of Consumers who have Never Used Financial Channels by Age



Source: Data provided to the Inquiry by Roy Morgan Research.

A physical presence in the form of an institution having its own ATMs is also likely to be important to the choice of institution of some consumers. This is because the cost of using another institution’s ATMs is such that consumers are likely to choose only institutions which have an ATM presence in their State.

The importance of an ATM presence may, however, change over the next few years as stored value cards and electronic cash become a reality. For example, it is expected that within the next year Australians will be able to buy mobile telephones which will allow them to download funds from their bank accounts onto reloadable stored value cards (SVCs) at any time as well as undertake bill payments. The feasibility of ‘anytime, anywhere’ banking will thus be a step closer. How quickly such technology will be taken up and capable of widespread use, though, remains to be seen.

The above data suggest that while new delivery mechanisms are important in assisting to create a national market, they are yet to achieve complete consumer acceptance.

[Behaviour of Institutions](#)

Another supply-side indicator of whether the market for retail banking products is national or regional is the behaviour of the institutions themselves.

National and multi-State institutions, with a small number of exceptions, price their products nationally—although most managers have the discretion to negotiate individual competitive deals to meet local competition.

On brand and management issues there is a greater variation in practices. For example, after its takeover of the Challenge bank, Westpac retained the Challenge brand identity and submerged the Westpac brand into it in Western Australia. Similarly, Advance retained the branding of the Bank of South Australia after its takeover. When the Commonwealth Bank did not retain the identity of the State Bank of Victoria, large numbers of customers were lost. The degree of autonomy given to State managers appears to vary between institutions.

[Conclusions on Geographic Dimension Issues](#)

In the Inquiry’s view, the market for some retail banking products is moving from regional to national. The pace of that movement varies depending upon the product. The market for a limited number of products, such as home loans and credit cards, may already be national. However, while the market for some other retail and SME products may be national in the future, they do not appear to have yet reached that point.

Barriers to Entry and Exit

Reducing barriers to entry is an important part of making any market more competitive. A merger may appear to be anti-competitive because of high concentration levels but, if the barriers to entry into the market are low — that is, if the market is contestable — the merger may be permissible.

The ACCC recognises the importance of barriers to entry in its mergers analysis criteria. It defines barriers to entry as:

any feature of a market that places an efficient prospective entrant at a significant disadvantage compared with incumbent firms. They may consist of sunk costs; legal or regulatory barriers; access to scarce resources enjoyed by incumbent firms; economies of scale and scope; product differentiation and brand loyalty; and the threat of retaliatory action by incumbents.³⁴

It considers that effective entry is:

that which is likely to have a market impact within a two year period: either by deterring or defeating the attempted exercise of significant market power by the merged firm.³⁵

Some barriers to entry can be overcome only by market forces. This is happening in some instances. For example, the need for a widespread branch presence has been traditionally considered to be a major barrier to entry into retail banking. It is used to explain the low penetration rate of foreign banks since deregulation. New technologies and alternative distribution mechanisms are likely to reduce the significance of this barrier. The increased potential for outsourcing functions and entering into joint ventures and agency arrangements in this sector will also reduce some of the barriers resulting from sunk costs and economies of scale and scope. Some traditional barriers to entry, however, remain — such as the high cost of building a new brand.

Other barriers to entry are regulatory and can be overcome or minimised by government action. One of the major goals of this Inquiry is to reduce

34 ACCC 1996, *Merger Guidelines: A Guide to the Commission's Administration of the Merger Provisions (ss. 50, 50A) of the Trade Practices Act*, p. 46.

35 ACCC 1996, *Merger Guidelines: A Guide to the Commission's Administration of the Merger Provisions (ss. 50, 50A) of the Trade Practices Act*, p. 48.

current regulatory barriers to entry. Inquiry recommendations which are likely to have an impact on the contestability of the market are discussed below in Section 10.4.5.

To the extent that the Inquiry's recommendations are implemented, their likely impact on entry, along with other market forces, should be taken into account in any future financial sector merger assessment.

Importance of Regional Banks

Regional banks have been an increasingly important competitive force in recent years.³⁶ In particular, along with credit unions and building societies, they have led the way on service, innovation and pricing on some products. Because consumers, including small businesses, are more likely to see regional banks, rather than credit unions and building societies, as acceptable substitutes to major banks, it is the former which have arguably imposed the greatest competitive pressure.

However, there is nothing immutable about the present position of regional banks. As new players, such as mortgage originators, continue to enter the financial system, as regulatory regimes change so that institutions such as credit unions and building societies are seen as safer and more nationally accessible, and as market conditions evolve, the importance of the role regional banks play must be continually assessed.

