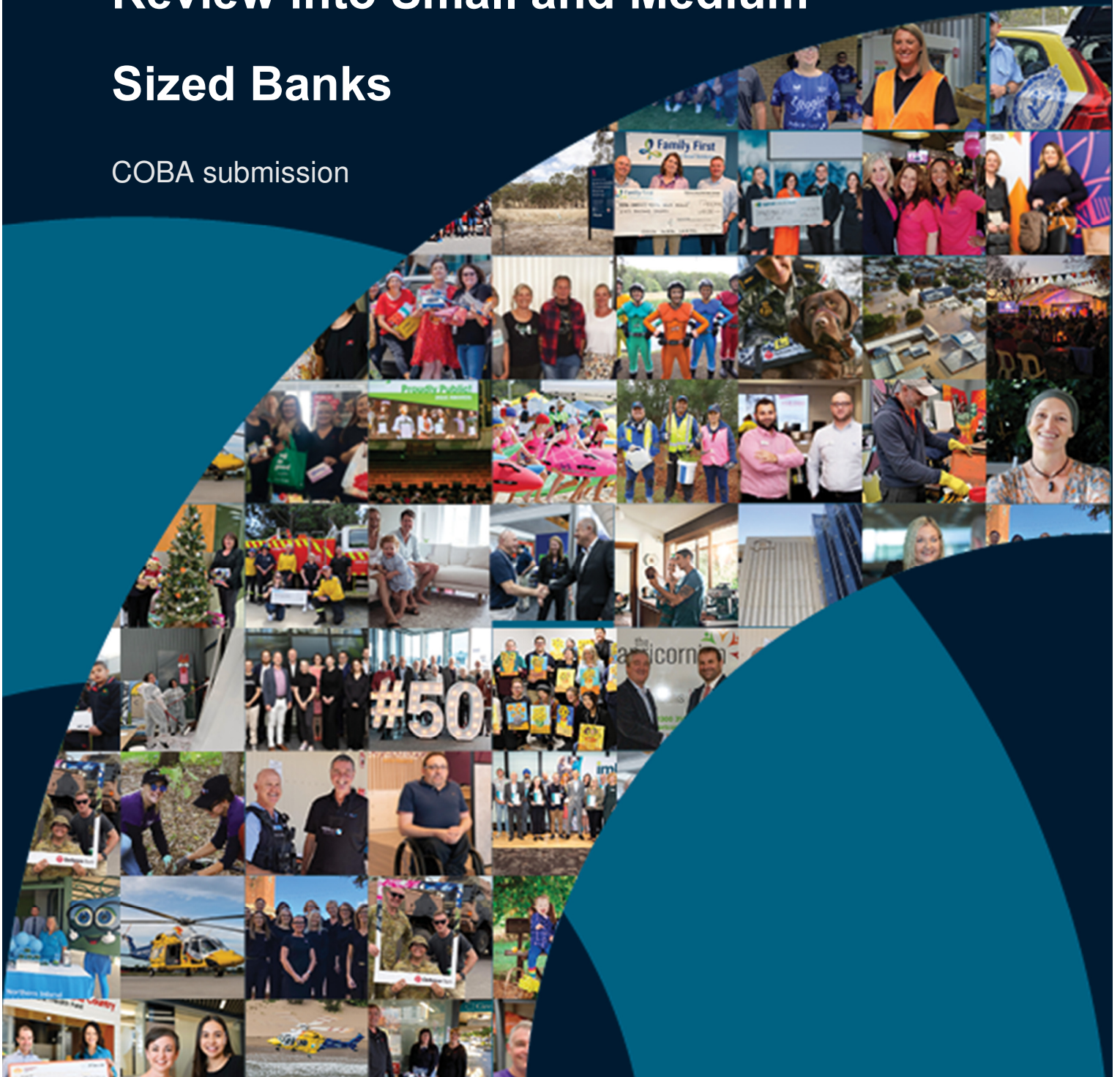




CUSTOMER  
OWNED  
BANKING  
ASSOCIATION

# Council of Financial Regulators Review into Small and Medium Sized Banks

COBA submission



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## Our members



# Introduction

COBA welcomes the Treasurer’s initiative in launching this review and acknowledging the vital role customer-owned banks play in a competitive and diverse banking system. A dynamic banking landscape, as highlighted in the Council of Financial Regulators (CFR) Issues Paper, is indeed “critical to Australia’s long-term prosperity”. A diverse system, where banks of all sizes and ownership structures can thrive, ensures consumers have greater choice and access to financial services tailored to their unique needs.

Customer-owned banks are fundamental to a diverse and competitive retail banking market. As the original peer-to-peer lenders, they emerged as a self-help solution to ensure all Australians had access to financial services. This people-first approach remains a core principle of the sector today.

COBA members, serving a diverse range of communities, tailor their services to meet a wide spectrum of customer needs, thereby promoting greater financial inclusion. Because they are owned by their customers, customer-owned banks prioritise the wider social and economic well-being of their communities, not just profits. This allows them to deliver outcomes that genuinely benefit their customers, extending their impact far beyond traditional financial services.

Despite providing financial services that put people and communities first, the current regulatory environment inadvertently creates an uneven playing field, increasingly favouring large, investor-owned banks. While no single regulation is intentionally designed to hinder competition, their cumulative effect has done just that.

Deregulation in the 1990s fuelled the growth of investor-owned banks, expanding their market share from approximately 50% in the early 1980s to over 95% in 2024. This trend was further accelerated by the Royal Commission, which, while leading to necessary reforms as a result of misconduct by major banks (with no adverse findings in relations against customer-owned banks), also saw the evolving regulatory landscape continue to disproportionately impact customer-owned banks and their ability to compete. The CFR Issues Paper acknowledges this dominance, noting that just nine investor-owned banks control 84% of Australia’s banking system assets, with the remainder being smaller investor-owned banks and customer-owned banks.

This review presents a critical opportunity to rectify this imbalance and create a truly dynamic banking landscape by recalibrating the regulatory framework. COBA’s submission offers several recommendations, and we encourage the CFR and the Government to seize this opportunity to create a dynamic and thriving banking sector.

This isn’t about weakening necessary safeguards but rather ensuring a level playing field where all banks, regardless of size or ownership structure, can thrive. A tailored regulatory approach combined with appropriate government support that recognises the distinct models and risk profiles of different banks, is essential. This will allow customer-owned banks to focus on what they do best – meeting the unique needs of their members and communities – while also promoting greater competition and choice within the Australian banking sector.

Ultimately, we believe this review is not only an opportunity to create a truly competitive banking landscape, but to deliver better outcomes for Australians. When customer-owned banks grow, everyone benefits through increased financial inclusion, innovation, community investment, better services and rates, and a more resilient Australian economy.

## Contact

[Redacted contact information]

[Redacted contact information]

## **The Customer Owned Banking Association**

COBA is the industry association for Australia's customer-owned banks (mutual banks and credit unions). Collectively, our sector has over \$182 billion in assets and is the fifth largest holder of household deposits. Our members range in size from less than \$200 million in assets to around \$25 billion in assets – all significantly smaller than our ASX-listed peers. Customer-owned banks account for around two thirds of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition and market leading levels of customer satisfaction in the retail banking market.

# Recommendations

## **Recommendation 1 – supporting the growth of customer-owned banks**

The Government and regulators should commit to a growth and innovation mindset to the regulation and supervision of customer-owned banks while also meeting other objectives, including financial stability and consumer protection. This approach should recognise the key role our sector can play in solving issues in the financial sector. This will allow customer-owned banks to chart a different path to major banks and provide genuine choice to customers.

## **Recommendation 2 – financial support to level the playing field**

The Government should help level the playing field for customer-owned banks by providing support in the form of subsidies, grants or tax concessions to assist smaller banks meet compliance obligations, to provide social benefit to the community, and to assist in the digital transition.

## **Recommendation 3 – consistent and proportionate tiering approach**

The Government and regulators should adopt a consistent tiering approach to regulating different sized banks and apply these thresholds consistently across different regulatory regimes and agencies. A tiered approach should have more than two tiers. This tiered approach could reflect the following categories as used in the CFR Issues Paper and be based on system assets (for example, with 1% or c\$50 billion threshold).

Existing regulations and reporting requirements currently applying to banks should be reviewed over time to incorporate this tiered approach to regulation.

## **Recommendation 4 – enhanced mandates and accountability**

The Government should amend APRA's mandate to include a secondary competition objective that would require it to actively consider competition as its secondary objective after its primary objective of stability and safety. This would place competition above the other balancing objectives in its mandate.

The Government should amend regulator mandates to adopt a corporate diversity clause similar to UK regulators. This would require regulators to consider the customer-owned banking model in decision-making processes. This would ensure that regulators have a deep understanding of the drivers as well as the consumer and community potential of our model and can support it accordingly.

These changes should be accompanied by a clear accountability mechanism for regulators to demonstrate how they have met these enhanced mandates.

### **Recommendation 5 – regulatory coordination**

Building on progress to date, all participating agencies should use the Financial Services Regulatory Initiatives Grid process to actively coordinate and plan their policy projects and implementations to minimise the overlap of regulations and support smooth delivery. This will ensure that the Grid moves beyond a transparency measure and delivers the intended better regulatory outcomes for regulated entities.

### **Recommendation 6 – reducing wholesale funding costs**

The Government should utilise its balance sheet to lower the wholesale funding costs for customer-owned banks to reduce the cost disadvantage around wholesale funding compared to larger banks.

This could include through providing credit rating support, debt guarantees, Australian Office of Financial Management support as a cornerstone investor and providing some form of a government guarantee and aggregation on smaller bank Residential Mortgage-Backed Security. Given our views on sustainable price competition, this support should only be for smaller Authorised Deposit-taking Institutions that are subject to the significant other cost pressures due to regulation.

### **Recommendation 7 – supporting customer-owned bank lending**

The Government should support customer-owned banks to encourage lending that supports good social and environmental outcomes to help fulfil the potential of our for-purpose model. This includes working cooperatively with APRA on reforms to the capital, reporting and supervisory framework activities such as lending to first home buyers and households for environmental upgrades.

### **Recommendation 8 – leveling the tax playing field**

The Government should consider options to address the tax inequality around franking credits, such as reducing the corporate tax rate on customer-owned banks to support growth.

### **Recommendation 9 – correcting the anomaly in RITC 16**

The Government should amend Reduced Income Tax Credit 16 (RITC 16) to include mutual building societies and former mutual building societies in the definition to support greater collaboration across the customer-owned banks sector and correct the anomaly around collaboration.

**Recommendation 10 – facilitative approach on merger approvals**

Relevant regulators should take a facilitative approach to merger processes and policies to ensure that once customer-owned banks have taken the decision to explore a merger that the regulatory processes are as expedient as possible. This includes examining the Treasurer delegations and ACCC's approach under the new merger regime.

**Recommendation 11 – facilitative approach on collaboration**

Relevant regulators should take a facilitative approach to collaboration between customer-owned banks to support sustainability and competitiveness.

# Our unique model

## What is customer-owned banking?

Customer-owned banks are fundamental to a diverse, thriving and competitive retail banking market in Australia. Our sector serves over 5 million Australians and provides a distinct alternative to investor-owned banks, offering consumers purpose-led banking that puts people and communities first.

We have a unique model that provides a competitive counterpoint in the banking sector. We were formed as a self-help solution to solve issues communities face including access to housing and personal finance.

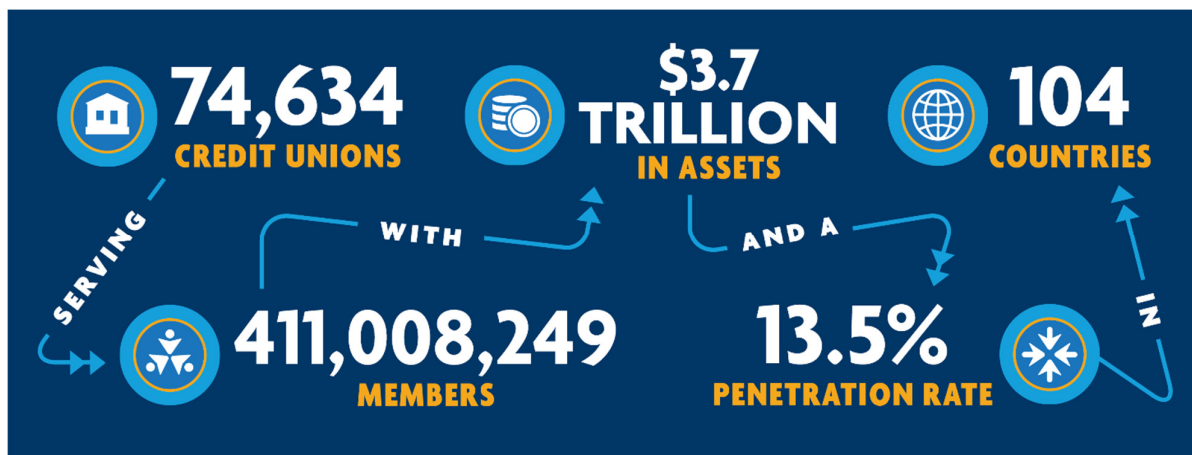
Customer-owned banks are part of the wider Australian cooperative movement, with over 1,819 active co-ops and mutuals in Australia with a combined 34.8 million memberships. These organisations play a vital role in the economy, employing 89,046 people and supporting over 68,236 small businesses through trade credit and bulk buying groups in 2023. With a combined turnover exceeding \$163.3 billion, Australia's co-ops and mutuals demonstrate significant economic strength.<sup>1</sup>

The cooperative movement continues to gain momentum, by disrupting industries or filling gaps left by traditional businesses. For example, in small towns across Australia where hotels and local newspapers are closing, communities are forming cooperatives to revive these services.

This cooperative movement extends beyond Australia's borders with the value of the global movement being recognised this year through the United Nations 2025 International Year of Cooperatives (**Exhibit 1**).

As customer-owned financial cooperatives, COBA is also a member of the World Council of Credit Unions (WOCCU). This affiliation enables us to advocate for policies that support credit unions and mutual banks, leverage global insights, and participate in knowledge-sharing initiatives that enhance the competitiveness and resilience of its members. WOCCU works to advance financial inclusion through the credit union and cooperative model by engaging in international advocacy, development, education and networking that empowers underserved populations, and promotes more equitable and resilient communities. Membership with WOCCU connects our members to a global network of more than 50 national and regional credit union associations representing over 60,000 credit unions with more than 270,000,000 members in 80+ countries. While WOCCU covers the world's credit unions, the movement is even bigger than credit unions with cooperative banks and building societies also playing a part in cooperative banking.

**Figure 1: The global reach of the credit union movement**



Source: World Council of Credit Unions

Customer-owned banks in Australia are currently dwarfed by their listed bank peers and access scale through collaboration, outsourcing and mergers. We recognise the smaller average size of customer owned

<sup>1</sup> <https://bccm.coop/wp-content/uploads/2024/06/2024-NME-Report-web-version.pdf>.

banks has some advantages, such as the ability to remain close to and understand their customer-base, and a capacity to be nimbler than their larger peers. However, the lack of scale can make it very difficult to keep up with the pace and volume of regulatory change while remaining competitive and innovative.

Ultimately, there is substantial public interest in ensuring customer-owned banks can remain and thrive in a banking market that otherwise demonstrates stagnancy and little in the way of interest from other potential competitors.

### Exhibit 1: United Nations 2025 International Year of Cooperatives<sup>2</sup>

With the United Nations declaring 2025 the International Year of Cooperatives (ICY25) under the theme '*Cooperatives build a better world*', it emphasises the need for a regulatory framework that supports the growth and competitiveness of financial institutions that put people and communities first. This year aims to raise global awareness of the vital role cooperatives play in advancing social, economic, and environmental well-being.

The key objectives for IYC25 are:

- Governments creating an enabling environment for cooperatives
- Cooperatives promoting public awareness, developing new leaders, and leveraging cooperation
- Institutions and development agencies promoting cooperatives through education, strengthening capacities, and facilitating international collaboration
- The public understanding the cooperative identity and supporting cooperative initiatives

## History of the model

Australia has a long and proud history of customer-owned banks – current and former credit unions and building societies who share the same customer-owned model.

### Credit Unions

Credit unions have a rich history dating back to the 19th century when they emerged as cooperative financial institutions aimed at providing affordable credit to working-class individuals. The concept was pioneered in Germany in the 1850s by Friedrich Wilhelm Raiffeisen and Hermann Schulze-Delitzsch, who established cooperative banks to help rural farmers and urban workers access credit without falling into debt traps.<sup>3</sup> The idea spread across Europe and North America, with Canada's first credit union, *Caisse Populaire de Lévis*, founded in 1900 by Alphonse Desjardins.<sup>4</sup> In the USA, the movement gained traction in the early 20th century, leading to the passage of the Federal Credit Union Act in 1934, which allowed for federally chartered credit unions. Over time, they have evolved into a global financial force, serving millions of members with savings, loans, and other financial services while maintaining their cooperative principles (**Exhibit 2**).

### Exhibit 2: WOCCU international operating principles for financial cooperatives<sup>5</sup>

#### Cooperative Structure

- **Member Owned:** Customer-owned banks are owned by the customers who use their services.
- **Member Controlled:** Customer-owned banks are democratic institutions, controlled by their customers-owners, who actively participate in electing their board representatives and the governance of the institutions.

<sup>2</sup> <https://www.un.org/en/desa/cooperatives-launch-2025-international-year>.

<sup>3</sup> Gary Lewis, *People Before Profit: The Credit Union Movement in Australia* (1996), Wakefield Press, Kent Town SA.

<sup>4</sup> Ibid.

<sup>5</sup> [https://www.woccu.org/documents/2017\\_woccu\\_international\\_operating\\_principles](https://www.woccu.org/documents/2017_woccu_international_operating_principles).

- **Democratic Control:** Customers-owners have equal rights to vote (one member, one vote), regardless the amount of savings or deposits they have with the customer-owned bank.

#### Service to Members

- **Financial Inclusion:** Customer-owned banks provide access to affordable financial services to all, including the underserved.
- **Financial Sustainability:** Focused on building financial strength and reserves for continued service.
- **Maximising Member Economic Benefit:** Encouraging financial well-being of members through fair interest rates and savings.

#### Social Responsibility

- **Financial Literacy:** Providing financial literacy education and promoting community development.
- **Network Cooperation:** Collaborating with other cooperatives locally, nationally, and internationally.
- **Community Responsibility:** Supporting a just, healthy, and prosperous community through ideals of self-help, mutual assistance and economic empowerment,
- **Global Vision:** Building, championing, defending and growing a global community that improves lives through cooperative financial institution.

## Bank First

Bank First has a long history of serving educators and public servants. Over 50 years ago, 48 teachers from the Victorian Teachers Union pooled \$10 each, starting the customer-owned bank with initial capital of \$480 kept in a shoebox. Bank First's very first loan of \$200 was granted to a female teacher who, after separating from her husband, needed to secure housing for herself and her two children. While traditional banks turned single and separated women away, Bank First stepped in to help, demonstrating its commitment to financial inclusion from the start.



## Traditional Credit Union

When major banks abandoned remote and regional communities in the Northern Territory, Indigenous elders established Traditional Credit Union – Australia's only Indigenous-owned financial institution – to ensure their people had access to essential banking and the opportunity to shape their own economic futures. Not only does Traditional Credit Union provide essential banking services to First Nations people in remote areas of Northern Australia, but it also provides Indigenous employment and training as well as financial and digital literacy.

## Queensland Country Bank

Denied credit by traditional banks in 1971, Mount Isa's mine workers formed their own solution: a credit union to provide essential banking services and small loans. As word spread about the people-helping-people model, other industries including sugarcane and agriculture joined. Today, Queensland Country Bank serves over 100,000 members throughout Queensland and beyond.



## Building Societies

Building societies originated in the late 18th century in the UK as cooperative financial institutions aimed at helping working-class individuals acquire homeownership. The first known building society, the Ketley's Building Society, was established in 1775 in Birmingham, England, by Richard Ketley, a landlord who created a mutual savings scheme where members pooled their funds to finance home construction.<sup>6</sup> Initially, these were terminating societies, meaning they dissolved once all members had purchased homes. By the mid-19th century, permanent building societies emerged, allowing continuous membership and financial services beyond home loans. The movement expanded rapidly, leading to the *Building Societies Act 1874*, which provided a legal framework for their operations.<sup>7</sup>

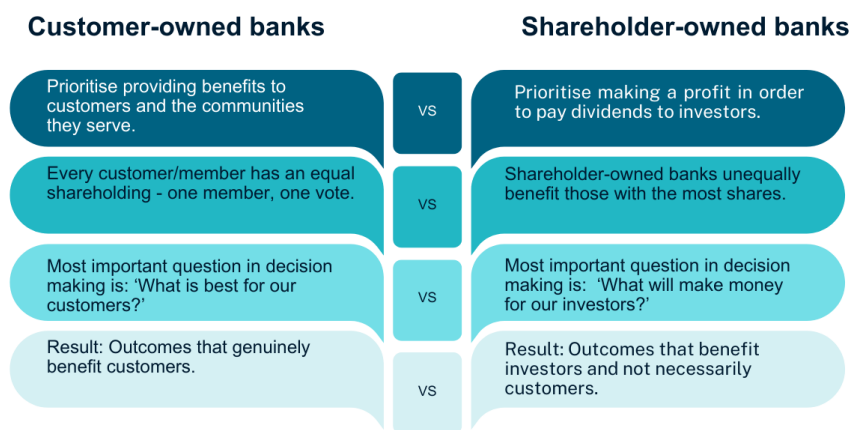
Building societies in Australia have played a significant role in providing home loans and financial services since the 19th century. Modelled after their British counterparts, they emerged in the mid-1800s as mutual financial institutions, allowing members to pool savings to fund home loans. Throughout the 20<sup>th</sup> century, building societies expanded significantly, particularly in the post-Second World War era, as they provided an alternative to banks for home financing. By the 1970s, they became key players in the Australian mortgage market. Their legacy remains influential in the evolution of Australia's financial sector.

