



Submission

P&N Bank response to **Competition in the Australian Financial System**

Productivity Commision Draft Report

March 2018

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Summary

As a customer-owned bank, P&N Bank staunchly advocates a stable, competitive and sustainable banking sector on behalf of all Australians. We believe that the current major bank oligopoly and the competitive advantage they enjoy on a number of fronts is anti-competitive.

With the increasing regulatory burden disproportionately impacting smaller organisations such as ours, together with the inherent competitive inconsistencies highlighted in the Productivity Commission's Competition in the Australian Financial System Draft Report, P&N Bank appreciates the opportunity to provide our response herein.

The customer-owned banking sector has the potential to offer a compelling and diverse alternative to the major listed banks, characterised by superior customer service levels and enhanced advocacy and trust.

We believe that **genuine** competition in banking will benefit all Australians but in order for that to occur, a more level playing field must be established.

Without the changes required to level the playing field, organisations such as P&N Bank may not be able to realise their potential.

Without significant reform and with the existing disproportionate regulatory burden, Australia's customer-owned banking sector could become irrelevant which would be to the detriment of the existing 4,000,000 customers and future generations of potential customers.

P&N Bank

P&N Bank is now the only locally domiciled ADI in Western Australia. Other financial institutions in the WA market are either a brand or a sub-branch of entities domiciled in other states or overseas.

P&N Bank began like many other customer-owned banking organisations. Over 40 years ago, members of the police, nursing and later the energy sector pooled their funds to support members who might not otherwise have received financial support from traditional banks. P&N's target audience later expanded to include the general public.

In 2013, to appeal more broadly, Police & Nurses Credit Society rebranded to P&N Bank. With some 93,000 active customers, P&N Bank has some 330 staff and offers contemporary retail banking products and services through various distribution channels including contemporary digital offerings.

With assets of \$4B and very high customer advocacy and satisfaction scores, P&N Bank is one of the top 10 customer-owned financial institutions and is recognised as the Best Mutual (RFi Australian Lending Awards 2017 and 2018).

Our purpose is to enrich the lives of our customers and their communities.

At the heart of P&N is our belief in the power of the collective in enhancing the value of the individual.

Our aim is to attract more customers to the benefits of customer-owned banking and create exceptional experiences for those who bank with us.

P&N Bank endorsement and recommendations

Competition framework and assessment

P&N Bank strongly support:

Draft Finding 2.1 Key features of workable competition in the financial system

Commentary Draft Finding 2.1 Consumer choice and switching

In order to demonstrate the exploitation of existing bank customers, commentary in the draft report supported by figure 2 (below) points to 15% of bank customers paying interest rates above the standard variable rate (SVR).

This significantly underplays the level of exploitation that exists in the industry:

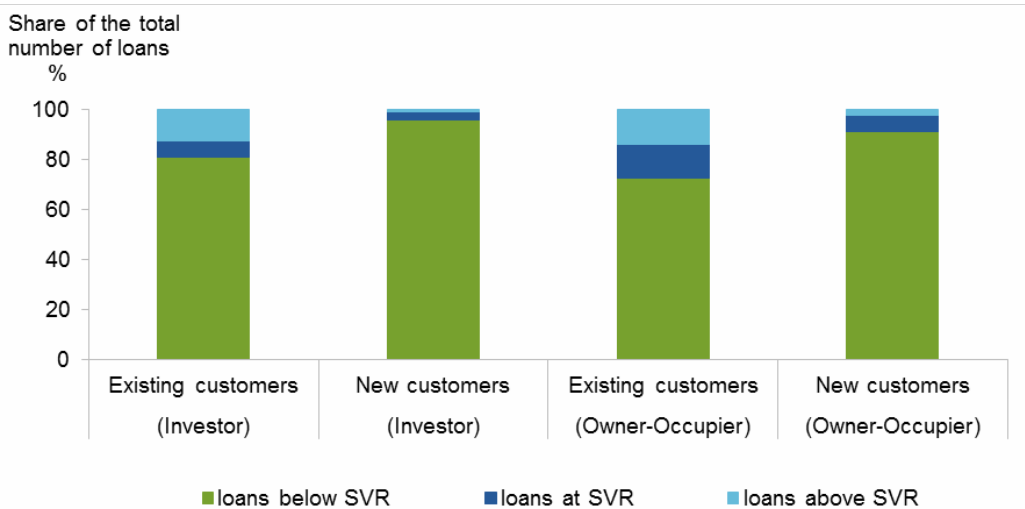
1. The standard variable rate (SVR) is a notional interest rate that is rarely quoted for sale. In the industry it serves as a benchmark only, with all advertised products and the majority of HL portfolios sitting at interest rates well below that rate. By using SVR as the base line for this comparison it's easy to demonstrate a more favourable position i.e. a large proportion (85%) of loans on the portfolio sitting below that rate.
2. More relevant in understanding the degree of exploitation is the proportion of existing eligible customers sitting on interest rates higher than the Bank's lowest advertised interest rate. This measure exposes the practice of front book/back book pricing, where new customers are attracted on new products with lower interest rates, whilst existing customers remain on products sitting at the higher rate (driving revenue at higher margins), with no future offer to switch to the better product or the lower rate.