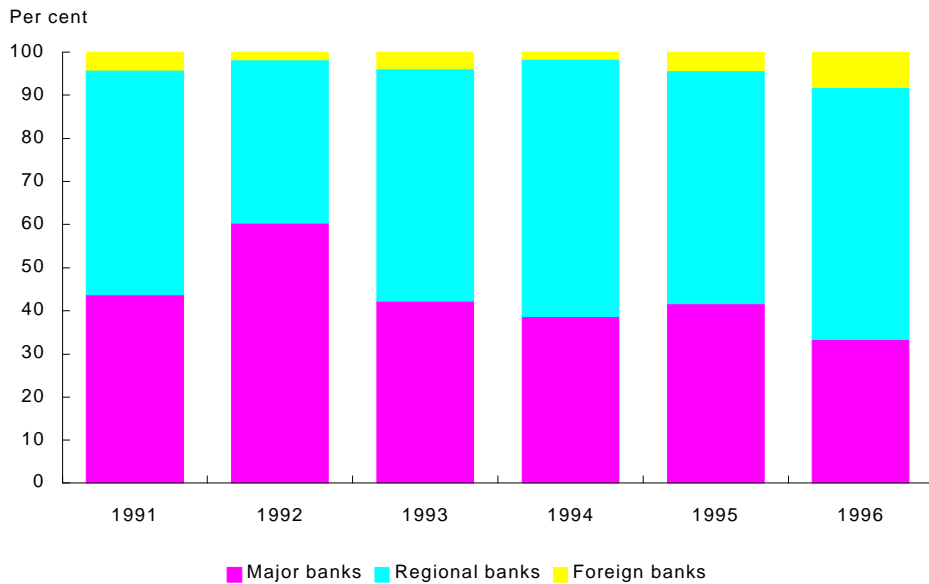
Comprehensive data on the competitive role regional banks have played in recent years can be found in the information compiled by Cannex for the annual Bank of the Year awards run by Personal Investment Magazine.³⁷ The results are summarised in Figure 10.10. They show that regional banks have outperformed the majors overall for several years running. In some categories, such as service provision and term deposit, transaction and business accounts, they consistently take all, or most, of the top three places.

36 A large number of regional banks were previously building societies.

37 For these awards, information is collected on interest rates on all of the main categories of products for all banks on a monthly basis. Information is also collected on product features, fees and charges. These different aspects are then weighted.

Regional Banks Score Highest . . .

Figure 10.10: Bank Awards



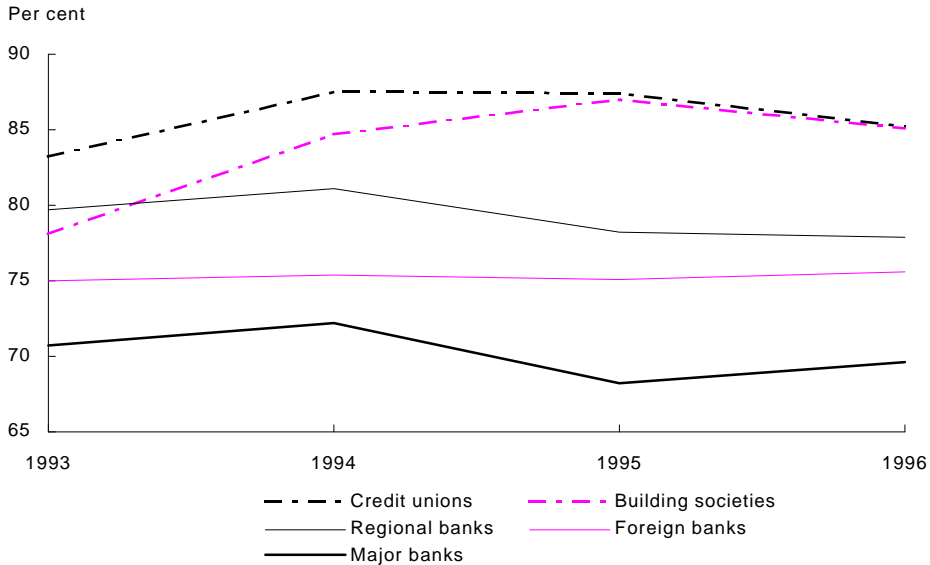
Note: Gold, Silver and Bronze awards counted, shared awards counted twice. Foreign banks did not contest all categories. BNZ treated as a major after takeover by the National Australia Bank in November 1992. Town and Country treated as a regional throughout.

Source: Data provided to the Inquiry by Cannex (Aust); *Personal Investment Magazine*, August 1991, August 1992, July 1993, August 1994, August 1995, August 1996.

As Figure 10.11 shows, however, on customer satisfaction ratings, credit unions and building societies are ahead of all types of banks. These findings confirm the findings in Table 10.1.

Credit Unions and Building Societies Lead the Way on Customer Satisfaction . . .

Figure 10.11: Customer Satisfaction



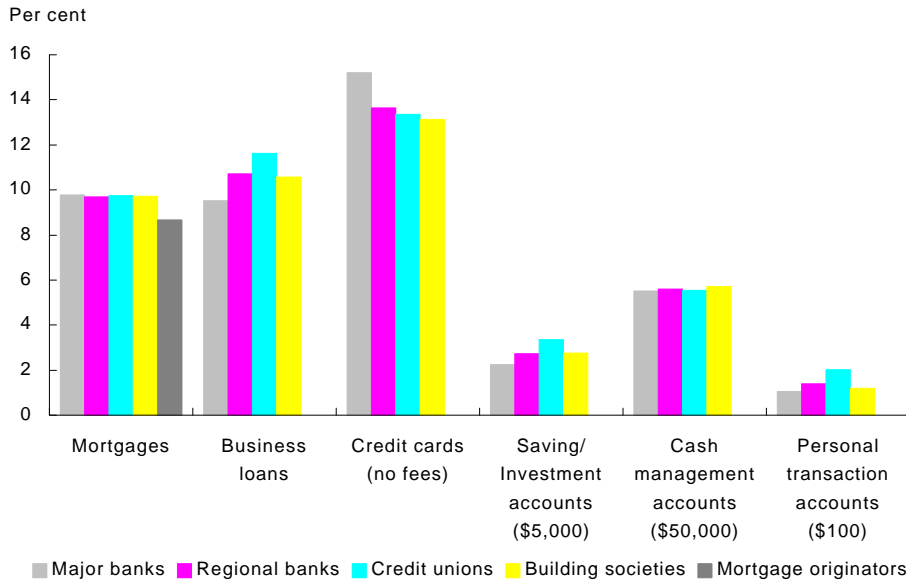
Note: Based on the proportion of each group either 'Very Satisfied' or 'Fairly Satisfied'.
Source: Data provided to the Inquiry by Roy Morgan Research.