## A unique ownership structure

Because customer-owned banks are owned by their customers, they are driven by a unique purpose: to prioritise the people and the communities they serve rather than achieving profits in order to pay dividends to external investors. This model enables customer-owned banks to focus solely on providing value and service to their members.

As owners, customers have a direct voice in the way their financial institutions operate. They can attend the customer-owned bank's Annual General Meeting to ensure decisions reflect their collective needs and community priorities. Each member has an equal vote ("one member one vote") – regardless of their investment or borrowing – creating a truly democratic structure which ensures the bank remains accountable to its members.

**Figure 2: The customer-owned banking difference**



Because of this ownership structure, when customer-owned banks make decisions, they consider the wider social and economic well-being of their communities, not just profits. This allows them to deliver outcomes that genuinely benefit their customers, including market-leading services, competitive rates, and significant contributions to local communities.

<sup>6</sup> <https://www.bsa.org.uk/information/consumer-factsheets/general-information/the-history-of-building-societies>.

<sup>7</sup> Ibid.

### Exhibit 3: Examples of the customer-owned banking difference

- The May 2024 Roy Morgan Customer Satisfaction survey showed COBA members had significantly higher scores than the major four banks – 89.5% for the customer owned banking sector as a whole, compared to 75.4% for the majors. This is an ongoing trend. In the last 20 years, while customer satisfaction for major banks has dipped as low as the mid-50% range, customer satisfaction for mutual banks, credit unions and building societies has consistently remained above 80%.<sup>8</sup>
- Roy Morgan research has found that customer-owned banks are collectively the most trusted when it comes to banking in Australia.<sup>9</sup>
- Deeply rooted in their communities, customer-owned banks actively support local initiatives and charities. In financial year 2022-23, research by a leading economist showed customer owned banks gave back to their communities at a rate nearly nine times higher than the major banks.<sup>10</sup>

## An under-recognised banking model

Despite serving over 5 million members and playing a vital role in supporting communities, customer-owned banks face significant hurdles around awareness and understanding of our unique model and impact.

As highlighted by the Senate inquiry into cooperative, mutual, and member-owned firms, the sector is 'largely ignored' in secondary and tertiary education. This has led to a knowledge gap among key professions and government agencies, which hinders the sector's growth and potential.<sup>11</sup>

Regulators, in particular, need a deeper understanding of the fundamental differences between customer-owned and investor-owned banks to craft effective industry policy. With the current investor-owned model acting as a de facto default, there remains a risk of uneven playing fields being inadvertently created or further exacerbated.

This lack of education and awareness also extends to the public, making it difficult for people to grasp the benefits compared to the more familiar investor-owned structure. This can hinder customer-owned banks' ability to attract new members and expand their reach. We consider that opportunities should be taken to improve consumer awareness around the customer-owned banking model through relevant government channels.

### Consideration

The customer-owned banking sector provides a valuable for-purpose alternative to investor-owned banks, at both an individual bank and collective sector level. This for-purpose nature is structural to the customer-owned model.

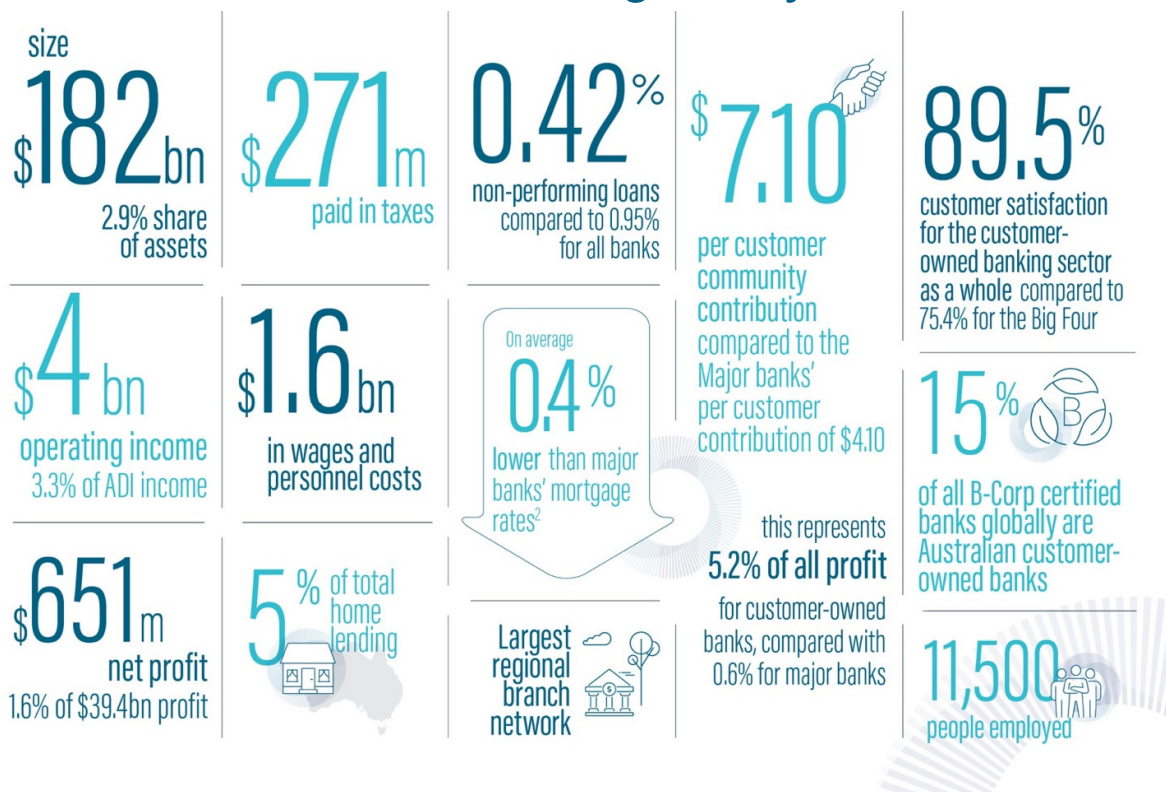
<sup>8</sup> <https://www.customerownedbanking.asn.au/customer-owned-banks-continue-to-outshine-other-banks-in-customer-satisfaction/>.

<sup>9</sup> <https://www.customerownedbanking.asn.au/customer-owned-banks-as-a-group-are-the-mosttrusted-banks-in-australia-roy-morgan/>.

<sup>10</sup> <https://www.customerownedbanking.asn.au/customer-owned-banks-deliver-more-community-investment-and-better-rates/>.

<sup>11</sup> [https://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Cooperatives](https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Cooperatives).

## Customer-owned banking today



Source: COBA Impact Report

### Diverse members, diverse solutions

COBA members are united by a commitment to people, but their strength lies in their incredible diversity. Customer-owned banks serve a wide range of communities, each bank tailored to the unique needs of its members. This network encompasses everything from focusing on specific professional, ethnic, or geographic communities to customer-owned banks seeking to bring the customer-owned difference to all Australians.

#### Exhibit 4: Examples of customer-owned banking communities

- Frontline workers, including teachers, firefighters, and defence personnel, benefit from institutions such as Teachers Mutual Bank Limited and Defence Bank, which offer specialised support, services, and products tailored to their unique needs.
- For regional Australians who value a strong connection with their financial institution, customer owned banks like Geelong Bank, South West Slopes Bank, Broken Hill Bank, and BankWAW prioritise serving their local communities.
- For over 60 years, Dnister Ukrainian Credit Cooperative has been a pillar of the Ukrainian and Latvian communities in Australia, providing exceptional financial services and supporting their unique cultural heritage.

The sector's service offerings reflect this incredible diversity. Some customer-owned banks prioritise in-person banking, collectively operating the country's largest regional branch network (23% of regional branches).<sup>12</sup> However, recognising that one size does not fit all, many customer-owned banks focus on digital and telephone solutions to cater to the needs of their members. This is particularly important for institutions like Teachers Mutual Bank Limited, which serves frontline workers in cities who may not have time for traditional branch visits (that is, during 9-5 working hours) due to their work schedules.

Ultimately, a diversified banking landscape benefits all Australians by catering to a wider range of financing needs and promoting financial inclusion. As nimble and community-focused banks, customer-owned banks are well positioned to respond to these needs.

## Beyond financial services

Customer-owned banks operate with a distinct purpose: to serve their members and communities. This commitment goes beyond offering financial products; they actively contribute by investing in their communities, creating jobs and providing crucial services. Policymakers should therefore view customer-owned banks as more than just banks, but as sustainable, for-purpose businesses that are deeply invested in the well-being of the communities they serve.

### Traditional Credit Union

Australia's only indigenous-owned financial institution Traditional Credit Union's mission extends to offer training and employment opportunities for young First Nations people. The customer-owned bank also runs Centrelink and Medicare agencies in various communities, ensuring essential government services reach remote areas.



### Dnister Ukrainian Credit Co-operative

Dnister Ukrainian Credit Co-operative has been actively supporting Ukrainians uprooted by war. Recognising the challenges faced by those fleeing their homes, Dnister has not only streamlined the account application process with a dedicated form for those still travelling but also developed comprehensive online resources in Ukrainian about the Australian banking system and available community support.

### Defence Bank

The Defence Bank Community Dogs program supports serving and ex-serving Australian Defence Force (ADF) members who are living with injuries or illnesses, such as post-traumatic stress disorder (PTSD). The initiative is the only independent program in the country that rescues and trains dogs to support veterans with the conditions they may be experiencing. It offers veterans the opportunity for rehabilitation and reconnection with the community.



### Beyond Bank

Beyond Bank has transformed its branches into safe havens for victims of family and domestic violence, including financial abuse. Victims can use meeting rooms in branches to meet with lawyers or support workers. This means that if the abuser is tracking the victim through their phone, it appears they are 'just' visiting a bank. The bank also has a discreet call-back service where victims can ask for financial support.

<sup>12</sup> <https://www.apra.gov.au/authorised-deposit-taking-institutions-points-of-presence-statistics>.

## Community foundations and programs

Many customer-owned banks have established community programs or partnerships that extend their community support far and wide. Not only do they create meaningful change, but they also invite members to be part of the journey and give back to the communities they know and love.

### Exhibit 5: Customer-owned bank community partnerships

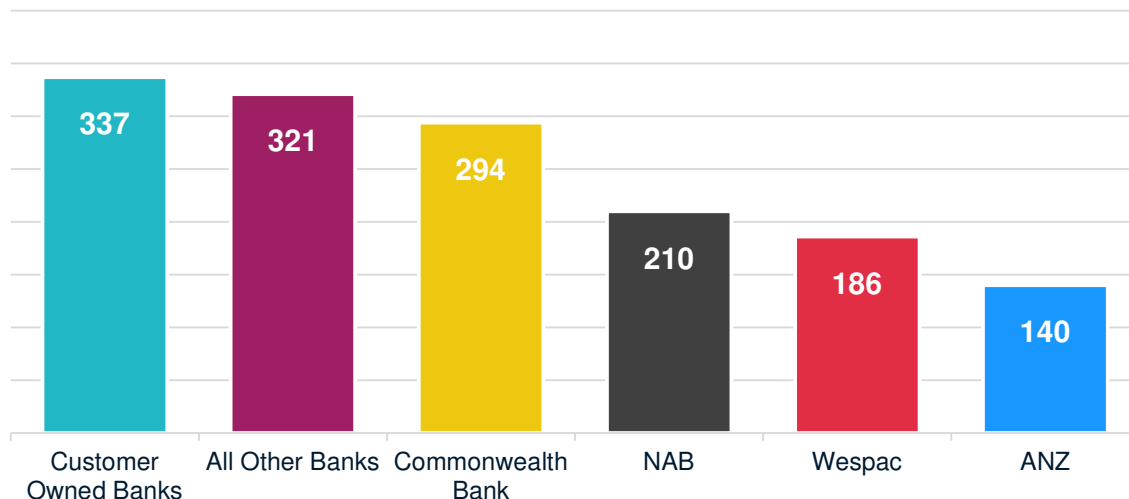
- The IMB Bank Community Foundation has been supporting local initiatives since 1999. In 2024 – its 25th anniversary year – the Foundation announced funding for another 58 diverse community projects. This brings the total number of grassroots initiatives supported to over 1,000 with more than \$12m pledged in grant funding.
- Queensland Country Bank has a long-standing history of supporting community through its Good for Good program, which has been running since 2005. Following the rollout of its latest round of grants, it will have injected \$3 million back into Queensland.
- Regional Australia Bank’s Community Partnership Program has over the last 15 years grown from humble beginnings to distributing \$2.76 million in 2024 alone, helping over 2,200 organisations across 38 communities. From healthcare and education to sports and elderly care, the funds go towards projects that make a lasting impact and strengthen local connections.

## Supporting regional communities

Customer-owned banks play a vital role in building strong local economies, which are, in turn, crucial for a healthy national economy.

In contrast to the major banks headquartered in Sydney and Melbourne, customer-owned banks demonstrate a strong commitment to regional Australia. Many are headquartered in regional cities like Toowoomba, Newcastle, Launceston, Townsville and Wollongong, with 52% of staff living and working outside metropolitan areas. This regional focus ensures customer-owned banks contribute to local economies and provide valuable employment opportunities for a skilled workforce. The sector also collectively operates the country’s largest regional branch network (**Graph 1**).

**Graph 1: Significant customer-owned banking regional branch presences**

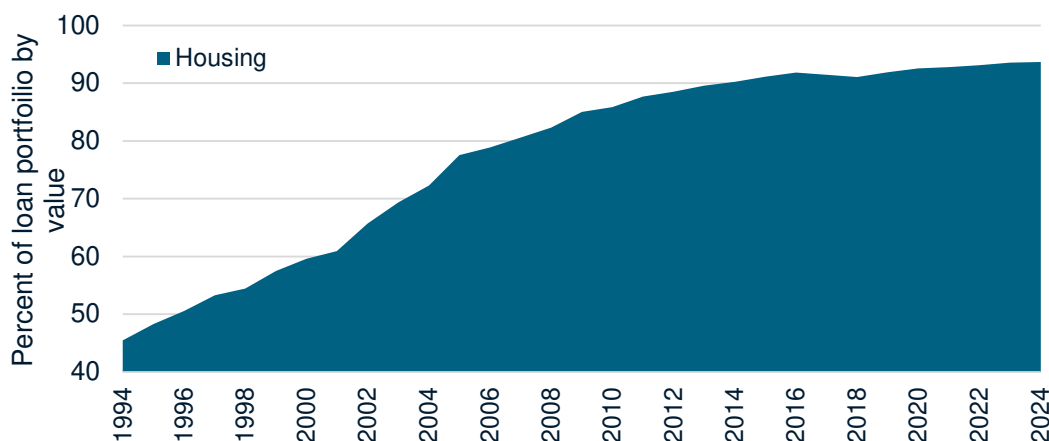


Source: COBA analysis on APRA ADI’s points of presence - June 2024

## Shift towards mortgage lending

Over time, regulatory settings and economic trends have led customer-owned banks to shift their lending portfolios primarily toward mortgage lending (**Graph 2**). While building societies have traditionally focused on mortgages, credit unions originally specialised in personal lending – a role they still maintain in some international markets. Although the current business model is heavily mortgage-centric, there is potential for diversification into other financial and non-financial products where trust in the customer-owned model could provide a competitive edge. This broader perspective reinforces the idea that our sector are more than just banks, and future opportunities presented to regulators should be considered through this lens.

**Graph 2: Customer-owned banks currently heavily focussed on mortgages**



Source: COBA historical data, APRA QADIP

## International context

In the context of other Organisation for Economic Co-operation and Development (OECD) countries, Australia's customer-owned banking sector is relatively small. Collectively, our sector has over \$182 billion in assets and is the fifth largest holder of household deposits in Australia. In total, our sector holds 2.9% of overall market assets. Customer-owned banks operate in a banking sector increasingly dominated by investor-owned institutions. This shift stems from deregulation, which allowed investor-owned banks to gain market share, growing from about 50% in the early 1980s to over 95% market share in 2024.<sup>13</sup>

In the USA, customer-owned banks – predominantly credit unions – hold 6% of assets,<sup>14</sup> while in Canada, the sector holds 6.4%<sup>15</sup> of market assets. In the UK, the sector provides 72% of all the net lending, 30% market share of mortgage lending and holds 19% of savings.<sup>16</sup> In Europe, customer-owned banks hold 20% of assets,<sup>17</sup> largely due to Crédit Agricole, the world's largest cooperative financial institution.

Ultimately, there is growth potential in the sector to ensure that it becomes a strong counterpoint to the investor-owned model that was widely criticised during the Royal Commission.

<sup>13</sup> David Richardson, *The rise and rise of the big banks*, The Australia Institute (2012), p 7, <https://australiainstitute.org.au/report/the-rise-and-rise-of-the-big-banks/>.

<sup>14</sup> <https://www.federalreserve.gov/econres/notes/feds-notes/trends-in-credit-unions-share-of-us-private-depository-household-lending-20250131.html#:~:text=Credit%20unions%20have%20also%20increased,by%20around%208%20percentage%20points.>

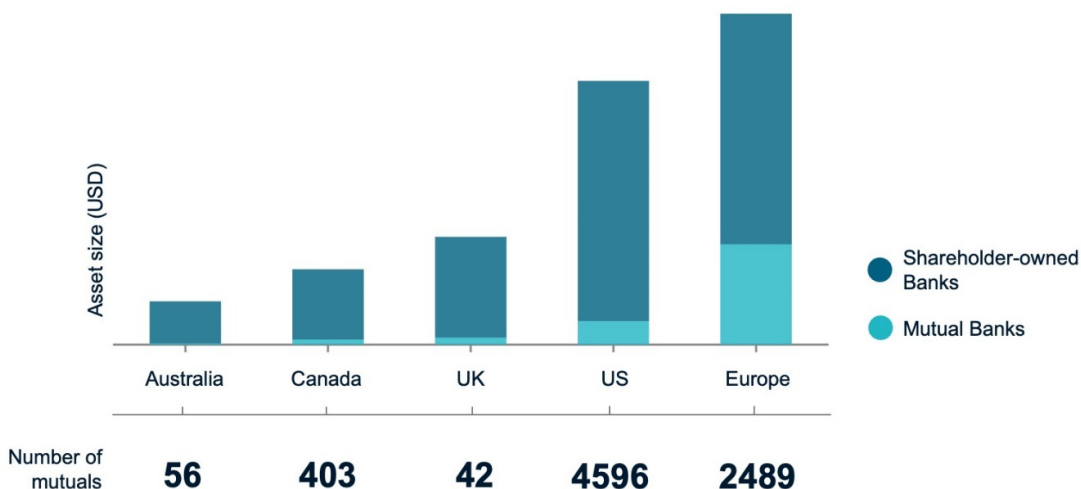
<sup>15</sup> <https://ccli.ubc.ca/wp-content/uploads/2023/06/Canadian-Credit-Unions-and-Effective-Climate-Governance.pdf>.

<sup>16</sup> <https://www.bsa.org.uk/statistics/building-society-dashboard>.

<sup>17</sup> <https://www.eacb.coop/en/european-association-of-co-operative-banks.html>.

**Graph 3: Customer-owned banking comparisons**

## Size of mutuals outside Australia



### Exhibit 6: Policy and regulation to support customer-owned banking

- In the UK, regulators are explicitly required to consider mutuals and must report on their compliance with the corporate diversity clause. The UK’s Centre for Financial and Management Studies says one of the key findings of post GFC research is that diversity is an important yet neglected source of systemic stability and resilience.<sup>18</sup>
- In the USA, credit unions are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organisations and have the specified mission of meeting the credit and savings needs of consumers. This allows them to focus on their mission of “people helping people”.
- The USA also has a community investment finance regime, which provides grants, loans, and tax credits to credit unions, allowing them to increase their lending capacity and expand their services in lower socioeconomic and underserved communities (Exhibit 8)

### Consideration

Proactive policy and regulatory support can help customer-owned banks to grow and bring our for-purpose model to more Australians.

<sup>18</sup> Measuring Diversity in Financial Services Markets: A Diversity Index, Centre for Financial & Management Studies (UK) April 2013.

