



Productivity Commission Inquiry into Competition in the Australian Financial System

ACCC submission in response to the
Draft Report

April 2018

1. Introduction

The Australian Competition and Consumer Commission (ACCC) welcomes the opportunity to comment on the Productivity Commission's draft report on *Competition in the Australian Financial System* (the PC Draft Report).

The PC Draft Report contains many recommendations to advance competition in the financial services sector, including: the need for a regulator to champion competition in the sector; and, actions to support transparency of prices and in the processes used to develop financial sector regulation.

This submission builds on the ACCC's initial submission to the Productivity Commission's inquiry and our opening remarks at a public hearing on 28 February 2018. It also provides further detail in response to some of the questions raised by the Productivity Commission at that hearing. Specifically, this submission outlines:

- the ACCC's recent engagement with, and work in, the financial services sector
- the expanded role of the ACCC in the sector, and
- the ACCC's response to questions taken on notice at the Productivity Commission's public hearing on 28 February.

2. Recent ACCC engagement on financial services sector issues

Since its first submission to the Productivity Commission's inquiry in September 2017, the ACCC has been engaged in a number of activities involving competition and consumer issues in the Australian financial services sector. These activities include:

- the release of the Interim Report on 15 March 2018 for the ACCC inquiry into residential mortgage pricing by banks subject to the Major Bank Levy
- progressing an inquiry into the supply of home, contents and strata insurance in Northern Australia
- the investigation of complaints relating to excessive card payment surcharges by merchants
- being appointed 'lead regulator' in the development of the Open Banking initiative,¹ and
- fostering competition in cash equities clearing and settlement services.

Further detail of our work on these matters is provided below.

The ACCC has also continued to engage in the work of the Council of Financial Regulators (CFR) through the CFR's Competition Working Group and the Financial Market Infrastructure (FMI) Steering Committee. As outlined at the Productivity Commission's public hearing, the ACCC has continued to liaise with the Reserve Bank of Australia (RBA) on potential competition issues raised by network routing for contactless card payments, including implementing merchant choice on default routing.

2.1. ACCC Interim Report for the Residential Mortgage Price Inquiry

The ACCC's Interim Report for the Residential Mortgage Price Inquiry (ACCC Interim Report) examined the motivations, influences and processes behind the pricing decisions of the five banks subject to the Major Bank Levy (the Inquiry Banks),² between 30 June 2015

¹ https://static.treasury.gov.au/uploads/sites/1/2018/02/Review-into-Open-Banking-_For-web-1.pdf.

² The Inquiry Banks are: ANZ; Commonwealth Bank; Macquarie Bank; National Australia Bank; and, Westpac.

and 30 June 2017. The ACCC's Final Report will be provided to the Government after 30 June 2018, following the conclusion of the price monitoring period.

A key finding of the ACCC's Interim Report is that price competition between the Inquiry Banks, particularly the big four banks, has been less than vigorous. Signs of accommodative oligopoly behaviour, particularly among the big four banks, include:

- an intense focus on each other with little regard to other lenders when setting variable interest rates
- evidence they do not seek to compete by consistently offering the lowest headline rates, but instead aim to achieve a 'mid-market' position or broadly align their headline rates with the other big four banks
- during late 2016 and early 2017, separate actions by two of the big four banks to reduce the size of discounts offered to borrowers with a view to leading rivals to follow, and achieving this result for some period.

The ACCC Interim Report's other key findings include the lack of transparency in residential mortgage prices, and the consequences for consumers, and the effects of prudential regulation on residential mortgage prices and competition. These are discussed further below.

Opaque discretionary discounts make it difficult for borrowers to compare products

Like the PC Draft Report, the ACCC Interim Report found that most residential mortgage borrowers receive a discount off the relevant indicator rate (referred to by the ACCC as the 'headline interest rate'). In fact, the ACCC Interim Report found that each Inquiry Bank had 44 per cent or more of its borrowers receiving a discount of over 90 basis points in June 2017. Depending on the product, these discounts took the average interest rates paid by borrowers to 78–139 basis points below the relevant headline interest rate.

The ACCC Interim Report also found that the discounting strategies of the big four banks since June 2015 have resulted in new borrowers paying interest rates that are up to 32 basis points below those paid by existing borrowers on standard variable interest rate residential mortgages.

There are a number of factors the Inquiry Banks take into consideration when determining what, if any, discount they will offer a borrower. Some of those factors have included: the borrower's risk profile; the geographic location of the borrower or their residential property; the borrower's value (or potential value) to the bank; and, the bank's desire to write new business. A borrower's ability to negotiate has also been an important factor in what, if any, discount they receive.

Since the decision criteria for discretionary discounts vary across lenders, borrowers can find it difficult to determine in advance what, if any, discount they may be eligible for. Borrowers have increasingly turned to mortgage brokers to give them a broader view of the options available across a range of residential mortgage lenders. However, as identified in the PC Draft Report, mortgage brokers face conflicts of interest that mean borrowers may not always get the best advice from this source.

The publication of interest rate data to improve transparency

The PC Draft Report makes two recommendations to improve the transparency of residential mortgage prices. The first relates to the collection of data from mortgage lenders on interest rates for residential home loans (Draft Recommendation 8.3). The second relates to the

publication of that data in formats useful to both consumers and third parties (Draft Recommendation 8.4).