Figure 10.12 sets out the interest rate differences between different categories of institutions in 1996.³⁸ It shows that in each of the product categories other than business loans, regional banks, on average, price more competitively than major banks. It also shows that credit unions, building societies and mortgage originators offer the most competitive prices for some products. This represents very little change from the situation in 1993.

38 Compiled from Cannex (Aust) data which provided interest rates for each class of product (on either a weekly or monthly basis) for every institution offering the product. This information was then averaged across institutional categories to arrive at these comparisons.

***Average Interest Rates Offered
by the Major Banks Usually
not the most Competitive . . .***

Figure 10.12: 1996 Interest Rate Comparison Between Classes of Institutions



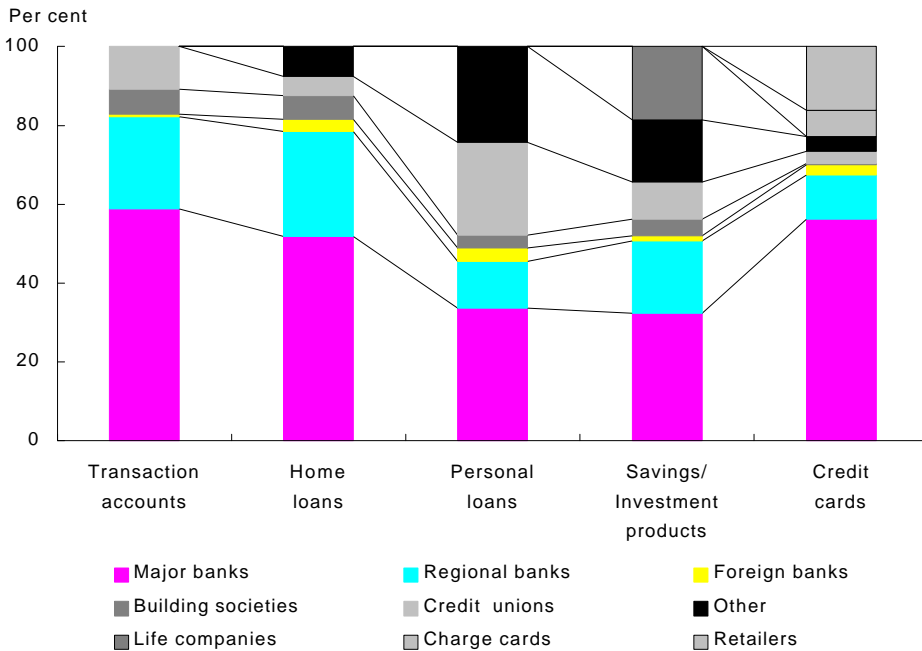
Source: Data provided to the Inquiry by Cannex (Aust).

While this evidence may suggest that credit unions and building societies are as important as, if not more important than, regional banks for engendering competition, other factors undermine such a finding at this time. Despite the fact that credit unions and building societies now have a similar level of prudential regulation to banks, many people do not appreciate this and, as noted earlier, do not consider these institutions to be as safe as banks. This, along with the facts that such institutions are not perceived to offer as wide a range of products or to be as nationally accessible, is reflected in their low market share for most products, as seen in Figure 10.13. It can also be seen from the fact that only 9 per cent of consumers consider a credit union, and 5.1 per cent consider a building

society, to be their main financial institution — as opposed to 62.7 per cent for major banks and 21.5 per cent for regional banks.³⁹

Banks Dominate Market Share for All Products . . .

Figure 10.13: 1996 Market Share of Institutions by Number of Accounts



Source: Data provided to the Inquiry by Roy Morgan Research.

Figure 10.13 is also evidence that non-deposit taking institutions are now providing a degree of competition for a number of products.

As noted above in the section on supply substitutes, however, regional banks are virtually the only source of competition to the major banks for small business products, notably small business loans.

39 Data provided to the Inquiry by Roy Morgan Research.

10.4.3 International Comparison of Price Competition

The ACCC's methodology is designed to help it answer the question: will the merger in question lead to a substantial lessening of competition in a substantial market? It is thus useful to understand the extent of competition under the existing structure. Price is perhaps the most important indicator of competition.

Figure 10.12 above gives one indication of the extent of price competition among Australian institutions.

While caution must be exercised in drawing conclusions from comparative international data, it is useful to look to such comparisons for an indication of the relative price competitiveness of the Australian system.

A short analysis of comparative pricing information is set out below. It is based on information provided to the Inquiry by the RBA. This information represents the RBA's best efforts to compile broadly comparable international data.⁴⁰ Fewer countries are included in the RBA's data than the OECD's because of the RBA's concerns about the comparability of the data at this level of detail. The issue of comparative bank costs is also considered in Chapter 6.

Figure 10.14 (A) shows that Australia's net interest margins are relatively high by international standards, even when adjusted to take account of the relatively large role of bill acceptances in Australia. Australia's non-interest income, however, is comparatively low — especially when adjusted to treat bill acceptances as interest income (see Figure 10.14 (B)).

