

Competition in the Australian Financial System

Xinja Response to Draft Report

20 March 2018

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1 Introduction and Overview

1.1 Introduction

Xinja welcomes the opportunity to respond to the Productivity Commission's (the 'Commission') "Competition in the Australian Financial System: Draft Report" as an emerging entrant into Australia's established banking sector. We commend the consultation process, including Xinja's opportunity to appear at public hearings. We would also like to thank all the industry and non industry parties who have contributed to this important discussion. This response is in addition to Xinja's previous response to the Review.

Xinja will be, if all goes according to plan, Australia's first neo bank - subject to regulatory approval. We began building Xinja at the end of 2015 and applied to become a Restricted ADI with APRA in September 2017. Xinja is not a bank yet but is working with regulators to become one.

We have raised about \$10m, have a waiting list of 1000's, been granted our ACL and draft AFSL by ASIC recently and hope to become a Restricted ADI and become a bank in June this year.

By happy coincidence our first product shipped to our early customers in February, on time and on budget. I would like to thank our regulators ASIC and APRA and policy makers for their vision, assistance and guidance on our journey so far.

We aim to be a for profit and for purpose business and revolutionise the Australian banking industry in favour of everyday Australians. If successful we will be the first new retail bank since Macquarie bank some 25 years ago, and we feel it's time Australians got access to the same neo banking technology and experiences that have been available overseas for a number of years.

If it's helpful we'd like to share our experience of competing as a startup and building a neobank

It's worth mentioning that in many ways we are dealing with regulations that never envisaged the possibility of start-ups being new entrants in the banking sector. And it will take time to expose and rectify all of the regulatory booby traps waiting for new banks.

This review comes at an important time in our national financial history where we are informed by the experience of other markets who have now have thriving neobank competition – especially in the US, UK and Europe more broadly.

Xinja supports the key findings and recommendations of the Draft report. We believe people should be allowed to feel confident about complex money decisions and the Commission's recommendations, if implemented, will significantly contribute to that outcome.

Further, we would like to address a number of areas specific to competition in the retail banking sector, and to make further recommendations for the Commission's consideration.

1.2 Customers find it unnecessarily difficult to make good choices

The Draft Report echoes what customers have told us about what frustrates them about banking and money ie: it's not easy to make the right choices:

a) It's difficult for customers currently to compare products effectively:

There is a lack of accessible information and products are complex. There is a very strong case to be made for a new 'regime' of transparency.

b) There are brand or marketing smokescreens

This creates a false perception of competition for consumers. Much of what passes for competition is more accurately described as persistent marketing and brand activity designed to "promote a blizzard of barely differentiated products" and 'white labels' products. We cautioned against "new digital brands" that represent existing market forces. "I think we will see an emergence of new digital brands that are in fact only digital front-ends on old banks, designed to capture new audiences,". "But they will be backing onto the same products, the same level of service, the same expensive legacy systems and the same ethos, so it's hard to believe they will bring true benefits to customers." (*Eric Wilson, Xinja CEO*)

c) Trust is broken.

We have concerns about the lack of effective competition and the flow of commissions creating an environment where customers' best interests are sidelined. Customers tell us they trust "The Barefoot Investor" more than their bank.

d) Breaking up and moving on is hard to do.

Customers tell us that they'd like to switch and get better products and services but 1. All the existing players look the same and 2. It's a lot of work to

switch. “The incredible inertia of customers in terms of moving bank accounts” as cited in the report is evidence how hard this is to do. We see open banking as a great example of regulation and technology working together to create new opportunities for customers. We are encouraged by the PSD2 developments in Europe and believe open banking will be a critical part of the open data movement for consumers. We applaud the the open banking review recently released as a key contributor to consumer choice and convenience

1.3 Xinja supports the objectives behind the recommended reforms;

We support the objectives behind the Commission’s recommendations. We believe these objectives are appropriate for creating a more competitive financial sector that delivers better customer outcomes:

- clarity around how prices or features vary with product differentiation, with minimal scope for a provider or group of providers ... to exert significant influence over price;
- sufficient information for both providers and consumers to make informed decisions based on factors such as credit worthiness, risk or product choice (given product terms and conditions);
- low barriers for industry participants entering the market, for those expanding within it, and for existing providers that want to exit;
- a regulatory environment that does not impose undue distortions on the provision or access to particular financial products or particular providers, and is able to effectively assess and deal with the risks for competition that are posed by regulatory measures and market developments.