The ACCC strongly supports measures that improve the transparency of residential mortgage prices. Increased price transparency has the potential to stimulate more vigorous price competition among mortgage lenders to the extent that it empowers consumers to identify the lender, product and price that best meet their needs.

Mortgage lenders have knowledge about their products and the discounts they are willing to offer that consumers do not. More significantly, mortgage lenders also have access to the pricing information of their competitors, through mortgage brokers, for example.

Any measures developed as a result of the Productivity Commission's recommendations should be designed with the objective of addressing the information asymmetry between mortgage lenders on the one hand, and consumers on the other.

The Productivity Commission is recommending (at Draft Recommendation 8.3) that there be a consultation process to decide the types of data that could be collected, including the various features of the loan or borrower. The ACCC would welcome the opportunity to participate in such a consultation process.

In formulating its final recommendations on this issue, the ACCC encourages the Productivity Commission to consider the following issues to ensure these measures can meet its objective of improving consumer outcomes through greater price transparency and increased competition in the residential home loan market.

Whilst supportive of measures to increase transparency, the ACCC notes that the frequent publication of detailed contemporary pricing information could lessen, rather than promote, competition if it creates a focal point that facilitates (oligopolistic) tacit coordination on price, particularly among the big four banks.

The Productivity Commission is currently proposing that ASIC should develop an online tool that:

- allows consumers to select different combinations of loan and borrower characteristics
- reports median interest rates for loans issued in the previous month with those characteristics, by lender, and
- details the specific fees and charges that would affect the total cost of a loan.

The Productivity Commission has also recommended that the underlying data should be published in a way that is accessible to third parties so that they may develop comparator websites and is in a machine-readable format.

The ACCC Interim Report found that the pricing behaviour of each of the Inquiry Banks already appears consistent with 'accommodating' a shared interest in avoiding the disruption of mutually beneficial pricing outcomes. The proposed publication of detailed, contemporary interest rate data by lender could make it even easier for banks, particularly the big four banks, to compete less vigorously on price in the future. This is because it may enable them to more effectively signal to each other that they are not competing aggressively on price and, at the same time, enable them to detect and retaliate against any attempts by a rival to deviate from a 'tacit consensus' not to compete aggressively. However, the ACCC recognises that the Productivity Commission's recommendation may simply be making information available to consumers that is already available to the banks.

The risk identified will be low if there are many lenders with an ability and incentive to strongly compete on price. However this may not be the case if those lenders face a

significant cost disadvantage or find it easier to achieve performance targets by following the lead of the big four banks rather than challenging them on price.

If Draft Recommendation 8.4 is adopted, the ACCC suggests there be price monitoring from the outset to assess whether the initiative is facilitating a lessening of competition.

It is also important that borrowers do not come to regard the proposed online tool, or comparator websites using the published underlying data, as offering a 'one-stop-shop' service that saves them from having to shop around to identify the lender and loan product that best meets their needs. The publication of median rates means that individual borrowers will not know whether, given their personal circumstances, they may qualify for rates that are higher or lower than the cited median rate. They will still need to make their own enquiries to confirm which lender and product best meets their needs and the ACCC suggests they be encouraged to do so.

The effect of prudential benchmarks on interest rates and competition

Like the Productivity Commission, the ACCC has observed that residential mortgage interest rates have been particularly affected by two policy initiatives aimed at addressing emerging risks to both individual authorised deposit-taking institutions (ADIs) and the broader financial system from the housing sector. The first of these initiatives, announced by APRA in December 2014, was for ADIs to limit their annual growth in residential mortgage lending to investors to 10 per cent. The second initiative, announced by APRA in March 2017, was to limit residential mortgages with interest only repayments to 30 per cent of total new mortgage lending.

The ACCC Interim Report observed that the Inquiry Banks tried a number of different approaches to comply with the investor cap, including reducing discounts for new investor borrowers and tightening their criteria for approving new investor loans. However, these actions were deemed to be insufficient by some Inquiry Banks to ensure their compliance.

These banks chose to increase their headline interest rates for investor borrowers (affecting new and existing loans) to reduce demand and ensure their total investor borrower portfolio did not grow by more than the 10 per cent benchmark. In addition, the banks increased their headline interest rates for interest only borrowers. This also affected new and existing loans despite the March 2017 APRA measure only applying to new lending.

Once some Inquiry Banks had increased their interest rates on investor loans, some of the other Inquiry Banks stated that they needed to follow those increases otherwise they would risk being inundated with new loans that (if approved) would put them in breach of APRA's investor growth limits. As a result, there is now less scope or incentive for Inquiry Banks (or other ADIs) to lower interest rates to attract investor borrowers due to the risk of non-compliance with APRA's investor growth limits.

The ACCC Interim Report notes that, while the Inquiry Banks may have publicly explained the reasons for some of their interest rate increases as being the result of prudential benchmarks, there were sometimes other factors in play. For example, while the decision of at least one Inquiry Bank to increase headline variable interest rates was prompted by APRA's benchmark, the expected 'substantial economic benefit' of hundreds of millions of dollars in additional revenue was an important consideration in the decision. The opportunity to bolster its return on equity was part of the reason another Inquiry Bank increased its headline variable interest rates for investor loans in July 2015.