The RBA suggests that the differences in the relative importance of interest income and non-interest income can be overcome by looking at the ratio of total income to total assets as shown in Figure 10.14 (C). Under this measure

⁴⁰ The banks included in the study were chosen on the basis that they were representative of their domestic banking industries. The data represents the weighted average statistics for banks in the sample. In most countries the top four or five banks were selected: Australia (the four major banks); New Zealand (four banks); the United Kingdom (four banks). Canada (five banks) and the US (40 banks). They are banks which have a significant presence in their home market, with a mix of business and household services and customers, plus securities investment/trading activities, and payment system obligations.

Australia is at the high end of the middle of the group but would appear to be reducing the total revenue generated relative to its asset base (ie the cost to the customer).

Where Australian banks stand on profitability depends upon the measure used. When profits before provisions for bad debts and tax are considered as a percentage of equity, Australia's levels appear broadly similar to, if a little lower than, those for comparable full-service banks in other countries (see Figure 10.16 (D)). When profits before provisions for bad debts and tax are considered as a percentage of assets, however, Australia's profitability is towards the top of the group measured.

Based on this limited sample, it would appear that the cost to consumers of Australia's four major banks is better than for some overseas banks but is below world best practice.⁴¹

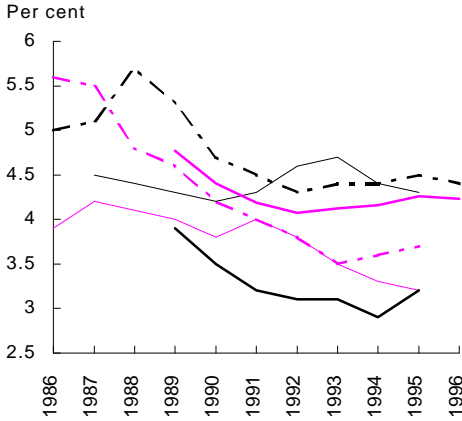
Chapters 6, 11 and 15 provide a range of other indicators on competitiveness trends in the Australian financial system.

41 For a discussion of international comparisons of bank margins see Reserve Bank of Australia 1994, *International Comparisons of Bank Margins*. The RBA provided the Inquiry with information to update that submission.

Figure 10.14: International Comparison of Price Competition

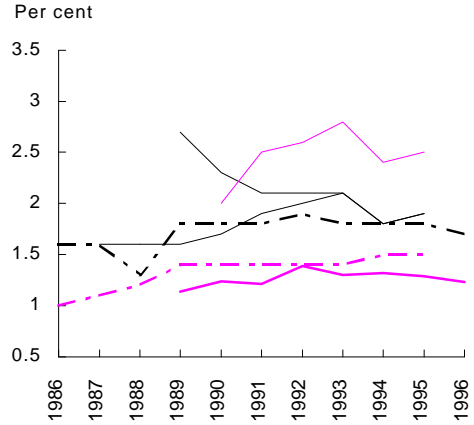
Australian Interest Margins are Relatively High ...

(A) International Net Interest Margins



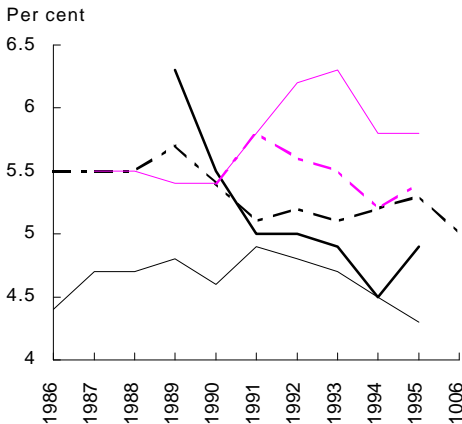
Australian Non-Interest Income is Relatively Low ...

(B) International Non-Interest Income as a per cent of Assets



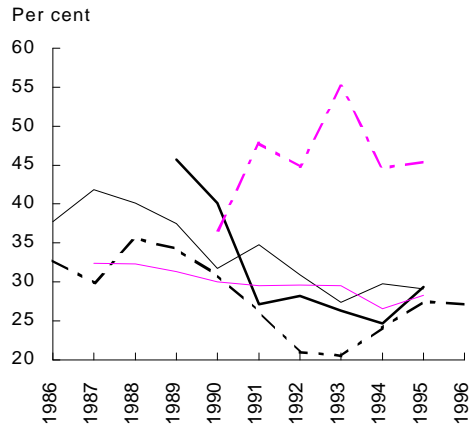
Australian Overall Revenue High End of Middle ...

(C) Income as per cent of Assets



Australian Profitability is Similar to Comparable Banks ...

(D) Profit before Provisions for Bad Debts and Tax as per cent of Equity



- - - - Australia ——— Canada ——— New Zealand
 - - - - United Kingdom ——— United States ——— Australia Adj.

Note: The New Zealand figures exclude Westpac because of its branch status in New Zealand.
 Source: Data provided to the Inquiry by the RBA.

10.4.4 Potential Benefits and Losses from Mergers

Potential benefits from mergers may be relevant to assessing the impact of a merger on competition under s. 50 of the Trade Practices Act if they can be shown to be pro-competitive. More commonly, they would be relevant to assessing public benefit considerations under the Act's authorisations procedures. This means that the onus will be on the institution claiming the benefit to satisfy the ACCC that the acquisition would result, or would be likely to result, in such a benefit to the public that the acquisition should be allowed to take place. Any potential detriment from a merger may also be weighed in assessing the public benefit of a merger.

