Productivity Commission Inquiry into Competition in the Australian Financial System

Australian Competition and Consumer Commission submission

September 2017

Executive Summary

The Australian Competition and Consumer Commission (ACCC) welcomes the opportunity to make a submission to the Productivity Commission's (PC) *Inquiry into Competition in the Australian Financial System*. We note that the inquiry's terms of reference centre on the banking sector. We have focussed this submission on promoting competition in the banking sector to enhance the welfare of all Australians.

This submission provides our observations on the issues we consider may warrant consideration by the PC in the course of its deliberations.

State of competition in retail banking markets

A number of market structure and behaviour indicators, taken together, suggest that the current oligopoly structure of retail banking in Australia is not vigorously competitive, and has not been for some time.

It is not clear that sustained high profits of the large banks (compared internationally) can be traced to exceptional performance. To the contrary, there appears to be an element that reflects the degree to which the competitors of the large banks are handicapped in their ability to effectively contest the market.

We consider that there may be several factors impeding effective challenge by new entrants and smaller rivals, including but not limited to:

- government regulation and policies in the banking sector
- barriers arising from large banks' expansion into other financial services markets, and
- barriers to customer switching.

We recognise that there is an important role for government to safeguard the stability of the banking system. However, competition policy should not be viewed as a threat to this objective. Indeed, increased competition in concentrated retail banking markets could help make those markets more robust and effective over time, and less prone to poor performance and failure.

We consider it timely that there be a full review of barriers to competition in financial services markets with a view to identifying opportunities for reform by government and the industry. We also highlight that the inquiry provides an opportunity to consider the impact of the "four pillars" policy on competition.

Initiatives to reduce barriers to competition in retail banking

The ACCC's view is that the following measures would make a significant contribution to more competitive retail banking in the future:

- Reforms proposed to reduce restrictions on the use of the term "bank".
- APRA's phased approach to licensing Authorised Deposit-taking Institutions (ADIs), recognising that it may not be necessary or beneficial to subject new entrants to the same regulations as large incumbents.
- Proposed relaxation of 15% ownership cap on ADIs.
- Introduction of Open Banking to make it easier for consumers to switch to better offers.

We also consider there is very considerable potential for pro-competitive disruption in Australian financial services markets, given their data intensity and the demonstrated willingness of Australian consumers to embrace products and services delivered via the Internet and mobile technologies.

We welcome insights from the PC on opportunities for disruptive innovation to potentially transform market structure and firm behaviour in the financial system, and the extent to which pro-competitive disruption is being stifled, including by government regulation or the behaviour of large incumbents.

1. Introduction

We welcome the opportunity to make a submission to the PC's *Inquiry into Competition in the Australian Financial System* (PC Inquiry). References in this submission to the financial services sector and financial system are consistent with the scope of the PC's Terms of Reference and Consultation Paper, which focuses predominantly on the banking sector.

A competitive financial services sector is integral to the proper functioning of Australia's economy. The sector is faced with changing consumer needs and wants, "disruptive" technology, government regulation, and various proposals for regulatory reform.

The ACCC is the statutory authority responsible for the administration and enforcement of the *Competition and Consumer Act 2010* (CCA). The overarching objective of the CCA is to enhance the welfare of Australians through the promotion of competition and fair trading, and through consumer protection.

This submission provides our observations on issues which we consider warrant inquiry by the PC. Primary of these is the range of indicators which, taken together, suggest that Australia's banking sector is not vigorously competitive.

The large banks[1] each have considerable market power. For various reasons, their ability to sustain profits which are high by international standards has not stimulated the new entry or significant expansion by smaller players that might otherwise be expected.

In these circumstances, this inquiry is a timely opportunity to better understand why we do not observe a more competitive dynamic in Australian retail banking, along with the attendant benefits of competition for consumers. To this end, we identify some of the potential barriers to entry and expansion in retail banking markets, recognising that there are others that will also be relevant to the inquiry. We also register our support for a number of initiatives that should help to make it easier for new entrants and smaller players to challenge the product and service offering of the large banks.

We consider the ACCC's mandate to examine competition issues in the financial services sector and this inquiry to be complementary. We look forward to working with the PC in the course of the inquiry, with a view to promoting highly effective and competitive financial services markets over the longer term. We anticipate providing a more detailed submission in response to a draft report and recommendations.

2. Recent ACCC engagement in the financial services sector

2.1. Competition Policy Review

Arising out of the recommendations of the *Competition Policy Review*, the Competition and Consumer Amendment (Competition Policy Review) Bill 2017 and the *Competition and Consumer Amendment (Misuse of Market Power) Act 2017* make significant amendments to a number of areas of the CCA. Perhaps of most relevance to the financial services sector is the inclusion of a prohibition on concerted practices for the purpose, or with the effect, or likely effect of substantially lessening competition (SLC); and the amendment of the misuse of market power provision to focus on the purpose, or effect or likely effect of SLC.

[1] In this submission "large bank" will refer to Commonwealth Bank of Australia (CBA), Westpac Banking Corporation (Westpac), National Australia Bank (NAB), and Australia and New Zealand Banking Group (ANZ).

In relation to concerted practices, the Explanatory Memorandum states that a concerted practice is:

> any form of cooperation between two or more firms (or people) or conduct that would be likely to establish such cooperation, where this conduct substitutes, or would be likely to substitute, cooperation in place of the uncertainty of competition.[2]

The concerted practices prohibition will fill a gap in Australia's competition law relating to anti-competitive activity by firms that eliminates strategic uncertainty between competitors and facilitates coordination, but which falls short of an "arrangement or understanding" as interpreted under Australian law.[3]

The amendment to the misuse of market power provision has removed the requirement that a firm "take advantage" of its substantial market power in order to contravene the CCA, and replaced it with the SLC test found elsewhere in the legislation. This simplifies the provision and will enable the ACCC to take action against firms with substantial market power that engage in unilateral conduct for the purpose or effect of SLC.

These important amendments are likely to significantly improve our capacity to tackle anti-competitive conduct in the financial services sector, due to the concentrated nature of the markets (discussed further at 3.1 below).

2.2. The ACCC's Financial Services Unit

As part of the 2017-18 Budget, the Government provided the ACCC with additional funding of $13.2 million over four years to establish a Financial Services Unit (FSU) to undertake regular inquiries into competition issues across the financial system. An additional $1.2 million has been provided in 2017-18 for the first task of the FSU to undertake a price inquiry into residential mortgage products.

Alongside the ACCC's role in promoting competition in financial services through our enforcement, mergers and adjudication work, the FSU will monitor competition in Australia's financial services sector by assessing competition issues, undertaking market studies, and reporting regularly on emerging issues and trends in the sector.

The PC Inquiry is likely to identify additional competition issues in financial services markets that may warrant referral to the FSU in due course.

2.3. Residential mortgage products price inquiry

On 9 May 2017, the Treasurer, the Hon. Scott Morrison MP, directed the ACCC to inquire into prices charged or proposed to be charged by ADIs affected by the Major Bank Levy in relation to the provision of residential mortgage products in Australia from 9 May 2017 to 30 June 2018. We have been directed to have regard to the Government's view that banks need to fully and transparently account for their decisions, and hence how they balance the needs of borrowers, savers, shareholders and the wider community. The Treasurer also directed us to report on the inquiry and provide information to the market as we deem appropriate, with a final report to the Treasurer at the conclusion of the inquiry.