## Creating sustainable diverse competitors

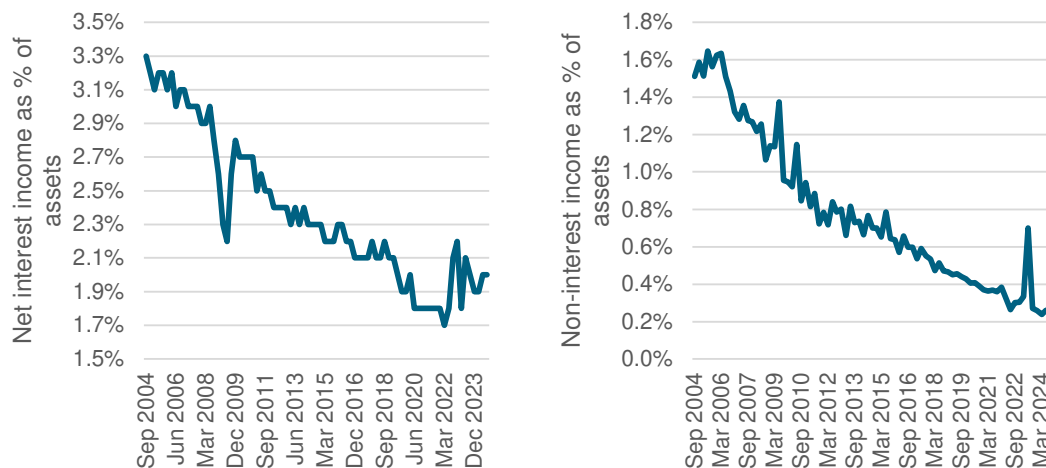
Banks, including customer-owned banks, generate revenue through accepting deposits, which they pay interest on, and then lending to customers via mortgages and other loans. The difference between the interest paid to customers on deposits and the interest received from lending is known as net interest income. Net interest income is not a pure profit measure as the margin is crucial to cover expenses.

These expenses include non-discretionary operating expenses such as complying with regulation and arranging and approving loans. Regulatory compliance, in particular, is a major contributor to rising costs for customer-owned banks. While regulation brings benefits like system stability and consumer protection, it also imposes a financial cost, however these costs can be alleviated through better proportional regulation and support for smaller banks.

The other group of expenses are termed discretionary and include delivering services through branches and digital channels, investing in innovation, pursuing strategic initiatives and growing the capital base. While categorised as discretionary, they are in fact critical for business survival and future growth.

Overall, digital transformation has become essential for both non-discretionary and discretionary expenses and the costs associated with this digital uplift are increasing significantly.

### Graph 4 and 5: Declining sector net interest income and non-interest income

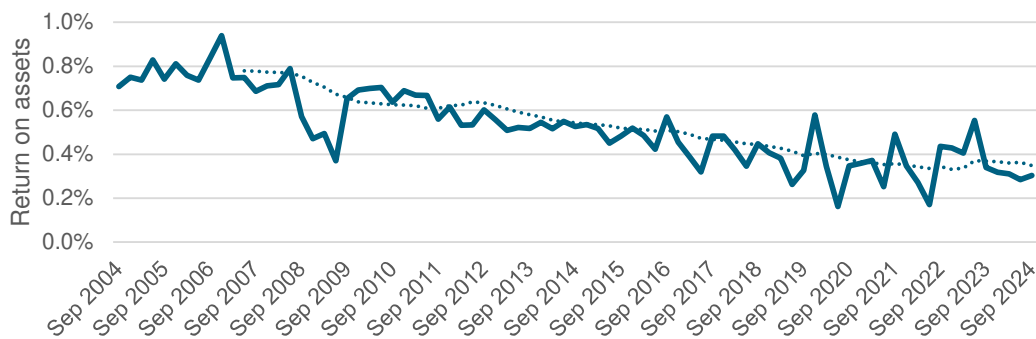


Source: COBA estimates on APRA QADIP

Competition in the Australian mortgage market has been fierce and, as a result, the net interest margins have compressed to historic lows. While the margins of customer-owned banks remain higher than major banks due to a deposit-focused funding structure,<sup>19</sup> this advantage is offset by the relatively higher operating costs of customer-owned banks. Non-interest income, which includes fees and charges, also help cover expenses, and these too have significantly declined over this period.

This has all been as a result of policymakers having a primary focus on price competition which has had unintended consequences. Margins have eroded, disproportionately impacting smaller banks, limiting their growth, innovation and capital investment. If the focus on price competition continues at the expense of other considerations such as market diversity and innovation, then Australia will be left with a banking sector where only very large homogeneous competitors can survive.

<sup>19</sup> CFR Issues Paper.

**Graph 6: Customer owned banking profitability**

Source: COBA estimates on APRA QADIP

Regulatory measures, including compliance costs and price regulation, can disproportionately burden smaller banks while larger banks can better absorb their impact. This includes policies deliberately designed to intensify price competition and to restrict fee income.

On this basis, policymakers and regulators must consider how their actions to drive price competition or to restrict fee income can impact market dynamics. Expectations around fees, shaped by major banks' ability to use their size and diversity of business lines to cross-subsidise, may not suit smaller, customer-owned banks that rely on fees to directly recover certain costs. Activities that seek to intensify price competition need to consider the potential impact on diversity, choice and meeting the needs of particular customer segments. Otherwise, Australia risks sleepwalking towards a banking sector of homogenous factory scale entities. The European Association of Co-operative Banks summarises this issue as follows:

“Striking the right balance between regulatory intervention, regulating innovation and ensuring a level playing field is crucial. We must ensure that all actors in the financial sector, remain competitive while meeting diverse financial needs. Competitiveness without profitability is not sustainable.”<sup>20</sup>

### Consideration

When regulating our sector, it should be done in a manner that supports a sustainable and diverse landscape. Customer-owned banks should not be viewed simply as interchangeable providers of banking services and products. A nuanced regulatory framework would recognise and support the unique value customer-owned banks bring, acknowledging that they are owned by their customers and operate with different priorities than traditional shareholder-owned banks.

## Leading the way in innovation

For nearly two centuries, customer-owned banks have offered a distinctive and community-focused alternative to traditional investor-owned institutions. In a banking landscape dominated by a handful of major players, customer-owned banks put people first and provide purpose-led banking that truly serves the needs of its members and their communities. That is why, since their beginnings, customer-owned banks have led the way in delivering innovation for their communities.

<sup>20</sup> [https://v3.globalcube.net/clients/eacb/content/medias/press/press\\_releases/2024/manifesto\\_eacb\\_2024\\_final\\_2.pdf](https://v3.globalcube.net/clients/eacb/content/medias/press/press_releases/2024/manifesto_eacb_2024_final_2.pdf).

A customer-owned bank was the first to install a 24-hour ATM at a retail outlet (1970s), the first to operate an EFTPOS facility (1980s), and the first to trial a Visa Disposal Stored Value Card (1990s). Customer-owned banks were among the first to adopt Apple Pay and Android Pay, and the first to market with the New Payments Platform.

This customer-focused dedication ensures our sector continues to provide innovative and relevant solutions for customers. However, this is becoming increasingly difficult as economic and policy settings constrain our members' options, forcing a redirection of resources away from crucial investments in technology, service enhancements and product development that would further benefit customers.

#### **Exhibit 7: Recent examples of customer-owned banking innovation**

- Many customer-owned banks offer shared equity schemes, helping eligible customers buy their first homes sooner and with less deposit required. Police Bank has been running a shared equity scheme in partnership with HOPE Housing since 2022, which enables essential workers and their families to purchase a home in the community they serve by bringing together the homeowner's deposit, bank funding, and a shared equity co-investment in the property chosen by the essential worker.
- Traditional Credit Union is planning to roll out its innovative 'Bank in a Box' initiative to ensure permanent access to financial services in remote locations. Inspired by a successful remote laundry program, this involves placing secure, cyclone-proof containers equipped with banking technology in remote communities in the NT. These containers can serve as mini branches, providing access to cash, video conferencing with staff in Darwin, and even facilitating connections between community members.

#### **Recommendation 1 – supporting the growth of customer-owned banks**

The Government and regulators should commit to a growth and innovation mindset to the regulation and supervision of customer-owned banks while also meeting other objectives, including financial stability and consumer protection. This approach should recognise the key role our sector can play in solving issues in the financial sector. This will allow customer-owned banks to chart a different path to major banks and provide genuine choice to customers.

# Creating a level playing field for smaller banks

A key option is targeted Government assistance designed to encourage innovation and delivery of social goods by smaller banks. Such support could assist smaller banks to expand their offerings to underserved segments of the community, or to overcome one-off major investment hurdles to facilitate digital transformation or regulatory compliance, noting costs fall disproportionately on smaller banks.

## Assistance to meet compliance obligations

Smaller banks face proportionately higher fixed costs than major banks, making it challenging to meet both compliance obligations and invest in new products and services. Recognising the value of choice and competition in the banking market, alongside the importance of consumer protection and stability, the government could consider aiding smaller banks with compliance costs. Such support would mitigate smaller banks' competitive disadvantage, freeing up resources to tailor products and services to their communities, ultimately increasing choice and competition in the market. This assistance could come in the form of grants or tax incentives that could be time-limited and targeted to assist smaller banks meet significant new compliance burdens.

## Digital transformation incentives

Digital transformation is sweeping through the financial services industry and is seeing significant upgrades to existing systems and a stronger demand from the market for new and innovative products and services. This is causing major shifts in consumer expectations and changes in how people bank, however, these investments are resource intensive which disadvantages smaller banks. To assist smaller banks through this challenge, grants or tax incentives could be provided to smaller banks to make the investments in digital infrastructure more easily achievable. These incentives could be targeted towards specific activities, such as assisting in the costs of delivering Open Banking, invest in artificial intelligence driven customer service, or cybersecurity enhancements that help smaller banks operate more efficiently and securely.

## Enhanced collaboration with fintechs

To assist with addressing the scale advantage available to large banks, smaller banks could be encouraged to form strategic alliances with financial technology businesses or 'fintechs'. These collaborations could help smaller banks address the digital transformation and be able to offer financial services at lower costs, for example, through mobile banking apps, alternative lending models, or even AI services. This would be further assisted through the more widespread use of regulatory sandboxes that would allow smaller banks to participate in these collaborations and to experiment with new business models and technologies. Grants or tax incentives could also be provided to both smaller banks and fintechs that engage in these activities and to assist in the development of new products and services.

An example to facilitate innovation and collaboration between smaller banks and fintechs is the approach taken in the USA to exempt smaller banks from credit/debit card interchange fee caps. The exemption allows smaller banks to charge higher interchange fees, which creates additional revenue streams to invest into innovation. The impact of this in the USA is that it has made smaller banks the partners of choice for both fintechs and major card issuers, which has provided opportunities for the development of new products and for smaller banks to offer better services. If policymakers decided to extend a similar exemption to smaller banks in Australia, we expect that the impact on merchant fees and on Australian consumers more broadly should be minimal while potentially delivering significant competitive benefit to smaller banks by encouraging innovation.<sup>21</sup>

<sup>21</sup> <https://www.ecfr.gov/current/title-12/chapter-II/subchapter-A/part-235>.

## Supporting banking diversity to balance social and financial benefits

Customer-owned banks have a long history of serving those parts of the community that have faced challenges in obtaining access to banking services that fit their diverse needs. Customer-owned banks combine the thrift of the private sector with the social purpose of government, presenting an ideal model to support social goals and help to solve financial and banking problems facing Australians.

To support the sector to continue serving these communities, both geographic and non-geographic, and to expand product offerings, a framework of grants, tax incentives or incentives could be established to ensure that these communities, such as low-income families, indigenous Australians, essential workers, seniors and regional communities, can continue to receive access to appropriate banking services.

While our sector will continue to support their communities in the absence of incentives, customer-owned banks are subject to increasing economic and regulatory pressures which, when combined with their smaller scale, can create difficulties in continuing to balance social benefit and financial benefit, given the ultimate need for financial sustainability. Unless there is change, these pressures will hamper the ability for customer-owned banks to continue delivering the same level of social-purpose in a sustainable manner. Without a strong customer-owned banking sector applying pressure in the for-purpose space, there is also a risk that investor-owned banks could pull back on their social benefit activities.

COBA notes that other countries use a mix of incentives or regulatory requirements that mandate community contributions. An incentive model is more effective in achieving desired community outcomes by encouraging the for-purpose focus that is already prevalent in our sector. Incentives also provide more flexibility for banks to tailor responses to diverse community needs, whereas top-down mandated community contributions may not be as effective. However, mandated contributions may be more appropriate for large, diversified competitors.

One area of potential interest relates to regional banking. Closure of bank branches is not a new phenomenon in Australia, particularly as customers have overall shown a preference for digital services and customer foot traffic has fallen. However, branch closures tend to have a bigger impact on those in regional and rural Australia as they have fewer accessible physical options for banking and have a larger proportion of digitally excluded individuals. This framework could also include examining potential mechanisms to support face to face banking in regional areas.<sup>22</sup> However, any proposals should acknowledge that customer-owned banks must have the freedom to allocate their limited resources how they choose to respond to changing customer behaviours and demands.

### **Recommendation 2 – support to level the playing field**

The Government should help level the playing field for customer-owned banks by providing support in the form of subsidies, grants or tax concessions to assist smaller banks meet compliance obligations, to provide social benefit to the community, and to assist in the digital transition.

<sup>22</sup> <https://www.afr.com/politics/federal/banks-face-new-levy-to-keep-rural-branches-open-20241115-p5kqwu>.

## **Exhibit 8: International examples of government interventions in social benefit in banking**

### *Community Reinvestment Act (CRA)*

In the USA, the Community Reinvestment Act (CRA) ensures that larger financial institutions meet the needs of their local communities, particularly low and moderate-income communities. The Act is targeted at larger banks, not credit unions, to address the disparity in appetite to deliver banking services or support to varying customer cohorts.

Banks are assessed by their regulator on the level of lending activities to low- and middle-income individuals, small businesses, agribusiness, and community development lending. Additionally, they are assessed on their investment in community development projects and the accessibility and quality of financial services, including branch locations and hours of operation, financial literacy programs and availability of financial counselling and affordable banking products.

Banks subject to CRA obligations often collaborate with credit unions to meet their CRA requirements by investing in or lending to credit unions serving low to middle income areas. This provides credit unions with funding and resources to increase community initiatives.

### *Community Development Financial Institutions Fund (CDFI)*

The Community Development Financial Institutions Fund is funded and administered by the US Department of the Treasury. The Fund aims to see all people and communities are given access to the lending, investment capital and financial services they need to prosper. The Fund targets underserved people and communities by empowering financial services providers with specialised support to serve these cohorts. To participate in the program, credit unions in the USA can apply to be certified as a CDFI. CDFIs are then provided with financial assistance to promote economic growth and financial prosperity in target communities.

CDFIs can access financial assistance grants to increase lending and investment in target communities, technical assistance grants to build capacity, such as staff training or technology upgrades, tax credits and other incentives, and affordable capital. CDFI credit unions often use these resources to expand services like affordable home loans, small business lending, and financial literacy programs. Over \$8 billion has been awarded to USA CDFIs since 1994, for the benefit of low-income communities and vulnerable cohorts.

### *Indian Self-Help Group Bank Linkages*

Self-Help Groups (SHGs) for women in India play a crucial role in empowering women socially and economically. These community-based groups, similar to cooperatives, typically comprising 10-20 women, promote financial independence through savings, micro-loans, and income-generating activities. Supported by government initiatives like the National Rural Livelihood Mission (NRLM) and NGOs, SHGs provide women with access to credit, skill development, and entrepreneurial opportunities. Beyond financial benefits, they foster collective decision-making, confidence-building, and social awareness, helping women challenge gender inequalities and improve their families' well-being. By encouraging solidarity and self-reliance, SHGs significantly contribute to rural development and women's empowerment in India.

To support these SHGs, the Reserve Bank of India has created the SHG-Bank Linkage Programme which creates expectations that Indian commercial banks provide incentives for their branches to lend to these SHGs in a 'simple and easy' manner. While a world away from Australia's banking system, this shows the power of finance and cooperatives to deliver social outcomes.

# Improving proportionality

Regulatory burden, or the cost of compliance with regulation, has a disproportionate negative impact on smaller banks due to their relative size. The significant additional costs required by smaller banks to meet new and existing regulations can divert resources from vital investments in customer delivery and innovation – key areas where customer-owned banks have historically delivered competition to the larger banks. Larger banks can implement regulatory change at scale, which provides them with a distinct competitive advantage in the current environment of continuous and fast-paced regulation.

## Greater utilisation of tiering by regulators in approaching regulatory frameworks

The Australian banking system currently uses some elements of tiering to apply differing obligations to different banks. This tiering brings some proportionality into applying regulation or identifying banks subject to more oversight. In general, APRA is the most prominent user of tiering.

The first tier is domestic systemically important banks (D-SIB) which APRA applies to the four major banks. It does so due to size, market importance and interconnectedness leading to their distress or failure causing significant financial system consequences. This was a concept developed by the Basel Committee after the Global Financial Crisis to identify systemically important banks that would be subject to higher loss absorbency capital requirements to mitigate the risks of being 'too-big-to-fail'.<sup>23</sup>

The second tier is significant financial institutions (SFI) applying to ADIs with more than \$20 billion in assets.<sup>24</sup> APRA regards these institutions as having sufficient operational complexity to justify the designation. This leads to an effective third tier where non-SFIs can see reduced reporting or other obligations imposed under different instruments or regimes.<sup>25</sup>

COBA considers the D-SIB approach to be an appropriate example of proportionality but considers the SFI approach, while well intended, to be insufficient to truly achieve proportionality. This is because the current threshold of the SFI is no longer appropriate given market changes. In the CFR Issues Paper<sup>26</sup> the CFR adopted the following method for distinguishing between differently sized banks to classify as major, medium, small and very small:

- Major bank: has more than 10% system assets (\$530 billion at June 2024).
- Medium bank: has between 1% and 10% system assets (between \$53 and \$530 billion).
- Small bank: has between 0.1% and 1% system assets (between \$5.3 and \$53 billion).
- Very small bank: has less than 0.1% system assets (less than \$5.3 billion).

Based on these categories, the SFI threshold at \$20 billion in assets is applying to banks that are approximately 0.4% of system assets and being treated in a similar regulatory fashion as major banks exceeding 10% of system assets. For example, under the Financial Accountability Regime, which imposes different obligations on SFIs and non-SFIs, COBA's largest member with c.\$24.5 billion in assets<sup>27</sup> is treated in the same manner as Australia's largest ADI at c.\$1.4 trillion<sup>28</sup> despite only being c.2% of its size. The current SFI threshold also acts as a disincentive for mergers that could assist members to achieve greater scale.

Another example where we are concerned that regulators are not properly considering the risk differences between differently-sized banks is in the 'three lines of defence' model, as all banks are expected to fully implement the model for all material risk types. While this may be an appropriate model for large and

<sup>23</sup> APRA, *Information Paper: Domestic systemically important banks in Australia* (December 2013), 5-7.

<sup>24</sup> Prudential Standard APS 001 Definitions.

<sup>25</sup> For example, under the Financial Accountability Regime there exists less reporting obligations on non-SFIs.

<sup>26</sup> Issues Paper, 3.

<sup>27</sup> At December 2024.

<sup>28</sup> At June 2024.

complicated banks there does not appear to be recognition that for much smaller and simpler banks this may not be practical or conducive to the best possible risk management.

While we appreciate the efforts being made by APRA and the Government towards proportionality, we note that these tiers are only used by APRA. We are not aware of similar attempts towards adopting a tiered approach being taken by other regulators or regulatory frameworks. This creates the impression that other regulators prefer a 'one size fits all approach' be adopted to their regulatory frameworks.

A stronger more proportionate tiering approach is necessary to help mitigate the competitive disadvantage that smaller banks face in meeting fixed compliance costs. The CFR Issues Paper demonstrates the differences facing major, medium, and smaller banks when it comes to regulation. Every compliance dollar spent by a customer-owned bank could alternatively be used for consumer or community programs. It is important that the marginal benefits of this compliance spend and further improved risk management practices are balanced against this opportunity cost.

The existing tiering used by APRA should be more explicit in aligning with these thresholds so that the D-SIB designation continues to apply to the major banks, and is used more consistently in applying greater oversight to those banks. The SFI threshold should be at least lifted and aligned with the medium bank threshold the CFR has used of approximately \$53 billion in assets. This asset threshold should also be regularly reviewed to ensure it remains set at an appropriate rate due to inflation. This tiered approach should be adopted across as much legislation and as many agencies as appropriate and possible. Finally, once a more appropriate tiering structure is adopted then existing laws should be reviewed over time to identify where this tiering could be better incorporated and not only applied to new laws.

### **Recommendation 3 – consistent and proportionate tiering approach**

The Government and regulators should adopt a consistent tiering approach to regulating different sized banks and apply these thresholds consistently across different regulatory regimes and agencies. This tiered approach could reflect the following categories as used in the CFR Issues Paper and be based on system assets (for example, with 1% or c\$50 billion threshold).

Existing regulations and reporting requirements currently applying to banks should be reviewed over time to incorporate this tiered approach to regulation.

### **Consideration**

In developing requirements for each tier, regulators should carefully consider the requirements that should apply to each tier, rather than designing policy based on the largest banks by default, and subsequently retrofitting it to smaller banks.

Government and regulators should always consider whether all banks must be subject to new regulations (for example, Consumer Data Right action initiation). Cost benefit analysis should also consider the marginal costs and benefits of the regulation applying to smaller banks.

## **Transparency in policy and regulatory development**

We welcome recent Government efforts to improve transparency in the policy and regulatory process through an increasing use of public and private consultations. This sees agencies engaging with industry and the public more consistently by outlining issues and thinking on how to respond to issues. However, improvements could be made to increase transparency in the policy and regulatory development processes that will help facilitate greater proportionality in the system.