Efficiencies from Bank Mergers

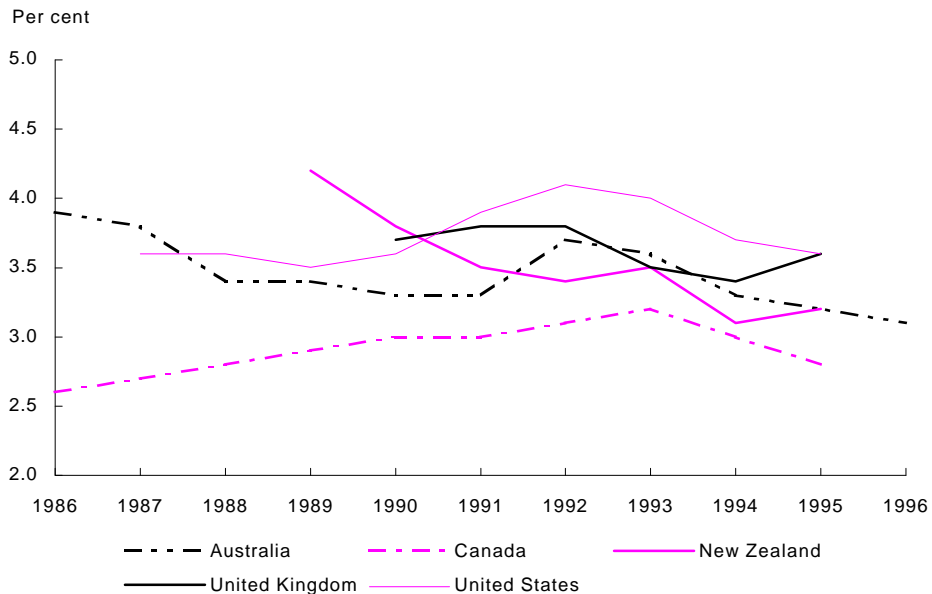
There is room for the Australian banking industry to become more efficient. McKinsey and Company, for example, have estimated that Australia's retail banking labour productivity is up to 40 per cent behind that of the United States.⁴² When the ratio of operating expenses to total assets of the major Australian banks is compared with that for comparable overseas counterparts, as in Figure 10.15, Australia appears around the middle for efficiency. Chapters 6, 11 and 15 provide other indicators of the relative efficiency of the Australian financial system.

In practice, the issue of whether or not a merger is likely to result in efficiency gains will probably be relevant only if the merger proposal is thought to breach s. 50 of the Trade Practices Act and authorisation is applied for.

⁴² McKinsey & Company with the McKinsey Global Institute 1995, *Growth Platforms for a Competitive Australia*, p. 102.

Cost Efficiency of Australia's Big Four Banks around Middle for Comparable International Banks . . .

Figure 10.15: International Comparison of Efficiency — Operating Expenses as per cent of Assets



Source: Data provided to the Inquiry by the RBA.

The evidence from studies on bank mergers and efficiencies to date has been, at best, equivocal on whether or not there are efficiency gains to be derived from mergers and, on the whole, points towards there being no general correlation between bank mergers and improved efficiency — although it is clear that some mergers do result in efficiency gains.⁴³

This is not inconsistent with claims that bank mergers can remove a large amount of costs from the merged entity. Rather, they are two different concepts. Efficiency effects of a merger are typically measured by an expense ratio such as total expenses to total assets. Cost savings, on the other hand,

⁴³ See for example, Berger, Hunter and Timme 1993; Rhoades 1994; Deloitte Touche Tohmatsu International 1995; Walker 1994; Siems 1996.

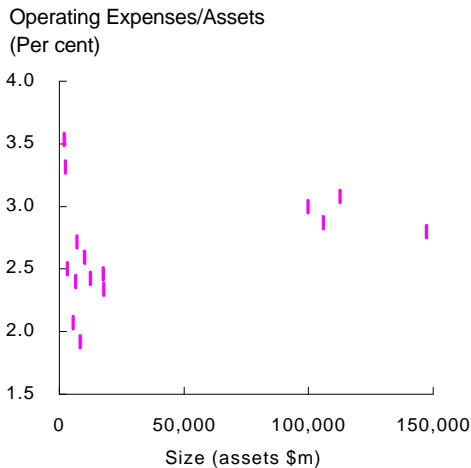
are measured only by reference to savings in gross expenses. In terms of benefits to the community, it is efficiency gains which have the greatest implications for the real long-term performance of the industry.⁴⁴

As illustrated in Figures 10.16(A) and (B), one need only look at the Australian situation to see that size alone does not determine levels of efficiency in retail banking.

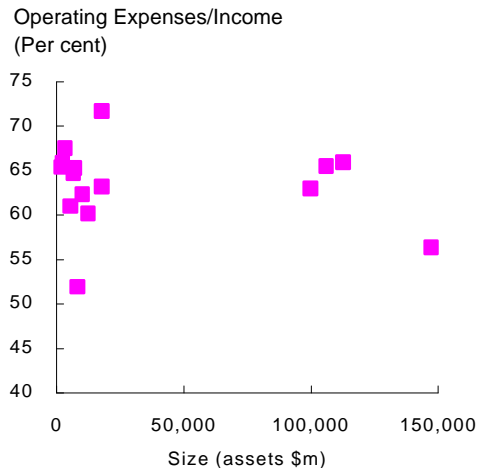
No Clear Correlation between Efficiency and Size . . .