As part of our inquiry, we have required the banks affected by the Major Bank Levy to provide information and produce documents to explain any changes or proposed changes to prices (fees, charges or interest rates) in relation to residential mortgage products.

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[2] Explanatory Memorandum, Competition Policy Review Bill 2017, at 28 (emphasis added).

[3] ACCC, Submission to the *Competition Policy Review* – Response to the Draft Report, at 44.

Like other price inquiries,[4] a key objective of our inquiry is to promote transparency around the pricing decisions of banks with respect to residential mortgage products. This includes seeking to understand and explain how the banks make their pricing decisions and the factors considered when making these decisions (for example, this could include the extent to which pricing decisions are impacted by external events such as changes in the regulatory environment or changes to the official cash rate). Our role does not mean that the ACCC can prevent the banks from increasing or decreasing their prices as they see fit (provided they do so independently).

Our price inquiry will complement the PC Inquiry's examination of the degree and nature of competition in the provision of mortgages for households.

2.4. Recent ACCC actions in the financial services sector

The ACCC routinely engages with the financial services sector when considering proposed mergers and applications for authorisation or notification of conduct that may have anti-competitive effects that are relevant to that sector. In terms of our enforcement functions, over the past two years, we have successfully brought civil penalty proceedings against ANZ, Macquarie Bank and Visa Worldwide Pte Ltd (Visa) in respect of anti-competitive conduct in contravention of the CCA.

In making merger decisions, the test applied is whether the merger or proposed merger is likely to result in a substantial lessening of competition in any relevant market. Authorisation confers statutory protection against legal action for conduct that may otherwise be in contravention of certain provisions of the CCA. Authorisation can be granted if we are satisfied that the public benefit of the conduct outweighs any public detriment (including any lessening of competition).

In the course of enforcing compliance with the CCA, the ACCC has examined a number of issues in financial services markets, including:

- In March 2017, we issued a determination denying authorisation to four banks (Commonwealth Bank of Australia, Westpac Banking Corporation, National Australia Bank, and Bendigo and Adelaide Bank) to collectively bargain with Apple and collectively boycott Apple Pay. The banks sought authorisation to bargain with Apple for access to the Near-Field Communication (NFC) controller in iPhones, and reasonable access terms to the App Store. We accepted that Apple providing the banks access to the iPhone NFC controller was likely to lead to increased competition in mobile payment services and that this was a significant public benefit. However, we also considered the likely distortions to and reductions in competition caused by the conduct would be significant. We consulted with consumers, financial institutions, retailers and technology companies in reaching our decision.
- In December 2016, the Federal Court determined penalties of $9 million against ANZ and $6 million against Macquarie Bank for attempted cartel conduct.[5] The conduct concerned traders employed by a number of banks in Singapore, who communicated via online chat rooms about daily submissions to be made to the Association of Banks in Singapore (ABS) in relation to the benchmark rate for the Malaysian ringgit (ABS MRY Fixing Rate). During 2011, ANZ and Macquarie traders attempted to make arrangements with other banks to make high or low submissions to the ABS MYR Fixing Rate. ANZ admitted to ten instances of attempted cartel conduct, and Macquarie Bank to eight instances.

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[4] The ACCC is currently undertaking four other pricing inquiries into: the competitiveness, trading practices and transparency of the Australian dairy industry; the competitiveness of retail electricity prices in Australia; the supply of and demand for wholesale gas in Australia; and the supply of home, contents and strata insurance in Northern Australia.

[5] *ACCC v Australia and New Zealand Banking Group Limited* [2016] FCA 1516.

- In September 2015, the Federal Court ordered Visa to pay a pecuniary penalty of $18 million following a finding that Visa engaged in anti-competitive conduct.[6] During a five-month period in 2010, Visa implemented and maintained a moratorium by making changes to the Visa rules which prohibited the further expansion of the supply of dynamic currency conversion (DCC) services on point-of-sale transactions on the Visa network by rival suppliers of currency conversion services in many parts of the world, including in Australia. DCC is a service which competes with Visa's currency conversion services by giving international cardholders a choice to complete a transaction in their home currency rather than in the local currency of the merchant. The conduct meant that merchants that were not already offering DCC to their customers could not choose to offer DCC. The Court declared that Visa contravened s.47 of the CCA.
- We have also considered proposals for other types of conduct or arrangements in a broad range of financial services markets. For example, we assessed applications for authorisation of arrangements between members of ATM networks not to charge each other's cardholders for ATM transactions.[7] In these cases, we considered that the conduct was likely to lead to a net public benefit irrespective of how the market was defined (the benefit being that smaller financial institutions could compete more effectively if their customers had access to a larger network of fee-free ATMs).[8]
- In recent years we have also considered a number of mergers in the financial services sector, including CBA's acquisition of BankWest (2009) and Aussie Home Loans (partial acquisition in 2008 and remaining interest in 2013), and Westpac's acquisition of St George (2008).

It is important to note that the CCA merger provisions are separate to the "four pillars" policy, which is discussed further at section 3.2 below. This policy operates to prevent a merger between any of the large banks, but otherwise does not prevent those banks from making other acquisitions, including of smaller banks that may be challenging their market position. Such a transaction would be considered under the mergers provisions, and acquisitions by foreign entities may require approval from the Foreign Investment Review Board on national interest grounds.

2.5. Working collaboratively with other regulators

As outlined in the Financial System Inquiry *Final Report*[9] (FSI Final Report), independent and accountable regulators are necessary to maintain trust and confidence in the financial system.

We recognise the remit and expertise of other regulators in the sector, including the Australian Prudential Regulation Authority (APRA) in the prudential regulation of banking, insurance and superannuation; the Australian Securities and Investments Commission (ASIC) in its market conduct and integrity role; and the role of the Reserve Bank of Australia (RBA) in maintaining financial stability.

More recently the ACCC has participated in the work of the Council of Financial Regulators (CFR) through the Financial Market Infrastructure (FMI) Steering Committee[10] which

[6] *ACCC v Visa Inc* [2015] FCA 1020.

[7] Cashcard Australia Limited, A91429, 2014; Cuscal Limited, A91450 – A91452, 2014; Suncorp-Metway Limited A91509-09, 2015; Bendigo and Adelaide Bank Ltd, A91546 & A91547, 2016.

[8] Cashcard Australia Limited, A91429, Final Determination, 2014 at 5-6: "The ACCC considers that the agreement between FeeSmart sub-network members not to directly charge each other's cardholders for ATM transactions will be pro-competitive, providing a public benefit by allowing smaller institutions to develop arrangements that facilitate access to direct charge free ATM transactions for their cardholders at a range of ATMs."

[9] Financial System Inquiry, *Final Report*, November 2014 at 233.

[10] Note the FMI Steering Committee is an advisory group, but does not have decision making authority.

comprises the RBA, APRA, ASIC and the Treasury (the Agencies) in the review of competition in clearing and settlement of Australian cash equities. The first part of the review (*Review of Competition in Clearing Australian Cash Equities: Conclusions*)[11] resulted in the CFR publishing two policy statements in relation to the review of competition in clearing:

- regulatory expectations for conduct in operating cash equity clearing and settlement services in Australia (the Regulatory Expectations),[12] and
- minimum conditions for safe and effective competition in cash equity clearing in Australia (the minimum conditions).[13]

In essence, the Regulatory Expectations are intended to apply to the ASX while it remains the sole provider of clearing and/or settlement services. The minimum conditions are intended to provide guidance to ASX and any potential new entrant about the requirements that would be in place in an environment of competition in clearing.

