wide bay
AUSTRALIA LTD
banking your way

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26 March 2014

Financial System Inquiry
fsi@fsi.gov.au

Dear Sir/ Madam

FINANCIAL SYSTEM INQUIRY SUBMISSION

Wide Bay Australia Ltd ("Wide Bay Australia") provides the following submission in line with the terms of reference of the Financial System Inquiry ("FSI)".

Wide Bay Australia is a publicly listed building society with total assets in excess of $2.6 billion, providing deposit, credit, insurance and banking services to personal and business customers across Australia, principally in regional and metropolitan Queensland.

This submission addresses key elements of the FSI terms of reference.

1. **The consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the Global Financial Crisis ("GFC").**

   The 1997 Wallis Inquiry identified inefficiencies in the financial services system at that time, in terms of product disclosure, licensing, conduct and financial markets. The current financial system is the result of an extensive legislative and regulatory reform agenda, which followed the Wallis Inquiry.

   Two new regulatory bodies were recommended, the first being the Australian Securities Investments Commission ("ASIC"), who is responsible for financial markers and the second, the Australian Prudential Regulation Authority ("APRA") responsible for the prudential supervision of ADIs. APRA's oversight of ADI's complements the Reserve Bank of Australia's ("RBA") oversight of the banking system.

   The Australian Financial system performed well throughout the GFC due to prudential regulation. However significant changes have taken place since 1997 and the GFC. Technology, with the introduction of the worldwide web in 1996 has changed the basic ways financial products are distributed. Previously bank branches were the dominant distribution channel, but now with internet banking, apps, Smartphones, tablets, etc. this is no longer the case.

2. **Philosophy, Principles and objectives underpinning the development of a well-functioning financial system.**

   A modern risk management framework encouraging appropriate risk management practices needs to be adopted, taking to account the changes to the financial sector since 1997. Regulation cost must be balanced with the safety of the system to ensure cost effective regulation.

   In David Murray's Keynote Lunch Address of 14 February2014, he asked "whether we still believe that the Government should not intervene to guarantee financial institutions."

   There is no doubt, from Wide Bay Australia's experience that the Deposit Guarantee, while resulting from immediate concerns about the GFC, has resulted in increased confidence in our organisation and resulted in a more even playing field, with greater liquidity and competition in the Australian deposit market.

   We strongly believe that withdrawal or reduction of the Guarantee will result in deposit funds migrating away from regional banks, building societies and credit unions to larger banks based on 'unfounded' assessment that these banks are safer or as a result of promotion by major banks of their perceived strength and superior credit ratings. This means the big banks get even bigger and the "too-big-to-fail" issue is compounded.

   Unfortunately individual 'mum and dad' investors, which are the mainstay of smaller ADI's, do not always have the skills to assess an individual institution's creditworthiness.

   Any loss of deposit funds will increase the cost of loan funds to smaller lenders and make it difficult for institutions such as Wide Bay Australia to maintain competitive loan interest rates and/or maintain funding levels for new and existing customers.

   It is unlikely that lenders would abuse deposit protection by becoming more lax in managing risk, given the high standards of prudential regulation and supervision by bodies such as APRA.

3. **Emerging opportunities and challenges that are likely to drive further change in the global and domestic financial system.**

   We believe one of the biggest challenges of the financial system, is finding a solution to the longevity challenge we are facing as a community. The Institute of Actuaries of Australia advised, "by 2015 almost a quarter of the population will be aged over 65 compared to currently 14%." Many Australians who are leaving the workforce and relying on superannuation are having, for the first time in their lives, to take responsibility for significant funds and often find the system overwhelming and complicated. The opportunity for ADI's is developing a range of suitable products that are "easy to understand" to address this longevity risk. The challenge will be the regulatory issue associated with these products.

   Technology is continually changing and will provide further challenges to the financial system. New technology has changed the landscape. Internet currencies, peer-to-peer lending and real-time retail settlement of payments are on the horizon. Newcomers such as Google and Bitcoin are waiting to provide payments services independent of the banking and financial system, using devices to emulate what is done in the banking system. These companies being 'non-bank', escape the regulatory burdens associated with ADI's. New technology carries adjustment costs, more regulation, and new risks. Privacy and security liability (and cyber more generally) is a very real risk for companies like Wide Bay Australia, which control large amounts of confidential customer information.

Regulatory changes continue to be a big challenge facing the building societies, credit unions and mutual banks sector. Some of the regulatory compliance requirements for 2014 are:-

Comprehensive Credit Reporting, AML/CTF/FATF and Anti Bribery, ICAAP, Capital, Liquidity, Financial Claims Scheme, FATCA, Living Wills/Recovery Plans, Privacy etc.