These findings highlight the need for careful consideration of the likely competition effects of new regulatory proposals. The ACCC sees merit in recommendations that support this outcome. This is discussed further in Section 3 of this submission.

2.2. The ACCC's Northern Australia Insurance Inquiry

In May 2017, the ACCC was directed by the Treasurer to hold an inquiry into the supply of residential building (home), contents and strata insurance products to consumers in Northern Australia (the Insurance Inquiry).³ The Insurance Inquiry will run until November 2020 with the first report due to the Treasurer in November 2018. The Insurance Inquiry is considering a number of issues including:

- insurance pricing and insurers' approach to risk assessment, the key cost components of insurance, and insurer profitability
- competitiveness of markets, including the behaviours and practices of insurers
- consumer engagement with insurance markets including barriers to consumer choice
- incentives and remuneration structures of intermediaries, and the impact this has on consumer outcomes, and
- other regulatory issues that may not be supporting the development of competitive markets for insurance in Northern Australia.

The Insurance Inquiry has received over 280 submissions from consumers, insurers, industry associations, consumer bodies, broker groups and other stakeholders. Public forums have been conducted in Broome, Karratha, Rockhampton, Mackay, Cairns, Darwin, Townsville and Alice Springs.

Productivity Commission recommendations in relation to general insurance

The PC Draft Report has several findings indicating that effective competition in Australia's general insurance markets may be limited. The Productivity Commission has also made three draft recommendations to address some of the competition and consumer issues identified.

Draft Recommendation 11.1: Comparative pricing information on insurance renewal notices

As the Productivity Commission has recognised, the prices of retail general insurance products have been increasing over the last 10 years. This trend has been especially stark in relation to home, contents and strata insurance products in Northern Australia. The ACCC acknowledges that insurance premiums can increase for a number of reasons, including through revisions to an insurer's assessment of risk, or an adjustment to the amount for which the property is being insured.

The ACCC supports the proposed requirement for insurers to disclose the previous year's premium and annual percentage change on insurance renewal notices. This measure would provide customers with easy access to relevant pricing information and may prompt them to consider switching their insurance providers. Further, it is unlikely to impose high regulatory costs upon insurers. This policy proposal has a weight of support behind it, having been previously recommended in the Senate Economics References Committee (SERC) Report in 2017.⁴

Additional measures may help consumers make informed product choices having regard to policy coverage, product options, and the level of excesses as well as pricing. In that regard,

³ Terms of Reference are available at: www.accc.gov.au/system/files/Northern%20Australia%20Insurance%20Inquiry%20%E2%80%93%20notice.pdf.

⁴ The Senate, Economics References Committee, August 2017, "Australia's general insurance industry: sapping consumers of the will to compare", pp. ix, 27-42.

the ACCC notes the broader set of recommendations made by the SERC in its 2017 Report aimed to improve transparency and informed decision making in the general insurance industry.

This issue will be explored further in the course of our Insurance Inquiry.

Draft Recommendation 11.2: Transparency on insurance underwriting

The ACCC supports the recommendation calling for disclosure of a full list of brands underwritten by the same insurer on an insurance brand's website and on ASIC's website. This recommendation could also extend to 'white label' insurance products.

In principle, greater consumer awareness of alternative insurers could facilitate greater searching and switching behaviour. The draft recommendation could assist with this, albeit only in relation to brands underwritten by a single insurer. The publication of a complete list of insurers and their brands would possibly have a greater potential to raise consumer awareness of alternative insurers' offerings. However, some insurance brands may not service all areas of Australia. Any list of brands on offer would ideally also include an indication of which areas of Australia they do and do not service.

More broadly, our Insurance Inquiry will be considering industry structure and concentration, and the ways in which an insurer's brands share information or compete with one another.

Draft Recommendation 11.3: Phase out distortionary insurance taxes from mid-2018

Stamp duties and other levies contribute to the overall premium paid by consumers. When these duties and levies are set as a percentage of a base insurance premium, consumers in areas with higher base premiums for a given sum insured (such as Northern Australia) will pay disproportionately more than consumers in other areas.

Our Insurance Inquiry will report on the magnitude and effects of duties and levies, and explore options to ameliorate their distortive effects, including phasing them out.

2.3. Other areas of ACCC engagement in the financial services sector

Excessive surcharging on card payments

Collectively, the RBA's standard relating to merchant surcharges for card transactions⁵ and the *Competition and Consumer Act 2010* (Cth) (CCA) are intended to promote efficiency and competition in the payments system by allowing merchants to levy cost-reflective surcharges for different payment methods. Under these arrangements, businesses are not prohibited from levying a surcharge on card payments but the surcharge cannot exceed the cost incurred by the merchant in accepting payment by that method. A ban on excessive card payment surcharges came into effect in two stages: applying to large merchants from 1 September 2016 and to all merchants from 1 September 2017.

The ACCC has a role in supporting competitive outcomes in the payments system by investigating complaints relating to excessive payment surcharges and promoting compliance (including publishing guidance material for consumers and businesses as well as engaging with banks (who are the major acquirers of card transactions)).