Agencies can be opaque on what their policy making processes are, what factors they are considering, and how much weight will be applied to specific factors. This opacity makes it difficult for industry and the public to understand whether regulators or policymakers are, for example, considering the cumulative impact of new regulations and its impacts on the costs on smaller banks. This compares with, for example, how the UK Prudential Regulation Authority has publicly consulted on its policy making processes and sought feedback on it.<sup>29</sup> Further it is unclear how agencies decide that an issue needs to be resolved and how particular responses are arrived at. Based on currently available information it is not clear that regulators or policy makers consider the following:

- *Effectiveness of existing laws*: it is unclear whether and how effectively regulators and policy makers examine whether existing laws can be used to address new problems, or where a genuine gap is identified, whether this issue could be resolved through an amendment or tweak of the existing law rather than creating a new regime. New regulatory regimes should only be created if there are no reasonable alternatives, and policy makers and regulators bear the onus of proving the case that regulation is needed.
- *Impact on competition*: it is not clear whether there are robust considerations of the impact of regulation on competition, especially how regulation could disproportionality impact smaller banks in comparison to large banks due to the higher fixed compliance costs.
- *Impacts on different business models*: it is not clear whether regulators and policymakers properly consider different business models when deciding whether and how to regulate. It appears that there may not be a full and proper weighing of how customer-owned banks have different risks and different responses compared to investor-owned banks.
- *Adequacy and robustness of Regulatory Impact Statements (RIS) and Cost Benefit Analysis (CBA)*: the use of RIS and CBAs in the policy and regulatory development process is inconsistent and often appears to be 'tick the box' exercises. Many RIS and CBAs often do not appear to seriously consider alternative options, and we are not aware of any recent RIS or CBAs that have preferred a non-regulatory intervention over regulation.
- *Post-implementation reviews*: to COBA's knowledge post-implementation reviews are either not used by policymakers and regulators or are only used in limited circumstances. For example, we are aware of a post-implementation review being conducted on the Compensation Scheme of Last Resort, but we are not aware of similar reviews being undertaken for many of the other major regulatory changes of recent years.

While COBA welcomes the Treasurer's recent revision of APRA's Statement of Expectations to improve proportionality and the consideration of different business model, and revising mandates will permanently enshrine this intent into regulator's mandates.

<sup>29</sup> Prudential Regulation Authority, *The Prudential Regulation Authority's approach to policy* (September 2022) Discussion Paper D4/22.

#### **Recommendation 4 – enhanced mandates and accountability**

The Government should amend APRA's mandate to include a secondary competition objective that would require it to actively consider competition as its secondary objective after its primary objective of stability and safety. This would place competition above the other balancing objectives in its mandate.

The Government should amend regulator mandates to adopt a corporate diversity clause similar to UK regulators. This would require regulators to consider the customer-owned banking model in decision-making processes. This would ensure that regulators have a deep understanding of the drivers as well as the consumer and community potential of our model and can support it accordingly.

These changes should be accompanied by a clear accountability mechanism for regulators to demonstrate how they have met these enhanced mandates.

#### **Financial Services Regulatory Initiatives Grid**

The Government's Financial Services Regulatory Initiatives Grid has been the single biggest transparency improvement in policy development. The Grid is a major step forward in transparency with the first iteration providing highly useful information and guidance making it easier for industry, especially smaller banks, to be aware of future consultations and changes. COBA strongly supports the Grid but believes that it could be improved further as a means for greater coordination of policy projects and implementations among the Grid agencies.

Additionally, we note other calls for improvements in how regulation could be clearer and better targeted and measures to improve transparency, such as was made by the Australian Law Reform Commission (ALRC) in its Review of Legislative Framework for Corporations and Financial Services Regulation.<sup>30</sup> We believe that those agencies subject to this review, as well as others such as the Attorney-General's Department and AUSTRAC, should closely examine those recommendations to identify further improvements that could be made to their respective frameworks and approaches.

#### **Recommendation 5 – regulatory coordination**

Building on progress to date, all participating agencies should use the Financial Services Regulatory Initiatives Grid process to actively coordinate and plan their policy projects and implementations to minimise the overlap of regulations and support smooth delivery. This will ensure that the Grid moves beyond a transparency measure and delivers the intended better regulatory outcomes for regulated entities.

<sup>30</sup> ARLC, *Final Report – Confronting Complexity: Reforming Corporations and Financial Services Legislation*, ALRC Report 141 (November 2023).

## Considerations

- The UK's Strong and Simple regime provides further thoughts about what could be introduced into Australia. However, while 'strong and simple' approaches can reduce administrative burden, if overly conservative (for example in capital requirements) then they can reduce growth prospects.
- Regulators should also consider the use of 'opt out' clauses where entities can opt-out of certain requirements if they can provide a case (for example, CPS 230 coverage). A potential area is CPS 511 remuneration for customer-owned banks due to our non-equity compensation packages.
- Agencies should publicly disclose policy development processes so that industry can understand how and when to engage to ensure that proposals can adequately reflect more considered industry input.
- Agencies should consider undertaking cost benefit analysis and/or regulatory impact statements for all major changes to regulatory frameworks, including amending instruments, and not just for new instruments.
- Agencies should consider adopting more external oversight of the RIS/CBA processes. Reviews of these processes by external parties would encourage transparency by agencies and policymakers and provide greater assurance to industry.
- Post-implementation assessments should be mandatory for all major changes. These assessments should outline how the changes have affected smaller banks. These assessments should have a mandate to identify ways to lower costs and increase competitiveness from these reviews, which should include a mandate to actively consider whether regulation should be removed or wound back for smaller banks. Consideration should be given as to whether these should be conducted by external third parties to assess both the effectiveness of the frameworks, and the relevant agencies in developing and implementing the framework.
- Consideration should be given to the recommendations made by the ALRC in its Review of the Legislative Framework for Corporations and Financial Services Regulation with a focus on adopting, as appropriate, its suggested improvements to legislative drafting and data reporting and accountability for agencies.

## Enforcement and supervision

Enforcement and supervision are important aspects of any regulatory regime. These are necessary and appropriate activities for regulators to perform to ensure the law is enforced to achieve the intended regulatory goals and banks are meeting community expectations. However, the experience of our members suggests there is greater scope for proportionality to be reflected in regulator approaches to enforcement and supervision.

Our members' interactions with regulators suggests that, at times, regulators do not have the tools, knowledge or flexibility to apply proportionality, even where it would be appropriate and reasonable to do so. This can lead to a strong risk aversion among smaller banks which fosters a mindset focused on maximising risk and compliance, rather than innovation. This risk aversion leads to a focus on 'excessive' compliance that can curtail investment into new products or the exploration of new business models.

COBA recognises that APRA seeks to take a different approach to its supervision of smaller banks compared to large banks. However, some of our members report that this can be haphazardly applied. This can result in an inflexible checklist approach to supervision that sees our members subject to excessive inquiries, information requests, unprioritised findings from on-site reviews or visits, and large exposure approvals.

We further note that the rigid application of the 'three lines of defence' model to small banks, without regard to a bank's risk profile, imposes substantial resourcing requirements and costs while not necessarily adding much risk management benefit. COBA suggests that the principles of independent review and challenge with independent reporting lines should be maintained but could be applied with less prescription in relation to who can or should do what within a smaller bank.

We suggest there is capacity for a more nuanced approach to how regulatory instruments are interpreted and applied to small banks, and greater guidance within regulators as to the appropriate application of supervisory principles to smaller banks.

## Regulator guidance

Regulator guidance outlining expectations about how entities will comply with laws is a valuable tool for all regulated entities. However, much of the guidance that is currently issued by regulators is framed as general commentary that is suitable for all regulated entities and is not tailored towards size. We recognise that the guidance's intent is usually to outline a best practice approach to responding to an issue and may not necessarily be what an entity is actually required to do to comply with the law, as guidance is not legal advice. Additionally, we recognise that regulator resourcing can impact on the type and volume of guidance that is issued as a matter of practicality. Consideration could be given towards providing more targeted and nuanced guidance that acknowledges that different sized entities may not necessarily be subject to the same regulator expectations. The concern we have is that in seeking to 'cover the field' with guidance, the regulators will default to providing guidance that will be more helpful to larger banks but may be excessive or inappropriate for smaller banks.

Absent a tailored approach, smaller entities tend to adopt the guidance in full without necessarily making appropriate adjustments due to their size. These banks will take this approach due to their risk aversion and desire to avoid enforcement and supervision activity. This can be exacerbated in instances where guidance is not issued by regulators and consultants are relied on for advice. These consultants will usually encourage smaller banks to adopt practices used by large banks. In instances where consultants do provide more nuanced guidance it can create impositions on small banks that requires more time, cost, and expertise that may not be available. More targeted and tailored advice from regulators outlining where different approaches and expectations are applied to smaller banks will assist in a more proportionate application of the regulatory frameworks.

### Considerations

- Smaller banks can struggle to interpret regulator expectations in a proportionate manner. Regulators could adopt more targeted programs, such as staff assigned to smaller banks to assist with implementation queries, and the preparation of more targeted guidance to help outline clear and proportionate expectations to smaller banks. This would assist them to meet obligations in a cost-effective manner rather than leaving smaller banks to rely upon guesswork or consultants who apply large bank frameworks.
- APRA should review the proportionality of its expectations for customer-owned banks, particularly when it comes to the transferability of expectations from larger banks. For example, a strict adherence to the three lines of defence model can be excessively costly for customer-owned banks with the need to get specialised Line 2 staff.
- Regulators could incorporate a more proportionate and targeted enforcement approach for smaller banks.

## Reporting

Reporting obligations can impose significant costs on smaller banks, which applies to both regular statutory reporting and ad-hoc data requests made by regulators. While the costs of implementing new regulations, covered further in **Appendix A**, can be a burden on smaller banks, they tend to be mostly felt at the front end through the extra resources needed to make the changes with additional costs for ongoing compliance. However, the costs of reporting can be significant over the longer term and arise from the requirements on banks to create new data sets, or to collect data that was previously not collected. Our members advise that reporting requirements can be further exacerbated when they are subject to what can be extensive and burdensome follow-up queries and additional requests to provide more data and clarifications.

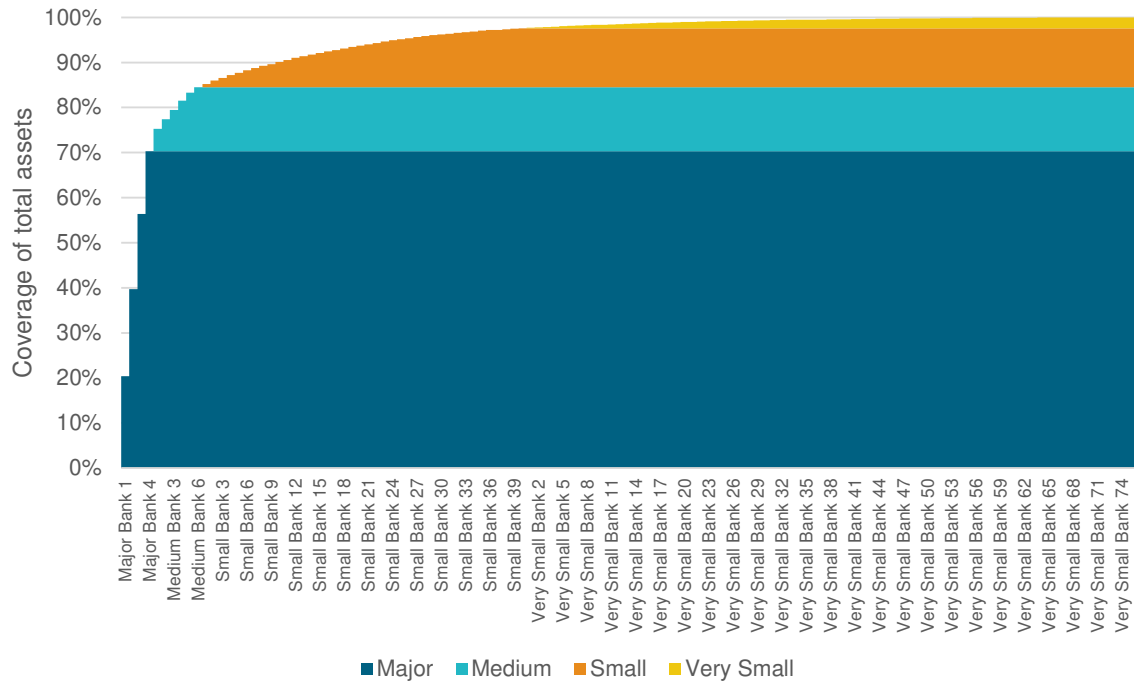
We do not oppose reporting or data collection when the intent and purpose is clear and valuable. However, at times the objective of data collection and reporting is not always clear, and it can be unclear how (or even if) the data is used to meet regulatory objectives. For example, our members are currently subject to extensive reporting obligations to both ASIC for its breach reporting regime, and to AUSTRAC to make Suspicious Matter Reports (SMRs). All of these reports are highly detailed and require significant resources to lodge each report, but it is often not clear what is achieved from these types of reporting. To be clear, COBA is not saying that banks should not report this data but rather that reporting such as ASIC's breach reporting could be more targeted. Additionally, the use or purpose of other forms of reporting, such as SMRs to AUSTRAC could be clearer.

We note that there is a difference between forms of reporting and requests for information that can occur as part of enforcement activities. These requests are made at the individual bank level and focused on determining the level of compliance by that bank with the regulatory regime. However, even in these matters, similar to our comments above under enforcement and supervision, these requests could be more tailored to reflect the relative simplicity and more limited resources of smaller banks. Similar considerations should be applied for reporting when it comes to merged entities, given the prevalence of mergers in our sector.

COBA believes that policymakers and regulators should actively consider, in each instance of data collection or reporting, whether the obligations or requests should be imposed on smaller banks, or if it is to be imposed, whether a simpler, less burdensome request should be made. In instances where data is being collected from major banks, regulators should consider whether the collections should go beyond those banks (that is, whether more than 80% coverage is actually needed) due to the significant market coverage of these entities (**Case Study 1**). **Graph 7** shows the relative coverage of a small number of large banks.

Another example of excessive reporting is APRA's ARS 750.0 Agricultural Reporting form which requires all banks to report their farming exposures, despite limited farming lending from smaller banks. Again, COBA acknowledges that it can be appropriate to extend reporting obligations from the major banks to small banks, however, we ask that regulators and policymakers be more judicious in their application of reporting and data requests. Requests need to better consider whether the marginal gains from collecting the data or information is offset by the marginal cost that is imposed on smaller banks given their lower ability to absorb these costs.

**Graph 7: Declining marginal benefit to data collection on smaller banks**



Source: COBA estimates based on APRA Monthly ADI statistics

### Considerations

Adopt a tiered approach to both regular and ad hoc reporting with active consideration given to imposing differing obligations on differently sized banks based on the amount of data actually needed to achieve the intended goal. When imposing reporting obligations on small banks, meaningful proportionate concessions on the amount and type of data collected should be made.

Reduce frequency of reporting for small banks. For example, change monthly reporting to quarterly and quarterly reporting to six monthly or annual.

Consideration should be given as to whether ad hoc data requests or reporting can be initially limited to the major banks, and where extended to smaller banks requests should be proportionate.

Before making data requests or developing reporting obligations, agencies should actively consider what value will actually be gained from covering small banks or imposing the obligation when data covering most of the system could be gained from major banks.

### **Case Study 1 – ad-hoc ACCC deposit competition information request**

As part of developing its Retail Deposits Inquiry response<sup>31</sup>, the ACCC approached a number of ADIs, including some COBA members with information requests on deposit account offerings. This was a substantial request in terms of the volume and breadth of data sought by the regulator in a very limited period of time.

This data request was substantially the same as that given to a major bank, however, unlike a major bank, our members are too small to have staff dedicated to responding to regulator requests. The size, timeframe and lack of forewarning of the data request caused significant disruption to our members' resourcing as existing staff were reallocated at short notice to comply with the request.

Selected customer-owned banks each provided thousands of documents to the ACCC and incurred tens of thousands of dollars in costs from external consultant support and lost significant staff hours as part of their response to the request.

The lack of proportionality, limited response timeframe and insufficient forewarning all exacerbated the impact of this substantial data request on customer-owned banks.

### **Implementation approaches**

Implementing new laws and regulations tends to be the main area where regulators attempt proportionality, predominately through staggered implementation periods for smaller banks. Additionally, regulators have, at times, made efforts to take an educative approach to implementation that seeks to provide a hand up to smaller banks. We appreciate the efforts made by regulators in taking this approach. However, we believe that there are additional steps available when providing more fixed time periods for implementation and the sharing of more learnings from the experience of major banks.

Implementation periods are critical as they provide regulated entities with time to adjust operations to meet new laws. This can include changes to processes and procedures, acquiring new technology to perform compliance functions, or scaling up existing resources for compliance actions. This can often see the need for large costs to achieve these goals, which then shifts to increased operating costs overall to ensure ongoing compliance. Having longer implementation periods helps to manage this issue by allowing the entity to spread these costs out over a longer period of time and provides an opportunity for smaller banks to explore collaborating with others on obtaining shared services, as appropriate.

The need for external advice or specialist consultants can exacerbate implementation costs. In instances where large scale changes are being made in a short period of time, the ability to acquire this advice affordably and in a timely manner can be challenging. Providing longer implementation periods also helps address this issue by providing more time for small entities to acquire the necessary services at a reasonable price, usually after the initial demand from the larger entities has been resolved.

Given the above, we are concerned there is a tendency towards providing relatively short implementation periods, and a tendency to not accept industry advice on the appropriate length of these periods. The challenge with overly short implementation periods is that many of the final details are not known until relatively shortly before the commencement of the law. This is because often there needs to be regulations, rules and guidelines prepared and consulted on. These documents and instruments are essential for providing key details to operationalising the reform but are often only finalised shortly before the laws commence, leaving limited time for entities to incorporate this material.

Further, during consultations on draft instruments Government will often seek input on what would be an appropriate implementation period. However, we have found that industry advice will rarely be accepted

<sup>31</sup> [www.accc.gov.au/inquiries-and-consultations/retail-deposits-inquiry-2023](http://www.accc.gov.au/inquiries-and-consultations/retail-deposits-inquiry-2023).

and overly short periods are usually chosen instead. Our first concern with this is that agencies tend to underestimate the time and resources needed by industry to effectively implement changes. A second concern is the lack of transparency when policymakers and regulators choose to not accept industry advice on this issue.

The Regulatory Initiatives Grid is expected to address some implementation issues. However, regulators should consider other innovative approaches to implementation that would assist smaller banks. This includes the staggering more commencement dates for different sized banks, and using this staggered approach to assist in developing guidance for smaller banks or considering alternative approaches. For example, this could see the major banks first implementing a law with the regulators then considering the lessons learnt from implementation. Regulators could then adopt a different implementation approach for smaller banks using the lessons learnt from the major bank implementation. They could decide that alternative, more moderate, obligations be imposed, or that more specific guidance be provided to give a hand up to smaller banks.

### **Case Study 2: FAR implementation**

An example of both good and bad implementation was the Financial Accountability Regime (FAR) in 2023-2024. After the passage of the Bill through Parliament, APRA and ASIC both developed a good implementation strategy and communicated this to industry on how each wished to approach implementation for the six-month period following the law's passage through Parliament. However, this did not eventuate as, for reasons that not been adequately or publicly explained, the finalisation of the Minister Rules was delayed by many months and were only finalised on 5 March 2024, a mere nine days before the laws came into force.

The Rules provided key details without which compliance with the primary law was very difficult. This delay meant that there was minimal time for regulated entities to understand and comply with the laws and the implementation plan of the regulators was unable to be followed through. However, following input from industry, the regulators announced their intention to adopt a focus on education for the first six months of the law, which along with various pieces of guidance that were also released, greatly assisted COBA members to meet their compliance obligations.

The lesson from the FAR implementation is on the importance of clear communication and how an informative guidance approach focused on educating regulated entities can deliver the desired outcomes in an easier manner for industry. The other lesson is that the late finalisation of Ministerial Rules can make it near-impossible for entities, especially smaller entities, to comply with regulatory change efficiently and effectively.

### Case Study 3: Consumer Data Right vs. Comprehensive Credit Reporting

The Consumer Data Right (CDR) in Australia was introduced to empower consumers by giving them greater control over their data. Initially rolled out in the banking sector under Open Banking, the CDR is expanding into the energy and telecommunications sectors.

Data holders—such as banks, energy providers, and telecommunications companies—are required to securely share consumer data upon request with accredited data recipients (ADRs). While major banks have robust infrastructures to support CDR compliance, smaller institutions, such as customer-owned banks, face challenges in meeting the same stringent requirements. Ultimately, the Government made the decision to apply the CDR onto all ADIs irrespective of size, unlike the UK which only applied it to the nine largest banks.

COBA's 2017 submission on Open Banking noted that:

*“Given that Australia’s major banks hold 77 per cent of the personal deposits market, an effective Open Banking regime requires the participation of the major banks but does not require the participation of all other banking institutions from day one. Competitive forces will ultimately drive all banking institutions into an Open Banking regime once it is established.”*

Ultimately, customer-owned banks have now spent around \$100 million to be compliant with Open Banking with limited benefit. We note that there is a ‘de minimis’ threshold now for non-ADI lenders in the CDR. While we look forward to supporting the future success of the data sharing regime, it is critical that future regulatory regimes consider how to include entities and whether market forces can pull through adoption. An example could be the approach to Comprehensive Credit Reporting (CCR).

