



FAST FORWARD THE PRODUCTIVITY COMMISSION BANKING COMPETITION REVIEW

The Turnbull Government should allocate funds in the May Budget to bring forward a planned Productivity Commission review of banking competition.

There is an urgent need for well-considered measures to promote competition in banking. In its response to the 2014 Financial System Inquiry (FSI), the Government agreed to implement periodic reviews of competition in the financial sector. The Customer Owned Banking sector is calling for allocation of funding to enable the Productivity Commission to complete the first such review by the end of 2017. The Government's current commitment is to commence, but not complete, such a review in 2017. Given the state of competition in the banking market, we can't afford to wait.

The case for an accelerated timetable for the Productivity Commission review is underlined by the House Economics Committee's November 2016 report that was highly critical of the state of competition in the banking market, finding that:

- Australia's banking sector is an oligopoly
- Australia's four major banks have significant pricing power, higher than average returns on equity and large market shares
- A lack of competition in Australia's banking sector has significant adverse consequences for the Australian economy and consumers, including reduced incentive for major banks to innovate and allowing major banks to use their pricing to extract excess profits from consumers.

An expedited, expert review is sorely needed to identify the barriers to a more competitive market and measures to overcome those barriers.



INCREASE CUSTOMER OWNED BANKING'S CAPACITY TO RAISE CAPITAL AND COMPETE

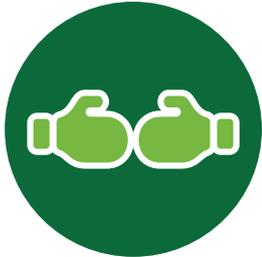
APRA should respond positively to the Senate Economics Committee recommendation that it set a target date for the outcome of discussions with the co-operative and mutuals sector on issues of capital raising and bring those discussions to a timely conclusion.

Customer Owned Banking institutions do not have capacity under the prudential standards to directly issue, on a 'going concern' basis, the highest quality capital instruments, i.e. Common Equity Tier 1 (CET1) instruments.

Listed banks regularly issue CET1 capital instruments, and it is important that mutual banks, credit unions and building societies also have the capacity to do so while preserving their mutual model. Having the option to raise capital in addition to retained earnings allows for more ambitious growth targets, diversifies funding options and provides capacity to seize acquisition opportunities and invest in technology and innovation.

Prior to the Basel III changes to the prudential framework, Customer Owned Banking institutions did have capacity to issue the highest quality capital instruments and did issue such instruments. APRA's prudential framework has fallen behind comparable jurisdictions, i.e. Europe and the UK, where mutual banking institutions have been given capacity to issue CET1 instruments. Canada is also taking steps to deliver this capacity.

Allowing Customer Owned Banking institutions to directly issue CET1 instruments that are consistent with the mutual model can be achieved by removing the current prohibition on the direct issuance of mutual equity interests (MEIs) and modifying the definition of MEIs in APS 111 Capital Adequacy: Measurement of Capital to better align with ASIC's Regulatory Guide 147 Mutuality - Financial institutions.



EMPOWER APRA TO FOCUS MORE ON COMPETITION

Amend the APRA Act to give the prudential regulator an explicit 'secondary competition objective' and require APRA to report annually against this objective.

APRA's UK counterpart, the Prudential Regulation Authority (PRA) has since March 2014 been subject to a 'secondary competition objective' (SCO). In June 2016, the PRA delivered its first Annual Competition Report setting out how it is delivering against its SCO and the steps it is taking to drive more competition and innovation in financial services markets.

The SCO states that: "When discharging its general functions in a way that advances its objectives, the PRA must so far as is reasonably possible act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorized persons in carrying on regulated activities."

The SCO does not make the PRA a front-line competition regulator and there is no reason why effective competition should undermine prudential standards that emphasise the safety and soundness of firms and the stability of the financial system.

APRA has considerable power and discretion as the prudential regulator of banking institutions but it does not give sufficient attention to the impact of its decisions on competition. Under its current mandate as prudential regulator, APRA "is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia."

APRA interprets its mandate in the following way: "It is not our job to set standards for competition, efficiency et cetera, but if we are faced with a policy choice that delivers prudential outcomes, which one is more likely to have a better competition outcome? Or, how can we achieve prudential outcomes, first and foremost, without damaging any of those other considerations."

The FSI found that there needs to be a stronger focus on competition in the financial system and "that there is complacency about competition, and that the current framework does not systematically identify and address competition trade-offs in regulatory settings."

Introducing an explicit SCO and related reporting obligation for APRA will increase this powerful regulator's focus on competition and improve accountability.