The Regulatory Expectations are not legally enforceable under the existing legislative framework. Accordingly, the conclusions of the review recommended that legislative changes be implemented to grant the relevant regulators rule-making powers that would enable them to impose enforceable requirements on the ASX consistent with the Regulatory Expectations if these expectations were either not being met or were not delivering the intended outcomes. These powers would be held in reserve and would be expected to be used only in the event of a material deviation from the Regulatory Expectations or where the ASX's conduct was generating undesirable outcomes for the market. In addition, the Conclusions recommended that the ACCC be granted an arbitration power that would provide for binding resolution of material disputes, arising where a user was seeking access to any aspect of the ASX's monopoly cash equity clearing and settlement (CS) services, consistent with the Regulatory Expectations. The ACCC may therefore have regard to the Regulatory Expectations when making a binding determination under the proposed arbitration power. The Government has committed to pursue legislative changes in accordance with these recommendations.

Of particular interest to the PC may be the view taken by the FMI Steering Committee that should a committed competitor emerge for any aspect of the ASX's cash equity CS services, the Agencies will review and make any necessary changes to the scope of the Regulatory Expectations to exclude that particular aspect. The Agencies also expect to review the Regulatory Expectations periodically, including in the event of material changes to the operating environment for these services. Such reviews may assess the continued appropriateness of the Regulatory Expectations and their effectiveness in delivering the intended outcomes, with consideration given to stakeholder feedback.

A review of the conduct of cash equity settlement services in Australia provided by the ASX is continuing.[14]

[11] The Conclusions and the Government's response are available at http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Review-of-competition-in-clearing-Australian-cash-equities.

[12] See https://www.cfr.gov.au/publications/cfr-publications/2016/regulatory-expectations-policy-statement/

[13] See https://www.cfr.gov.au/publications/cfr-publications/2016/minimum-conditions-safe-effective-cash-equity/

[14] See https://www.cfr.gov.au/publications/consultations/safe-and-effective-competition-in-cash-equity-settlement-in-australia/index.html

3. ACCC observations on the state of competition in retail banking

The ACCC acknowledges that the PC is undertaking a comprehensive review of the state of competition in the financial system. This submission focusses on the state of competition in retail banking, rather than the financial system more broadly. The discussion is not exhaustive but is intended to assist the PC to progress its review at this early stage. As the competition regulator in Australia, we take the view that competition is fundamental to making markets work in the long term interests of consumers. We endorse the view of the OECD in its 2009 report on Competition and Financial Markets that: “competition encourages efficient and innovative financial services, while stability is essential to the systemic trust on which the sector depends”.[15] All else being equal, we expect that competition will deliver better products, greater innovation, lower prices and improved international competitiveness. We expect competition to spur inefficient financial institutions to improve their performance or exit the market. Further, we expect to see a healthy level of customer switching, generating better terms for consumers and more efficient processes for financial institutions.

3.1. Observations on market structure and bank behaviour

The ACCC assesses the state of competition in a market having regard to a broad range of indicators, including: market shares and concentration; the height of barriers to entry and expansion; the rate of product and service innovation; symmetry in the pass through of cost reductions and cost increases; the ease with which customers can switch to substitute products and sources of supply; and the countervailing power of customers. Attachment A provides an overview of the framework the ACCC adopts to assess the state of competition in a market, and how a market may change as a result of a merger, acquisition or other firm conduct, such as anti-competitive conduct in breach of Part IV of the CCA.[16]

Retail banking markets in Australia are characterised by oligopolies comprising the large banks, who can influence products, prices and other conditions in important markets either alone or together. The ACCC considers that in situations of oligopoly, all else being equal, a market structure that enables a competitive fringe of second tier firms to effectively challenge the price and service decisions of large incumbents is likely to produce significantly better outcomes for consumers than one that does not.

When we look at retail banking markets in Australia we observe a number of indicators that, taken together, suggest that the current oligopoly structure is not vigorously competitive and has not been for some time, including:

- concentrated market structure[17] with the largest players maintaining significant market shares over a considerable time, largely unchallenged by smaller players, many of whom offer a less extensive range of products and services
- the largest players have been able to sustain very high margins and overall profits by international standards without attracting significant new entry or expansion by smaller players

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[15] OECD, *Competition in Financial Markets: Key Findings*, 2009 at 7.

[16] Further information about the ACCC’s approach to merger assessments can be found in the merger guidelines: www.accc.gov.au/publications/merger-guidelines

[17] See for example: Deborah Healey and Rob Nicholls, ‘Enhancing Competition: Challenges for Australian Retail Banking’, (2017) 28 JBFLP 48, at 56; Deloitte Access Economics, *Competition in Retail Banking*, Australian Bankers’ Association, March 2014, at 25 – 28.

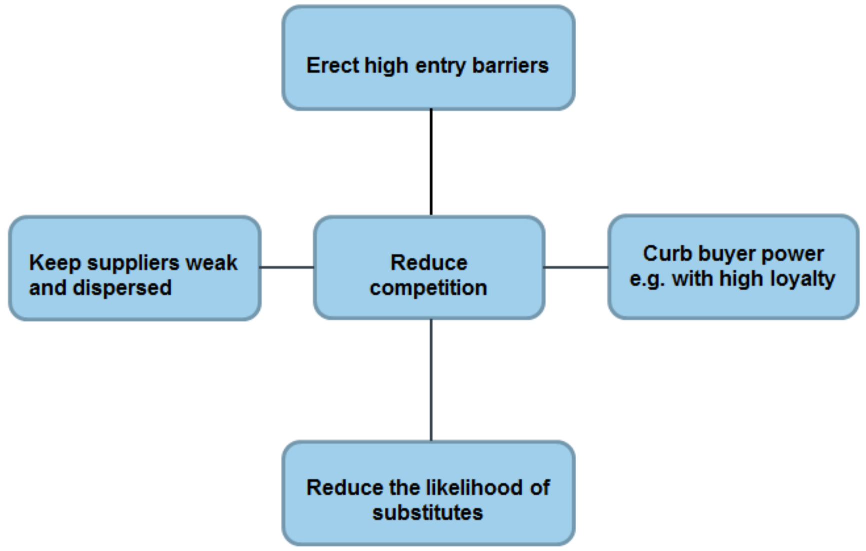
- over time the large banks have been relatively quick to pass through RBA interest rate increases to mortgage customers, but slow to pass through rate reductions, indicating longstanding asymmetry in cost pass through
- a high degree of symmetry in the product and service offerings of the large banks and we do not observe strong rivalry between them to be the first to roll out new products and services to better meet the needs and wants of consumers, and
- low levels of customer switching.

The ACCC notes the strong focus historically of the large banks on delivering a high Return on Equity for shareholders. While it is self-evident that firms will strive to maximise profits, which in most circumstances promotes economic welfare, it is not clear that sustained high profits in the Australian banking sector reflect a reward for repeated exceptional performance by banks in responding to the needs and wants of consumers. To the contrary, there appears to be an element that reflects the degree to which the competitors of the large banks are handicapped in their ability to effectively contest the market.