⁵ Reserve Bank of Australia, *Standard No. 3 of 2016: Scheme rules relating to merchant pricing for credit, debit and prepaid card transactions*, RBA, Sydney, May 2016.

In November 2017, Red Balloon Pty Limited paid penalties totalling \$43 200 following the issuing of four infringement notices by the ACCC for alleged excessive payment surcharges in respect to payments made by MasterCard credit, Visa credit, Visa debit and MasterCard debit respectively.

Open Banking and access to consumer data

The Treasurer released the report of the *Review into Open Banking* on 9 February 2018.⁶ The release of the report followed an announcement by the Assistant Minister for Cities and Digital Transformation in November 2017 that the Government would introduce a consumer data right, first in banking, and then in the energy and telecommunications sectors.⁷

The *Review into Open Banking* outlines a framework for a general consumer data right (as originally recommended by the Productivity Commission),⁸ and the implementation of that right in the banking sector. The report makes a number of recommendations including: the proposed regulatory framework; the data that should be within scope of the right; the necessary privacy and security safeguards to ensure trust and integrity in the system; and, the technical standards that should underpin data transfer.

The report also proposes a multi-regulator model, with the ACCC as the lead regulator and primary responsibility for privacy remaining with the Office of the Australian Privacy Commissioner. Under this model, the roles proposed for the ACCC include making rules to implement the specifics of the data right, and taking enforcement action to ensure that participants in the new framework meet their obligations. The ACCC is undertaking preparatory work in anticipation of this new role, recognising that formal commencement will be determined once the government has finalised its response to the report.

The ACCC supports the implementation of a consumer data right, including in the banking sector.⁹ Giving consumers greater access to, and control over, the data that is held about them by business, including the ability to direct that such data be copied and provided to a third party, is a significant competition and consumer reform. As the Treasurer noted:

Granting third-party access to a customer's data will allow rival providers to offer competitive deals, products that are tailored to individual needs, and enhanced services that simplify the choices customers face when accessing banking services.

It should simplify the process of switching between banks and help to overcome the 'hassle factor' that sees customers stay with their current bank even in the presence of more competitive deals elsewhere.¹⁰

The ACCC continues to engage with Treasury and other agencies as the open banking and consumer data right proposals progress.

Cash equities clearing and settlement

The CFR, in conjunction with the ACCC, has completed two reviews in recent years concerning the potential for competition in the provision of clearing and settlement services for cash equities currently provided by the Australian Securities Exchange (ASX). The first, as noted in the ACCC's previous submission, was completed in 2015 and focussed on

⁶ https://static.treasury.gov.au/uploads/sites/1/2018/02/Review-into-Open-Banking-_For-web-1.pdf.

⁷ The Hon Angus Taylor MP, Assistant Minister for Digital Transformation and Cities, 'Australians to own their own banking, energy, phone and internet data', Media Release (26 November 2017).

⁸ Productivity Commission, *Data Availability and Use*, Inquiry Report No. 82 (31 March 2017).

⁹ ACCC submission on PC draft report on Data Availability and use, January 2017 available at: http://www.pc.gov.au/__data/assets/pdf_file/0019/212383/subdr331-data-access.pdf.

¹⁰ <http://sjm.ministers.treasury.gov.au/media-release/010-2018/>.

competition in clearing. The second was completed in September 2017 and focussed on competition in settlement functions.

Following the reviews, the CFR and ACCC published:

- *Regulatory Expectations for Conduct in Operating Cash Equity Clearing and Settlement Services in Australia* (the Regulatory Expectations).¹¹ The Regulatory Expectations apply to the ASX while it remains the monopoly provider of clearing and/or settlement services, and are aimed at concerns about potential discrimination and monopoly pricing. The Regulatory Expectations were revised following the second review to clarify, for instance, that services include the provision of data necessary for clearing and settlement.
- *Minimum Conditions for Safe and Effective Competition in Cash Equity Clearing in Australia* (Minimum Conditions (Clearing))¹² and *Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia* (Minimum Conditions (Settlement)).¹³ The Minimum Conditions provide guidance to the ASX and any potential new entrant about the requirements that would be in place in an environment where there was competition in clearing and/or settlement.

The reviews have a number of recommendations and conclusions, including legislative reforms to provide:

- the ACCC with powers to arbitrate disputes relating to price and non-price terms and conditions of access to the ASX's monopoly clearing and settlement services for cash equities in Australia, and
- ASIC with powers to make rules that impose specific obligations on cash equity clearing and/or settlement facilities to act in accordance with the principles enshrined in the Regulatory Expectations, Minimum Conditions (Clearing) and Minimum Conditions (Settlement).

In response to these reviews, the Government: endorsed the recommendations and conclusions; and, stated a policy stance of openness to competition in the provision of both clearing and settlement services for cash equities in Australia.¹⁴

Since finalising the reviews, the ACCC has been working closely with the CFR and the Government on the development of legislation that will provide ASIC and the ACCC with their respective rule-making and arbitration powers.

