TITLE: **Piggy banks telling porky pies over the costs of borrowing**

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Capricious rate rises undo customers' efforts to find the best deal.

Australia's banks seem to have embraced the credo that if you are going to tell a lie, you might as well tell a big one. One of the biggest is that when the Reserve Bank lifts official interest rates, the banks have no choice but to pass on the rate rise in full to their home loan customers. This sounds credible on a first hearing, but it simply doesn't fit with the way banks operate nowadays.

Banks source the money they lend us in a variety of ways, including our savings accounts (on which they pay us a pittance), from overseas lenders (on which they don't pay the official interest rate) and from the Australian money market (where they do pay the official interest rate). Only about one-third of the banks' funds come from the Australian money market, which means that when the official rate rises by 1 per cent, the banks' costs only rise by about a third of 1 per cent.

Put simply, when the big four banks pass on the RBA rate rises in full - and then some - their profits increase accordingly. They do so simply because they can, without fear that governments will intervene or that consumers will leave in droves. Why switch banks when the rest are just as bad?

When Joe Hockey began talking about the need for reform in the banking sector, Labor missed a wonderful opportunity both politically and in policy terms. It could have appointed Hockey chairman of an inquiry into banking reform, thereby making the opposition responsible in part for the outcome and highlighting the tension between the Liberal Party and its traditional business-based constituency.

Moreover, such an inquiry could have shown how the new minority government could work differently, and at the same time expose how flawed the current banking regime is. In other words, the government could have united Parliament in a battle against the most powerful companies in the country.

The rhetorical battle now is apparently between a "calm and considered approach" to reform, as Wayne Swan advocates, and quick and decisive action, which Hockey demands. The emphasis on division, which actually conceals underlying agreement, is not a great start to what will be a tough battle to defend bank customers against the might of the big banks.

The interests of all the political parties will be better served by presenting a united front on the need for reform, even if there are some differences about the best way forward. So where to from here?

Hockey's **nine-point plan** is a great start. After enduring an uncomfortable few days as his proposals were scrutinised, Hockey is now seen by many Australians as a hero - the guy who's prepared to take on the banks. Never mind that the Greens have a long-standing bill before the Parliament to, among other things, abolish ATM fees.

The government's focus on short-term media strategy by rebuking and ignoring these ideas has turned out to be poor long-term political strategy. Backed up by advice from Treasury, the government will identify flaws in the various proposals. But, again, the only winner from this approach will be the banks.

So what should be done?

First, the government could ensure that when someone signs a variable interest mortgage contract, it is understood that they are signing up to pay a fixed mark-up over the official interest rate. While the official rate may vary over the course of the loan, the profit margin earned by the bank would remain steady.

This would ensure that all the effort by consumers to identify the best product isn't made redundant by bank executives in search of a bigger bonus. The principle of transparency could be extended to other banking products, with the official rate and mark-up provided on every statement.

Everyone in this debate (even the banks, if you believe them) agrees that more competition is a good thing. To encourage people to vote with their feet, let's make bank account numbers work like mobile phone numbers: portable from one provider to another, with the onus on the provider to do all the hard work to switch you over.

Another way to bring the banks into line is to give our regulators more teeth. The big four are too big, controlling $4 of every $5 that's borrowed and lent in Australia. If the body responsible for promoting competition, the Australian Competition and Consumer Commission, were able to break up banks that got too big (instead of just preventing mergers), then the excessive concentration of market power that has developed since the early 1980s could be mitigated.

Going further, the government could enforce structural separation between different bank functions (deposit-taking, lending, funds management and so forth). This would prevent customers suffering when banks get too enthusiastic about elaborate subprime investment strategies.

These aren't radical ideas; most have been put in place in other countries. But Australia is in an almost unique position in not having properly learnt the primary lesson of the global financial crisis: that strong regulation of the financial sector is good public policy.

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