As Harvard Business School economist Michael Porter has observed, firms can attain commercial success by reducing competition in various ways, including by erecting high barriers to entry, keeping suppliers dispersed and weak, creating strong consumer loyalty, and by reducing the likelihood that other firms are able to offer incumbents' customers products that could be considered substitutable (see Figure 1).

Figure 1

The five forces of commercial success



Source: Adapted from Michael Porter "How competitive forces shape strategy," HBR, 1979

We think that the behaviour of the large banks, along with measures that protect large banks against the risk of failure, which are discussed further below, may be key factors contributing to the continuing difficulties faced by competitors.

We also observe that several of the large banks sell similar products under different brand names.[18] This may be distorting public perception of the state of competition in retail banking in Australia. We consider that the PC is in a position to shed light on how bank behaviour and government regulation may be reducing competition in Australian retail banking.

3.2. The role of the "four pillars" policy

We would welcome consideration by the PC of the impact on competition of the Federal Government's "four pillars" policy. We invite the PC to consider the operation and scope of the "four pillars" policy, including whether the policy considerations that underpin the policy remain.

When introduced in 1990, the objective of the "six pillars" policy (as it was known then) was to prevent mergers between the large banks and the two major life insurance companies at the time. The policy has been maintained by successive governments, but was narrowed to the "four pillars" policy in 1997 to only prevent mergers between the large banks.[19] The policy does not operate to prevent the large banks from acquiring other banks that may challenge the large banks (challenger banks) although the Australian merger control regime would apply to such acquisitions.

In 1997, the Government decided to remove the former Government's blanket prohibition on a foreign takeover of any of the large banks. Any proposed foreign takeover or acquisition will need to be assessed, like any other proposed foreign takeover or acquisition, on a case by case basis on its merits in accordance with the *Foreign Acquisitions and Takeovers Act 1975*.[20]

Arguably, the administration by the ACCC of the mergers provisions in the CCA enables mergers to be assessed on competition grounds and if necessary for the ACCC to apply to the Federal Court to challenge any merger that would be likely to substantially lessen competition. However, the "four pillars" policy provides clarity and certainty that any mergers between the large banks would not be permitted. In that sense, the policy reflects a decision by the government to prevent further consolidation in an otherwise concentrated market rather than leaving this decision potentially with the Court, should a merger be challenged on competition grounds.

Conversely, it could be argued that the policy insulates the large banks from competition. Arguably the effect of the "four pillars" policy in addition to the implicit guarantee and prudential measures entrenches the large banks' strong position in relevant markets and reinforces their "too big to fail" status. Whether this limits the ability of new entrants and smaller banks to constrain the large banks is a question we consider warrants further

[18] For example: CBA brands include BankWest, Residential Mortgages Group Pty Ltd, Aussie Home Loans; NAB brands include UBank, Homeside Lending, Advantedge, MLC and NAB Private Wealth; Westpac brands include RAMS, St George, BankSA, Bank of Melbourne

[19] Government media release April 1997, 'Release of the report of the Financial System Inquiry and initial Government response on mergers policy': https://fsi.treasury.gov.au/content/PublicInformation/Pressreleases/PR090497.asp; Wallis Inquiry Final Report, p. 427

[20] Government media release April 1997, 'Release of the report of the Financial System Inquiry and initial Government response on mergers policy Further, section 63 of the *Banking Act 1959* requires the Treasurer's prior written consent for the restructuring of an ADI, taking into account the national interest but not unreasonably withholding approval. Section 64 allows the Treasurer to impose conditions as part of an approval. Similarly, the *Financial Sector (Shareholdings) Act 1998* requires the Treasurer's approval for an application to take more than a 15 per cent stake in a financial sector company, and also allows conditions to be imposed. In addition to complying with APRA requirements, acquisitions by foreign entities may require approval by the Foreign Investment Review Board (FIRB) on national interest grounds. FIRB approval for foreign investment is required under the *Foreign Acquisitions and Takeovers Act 1975* (FATA). Under the FATA, the FIRB assesses proposals and provides advice to the Federal Treasurer who is responsible for administering the regulations and approving foreign investments that fall within the jurisdiction of the FATA. FIRB guidelines note that in addition to the FATA, foreign investment in banking is governed by the *Banking Act 1959,* the *Financial Sector (Shareholdings) Act 1998* and banking policy – the FIRB also has regard to these legislative requirements when examining foreign investment proposals in banking: see https://firb.gov.au/resources/guidance/gn43/.

consideration. We have not formed final views on this issue. If as a result of the practical application of the policy it provides advantages to the large banks, we ask the PC to consider whether the policy should be extended to other banks so that they have the same benefits, and whether it might be extended to prevent large banks acquiring smaller firms that pose a credible competitive threat to the incumbents. The divergent views about the policy are outlined in the box below.

Views on the "four pillars" policy

Competition objective

The Government's stated policy objective is to prevent further concentration in the banking sector, and associated anti-competitive effects.[21] Some commentators have stated that the "four pillars" policy gives an additional level of certainty beyond existing competition laws.

There are divergent views about "four pillars" policy from a competition perspective. Two particular views against it are:

- The mergers assessment framework under the CCA is sufficient to prevent any potential mergers that raise substantial competition concerns. The Wallis Inquiry recommended removing the "six pillars" policy on these grounds, arguing that existing competition and banking laws are better placed to assess mergers in the context of dynamic and evolving markets than a "static policy".[22] Similarly, a report published by the Centre for International Finance and Regulation (CIFR) in August 2015 on competition in financial services argued that the CCA provides sufficient merger protections.[23]
- The policy may contribute to anti-competitive outcomes. Some contend that the "four pillars policy" also operates to "cocoon" or protect the large banks from competition.[24] The CIFR report argues in favour of removing the policy because it considers the policy entrenches the perception that the large banks are protected by implicit government guarantees, which results in market distortions and gives them advantages over smaller industry participants. The report argues that the policy has contributed to vertical and horizontal integration by the large banks, and also to a regulatory culture that focuses on these banks at the expense of competition and innovation: *"The institutionalisation of these banks has the potential for both a lessening of intensity of competition and the creation of a regulatory blind spot in respect of digital disruption."*[25]

In contrast, the FSI in 2014 and the 2009 Senate Inquiry into Aspects of Bank Mergers argue in favour of retaining the policy from a competition perspective, with the former inquiry concerned about any further concentration in the sector, and consider it continues to provide an additional level of protection above competition laws.[26]

Prudential objective

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[21] Government media release April 1997, 'Release of the report of the Financial System Inquiry and initial Government response on mergers policy': https://fsi.treasury.gov.au/content/PublicInformation/Pressreleases/PR090497.asp; Wallis Inquiry Final Report, p. 427

[22] Wallis Inquiry Final Report, pp. 427, 429

[23] CIFR Report on Competition in Financial Services, August 2015, p. 6

[24] See Rodney Maddock, 'Four pillars or four pillows? Banking's comfy collective', *The Conversation*, 18 Feb 2014, https://theconversation.com/four-pillars-or-four-pillows-bankings-comfy-collective-23297; and Deborah Healey and Rob Nicholls, 'Enhancing Competition: Challenges for Australian Retail Banking', (2017) 28 JBFLP 48, at 50.

