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Competition in the Australian Financial System
Productivity Commission
GPO Box 1428
Canberra ACT 2601
By email financial.system@pc.gov.au

# Competition in the Australian Financial System Productivity Commission Draft Report, January 2018

Dear Sir/Madam

Thank you for the opportunity to comment on the *Competition in the Australian Financial System Productivity Commission Draft Report*.

MyState Limited (MYS) is the Non-Operating Holding Company of a diversified ASX listed group and is a provider of banking, trustee and wealth management services to customers across the country through our retail brands - MyState Bank, The Rock and Tasmanian Perpetual Trustees.

MyState Limited was formed in September 2009 following the merger of MyState Financial Limited, an authorised deposit-taking institution, and Tasmanian Perpetual Trustees Limited (TPT), a trustee and wealth management company. On 1 December 2011, MyState Limited acquired The Rock Building Society Limited (The Rock) based in Rockhampton Queensland. On 6 October, 2014, following authorisation from the Australian Prudential Regulation Authority (APRA) MyState Financial Limited changed its name to MyState Bank Limited (MyState).

MYS has approximately 210,000 customers across Australia and approximately 64,000 shareholders. MyState Bank Limited is a member of the Australian Bankers Association (ABA) and an affiliate member of the Customer Owned Banking Association (COBA).

We believe small and regional banks play a key role in the Australian financial system, however as a result of ongoing prudential settings and regulatory change, the financial system has evolved to the competitive detriment of the small and medium Authorised Deposit-taking Institutions (ADI)'s.

There has been a long term tendency toward increased concentration in the hands of the major banks, which has progressed unabated and has been enabled by the regulatory playing field and continuing implicit government support for the major banks. This has provided a significant advantage to the major banks to maintain and grow profitability and market share.

We believe the Government needs to examine ways to make the framework in which the industry operates to achieve competitive neutrality.

We acknowledge the draft report is a strong endorsement of the views raised by small and medium banks in response to the consultation paper. We support the regional banks second submission dated March 2018 to which MyState was a contributor. In addition, we emphasise the following opportunities to create further competition in the banking industry.

## Opportunities to create further competition in Australia's Financial System

### The Majors oligopoly

The draft report found that Australia's banking industry is a strong oligopoly with a long tail of smaller providers. We recognise the oligopolistic structures inherent within the Australian banking industry are an impediment to competition and strongly endorse policies to achieve competitive neutrality and enhance the ability of smaller ADI's to compete.

The Productivity Commission's (PC) draft report notes the major banks are increasingly expanding their dominant position into markets traditionally served by smaller banks and focusing on home loans rather than historic areas of focus such as business lending. It also notes the Reserve Bank estimated the funding advantage for the major banks over smaller banks to have averaged around 20 to 40 basis points from 2000 to 2013 - worth around $1.9 billion annually to the major banks.

This is in addition to economy of scale advantages that the major banks have, resulting in lower cost to income ratios than the smaller banks and further advantages to the major banks who are able to achieve higher returns, and therefore, reinforcing oligopolistic structures and market power of the major banks, to the detriment of competition and the smaller banks, the Australian consumer and the stability of the banking sector with increasing concentration risk.

We have a strong focus on our customers in all interactions and believe a customer centric culture is one of the key components for the smaller banks to win business in the current market. The recent failures of conduct in the larger banks have had an adverse impact to the overall image of the banking sector and has eroded the trust and confidence in the sector as a whole, notwithstanding many smaller banks have not engaged in the types of practices and behaviours now under such scrutiny.

### Cost of APRA interventions on home loans

The draft report found that the prudential and macro-prudential regulations imposed by APRA were excessively blunt and have either ignored or harmed competition and provide the major banks an even greater competitive advantage.

The macro-prudential interventions have left smaller ADIs with even less scope to challenge the already dominant position of the major banks. Whilst the macro-prudential intervention has enabled larger banks, which typically have much higher proportions of their loan portfolios as investor loans or interest only loans compared with smaller ADIs, to use their market power to increase pricing on these loans, improve margins and profitability to the detriment of competition for the customer. The APRA cap has inadvertently provided disproportionately more financial benefit to the major banks and at the same time reduced scope for effective competition within these segments.

Along with other smaller regional banks, we are keen to explore mechanisms that still support the desire for macro-prudential targets to be met however without detrimental impacts on competition and consumer choice.

We acknowledge the difficulty of applying regulatory constraints across such a diverse industry, however, a "one size fits all approach" to regulatory change is inequitable, unfair and ultimately anti-competitive. This approach can lead to more consumers approaching the non-APRA regulated non-bank industry to meet their borrowing needs, thus undermining the original intention to enhance financial stability.