It is worth highlighting that P&N Bank, a customer-owned bank, with a commitment to provide value and reward loyalty, has **85% of all eligible owner occupied borrowers sitting on its lowest available advertised home loan interest rate (the &Home Loan).**

As a result P&N has accepted the limitations this customer first decision places on P&N's margin income. This is a contrasting distinction over and above the finding in Figure 2 below.

Please also refer to P&N's Response to Draft Recommendation 3.1 and 8.4.

Figure 2 New home loan customers pay lower interest rates



Compared with standard variable rate (SVR)

Commentary Draft Finding 2.1 - Reforms that promote competitive behaviour by firms

P&N Bank strongly endorse and support a regulatory environment that does not impose undue distortions on the provision of access to particular financial products or particular providers, and is able to effectively assess and deal with competition risks posed by regulatory measures and market developments.

P&N Bank seek reforms that treat non-complex products such as at call deposit, transaction and term deposit accounts (commonly referred to as basic deposit products) in more simple terms compared to complex PDS material.

We do not believe it is in consumers' best interests to be burdened with the same complexity of regulatory material for basic deposit products or transaction account as is required (rightly so) for more complex products such as corporate bonds, cash management trusts, debentures or loans.

P&N Bank strongly support:

Draft Finding 2.2 Competition and stability must co-exist

Draft Finding II.1 State of competition in the financial system

Draft Finding III.1 Consumers' capacity to put competitive pressure on providers is often limited

The landscape of retail banking

P&N Bank strongly support the following five points:

Draft Finding 3.1 The major banks' oligopoly power

P&N Bank agrees with the findings in Draft Finding 3.1, other than to point out that we would not necessarily follow the lead of the major banks to pricing if the regulatory and competitive environment were more favourable as, unlike the major banks, we do not seek to maximise profits for shareholders.

Draft Finding 4.1 A consolidation in banking

The oligopolistic dominance of the four big banks (and their sub-brands) is well documented.

P&N strongly support that all bank sub-brands should be overtly transparent in their disclosures to consumers, clearly demonstrating that they are a division of the parent bank and that they operate under the banking licence of the parent. Full disclosure of ownership is particularly relevant to consumer understanding of the Financial Claims Scheme, e.g. consumers do not necessarily realise that they are only covered for one \$250,000 Government Guarantee if they hold deposits with both Bankwest and CBA which operate under the one licence.

Second tier ADI's have been consolidated across the national banking landscape to the point that there are now very few alternatives to the major banks.

This is particularly evident in the WA market (as indicated above) where one large player dwarfs all others across its two distinct bank brands.

Australian banking consumers deserve a disclosure regime that allows them to make a genuine choice about whether or not to deal with a major bank.

Clear and overt disclosure of the real identity of lenders and deposit-takers would deliver:

- a more informed market;
- more empowered consumers;
- more accountability and
- greater transparency.

Draft Recommendation 4.1 - Reducing regulatory barriers to entry and expansion

Draft Finding 5.1 Cost of funds for different size banks

Draft Finding 6.1 - Cost of APRA interventions on home loans

The residential home loan market

Draft Recommendation 8.1 Duty of care obligations for lender-owned aggregators

P&N Bank agree that the disclosure of aggregator or broker ownership is paramount to minimise any potential risks associated with a conflict of interest that could lead to poor consumer outcomes. ASIC should also impose a clear legal duty on all mortgage aggregators and brokers to act in the consumer's best interests.

Draft Recommendation 8.2 Mortgage broker disclosure requirements

P&N Bank supports Draft Recommendation 8.2.