[25] CIFR Report on Competition in Financial Services, August 2015, 91-93. A more recent article by Rob Nicholls, who co-authored the CIFR Report, and Deborah Healey 'Enhancing Competition: Challenges for Australian Retail Banking', (2017) 28 JBFLP 48, also argues that the 'four pillars' policy hinders competitive entry and exit.

[26] Financial System Inquiry, *Interim Report*, July 2014, at 1-13, 2-20; Senate Inquiry into Aspects of Bank Mergers, 2009 at 5.59.

There are also diverging views on whether or not the policy contributes to financial stability. The FSI Final Report recommended the policy should be retained because it argued that concentration in the banking sector, combined with a similarity of business models across banks, has the potential to destabilise the Australian financial system. [27] Others have also held the view that a greater diversity of supply enables better risk management of the financial system.[28] In contrast, the Wallis Inquiry Final Report argued that there would be no significant difference between managing risk from the size of the existing four banks and the size of the banks following any merger. In addition, the CIFR report suggested that the "four pillars" policy may in fact lead to increased risk in the financial system because it encourages horizontal and vertical integration by the large banks in the banking sector.[29]

3.3. Barriers to entry and expansion

In essence, barriers to entry and expansion are obstacles faced by firms seeking to profitably enter or expand at a scale (and scope) that allows them to effectively compete on their merits with incumbents in a market. We consider that barriers to entry and expansion (and therefore to competition) are key to understanding why the high profits being earned by the large banks in Australia have not stimulated new entry or expansion by second tier banks.

In competitive markets, the threat of entry and/or expansion plays an important role in constraining the price, service and investment decisions of incumbents. Where there is a credible threat of entry or expansion, incumbents know that if they earn profits in excess of a fair compensation for risk, or are slow to respond to the changing needs and preferences of consumers by developing new products or new business methods, they could lose market share (and future profits) to rivals. Barriers to entry and expansion tend to weaken, and in the extreme may eliminate, this threat, reducing the pressure on incumbents to constantly strive to improve their offer.

Barriers to entry and expansion can take many forms and may be classed into three broad types: regulatory, structural and strategic. In this submission we provide comments and observations in relation to:

- regulatory barriers to entry and expansion
- barriers associated with the continuing expansion of large retail banks into other financial services markets, and
- barriers to customer switching.

3.3.1. Regulatory barriers to entry and expansion

Financial services in Australia are subject to a range of regulatory requirements, and we consider there are strong market failure justifications for government regulation of financial services markets. For example:

- There are significant detrimental spillovers to other markets in the Australian economy when financial services markets are not fully effective. The FSI Final Report noted:

> Australia should aim to have financial institutions with the strength to not only withstand plausible shocks but to continue to provide critical economic functions, such as credit and payment services, in the face of these shocks.[30]

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[27] Financial System Inquiry, *Final Report*, November 2014, p. 34

[28] Rodney Maddock, 'Four pillars or four pillows? Banking's comfy collective', *The Conversation*, 18 Feb 2014, https://theconversation.com/four-pillars-or-four-pillows-bankings-comfy-collective-23297

[29] CIFR Report on Competition in Financial Services, August 2015, pp. 92-93

[30] Financial System Inquiry, *Final Report*, November 2014, at xviii.

- Absent appropriate prudential standards, a loss of confidence in a large bank can spread across the market, including because financial institutions are interconnected (e.g. banks are linked through inter-bank markets and payment systems). [31]
- Consumer protection regulations are important, otherwise firms may increase profits by behaving in ways that are unproductive and welfare reducing, including by taking advantage of customers' behavioural biases and relative lack of information about how a bank's processes and decisions affect them.

The ACCC acknowledges that maintaining the sustainability and stability of the financial services sector in Australia is an important objective for government to maintain confidence in Australia's financial system.

However, we think the objectives of competition policy are at least as important. Competitive markets are the most effective mechanism to encourage the efficient use of resources. In particular, competitive markets encourage:

- firms to produce and offer products most valued by consumers (allocative efficiency)
- the most productive firms to prosper and see inefficient firms decline (productive efficiency), and
- firms to innovate and invest to build productive capacity for the long term (dynamic efficiency).

While there are exceptions, protecting the competitive process is the most effective way of maximising total economic welfare.

The challenge for government is to regulate to address market failure concerns, recognising that regulation can itself cause failure in markets. This can occur when regulation is excessive to that needed to achieve the regulatory objective or if it induces other types of market failure. For example, government initiatives to protect large players from failing can encourage excessive risk taking by those players (moral hazard).

The ACCC does not consider there to be an inevitable conflict between the twin objectives of a stable financial system on the one hand, and competitive financial services markets on the other. For example, it is not necessary to sacrifice competition policy objectives in order to limit the detrimental spillover effects of poor financial market performance to other parts of the economy. Indeed, competition policy and regulation can help make financial services markets more robust and effective over time and less prone to poor performance and failure. The OECD has said about the banking sector that a:

> more competitive market structure can promote stability by reducing the number of banks that are "too big to fail"… In many countries, competition in the [banking] sector is oligopolistic, so it is difficult to blame excessive competition for the instability that led to the [GFC]. Indeed, in a broad sense, the oligopolistic structure contributed to the [GFC]; it meant that many banks were systemically important, leading to moral hazard, implicit guarantees and excessive risk taking.[32]

Some of the measures that have been put in place by the Federal Government to facilitate stability, including during the Global Financial Crisis (GFC), are now potentially in conflict with the objectives of competition policy and regulation. For example, it has been recognised that since the GFC, Australian ADIs, and especially the large banks, have benefitted from an implicit guarantee, which provides them with a funding cost advantage over non-bank institutions; gives the large banks an advantage over smaller banks; weakens the market

[31] OECD, *Competition in Financial Markets: Key Findings*, 2009 at 7.

[32] OECD, *Competition in Financial Markets: Key Findings*, 2009 at 7

discipline provided by creditors; and potentially causes moral hazard by encouraging inefficiently high risk taking.[33]

There were also a number of regulations introduced prior to the GFC that may be unnecessarily restricting new entry and expansion (from a small base) in financial services markets. For example:

- An institution seeking to be prudentially regulated as an ADI is required to be authorised under the *Banking Act 1959* and subject to APRA's authorisation process.[34] Institutions must satisfy APRA that they are able to comply with minimum requirements with respect to capital adequacy and prudential requirements from the commencement of their banking operations and on a continuous basis. Applicants proposing to use the term "bank" must have a minimum of $50 million in Tier 1 capital.
- The *Financial Sector (Shareholdings) Act 1998* (FSSA) limits an individual's shareholdings in ADIs and insurance companies to a 15% ownership. This is likely to disproportionately affect start-ups and smaller players.

Over time such measures may cause Australia's largest banks to become less disciplined in their approach to risk and give them a competitive advantage unrelated to merit over smaller rivals and prospective new entrants, thereby distorting the process of competition in financial services markets in Australia.

We consider that it is now timely to review these measures to better understand whether they remain necessary and whether they may, perhaps unintentionally, be stifling welfare-enhancing competition in Australian financial services markets.

3.3.2. Barriers resulting from expansion of the large banks into other financial services markets

We note the continuous expansion of the large banks into other financial services markets in Australia, including vertically and horizontally related markets, allowing these banks to bundle their products and cross-sell. This expansion could be pro-competitive to the extent that it reflects efficiencies (economies of scale, scope and network density), customer preferences and/or allows firms to achieve an appropriate rate of return on their investments.