In 2018, the Government introduced legislation to create a mandatory CCR framework which required major banks to share positive credit data, expanding beyond the previous negative reporting system. Other banks were not mandated in but could be designated at a later date.

According to ARCA, currently more than 80 credit providers in Australia are supplying CCR data as at the end of June 2023. This is despite only the major banks being mandated and shows how market forces can pull through adoption.<sup>32</sup>

### Considerations

Regulators should adopt tiered implementation periods for subordinate instruments whereby smaller banks are given more implementation time. When developing implementation periods for Bills before the Parliament the agencies should recommend the adoption of tiered implementation periods.

Government and regulators should more fully utilise tiered implementation periods to gather learnings and lessons from major bank implementation that can be provided to smaller banks to assist them to adopt new laws.

Government and regulators should consider the use of designation instruments to ensure that there is sufficient time for any meaningful learning from larger bank compliance to be incorporated into both smaller bank, industry supplier and regulator processes. This may include further tailoring requirements or potentially addressing policy objectives in other manners. A ‘stop and pause’ approach is likely to have greater benefits for smaller banks compared to the current additional time approach.

<sup>32</sup> <https://www.creditsmart.org.au/comprehensive-credit-reporting/credit-providers-that-currently-participate-in-ccr>.

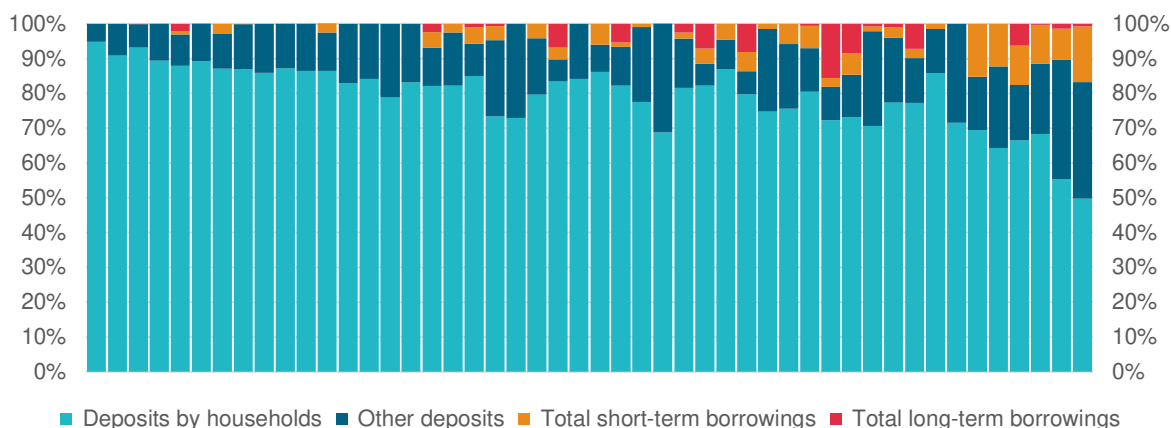
# Improving funding and capital access

Customer-owned banks are generally conservative in nature, lending to collateralised borrowers, operating with healthy leverage ratios and high capital buffers. This places our sector in a strong underlying position to grow and provide effective competition in the marketplace. Given the small sector market share, there is a significant opportunity for our sector to grow, however, this growth is often constrained by access to reliable, scalable, and affordable sources of funding. Government support to access a broader range of cost-effective funding sources is essential to supporting the sector being able to grow to provide diverse range of competitive products and value propositions to a wide range of Australians.

## Funding Considerations

Customer-owned banks have different funding profiles compared to larger banks in Australia. Most of our funding (~85%)<sup>33</sup> is sourced from retail deposits with the balance generally coming from wholesale debt markets and securitisation (**Graph 8**). However, even within our cohort, there are a range of funding profiles with smaller customer-owned banks unable to access many wholesale funding markets due to scale and their relatively simple business model.

**Graph 8: Diversity of customer-owned banking funding profiles**



Source: APRA Monthly ADI Statistics – December 2024

## Deposit Funding

As the original ‘peer to peer’ lenders, customer-owned banks are very active in the marketplace for retail deposits, offering a wide array of products to meet the needs of our broad retail customer base. Our small size, our members are price takers in the retail deposit market and, given the importance of customer deposits in the funding profile, customer-owned banks compete vigorously in the market.

## Wholesale Funding

Access to wholesale funding sources is critical to support the growth and competitiveness of the sector, given the finite supply of retail deposits in Australia. This is evidenced through larger banks historically sourcing more of their funding from these sources relative to smaller banks, due to the greater scalability of the wholesale market compared to the deposit market.

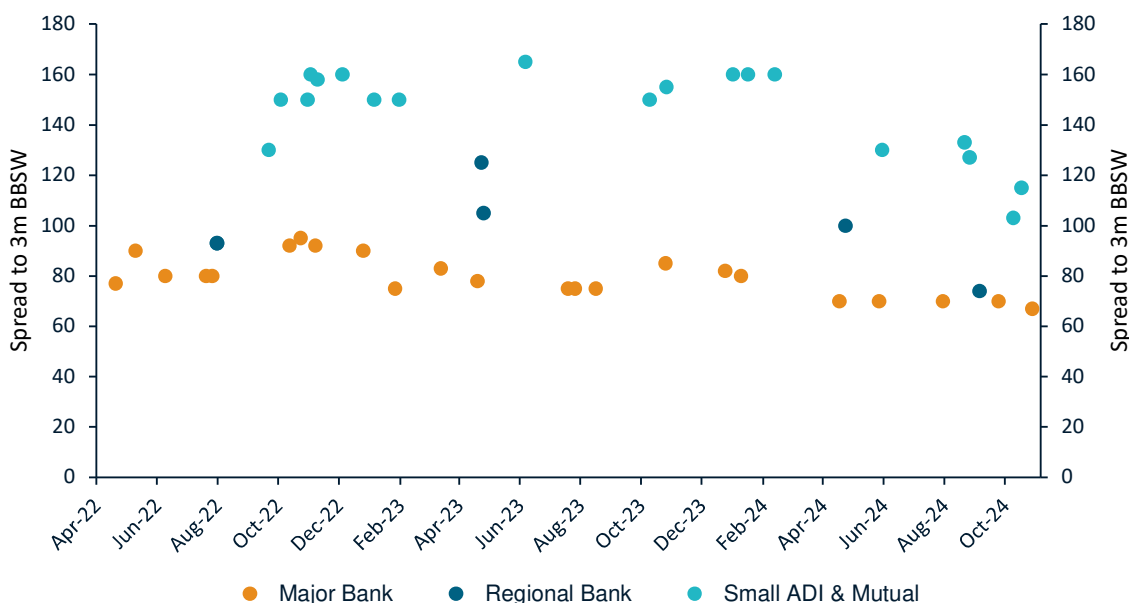
<sup>33</sup> APRA, Quarterly authorised deposit-taking institution statistics (September 2024).

Wholesale funding markets can comprise a broad range of markets and tradeable securities, however, many customer-owned banks face limitations when accessing these markets. The range of markets and security types available to the sector generally increases with asset size – very small customer-owned banks (with hundreds of millions of dollars of assets) may only be able to access wholesale term deposits or very short term debt (for example, 3-month Negotiable Certificates of Deposit), while larger customer-owned banks can seek funding through longer term debt including 3- or 5-year unsecured debt securities.

Secure, longer-term sources of debt funding offer more opportunities for growth, given the longer tenor and deeper investor base for these securities. However, there are several constraints facing customer-owned banks in accessing these markets.

Investors generally consider regular issuance, a sufficiently high credit rating and the secondary market liquidity of the debt securities (supported by large issuance sizes) when assessing the bank debt issue attractiveness. Small customer-owned banks do not have sufficiently high funding requirements to issue with the size and regularity that investors require and face higher relative costs in establishing and maintaining a debt issuance program. Larger customer-owned banks access the wholesale debt market at higher credit spreads relative to larger sized ADIs. Large customer-owned bank issuance spreads for 3- and 5- year senior unsecured debt are currently around 50 basis points higher than the major banks, and smaller customer-owned banks that access the term wholesale market would need to pay even higher credit spreads (**Graph 9**).

**Graph 9: Bank spreads on Australian Dollar Senior Unsecured Issuance (3-year)**



Source: COBA figures based on public information

This spread differential is due to:

- Lower credit ratings – customer-owned banks are generally rated around BBB while major banks enjoy a rating around AA (inclusive of a 1-notch benefit assigned by rating agencies due to implied government support),
- Low frequency of issuance,
- Low issuance sizes relative to larger banks, and
- Lower name recognition among investment managers, particularly internationally.

This results in a smaller pool of available investors for our senior unsecured debt and increases its cost.

Reducing the funding spread between our sector and our larger peers would allow customer-owned banks to better compete on a more even playing field and provide customer-owned banks with more opportunities to grow and offer better products to suit the needs of retail banking consumers.

## Securitisation

Securitisation<sup>34</sup> of home loans into Residential Mortgage-Backed Securities (RMBS) offers an important source of funding for our sector, however, few customer-owned banks can access this funding due to the increased cost and complexity of a RMBS transaction relative to accessing wholesale debt markets generally. Customer-owned banks with a balance sheet size exceeding the high single digit billions of dollars are generally able to access RMBS markets.

Challenges remain for customer-owned banks to access securitisation, including:

- Minimum transaction sizes (transactions in the hundreds of millions of dollars are considered the minimum size to be economical) restrict access to RMBS markets to only the larger customer-owned banks, as small customer-owned banks do not write sufficient loans or have the balance sheet scale to support such a large transaction.
- The establishment and ongoing maintenance of a securitisation program is costly as legal fees, credit ratings, investor roadshows, and ongoing internal staffing resourcing are required. Only larger customer-owned banks have the scale and access to expertise needed to afford such fixed costs given minimum transaction sizes.
- Securitisation warehouse facilities, predominantly provided by major and international banks, also require minimum sizing and entail similar fixed costs meaning large, regular transaction volumes are required in order to use them effectively.

Despite the ability for larger customer-owned banks to issue RMBS, costs to launch and manage a RMBS programme are higher than those faced by larger banks which can utilise economies of scale to reduce issuance and management costs. Furthermore, our RMBS transactions price at a higher spread to those issues by larger ADIs. This further increases the cost of undertaking a securitisation funding transaction. The additional spread can be in the order of 10-30 bp depending on the size of the customer-owned bank, despite the asset quality of the underlying loan portfolio being on-par with or better than that of larger ADI transactions.

Drivers of the higher spread can include:

- Smaller transaction volumes which result in a smaller pool of interested investors. Transactions above \$750 million typically include the broadest range of investors, however, few of our RMBS transactions are able to reach this size. A smaller transaction size will also be perceived as having lower secondary market liquidity by investors which can affect pricing.
- Lower frequency of issuance also results in a smaller investor base as some investors are unwilling to undertake costly due diligence on infrequent RMBS issuers.

Securitisation transactions can be undertaken either to exclusively raise funds which can be cycled into new loans or to undertake capital relief, which also provides banks with a decrease in risk weighted assets.<sup>35</sup> RMBS capital relief transactions are a relatively expensive form of improving a bank's capital position as the pool of available investors for relatively small tranches of junior (higher risk) notes is limited and therefore these investors may be able to command a significant price premium to acquire these securities. Furthermore, the onerous *APS 120 Securitisation* requirements add additional risk and complexity in undertaking these transactions.

<sup>34</sup> Securitisation is the process of pooling financial assets, such as loans or mortgages, and converting them into tradeable securities that can be sold to investors.

<sup>35</sup> Capital relief securitisations allow financial institutions to free up regulatory capital by transferring the credit risk of certain assets, in this case mortgages, to external investors. This is achieved by packaging these assets into securities and selling the risk associated with them, often through selling a junior (higher-risk) tranche that investors purchase. This is in contrast to funding-only securitisations which see the bank retain the junior tranches on their balance sheet.

Generally, RMBS transactions are more costly to undertake for customer-owned banks than their larger peers due to the relatively small scale and infrequent issuance of RMBS. This places customer-owned banks at a further disadvantage when seeking funding or capital relief through securitisation transactions.

## Self-Securitisation

APRA requires banks on the Minimum Liquidity Holdings (MLH) regime<sup>36</sup> with more than \$1 billion in liabilities to maintain a self-securitisation<sup>37</sup> program of 10% of eligible liabilities with a requirement to be able to upsize this to 20% within a 30-day period.<sup>38</sup> This has been implemented to enhance the liquidity position of banks and allow better access to funding in times of financial stress. By holding a pool of self-securitised assets (typically RMBS), banks have a liquid, high-quality asset that can be rapidly converted into cash through RBA facilities if the need arises, for example, if traditional funding markets close due to global economic turmoil.

Although access to emergency liquidity is very important to all banks, APRA's internal securitisation requirement imposes additional costs on customer-owned banks. This is because it involves significant administrative costs to establish and maintain and, in practice, it locks up a significant portion of available collateral which is then unable to be utilised for external securitised funding transactions.

The Credit Union Financial Support Scheme (CUFSS) provides an alternative, APRA-approved source of emergency liquidity for customer-owned banks, with participants pooling resources to support members in a liquidity crisis (**Case Study 4**). CUFSS is a collaboration between customer-owned banks that seeks to solve a problem to ensure that they can meet their regulatory requirements.

### **Case Study 4: Credit Union Financial Support System – lender of last resort**

The Credit Union Financial Support System (CUFSS) is our sector's self-funded and operated emergency liquidity support scheme, membership of which is open to all customer-owned banks.

CUFSS currently comprises 37 members and pools contributions from member banks to create a reserve fund. When a member faces liquidity issues, it can request emergency support from the scheme by temporarily drawing on the funds held in reserve with each member committing a contingent 3% of their assets (or a maximum of \$100 million) to this reserve. CUFSS also provides a monitoring and information sharing service for members thereby playing a proactive role in assisting and advising them on financial performance and risks.

Very small customer-owned banks, which do not have access to self-securitisation programs (that is, the RBA as a lender of last resort) and therefore have fewer options for sourcing liquidity, are beneficiaries of the scheme, which APRA has approved as an alternative emergency liquidity support option – reducing the burden on very smaller banks in needing to comply with more onerous liquidity requirements.

CUFSS enhances banks' operations and therefore depositor confidence and contributes to the overall stability of the customer-owned banking sector, thus highlighting the value of cooperation within the sector.

<sup>36</sup> All customer-owned banks are currently on the MLH regime.

<sup>37</sup> A securitisation which is solely for the purpose of using the securities created as collateral in order to obtain funding via a repurchase agreement with the Reserve Bank of Australia (RBA).

<sup>38</sup> [www.apra.gov.au/sites/default/files/2022-12/Letter%20-%20Contingent%20liquidity\\_Final%20guidance.pdf](http://www.apra.gov.au/sites/default/files/2022-12/Letter%20-%20Contingent%20liquidity_Final%20guidance.pdf).

## Multi-seller securitisation

Multi-seller securitisation can be an effective tool for smaller customer-owned banks to access capital markets without the need to independently meet the scale and complexity required for traditional securitisation programs. However, the existing requirements for multi-seller securitisation structures often pose barriers for our sector due to high administrative burdens, stringent risk-sharing obligations, and limited flexibility.

There are however a few examples of customer-owned bank driven programs in this space such as the now de-commissioned Integris securitisation platform (previously operated by Cuscal). This proved to be an effective tool for smaller banks to engage in off-balance sheet lending, thus helping uphold customer relationships that would almost otherwise have been lost to larger banks. Similarly, the industry continues to maintain a syndicated lending platform (ConnXsyn) to facilitate large exposure issues and diversification of the loan book (**Case Study 5**).

### Case Study 5: ConnXsyn – syndicating lending

ConnXsyn was established circa six years ago to support the syndication of residential mortgages for smaller customer-owned banks in Australia. It was designed to help address the challenges smaller customer-owned banks had in funding loans: typically, liquidity issues, large exposures and/or the need to diversify risk in the loan book. ConnXsyn is a good example of industry collaboration as it is owned by a number of small customer-owned banks and used to support the lending of a broader range of small customer-owned banks.

In essence, the “borrowing” ADI leverages the platform to find a suitable “depositor”. When a customer approaches a participating customer-owned bank for a loan, it may not be possible for that smaller bank to directly fund the loan due to the loan’s size or characteristics. In this instance the ConnXsyn platform facilitates the loan funding by another participant, which allows the original bank to provide the loan and retain the customer.

This approach, which has the support of the regulator, facilitates effective collaboration across smaller customer-owned banks and enhances the competitiveness of the sector as a whole.

Consistent with customer-owned bank interest in promoting a green lending platform (in addition to bridging the gap from Integris) going forward, work is currently underway to explore the feasibility of a multi-seller securitisation warehouse for COBA’s smaller members (primarily <\$1bn in assets) in partnership with the Clean Energy Finance Corporation’s Household Energy Upgrades Fund. An important constraint facing customer-owned banks seeking to lend under the scheme is the high risk weighting for green loans with green loans considered “personal loans” and carrying a 100% risk weighting.

## Covered bonds

Customer-owned banks are unable to effectively issue covered bonds. Covered bonds are highly complex financial instruments that require substantial operational scale and sophistication to issue economically. The scale required to access the covered bond market effectively is beyond the reach of most customer-owned banks noting that the regional banks have only just started issuing in this format in recent years.

Issuance volumes need to be sufficiently large to attract institutional investors and to cover the fixed costs associated with structuring and issuing the bonds. These costs include compliance with regulatory requirements, ongoing asset pool management, and the establishment of bankruptcy-remote structures.

Regional and major banks, with their larger asset bases and more extensive resources, dominate this market. Furthermore, while there is regular Australian dollar issuance, the covered bond market is largely tailored to European investors, who require large and frequent issuances to ensure liquidity and

marketability. For customer-owned banks, meeting these demands is unfeasible, effectively barring them from participation.

Even if regulatory changes were made to streamline the operation of covered bonds, such adjustments are unlikely to materially impact our sector's funding costs or accessibility to this market. The fundamental barrier for customer-owned banks lies not solely in regulatory complexity but in the structural, operational and economic realities of our smaller scale. As a general guide, banks with an asset size under \$50 billion are unlikely to be able to efficiently access the covered bond market. For comparison, the largest customer-owned bank has an asset size ~\$25 billion.

Without the ability to issue covered bonds, customer-owned banks remain reliant on other, potentially more expensive funding sources, such as securitisation or wholesale funding. This reliance places them at a disadvantage relative to larger peers, who can leverage the lower costs and longer tenors associated with covered bonds to enhance their competitive positioning.

## Capital considerations

Access to capital is a vital component of any bank. Capital acts as a buffer against financial shocks, such as loan defaults or market volatility, and strengthens resilience during economic downturns. Additionally, robust capital levels enhance investor, depositor and market confidence in a bank.

In a regulatory context, APRA requires banks to hold sufficient levels of capital against their assets on a risk weighted basis. In the case of customer-owned banks these assets are typically mortgages and personal loans. Therefore, capital generation is a fundamental driver of growth for all banks as sufficient levels of new capital must be held when new loans are written.

However, customer-owned banks face unique constraints in their ability to increase capital compared to their listed peers. Unlike publicly listed banks, which can issue equity to raise additional funds, customer-owned banks primarily rely on retained earnings as the primary method of capital generation. This reliance on internal resources limits their ability to scale quickly and invest in growth opportunities.

To address these limitations, larger customer-owned banks have adopted alternative methods of managing capital, such as capital relief securitisation transactions. While these transactions can provide some relief, they are inherently more complex to execute and typically yield more limited and non-permanent increases in capital (as the capital benefit of these securitisations reduces as loans are repaid). As a result, RMBS capital relief transactions can help enhance balance sheet efficiency but come with significant costs. The prudential requirements under APS 120 Securitisation add complexity, making such transactions less attractive or feasible for smaller customer-owned banks.

Mutual Capital Instruments (MCIs) represent another potential avenue for raising capital.<sup>39</sup> However, these instruments are even more complex and expensive to execute compared to securitisation transactions and through the Mutual Equity Interest are considered a higher cost way to access Common Equity Tier 1 capital. Significant resources must be devoted to addressing the intricate regulatory, market and structural requirements associated with MCIs which often deter customer-owned banks from pursuing this option, leaving them with limited alternatives to boost their capital base. They are also a higher cost of capital option.

Although MCIs were implemented by the Government in 2019 following the recommendation in the *Independent Facilitator Review Report on Reforms for Cooperatives, Mutuals and Member-owned Firms*, only one entity, Australian Unity,<sup>40</sup> has issued an MCI to date – which supported the capital position of the entire operating group rather than as a bank instrument. This limited take-up highlights the complexity and cost associated with issuance of these instruments.

Another challenge faced by customer-owned banks is the impact of Pillar 2 capital requirements, which reflect supervisory judgement imposed by regulators. These requirements often include undisclosed capital

<sup>39</sup> MCIs or 'shares' would be issued as Mutual Equity Interests (MEIs) in order to become Common Equity Tier 1 capital.

<sup>40</sup> Which operates across multiple sectors, including healthcare, wealth, retirement living, and banking.

overlays that may disproportionately affect smaller banks. Such overlays can create barriers to growth by tying up capital that could otherwise be used for expansion or enhancing competitiveness.