1.4 Xinja agrees with the Commission’s views on the role of new entrants

We strongly agree that key to real competition into the market is to encourage new entrants (p80), and how important it is for start-ups like Xinja to have access to capital.

ASIC in January changed the requirements around crowdfunding, allowing Xinja to go to the retail market. We have since raised >\$1.8m in equity crowdfunding – and this is important, however insufficient to properly ‘enter’ the market as a viable bank and lender.

We look forward to the passage of legislation currently before Parliament that will make it easier for start-ups like Xinja to enter the market and create competition, allowing them to use the term 'bank'. (p126)

We would like to highlight the need for regulations relating to ownership to take into account the impact on startups, and in particular the need for startups to be able to have particular capital structures and ownership distributions, and for those regulations to be proportionate to the limited risk that such ownership structures pose on the financial system overall until they reach a significant size and scale.

With a credit license Xinja can issue mortgages to the extent we have funds to lend. Our first challenge is access to wholesale funding. The second challenge is that even where we can access wholesale funding, a restricted ADI would limit our ability to offer offset accounts with those mortgages. This means we have to make difficult choices around how we split our \$2m cap on deposits between offset accounts to provide a better outcome for home loan customers, which means a small number of mortgage customers would be sufficient to absorb that cap, thereby limiting overall how fast Xinja can grow until that cap is lifted – which limits how quickly we can access wholesale funding and investment funding.

1.5 Technology can help customers cut through complexity

We see a significant role for technology to reduce complexity and allow customers to make better, faster money decisions without the angst. We believe it's time Australians had access to this kind of technology already available in other parts of the world. We'd like the opportunity to bring that to Australian consumers and see a thriving neobank market that is ripe with innovation making customer lives better.

2. Summary of Additional recommendations

We would like to propose further recommendations in 4 areas:

1. Empowering Consumer choice and confidence
2. Encouraging new entrants
3. A more competitive home loan market
4. Expanding the benefits of competition

2.1 Additional Recommendations to enable better customer choice and confidence:

Recommendation 1: That ASIC's work on financial education via MoneySmart, as well as ASIC's work on the national financial literacy / capability strategy - be incorporated into the broader framework of empowering consumers to make good choices.

- [39% of workers spend over 2 hours per week thinking about finances while at work](#) (9.5% of paid salary hours) Yet we only spend 30 minutes a week actually doing finance, compared to the [1.8 hours a day on Facebook](#). We believe this engagement level is also an indicator of relative power consumers feel they have when it comes to financial services.
- [41% of people want to spend less time on money admin](#) - reflecting the burden of effort on consumers in order to get competitive outcomes
- We also note the value of good financial advice, however only [14% of the workforce use a financial planner](#). The perception is that they are too expensive, too sales- focused, and lack independence. (*nb: sources cited behind links*).

We believe a stronger national financial capability strategy is a crucial for empowering consumer choice.

2.2 Additional Recommendations to To encourage new entrants:

Recommendation 2: Prudential regulation be more risk based, rather than treating all regulated entities as if they posed the same financial system risk as larger institutions.

Recommendation 3: Regulation take into account differences in the business life cycles of early stage participants.

Recommendation 4: The functions of a competition body should specifically include analysis of the competition impacts on startups and early stage competitors

2.2 Additional Recommendations to improve competitive outcomes in the home loan market:

Recommendation 5: In relation to the recommendation to centrally collate home loan rate data to be made available to consumers, that technology be leveraged to make that data as current or real time as possible.

Recommendation 6: That customers have visibility of whether their brokers or advisors are lender owned, as well as visibility of whether the home loan recommended to them is also a higher commission paying home loan, whilst acknowledging that receiving quality advice on such an important purchase is essential.