However, in the longer term it could increase or entrench the large banks' market power by increasing barriers to entry and expansion to the extent that it forces rivals to enter/expand at multiple levels of a vertical supply chain and/or supply more products. This could deter entry and thwart expansion by smaller players who otherwise would have provided an important source of competitive constraint on the large banks. In the extreme it could force the exit of smaller players. This would not be in the long term interest of consumers.

Where this expansion occurs through large bank acquisition of an existing business, the ACCC will scrutinise such acquisitions, particularly where the target is a vigorous and effective rival that drives significant aspects of competition in financial services markets such as in relation to price, innovation or product development, even though their market share may be modest.

Australian merger control relies upon the courts as the final decision maker to prevent mergers, which are "likely to have the effect of SLC in the relevant market". Where a merger is likely to result in a significant increase in concentration in a market, courts in the United States adopt a "rebuttable presumption" that the merger is likely to substantially lessen competition and therefore should be prevented from proceeding absent evidence to the

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[33] Financial System Inquiry, *Final Report*, November 2014 at 45.

[34] APRA, ADI Authorisation Guidelines, April 2008.

contrary.[35] Historically, Australian courts and tribunals have not taken this approach in merger cases.

Other than through its merger clearance process, the ACCC is not empowered to directly intervene to influence the formation of less competitive market structures. However, the recently amended s.46, along with the proposed amendments to s.45 (if enacted), will empower the ACCC to investigate and, where warranted, take action against a wide range of anticompetitive conduct in financial services markets. This includes conduct by a large bank that leverages its market power in one financial services market into a (vertically or horizontally) related market for a purpose, effect or likely effect of substantially lessening competition in that related market. The courts have provided useful guidance on the meaning of “likely” and “substantial” in this context (see Attachment A).

We also consider there are a number of ways in which government can influence the formation of more competitive market structures, including by reforming regulations that are making it difficult for new entrants and smaller players to compete with the large banks, introducing open banking and facilitating pro-competitive disruption in financial services markets.

We welcome insights that the PC can provide about the extent to which the expansion of the large banks may be increasing barriers to entry and expansion in financial services markets.

3.3.3. Barriers to customer switching

There are several possible explanations for the observed low rates of customers switching in the banking sector, including the difficulties customers face to switch banks, large banks having faster approval times than smaller banks for residential mortgage products, and large banks having greater expertise than smaller banks in assessing loans to riskier groups such as SMEs.

The ACCC considers that consumers face material (transaction) costs to switch banks. In the first instance, customers encounter costs to ascertain whether the service offering of an alternative bank is better for them and it can be difficult for them to compare the offers of different banks. In some circumstances, they may be better off splitting their banking arrangements between two or more institutions. If they form the view that they can do better by switching to another bank or banks they may to need to go through a number of steps to switch, including:

- presenting themselves in person and showing correct identification to open new account
- taking stock of all their direct debit arrangements and contacting each debtor to advise them of the new account details, and
- taking steps to close the old account once all direct debit arrangements have been transferred over.

These costs have the potential to insulate the large banks to some degree from the threat of losing customers to a rival. We welcome insights that the PC can provide about factors that tend to inflate these costs and/or limit customers’ ability to compare bank offers (e.g. due to differences in product bundling across large banks). We note the government’s open banking initiative and work following the PC’s report on data availability and use, discussed below at section 4.4.

[35] United States Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, 19 August 2010, at [2.1.4] and [5.3].

4. Initiatives to reduce barriers to entry and expansion in the financial services sector

As noted above, we consider it timely that there be a full review of regulatory barriers to competition in financial services markets, with a view to identifying opportunities to reform measures that conflict with the objectives of competition regulation.

In addition to any reform opportunities identified by such a review, we consider that the following measures would greatly contribute to the formation of more competitive financial services markets in future.

4.1. Proposed reforms to permitted use of term "bank"

We support the Federal Government's proposed expansion of the permitted use of the term 'bank'. We consider lowering the minimum of $50 million in Tier 1 capital will help new entrants to the market where their use of the term 'bank' may be an essential component in a new entrants' business model, particularly in its early phases.[36]

4.2. Proposed licensing reforms

We support APRA's proposal on a phased approach to authorising new entrants to the banking industry.[37] We note that a phased approach for licensing ADIs, including the introduction of a Restricted ADI license, is intended to support increased competition in the banking sector by reducing barriers for new entrants being authorised to conduct banking business. A Restricted ADI license would allow applicants to obtain an ADI license while still developing the full range of resources and capability necessary to meet the prudential framework. This measure recognises that the current requirements can discourage new entrants from entering the market and may also lead to the public perception that small banking businesses differ from larger players in terms of prudential and regulatory protection.

We note that in 2014, the UK's Prudential Regulation Authority (PRA) made changes to its bank licensing process to encourage new applications. These changes included:

- a reduction in capital requirements for new entrants to a minimum of £1 million (down from £5 million), and
- the introduction of a two-phase licensing process that allows new entrants to obtain a "restricted license", after which they have a year to raise required capital, hire staff, and invest in technology systems.[38]

As a result of these measures, between 2014 and November 2016, a total of 14 challenger banks had been approved in the UK. As of July 2016, a further 20 entities were reportedly in talks with the PRA to obtain a license.[39] Examples of recent challenger banks in the UK are:

- Atom Bank is a digital-only bank which delivers a range of personal and business banking products through a smartphone app. Atom secured a banking license in June 2015 and launched in April 2016.

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[36] See Exposure Draft Explanatory Materials, *Treasury Laws Amendment (2017 Measures No.8) Bill 2017*.

[37] APRA, Discussion Paper, *Licensing: A phased approach to authorising new entrants to the banking industry*, 15 August 2017.

[38] HoR Standing Committee on Economics, Review of the Four Major Banks: First Report – p58 http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Four_Major_Banks_Review/Report

[39] HoR Standing Committee on Economics, Review of the Four Major Banks: First Report – p58 http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Four_Major_Banks_Review/Report

- Starling Bank is a mobile-only bank which received a banking license in July 2016. It offers a full-service bank account and emphasises transparency and connectivity, with a range of features to help consumers keep track of their finances.

4.3. Relaxation of 15% ownership cap and review of one-size-fits-all approach to prudential regulation

We support the Federal Government's recent announcement that it would relax the legislated 15% ownership cap, whether through the existing ministerial discretion or legislative change.[40]

We welcome further discussion and consideration about how smaller players and new entrants are regulated compared with large incumbents. We agree that when considering prudential regulation, the same requirements do not necessarily need to apply to new entrants.

4.4. Open Banking to make it easier for consumers to switch banks

We strongly support measures to reduce the costs and inconvenience to consumers of switching to a rival bank, particularly measures that improve consumer access to data and make it easy for them to port their account number to a rival.

We see the opportunity in the banking sector today as being similar to the opportunity in the telecommunications industry some 15 -20 years ago where competition between carriers was stimulated by making it easier for customers to switch service providers.

Although the large banks may resist such a measure, in the same way there was resistance to telephone number portability from Telstra 15 -20 years ago, any resistance should not be allowed to stifle an opportunity to empower new entrants and smaller players to more effectively challenge the large banks.

