Members Equity Bank Pty Ltd
ABN 56 070 887 679

Level 16, 360 Collins Street Melbourne VIC 3000
GPO Box 1345 Melbourne VIC 3001
t 03 9605 6000 f 03 9605 6999
w mebank.com.au

3 December 2010

The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Secretary

ME Bank is pleased to provide the following submission to the Committee and looks forward to an opportunity to discuss points of interest in further detail.

1. Introduction

ME Bank is a wholly owned subsidiary of Industry Super Holdings which in turn is owned by 33 industry superannuation funds, including the largest funds, AustralianSuper, HOSTPLUS, Cbus and HESTA. ME Bank's philosophy is to offer ethical, low-cost and innovative banking services to members of industry super funds, employers and trade unions.

The Bank strongly supports competition within the Australian banking sector as being critical to the efficient allocation of capital, protecting consumers' rights and interests, and promoting economic growth.

Within the banking sector there are a number of distinct markets including home lending, deposits, small business and personal lending. ME Bank - while offering a wide range of consumer and small business banking services - is primarily a home mortgage provider, and accordingly our submission focuses on the mortgage market.

The Bank's submission is based on two key observations:

Capital market failure

Smaller banks and the non-banking sector are critical to providing an innovative, low cost alternative to the dominant major banks. To the extent the smaller banks rely upon securitisation to fund their lending programmes, Government intervention is required as these markets remain disrupted.

Consumer sovereignty

Secondly, the smaller banks and non-banks have a demonstrated record for providing superior customer service. Current regulations and procedures however, act as an effective deterrent to most consumers exercising their sovereignty and switching from the major banks. Government intervention is required to empower consumers to freely exercise their preference.

2. Scope

This submission responds to the following 3 areas of investigation:

(i) the current level of competition between bank and non-bank providers;

(ii) the ease of moving between providers of banking services; and

(iii) regulation that has the impact of restricting or hindering competition within the banking sector, particularly regulation imposed during the global financial crisis.

3. The current level of competition

The global financial crisis (GFC) had a significant impact upon the domestic mortgage market with the effective collapse of securitisation markets and the consequent competition for balance sheet deposits driving many non-bank mortgage originators from the market. Furthermore, the consolidation of second tier banks St George Bank and BankWest into Westpac and the CBA respectively has produced an unprecedented concentration of market power.

The result is a mortgage market dominated by the four major banks and a significant reduction in competition and choice.

ME Bank has survived the GFC as an independent, mutually owned mortgage provider not withstanding our previous reliance upon securitisation has required a rebuilding of our business model and in particular a diversification of our funding sources. The Bank's ability to be a competitive alternative to the current oligopolies will require Government policy support and intervention as outlined in this submission.

3.1 AOFM Programme

The Bank supports the Government's initial intervention via the Australian Office of Financial Management (AOFM) as being essential to improve liquidity and funding during the continuing dislocation of global capital markets. The Bank has relied upon the AOFM to place $4.2 billion of residential backed mortgage securities (RMBS) in 5 transactions over the past 24 months. These transactions have been critical in providing funding to support the Bank's mortgage lending programme, allowing ME Bank to be a viable, competitive alternative.

Until capital markets and securitisation are independently supported by private markets, continued AOFM support is critical to the capability of ME Bank to secure sufficient funding at a reasonable margin.

3.2 Further Enhancements

While the AOFM program has been successful, we submit there are a number of enhancements that would assist institutions such as ME Bank to continue as an effective, competitive alternative.

3.2.1 Continued funding

To allow medium term planning, an early commitment by Government to continued funding of the AOFM program is recommended. Approximately $4 billion remains and to date 18 lenders have relied upon the AOFM as cornerstone investors to fund $26.2 billion in mortgage lending.

3.2.2 Security Ratings

The AOFM programme has a number of limiting criteria which if modified would improve funding opportunities for smaller lenders. The requirement that restricts the AOFM to the purchase of 'AAA' bonds that have been rated by two agencies for each term transaction is a difficult impediment.

We propose that the AOFM be permitted to support transactions with a 'AAA' rating from a single agency, particularly for lower subordinated tranches within a securitisation bond structure.

3.2.3 Investment Criteria

Currently investor demand for Class AB bonds from a securitisation trust is limited and the market for term Class B Bonds is non-existent at a margin that supports a rating and competitive home loan pricing. The AOFM mandate should be expanded to permit the purchase of these lower subordinated tranches within a bond structure.

4. Additional Funding Considerations

Beyond securitisation there has been some public discussion regarding additional funding options requiring Government support, including:

a) Agency model

The Agency model is the securitisation of mortgage backed securities by Government agencies. The most notable example has been in the United States with Freddie Mac and Fannie Mae.

