

Notes

1 Sources of Bank Behaviour and Institutional Change: Interactions among Structures, Institutions and Agents

1. Prudential supervision is supervision of balance-sheet ratios and risk diversification including off-balance sheet risks, on-site inspection and external auditing. It involves the supervision of balance-sheet ratios with special reference to capital adequacy or liquidity and of norms aimed at a proper diversification of risk exposure. It is an essential objective of financial policy for attaining the objective of the prevention of systemic risks (i.e., risk of widespread contagion-failure in a company spreads to entire organisation and/or industry). Bank merger regulation relates to competition policy. It is about prohibition of restrictive business practices and cartels (OECD, 1992: 34–35). In other words, prudential regulation aims to minimise their chance of insolvency – inability to meet demands of creditors which may lead to bankruptcy. The merger regulation, on the other hand, mainly refers to preventing ‘undue concentration of economic power’ (Ibid.: 32).
2. New prudential and disclosure regulators constituted the ‘twin peaks’.
3. I thank Timothy Legrand for drawing my attention to Archer’s ‘the morpho-genetic cycle’.
4. This conceptualisation is based on an insight provided by the literature on institutional complementarities that will be discussed below.
5. A light supervisory touch – flexible and informal style of regulation – is considered as a characteristic of British regulatory culture. BOE and FSA had adopted this approach before the GFC.
6. I thank Graeme Hodge for helping me develop this figure.
7. I thank John Campbell for helping me develop this table.
8. Sub-prime lending refers to any lending that has increased credit risk.
9. Mortgage market structure will be discussed in section 1.4.5.
10. The HHI measures market concentration and equals the sum of the squares of the four largest banks’ market share in total industry assets. It can vary from 0, representing perfect competition, to 1, representing monopoly.
11. Although Cohen considers the British Pound as an elite currency along with the Australian and Canadian Dollar, and the Swiss Franc, this study considers it as a patrician currency. This is because the City of London is a world financial centre after New York where sterling denominated securities are also issued by foreign banks (see McKinsey and Company, 2007); amounts outstanding and net issues of debt securities by currency in global capital flows show that the British Pound is the third currency, after the US Dollar and Japanese Yen (IMF, 2008a: 146).
12. Light-touch approach in financial supervision and regulation that prevailed in most of the capitalist economies can be summarised as follows:

Markets are in general self-correcting, with market discipline a more effective tool than regulation or supervisory oversight through which

to ensure that firms' strategies are sound and risks contained. The primary responsibility for managing risks lies with the senior management and boards of the individual firms, who are better placed to assess business model risk than bank regulators, and who can be relied on to make appropriate decisions about the balance between risk and return, provided appropriate systems, procedures and skilled people are in place. Customer protection is best ensured not by product regulation or direct intervention in markets, but by ensuring that wholesale markets are as unfettered and transparent as possible, and that the way in which firms conduct business (e.g. the definition and execution of sales processes) is appropriate (FSA, 2009: 87).

13. Recently, key elements of good financial supervision have been defined by the IMF staff as intrusive, sceptical, proactive, comprehensive, adaptive, and conclusive. To achieve these elements, the 'ability' to supervise, which requires appropriate resources, authority, organisation and constructive working relationships with other agents must be complemented by the 'will' to act. Supervisors must be willing and empowered to take timely and effective action, to intrude on decision-making, to question common wisdom, and to take unpopular decisions. Developing this 'will to act' is a more difficult task and requires that supervisors have a clear and unambiguous mandate, operational independence coupled with accountability, skilled staff, and a relationship with industry that avoids 'regulatory capture' (Viñals and Fiechter, 2010: 4).

2 Institutional Theory and Varieties of National Financial Systems

1. However, peak associations are not always significant actors in policy networks. As will be shown in Chapter 5, the major banks in Australia mobilised individually rather than collectively.
2. Moran first made the distinction between the concepts 'esoteric' politics and 'exoteric' politics in financial policymaking. He defined British banking politics as 'esoteric' prior to 1970. By this he meant that the term 'esoteric' points to a private, informal and technical tendency in banking policy discussions (Moran, 1984).