3. Competition advocacy in financial services

The role of the ACCC as an advocate for competition in the financial services sector was expanded in the 2017-18 Budget when the Treasurer announced that:

*A permanent team will be established within the ACCC to investigate competition in our banking and financial system.*¹⁵

¹¹ <https://www.cfr.gov.au/publications/cfr-publications/2016/regulatory-expectations-policy-statement/pdf/policy-statement.pdf>.

¹² <https://www.cfr.gov.au/publications/cfr-publications/2016/minimum-conditions-safe-effective-cash-equity/pdf/policy-statement.pdf>.

¹³ <https://www.cfr.gov.au/publications/cfr-publications/2017/minimum-conditions-safe-effective-competition/pdf/policy-statement.pdf>.

¹⁴ Media release issued by the Honourable Scott Morrison MP, Treasurer of the Commonwealth of Australia, 12 October 2016 available at: <http://sjm.ministers.treasury.gov.au/media-release/110-2016/>; and 7 September 2017 available at: <http://sjm.ministers.treasury.gov.au/media-release/087-2017/>.

¹⁵ Budget Speech delivered by the Honourable Scott Morrison MP, Treasurer of the Commonwealth of Australia, 9 May 2017. Available at: <http://www.budget.gov.au/2017-18/content/speech/html/speech.htm>.

Following this announcement, the ACCC established a Financial Services Unit (FSU). The FSU was established to proactively undertake regular inquiries into issues to promote competition. In doing so, it will facilitate more consistent and focused scrutiny of competition matters in the financial services sector, which can drive innovation, choice and better outcomes for consumers. This role is in addition to the ACCC's enduring role enforcing the CCA.

The Residential Mortgage Price Inquiry (Section 2.1) is the first task of the FSU. Once this inquiry is complete, the FSU will commence its market studies work to promote competition (Section 3.2).

3.1. Engagement with the CFR

The PC Draft Report states that the competition champion should be a member of the CFR. The CFR is not a decision-making body. Instead, it is the CFR members, the individual financial regulators, who are responsible and accountable for decisions on new regulation. The membership of the CFR is appropriately a decision for Government.

The ACCC notes that there is a record of collaboration between the ACCC, the CFR and its members. For example, the ACCC is a member of the CFR Competition Working Group. Further the ACCC has collaborated with financial regulators and the CFR on a range of competition-specific matters, including the review of competition in clearing and settlement services (Section 2.3). Significant additional opportunities exist to expand the ways in which engagement between the ACCC and the financial regulators could occur.

With the establishment of the FSU, the ACCC now has the ability to support APRA, ASIC, and the RBA in their consideration of competition issues within the existing regulatory architecture.

A greater emphasis on competition considerations in the financial services regulatory decision making process could occur in a number of ways. The ACCC can provide advice to regulators on the likely impact on competition of different regulatory proposals under consideration, particularly where the proposal has potentially significant and wide-reaching impacts. The ACCC can also contribute to the design of regulation to minimise the adverse impacts on competition while still achieving prudential objectives, or undertake ex-poste assessments of the competition outcomes of a particular measure affecting the financial services sector. Importantly, our experience with competition issues in other sectors of the economy can also provide useful insights about regulatory innovations in other markets.

When assessing competition effects of conduct, including new regulatory proposals, the ACCC focuses on the impact on the process of independent rivalry between firms in a defined market. This assessment is not limited to the behaviour of regulated entities within a market and consequences in related markets are also considered. These assessments consider the likely reactions of incumbents and prospective new entrants, and the likely consequences for consumers. This approach can help to reveal potential unintended adverse consequences of regulatory proposals and inform improvements to the final design of the regulation.

A lack of product or process innovation among market participants may not be a concern for a prudential or conduct regulator as long as regulated firms remain solvent, the financial system is stable and/or markets operate in an orderly manner. However, this can be of significant concern to the ACCC as it signals a lack of dynamic efficiency. Competition is an important driver of dynamic efficiency in markets.

3.2. The role of the ACCC's market studies

The FSU's future program of market studies will improve the ACCC's understanding of industry practices and dynamics in the financial services sector.

While the precise scope of this program is still being determined, some of the matters being considered include: an assessment of the impact of regulatory measures affecting the ability of smaller ADIs to compete against the big four banks, barriers to entry in financial services markets and the constraints on consumer switching. The work program will also be informed significantly by the Productivity Commission's final report into competition in the Australian financial system.

The PC Draft Report (p. 452) notes that *'[m]acroprudential policies do not have a long track record and, as a result, there is not a wide set of experiences upon which to draw'*. The report goes on to highlight the need for *'ongoing analysis of macroprudential policy outcomes, particularly on competition, to better understand the effectiveness of these policies, inform future policy decisions, and to clearly communicate policy objective(s)'*.

Market studies can play an important role in this process of review. The ACCC's current work in the Residential Mortgage Price Inquiry has shown how a market study can highlight competition issues arising from policy measures such as APRA's growth benchmarks for investor and interest only lending. In doing so, they can inform future policy initiatives.

Finally, financial services markets are continually evolving. As a result, even carefully considered policies that were once balancing prudential and competition outcomes can detract from competition as market circumstances change. Market studies provide a means through which such instances can be identified, brought to the attention of policymakers, and solutions for remedy advanced.