## Ensuring competition in high loan-to-value ratio home lending

The capital framework as it applied to home loans is very important to customer-owned banks given the outsized importance of this lending type to the sector's business model. The capital framework incentivises banks to offer lower loan-to-value (LVR) mortgages as banks are required to hold more capital for higher LVR mortgages, and significantly more capital for high LVR loans which are not protected through Lender's Mortgage Insurance (LMI).

**Table 1: Risk weights for standard home loans**

LVR (%)		Risk weight (%)						
		≤ 50	50.01 - 60	60.01 - 70	70.01 - 80	80.01 - 90	90.01 - 100	> 100
Owner-occupied principal-and interest	LMI	20	25	30	35	40	55	70
	No LMI					50	70	85

Source: Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk

For high LVR applicants, which are typically first home buyers due to the large deposit gap, there is a strong incentive for banks to require LMI as a condition of the loan. As a result, banks generally require prospective applicants to hold a LMI policy in order to obtain a loan with an LVR over 80%.

Therefore, LMI is a very important tool to assist first home buyers with low deposits into the housing market. Smaller banks, including all customer-owned banks, rely on the existence of an accessible and affordable LMI market to continue to provide aspiring home buyers with high LVR loans while managing their own credit risk. This stands in contrast to the major banks which have the scale and financial capacity to operate their own LMI in the absence of a private market (that is, self-insuring). Self-insuring is uneconomical for smaller banks.

### Considerations

In order to support customer-owned banks in undertaking their primary business of lending to a broad range of home buyers, the financial regulatory framework should continue to incentivise the provision of privately operated LMI, and government actions should ensure that LMI remains available to the customers and banks which rely upon it.

## Supporting lending under the Home Guarantee Scheme

Many customer-owned banks support first home buyers by offering home loan products supported by the Government, primarily through the Home Guarantee Scheme (HGS). This is an important competitive offering for some customer-owned banks as accessing the HGS through a customer-owned bank is often the first time customers consider our sector as an option for their overall banking needs.

APRA treats home loans written with the support of the HGS as <80% LVR loans for risk weighted purposes.<sup>41</sup> The capital treatment is provided because Housing Australia provides a guarantee of up to 20% of the property value to HGS lenders. This ensures that this aspect of the capital framework does not

<sup>41</sup> Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk.

act as a disincentive to write HGS loans, however the number of high-LVR exposures (which includes those made under the HGS) at an individual bank can be limited by APRA which reduces the ability of some banks to write HGS loans.

APRA requires banks to manage the overall level of risk from their lending activities which includes setting risk limits for a bank's residential mortgage portfolio. This includes limits to LVRs and specifically limits on high LVR loans for new originations and for the overall portfolio.<sup>42</sup> COBA members have identified these requirements as a potential barrier to increasing lending to first home buyers, even through the HGS.

Although HGS loans carry the same risk weight as standard <80% LVR loans (which do not require LMI), APRA considers the underlying LVR of the loan (which can be up to 98%) for reporting purposes when monitoring a bank's high LVR exposures. This inconsistency in treatment can result in a reduced ability for customer-owned banks to offer HGS loans compared to the major banks, and therefore has a direct impact on competition. This is because HGS loans can make up a relatively high proportion of the total lending of a COB over any given period compared to that of a major bank which has a broader range of customers seeking loans across the LVR spectrum.

It is also important to highlight the disparity in capital treatment between an LMI-supported loan and one written under the HGS scheme. For example, HGS loans are assigned a 35% risk weight while LMI-supported loans see a 40-55% risk weight assigned (depending on LVR), despite both loan types being effectively insured from the lender's perspective. These risk weights are only applicable to banks under the Standardised Approach to managing credit risk, which includes all customer-owned banks and other small ADIs.

## Ensuring a competitive standardised approach to capital

Smaller banks, including all customer-owned banks, are unable to use the alternative Internal Ratings-based (IRB) approach for calculating capital requirements because of the significant operational, financial, and regulatory barriers associated with adopting this methodology. The IRB approach, which allows banks to use their own internal risk models to determine credit risk and corresponding capital requirements, is primarily designed for larger, more sophisticated financial banks and is prohibitively expensive for smaller banks to implement. We note there have been limited new IRB banks over the last decade.

Moreover, our sector typically lacks the scale and volume of loan data required to meet the strict regulatory requirements set by APRA to utilise the IRB approach, including model validation, stress testing, and compliance reporting. As a result, customer-owned banks must rely on the simpler Standardised Approach, which assigns predetermined risk weights to assets and is more cost-effective but less capital efficient. This can result in smaller banks experiencing a disadvantage when exposed to discrepancies in risk weightings for different types of lending.

## Appropriate risk weightings for major bank exposures

APRA's approach to managing risk through capital risk weightings on major bank exposures imposes additional capital constraints on customer-owned banks. The current framework excludes the implicit government support the major banks receive when determining that bank's credit rating and therefore the corresponding risk weight associated with this exposure.

Adjusting capital requirements for debt issued by major banks to reflect their full credit rating, rather than excluding the implicit government support uplift, could provide a more accurate assessment of the risk associated with these exposures. Major banks in Australia benefit from an implied government support buffer, which enhances their creditworthiness and reduces the likelihood of default. By excluding this uplift when determining risk weightings, the current framework may overstate the risk of holding major bank debt, leading to higher-than-necessary capital requirements for holders of these assets, including customer-owned banks.

<sup>42</sup> Prudential Practice Guide APG 223 Residential Mortgage Lending.

This change could free up capital for customer-owned banks, enabling them to allocate it more effectively towards lending, growth initiatives, and competitive member services. Furthermore, aligning risk weightings with the true creditworthiness of these assets would create a more consistent and equitable regulatory framework, recognising the stability and systemic importance of major banks in Australia's financial system.

## Support Options

As illustrated in the above, customer-owned banks face a range of barriers when accessing a range of affordable funding sources and generating capital to fund new lending. Government support is needed to address these barriers; carefully targeted support measures have been proposed which would reduce the funding gap between large banks and customer-owned banks thereby strengthening the competitive position of customer-owned banks.

Government support in accessing wholesale or securitisation markets is a vital component – although retail deposit funding is very important for customer-owned banks, the best opportunities for growth stem from making it easier and cheaper for customer-owned banks to access a range of funding sources and should be taken in conjunction with any possible reforms to accessing retail deposit funding.

Given the significant differences in size and operating complexity across our sector, a range of options will need to be considered to ensure that the sector as a whole is supported. It is important to recognise that each support option will have different impacts and benefits across the sector and the design of government support schemes must ensure all customer-owned banks stand to benefit.

## Wholesale funding

Access to wholesale funding sources is critical for the growth and competitiveness of our sector. However, customer-owned banks face significant challenges in accessing these markets, primarily due to structural and market-based limitations. To address these challenges, several government-supported measures could be implemented to enhance our access to wholesale funding and reduce associated costs.

Implementing these measures would only impose modest obligations on the government and associated entities, and address key structural disadvantages faced by customer-owned banks in the wholesale funding market. By reducing funding costs, broadening investor participation, and enhancing access to securitisation, these initiatives would strengthen the ability of customer-owned banks to compete with larger banks and support their members effectively.

### **Recommendation 6 – reducing wholesale funding costs**

The Government should utilise its balance sheet to lower the wholesale funding costs for customer-owned banks to reduce the cost disadvantage around wholesale funding compared to larger banks.

This could include through providing credit rating support, debt guarantees, Australian Office of Financial Management support as a cornerstone investor and providing some form of a government guarantee and aggregation on smaller bank Residential Mortgage-Backed Security. Given our views on sustainable price competition, this support should only be for smaller Authorised Deposit-taking Institutions that are subject to the significant other cost pressures due to regulation.

We provide comment below on some potential options.

### **Government credit rating support and debt guarantees**

Government credit rating support or debt guarantees represent a key mechanism to level the playing field for customer-owned banks. Customer-owned banks often face higher funding costs due to their relatively lower credit ratings compared to larger financial institutions. A Commonwealth Government guarantee on customer-owned bank debt would significantly improve credit ratings, leading to reduced issuance costs and increased investor confidence.

Such a guarantee would also broaden the pool of investors willing to purchase customer-owned bank debt, including institutional investors who typically require high credit ratings for their portfolios. A historical precedent for a government scheme to support bank wholesale funding access exists in the Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding, which operated between 2008 and 2010.

### **Expanding the investor base for customer-owned bank debt**

Expanding the investor base for customer-owned bank debt could also provide significant benefits. Government incentives for private investors could make this debt a more attractive investment. For example, offering favourable liquidity treatment by categorising customer-owned bank debt as a high-quality liquid asset (HQLA) would make it more appealing to institutional investors. Similarly, capital relief for banks or superannuation funds that invest in customer-owned bank debt, or targeted tax concessions for investors, could incentivise greater participation in these markets.

Such measures would not only increase the volume of funds available to customer-owned banks but also improve pricing by creating a more competitive market for their securities.

### **AOFM support for customer-owned bank debt issuance**

The Australian Office of Financial Management (AOFM) could play a pivotal role in supporting customer-owned bank debt issuance by acting as a cornerstone investor. The AOFM could commit to purchasing a fixed proportion of new customer-owned bank debt issuances. This guaranteed participation would provide confidence to other investors, encourage larger deal sizes, and would be expected to lower spreads to larger issuers.

AOFM involvement could also help smaller customer-owned banks that currently struggle to meet the scale and frequency requirements of wholesale debt markets. By bridging this gap, the government could enable these institutions to secure funding on more favourable terms.

AOFM support could be modelled on the existing Structured Finance Support Fund which was launched in 2020 to provide support for non-ADI and ADI lenders through securitisation markets.

### **Publicly supported RMBS market**

The provision of government support for RMBS transactions would allow customer-owned banks to access this valuable funding source more readily. Government support would be most effective through the provision of a government guarantee over customer-owned bank RMBS. This guarantee would increase the investor attractiveness of the securities and result in a wider market and better pricing, leading to a meaningful decrease in the sector's funding costs.

This would be complemented by a government RMBS aggregator which aggregates customer-owned bank securities and markets them, with the government guarantee, to investors. This would provide substantial support to small customer-owned banks which have high-quality loans on their balance sheet but do not have the scale nor resourcing to be able to launch their own RMBS transactions.

A broadly similar model exists in Canada, operated through the Canada Mortgage and Housing Corporation.

### **Reducing capital requirements on private RMBS warehouses**

Reducing capital requirements for the providers of private RMBS warehouses (that is, major banks) would lower the cost of warehouse facilities, making it more affordable for customer-owned banks to initiate RMBS transactions. This reduction in cost could improve the economics of securitisation for customer-owned banks, enabling more effective participation in private markets.

### **Reducing APRA internal securitisation limits**

Adjusting APRA's internal securitisation limits would increase the availability of securities for use in private RMBS transactions or other funding mechanisms, such as Term Funding Facility (TFF)-like arrangements. By allowing customer-owned banks to retain a greater proportion of their own securitised assets, this measure would reduce costs and improve funding flexibility.

This change would balance the operational needs of customer-owned banks while still ensuring that some securitised assets remain for prudential purposes.

### **Providing accessible funding through the RBA**

The RBA could develop a mechanism which provides stable, competitively priced funding to customer-owned banks, as an alternative to accessing wholesale funding sources or securitisation. Such a mechanism could provide stable long-term funding at a rate pegged to the Official Cash Rate which would ensure cost-effectiveness while maintaining alignment with broader monetary policy objectives. This measure would be particularly beneficial for smaller customer-owned banks that lack the scale to establish their own securitisation programs or access wholesale debt markets.

Precedent exists for the development of such a funding source with the RBA setting up the Term Funding Facility in 2020 to support banks in offering low-cost lending throughout the pandemic.

### **Easing multi-seller securitisation risk sharing requirements**

Targeted reforms to multi-seller securitisation would provide more viable and cost-effective funding options for smaller ADIs. Participants are often required to share risk on a pro-rata basis, which can be disproportionate to their individual contribution to the pool. Adjusting this requirement to allow for differentiated risk-sharing based on the credit quality of underlying assets (or the size of individual contributions) could reduce this burden. Other value-adds might include simplifying documentation, reporting standards, and introducing standardised asset pool criteria.

## **Deposit Funding**

The Financial Claims Scheme (FCS) plays a vital role in ensuring depositor confidence in the Australian banking sector. For customer-owned banks, reforms to the FCS could enhance competitiveness and improve their ability to attract retail deposits—a critical funding source. However, the current structure of the FCS does not fully account for the unique challenges faced by customer-owned banks. Targeted adjustments could provide customer-owned banks with a more level playing field, strengthening their funding stability and competitive position in the financial sector.

### **Increasing the FCS Limit for All Deposit Accounts**

Raising the FCS limit across all deposit accounts could provide significant benefits to customer-owned banks by increasing depositor confidence, particularly among large depositors. An increase in the FCS above the existing \$250,000 cap for all ADIs could see more large deposits held at customer-owned banks as some account holders currently spread their funds in excess of the FCS cap across multiple ADIs to take advantage of the guarantee.

Larger deposits, and an increased stability of large deposits may support customer-owned banks in reducing funding costs, as deposit funding is typically cheaper and easier to source than wholesale funding.

This is particularly valuable for small customer-owned banks which do not have ready access to long-term wholesale debt markets.

### **Maintaining FCS Funding Arrangements**

Any adjustments to the FCS should not result in increased costs to beneficiaries of the guarantee. For example, the implementation of a pre-funded FCS would impose significant costs on ADIs and affect smaller banks including customer-owned banks which are least able to bear these increased costs. Given customer-owned banks rely on retail deposits for the vast majority of their funding, any change to the scheme which makes it more challenging for customer-owned banks to access retail deposits will have a disproportionate impact on the sector.

A pre-funded scheme would require customer-owned banks to contribute to a fund in advance, reducing the capital available for growth and therefore resulting in competitive harm to the sector. Historically, the FCS has been funded on an ex-post basis; the stability and resilience of the Australian banking system has meant that the FCS has never been activated for any ADI, even during the Global Financial Crisis.

#### **Considerations**

Reviewing the FCS to examine raising the FCS limit across all deposit accounts and to ensure that it is fit for purpose is likely to support financial safety. This could create greater deposit stability and allow more proportionate regulation.

The Government should maintain the current post-funded Financial Claims Scheme arrangements. Any pre-funding will disadvantage smaller banks due to their higher proportion of insured deposits. COBA notes that in the rare event that the FCS is called upon and there is a subsequent shortfall that this is eventually borne by banks through an industry levy.

## **Capital**

Capital adequacy is a fundamental requirement for financial institutions, ensuring stability and resilience in the face of economic fluctuations. However, the current regulatory framework can place disproportionate capital burdens on customer-owned banks, limiting their ability to compete effectively with larger financial institutions. Adjustments to risk weightings and increased transparency in capital requirements could provide customer-owned banks with much-needed capital relief and promote a more equitable banking environment.

### **Reducing risk weightings for safe exposures**

Under the existing framework, funds that customer-owned banks hold in at-call accounts with major banks are assigned a risk weighting, even though these deposits are effectively risk-free. In contrast, major banks holding funds in Exchange Settlement Accounts (ESAs) with the RBA benefit from a nil risk weighting for similar exposures.

Adjusting risk weightings for customer-owned bank held funds in major bank at-call accounts to reflect their very low risk profile would reduce the capital burden on customer-owned banks. This change would recognise the inherent safety of these exposures and align their treatment with that of ESAs.

Currently, the establishment of ESAs is prohibitively expensive and administratively complex for small customer-owned banks, effectively excluding them from accessing this benefit. By addressing the inequity in risk weightings, APRA could provide immediate capital relief to customer-owned banks, enabling them to allocate resources more effectively toward growth and member services.

Alternately, reducing the cost and complexity of ESA establishment would make it easier for smaller customer-owned banks to access this form of low-risk fund management. This would allow more customer-

owned banks to hold funds directly with the RBA, gaining the same nil risk-weighted treatment as major banks.

### **Increasing Transparency in Capital Requirements**

The lack of transparency in the application of Pillar 2 capital add-ons creates uncertainty and potential inequity in the regulatory landscape. Smaller banks, including customer-owned banks, often suspect that they face higher relative capital penalties compared to larger institutions.

APRA could examine ways to address this issue, such as by publishing a distribution of Pillar 2 capital add-ons across the ADI population. This data would provide insights into whether smaller banks are disproportionately affected by higher capital requirements. Greater transparency would not only enhance trust in the regulatory process but also allow stakeholders to identify and address any systemic imbalances.

Improving transparency between the Internal Ratings-Based (IRB) and Standardised approaches to capital would also support a more level playing field across the banking sector. Currently, the differences in how risk-weighted assets (RWAs) are calculated under these approaches can create a competitive imbalance, with IRB banks often benefiting from lower capital requirements for similar exposures compared to smaller banks using the Standardised approach. This lack of visibility into how these differences impact capital requirements and pricing creates challenges for stakeholders, including regulators, policymakers, and smaller banks, to fully understand the extent of the disparity.

Introducing greater transparency could involve publishing comparative data on RWAs, capital outcomes, and average risk weights across the two approaches. This would highlight where and how the differences arise and enable informed discussions about potential reforms to address inequities. Enhanced reporting requirements or regular public disclosures by IRB and Standardised banks could also help ensure that the advantages of IRB accreditation are proportionate to the resources and risks involved. By increasing clarity, the industry and regulators would be better positioned to identify targeted solutions, such as adjustments to the Standardised framework or other capital relief measures, to ensure fair competition while maintaining financial stability.

### **Facilitative approaches to lending for social good**

The Government should incentivise customer-owned banks to undertake lending aimed at facilitating social good through targeted changes to APRA's prudential framework. A broad approach would involve reducing risk weightings on lending categories which support good social and environmental outcomes. For example, banks on the Standardised approach could see lower risk weightings for lending for affordable properties for first home buyers and household energy upgrades or other sustainability initiatives. This would see immediate incentives to increase lending for these types of activities.

A more targeted approach could see APRA treating HGS loans as <80% LVR loans for reporting purposes when monitoring a bank's high LVR exposures. The current inconsistency in treatment can result in a reduced ability for customer-owned banks to offer HGS loans compared to the major banks and therefore has a direct impact on competition. This is because HGS loans can make up a relatively high proportion of the total lending of a customer-owned bank over any given period compared to that of a major bank which has a broader range of customers seeking loans across the LVR spectrum. Ultimately, this results in the Government's ambition to support more aspiring home buyers to enter the market being constrained by the regulatory approach taken by APRA. More effective coordination between government policy makers and regulators is needed to ensure alignment of priorities and consistent outcomes for the sector.

Many customer-owned banks are also looking to support their members in decreasing their environmental footprint through the provision of green loans for assets such as electric vehicles and home efficiency upgrades. APRA's capital framework assigns a 100% risk weighting<sup>43</sup> to these types of loans which

<sup>43</sup> Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk.

increases the amount of capital required to be held against the loan. APRA should reduce the capital requirements on these exposures to support the provision of green loans by customer-owned banks.

### **Recommendation 7 – supporting customer-owned bank lending**

The Government should support customer-owned banks to encourage lending that supports good social and environmental outcomes to help fulfil the potential of our for-purpose model. This includes working cooperatively with APRA on reforms to the capital, reporting and supervisory framework activities such as lending to first home buyers and households for environmental upgrades.

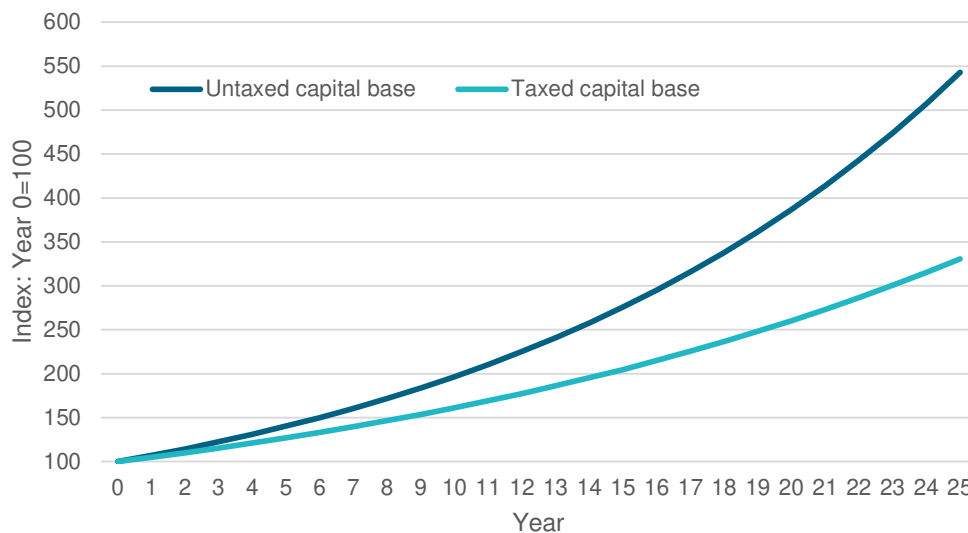
# Ensuring a level tax playing field

Tax settings play a pivotal role in shaping the behaviour of companies by influencing their investment decisions, operational strategies, and financial structures. Favourable tax policies, such as reduced rates or targeted incentives, encourage businesses to allocate resources toward desired activities like research and development, sustainability, or job creation. By aligning tax policies with broader economic and social objectives, governments can drive corporate behaviour that fosters innovation, sustainability, and economic growth while ensuring fairness and transparency.