3 The Sources and Consequences of Bank Behaviour

1. Strong here refers to financial soundness which is above the median of a peer group.
2. ADIs are the only financial firms permitted to accept deposits and, thus, they are subject to prudential regulation. As of 2010, ADIs include 11 banks (4 major banks and 7 smaller banks), 11 building societies and 112 credit unions. There are also 9 foreign banks operating in the Australian market through locally incorporated subsidiaries, and 34 foreign banks have branches in Australia (Donovan and Gorajek, 2011).

3. Most foreign banks could not obtain banking licences and establish subsidiaries until 1985, when Australian banking was opened to foreign bank competition (see Pauly, 1988). In February 1985, 16 foreign banks were permitted to establish local banking subsidiaries but they were required to confine their deposit-taking activities to the wholesale market. In 1992, the foreign banks were allowed to establish branch operations to conduct wholesale banking. However, despite these restrictions foreign banks participated in the financial industry through corresponding arrangements with Australian banks, through representative offices, and through the activities of foreign-owned merchant banks (Skully, 1987; Edey, 1996: 26–29).
4. Most recently, the major banks have increased their market share of ADI assets at about 10 percentage points since 2005. This was partly due to two acquisitions of smaller banks in late 2008: Westpac acquired St. George Bank, the fifth largest bank at the time, and Commonwealth Bank acquired the eighth largest bank at the time, the foreign-owned Bankwest in October 2008 and in December 2008, respectively.
5. It should also be noted that there has been a relative decline in the interest margin as the Australian banks have adopted a ‘user pays’ approach which resulted in higher fees (see OECD, 2010; Bakir, 2004).
6. Mortgage market products in Australia include home equity loans, low-doc loans, high loan-to-valuation ratio (LVR) loans, interest-only loans, non-conforming, shared appreciation and reverse mortgages (see RBA, 2005).
7. The four largest banks in New Zealand are owned by Australian banks: the Australia and New Zealand Bank (a subsidiary of the ANZ), Auckland Savings Bank (wholly owned by CBA), Bank of New Zealand (owned by NAB), and Westpac (a subsidiary of the Westpac Banking Group).
8. Unfortunately, an internationally comparable wholesale funding use measure is not yet available due to a lack of data.
9. The financial deregulation of the 1980s included the removal of ceilings on interest rates, abolition of banks’ lending limits, floating the A\$, abolishing exchange controls, and licensing 16 foreign-owned banks. (For extensive review and discussion of financial deregulation in Australia, see Edey, 1996)
10. Carmichael was also the former chairman of APRA and member of Wallis Committee.
11. I thank Vivien Schmidt for pointing to this work.
12. This view contrasts with Kelly who argues that ‘the 1980s campaign to reinvent the Australian political tradition was driven by economic crisis... [T]he issues for the 1990s are the speed with which the Settlement is dismantled and the nature of the system which replaces it [that is neoliberalism]’ (Kelly, 1994: 13–14).
13. Following HIH’s collapse, APRA introduced a Probability and Impact Rating System (PAIRS), to classify regulated financial institutions in two areas: the probability that the regulated entity might be unable to honour its financial promises to beneficiaries including depositors, policyholders and superannuation fund members; and the impact on the Australian financial system should the institution fail.

4 The Political Economy of Prudential Regulation in Australia

This chapter is based on Bakir (2003, 2009).