4. **Policy recommendations to ensure our financial system builds on its strengths and remains appropriate for the Australian economy.**

In David Murray's Keynote Lunch Address on 14 February2014, he advised "the Committee is particularly keen to ensure we have a system that balances competition, innovation, efficiency, stability and consumer interests and meets Australia's needs from both end users of the system and financial institutions".

Regional operated ADI's and lenders such as Wide Bay Australia play a significant role at a local level in ensuring competition in our immediate marketplace and provide additional choice to consumers.

Financial Claim Scheme (FCS)

As mentioned above the Australian Government's decision announced on 12 September 2011 to extend indefinitely the FCS, which guarantees deposits of up to $250,000 per person, per ADI, is a major factor in respect of the stability and future operations of our sector.

Wide Bay Australia fully supports any measures taken by the Australian Government to assist smaller ADI's to consolidate their position as alternate providers of mortgages, deposits and financial services and thus increase competition in the Australian banking sector.

The withdrawal or reduction of the FCS would penalise smaller ADI's more than the larger banks, as it could lead to deposit funds flowing to the major banks which are perceived as being more secure because of their size.

Funding

Wide Bay Australia uses the "Standardised" approach for calculating regulatory capital, which means we apply a risk weighting of 35% on home loans. Major banks use the Internal Ratings based (IRB) approach which means they can apply a risk weighting as low as 16%. A major bank could therefore hold c. 50% less capital for a housing loan for the same borrower and residential security.

This is a significant disadvantage for smaller lenders. We need to 'even up the playing field' to allow competition and consumer choice.

Deposits

The November 2012 Senate Economics Committee report on the post-GFC banking Sector, recommended that inconsistencies between the taxation of interest on ADI deposits compared to other methods of saving should be addressed. They drew attention to the broader benefits, noting that:

"Encouraging domestic deposits would provide banks with a larger source of stable funding, reducing some of the risks from sourcing funds from unstable international wholesale debt markets. Further an increased pool of deposits may help alleviate any long-term competition implications arising from the major banks encroaching on a funding source relied on by smaller ADIs."

Wide Bay Australia supports the review of taxation on deposits. Deposits are an important source of funding for smaller ADI's.

Liquidity

The new APRA liquidity standard introduced in January 2014 meant that ADI's under the Minimum Liquidity Holding (MLH) regime are now unable to hold RMBS in their MLH portfolio. Major banks, under the Liquidity Coverage Ratio (LCR) regime can hold RMBS to form part of their regulatory liquidity and therefore able to generate higher return.

This is another example of the "uneven playing field" for smaller ADI's.

Regulation

ADI's are all subject to the same regulatory framework. The Major banks can achieve "economies of scale" compared to the smaller ADI's who are subject to the same regulatory compliance. This then impacts on the competiveness of the industry.

The volume of regulatory compliance is enormous and complex. APRA, ASIC, RBA, ACCC, Austrac, ASX, ATO and the Privacy Commission are some of the regulatory bodies Wide Bay Australia reports to. There are continual regulatory changes taking place, some with very short timeframes to implement e.g. the recent Amendments to the Privacy Act 1988, which came into effect on 2 March 2014, with regulations only issued mid- Dec 2013, Credit Reporting Privacy Code issued 22 January 2014 and guidelines released 7 March 2014.

Another example of this is in regards to the AML/CTF enhanced customer due diligence requirements.

The final AML/CTF Rules are expected to be released "March 2014" for commencement from 1 June 2014. Austrac have advised that an Assisted Compliance Period will be available until 31 December 2015 during which no civil penalty actions will be taken by Austrac for non-compliance. This will be subject to the following proposed conditions:

- Institutions have a detailed transition plan signed off by the CEO or Board for the actions and timeframes to achieve full compliance, giving Austrac a copy of the plan on request and regular monitoring of compliance with the plan.

The handling of these draft changes by Austrac is sub-optimal. Industry is very disappointed with how the changes are being managed. The expectation is that no-one will be in compliance with the draft / proposed requirements from Day 1 and the proposed requirement for a detailed transition plan is unworkable given the short timeframe between finalisation of the revised Rules (assuming that occurs this month) and commencement date of 1 June 2014 when institutions must have the proposed "detailed transition plan".

Rushing changes creates confusion and unnecessary costs.

The following attachment forms part of our submission but is to remain in confidence.

We thank you for this opportunity to submit our comments. Please do not hesitate to contact me on 07 41504001 if you have any queries in regards to our submission.

Yours faithfully,

Martin Barrett
Managing Director