The ACCC notes the PC *Inquiry Final Report into Data Availability and Use* which recommended the legislation of a "Comprehensive Right" for consumers over data, and welcomes the Government's decision to introduce an Open Banking regime in Australia. The PC report examines a range of issues including the benefits and costs associated with making public and private data more widely available, options for collecting, sharing and releasing data, how consumers can benefit from access to data and how to maintain individual privacy and control over data use. These are major reforms that will greatly improve consumers' access to and control over their banking data. We refer the PC to the Review into Open Banking in Australia, currently being undertaken by the Treasury.

In this context, we reiterate the following statement made in our submission to the PC's Inquiry into Data availability and Use:

> Giving consumers the ability to direct a data custodian to copy personal data to a third party is an important component of assisting consumers to compare competing offers, and to make a more informed choice about what best suits their needs. It should also make easier the act of switching from one service provider to another, particularly for more complex products and services where there can be a reluctance to change…
>
> The PC's proposal should also encourage service providers to make more tailored offerings to consumers, and to innovate and market new or different products and services that better meet consumer preferences. This could include new entrants, as

[40] See http://www.budget.gov.au/2017-18/content/glossies/factsheets/html/FS_innovation.htm

empowering consumers to direct data to these start-ups would likely assist in lowering barriers to entry.[41]

We note that in response to the PC's report, the Department of Prime Minister and Cabinet has set up the Data Availability and Use Taskforce. The taskforce is responsible for preparing the Government's response to the PC's report.

We also note developments in the United Kingdom in this area, with the Competition and Markets Authority currently rolling out a mandated Open Banking standard. We also note this is currently under consideration by the Commonwealth Treasury's review into Open Banking in Australia.

5. Facilitating pro-competitive disruption in financial services markets

In recent years, much attention has been given to the potential for new technologies or business models to profoundly "disrupt" industries and trigger a pro-competitive response from incumbents. The potential for welfare improvement from disruptive innovations is potentially greatest in large markets dominated by a small number of incumbents that are slow to adopt new technologies and business models.

As recognised by the OECD, disruptors or "challengers" often take the form of a new entrant or a small player seeking to challenge the market share of large players. They offer customers new ways to satisfy their unmet or under-met needs and wants. Their products and services are often delivered via the Internet or mobile technologies, which permits them to scale up quickly without incurring large sunk costs prior to entry.[42]

We welcome insights from the PC on opportunities for disruptive innovation to potentially transform market structure and firm behaviour in the banking sector, given its data intensity and Australian consumers' demonstrated willingness to embrace product and service delivery via the Internet and mobile technologies.

We also welcome insights from the PC as to how the corporate strategies of large incumbents and/or regulatory interventions may be deterring or delaying the emergence of disruptors in the Australian financial services sector.

We note that not all companies that utilise new technology to deliver financial services (called "Fintechs") aspire to grow their business to seriously challenge the offering of large incumbents. For some the goal is to develop a business into a growing concern and then sell it to an incumbent. However, those that do aspire to continue in the market appear to be vulnerable at the start-up stage to takeover and strategic behaviour by established incumbents.

We invite the PC to consider whether there is any evidence of pro-competitive disruption being stifled in financial services markets. For example:

- The UK experience suggests that "challenger" banks have found it difficult to build scale against the incumbents. Few customers have moved away from traditional deposit accounts despite significant efforts by online and mobile challenger banks. One reason for this may be incumbents' ability to "fast follow" moves by challenger banks. If customer defections to challenger banks accelerate, incumbents can quickly follow with visually appealing front-end offerings or an online bank of their own.

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[41] ACCC Submission to Productivity Commission inquiry into Data Access and Use, January 2017.

[42] OECD Directorate for Financial and Enterprise Affairs Competition Committee, *Key Points of the hearing on disruptive innovation*, 16-18 June 2015

- The FSI Final Report noted that in Australia current regulatory settings impede the development of crowdfunding, and that "Australia is already lagging other jurisdictions in facilitating crowdfunding" (a view supported in a more recent report by Deloitte[43]).[44]
- We note that mobile payment systems have taken off in other countries, e.g. Alipay in China[45], PayTM in India[46], Wing in Cambodia[47], M-PESA in Kenya[48] and Swish in Sweden[49]. We invite the PC to consider why none of these technologies has disrupted contactless payment systems in Australia.

5.1. What can the ACCC and other regulators do to facilitate pro-competitive disruption?

We recognise that the acquisition of small Fintech start-ups by established banks has the potential to lessen future competition in financial services markets. The ACCC relies on s.50 of the CCA to scrutinise takeovers of innovative start-ups. In future, we expect that the work of the FSU will provide additional insights and assist our assessment of whether a proposed future merger or acquisition involving a small Fintech is likely to substantially lessen competition in a relevant financial services market.

Further, if the ACCC forms the view that a large bank or banks are engaging in conduct that may be stifling pro-competitive disruption, we are empowered to investigate and take action, where appropriate, if we are satisfied that the lessening of competition is "likely" and "substantial". This is particularly the case under the newly amended s.46 and if the proposed amendments to s.45 of the CCA are enacted.

We invite the PC to consider how the ACCC and other regulators might keep their regulation technology neutral and not, perhaps inadvertently, stifle pro-competitive disruption in Australian financial services markets.[50]

We also invite the PC to consider whether changes to Government policy, including the "four pillars policy", could facilitate a more competitive banking environment.

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[43] Deloitte and World Economic Forum, *The Future of Financial Services: Impact for Australia*, 2016, at 10.

[44] Financial System Inquiry, *Final Report*, November 2014 at 178, 179.

[45] Alipay was intially created in 2004 as a means of facilitating payments between buyers and sellers on Taobao, Alibaba's business-to-consumer platform, it has since evolved to provide online mobile and payment services. Its primary product is Alipay Wallet, a digital wallet which allows consumers to conduct transactions directly from their mobile device. Similar to PayPal, Alipay is linked to a bank account or credit card via a mobile app. Once this is done, consumers can make payments using the Alipay Wallet, including at point-of-sale and online. At point-of-sale, Alipay uses QR codes to complete transactions, which allows merchants to accept the service without investing in costly payment terminals.

[46] PayTM is an online payments platform that provides consumers with an integrated digital wallet, cash can be transferred into the digital wallet via online banking, debit and credit cards, or by depositing cash via select banks and partners. Consumers can then use the mobile wallet to make payments.

[47] Wing allows consumers to transfer money and pay bills via their mobile phones for a small fee. Consumers without an account can also send and receive money through the company's network of cash express points throughout the country.

[48] M-PESA allows consumers to transfer and pay money using their mobile. Money is stored on an account on the user's phone, and cash can be deposited or withdrawn at one of the network of 40,000 Safaricom agents throughout the country. M-PESA has since expanded into loans and savings products, and has begun to move into other countries including Tanzania, Afghanistan and India.

[49] Swish is a direct payment app that is used for consumer-to-consumer transactions, which are conducted in real time. Transfers on Swish are instant, free of charge, and require only the recipient's phone number to transfer money to them. A study by KTH Royal Institute of Technology credited the app with the reduction of cash circulating in Sweden: https://www.kth.se/en/forskning/artiklar/cashless-future-for-sweden-1.597792.

[50] For example, the ACCC is working with the CFR and ASX to ensure the ASX's Clearing House Electronic Subregister System (CHESS) replacement program will allow interoperation to accommodate new entrants.