1. For comprehensive overviews of the Wallis Report, see Harding (1997); Lewis (1997); Harper (1998); Perkins (1998).
2. The term 'entity-specific' is preferred in this book to widely used 'institution-specific' term to reflect the intended meaning.
3. Toohey (1994: 150) uses the term 'official family' as 'the main economic advisory bodies... [which]... include the departments of Treasury, Finance, and Prime Minister and Cabinet, the Reserve Bank and the Industry Commission' in order to point to actors who input into economic policy. However, as will be shown later, the family members do not have equal powers. In fact, the Treasury dominated and shaped the policy debate during the Wallis era.
4. Superannuation is a key element of government policies to address the long-term consequences of an ageing population. The Wallis Report found that:

Australia's ageing population has led successive Commonwealth governments to mandate compulsory superannuation to encourage individuals to bear greater responsibility for their retirement funding. This has resulted in a growing proportion of the nation's financial wealth being invested in superannuation relative to other investment vehicles. In addition, it has caused a shift in household assets towards market-linked investments, meaning that households are directly bearing a greater proportion of investment risk than in the past. (FSI, 1997: 119)

In addition, superannuation is both a public policy instrument and a financial product. Accordingly, there was a case for prudential regulation of the superannuation sector. It has been pointed out that:

The compulsory nature of some superannuation savings, the lack of choice for a large number of members, the mandatory long-term nature of superannuation and the contribution to superannuation of taxation revenue forgone provide a case for prudential regulation of all superannuation funds, even where investors have knowingly accepted market risk. (Treasury, 2001b: 2)

5. It has been argued by the Treasury that consumers assumed that the RBA's supervision implied that bank deposits were guaranteed by the government, and that this guarantee also extended to superannuation, and the life and general insurance products offered by the banks (Treasury, 1996: 4).
6. The RBA had responsibility for banks; the ISC had responsibility for insurers and superannuation funds; the ASC was responsible for the enforcement of the market conduct and disclosure requirements; and the state and territory-based State Supervisory Authorities had responsibility for building societies, friendly societies and credit unions under the administration of the AFIC.
7. The article was published by the Centre of the Study of Financial Innovation located in London.

8. Particularly, a significant factor behind the need for the 'twin peaks' approach was knowledge about the obsolescence of institutional regulation in the financial services industry where institutional, sectoral, and product boundaries were eroding due to technological and technical innovations in finance (Taylor, 1995). Although Taylor proposed the model for the UK, its influence in Britain was more limited. Taylor disagreed with the decision to create a single regulator (i.e., Financial Services Authority) for the UK.
9. Taylor's 'twin peaks' chapter was cited in the Inquiry's Discussion Paper (FSI, 1996: 415). Oddly, it was neither cited in the bibliography to the Inquiry's final report (FSI, 1997) nor in that of the Treasury submission (1996). In their submissions to the Inquiry, on the other hand, the National Australia Bank (NAB, 1996: chapter 6: 12) provided support whereas the RBA (1996: 131) offered alternatives to the 'twin peaks' idea with direct references to Taylor (1995).
10. The Wallis Committee met with a large number of organisations and individuals, both in Australia and overseas. Appendix B of the Inquiry's final report lists institutions and individuals that the Committee met with (FSI, 1997: 717–722). Oddly enough, Taylor was forgotten in this list. In addition, he was not affiliated with any of the listed institutions at the time.
11. Kingdon (1995: 174) notes that there are two categories of policy windows: 'problem window...opened by a problem that presses in on government,' and 'political window...opened by an event in the political stream – a change in administration, a shift in national mood, an influx of new members of Congress.'
12. Of course, in the cut-and-thrust of political debate, arguments for the Inquiry were inevitably framed in terms of the need to react to problems. As will be detailed later, the problems, however, were those likely in the future, not those in the past.
13. On 21 October 1998, Costello used the words 'twin peaks' at the International Conference of Banking Supervisors in Sydney in referring to this new organisational framework for the regulation of the financial system.
14. Costello was elected a member of the House of Representatives in 1990. During the period the Liberal Party was in Opposition until 1996, he served as shadow minister in a number of areas including shadow Minister for Finance and shadow Treasurer.
15. Both Howard and Keating established financial system inquiries as Treasurers before they ran for party leadership and the prime ministership. To illustrate briefly, in January 1979, Howard established the Campbell Committee of Inquiry into the Australian financial system as Treasurer of the Fraser government. The Committee presented the final report to Howard on 29 September 1981. In September 1985, his colleagues elected Howard as leader of the Liberal Party. He subsequently became Prime Minister on 11 March 1996. Paul Keating became Treasurer when the ALP returned to government on 11 March 1983. On 15 October 1983, he formed the Martin Committee of Review to assess the Campbell Report. In February 1984, the Martin Review Group endorsed the Campbell Report. Keating served as Treasurer until 1991. He replaced Bob Hawke as leader of the ALP and Prime Minister in December 1991 and led the ALP to its fifth term of government in March 1993. Unsurprisingly, 28 days after the Cabinet endorsement of the Wallis

