

# **Productivity Commission Inquiry into Competition in the Australian Financial System**

## **Heritage Bank submission to the Productivity Commission**

### **Heritage Bank**

Heritage Bank ('Heritage') is Australia's largest customer-owned bank and one of the three largest mutual ADIs in the country. Heritage's history stretches back 142 years to its beginnings as a building society founded in Toowoomba in 1875, making it one of the oldest mutual financial institutions in the country. Heritage has grown to more than \$9 billion in assets, 300,000 customers, 800 staff (including 470 in the Toowoomba region) and circa 60 branches across southern Queensland. Heritage is a national player in the mortgage market; having sourced loans from brokers for twenty years, and now has customers around Australia sourced via a network of mortgage broker partners.

### **Impact of regulatory changes on competitive neutrality**

Heritage Bank welcomes the opportunity to participate in the Productivity Commission's Inquiry into Competition in the Australian Financial System. Heritage considers competition to be a significant issue within the Australian banking market, impacting the ability of Authorised Deposit taking Institutions (ADI's) to effectively provide outcomes for consumers; limiting product provision, pricing, quality of service and innovation.

Heritage believes that competition is a tool for promoting a healthy, stable and safe financial system that is being neglected in favour of burdensome, misdirected regulations, which are having an increasing impact on smaller ADI's abilities to continue to provide high quality products and services to the market.

- Heritage Bank understands and appreciates APRA's statutory mandate to ensure the ongoing safety and stability of the Australian Financial System. It is our opinion however that that this objective is disproportionately advanced by APRA at the expense of the competitive integrity of the market. Many of the prudential changes implemented in the past decade have been formulated from a narrow perspective that favours scale and uniformity.
- Heritage Bank firmly believes that increased competition within the Australian Financial System would complement APRA's primary focus of maintaining financial safety and stability. Lack of competition has contributed to inappropriate conduct by larger firms as well as insufficient choice, constrained access and poor quality outcomes for consumers.
- Heritage Bank recognises that the oligopolistic nature of the Australian banking sector provides the major banks too much market power that is being utilised to the benefit of shareholders, rather than customers or the broader financial system.
- Government agencies have introduced a number of regulatory changes into the financial system over the past decade. The burden associated with regulatory change has disproportionately impacted smaller ADIs who have limited revenue bases to absorb these costs. Increased regulatory costs inadvertently provide a competitive advantage to the major banks who can spread their compliance costs over a significantly larger base.
- Heritage acknowledges the difficulty of applying regulatory constraints across a diverse sector, however a 'one size fits all' approach to regulatory change is inequitable and anti-competitive. Ironically many regulatory changes are introduced in response to issues arising within the larger

financial institutions. These behaviours are not evident within smaller ADIs yet the rules are almost always applied uniformly. A different mindset amongst regulators is needed to recognise established behaviours, target offenders (not the industry as a whole) and promote the benefits of diversity and competition. Independent oversight of regulatory action (e.g. via non-executive Board members) would assist to broaden the mindset of regulators.

- Customer owned banks exist primarily to deliver value to their customers through competitive pricing, quality service and by reinvesting profits into the company to promote future growth. The primary objective is to provide value to members rather than maximising shareholder return. The current regulatory environment fails to sufficiently recognise the benefits of a healthy mutual ADI sector. The majority of mutual ADIs operate under a sound and conservative business model that is inherently different to financial institutions that exist primarily to produce profits for shareholders. Greater consideration needs to be given to the mutual sector to consider targeted and proportionate regulation that recognises differences and accommodates mutual business structures.
- Heritage Bank acknowledges APRA has attempted to increase the regulatory focus on competition in recent years, however the inconsistent application of this focus and lack of urgency has resulted in a number of failings in actual outcomes for the mutual industry.
  - Major Banks continue to benefit from implied financial support from the Australian government, negating the integrity of the individual credit rating system and providing a competitive advantage through lower funding costs. Heritage acknowledges that APRA has stated its intentions to reduce any implicit guarantees however further tangible action is required to remove market distortions.
  - The implementation of Investor lending caps has resulted in the establishment of a consistent distribution of market share, by limiting the ability of smaller ADI's to expand their investor lending portfolio. This unnecessarily protects the market share of ADI's who experienced significant growth in investor lending prior to the establishment of caps while also producing significant pricing distortion as consumers have limited refinancing or switching ability.
  - The proposed issuance of Mutual ADI Common Equity Tier 1 (CET1) capital instruments, while intended to assist smaller ADI's to increase their access to new capital sources, is severely limited in its application due to the suggested 15% cap. Caps imposed on CET1 issuance inherently discriminates against smaller ADI's by imposing restrictions on the size and frequency of transactions, undermining the fundamental benefits of the instrument.
  - Inconsistent legislative treatments for mutual entities inhibit competitive neutrality. There are numerous examples of discrepancies in the way mutual and listed entities are treated for tax purposes, for example franking credits. Many retail investors in capital and hybrid capital instruments, particularly retirees, actively seek franking credits when making investment decisions. Mutual entities pay the same rate of tax as listed entities therefore should be entitled to the same treatments in relation to franking credits.
  - Under the current prudential capital management regime all investments of an 'intangible' nature are a deduction from capital for prudential capital purposes. This rule was introduced in response to uncertainty associated with innovative tax structures applied by one of the major banks. What it means for all ADIs is that capitalized technology costs associated with investments in software licensing and consultancy are effectively funded entirely from core capital. Upgrading digital capabilities requires significant investment. Funding that

investment out of capital is a massive challenge for mutual ADIs. The scale of investment required puts the sector at a huge disadvantage compared to the listed banks, which have already used their much more flexible access to capital to invest in technological transformations. The current restrictions in relation to capital raising extend the timeframes associated with investment and delivery and act as a significant barrier to adopting technologies crucial to remain relevant to the customer bases of mutual ADIs.

- In addition to the above, competition continues to be hampered by consumer attitudes towards switching and refinancing. Improvements in the provision of product comparison data would give consumers an increased confidence in changing their product provider, forcing ADIs to innovate, improve value and ensure consumers are being provided with the correct product. Any comparison of products should be founded on well researched market studies to identify existing barriers to switching, with interventions designed to reduce barriers as much as possible.

We support the work being done by the Productivity Commission to assess the competitiveness of the financial sector. As Australia's largest Mutual Bank, we would welcome the opportunity to discuss our submissions and concerns with you.

Yours sincerely,

Peter Lock

Chief Executive Officer