31 March 2014

Mr David Murray AO
Chairman
Financial System Inquiry
GPO Box 89
Sydney NSW 2001

Dear Mr Murray

Submission to the Financial System Inquiry from P&N Bank

I write on behalf of P&N Bank's 100,000 members to ask the Murray Financial System Inquiry Committee to consider the recommendations contained in our attached submission as part of your Inquiry and subsequent recommendations to the Australian Federal Government.

Mutual organisations are operating within an environment that is heavily weighted in favour of the large banks. If the playing field is leveled, Australian consumers will benefit from a marketplace that offers *genuine choice* from smaller ADI's.

We trust the Committee will closely examine and address this imbalance.

We would welcome the opportunity to expand on any of the arguments raised in this submission and, if the Committee proposes public hearings, would welcome the opportunity to appear and advocate on behalf of our members.

Yours sincerely

Andrew Hadley
Chief Executive Officer

cc COBA

WA's **member-owned** bank

SUBMISSION

MURRAY FINANCIAL SERVICES INQUIRY COMMITTEE

P&N BANK

31 March 2014

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Corporate History and Background Information

As Western Australia's largest locally owned bank, P&N Bank has provided a range of retail banking and financial services to the Western Australian community for more than 30 years.

Operating under a mutual banking model, P&N Bank is an Approved Deposit Taking Institution (ADI). Those who bank with us, our members, are our owners. Profits are either retained as capital or reinvested back into the organisation for the benefit of members.

Our origins began in Western Australia in 1990 as Police & Nurses Credit Society (PNCS), which originated from the merger of the Police Credit Society of Western Australia Ltd and Western Australia Nurses Credit Society Ltd. In 2001, PNCS successfully merged with Energy Credit Union Ltd, which originated from a number of smaller WA credit unions. Around 15 West Australian credit unions make up our history, the oldest being established in 1949.

In March 2013, after obtaining approval from APRA to trade as a mutual bank, PNCS changed its name to P&N Bank, largely as a result of market research that indicated the "occupational based" branding was limiting our potential to expand and appeal to a broader customer base. Since the rebrand, research has shown widespread acceptance by members with our customer satisfaction rating at 97% (Wallis Strategic Market & Social Research - Satisfaction amongst members of P&N Bank. 30 July 2013.) alongside an increasingly strong prompted brand awareness score amongst the general public.

Our Board, Executive and Staff are proud of P&N's heritage and are passionate about the role we play in providing the community with a genuine banking alternative to the larger listed banks.

With assets under management approaching $3 billion, a workforce of over 300 employees, 17 branches in WA and a Perth based Contact Centre, we offer a wide range of financial products and services, including home loans, personal loans, reverse mortgages, term deposits, credit cards, financial planning, insurance, conveyancing services and foreign exchange.

P&N Bank is a member of the Customer Owned Banking Association (COBA) and endorses the core recommendations contained in their submission to the Murray Inquiry on behalf of the customer owned sector.

In tendering our own submission, we wish to draw the Committee's attention to a number of particular issues that have significant relevance to our 100,000 members in Western Australia.

Recommendation One

Remove the competitive disadvantage that exists based on current minimum capital requirements and the allocation of risk weighted assets to create a more level playing field between large and small ADI's.

Currently the larger banks that operate under the internal advanced model receive distinct advantages in this area. The combined risk weighting cost impact and minimum holdings of capital on ADI's operating under the standardised model can be up to four times more than those organisations operating under the internal advanced model. This diminishes the ability for smaller ADI's to compete on a level playing field, which in turn greatly impedes their ability to grow and ultimately affects the level of true competition on offer to Australian consumers.

Capital

The capital minimum including safety buffers, as deemed by APRA, for mutual banks such as P&N is in the range of twice that of the larger banks. This places a particular burden on our ability to compete in the housing loan market. More available lending funds would equate to more WA borrowers having more choice.

Risk Weighting

The minimum for mutuals using the standardised approach as defined by Basel III is almost twice that of the major banks.

This creates an anomaly whereby two houses of similar value standing side-by-side in the same street in suburban Perth have vastly different risk weighting of asset models applied to them. Home A, funded by a home loan from a major bank, requires about half as much capital to be held against it compared to Home B, next door funded by P&N Bank.

P&N Bank, its members and potential new members are at a clear competitive disadvantage in regards to pricing.

We would draw attention to the observation made in COBA's discussion paper:

"The competitive disadvantage imposed on all smaller lenders in the context of credit risk is particularly anomalous for customer owned banking institutions because of their strong and sustained track record of prudent lending. Customer owned banking institutions have consistently delivered lower levels of non-performing loans than the major banks." (p6, COBA Financial System Inquiry Discussion Paper: Competitive neutrality in the Retail Banking Market February 2014.)

In Australia the customer owned banking sector has demonstrated:

- lower earnings volatility over the past 35 quarters, compared to major banks;
- consistently higher levels of capitalisation than the major banks; and
- significantly lower credit impairment than the major banks.

We contend that a competitive customer owned banking sector actually improves stability by pushing back against the systemic risks inherent in a system dominated by a small number of very large listed banking institutions.

Recommendation Two

Reflect the benefit from the implicit guarantee for D-SIBs (domestic systemically important banks) by increasing the High Loss Absorption capital requirement above 1%.

We wish to highlight the inequitable situation faced by all customer owned banks, and in particular within our regional market where one institution dwarfs all others and enjoys the implicit Government guarantee.