Recommendation 7: We recommend that analysis of competition in the home loan market include analysis of::

- barriers to entry and expansion specifically in the area of home loans with offsets, and
- impact of deposit restrictions for RADIs on their ability to compete with established banks and to grow

Recommendation 8: That the assessment of the competitiveness of the wholesale funding market be informed by the ACCC's experience in wholesale markets in other sectors such as utilities & telco

2.2 Additional Recommendations to expand the benefits of competition

Recommendation 9: That the functions of a competition body include some consideration of how the benefits of local competition is facilitating Australia's ability to compete internationally

3. Response to Report Findings

We agree with findings on the overall state of competition and want to highlight and expand the key findings relevant to competing as a banking startup

3.1 The overall state of competition

a) Our stability has cost us competition

We have to our credit a strong financial system that withstood the GFC, however current levels of profitability indicate that competition is not as strong as it could be, especially at a time where so much information, technology and innovation is available to other parts of the world.

We agree the four pillars policy has served its original purpose and now there is a need for more focus on competition policy. While the 4 pillars policy may have achieved the objective of preserving competition between the big 4, this may have come at the expense of

constraining competition from outside entrants, especially start ups. Whilst start-ups have fuelled competition in so many other sectors of the economy (eg. Atlassian, Canva), banking customers specifically are yet to fully benefit from increased competition in this sector.

b) Limited consumer power

We note that consumers experience limited power when it comes to financial services, especially in banking and home loans. The key factors behind this have been highlighted in the draft report:

It is not easy for customers to make good choices

We note some key findings from ASIC's recent consultation on the National Financial Literacy Strategy:

- 42% of people do not feel confident about managing their money day-to-day¹
- 36% find dealing with money stressful and overwhelming²
- 21% struggle understanding financial matters³

We believe this provides an important mirror for the industry, and expect these experiences to change as more power shifts back into the hands of consumers.

Channels for information and advice could be more useful

Existing channels are not as effective as they could be in assisting customers make good choices. In particular, we believe in the potential for technology to facilitate a better decision making experience for consumers. Many customers tell us their advisor of choice is the barefoot investor

The illusion of choice

Competition in the quality of services - much of what passes for competition is more accurately described by the Commission as "persistent marketing and brand activity designed to promote a blizzard of barely differentiated products and 'white labels'.

1

<http://www.financialliteracy.gov.au/media/560753/cp295-national-financial-literacy-strategy-consultation-2017.pdf>

2

<http://www.financialliteracy.gov.au/media/560753/cp295-national-financial-literacy-strategy-consultation-2017.pdf>

3

<http://www.financialliteracy.gov.au/media/560753/cp295-national-financial-literacy-strategy-consultation-2017.pdf>

There is consumer confusion on product differences with a proliferation of brands but far fewer actual providers. This largely explains why a proliferation of products and choice is not driving a noticeable difference in pricing or customer benefits. In an oligopolistic market - the market typically only responds to the actions of the key players (eg. when one of the big 4 removed ATM fees) - more so than the actions of any individual smaller players.

The illusion of aligned interests

Lender owned Brokers and advisors are conflicted and this is not always transparent to customers. We note there is no requirement for conflicts of interest to be declared.

High effort for consumers to find, assess and capture benefits of choice and competition

We particularly agree with finding that consumer power is limited, and we find there is a great deal of effort for customers to exert consumer power. It is important that we consider not just the range of choices available to customers, but also the relative effort required for customers to find those choices and easily assess or identify that better options are available, and accessible.

c) Current market structures favour larger established players

We agree that in retail banking, price rivalry is limited because current market structures favour larger, established institutions over smaller, less established ones let alone startups and new market entrants.

We particularly agree with draft finding 3.1 – that major banks oligopoly power is supported by regulatory settings, making price competition difficult even after you consider barriers to entry, which are difficult enough.

We also note that current structures also favour larger new entrants eg. overseas banks, Amazon, FB, Google at the expense of local startups.

When it comes to access to capital, local startups like Xinja begin with a disadvantage both because our capital needs are high (compared to startups in other sectors), we have the same capital requirements as established larger players (until regulations change, it's still a \$50m barrier to entry), our access to capital is limited (Australian vs overseas market) and key sources of funding in this market come from competitors (ADIs for wholesale funding).

