

Inquiry into promoting economic dynamism, competition and business formation

Matters arising from 30 June 2023 Public Hearing

HP01QON

HP01QON	Dr Mulino	<p>Mr Lock: In our research, the research that's done through Heritage and People's Choice, we use a Canstar measurement for that, which shows that over time—and we look at it through a bucket—our customers would be better off to the tune of about \$59 million a year, better off banking with Heritage and People's Choice than they would be through banking with one of the big four....</p> <p>CHAIR: You say \$59 million. Is it possible to express that, say, in terms of how many basis points difference that would be on a home loan, just to make it very concrete?</p> <p>Mr Lock: We could. I don't have that. But we can make that, because we do split that off between our borrowers and our depositors. A bank like ours—there are 720,000 members. Probably 200,000 of those would be borrowers and 500,000 of those would be depositors. So we have to look, as member organisations, to balance that offering over the full membership, not just those who are borrowing or those who are depositors. CHAIR: Yes, but it'd be great to get some kind of sense of that.</p>	Proof Transcript, 30 June 2023, p. 3.
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Answer

Heritage Bank engaged Canstar to prepare a Member Valuation Report for the 2021/22 financial year. The report involved a comparative analysis of the rate differential between Heritage Bank and the four major banks for each product in Heritage Bank's portfolio. This comparative data was then translated into a dollar value summarising the total amount that Heritage Bank customers were better off, both for lending products and for deposit products. This report was prepared before the merger and involved Heritage Bank products only, not People's Choice.

Based on the 2022 Canstar Member Valuation, Heritage members benefited by a total of \$93.2 million at June 2022, made up of \$58.5 million for borrowers and \$34.7 million for depositors.

This translates to a benefit of 43bps for depositors and 64bps for borrowers, which produces an overall benefit of 54bps.

HP02QON

<p>HP02QON</p>	<p>Dr Mulino</p>	<p>Mr Lock: Heritage and People's Choice, for example, have seven community bank models operating within our 90 branches. They developed, actually, in Crows Nest, which is about 70 kilometres down the road from here—not even 70 kilometres. That model is a joint venture model that was introduced 22 years ago. We have seven of those models now. Recognising that communities need banks, that was a very progressive community recognising that banks were leaving town. They approached us. We worked with them to develop this joint venture model to place those services back in town. We now have seven of those models operating—not all in regional areas as well; some of those are in metro areas. But collectively they have provided over \$75 million worth of economic benefit back to the communities in which they operate. We do monitor that and report on that frequently. We think that's a very good model and a repeatable model that we can introduce into communities. But it does need some kick-off equity from the communities to do that. We proposed in the submission to the Senate inquiry that there was a good opportunity for communities and governments to work together to get that seed capital together to make those community models viable. That could be done via a grant, that could be done via a matching process or that could be done via a loan. The initial seed capital, about \$500,000, can easily be repaid within an acceptable period of time once these joint venture models are up and running.</p> <p>CHAIR: It'd be great to get some more information on that on notice, if that's okay, so that we can look at that as a case study.</p>	<p>Proof Transcript, 30 June 2023, p. 4-5.</p>
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Answer

The Heritage Bank Community Branch model had its origins in the small town of Crows Nest, north of Toowoomba. In 1999, after all the major banks had closed, the Crows Nest community sought to retain a financial services provider. Community leaders approached Heritage, which developed the model that has proven extremely effective. Heritage now operates seven Community Branches in south-east Queensland.

Under the model, the Community Branches are joint ventures between Heritage Bank and a community company that represents the local community, formed specifically to be part of the joint venture. Those companies have Boards with Directors who serve voluntarily. There is joint representation of Heritage and the community partner in the overall governance structure.

Set-up costs are shared, with the community responsible for raising its share of the start-up capital required to establish the branch. In our current Community Branches, this has involved local residents individually investing small sums to collectively reach the amount required to establish the branch. Those residents are then repaid the amount they invested over time, plus interest, as

the branch becomes profitable. The start-up capital covers the premises' fit-out costs, and initial ongoing expenses after opening.

Profits from the branch's operations are shared 50:50, with the community company's share returned to the community in the form of grants to community events and organisations. Importantly, Heritage imposes no charges or franchise fees, unlike other community banking models.

Our Community Branches provide the same banking services as regular Heritage branches. The benefits for the local community include:

- Retention of banking services in the local community.
- Local employment opportunities, with branch managers and staff who live in the local community.
- Further economic benefits through other goods and services required for the branch operation.
- Potential for substantial funding for community organisations, charities and projects through distribution of profits in the form of grants.

Heritage's seven Community Branches have collectively generated \$75 million for their local communities since the first opened at Crows Nest in 1999. This is the amount that has been generated through community grants, along with the salaries of staff, the rent they pay and all the other services they use.