Draft Recommendation 8.3 Collection of home loan interest rate data

Please see P&N's response to Draft Recommendation 8.4 below. P&N Bank believe the underlying data would better add value to consumers if it provided a comparison between new residential home loan rates and existing comparable loan rates, further highlighting front book/back book pricing anomalies.

Draft Recommendation 8.4 Interest rate transparency for home loans

While the home loan comparison rate methodology was a way of demonstrating comparability across product rates and fees, we acknowledge that it may not reflect real life scenarios based on borrower type, LVR, actual loan terms/amounts - or how pricing strategies are applied over the duration of that loan.

The statistical collection of interest rate data for new residential home loans would support greater transparency and open up opportunities for third parties. While comparison websites currently exist in the market (e.g. Canstar, InfoChoice, Ratecity), ASIC would need to consider their current limitations outlined in their MoneySmart website.

Natural market forces for new residential loans influence competition, with resultant pricing confined to a narrow range. What is not considered, is what could potentially happen to that new loan over time as lenders manage pricing across their older products to subsidise acquisition lending pricing.

P&N Bank consider pricing for existing loans as important as new loans. What should be of importance to a prospective borrower is not only the purchase interest rate, but how this would compare to a median interest rate for a seasoned portfolio of existing comparable loans. A minor variance between these rates should provide prospective borrowers a level of comfort that they would not be disadvantaged over time.

Any statistical collection of interest rate data requires very clear rules and framework to ensure the aggregated data is a consistent representation of the broader industry. While we have seen some lenders make sizable shifts in reclassifications with other APRA statistical data, interest rate data needs a very high level of accuracy as it will underpin borrower decisions.

Draft Recommendation 8.5 Lenders' mortgage insurance refund

P&N Bank agree in principle, provided it does not drive up premiums for consumers or negatively impact lenders.

P&N strongly recommend an investigation into LMI portability - especially for refinancing.

Draft Finding 8.3 If you have a high loan-to-value ratio, you are probably paying for it twice over **Information Request 8.3 Are changes needed to lender mortgage insurance?**

Based on APRA's current risk weights for residential mortgages, exposures over 90% LVR insured by an acceptable LMI carry a higher risk weighting.

While it may look like borrowers are paying twice (e.g. a lender mortgage insurance premium and a potentially higher interest rate), pricing for a loan over 90% LVR addresses the level of additional capital required by APRA to support this LVR profile.

APRA's indicative risk weights under the Basel IV standardised approach may create greater variation in capital requirements, and potentially greater complexity in products and pricing across the industry.

Competition in credit provision to small and medium businesses

Draft recommendation 9.1 Standardised risk weightings for SME lending

P&N Bank support this recommendation. Rather than applying a single risk weight to all small and medium business lending not secured by a residence, there should be risk weighting flexibility according to variables associated with a commercial loan such as the underlying security and the Loan to Value ratio (as seen in home loan lending).

Integrated services and the provision of warehouse funds

Information Request 7.1 How will Prudential Standard APS 120 affect you?

The revised Prudential Standard APS 120 will see the major banks passing down additional risk weighting warehouse capital impacts to those smaller ADIs who are accessing that facility. There is a disproportionate impact down the chain.

For example, P&N Bank will hold capital during a securitisation as well as paying again for the risk weighted capital that the warehouse bank passes down. There is an unintended double impact that P&N does not support.

Competition in the payments system

Draft Recommendation 10.3 Ban card interchange fees

P&N Bank oppose this recommendation and support COBA's view below in relation to card interchange fees.

Customer Owned Banking Association (COBA) CEO Michael Lawrence's presentation to Productivity Commission (Competition) - Public Hearing 1 March 2018

Proposal to ban card interchange fees

"...Finally, I will make some brief comments about the Draft Report's recommendation to ban card payment interchange fees.

We oppose this recommendation.

Interchange fees are a mechanism to enable sharing of costs of certain benefits that card issuers provide to merchants. These benefits include processing transactions, preventing fraud and authorizing transactions.

Merchants should bear at least some of the cost of benefits provided to them by card issuers.

Banning interchange fees would affect competition by having a disproportionately greater impact on smaller card issuers that do not participate in the merchant acquiring market.

Major banks dominate both the card issuing and merchant acquiring sides of the payment card market. The loss of compensation for costs sustained by the card issuing side of their business could be balanced by not having to pay interchange fees from the merchant acquiring side of their business.