Figure 10.16: Efficiency and Size Measures

(A) 1995 Operating Expenses to Assets Ratios for Australian Retail Banks



(B) 1995 Operating Expenses to Income Ratios for Australian Retail Banks



Note: Data in these figures represent efficiency ratios for total group operations (Australian and overseas).
Source: Data provided to the Inquiry by KPMG.

It is clear that cost savings can be made in mergers—especially using technology to achieve economies of scale in processing. (This does not conflict with the argument that mergers will not necessarily result in efficiency gains since, as discussed below, mergers may also introduce new costs or result in losses of existing sources of revenue which counterbalance

44 Rhoades 1994, p. 9.

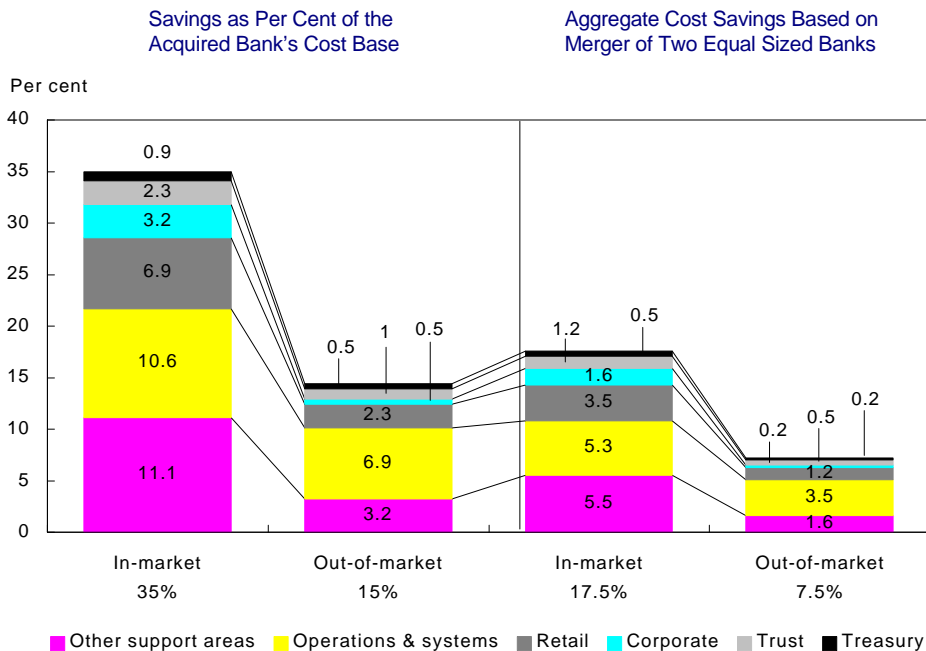
other savings.) As technology plays an increasingly important role in banking, it is likely that the importance of these savings will increase.

Savings are potentially greatest in in-market mergers (ie where the merging entities operate in the same market prior to merger) because, in addition to systems savings, there are savings from rationalising branches and other areas of duplication.

One estimate of the potential cost savings from mergers is set out in Figure 10.17.

Large Savings Claimed from Bank Mergers . . .

Figure 10.17: Estimated Savings from Bank Mergers.



Note: Estimates are based on US data from First Manhattan Consulting Group, however, the National Australia Bank considers them to be equally applicable to Australia.

Source: National Australia Bank, Submission No. 131, p. 5-9.

Savings of this magnitude are also being predicted for several recent Australian and New Zealand mergers. In the 1997 in-market merger between St George and Advance banks, St George estimates that a 15 per cent reduction in expenses of the combined entity's cost base will be achievable. It expects that it will take 30 months to achieve these savings.⁴⁵ Westpac's expectation is that savings in excess of 35 per cent of the acquired bank's cost base will be achieved from its Challenge and New Zealand Trust Bank mergers.

Experience has shown, however, that while some mergers may achieve significant cost savings they are not guaranteed and many mergers do not achieve them. It should also be noted that mergers are not the only means of achieving such savings. Others include outsourcing and joint ventures.

A range of reasons can explain failures to achieve expected savings and consequent efficiency gains. These include difficulties in blending systems and cultures, the flight of customers from the acquired institution, the levels of efficiency in the pre-existing institutions and, most importantly, a factor which underpins all other factors, the quality of the management of the new institution.

As with other issues associated with mergers, it is thus not possible to make findings about potential efficiency gains from mergers in the abstract. Full details of the specific merger proposal need to be known.

The Inquiry is of the view that the onus should be on the institution asserting efficiency gains to make its case to the satisfaction of the ACCC or the Australian Competition Tribunal or appropriate Court.

National Champions

The national champions argument is that firms need a sufficient critical mass in their domestic market to compete successfully in global markets. While accepting that the national champions argument may be more clearly applicable for some manufacturing industries, the Inquiry saw only limited evidence to support the claim that banks need a sufficient critical mass in the

45 St. George Bank, Supplementary Submission No. 99, p. 21.

domestic market to compete successfully globally. However, the Inquiry is aware of claims that size overall may provide a range of benefits such as access to funds at a reduced cost and the ability to fund research and development expenditure across a broader base of activity.

In practice, this issue would be relevant only in an authorisation procedure under the Trade Practices Act. In that event, it would be up to the institution claiming the national champions benefit to make its case to the ACCC or the Australian Competition Tribunal.