4. Matters raised at the Productivity Commission's public hearing and other issues

The ACCC appeared before the Productivity Commission's public hearing in Sydney on 28 February 2018. At that public hearing it was agreed that the ACCC would respond to two questions raised by the Productivity Commission in this submission. Those two questions were:

- whether an access regime should be established for the New Payments Platform (NPP)
- whether the ACCC sees any issues with the current extent of vertical integration in the financial system and, if it does, whether the ACCC has sufficient powers to intervene to prevent further, detrimental integration.

This section sets out the ACCC's views on both issues.

4.1. Access to the New Payments Platform

The NPP is a significant piece of national infrastructure. Ensuring that access to the NPP is not unduly restricted is an important prerequisite for realising the benefits the NPP is expected to provide (including through competition introduced via new entrants to the payments system).

The ACCC considered the issue of access to the NPP as part of an application for authorisation of certain provisions of the NPP regulations (see Box 4.1). In granting authorisation in April 2017, the ACCC formed the view that the eligibility and settlement

provisions of the NPP were not unduly restrictive. No concerns over access to the NPP have been raised with the ACCC since the final authorisation was issued.

The decision on whether an access regime should be imposed is a matter for the RBA's Payment Systems Board. The ACCC continues to engage with the RBA on this issue, and will do so further, and in detail, if concerns arise.

The RBA has previously indicated that there are a number of reasons to anticipate that an access regime may not be needed:

- as many of the NPP's costs are fixed, there are incentives for NPP Australia Limited (NPPA) to *'get as many payments through the system as possible to lower the per-transaction cost'*
- there are already three aggregators providing indirect access to the NPP for institutions that *'do not want to incur the cost of participating directly'*
- the NPPA's governance arrangements, including the presence of two independent directors and one director from the RBA, and an objective in the constitution *'to promote the public interest (including through fair access – provide protection against anticompetitive restrictions on access)'*.¹⁶

The RBA has also noted that it will continue to monitor the NPP, *'including its arrangements around access and support for competition'*.¹⁷

¹⁶ Michele Bullock, *Fast Payments in Australia*, speech, Sydney, 13 March 2018.

¹⁷ Reserve Bank of Australia, *Submission: Competition in the Australian Financial System*, RBA, Sydney, September 2017, p. 39.

Box 4.1 The ACCC's authorisation of provisions within the NPP regulations

In October 2016, NPP Australia Ltd (NPPA), the owner-operator of the NPP, lodged applications for authorisation on behalf of current and future participants in the NPP for certain provisions of the NPP regulations. The provisions within the NPP regulations for which authorisation was sought related to:

- the suspension or termination of an NPP participant's permission to use the NPP
- the eligibility criteria against which NPPA assesses applications to become an NPP participant, and
- the process for settling payments that have been cleared through the NPP.

NPPA's applications were assessed through a transparent process that included public consultation (via both public and confidential submissions) and the release of a Draft Determination for public comment.

Before the Draft Determination was issued, concerns were raised by some stakeholders that incumbent market participants may have a conflict of interest between the goals of the NPP (increasing adoption for the benefit of consumers, which would include allowing new entrants to participate in the NPP), and benefiting their own organisations by restricting access by new entrants to the NPP.

NPPA publicly responded to these concerns, noting:

- the independence and transparency built into assessments of new applications
- the NPPA directors' legal obligation to act in the best interests of the company
- the composition of the NPPA Board which helps minimise any questions or risks of conflict of interest
- there are strong safeguards in place to ensure that NPPA's eligibility criteria will not be applied in a manner that disadvantages prospective NPPA members.

The ACCC did not receive submissions in response to the Draft Determination.

The ACCC was satisfied that the NPP provisions for which authorisation was sought would contribute to the security, efficiency, and integrity of the NPP, and were therefore likely to result in a benefit to the public. Further, the ACCC considered that any public detriment, including anti-competitive detriment, likely to result from the provisions was limited, because (among other matters):

- there were checks and balances around the use of the suspension and termination provisions
- the eligibility provisions and settlement provisions did not place unduly onerous obligations on firms that elected to directly participate in the NPP, and
- firms that could not or did not wish to comply with the eligibility provisions or settlement provisions were still able to use the NPP by entering into an arrangement with an NPP participant.

The suspension and termination provisions were authorised for five years (that is, until April 2022), and the eligibility provisions and settlement provisions were authorised in perpetuity.

4.2. Integration in the financial system from mergers and acquisitions

The PC Draft Report, and questions raised with the ACCC during the public hearing, refer to the level of integration that has occurred in the banking industry, particularly where it results in vertical integration and bundling of products across market segments, and whether this raises issues from a competition perspective. The ACCC notes that integration in the financial system may also raise consumer protection issues, for example arising from inappropriate cross selling of financial products or where ownership of multiple brands across various functional levels can mislead consumers as to the actual level of choice available.

The report refers to integration that has occurred as a result of acquisitions and mergers. However integration may also result from organic expansion by existing players either horizontally or vertically. Integration that results in this way is generally less likely to raise competition concerns and therefore not come to the attention of the ACCC. It is not clear whether the integration referred to in the PC Draft Report is primarily the result of organic growth or acquisition activity.

Section 50 of the CCA prohibits mergers or acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in a market. The merger regime applies generally across all sectors of the economy.

