SUNCORP

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Statement to the Productivity Commission Inquiry into Competition in the Australian Financial System

David Carter, Suncorp CEO Banking & Wealth

I would like to thank the Commissioners for the opportunity to appear at today's hearing. Suncorp strongly supports the Productivity Commission's work in relation to competition, as we see the Inquiry as an important opportunity to initiate reforms which will ultimately drive better outcomes for customers. In our view, one of the best ways to deliver this is by improving the ability of all banking institutions to compete on a level playing field.

The Commission's Draft Report is a comprehensive document which identifies a large number of potential issues and possible improvements. Many of the impediments to competition that we raised through our initial submission have been addressed in the Draft Report. We are therefore largely supportive of the Productivity Commission's proposals and welcome the opportunity to consult further on this important topic.

Before turning to some of the key issues for smaller banks like Suncorp, I would also like to take a moment to acknowledge the strengths of Australia's financial system. While we see opportunities for improvement, our financial system is far from dysfunctional and has largely operated well in serving the interests of all Australians. Australia's regulators have ensured that financial stability has been maintained, and this focus undoubtedly positioned the country solidly during the global financial crisis. Customers have been safe in the knowledge that their hard-earned money is protected by responsible banks operating within a well-functioning prudential framework.

While the major banks hold a dominant position in the market, having four strong and globally recognised banks operating in Australia is also a strength for our system and, one that in many regards, has benefited our economy. As a net capital importer, access to international funding markets is essential, and the scale and profile of our major banks improves their ability to gain access to these markets, while simultaneously freeing up access to domestic markets for smaller banks. In many regards, this equation strikes a good balance for all parties, and we should be wary of imposing any significant changes on these market structures given the risk of unintended consequences. It's a symbiotic relationship that may very well help to insulate Australia from future shocks and disruptions in the global economy.

However, there are several areas where we believe the prudential and regulatory settings could be adjusted to enable smaller banks to more fairly compete against the major banks. In particular, we continue to hold concerns about funding costs, risk weights, macroprudential interventions, and the disproportionate burden of regulations on smaller institutions. We seek reforms in these areas as we believe positive changes will allow smaller banks to more effectively bring competitive tension to the sector, which will inevitably spur greater innovation and choice, and deliver better outcomes for all customers.

APRA's recent paper on implementing Basel contained some encouraging proposals around risk weights, including potential reductions for some low risk residential mortgages held by standardised ADIs. However, uncertainty remains around final calibrations, particularly for some IRB elements. Suncorp has already made a significant investment in developing the risk models needed to achieve IRB accreditation, and we would not want to be penalised for being a regional bank leader in this area. Risk weights have an impact on decisions that banks make about lending products, and it is important that the settings are calibrated in a way that does not undermine consumer outcomes.

Macroprudential caps on investor and interest-only lending continue to distort competitive tensions in lending markets, and have allowed those with the largest investor and interest only portfolios to use their pricing power in these areas to offset particularly sharp pricing on low-risk owner occupier principal and interest loans. We welcome the Productivity Commission's finding in its Draft Report that banks' ability to compete on price had been “constrained significantly” by macroprudential interventions. While we maintain concerns about the caps, we have been encouraged by APRA’s recent comment that the investor cap was “potentially becoming redundant.” The investor cap has already had a significant impact on aggregate lending levels across the industry, and other measures introduced by APRA and ASIC have addressed regulator concerns around lending standards. As such, we believe the investor cap is no longer needed, and that its removal would once again allow banks to compete for this type of lending. We continue to observe that the non-ADI sector has benefitted from macroprudential caps, and has been able to fill some of the gap created by the reduction in credit to investor and interest only. We continue to observe that that sector is subject to much lower capital and regulatory requirements, and has enjoyed significant growth and commensurate returns.

Further, the major banks continue to hold a significant funding cost advantage over their smaller rivals. While their size and scale will always give them a price advantage in funding markets, we believe that the three-notch credit rating upgrade they receive, due to the perception of government support, provides them with an additional unfair advantage on top of this. It begs the question - how can this be good for customers?

Small banks’ ability to compete on price is ultimately driven by their ability to source capital to support growth – in both retail (mortgages) and small business loans, which is typically the focus of those banks. The owners of capital require a suitable return, or return on equity (ROE). “R” is influenced by funding costs or revenue side, and business expenses or expense side. “E” is influenced by risk weights used to determine capital requirements. Large banks have scale advantage and this is a natural economic outcome. However, this is being compounded by increased regulatory activity and the cost associated, which is likely disproportionate for smaller banks. Post GFC ROE in smaller banks have averaged close to half those in larger banks. In order to witness greater price competition, it would seem necessary to first deliver ROE that can attract incremental capital to the small banks.

Finally, I would like to emphasise that competition in the banking sector is about far more than price competition. While price will always be an important consideration for a customer, other important factors, such as product features, customer service, and the reputation of the banking institution are also highly significant. What is important is that customers are empowered to choose a product that provides them with a combination of price and other factors that meet their needs. In this regard, we believe that the broker sector continues to play an important and valuable role, providing customers with additional choice and service, which is about more than simply identifying the cheapest product.

Thank you again for the opportunity to be here today and I welcome your questions.

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