

19 May 2017

Mr Greg Hammond OAM  
Review Chair

**Reforms for Cooperatives, Mutuels and Member-owned Firms**

Ref Num: {9245FEA4-824B-42DD-86A6-AA59985AA895}

Dear Mr Hammond,

**Submission to Hammond Inquiry - Unshackle the barriers to competition and choice**

On behalf of P&N Bank's 90,000 members, I am writing to ask the Hammond Inquiry to consider the recommendations for legislative reform contained in our attached submission as part of your subsequent recommendations to the Australian Federal Government.

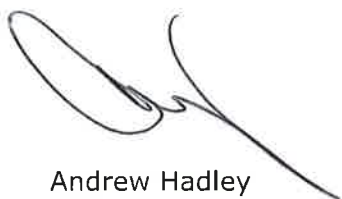
Our members expect all the services of a contemporary retail bank and in this era of disruption and fast paced technological advances, we need capital to continue to develop and grow on their behalf.

P&N is confident that with legislative change, supported by interim regulatory change if necessary, a mutual banking sector with access to capital will have greater opportunity to provide more genuine competition, while fostering enhanced awareness of mutuels and co-operatives in academic and societal settings.

I would welcome the opportunity to expand on the information raised in this submission at one of your proposed round table meetings.

Should you have any questions at any time, please feel free to contact me directly on 0419 784 293.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Andrew Hadley', with a long, sweeping tail stroke extending to the right.

Andrew Hadley  
**CEO**



## **HAMMOND INQUIRY - RESPONSE TO TERMS OF REFERENCE**

### **BACKGROUND**

#### **Mutual Sector**

As a member owned bank, P&N Bank is a staunch advocate of a vibrant and sustainable mutual banking sector and the ensuing benefits to the economy and Australian consumers.

Our sector continues to offer a compelling and diverse alternative to the major listed banks, often with greatly superior customer service, more competitive pricing and broader member benefits.

We believe that genuine competition will benefit all Australians but in order for that to occur, a more level playing field must be established. Without a real ability to grow and thrive, the mutual banking industry will struggle to increase its relevance.

#### **P&N Bank**

P&N Bank is now the only locally domiciled ADI in Western Australia. Other financial institutions are either a brand or a sub-branch of entities domiciled in other states or overseas.

P&N Bank began like many other mutual banking organisations. Over 40 years ago, members of the police, nursing and later the energy sector pooled their funds to support members who might not otherwise have received financial support from traditional banks. P&N's target audience later expanded to include the general public.

In 2013, to appeal more broadly, Police & Nurses Credit Society rebranded to P&N Bank. With some 90,000 active members mainly domiciled in Western Australia, P&N Bank has 330 staff and offers contemporary retail banking products and services through various distribution channels.

At the heart of P&N is our belief in the power of individuals coming together, to enjoy the benefits of being part of something that is bigger and stronger than they would be alone.

With high customer satisfaction and Net Promoter scores, P&N Bank provides genuine competition in the WA banking environment. However, while P&N's offering is gaining popularity and delivering strong sales and business growth, there is a significant lag in the resultant increase to profits. Without the ability to raise capital, P&N can only develop and grow at a modest rate less than the underlying demand using its retained earnings.

In this modern era of fintech disruption and ever changing consumer expectations, our sustainability and ability to genuinely compete is greatly diminished without the ability to invest in our future. In summary, P&N Bank is unable to fulfil its market potential without some type of capital reform.

## **Term of Reference 1 (TOR 1)**

*What regulatory and legislative barriers currently exist which impede Commonwealth-registered cooperatives and mutuals from accessing capital and how significant those barriers are;*

### **Barrier: Impediment to Raising Capital**

#### **Recommendation:**

P&N Bank strongly supports

- a. the need for prompt legislative change to permit a new Mutual Capital Instrument (MCI) for mutual ADIs to access CET1; together with
- b. the amendment of the Corporations Act 2001 to permit a clear statutory definition for mutuals in Australia identifying those entities that can access and issue the MCI.

While P&N Bank is not opposed to regulatory change allowing the issue of Mutual Equity Interests (MEI), we are primarily supportive of the legislative option because legislation;

- provides greater certainty as it avoids the risk of medium term policy changes;
- helps regulators by removing the onus from their policy function for deciding what new instruments (if any) should be authorised for mutual ADIs; and
- makes it more likely that Regulatory authorities will continue to respond to the needs of the sector, by following the intention of primary legislation, rather than interpreting the needs of mutual ADIs.

Without the ability to directly issue capital instruments to support our growth, P&N Bank has relied on the accumulation of retained earnings. This slow and incremental process is severely restrictive.

The lack of access to CET1 instruments has significantly constrained P&N Bank's ability to continue to offer new innovative products and services, and to expand its offering through acquisition or partnership.