I note that the Payment System Board carried out a comprehensive review of card payment interchange fees in 2015 and 2016 and the new benchmarks commenced only last year."

Improving outcomes for consumers

Information Request 12.1 Potential to increase the scope of financial advice to include some credit products

P&N Bank oppose this concept. Licensed financial advisers already have a clear remit with a very broad and detailed product set and compliance standards.

Adding a broader advice remit (that includes banking and consumer lending products) has the potential to create poor consumer outcomes.

P&N Bank believe this would be exponentially more risky for those planners that are vertically aligned.

Draft Recommendation 12.1 Rename general advice to improve consumer understanding

P&N Bank strongly support this recommendation.

The implicit definition of "advice" denotes informed recommendation or guidance.

From a consumer perspective, the terms General "Advice" vs Personal "Advice" are confusing, misleading and likely to result in poor consumer outcomes.

P&N Bank support:

- that the category currently named General "Advice" be renamed to General "Information" or similar, and
- current at call deposit, transaction and term deposit accounts (commonly referred to as basic deposit products) be carved out from the current General "Advice" regulatory obligations, and
- complex products (e.g. corporate bonds, cash management trusts, debentures or loans) other than basic deposit products should be treated under the same regulatory obligations as they currently are.

Information Request 12.2 Renaming general advice & merits of further changes

See P&N Bank's Response to Draft Recommendation 12.1 above, in line with the following feedback below.

In implementing Draft Recommendation 12.1, we request feedback on:

- *how the scale of transition costs associated with renaming general advice could be minimised, including the effect of varying the transition timeframe*

P&N Bank believe that the benefits of removing the misleading term General "Advice" outweighs the inconvenience of transitioning advertising, promotional and training materials albeit we strongly recommend that to minimise the costs involved in transition, that a reasonable time frame be assigned to this process to prevent wholesale scrappage and impost on resources. We consider a 6-12 month time frame would be optimal to transition.

- *barriers or unintended consequences of such a change, including licensing implications.*

We do not see barriers or unintended consequences provided a timely transition period is provided to minimise scrappage and resource impacts. Given that licensing is required to provide "Personal Advice", we do not foresee any implications in licensing if a change is applied to the term General "Advice".

We also seek information on the merits of:

- *redefining the activities that are currently regulated under general advice and providing a more customised regime for some activities*

See comments under Information Request 12.2 above. "General Advice" regulatory obligation should only apply to complex products such as corporate bonds, cash management trusts, debentures or loans and not at call deposit, transaction and term deposit accounts.

- *removing licensing and regulatory obligations currently associated with some or all forms of general advice.*

P&N Bank support the removal of regulatory obligations for simple at call products i.e. deposit, transaction and term deposit accounts. See above.

Draft Finding 13.2 - Tick and flick has not been effective

P&N Bank supports this finding.

The financial system regulators

Draft Finding 15.1 APRA not well placed to consider competition in the financial system

P&N Bank strongly agree with this finding and support both a secondary competition objective for APRA as recommended by COBA and also a mandate for the ACCC to be a more formidable counterweight to APRA's focus on financial stability.

Draft Recommendation 15.1 Statements of expectations for regulators

P&N Bank strongly support this recommendation on behalf of Australian consumers. Statements of Expectation will ensure greater clarity and understanding between the intent of Government Ministers and the Regulators. This in turn should contribute to less unintended consequences from regulatory reform and change.

Draft Recommendation 16.1 Review standardised risk weights for residential mortgages

P&N strongly support this recommendation and are working with COBA to make a submission on APRA's recently announced "Revision to capital framework for authorised deposit-taking institutions" issued on 14 February 2018.

Information Request 17.1 Which regulator should advance competition in the financial system?

P&N Bank strongly support both:

- APRA having a secondary competitive objective AND
- ACCC afford new proactive functions to supplement its current role in the financial system.

Without a competition objective within APRA's mandate, we believe that the current blunt regulatory approach will continue regardless of an alternate counterweight "competition regulator".

In addition, P&N Bank support ACCC being provided new proactive functions to supplement its current reactive role in the financial system.

Draft Recommendation 17.2 Transparency of regulatory decision making

P&N Bank strongly support transparency of regulatory decision making and the ability to provide commentary before regulations are enforced. Preliminary discussions at CFR meetings and a thorough consultation process with smaller ADIs will pre-empt any unintended consequences of regulatory reform or change.