We note the observation of the Productivity Commission in relation to competitive neutrality:

"Competitive neutrality removes artificial advantages and allows businesses to compete on a basis that offers the best cost and quality combinations to customers. This is likely to result in more effective competition and more efficient outcomes." (Productivity Research Report, January 2010)

As highlighted in COBA's Discussion Paper on this subject published in February this year, the big four banks:

"Benefit from a large and unacceptable implicit public subsidy; arguably don't compete aggressively with one another while competing aggressively against smaller players; are part of the only sector in Australia subject to anti-price signaling laws because of their anti-competitive behaviour; and feel they are protected from others entering the market.." (COBA Financial System Inquiry, Discussion Paper: Competitive Neutrality in the Retail Banking Market.)

COBA moves onto to quote APRA:

"As the Basel Committee argued, the moral hazard associated with implicit guarantees derived from the perceived expectation of government support can encourage SIBs (Systemically Important Banks) to take excessive risks, reduces market discipline and creates competitive distortions, further increasing the probability of distress in the future." (COBA Financial System Inquiry, Discussion Paper: Competitive Neutrality in the Retail Banking Market quoting APRA Information Paper Dec 2013.)

We believe this competitive distortion is having a significant negative impact on P&N Bank's capacity to act as a genuine alternative for consumers in the WA market place.

In particular, a direct consequence of the implicit guarantee is that the four major banks receive a significant upgrade in their credit rating (without cost) resulting in a larger differential in the cost of funding than should be the case. This curtails our capacity to compete – especially in the home loan market.

Consumer impact - housing affordability and access to credit in Western Australia

Housing affordability is a significant issue facing many Australians and is no doubt an important political and economic issue for the Australian Government.

As a legacy of the resources boom, access to affordable housing finance is a significant issue in Western Australia. The median house price in Perth in December 2013 was $535,000 despite falling iron ore prices and a decline in mining investment. This has created a massive challenge for younger Western Australians wanting to enter the housing market despite lower interest rates. In such circumstances, genuine competition among financial institutions offering housing credit has never been more important.

With fewer imbalances, there will be greater availability of funding from lenders such as P&N Bank and therefore a greater ability to provide a truly competitive alternative to the majors.

We strongly believe that increasing the High Loss Absorption capital requirement to above 1% would provide a reasonable step towards rebalancing the benefit the major banks currently derive from their D-SIB status.

Recommendation Three

Ensure that all bank sub-brands are overtly transparent in their disclosures to consumers that they are a division of the parent bank and do not hide their ownership in fine print.

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

Recent research by COBA shows there is a significant risk that a lack of transparency about the ownership of small banks by the big four is undermining genuine competition. (Source: COBA Media Release 28 February 2014.)

The situation is compounded by the fact that the major banks own a large number of home loan broking brands. Research commissioned by the customer owned sector confirms that a high percentage of Australians are unaware (over 80%) that the major four banks also own other mainstream lenders. The research reveals there is confusion about multi-branding by the big banks with just 52% surveyed saying St George was owned by a big four bank, down to a low of just 29% for RAMS. (Source: Australians Sentiment to Major Banks in Australia D&M Jan 2013 and Attitudes to Banking Survey Feb 2014 conducted by EMC for COBA.)

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 regional WA market 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 bank with a major bank.

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

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

Government Guarantee

The Australian Government guarantees deposits held in ADIs up to $250,000 per account-holder, **per ADI**.

Should the Financial Claims Scheme ever be invoked, those Australians who bank with bank sub-brands, could potentially be surprised with the real facts and be greatly disadvantaged because of a lack of understanding:

- of the **true ownership** of their bank and
- of the fact that the Government Guarantee only applies **per ADI**.

Consumers deserve to understand who they are really banking with and how the Government Guarantee on deposits is applied.

Recommendation Four

Unlock the accumulated franking credits held by mutual banks by permitting a tax offset on the first $1,000 of interest on member savings accounts.

Customer owned banks, unlike banks listed on the stock exchange, are at a disadvantage when it comes to the accumulation of franking credits. COBA estimates that customer owned banking institutions collectively have accumulated franking credits of more than $1.5 billion and are adding $150-$200 million per year.

The franking credits system does not take account of companies that pay tax but then *retain* rather than distribute after tax profits.

We believe mutuals should be given the ability to use their franking credits to offset the first $1000 of savings deposit interest earned by members per annum. This could make a significant difference to the competitiveness of the mutual sector without sacrificing risk and at little cost.

We draw attention to this quote outlined in COBA's submission Section 5.2.3:

"Customer owned ADIs should be able to pass on to their owners the benefit of having paid company tax, just as non-mutual companies can choose to do. Dividend imputation means company tax is a pre-payment of tax ultimately paid by the company's owners – akin to a withholding tax. Owners of companies that pay dividends are able to benefit from the tax paid by the company through a reduction in their personal taxation liabilities. Owners of companies that don't pay dividends, such as customer owned ADIs, are not able to benefit in this way. For customer owned ADIs, franking credits remain locked up, increasing year after year as the company continues to make profits, pay tax and prudently retain those profits as its main source of regulatory capital."

It is our strong belief that our members should derive some benefit from these franking credits.

Concluding Remarks

In closing, we urge the Committee to take careful account of the significant role played by mutual banks in the broader financial services market and in particular the specific circumstances faced by the mutual banking sector in WA.

We wish to draw the Committee's attention to the detailed arguments made in COBA's submission, especially those that highlight the limits the current system places on our sector's ability to ***genuinely compete on an equitable playing field.***

In our view, it is anti-competitive in WA that the market is so dominated by one large bank.

For the sustainability and strength of Australia's banking sector and in particular, the customer owned sector, we trust that our recommendations will receive favourable treatment by the Committee for the benefit of all Australians now and into the future.

Thank you for the opportunity to provide input to this timely and important review.