HP03QON

HP03QON	Dr Mulino	CHAIR:This can be one on notice. It's just headcount in staff so over the last 10 years—and obviously you've merged, so if there's a way of combining that—but also any kinds of strategies you have around outsourcing different functions. It's become an issue in some other parts of the sector.	Proof Transcript, 30 June 2023, p. 5.
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Answer

Headcount

Our data shows a relatively static but slightly increased headcount of employees across Heritage and People's Choice, up from 1,913 as at June 2013 to 2,002 as at June 2023.

The mix of role types has changed across this period. In particular, the number of staff engaged in Risk Management and Compliance activity has increased over recent years, along with more employees in cyber security and scam prevention. There has also been a significant increase in the project management resourcing to support the transformation programs that both Heritage Bank and People's Choice had embarked on before the merger

Outsourcing

As required under *Prudential Standard CPS 231 – Outsourcing*, Heritage and People's Choice maintains a register of outsourcing arrangements involving material business activities and reports those arrangements to the Australian Prudential Regulation Authority (APRA).

We have 14 active material outsourced arrangements on that register. They cover a range of facilitation functions that we do not have the capability or scale to be able to economically perform ourselves, for example wholesale payment services, data centres and Software as a Service arrangements.

Heritage and People's Choice, like most member-owned financial institutions, has historically carried out the majority of significant business functions in-house. As noted above, there are a small number of activities where it is simply unsustainable for us to attempt to carry out in house. In these circumstances, we partner with suppliers who can provide that service to us in a way that ensures we more effectively deliver for our members. That is particularly the case with technology, where many industries are moving to cloud-based third-party services rather than building and hosting these capabilities in-house.

However, Heritage and People's Choice is not looking to outsource large functional divisions as a way to reduce staffing costs and numbers. For example, we maintain two large contact centres, one in Adelaide and one in Toowoomba, while other financial institutions have outsourced that function and moved it overseas.

HP04QON

HP04QON	Dr Mulino	<p>CHAIR: Going back to scams, I agree that it's a very complicated issue and your sector and others are going on a journey. This is probably one to answer on notice. Are you able to give us a sense of how much the organisation's invested over time in that, say both by dollars in the systems and headcount? It can be hard to totally ring fence, I can imagine. There's cyber, there's scams and there are a lot of systems which have multiple purposes. So feel free to give a bit of context there. I imagine the trend is up and it's probably part of that broader regulatory compliance headcount trend that you talked about earlier. But it would be good to get a broad sense of how much of an impost that is on the bank, the scale.</p> <p>Mr Lock: We can do that. I will take that on notice and ask for that to be supplied on a sector basis. COBA, the Customer Owned Banking Association does have that data available and it does have a dedicated arm that coordinates our response to fraud. financial crime and</p>	Proof Transcript, 30 June 2023, p. 8.
		<p>scam activity. And you're right, Chair, that this isn't just scams as you might understand it but also financial crime activity, particularly if you take it down from the scam of 'Click here and I've got access to your banking information' to far more sinister impersonation of vulnerable customers and elderly customers. Elder abuse is something that we are particularly focused on in the sector and do have significant resources placed to it in order to pursue and prosecute, and we will always prosecute.</p>	

Answer

In terms of headcount, Heritage and People's Choice currently has 22 staff employed full time in managing scams and fraud. This is more than double the combined total of 10 staff employed in this function five years ago – 6 at Heritage Bank and 4 at People's Choice.

Quantifying a dollar value on the investment in cyber security and combatting scams is extremely difficult. Our investments in improved IT systems often deliver multi-faceted benefits, including better capabilities in addressing cyber security and fraud. It is extremely hard to apportion how much of that investment relates to those activities.

We made enquiries with our industry association, COBA, and unfortunately this data is not available on a whole-of-sector basis.

Cyber security and online fraud have become areas of significantly increased attention for Heritage and People's Choice in the past five years, as they have for the entire banking industry. To protect our members, we work constantly to identify scams and fraudulent behaviour, educate members and our employees, and improve our systems.

To help reduce the risk, we have established a dedicated Group Fraud Management team that is heavily occupied in developing and deploying strategies across the organisation. Those strategies include the following:

- We have invested more to upgrade our fraud detection software to identify new threats as they develop.
- We have established a Scams Hotline through our two contact centres which provides immediate assistance for members who believe they are being scammed.
- Additional efforts have included tailored member newsletters, warning emails in the lead-up to the festive season, awareness messages on account statements, specialised flyers in branches and on-hold messages.
- Internally, we have strengthened anti-scam content in our induction program for new employees, improved communication to member-facing employees to heighten awareness of current and emerging scam activity and established a dedicated scams awareness working group to maintain engagement across the organisation.
- We continue to partner with COBA Financial Crimes and the Australian Financial Crimes Exchange to develop effective detection rules and strategies. We have also strengthened our relationships with law enforcement and victim support agencies nationally.
- We have also begun a full end-to-end review of the Heritage and People's Choice scams management cycle, analysing our prevention efforts, active scams support and after care activities.