recommendations on 2 September 1997, Costello's claim for future leadership was for the first time on a newspaper headline (see *Australian Financial Review*, 30 September 1997).

16. As the *Sydney Morning Herald* pointed out 'Evans's response also indicates that the Reserve Bank and three of the four major banks [ANZ, CBA, WBC], which have been lobbying hard against the prudential shake-up, may be about to lose out' (*Sydney Morning Herald*, 8 July 1997).

5 The Political Economy of Competition Regulation in Australia

This chapter is based on Bakir (2004, 2005).

1. Throughout this study, merger refers to 'an amalgamation of two or more firms into a new firm' (Rutherford, 1995: 256).
2. Knowledge refers to '[a] well-probed belief, whether empirical or evaluative' (Lindblom, 1990: 123).
3. A full treatment of the factors associated with the history and evolution of bank merger regulation, and discussion of its practical and theoretical aspects in Australia extends beyond the scope of this chapter. For a comprehensive review of the Australian merger policy, see special issue of the *Australian Economic Review*, 1998, 31(1); Goddard (2000: 181–248).
4. The Act does not provide guidance on how the Treasurer is to exercise his discretion while stating that the Treasurer's consent shall not be unreasonably withheld. In practice, the Treasurer considers 'any prudential considerations, the potential efficiency gains resulting from any rationalisation, and any potential losses resulting from reduced competition in the financial sector' (Treasury, 1996: 143).
5. These laws required an approval from the Treasurer for any party wishing to buy more than 15 per cent of a bank or insurance company shares.
6. *Business Review Weekly*, in its 500 biggest Australasian companies survey, noted that the NAB, the CBA, the ANZ and the WBC were ranked the 1st, the 4th, the 5th and the 7th respectively in net profits totalling A\$2,869 billion in 1997. The NAB, the CBA, the ANZ, and the WBC were ranked among the biggest ten companies in Australasia as measured by market capitalisation in 1997 (see *Business Review Weekly*, 28 April 1997: 66).
7. To illustrate, the NAB, the WBC, the ANZ and the CBA were ranked in 64th, 84th, 89th, and 101st respectively among the world's top 1000 banks in total assets in 1996: see *The Banker*, July 1997: 147.
8. An overdraft is a credit facility which is given by a financial institution to a corporation. The aim is to allow a bank's customer to obtain credit on its current account in excess of the account balance.
9. The word 'potential' is used here because there is no automatic transfer of a power potential into an exercise of power (Coleman, 1996: 47).
10. The analysis of the AEC's annual returns between 1995–1998 revealed that 14 firms operating in the banking and finance sector were the largest donors among Australian Stock Exchange listed companies to political parties with A\$2,974,252 (Ramsay, Stapledon, and Vernon, 2001: 36). All

of these 14 firms donated A\$1,709,661 to the Liberal Party whereas 10 out of 14 firms gave A\$1,030,619 to the ALP. In particular, the WBC with A\$1,272,346 was the largest direct donor while the NAB with A\$455,330 placed ninth among the publicly-listed company donors during this three year period (ibid.: vii).