Employment Implications

Given the manner in which the financial system is evolving, it seems inevitable that there will be further staff redundancies by banks, with or without mergers. A concern of the Inquiry in shaping its recommendations was to provide a regulatory environment which would encourage growth of the Australian financial system and the consequent creation of new employment possibilities elsewhere within the industry. Many of these new employment possibilities will be located outside banks— including in industries which service the financial system.

The Inquiry considers that it is important for the financial system to continue its emphasis on training so that staff have appropriate and portable skills to assist them with employment opportunities into the next century and so that the industry has an available skilled labour pool.

The only issue the ACCC is legally able to consider in assessing a merger under s. 50 of the Trade Practices Act is the likely impact of the merger on competition. However, if a proposed merger was thought to be in breach of s. 50, and authorisation was applied for, it would be open to the Commission to consider the impact of any merger proposal on employment levels when weighing the public benefit implications of the merger.

Implications for Rural Customers

The Inquiry recognises that there will be a need to replace any rural bank branches which are closed with alternative delivery channels. If this occurs, the importance of a branch presence is likely to become less relevant to

individual consumers, if not to the community. As well as ATMs, EFTPOS, telephone and computer banking, new delivery mechanisms which may be of assistance in rural areas include mobile rural industry specialists and agency arrangements with non-financial services providers such as Australia Post. Rural and remote communities and institutions should work together to explore alternative delivery options which meet the needs of all concerned.

Any negative consequences that a merger poses for rural communities may also be a relevant consideration in an authorisations proceeding under the Trade Practices Act.

10.4.5 Concluding Comments

Summary of Assessment of Current Market

It is not for the Inquiry to make recommendations about particular merger scenarios and it is not possible to comment definitively on assessment criteria in the abstract. The Inquiry has not considered all of the issues which would normally be considered if an actual merger proposal was under consideration. This is both because it is not the Inquiry's role and because it is not possible to undertake the type of intensive facts based market inquiries necessary without a concrete proposal.

Nonetheless, the Inquiry makes the following observations based upon the limited demand and supply-side evidence presented above.

- The cluster of services approach adopted in the Westpac/Challenge merger — where the majority of commonly used retail banking products were included in the cluster — should be closely questioned and at least narrowed.
- The products which are likely to be central to any future proposals for bank mergers are retail transaction accounts and small business banking products — especially the provision of small business finance. This is because of the limited number of effective substitute suppliers to the banks for these products at this time.

- The market for some retail banking products is moving from regional to national. The pace of that movement varies depending upon the product. The market for a limited number of products, such as home loans and credit cards, may already be national. However, while the markets for some other retail and SME products may be national in the future, they do not appear to have yet reached that point.
- Regional banks have been an increasingly important competitive force in recent years. In particular, along with credit unions and building societies, they have led the way on service, innovation and pricing on some products. Because consumers, including small businesses, are more likely to see regional banks, rather than credit unions and building societies, as acceptable substitutes to major banks, it is the former which have arguably imposed the greatest competitive pressure.
- There is nothing immutable, however, about the present position of regional banks. As new players, such as mortgage originators, continue to enter the financial system, as regulatory regimes change so that institutions such as credit unions and building societies are seen as safer and more nationally accessible, and as market conditions evolve, the importance of the role regional banks play must be continually assessed.
- As with other issues associated with mergers, it is not possible to make findings about potential efficiency gains from mergers in the abstract. Full details of the merger proposal need to be known. The onus should be on the institution asserting efficiency gains to make its case to the satisfaction of the ACCC or the Australian Competition Tribunal or appropriate Court.

New Sources of Competition

The emphasis of this section has been on the current state of the market and what can reasonably be expected to occur over the next one to two years. There are, however, many other possible changes which, if they occur, may have implications for the merger assessment process. Among the most important of those possible changes are:

- further new sources of supply;
- further growth in consumer use of network delivery channels such as the Internet and of intelligent agents;
- widespread use of electronic cash;
- reduced transaction costs in switching accounts; and
- further reduced dependence upon branch banking.

These and other changes in the banking marketplace were described more fully in Part One.

Possible Impact of Inquiry Recommendations

Such possible new sources of supply and delivery channels can be facilitated by a range of means, including via the changes to the regulatory structure recommended in this Report.

Among the Inquiry's recommendations which, if implemented, should help to make the financial system more contestable are recommendations designed to:

- create a regulatory structure which facilitates competitive neutrality, that is, which has a functional rather than an institutional focus (Part Two);
- improve consumer protection for electronic and global transactions (Chapters 7 and 11);
- bring credit unions and building societies under the same prudential regulator as banks (Chapter 8);
- remove some restrictions on ownership requirements (Chapter 8);
- open up access to the payments system (Chapter 9);
- relax foreign investment policy (Chapter 10); and
- facilitate improved use of data for small business risk assessment (Chapter 11).

Implications for Major Bank Mergers

A key issue in the Australian banking sector is whether there should be mergers between the existing four major banks (ie four becomes three, or four becomes two). This is clearly a contentious issue based on frequently expressed public concerns about the existing state of competition in banking markets and the conventional assumption that a reduction in the number of large players could further reduce competition.

In some other industry sectors, particularly in the era of substantial import protection, domination of the small Australian market by three, four or five participants has led to sub-optimal competitive outcomes in terms of product, service and selling price.

Equally, there are now examples of industries where lower import barriers or other changes in conditions have produced more contestable outcomes in the marketplace, notwithstanding that the number of major domestic players may have fallen at the same time. In these cases, rationalisation has ensured that local participants can achieve scale economies and successfully contribute to competition, both in Australia and internationally.