4. Key recommendations relevant to banking competition

We support the recommendations in the report, and specifically want to mention key ones that relevant to competition in banking

We support the recommendations in the report, and specifically want to mention and expand on the key recommendations relevant to competing as a banking startup

4.1 Stability and Competition should co-exist

We agree that Australia, with an oligopolistic banking system, can (and should) seek to give genuine attention to both stability and competition. We want a stable financial sector in which to compete. This is important for attracting investment. But we also want one in which there are genuine commercial opportunities to compete for commercial returns. We support Finding 2.1 on Key features of Workable competition.

Recommendation: Specifically assess impacts on smaller and less established players.

We would also like to see that regulatory decisions proactively include an assessment of adverse consequences on the distribution of market power / barriers to entry for any particular set of participants - particularly smaller players and less established players

4.2 Reducing barriers to entry and growth

Xinja supports the recommendations in the draft report for reducing barriers to entry in banking, in particular:

- recommendation 4.1 - reducing barriers to entry.
- phased licensing
- removing restrictions on use of the term bank (especially in relation to the \$50m requirement)
- review of ownership rules - especially their impact on the ability of startups to be funded and to grow.

Recommendation: Give specific consideration of competitive impacts on RADIs

We believe that the experience of restricted ADIs can provide useful feedback on the effectiveness of measures to reduce barriers to entry and increase competition in

banking. Looking at the competitive impacts on RADIs can highlight areas where policy is achieving its objectives, and areas where there is more to be done. Examining the volume of applications for RADIs and the number of RADIs granted provides a useful starting point / gauge on the existence and growth in new entrants.

Barriers to entry in the home loan market for RADIs

Regarding competition in the home loan market, it is important to be aware of the specific barriers to competition in offset loans for RADIs.

It is critical that regulators have an understanding of the interdependencies between access to licenses, the ability to scale, the ability to source further wholesale and equity funding, and the ability to grow from a startup bank into a more mature one. There are not only barriers to entry, but also artificially created barriers to growth. With a credit license Xinja can issue mortgages to the extent we have funds to lend.

Our first challenge is access to wholesale funding. The second challenge is that even where we can access wholesale funding, a restricted ADI would limit our ability to offer offset accounts with those mortgages. This means we have to make difficult choices around how we split our \$2m cap on deposits between offset accounts to provide a better outcome for home loan customers, which means a small number of mortgage customers would be sufficient to absorb that cap, thereby limiting overall how fast Xinja can grow until that cap is lifted – which limits how quickly we can access wholesale funding and investment funding.

Extend the regulatory sandbox

In response to information request 4.1: We agree the sandbox should be extended to fintechs to become banks and providers of financial products, within a regime that still provide adequate production. If such an option was available to Xinja, it is likely that we would have been able to enter the market with a lower cost MVP that was not as capital intensive as the path we have had to follow, which would have changed our investment profile and made access to capital less restrictive due to the ability to demonstrate traction faster, earlier, and with less cost and risk.

Access Regime for the New payments platform

We support recommendation 10.5: Access regime for the NPP

We would also support measures to ensure the commercial arrangements between NPP participants and Identified Institutions are in line with the pro-access principles of the NPP, as well as measure to provide increased transparency and certainty of costs and timeframes for access.

4.3 Removing friction, barriers and complexity impacting on consumer choice and decision making

Complexity 1: Herding Cats - The need for open banking

Without a simple way for consumers to see all their accounts in one place, it is both difficult and risky to make good choices about financial products. Many consumers have multiple accounts spread across several institutions.

Currently, customers wishing to get a single view of their accounts - so they can see where they stand and make informed switching decisions - are required to go down the path of spreadsheets or non-bank aggregation services - until a more viable option is presented that can provide customers with the protection they should have.

We don't believe that customers should have to take such risks with their data in order to get on top of their money.

We note that it is easier for customers to find all their superannuation account but not all their bank and credit accounts.