## Corporate tax on customer owned banks

Customer-owned banks are subject to the applicable corporate tax rate depending upon their size (25%-30%). In 1993, the then Government removed the concessional tax treatment on credit unions as part of a wider tax reform package.<sup>44</sup> This previous concessional tax treatment was due to the tax principle of mutuality where entities cannot earn income by self-dealing. As a result, credit unions were able to grow and serve more people due to this supportive treatment. Given the importance of retained earnings as a capital source,<sup>45</sup> this tax change greatly diminished the credit unions' ability to grow the capital to support balance sheets (**Graph 10**). We estimate this took out over \$2 billion on a nominal basis from credit union balance sheets from 1994-2019.<sup>46</sup> This does not include any earnings on forgone capital.

**Graph 10: Stylised example of how taxation impacted the credit union capital growth trajectory**



Source: COBA estimates based on 7% return on equity, 30% tax rate.

## Addressing tax disadvantages due to the customer-owned banking model

One of the unique features of Australia's corporate tax system is the use of franking credits. Australia's franking credit system exists to avoid double taxation. When a franked dividend recipient is subject to a tax rate lower than the corporate tax rate, this results in a refund and a lower effective corporate tax rate. If franking credits are retained, then the effective tax rate all else being equal remains the same as the statutory tax rate.

<sup>44</sup> Taxation (Deficit Reduction) Act (No. 1) 1993.

<sup>45</sup> CFR Issues paper.

<sup>46</sup> COBA estimates based on historical data.

As the name suggests, customer-owned banks are owned by their customers, with 100% of profits reinvested in products and services to benefit their members. The ownership model means that there are no external shareholders and no payment of shareholder dividends. While major banks and shareholder owned banks release franking credits through paying dividends, customer-owned banks do not do so, thereby accumulate large franking credit balances. Customer-owned banks have at least \$3 billion in franking credits on more than \$7 billion of retained earnings.<sup>47</sup> The non-distribution of many of these franking credits has saved revenue for the Government as we continue to earn profits. At present, the sector pays \$230 million a year in tax, of which we estimate \$40-60 million would be refunded to our owners if we paid out dividends like the major banks.

Previous independent research commissioned by COBA<sup>48</sup> has estimated that because of the ability of listed banks to release franking credits, the major banks have an effective tax rate of between 22.15 and 25.5%, while customer-owned banks face a corporate tax rate of 30% and very limited tools with which to reduce this rate. While customer-owned banks try to deliver a competitive banking alternative, they are met with significant hurdles regarding regulation, funding and scale compared to those faced by major banks. If a competitive banking environment is desired, unfair tax settings must be addressed.

The final report of the Financial System Inquiry commented on the impacts of dividend imputation:

“Mutuals cannot distribute franking credits, unlike institutions with more traditional company structures. This may adversely affect mutuals’ cost of capital, with implications for competition in banking.”<sup>49</sup>

Ultimately, it is the customer that is most affected by this tax treatment. Through the unique ownership model of our members, their customers are owners of a company that does not pay dividends and as such, they cannot benefit from the financial gain that many other company shareholders continuously receive. For customer-owned banks, franking credits remain locked up, increasing year after year as the bank continues to make profits, pay tax and retain those after-tax profits as its main source of capital. There is risk to competition as the lower average tax rate of a major bank may distort decisions of Australian depositors and borrowers. The discrepancy in effective tax rates creates an uneven playing field.

We have long investigated options to unlock franking credits to even the playing field. One of the simpler options would be to apply company tax on customer owned banks at a rate that is comparable to the effective tax rate of listed competitors. This would allow greater retained earnings, which in turn become a customer-owned bank’s capital for the following year, allowing growth in the sector and providing more opportunities for Australians to bank customer owned.

From a broader public policy perspective, such a change could also benefit other small banks to crucially grow their capital base with the most benefit going to banks in their non-dividend paying growth phase.

### **Recommendation 8 – leveling the tax playing field**

The Government should consider options to address the tax inequality around franking credits such as reducing the corporate tax rate on customer-owned banks to support growth.

<sup>47</sup> COBA estimates based on member annual reports of our ten largest members.

<sup>48</sup> COBA submission to the 2014 Financial System Inquiry.

<sup>49</sup> *Financial System Inquiry Final Report* (November 2014), 278.

## Addressing the anomaly in GST for customer-owned banks

Under the Goods and Service Tax (GST), financial supplies such as the core products of COBA members, that is, loans and deposits, are input taxed. Input taxing is inherently anti-competitive because large banks have the capacity to lower their tax burden in ways that are unavailable to smaller banking institutions. This problem was well understood at the time of the introduction of the GST. A Treasury paper from 1999 *The Application of Goods and Services Tax to Financial Services* outlined the so-called “self-supply bias”:

“Input taxing financial supplies means that financial service providers have an insourcing — or self-supply — bias for business inputs used to make financial supplies. For example, if a financial service provider insources its accounting services, these services would not be subject to GST.

“However, if the financial service provider outsources these services, in the absence of special rules, GST would be payable on the full value of that service and the financial service provider would not be entitled to an input tax credit. A higher effective tax burden would be faced by smaller financial supply providers who outsource proportionately more of their business inputs. Larger market participants generally have a greater ability to insource services.

“For example, smaller financial service providers, such as credit unions or building societies, would have less scope to insource mortgage valuation services than would a large bank. Therefore, input taxing financial supplies has important implications for the relative competitiveness of different segments of the financial sector.”

The 2009 *Henry Tax Review* also noted this problem and associated efficiency costs, including:

“... businesses organising themselves to ‘self-supply’ goods and services to reduce the tax payable on their inputs. This gives large, vertically integrated businesses an advantage over smaller competitors.”

At the time of introducing the GST, the Government responded to the self-supply bias of input taxing by allowing financial institutions to claim back some of the GST paid on certain inputs in the form of a 75% ‘reduced input tax credit’ (RITC).

The Explanatory Statement for the RITC Regulations says the benefits of the RITC approach include “reduced bias to insource” and “lower compliance costs for smaller entities”. The list of RITCs includes a supply to a credit union by an entity owned by two or more credit unions. This item was modified by Regulation<sup>50</sup> in 2012 to accommodate mutual banks that formerly were credit unions but have not changed their ownership structure. However, the historical anomaly of excluding mutual building societies from the scope of the item has not been corrected.

The efficacy of RITC item 16 in reducing the anti-competitive impact of input taxing is under severe stress due to developments in the customer-owned sector over the past decade. The failure to accommodate mutual building societies and mutual building societies that have rebranded as banks in RITC item 16 is increasingly rendering the item ineffectual as a measure to improve the competitive position of customer-owned banking institutions.

This is compromising the customer-owned banking sector’s capacity to increase competitive pressure on the major banks. The major banks dwarf individual customer-owned banking institutions and have an unmatched capacity to minimise their GST burden by self-supplying key inputs.

Relevant developments in the customer-owned banking sector include continuing mergers, including mergers between credit unions and building societies, and credit unions and building societies rebranding as mutual banks.

<sup>50</sup> [http://www.austlii.edu.au/au/legis/cth/num\\_reg\\_es/antsastar20124n215o2012683.html](http://www.austlii.edu.au/au/legis/cth/num_reg_es/antsastar20124n215o2012683.html).

COBA is owned by its members and because the membership includes building societies and building societies that have rebranded as mutual banks, services provided by COBA do not qualify under RITC item 16. COBA's services include many that are typically self-supplied by major banks, including government and regulator relations, media services, regulatory compliance advice, legal advice, research and market intelligence, and support to fight fraud and financial crime.

### **Recommendation 9 – correcting the anomaly in RITC 16**

The Government should amend RITC 16 to include mutual building societies and former mutual building societies in the definition to support greater collaboration across the customer-owned banks sector and correct the anomaly around collaboration.

### **Retaining PCG 2017/15**

Alongside facilitative tax settings, the administration of tax can help reduce the regulatory burden on smaller entities. Recognising this, the ATO developed Practical Compliance Guideline PCG 2017/15 GST and Customer Owned Banking Institutions.<sup>51</sup>

The ATO outlines the rationale:

We acknowledge that customer owned banking institutions may experience difficulties in meeting the requirements of the GST law in the context of apportionment of their partly creditable acquisitions. The ATO is also conscious of its administration costs associated with seeking assurance of apportionment methodologies and in particular, consideration of the customer owned banking institutions' design, maintenance and use of apportionment methodologies. The rate set out in this Guideline is reflective of the resource commitment and low level of risk to revenue.

PCG 2017/15 allows customer-owned banks to use set rate of 18% when apportioning particular acquisitions rather than having to design, maintain and use complex apportionment methodologies. This 'simple and conservative' approach strikes a good balance between administrative burden and policy outcomes.

### **Considerations**

Given the limited resources of customer-owned banks, retaining approaches such as PCG2017/15 is beneficial for customer-owned banking tax arrangements, fitting in the 'simple and conservative' approach bucket.

<sup>51</sup><https://www.ato.gov.au/law/view/pdf?DocId=COG%2FPCG201715%2FNAT%2FATO%2F00001&filename=law%2Fview%2Fpdf%2Fcoq%2Fpcg2017-015.pdf&PiT=99991231235958>.

# Improving access to scale

As outlined in the CFR Issues Paper, there are several ways for entities to achieve scale with the most prominent ones in the customer-owned banking sector being mergers and collaboration, as well as outsourcing.

## Mergers

Mergers are a common occurrence in Australia's customer-owned banking sector, mirroring similar trends seen overseas. These mergers typically involve the coming together of two brands to create a larger customer-owned bank, enhancing their ability to reap the benefits of increased scale. However, the process is complex and requires navigating several challenges. From securing an initial agreement between banks, obtaining regulatory approvals and achieving seamless integration, each step must be carefully managed to ensure a successful transition.

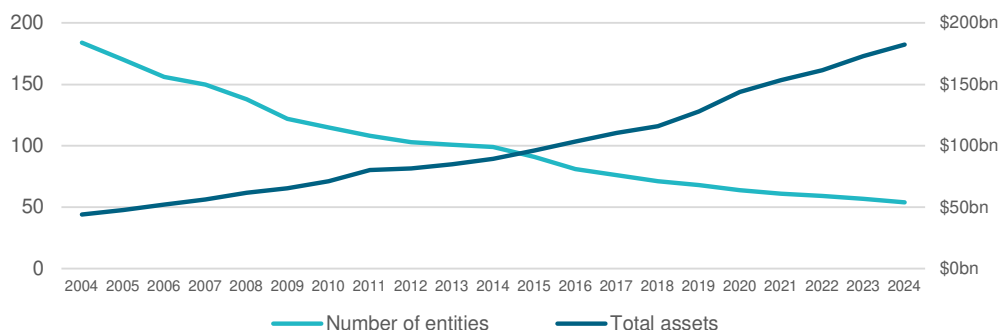
Despite these challenges, mergers play a crucial role in the ongoing evolution of the customer-owned banking sector, helping institutions grow inorganically while maintaining their member-first focus.

Recent COBA member media releases announcing planned mergers provide common rationales for why the mergers:

- “enable greater investment in even better products, services, digital banking technology for our members and creating a positive impact for communities and the environment.”<sup>52</sup>
- “allow us to deliver even greater experiences for our members, and increase the reach of our purpose driven banking to more Australians.”<sup>53</sup>
- “see members benefit from access to enhanced technological capabilities and greater physical distribution. It also gives our resources a boost, allowing us to better meet our ongoing prudential and regulatory obligations while increasing our focus on innovation, enhanced customer experiences and growth”.<sup>54</sup>
- “have the scale, capacity and resources to ensure that our members will continue to benefit from competitively-priced products while maintaining our unwavering commitment to exceptional service—a legacy we are proud of. We are confident that the additional scale achieved through the merger will lay the groundwork for the next phase of our growth in a strong and sustainable manner.”<sup>55</sup>

An overwhelming majority of mergers involving customer-owned banks are entities merging together showing the broader commitment to growing mutuality, with limited exits to non-mutual entities.

**Graph 11 – sector consolidation with sustained growth**



<sup>52</sup> Qudos Bank merger announcement.

<sup>53</sup> Qudos Bank merger announcement.

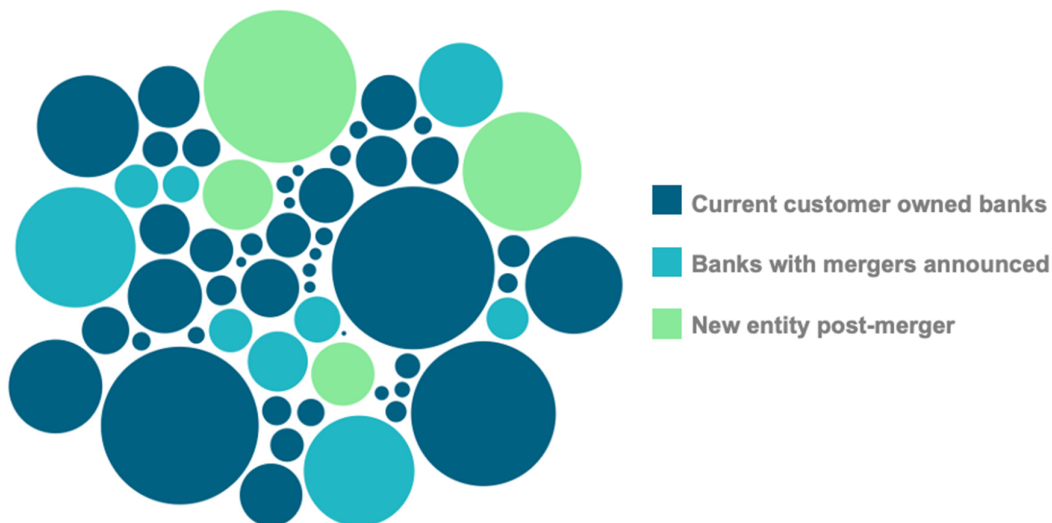
<sup>54</sup> Illawarra Credit Union merger announcement.

<sup>55</sup> G&C Merger Information document.

## Changing face of mergers

In the past, most mergers involved a larger bank acquiring a smaller merger bank. However, recent developments have started to see a shift towards the 'merger of equals' which require a more flexible and futureproof policy environment. This has implications for how regulators should consider merger processes as well as how they apply post-merger regulatory requirements.

**Graph 12 – changing shape of the customer-owned banking sector**



## Merger process

The start of a formal merger process involves signing a memorandum of understanding between two customer-owned banks to explore a merger's viability. This then involves a phase of due diligence where both banks will focus on identifying the benefits and risks of the proposed merger, along with developing the plans, strategies and structures needed to successfully merge.

For customer-owned banks, it is critical that any regulatory approvals around mergers are predictable, cost efficient, and timely. Additionally, merging banks can expend a lot of effort in the APRA process highlighting that the requirements should be targeted and minimised where appropriate. Approvals should also be timely to avoid having to change timelines around member votes (another important stage of the merger process).

Most customer-owned banking mergers are voluntary transfers under the *Financial Sector (Transfer and Restructure) Act 1999* (the Act) and Financial Sector (Business Transfer and Group Restructure) determination No. 2 of 2017 (the Rules). Under the Act, APRA may consult with ASIC, ACCC and ATO with these agencies being able to waive their consultation requirements through notification on a particular transfer or class of transfers.

Under the Rules, APRA provides a prescriptive list of requirements for the 'three letters' required to be provided to APRA on the merger. The first is a joint letter from the two CEOs outlining the proposed merger, including draft information documents to members. The second is a letter from the receiving CEO around plans for the post-merger entity. The third letter is a letter outlining evidence of the adoption of the transfer.

We believe that there may be scope for a review of these rules with a view to streamlining them given they are now seven years old and were drafted in a time before the 'merger of equals' of customer-owned banks that are seen today. Potential areas to examine possible efficiencies could be around costly reports or processes, such as developing strategies for a hypothetical entity without being able to fully engage with

that entity due to competition laws. COBA member feedback has noted that there was little guidance or clarity around what banks were expected to deliver to APRA through these approval processes. There may be further potential to define a minimum set of standards, documents and policies that will meet APRA's requirements, while ensuring that banks do not tie up excessive member capital given the uncertainty around approval.

## Treasurer approvals

As the CFR Issues Paper notes, there are instances (that is, where the target entity is more than \$5 billion in assets) where the Treasurer's approval is required for a voluntary transfer of business as the power has not been delegated to APRA. Around a third of mergers since the start of 2023 meet this threshold. This approval process has the potential to slow down the overall process for approving the merger. COBA considers the need to seek the Treasurer's approval to be unnecessary in a transfer of business between two customer-owned banks given there is unlikely to be a 'national interest' public policy reason to not approve such a merger. If this is the case, then Treasury can advise APRA on such issues as it makes its decision.

## Recent merger reforms

On 28 November 2024, the Australian Parliament passed the *Treasury Laws Amendment (Mergers and Acquisitions Reform) Act 2024*. This created a "mandatory and suspensory administrative system for acquisitions, with the Australian Competition and Consumer Commission as the first instance administrative decision-maker". COBA is concerned that these reforms and processes may add further uncertainty, time and cost into the process of merging two customer-owned banks. We acknowledge the regime's intent to examine "mergers most likely to impact Australian consumers if they are anti-competitive". However, we note that it is unlikely that the merger of two customer-owned banks would be anti-competitive and APRA is likely to consult with the ACCC prior to approving the transfer of business.

## Facilitative taxation treatment

Mergers can create a series of tax events due to the transfer of tax characteristics into the newly merged entity. Given the difficulty of mergers, a facilitative merger tax regime for customer owned banking institutions is an important and long-standing feature of the sector's mergers. As such it is critical that this regime continues to operate as it has for the last 25 years.

### **Recommendation 10 – facilitative approach on merger approvals**

Relevant regulators should take a facilitative approach to merger processes and policies to ensure that once customer owned banks have taken the decision to explore a merger that the regulatory processes are as expedient as possible. This includes examining the Treasurer delegations and ACCC's approach under the new merger regime.

## Collaboration

Collaboration with each other has long been a feature of the customer-owned banking sector both in Australia and overseas. Network cooperation is one of the credit union values. Collaboration can be considered as an activity along a spectrum between fully independent entities and a fully merged singular entity. While regulators can take steps to make collaboration easier, ultimately the responsibility for its success lies with the collaborating parties.

Collaboration does not come without cost. Collaboration proposals can be costly to develop without any guarantee that the proposal will be successful. Collaboration also requires entities to cede a degree of self-interest and, in the case of bulk buying, leads to greater homogeneity in product. It also creates a series of

dependencies upon other collaborators. When it involves outsourcing, it can create further complexity in the arrangements which can then interact with any third-party requirements – requirements that are normally already difficult for smaller banks to deal with due to their lower market power. As such, we suggest there is a facilitative approach to collaboration noting that the benefits from a public policy perspective are likely to outweigh the costs.

Collaboration should also be seen as an opportunity to improve quality of services rather than just a reduction of costs. For example, there may be certain types of collaboration that would improve the sector's risk maturity that would be beyond the access of any individual customer-owned banks.

Similar evidence has come from the COBA/APRA CPS 234 collaboration where some customer-owned banks received access from auditors that they would not normally have access to. This collaboration also brings to the fore wider options around collaboration – between industry and regulators (**Case Study 7**).

## Regulatory approvals

In terms of regulators' roles in collaboration, they can be explicitly approving, for example, ACCC on competition approvals or APRA on 'approvals' for collaborations that seek to meet regulatory requirements, or implicitly approving, for example, taking a facilitative or non-facilitative approach to sector's collaboration. The stances that regulators take can also impact an entity's willingness to collaborate. If entities do not perceive that regulators are likely to take facilitative approaches to sector collaboration, then entities are unlikely to pursue collaborative arrangements. This is because our sector does not have the large financial resources needed to create complex proposals that might be rejected by regulators.

Regulators can also support collaboration by being specific with regulatory requirements. Specific requirements can help narrow the gap on common expectations to create the potential for collaboration on regulatory compliance. As mentioned, additional time can also increase the ability to collaborate due to the additional work required to run a collaborative industry project.

### **Recommendation 11 – facilitative approach on collaboration**

Relevant regulators should take a facilitative approach to collaboration between customer-owned banks to support our growth.

### **Consideration**

ACCC should consider facilitative guidance around a set of safe harbour rules where customer-owned banks can collaborate and exchange information on back and middle office operational considerations.

ACCC should consider thresholds to allow safe harbours for collaboration between customer-owned banks noting that our sector in its entirety is still smaller than Macquarie Bank.

### **Case Study 7: Industry and regulator collaboration on CPS 234 tripartite audits**

In 2022, APRA and COBA collaborated to support our members to undertake tripartite audits of CPS 234 Information Security compliance. This involved COBA, APRA and an auditor hosting a 'kick-off' webinar as well as APRA sharing the CPS 234 audit scope requirements with COBA well ahead of the audit timetable, addressing the specificity issue around requirements and providing time to consider collective approaches.

COBA subsequently approached a range of audit suppliers to provide information packages on services to meet these requirements. These were then shared 'as is' with COBA's membership. While banks were able to choose whoever they wanted to, including those outside this group, they were now able to have generic information around the potential costs and quality of an audit that would meet APRA's requirements.

APRA and COBA also engaged around potential sequencing of the audit tranches, with COBA seeking volunteers for earlier tranches. Some COBA members also noted that this process allowed some of them to access a higher tier of auditor.