The significant mergers and acquisitions that have resulted in integration in the banking industry in the past decade have been reviewed by the ACCC and the reasons for its decisions on each are outlined in detail on our public register – these include Commonwealth/Bankwest¹⁸ and Westpac/St George¹⁹. Significantly most of these transactions occurred at around the time of the global financial crisis (GFC) and, in some of these reviews, the impact of the GFC was a relevant factor in the assessment. Since that time, there have been relatively few mergers or acquisitions that have been the subject of a public merger review by the ACCC.

In the absence of any recent significant merger reviews having been conducted by the ACCC in the banking sector, the ACCC has limited information on which to provide an overall view on the impact of integration in the banking sector. This will change with the ongoing work of the FSU. While the ACCC is not able to provide a view on the recent impact of integration, included below is an overview of the ACCC's approach and summaries of key merger decisions involving the major banks within the last 10 years.

The focus of the comments in the PC Draft Report appear to relate to integration that results in vertical integration and bundling of products across market segments (via conglomerate mergers). The ACCC agrees that such mergers in many cases will not raise competition concerns and can promote efficiency by combining complementary assets and services which may benefit consumers.

However, where insufficient competitive constraints remain in the relevant market post-merger, some vertical and conglomerate mergers may raise competition concerns. This can occur when the merged firm is able to increase its unilateral market power, for example when the firm has the ability and incentive to 'foreclose' rivals in downstream markets.

Past ACCC merger decisions

In the last five years, the ACCC conducted one public review of an acquisition in the financial system, which was Macquarie Bank Limited's proposed acquisition of Esanda Dealer Finance business.²⁰ This was a horizontal merger and did not involve vertical integration or bundling considerations.

Prior to this, in 2013 the ACCC conducted a public review of the Commonwealth Bank of Australia's (CBA) proposed acquisition of 67 per cent of the remaining issued capital in Aussie Home Loans Investments Pty Ltd (Aussie). The review involved consultation with a

¹⁸ <http://registers.accc.gov.au/content/index.phtml/itemId/852882/fromItemId/751043>.

¹⁹ <http://registers.accc.gov.au/content/index.phtml/itemId/839278/fromItemId/751043>.

²⁰ In 2015, the ACCC conducted a public review of Macquarie Bank Limited's proposed acquisition of Esanda Dealer Finance business. The ACCC did not oppose the proposed acquisition, concluding that on balance the combination of existing and potential competitive constraints would be sufficient to prevent a substantial lessening of competition as a result of the proposed acquisition. The merged entity will face continuing competition from Westpac/St George for all customers and from a number of other providers for most customers.

range of interested parties, including bank and non-bank lenders, mortgage aggregators, broker head groups and industry bodies. The ACCC did not oppose the proposed acquisition on the basis that:

- a number of alternative suppliers of home loans, including bank and non-bank lenders, and alternative suppliers of mortgage distribution services, including other broker head groups and mortgage aggregators would continue to provide a competitive constraint post-acquisition.
- relevant to the vertical aspect of the merger, while the CBA was likely to have the ability and incentive to increase the volume of, for example, 'white label' home loan products that it would supply through Aussie, this would not give rise to foreclosure of rival lenders to the extent that a substantial lessening of competition was likely to arise. The ACCC noted that Aussie brokers made up around 6 per cent of Australia's mortgage brokers and there were many other distribution channels through which lenders can access brokers and borrowers.

Only a few mergers or acquisitions have involved vertical or bundling considerations and in each case, the ACCC was satisfied that the acquisition would not result in a substantial lessening of competition due to the constraint the remaining competitors would continue to impose on the merged entity post-acquisition. For example, the ACCC publicly reviewed the following:

- In 2011, the ACCC decided not to oppose the CBA's proposed acquisition of Count Financial.²¹ The ACCC undertook extensive market inquiries with participants in the financial planning, mortgage broking, banking, superannuation and insurance sectors. The ACCC noted that the acquisition would increase CBA's presence in the supply of financial planning services and mortgage referral services which could potentially have reduced competition in the supply of these services and increased the ability of CBA to direct business to its upstream investment and mortgage related products. However, the ACCC was satisfied that CBA would continue to be constrained by a number of other significant financial planning dealer groups, mortgage broking firms and investment product providers.
- In 2010, the ACCC reviewed the National Australia Bank Limited (NAB) proposed acquisition of AXA Asia Pacific Holdings Limited (AXA) and subsequently the AMP Limited (AMP) proposed acquisition of AXA. Both involved the markets for wealth management and banking sectors. The ACCC conducted a lengthy public review of the two proposed acquisitions.

The ACCC decided to oppose the proposed acquisition by NAB, and remained opposed to the proposed acquisition following the offer of a proposed undertaking remedy in the retail investment platform market. The ACCC did not oppose AMP's proposed acquisition.