Whilst there are existing arrangements for a customer to give an advisor or planner access to their data for the purpose of assessing their current situation - customers are not able to as easily provide that information to a new service provider to assess whether a new service might be of benefit to that customer.

"The answer to this is often technology and it's time Australians had access to the kind of technology that is already available in other parts of the world,"

The Open Banking enquiry in Australia will, we hope, empower customers not only to change financial services providers more easily but give them access to a range of financial services where they can easily compare and identify the most competitive product for their needs. This is exactly where we are heading with Xinja.

Barrier / Complexity 2: Understanding the choices.

We propose leveraging technology so help consumers compare home loan rates: to maximise consumer access to real time information at the point at which they are making decisions.

In relation to recommendations 8.3 & 8.4: We agree with collection of home loan interest rate data and we strongly recommend that there be consideration of modern technology options for collecting this data and making it available to consumers so that it can be as real time as possible to help inform customer decisions (rather than relatively outdated data) eg. open APIs.

Validating Best interests: We recommend we extend Transparency to include relative commissions

We suggest expanding Recommendation 8.2: We also think it is important for consumers to have visibility of (1) when a broker or advisor or aggregator is lender owned and (2) the relative commissions paid by different lenders, not only that commissions are paid and how much. Eg. a consumer should have the right to know that the loan recommended to them is also the one for which the broker gets the highest commission relative to other loans / lenders that could have been recommended to the customer.

Reduce friction in switching – enable acquiring banks to act on customer behalf

We agree with finding 13.2 that the ‘tick and flick’ account switching facility has not been effective. Customers have told us that 1. They want to switch but don’t see any genuine alternatives to switch to that provide both high tech and good service and 2. Switching takes too much effort. Customers have also told us is that they want to be able to have someone manage their switch for them, with a guarantee that they won’t miss bills or incur fees as a result of the switch.

We propose a framework that enables acquiring banks to be able to act on behalf of customers (with customer consent) to seek the information necessary from their existing institutions to facilitate a smooth transfer of direct debits, and to be able to do so using technology.

4.4 Competition functions to analyse impacts on competition

Functions should include analysis of competition impacts

We support Recommendation 17.1: New competition functions of a regulator to include transparent analysis of competition impacts tabled in advance of measures proposed by regulators

We recommend that the analysis of competition impacts would be even more robust if it included specific analysis of impacts on smaller players, and new entrants and start-ups and their underlying cost structures and access to competitive wholesale funding. We also recommend that the analysis include the extent to which regulatory measures shift market power to consumers, enable better and easier decision making, and reduce friction to switching.

Consider benefits of local competition in facilitating Australia's ability to compete internationally

We would also like to add that whilst the scope of the report focussed on competition within the Australian Financial system, we are also strong supporters of developing a financial system that is internationally competitive.

In particular we note the balance of new entrants into the Australian system from overseas, relative to locally grown / built new entrants in the Australian system, compared again to Australian startups that are competing in international markets. Placing these lenses side by side puts the spotlight on the key areas of opportunity for creating a more competitive landscape locally, as well as creating competitive advantage that can be leveraged globally.

4.5 Role of different regulators

ACCC – on wholesale funding

We believe the ACCC may have some additional value to add when considering the competitive impact of regulations that apply to wholesale funding –the ACCC's experience in regulating wholesale pricing in markets such as utilities and telecommunications

ASIC – align with financial literacy strategy

We would like to commend ASIC's existing activities in financial literacy and the role of the national financial literacy strategy as an important input into how we bring competition to life. ASIC's MoneySmart activities already engages in a number of consumer education and protection measures, including on more complex financial products and services such as superannuation and investing.

We believe ASIC's current protection activities may have potential to evolve to include promoting competition – as both competition and consumer protection have consumer interests and choice at heart.

5 Thank You

We thank the Commission for the opportunity to respond to the Draft Paper and encourage ongoing engagement with end customers, as well as the broader startup and financial services community. We would welcome the opportunity to meet to discuss our response further, especially to share our customer insights. We believe Australia could be a global leader in innovation in consumer outcomes in financial services, and look forward to the Commission's continued leadership role in this area.

Regards,

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Submitted via email to financial.system@pc.gov.au