Aussie

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Insurance

26 August 2014

Financial System Inquiry Secretariat
Financial System Inquiry
GPO Box 89
Sydney NSW 2001

Dear Sir/Madam

RESPONSE TO THE FINANCIAL SYSTEM INQUIRY INTERIM REPORT – THE CONCENTRATION AND INTEGRATION OF THE MAJOR BANKS

Below for your consideration is a response prepared by AHL Investments Pty Ltd ("Aussie") to the Interim Report issued by the Inquiry on 15 July 2014. This response briefly addresses the request for further information on the concentration and integration of major banks (page 2-21) given the relevance of this issue to Aussie.

Is integration in the banking sector causing competition issues?

Aussie does not consider there to be any systemic competition issues attributable to integration in the banking sector. This view is centred on the residential mortgage sector in which Aussie operates and is based on the following considerations.

- **The existing market structure fosters competition while facilitating efficiency gains.** When coupled with the ongoing diversity of market players (regional banks, second tier banks, credit unions, building societies, securitisation funded models and international banks), vertical integration has led to a positive outcome for consumers given that consolidation has delivered efficiency gains that have supported new rounds of competition.
- **Cyclical market conditions have driven consolidation in the same way that future conditions may drive fragmentation.** Changes in debt markets have made it harder for lowly capitalised vehicles to participate in funding mortgages (e.g. via securitisation structures), driving consolidation in recent years. Many of the businesses relying on these models were operated in an unsophisticated manner where pricing did not adequately contemplate risk, and hence there was insufficient capital to manage through shocks.
- **Market mobility and availability of information.** As a result of rapid improvements in technology, consumers are increasingly aware of their options and more readily able to access comparisons either through brokers or online portals. Consumers are also more readily able to exit existing relationships with little or no restrictions/costs.

Is vertical integration distorting the way in which mortgage brokers direct borrowers to lenders?

Aussie does not believe vertical integration is distorting the way in which mortgage brokers direct borrowers to lenders. This position is based on the below.

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- **Aussie's lender panel share has not shown ownership bias.** The flows to CBA and the wider CBA group since the initial acquisition of an ownership interest in Aussie in 2008 demonstrate flow changes which are consistent with the institutions' level of competitiveness at any point in time. Consistent with this view, the share of sales by the major banks on Aussie's panel has declined in recent years.
- **The broker business model is not compromised by vertical integration.** Given the self-managed and independent nature of their business, brokers are required to be diligently aware of compliance requirements focused on the suitability of products for consumers' particular circumstances (with these obligations actively policed and punished if circumvented). Beyond these legal requirements, brokers are conscious that their reputation and that of their business are heavily driven by their ability to offer independent, tailored advice. In this regard Aussie has tools and processes that provide strong transparency to end customers as part of the loan and lender selection processes and the requirement for objectivity is regarded as paramount to a positive consumer experience. Finally, brokers have no rational incentive to favour the products offered by their parent company over another lender and will instead respond to any shift in market pricing and incentives.
- **Increasing broker use and availability has stimulated competition.** The surge in the proportion of broker-originated loans, and the increased availability of brokers, has encouraged competition in the lending market to the benefit of the consumer. Moreover, consumers are now able to verify the independent nature of broker advice through the use of comparison sites and other industry resources.

If so, what would be the best way to limit the adverse impacts?

Given the view that there has been minimal impact from integration, we do not believe that there are significant steps to be taken to limit any adverse impacts of this issue. However, to ensure that this issue does not generate any adverse impacts in the future, Aussie believes it is important to ensure the existing regulatory framework is effectively enforced across the industry, independent of participants' ownership structures or size.

Closing comments

Aussie can provide further data and explanation to support the views expressed above if requested.

We welcome any further questions or comments relating to this area of analysis from the Financial System Inquiry.

Yours faithfully,

Mr John Symond AM
Executive Chairman