ME Bank does not support the agency model as it does not result in a market led approach, instead relying upon a Government intermediary interposing with the market, restricting investor choice. This also disconnects each issuer from a direct relationship with investors creating concentration risk.

b) Government Guarantee

Under this proposal Government guarantees the mortgage security, controlling the asset quality and setting an appropriate fee structure.

ME Bank does not support this proposal as it creates long term uncertainty associated with eventual removal of the guarantee and creates a two tiered market (i.e. newly guaranteed and existing non guaranteed bonds).

c) Government Provided Lenders Mortgage Insurance

Currently lenders mortgage insurance is a duopoly market. The reintroduction of Federal Government underwriting of mortgage insurance would provide greater competition, confidence and transparency and provide significant support in attracting investment in RMBS.

The Federal Government agency, the Housing Loans Insurance Corporation (HLIC), operated from the early 1960s before being sold to GE Capital in 1999. The sell off of HLIC has greatly reduced competition and exacerbated the competitive disadvantage suffered by securitisers relative to banks funding on balance sheet.

Explicit Government insurance against catastrophic risk would commoditise mortgages to a greater extent, reducing margins (and interest rates) measurably.

ME Bank supports option C on the basis that it has historically been shown to be effective as a support mechanism for RMBS issuance.

5. Securitisation Regulation

Improved regulation of the process of securitisation would improve efficiency and access.

5.1 Alignment of Regulators

There is a pressing need for improved alignment and dialogue between policy makers (Treasury) , regulators (APRA/RBA) and industry to ensure that the policy objectives of improved competition (via securitisation) is not frustrated by unnecessary or unintended regulatory conduct.

Measures to improve the quality, efficacy, and coordination of engagement between relevant parties would be of material assistance in improving policy outcomes.

5.2 Class B Notes

A review of the capital treatment of Class B notes held by banks is required.

Recent industry discussions with APRA have not been entirely successful in determining a methodology for calculating how much risk has or has not been retained and consequently what level of regulatory capital must be applied to a securitisation trust. Clarity around this issue is essential for an ADI to determine the merits of a particular securitisation transaction and risk transfer.

5.3 APS120 Amendment to Support Date Based Calls

The existing prudential standard APS 120 should be amended to enable the reinstatement of date based calls by an ADI on a discretionary basis. Such an amendment would meet the requirements of fixed income investors and many international investors are seeking greater certainty around the maturity of RMBS.

5.4 Basel III – RMBS to satisfy Eligible Security Criteria

Impending changes to Basel III has opened a debate as to whether RMBS should become an eligible security under the proposed new global banking rules. ME Bank believes that Australian Regulators should maintain RMBS as an eligible security for liquidity purposes.

6. Regulatory Differences

A significant obstacle to improved competition is the regulatory differences that are applied to smaller ADIs compared to major banks. The higher levels of capital and liquidity required by APRA increase costs and reduce available liquidity for those competitors to the major banks, resulting in lower margins, reduced profitability and a more constrained capability - the antithesis of a more robust competitive market.

The higher standards imposed on the smaller ADI sector is largely driven by individual ratings, respective business models and balance sheet composition.

ME Bank, while recognising the reality of differential prudential standards, would welcome opportunities for closer liaison and dialogue between industry, Government and the regulators to ensure the most appropriate capital and liquidity requirements that encourage improved competition while maintaining systemic integrity.

7. Consumer sovereignty

   Critical to the functioning of competitive markets is the ability of consumers to exercise choice. There is considerable evidence to suggest that, despite attempts to facilitate customers changing banks, the effective level of choice is limited due to administrative constraints.

   In 2008, the Government introduced a package of measures intended to make it easier for customers to change bank accounts, including a switching service, a consumer hot line, and an education initiative.

   Research undertaken by ASIC however reveals very low levels of account switching and a strong disinclination by consumers to consider switching accounts due to the level of complexity, particularly in relation to direct debits from transaction accounts.

   It is our submission that in a market dominated by a few large providers, with strong evidence of consumer dissatisfaction, there is a pressing need for measures to improve consumer sovereignty. Current measures are clearly inadequate. There are alternative models in the UK and NZ which provide superior support for consumer choice by facilitating account switching. ME Bank supports these models.

Conclusion

ME Bank is determined to build on current momentum, subsequent to the GFC to provide a compelling, competitive alternative to the major banks.

To assist in this objective the Bank is calling for Government intervention:

- during a period of disrupted capital markets to improve access to funding; and
- to empower consumers to exercise their sovereign choice.

We are available to further address our submission.

Yours sincerely

Jamie McPhee
Chief Executive Officer
ME Bank