Clearly, retail financial markets have different characteristics with much less exposure at this time to import competition and uncertain economies of scale. Views have been expressed that the existence of four major banks has not led to optimum competitive outcomes in the past.

For the future, a key issue in the banking sector is whether the developments noted in this Report, such as entry by new participants, widening market boundaries and improving price efficiencies, together will bring an intense and lasting increase in competitive pressures. Many of the recommendations of the Inquiry are directed at furthering that objective. If the competitive impulse is, now or in the future, judged to be substantial, rationalisation of the existing four major participants could more readily be seen as a reasonable commercial response which could add, rather than detract, from effective competition. On that view, a merger may even provide a catalyst for industry change that promotes competitive outcomes.

Alternatively, the view may be taken that the major banks remain in a relatively strong position to exploit their respective competitive strengths,

and may well be able to entrench their market positions and counter many of the new competitive threats. In terms of brand, technology, resources, customer bases and access to capital, the present players have undoubted strengths.

The Inquiry cannot answer this question. Its Terms of Reference do not encompass the analysis of any particular merger scenarios. The question for the ACCC is to establish whether a merger would result in a substantial lessening of competition. In the event of specific propositions coming forward, it will be necessary for it to form a judgment taking account of the market conditions at that time.

Recommendation 84: Merger assessments should take account of changes occurring in the sector.

In the administration and interpretation of the merger provisions in the *Trade Practices Act 1974*, regard should be had to the substantial and rapid changes which are now occurring in the financial system, including those reported by this Inquiry, which are affecting the appropriate definition of markets and in general introducing new sources of competition.

10.5 Foreign Investment and Acquisitions

Approvals of foreign investment proposals in the banking and insurance sectors are currently required, in practice, under the Banking Act, the Banks (Shareholdings) Act, the Insurance Acquisitions and Takeovers Act, and banking and insurance policy, including prudential requirements. In addition, any acquisition of a substantial interest in an Australian institution, including a financial institution, must be approved by the Treasurer under the *Foreign Acquisitions and Takeovers Act 1975*. Acquisitions will be approved if they are judged not to be contrary to the national interest.

Government policy permits the issue of new banking authorities to foreign owned banks where the RBA is satisfied the bank and its home supervisor

are of sufficient standing, and where the bank agrees to comply with RBA prudential regulation. Similarly, foreign investment in insurance companies is permitted after an assessment which takes into account such issues as the suitability of the parent company and its demonstrated expertise in insurance.

The national interest considerations under the Foreign Acquisitions and Takeovers Act are not spelt out. They are influenced by an array of matters, including prudential concerns and the social and political climate of the time.

Government policy in recent years has specified that foreign owned banks will not be precluded from bidding for the regional and smaller banks and insurance companies. The policy of the previous Government, however, was that it would not approve the foreign takeover of any of the four major banks.⁴⁶ Table 10.2 sets out the percentage of each sector of the financial system which is controlled by foreign owned institutions.

The Inquiry is of the view there would be no economic disadvantage in some increase in the percentage of foreign ownership of the Australian financial system. Its view in this regard extends equally to the majors as to smaller institutions. Foreign ownership can bring with it a range of benefits for countries, including:

- injections of capital;
- access to new skills and technologies; and
- enhanced competitive pressure on the domestic market.

However, the Inquiry does not consider that a large scale transfer of ownership of the Australian financial system to foreign hands would be in the national interest. Such an eventuality could restrict the options for the future development of the financial system and Australia's place in the regional and global economy. The general scheme of regulation of foreign investment is sufficient to meet this objective.

46 See Department of the Treasury 1996, p. 3. See also, Keating 1992, p. 69; and Dawkins 1993, p. 4. for the policy statements setting out the ban on foreign takeover of the big four banks.

**Foreign Control Varies
by Sector . . .**

Table 10.2: Financial System Assets Controlled by Foreign Owned Institutions as at June 1996

Category of Institution	Total sector assets \$billion	Assets controlled by foreign owned institutions(a) \$billion	Sector assets controlled by foreign owned institutions per cent
Banks	483	70	14.5
Building Societies and Credit Unions	28	0	0
Merchant Banks	59	55.5	94
Finance Companies(b)	48.5	18	37
Other Non-Bank Financial Institutions(c)	24	7	30
Life Companies(d)	127	45	35.5
Non Life Super	154	42	27
Managers for Public Unit Trusts	55	23	42
General Insurance	58	18	31
Friendly Society and Common Funds	13	0	0

(a) Some estimation involved - especially for funds managers and insurers.

(b) Includes finance companies and pastoral financiers.

(c) Includes money market dealers, co-op housing, securitisers, intra group and other corporations.

(d) National Mutual included as foreign owned. The French company, AXA, owned 40 per cent of National Mutual Holdings at June 30 1996.

Source: Data provided to the Inquiry by RBA. (Compiled from various sources)

Thus, while the Inquiry favours removing the present policy prohibition on foreign takeovers of the big four banks, it would retain the application of the Foreign Acquisitions and Takeovers Act to the financial system.

Recommendation 85: General foreign investment policy should apply to the financial system.

The policy position prohibiting the foreign takeover of any of the four major banks should be explicitly removed and replaced with a policy which provides that all foreign acquisitions in the financial system will be assessed

under the general provisions of foreign investment policy under the *Foreign Acquisitions and Takeovers Act 1975*.

The Inquiry believes that a large scale transfer of ownership of the financial system to foreign hands should be considered contrary to the national interest. However, this does not preclude some increase in foreign ownership of aspects of the Australian financial system, including its major participants.