P&N has experienced four distinct scenarios in recent times where capital constraints have limited the Bank's growth potential:

### **Member Value Product Innovation**

Following the development of a five year strategic plan and compelling new brand belief in 2014, P&N took a new member value proposition (MVP) to market in late 2015 to drive member satisfaction, growth and brand health. An innovative, new lending product bundle, unique in Australia, was a key new product. Members could access a competitive variable rate home loan along with a platinum credit card also priced at the same low rate as the home loan (at the time 3.89% pa).



Offering the choice of a credit card at such a compelling rate, bundled with a low rate home loan, directly addressed the considerable public discontent towards high credit card rates at a time when cash rates were at historical lows.

The product take up was extremely high. So much so, that P&N Bank achieved 21% growth in lending in FY16, resulting in P&N Bank being the fastest growing mutual banking organisation in Australia.

However, given the inability to access additional CET1 capital, this growth had to be constrained. Capital levels were quickly diminished because the increasing risk weighted assets take time to drive increased revenue levels.

Having spent several years refining the new member value proposition, and seeing it resonate so strongly with the market, our business found it particularly difficult to have to constrain that growth.

Our 330 staff had been heavily engaged with our member first strategy and new MVP proposition. It was therefore difficult for them to understand why, after so much effort and sales success, P&N was not able to continue to grow our business on behalf of our members. They were not able to easily correlate the unprecedented sales success with the need to constrain growth in FY17. This was a particularly disheartening and difficult proposition for our whole organisation.

### **Industry Sector Innovation**

P&N Bank is a retail bank with no business-banking offering.

In our view the major listed banks underservice the WA small to medium business (SME) sector. This represents an ideal opportunity for an entity such as ours to offer a superior service proposition.

While keen to explore and expand into this sector, our limited access to capital has effectively limited the speed at which P&N can test and learn. In short, without access to capital, any steps towards expansion into the SME sector would be sub-optimal at best, therefore diminishing the chances for viability, success and growth.

### **Technology Partnership**

Partnership has never been more relevant given fintech disruption and the pace of emerging global trends in the banking, digital, mobile and payments sectors.

With the significant technology innovation emerging in retail and SME banking, P&N is keen to partner with emerging players who are likely to be successful disruptors.

With limited capital available, P&N Bank and other mutuals are unfairly restricted to take advantage of strategic opportunities to acquire, partner or work cohesively with banking entrants who can fundamentally change the nature and cost of the financial sector.

## **Limitations on growing at our natural pace**

Since the introduction of a range of new products and service offerings, P&N Bank has been writing business well in excess of organic system growth levels in WA.

APRA requires capital adequacy ratios to be calculated on total loan risk weights immediately on settlement of a loan. Mutuals like P&N Bank need to allow time (often years) for loans to generate enough income to flow into retained earnings which in turn incrementally improves capital. P&N's capital growth therefore lags considerably following strong business growth.

The mutual industry is severely disadvantaged from the listed banks in that there are few avenues available to attract and secure capital in anticipation of growth levels.

P&N Bank has over the last 18 months been operating well below our natural pace, despite demand from the public for our products, in order for capital levels to be self-sustaining.

Faced with a similar situation, major banks could raise capital under existing legislation with little effort.

As a result, mutual banks lack the agility to raise capital to take advantage of timely strategic and tactical opportunities.

On behalf of our members, we believe this imbalance is unfair and anti-competitive.

## **Terms of Reference 2 (TOR 2)**

*The pros and cons of inserting a definition of "mutual enterprise" into the Corporations Act 2001;*

### **Recommendation:**

As stated in TOR 1 above, P&N supports the amendment of the Corporations Act 2001 to permit a clear statutory definition for mutuals in Australia identifying those entities that can access and issue the MCI.

### **Pros**

The benefits of this legislative change would remedy the current anomaly that does not recognise mutuals in law. Mutuals currently voluntarily describe themselves as such as an expression of their business purpose.

Such a legal definition will be required to identify precisely which types of firms would qualify to issue any new mutual capital instruments.

A change to the Corporations Act 2001 would formally recognise our sector, legislate mutual-specific options and solutions, and this in turn would support the ability for mutuals to raise capital to enhance growth and development of the sector.

This descriptive legislative change would also provide the Australian mutual sector with its own unique identity. This would be useful in business and societal



sectors such as education and academia. An improved understanding of mutuals and co-operative models can only benefit our industry and consumers alike.

**Cons**

P&N Bank does not foresee any detrimental impact from the proposed legislative change outlined above.

**SUMMARY**

If P&N was able to, we would look to raise in the vicinity of \$25M of Tier 1 capital as a first tranche to support strategic opportunities that would benefit our members.

A capital issue of this size would create an increase of some 1.4% in P&N's Capital Adequacy Ratio (CAR).

P&N Bank fully supports and thanks the Federal Government for the Hammond Inquiry, the outcomes of which could significantly contribute to levelling that playing field on behalf of Australian consumers.

- Ends -