# Appendix A: Regulation as a constraint

Regulatory burden, or the cost of compliance with regulation, has a disproportionate and negative impact on smaller banks due to the relative scale imbalance with the major banks. The significant additional costs and effort required by smaller banks to meet new and existing regulations provides the major banks with a comparative competitive advantage over the smaller banks. The smaller scale of these banks means that more capacity relative to the large banks is absorbed by compliance costs which distracts these banks from focusing on customer delivery and innovation, which are key areas where customer-owned banks have historically delivered competition to the larger banks.

## Scale of growing regulatory burden

The financial services sector has experienced an exponential growth in new regulation over the last 15 years. Much of this growth has occurred due to issues identified in the financial services sector, including among banks, particularly relating to poor conduct by the major banks. This culminated in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry that recommended adopting a significant suite of new consumer protections. While recognising the reasons for regulatory growth, this growth and its impact on smaller banks needs to be considered in the banking competition context.

To quantify this growth in regulation, we have used Australian Law Reform Commission (ALRC)<sup>56</sup> datasets of primary and subordinate legislation. These datasets are valuable to demonstrate the growth of financial services legislation over the period 2005-2022.

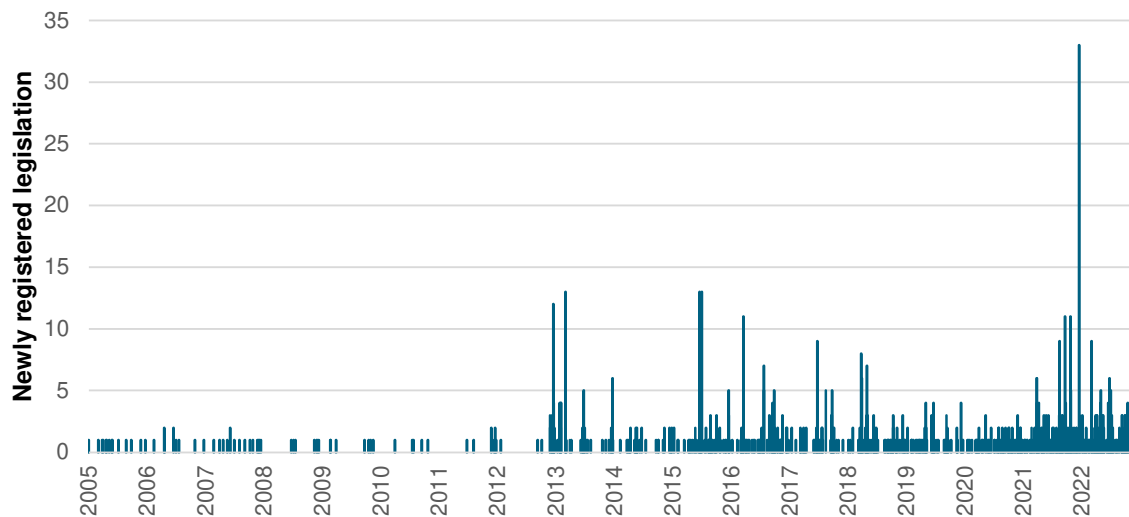
While there are certain limitations in this analysis,<sup>57</sup> we still believe that this is a useful measure to assess the scale and rapidity at which financial services legislation has grown and changed over the period. COBA has limited this analysis to “Financial Services Legislation” as categorised by the ALRC and does not include other forms of legislation that impacts on our members, such as workplace relations, competition laws, or state and territory laws, which also contribute to the regulatory burden. Additionally, we note that even where instruments have repealed or replaced existing legislation there is still a cost to industry in having to review and assess new laws to determine if changes are needed to their practices.

Graphs A.1 and A.2 show the number of legislative instruments that were registered in each year from 2005 to 2022, and the cumulative volume of this registered legislation is then shown to demonstrate the total increased volume of legislation that the financial services industry has grappled with since 2005.

<sup>56</sup> ALRC datasets, <https://www.alrc.gov.au/datahub/download-the-data/> accessed 8 January 2025.

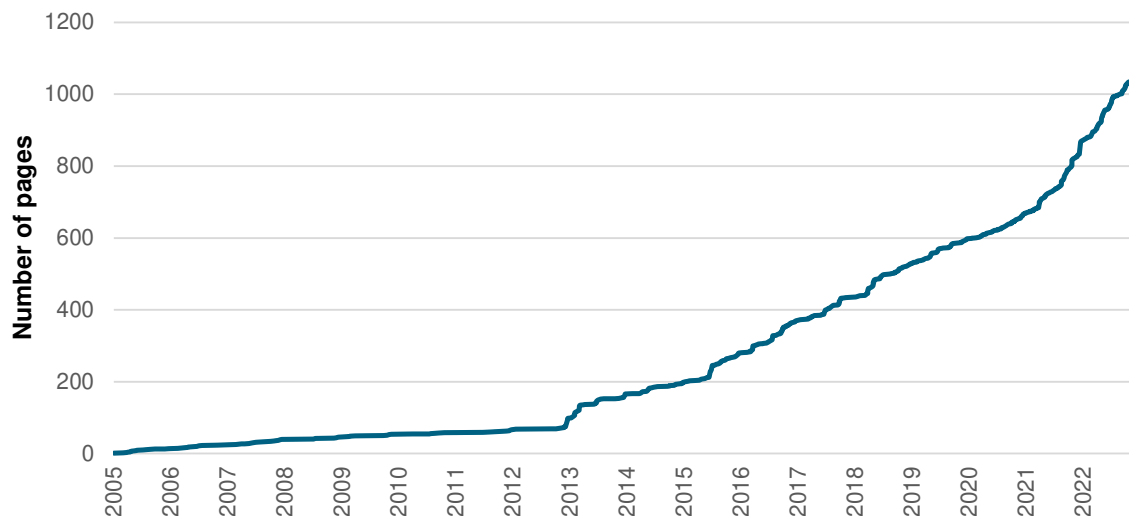
<sup>57</sup> We note that the laws classified as “Financial Services Legislation” are not limited to banks and covers the broader financial services industry, including insurance and superannuation. COBA also recognises that some of the instruments captured by this classification would include repeals of existing instruments which would likely lower the total number of instruments and pages of legislation needing to be complied with. We also note that the period from 2020 to 2022 includes various, mostly temporary, instruments made in response to the COVID-19 pandemic which will, at least partially, explain the large spikes in both the number of instruments and legislative pages registered.

**Graph A1: Increasing numbers of new registered financial services legislation**



Source: ALRC datasets.

**Graph A2: Accelerating cumulative financial services legislation**



Source: ALRC datasets.

From these graphs it is clear there has been a marked increase in the growth rate of legislation over the period. This has coincided with the implementation of various recommendations arising from the Financial System Inquiry, the Productivity Commission Inquiry, and the Royal Commission. We note that this significant increase in legislation was occurring even when accounting for the spike in COVID-19 related legislation from 2020 onwards.

COBA recognises the issues that were identified by the various Inquiries in the financial system, especially into the conduct of the major banks, and the need for Government to respond to and address these. We note that not a single customer-owned bank was called to appear before the Royal Commission. COBA, however, acknowledges that elements of these changes have delivered necessary protections for consumers and have delivered safer banks. As such, we believe that it is appropriate for the Government to consider how these regulations have impacted on the competitiveness of smaller banks.

## Why is this regulation growth a problem?

The key problem with this growth in regulation occurs, as outlined by Treasury, where “the total societal costs imposed by a regulation are greater than the societal benefits, then the regulation will detract from overall societal well-being, even if the regulation is effective in reducing the harm (or risk of harm) that it is directed at mitigating”.<sup>58</sup> The societal benefits of a safe and stable financial system need to be balanced with the need for banks to take prudent risks in lending, grow and innovate. For overly cautious and restrictive regulations, that while well intentioned, can go too far and creates barriers to people of more modest means and from other underserved parts of the community from being able to access banking and lending services. The regulation can also excessively hamper the ability of banks to innovate to meet the current and emerging needs of their consumers.

A key challenge is not just in the growth of regulation but the additional complexity that some of these regimes create. This issue of complexity has been recognised by ASIC as creating a “dizzying web of connections, references and definitions” and can be “less like an elegant tapestry and more like a painting by Jackson Pollock”.<sup>59</sup> What can exacerbate this further is the uncertainty that can exist in how the various regulators will approach the interpretation and application of these varying and complicated instruments. This when combined with the risk averse nature of customer owned banks means that many of our members will need to take a conservative approach to ensure they do not inadvertently fall a foul of the law.

Smaller banks have fewer resources compared to the major banks. This creates challenges for smaller banks to absorb and respond to this growth in the regulatory environment. In addition, we expect that there will be additional very significant changes to complex laws, like privacy, scams, and AML/CTF, that banks will also need to respond to in the near future. The increasing compliance costs on smaller banks are likely to further exacerbate the competitive disadvantage of smaller banks relative to the major banks, unless there is a change in approach.

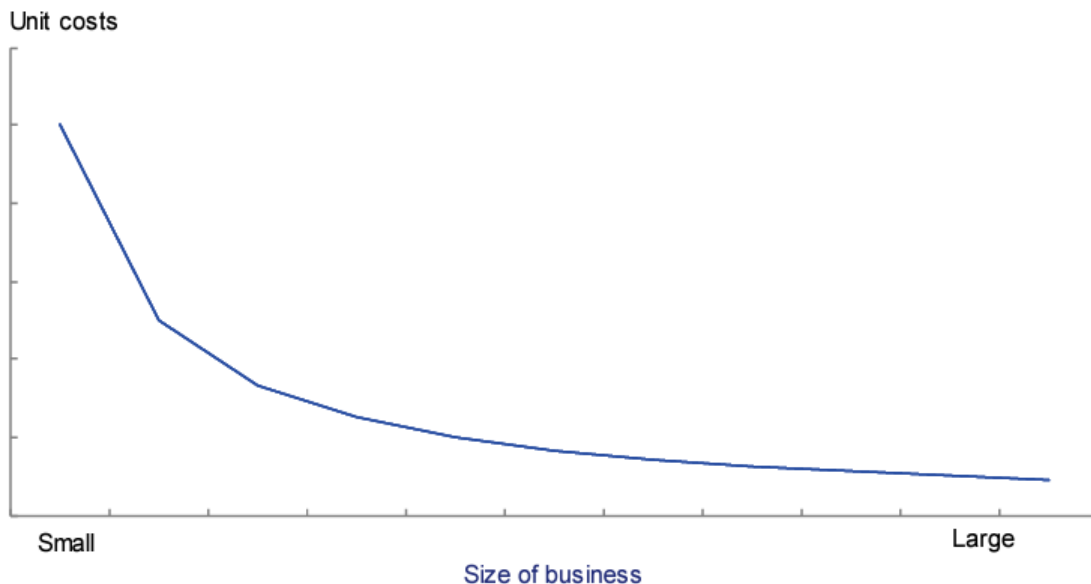
The impact of compliance costs and the outsized burden borne by smaller businesses can be visually shown in Figure A3.<sup>60</sup>

<sup>58</sup> Justin Douglas and Amy Land Pejoska, *Regulation and small business* (2017), 5, <https://treasury.gov.au/publication/p2017-t213722a>.

<sup>59</sup> Joseph Longo, ASIC Chair, *ASIC Annual Forum 2024: Bridging generations – regulating for all Australians*, Keynote opening address (14 November 2024), <https://asic.gov.au/about-asic/news-centre/speeches/asic-annual-forum-2024-bridging-generations-regulating-for-all-australians/>.

<sup>60</sup> Douglas and Pejoska, 3.

**Figure A1: Compliance costs of regulation and business size**



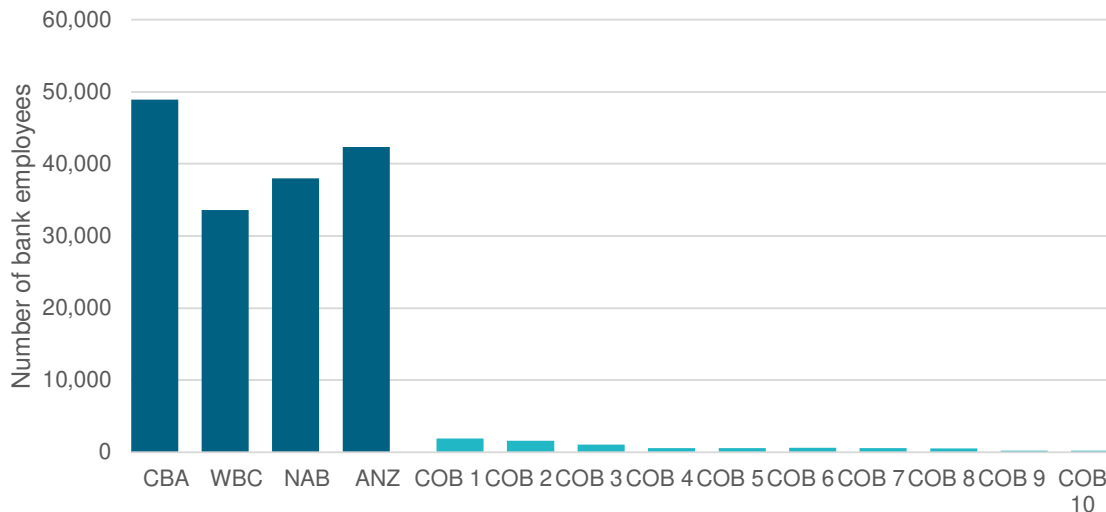
Source: Justin Douglas and Amy Land Pejaska, *Regulation and small business* (2017).

While this graph was created to illustrate the impact of regulation between small and large businesses, the principle remains the same when considering the impact of regulation on small and large banks. Disproportionate costs can arise through labour costs, as the largest non-interest expense for ADIs, and through the capacity to invest in and maintain technology. Due to the size of smaller banks these form a larger percentage of their operating costs compared to larger banks due to the inability to gain economies of scale like the larger banks. The fixed costs of regulation means that larger banks will experience a lower proportional cost as they are able to spread these costs over a larger number of customers. When regulation requires an investment in technology or labour, the proportional costs will be higher the smaller the bank.<sup>61</sup> With the current trajectory of the growth in regulation and these relatively higher fixed costs the gap in managing these costs between large and smaller banks will continue to worsen.

The staff resourcing discrepancy can be shown through comparisons of the staffing levels at each of the four major banks compared to COBA’s largest member. **Graph A3** compared the staffing levels between the four major banks with some of the larger customer-owned banks in the second half of calendar year 2024.

<sup>61</sup> Grant Thornton, *A case for proportionate regulation: A positioning paper* (August 2018), 8.

**Graph A3: Size difference between major bank and larger customer-owned bank staffing**



Source: Published staffing numbers in various months in the second half of 2024, internal COBA data

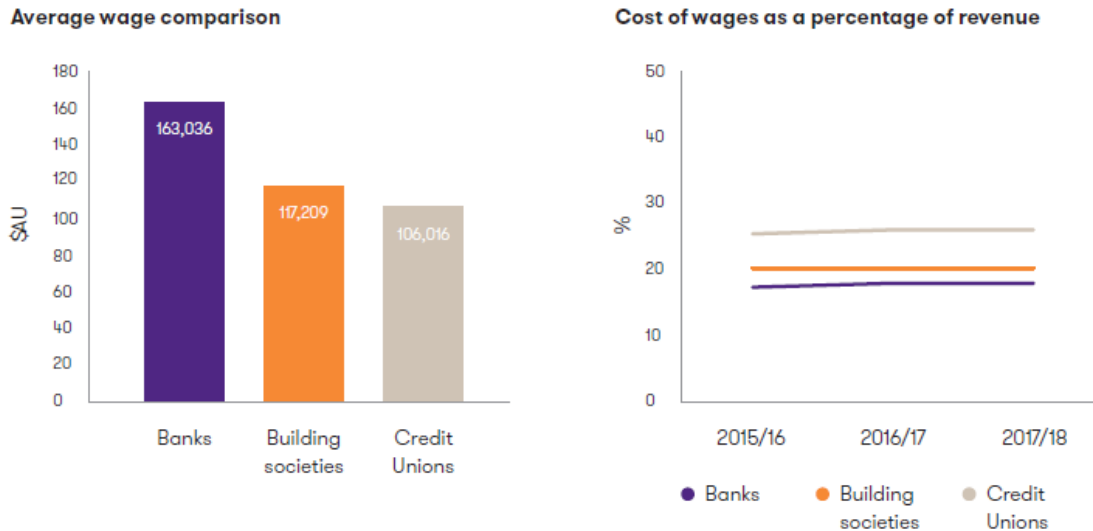
The impacts of regulation on smaller banks and the allocation on staffing to meet compliance costs can be shown through the experience of one of COBA’s larger members. In 2021, Beyond Bank Australia<sup>62</sup> had approximately 660 staff of which it had 37 full-time equivalent (FTE) people working on regulation and government related programs. While these were spread across the organisation, it accounted for approximately 5.6% of its workforce and was costing it approximately \$8 million a year. A 2018 survey showed that the percentage of a banks full-time equivalent workforce diverged significantly based on the banks size. This survey of banks indicated that the majors allocated approximately 1% of its FTE to compliance compared with 2% at other domestic banks and 4% at customer-owned banks.<sup>63</sup> The challenge this poses for smaller banks is that this sees the diversion of a disproportionate segment of its resources away from investing in the organisation to achieve its strategic objectives, and from investing in its local communities.

Additionally, in competing for talent to run the business, including compliance functions, smaller banks have fewer resources to obtain the staff compared to the large banks (**Figure A2**).<sup>64</sup>

<sup>62</sup> House of Representatives Standing Committee on Economics, *Australia’s four major banks and other financial institutions: smaller banks* (1 July 2021), Robert Keogh, CEO, Beyond Bank Australia.

<sup>63</sup> Grant Thornton, *A case for proportionate regulation: The cost of compliance* (November 2018), 6.

<sup>64</sup> Grant Thornton, n 26, 7.

**Figure A2: Average wage and cost of wage comparisons**

Source: Grant Thornton, *A case for proportionate regulation: The cost of compliance* (November 2018)

These charts demonstrate how labour costs can be a proportionally higher percentage of the total budget of the business of customer-owned banks compared to larger banks, while still not having the same purchasing power to attract and retain staff. This can be particularly challenging in instances where laws require the appointment of a certain statutory officers. For a large bank with tens of thousands of employees an additional senior officer is not necessarily a significant burden, however, for smaller banks this can be a significant impost on the business. Additionally, finding an appropriately qualified person to perform the role can be more difficult where the institution is regionally based, however, this can be somewhat mitigated by remote arrangements.

There are two further considerations where there can be challenges for smaller banks meet compliance costs compared to the major banks.

The first is that outsourcing compliance functions may not necessarily deliver as much benefit to smaller businesses to minimise the burden.<sup>65</sup> This is likely because the design of regulation can only remove some of the burden, for example, businesses will still need to hold records and complete attestations of compliance with regulators often using the refrain that businesses can 'outsource the compliance function, but cannot outsource the responsibility'.

The second is that there are further administration costs imposed related to the compliance, such as, education, monitoring and enforcement. However, these will also often be disproportionately higher for smaller banks compared to large banks because the many costs of regulations are also fixed.<sup>66</sup> Due to the more limited resources in these smaller businesses there will often be less time available to invest into understanding regulatory requirements as there are in larger businesses.<sup>67</sup> Further, larger businesses will have the resources to allow for the hiring or contracting of specialist expert staff that can allow it to understand and meet requirements in the most cost effective way and they have the necessary scale to do so in a cost effective manner.<sup>68</sup>

<sup>65</sup> Douglas and Pejoska, 3.

<sup>66</sup> Douglas and Pejoska, 4.

<sup>67</sup> Ibid.

<sup>68</sup> Ibid.

## Greater proportionality to help reduce relative costs

Proportionality in developing and applying the law brings justice and fairness by discerning the correct balance to imposing a reasonable restriction on a regulated entity. In banking, this recognises the major banks' entrenched dominance and scale and the difference in resources and capacity to respond to regulation. We submit that it is reasonable and fair to recognise that customer-owned banks are:

- less likely to undertake the harmful actions against consumers as the major banks are, as evidenced by no customer-owned banks being called before the Royal Commission; and
- even in those few instances where this does occur, their actions pose less risk to the system overall.

Both the Government and public have expressed concerns on banking concentration with the four major banks and the further entrenching of the oligopoly. The best means of reducing this concentration is to encourage the growth of smaller banks, especially customer-owned banks.

Proportionality in banking regulation requires that the size, scale and resourcing of smaller banks be considered alongside the, at times, disproportionate impact that new and existing regulation can have on smaller banks. Fairness dictates that reasonable adjustments be made in a clear and coherent manner to minimise these impacts on smaller banks.

If smaller banks grow in size and scale to become more significant players in the market, they will provide greater choice to consumers. Customer-owned banks are particularly placed to provide this competition from our for-purpose model which was historically built around underserved parts of the community. If these banks are unleashed and empowered, they could be used to alleviate social issues around responsible credit access, access to banking services, and sound financial advice and planning.

A clearer and more consistent approach to proportionality should be adopted by Government on how it regulates smaller banks if there is to be meaningful change in banking competition. We believe that, while well intentioned, prior attempts for proportionality have not been fully successful in achieving their desired outcomes. Previous proportionality attempts have often taken the form of providing slightly longer implementation periods for smaller banks to comply with new regimes, while still imposing the same or substantively similar obligations on smaller banks as the larger banks. While these approaches are welcome, broader change to regulatory approach is needed to support the growth of smaller banks.