The macro-prudential interventions have had and will continue to have significant impacts on competition in the banking industry. We strongly support the Commission's recommendation that APRA conduct and publish quantitative post-implementation evaluations of its macro-prudential policy, including costs and benefits to market participants and the effect on competition in a timely manner. In addition to this, we suggest that APRA conduct industry consultation on the design of the measures prior to their implementation to ensure unintended consequences do not ensue.

## Cost of funds for different size banks

The long term tendency toward increased concentration in the hands of the major banks has been accompanied by growing economies of scale enjoyed by the major banks. Increased scale has enabled lower cost structures, improved credit ratings, and the ability to access lower funding costs. The major banks have used these advantages to yield higher returns on products than that of smaller regional banks.

Earlier in 2017, the rating agency Standard and Poors' issued credit downgrades on almost all of the smaller regional banks, however did not downgrade the major banks because of the implicit support provided by the government to the systemically important major banks. Notwithstanding the introduction of the bank liability tax, the major banks still enjoy artificial funding cost advantages, providing them with a significant competitive advantage.

Further policy reform is needed to reduce the artificial funding cost advantages enjoyed by the major banks.

## Capital requirements

When it comes to risk weighting, smaller ADI's use an APRA-prescribed approach called the 'standardised' approach, whereas the major banks use an approach called internal ratings based (IRB). This IRB approach requires significantly less capital to be held by major banks against the same loan that would be provided by a smaller ADI applying the standardised approach. This differentiated risk weight approach provides the IRB banks a significant pricing advantage as they can return more superior returns on equity than smaller regional banks for loans issued to customers at the same rate.

It has been acknowledged that the major banks have invested in significant systems and modelling capability to be accredited as an IRB bank and the application of lower risk weights for lending recognise that fact. However, it could be equally posited that the major banks are inherently more complex institutions and with complexity comes significant risk and this complexity is not adequately incorporated into the IRB approach. While APRA has taken some positive steps to address the risk weight differential between the IRB banks and standardised banks, there is still more work to be done to ensure the smaller ADI's are not severely disadvantaged and the Australian consumer adversely impacted through a system which effectively reduces competition.

## Home loans through the Broker industry

We strongly support the broker industry and smaller regionally based ADI's rely on third party distribution channels to effectively compete with the scale and geographic advantages of the major banks.

The draft PC report found the growth in mortgage brokers does not appear to have increased price competition. We would argue that mortgage brokers are providing more choice for consumers and provide an effective point of market entry for smaller regional banks. However, we acknowledge that the channelling of products offered to consumers through the vertical integration of brokers may mean that some consumers are not given the choice of products that are most suited to them.

Further, the ownership of aggregators by lenders (or lending by aggregators on their own behalf), increases the potential conflicts of interest for brokers and carries the obvious risk that consumers have an illusion of choice rather than genuine choice in the market. Brokers should act in the best interests of the customer and a 'best interest' duty may be a way to achieve this. Ensuring the broker customer understands the identity of the broker's owner is an important factor when the customer is making a decision on which lender to proceed with.

## New competition functions for a regulator

We endorse regulatory reforms that seek to level the competitive playing field. We support the ACCC joining the Council of Financial Regulators (CFR) and forming the role of the 'Competition Champion' for the banking industry. We support the ACCC over ASIC in this function due to ASIC's focus and expertise being on supporting and protecting the consumers interests as distinct from promoting competition.

We support the Commission's recommendations of pre-implementation analysis by the Competition Champion of its macro-prudential policies, including costs and benefits to market participants and the effects on competition.

With the consistent scrutiny on increasing trust in the banking industry, we would like to see the CFR increase their transparency around their decision making. This is essential to ensure accountability and an active consideration of the effects on competition.

## Closing

We are pleased with the findings the draft report has presented and the positive steps the Commission has recommended to address competition in the Australian financial system. The gaps identified prove that the industry is a very concentrated within an oligopolistic market structure that needs to be addressed.

We are also strongly supportive of closer scrutiny over the differently regulated non-bank lenders. We believe this is fundamental to ensuring fair competition across the whole Australian financial system.

We welcome discussion on the need for a 'Competition Champion' and believe including effective competition as an objective of the regulatory framework will benefit consumers and provide a more level playing field for smaller banks. When competition in the financial system is strong, Australian consumers will have the ability to access the best products and services at the most competitive price.

As a smaller bank, MyState is well connected with its customers and communities and has been actively growing its customer base across Australia, particularly in recent times. We will continue to deliver competitive outcomes for all Australians but it is time that the government and regulators acted decisively to eliminate the barriers to effective competition and reverse the continuing trend of concentrating banking in the hands of the major banks, which only serves to perpetuate system risks and poor outcomes for the Australian consumer.

Yours faithfully

**Melos Sulicich**
**Managing Director & Chief Executive Officer**