6. Conclusion

We consider the ACCC's mandate to examine competition issues in the financial services sector and the PC's Inquiry to be complementary. We look forward to working with the PC as part of its inquiry, with a view to promoting highly effective and competitive financial services markets over the longer term.

Attachment A – ACCC Framework for assessing competition[51]

We view competition as the process of independent and continuing rivalry between firms to win and retain customers on their merits, including by offering the most favourable terms, differentiating their products and developing new products and better production methods.

The competitive process therefore produces winners and losers. Firms that offer lower prices and better products and services tend to win customers at the expense of firms that have higher prices, produce less preferred products, have lower service quality or are less efficient. In competitive markets, market participants are mutually constrained in their pricing, output and related commercial decisions to some extent by the price, service and investment decisions of other market participants (or potential market participants).

In taking action under the CCA, we generally assess competition in the context of specific transactions or conduct under investigation. In our market studies, we consider the state of competition more broadly. In all our competition assessments we consider consumer trends, market structures and firm behaviour (including how firms react to the price and service decisions of rivals).

A.2 Market Definition

The ACCC assesses the state of competition in a market or markets. We define relevant markets having regard to the availability of close substitute products and sources of supply for the good or service in question. This involves consideration of the product and geographic dimensions[52] of the rivalry between firms.

Market definition is not an end in itself, but a means of defining the field of inquiry for a competition assessment. Often the key findings of a competition assessment are not sensitive to whether the bundle of products supplied by firms, or products and services at vertical layers of a supply chain, are considered as a single market or separate markets.

Market definition is "purposive" and therefore assessed on a case-by-case basis, which means that the definition of a relevant market cannot be separated from the particular facts of the matter under consideration. Markets are not static; they evolve so that market boundaries can change (narrow or broaden) over time.

There are a number of issues that can arise in market definition. In the banking context, for example, a product or services forms part of a bundle of products or services that are purchased or supplied together. Such products may be assessed as being supplied in separate product markets or one aggregated market (sometimes referred to as a "cluster market").

To define the relevant markets in these cases, we consider, among other things:

- the split between products purchased or supplied separately, and products purchased or supplied together
- the costs involved in purchasing or supplying the product separately
- any obstacles to purchasing or supplying the product separately, and

[51] Further information about the ACCC's approach to merger assessments can be found in the merger guidelines: www.accc.gov.au/publications/merger-guidelines

[52] Sometimes market definition requires consideration of the functional levels of the supply chain or the timeframe over which substitution possibilities should be assessed. Generally, however, the functional and temporal dimensions of market definition are included in the product and geographic analysis.

- any assets or specialisation required to supply each product.

In defining a market involving vertically integrated firms, we will consider whether competition analysis is best conducted in the context of one relevant market enveloping multiple vertical layers of a supply chain or a series of separate markets each comprising one or more vertical layers of the chain. There need not be actual trade occurring between the different levels of the vertical supply chain for there to be separate markets. The potential for trade can be sufficient.[53]

To define the relevant markets where vertical integration exists, the ACCC will usually take into account, among other things:

- the patterns of exchange between firms at different vertical levels
- the split between internal transfers of each relevant product and third party transactions
- the costs involved in trading the product between firms at different vertical levels
- any obstacles to trade between firms at different vertical levels, and
- any assets or specialisation required to supply each product within the vertical chain.

A.3 Future with and without

In assessing the impact of particular conduct on competition, the ACCC and courts have tended to adopt a framework which looks at the likely state of competition "with" the impugned conduct, and compares it to the likely state of competition "without" the impugned conduct (sometimes called the counterfactual), to assess whether the conduct is likely to have the effect of substantially lessening the level of competition that would otherwise occur.

Some of the key articulations of the "with and without" framework by Australian courts and tribunals were developed in the authorisation context, where proposed conduct is evaluated. As a result, when articulating the test, courts and tribunals necessarily focused on the future with and without the proposed conduct. In the context of alleged anti-competitive conduct, existing and past conduct is often under examination, meaning the test will not necessarily be forward looking from the point at which the assessment is being conducted, but rather needs to assess the impact on competition from the time the relevant conduct occurred.

To illustrate, in *Dandy Power* (1982) Justice Smithers expressed the test as follows:

> To apply the concept of substantially lessening competition in a market it is necessary to assess the nature and extent of the market, the probable nature and extent of competition which would exist therein but for the conduct in question, the way the market operates and the nature and extent of the contemplated lessening. To my mind one must look at the relevant significant portion of the market, ask oneself how and to what extent there would have been competition therein but for the conduct, assess what is left and determine whether what has been lost in relation to what would have been, is seen to be a substantial lessening of competition.[54]

A.4 "Likely" and "Substantial" lessening of competition

Some conduct, such as the formation of cartel agreements, is prohibited *per se*.

The threshold determining when conduct otherwise raises concerns under the CCA or is anti-competitive is when the conduct is considered to have the purpose, effect, or likely

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[53] *Queensland Wire Industries Pty. Ltd v The Broken Hill Proprietary Company Limited & Anor* [1989] HCA 6.

[54] *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) 944 ALR 173 at 191.

effect of SLC in the relevant market. The precise point a lessening of competition becomes "substantial" is a matter of judgement and will always depend on the particular facts under consideration.

"Substantial" is not a defined term in the CCA, but has been interpreted by Australian courts as follows:

- In *Rural Press v ACCC* (2003), the majority of the High Court stated:

> The relevant questions in this case are whether the effect of the arrangement was substantial in the sense of being meaningful or relevant to the competitive process…[55]

- In *Universal Music v ACCC* (2003) (FFC) the Full Federal Court observed:

> The lessening of competition must be adjudged to be of such seriousness as to adversely affect competition in the market place, particularly with consumers in mind. It must be "meaningful or relevant to the competitive process": *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* [2000] FCA 38; (2000) ATPR 41-752 at para 114.[56]

- "Substantial" is interpreted in a qualitative way. For example, in *ACCC v Baxter* (2008), Justice Gyles observed in relation to the entire phrase "substantially lessening competition":

> Substantially lessening competition is not the same as monopolising a market and is not to be judged only on a quantitative basis.[57]
>
> "Substantial" is a relative concept, and does not require that there be an impact on the whole of the market in question.

"Likely" also is not a defined term in the CCA, but has been interpreted to mean a "real chance or possibility" that a substantial lessening of competition will occur. In the Full Court decision of *Monroe Topple* (2002), Justice Heerey expressed the test as:

> "Likely" does not mean "more likely than not". It is sufficient that there is a real chance or possibility that a substantial lessening of competition will occur.[58]

This characterisation has been referred to in a number of other Full Court decisions, including *Universal Music Australia v ACCC* (2003)[59] and *Seven Network Ltd v News Limited* (2009).[60]

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[55] *Rural Press Ltd v ACCC* (2003) 216 CLR 53 at [41].

[56] *Universal Music Australia Pty Ltd v ACCC* (2003) 131 FCR 529 at [242].

[57] *ACCC v Baxter Healthcare Pty Ltd* (2008) 170 FCR 16 at [391].

[58] *Monroe Topple & Associates Pty Ltd v Institute of Chartered Accountants in Australia* (2002) 122 FCR 110 at [111]. Justice Heerey referred to the decision of Deane J in the s 45D case *Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees' Union* (1979) 42 FLR 331 in support of this proposition.

[59] (2003) 131 FCR 529.

[60] (2009) 182 FCR 160.