In relation to both transactions, the ACCC reviewed competition effects across a range of markets including superannuation, insurance and banking, and following extensive investigation, the ACCC did not identify any competition concerns with respect to these markets. The key focus was retail investment platforms which provide a central hub for investors to access a range of investment products, and allow for consolidation of client information and reporting on these assets. The ACCC found that NAB was a significant competitor in the provision of retail investment platforms for investors with complex needs. The ACCC also found that AXA was on the cusp of delivering an innovative

²¹ Count Financial was one of Australia's largest networks of non-aligned financial planners. It used accountancy firms to sell financial products. Count provided a broad range of financial related services, including accounting, lending services, financial planning, and wealth management. The Count network comprised approximately 300 franchisees and 630 financial advisers, many of whom ran their business from accountancy offices.

platform that was likely to provide aggressive competition for investors with complex investment requirements.

While the ACCC opposed NAB's proposed acquisition of AXA, it was not the vertical aspects of the transaction that raised competition concerns. The ACCC investigated whether the proposed acquisitions could impact on the ability of regional banks to offer a complete suite of products in banking and wealth management markets, or provide either merged entity with the ability and incentive to restrict channels of distribution for the regional banks. The ACCC concluded that neither merged entity would have the ability and incentive to foreclose regional banks due to the existence of a range of alternative providers — both platform providers and nonaligned dealer groups — through which the regional banks may distribute their products. The ACCC also considered that regional banks predominantly supplied their banking products through their own branch networks, and were not reliant on retail investment platform providers to distribute their banking products.

- In 2009, the ACCC did not oppose NAB's proposed acquisition of a mortgage management business from Challenger Financial Services Group.²² The ACCC engaged extensively with market participants and concluded that:
 - the proposed acquisition would not result in a significant increase in market concentration. Post-acquisition, NAB's market share of the Australian home loan market would increase by less than one per cent, and
 - NAB was unlikely to use its control of the broker platforms it would be acquiring to favour its own products; constrain the ability of other lenders to utilise these platforms; remove its products from competing platforms; or restrict the ability of mortgage brokers to utilise other platforms to the extent that this would be likely to result in a substantial lessening of competition.
- In 2009, the ACCC did not oppose NAB's proposed acquisition of Goldman Sachs JBWere Private Wealth Management as there was limited competitive overlap between the merger parties with regard to full service stockbroking services since NAB did not offer this service; the existence of a range of alternative non-advisory stockbrokerage service providers; and the large number of dealer groups and independent financial advisors that would remain unaligned and not under the influence of NAB.
- In 2008, the ACCC did not oppose CBA's proposed acquisition of a 33 per cent share in Aussie because it would result in limited aggregation in the relevant markets and the remaining competitors would pose a constraint on the pricing behaviour of the merged firm post acquisition.
- In 2007, the ACCC did not oppose Westpac Banking Corporation's acquisition of RAMS Home Loans network. The ACCC concluded that:
 - the market concentration of the merged entity would not be sufficient to raise competition concerns as RAMS represented a small proportion of the national market for the supply of home loans,
 - there were sufficient alternative suppliers of home loan products including ANZ, CBA and NAB, and
 - barriers to entry into the home loan market for established non-bank deposit taking institutions and established foreign banks appear to be low.

²² NAB proposed to acquire Challenger's broker distribution businesses of Choice, PLAN and FAST, a multi-brand "white label" lending business that provides wholesale mortgage loans to mortgage managers who in turn distribute mortgages under their own brand.

Creeping acquisitions

Concerns about creeping acquisitions typically arise where a business with a substantial degree of market power acquires many small competitors over time. Concerns have previously been raised that the merger provisions in the CCA focus on the effect or likely effect of a particular acquisition or merger, and do not take account of the cumulative impact of acquisitions over time.

There have been a number of reviews looking at the adequacy of the CCA to deal with creeping acquisitions over the years. As the PC Draft Report notes, in 2015 the Competition Policy Review (Harper review) did not recommend any changes to the CCA to directly address creeping acquisitions, concluding that there would be complexities and costs. In particular, the Harper review noted that ‘in the absence of evidence of harmful acquisitions proceeding because of a gap in the law on creeping acquisitions, the Panel does not consider that a sufficiently strong case for change has been made.’²³ The ACCC supports this view at this time.

Merger notification to build an evidence base

Australia’s merger law does not contain compulsory notification requirements for merger parties to notify the ACCC before proceeding with a merger. However there is a high degree of voluntary notification by merger parties for transactions that may potentially raise competition concerns. This level of voluntary notification is largely driven by the incentive for merger parties to manage the risk of ACCC intervention prior to or following the transaction. In addition to voluntary notifications, information regarding proposed mergers is supplemented by information from bodies such as the Foreign Investment Review Board and APRA, and ACCC monitoring of the financial press.

The ACCC notes the PC Draft Report recommends that firms undertaking mergers or acquisitions within the financial system, including banks, insurers and other financial services firms, should notify the ACCC and ASIC on the nature and the size of these acquisitions as they undertake them. The purpose of this requirement would be to obtain data to determine whether integration via creeping acquisitions is substantially lessening competition.

The scope of the recommendation would likely result in a significant number of notifications and many of these would be unlikely to raise competition issues. Therefore this proposal would come at a cost to business and the agency receiving that information and the ACCC considers the benefits of requiring the information would be unlikely to outweigh the costs.

5. Conclusion

The ACCC appreciates the opportunity to respond to the PC Draft Report, and looks forward to the findings and recommendations of its Final Report.

²³ Competition Policy Review, Final Report, p. 323.