11. It should also be noted that figures released by the Electoral Commission did not actually disclose the true magnitude of financial benefits because the *Electoral Act* was not requiring disclosure of all political donations (see *Australian Financial Review*, 20 April 2001: 72). For instance, loans made to political parties, donations made through foundations and a loan write off by a bank were not captured by the Commission's reports. As will be shown below, in fact, the NAB was the largest corporate donor to the Liberal Party.
12. The concept of 'banking policy community' refers to both key regulators and regulated firms in the banking sector.
13. Bell and Warhurst argued that 'large Australian corporations [which also included the four largest banks and the AMP] interact with governments' through 'a new mechanism:...government relations function' (Bell and Warhurst, in Bell and Wanna, eds, 1992: 65). Conversely, the Australian banking community has a long history and strong experience in direct lobbying through their public and government relations departments. An interest in such departments was born in response to the nationalisation attempt in 1947 (May, 1968: 129–130). Further, contrary to the generalisation of Bell and Warhurst (1992: 65) that the large corporations mobilise via government relations divisions '[i]n response to changes in government policies which they perceived as a threat to their firms' interests...' such large corporations may mobilise to exploit the opportunities presented by, for example, a new government and/or an Inquiry as the majors did.
14. The FSU was representing the interests of 115,000 staff employed in the banking, insurance, credit union and friendly society sectors in 1995.
15. The figure corresponds to almost 22 per cent of the total number of employees (160,150) working in the four major banks in 1996. (For distribution of employees among the four banks, see *The Banker*, July 1997: 142). Employment in the financial services industry declined from 365,000 (almost 4.5 per cent of total wage and salary earners) in 1990, to below 300,000 (or 3.5 per cent) in mid-1995 (NAB, 1996: 11). 40,000 full-time jobs over the five years between 1992 and 1997 were lost alone from the four major banks (Burke, 1998: 336). During the six years between 1990 and 1996, the biggest four banks, especially the CBA and the WBC, cut 47,000 jobs (see Flint, 1997: 25).
16. The serious implications of bank mergers in rural and regional Australia were recognised by the ALP, which was also competing for rural and regional votes before the 1998 federal election. Evans argued that 102 country communities lost their bank branch between 1995–1998 and a further 201 rural towns were under threat (Hudson and Ferguson, 1998: 3).
17. Small business is defined as one that is independently owned and employs fewer than 20 people. This sector constituted almost 50 per cent of the workforce in all private sector business employment with 3.5 million people in 1996 (see McLennan, 1997: 1).

18. There was no empirical evidence supporting improvement in small business lending and bank mergers in Australia.
19. For example, Rob Bastian of the Council of Small Business Organisations of Australia said: 'The Government has also said it would look at ways to help small business get better access to equity capital. We expect good things because I believe John Howard has a good feeling for the sector' (cited in *Sunday Age*, 10 March 1996).
20. See also *Canberra Times*, 6 April 1997.
21. Section 12 of the Bill stated that the APRA *may* consult with other regulators including the ACCC and the ASIC about the competitive and corporate effects of transfers that need to be assessed.
22. Among the interest organisations opposing the merger policy change, the FSU was the only active one in the legislative debates. On 29 April 1999, the FSU appeared before the Senate Economics Legislation Committee to argue that the government was trying to dismantle the 'four pillars' policy by eroding the Treasurer's veto powers, and the ACCC's role in merger process.
23. For the required amendments, see '*Financial Sector (Transfers of Business) Bill 1999*'.
24. Following the approval of the Senate's amendments by the House of Representatives, these bills became effective in July 1999.
25. For the comparison of the domestic competition issues regarding bank mergers and the process of merger review by competition regulators in both Australia and Canada with special reference to mega bank merger policy bans, see Goddard (2000).
26. The author thanks William D. Coleman for this point.

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