CUSTOMER OWNED BANKING ASSOCIATION

24 April 2023

Committee Secretary
Standing Committee on Economics
Parliament House

By email: economics.reps@aph.gov.au

Dear Committee Secretary

Inquiry into promoting economic dynamism, competition and business formation

Thank you for the opportunity to provide brief input to the *House of Representatives Economics Committee Inquiry into promoting economic dynamism, competition and business formation*.

COBA is the industry association for Australia's customer owned banks (mutual banks, credit unions and building societies). Collectively, our sector has over $160 billion in assets and is the fifth largest holder of household deposits. 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.

Key Points

Regulatory costs impact the ability of firms to grow by diverting funding away from growth initiatives. For customer-owned banks, this can be as simple as reducing the retained earnings that are needed to underpin loan growth due to APRA's capital requirements.

While regulators can reduce regulatory costs with more proportional regulation, the volume of regulatory change continues to grow as the risk environment becomes more complex and dynamic.

Introducing an Australian Regulatory Roadmap like the Regulatory Initiatives Grid in the United Kingdom will assist regulators and policymakers to coordinate regulatory change and assist industry to plan and map out responses for regulatory change. This will reduce the costs of regulatory change.

A 'group think' of investor-owned banks currently dominates the banking market. In this context, the customer-owned banking sector and its customer owned ethos is a critical pillar of the Australian banking system.

Explicitly recognising corporate diversity in regulator mandates will entrench different business models, particularly the customer-owned model, as a default consideration when designing regulation to help address this 'group think' issue.

These clauses will support a stronger customer-owned banking sector that gives consumers a strong alternative.

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Impact of regulation on competition in banking

Policymakers and regulators need to recognise and respond to the impact on competition, innovation, and consumer choice of constantly ratcheting up regulatory compliance costs.

The increasing diversion of scarce resources away from customer service and innovation to meet new compliance obligations hits challenger banks hardest and gifts a competitive advantage to major banks. The ultimate losers from this entrenched trend are all banking customers who need a vibrant, dynamic, and innovative retail banking market.

The sheer scope of regulatory compliance is a challenge for all banking institutions. However, smaller lenders are subject to relatively higher regulatory costs due to the fixed cost factor and this hampers their capacity to grow and expand into new markets. This view is not controversial. For example, APRA has taken some steps with its new significant financial institution regime which introduces more proportionate requirements for smaller entities.

High regulatory costs hurt consumers because resources are diverted away from investment in product innovation, better service, and better pricing.

There is potential for a broader deadening effect on the economy's dynamism of too much regulation. As noted by the Reserve Bank Governor,[1] over the past 20 years as a society we have gone too far in the direction of regulation as the solution to problems.

> "We stop the downside through regulation, but the culture that's coming together with that regulation is limiting the upside and the dynamism in the economy.
>
> "I fear that over time we've erred too far in the direction of regulation.
>
> "We want firms who are prepared to grow, to invest and to hire people—that's what I'm really talking about—and to develop new products and new ways of doing things and to grow the economy, because ultimately the economic growth delivers jobs and incomes to people, which is what is important."

It is critically important to acknowledge the opportunity cost of imposing new regulatory requirements that force banks to divert scarce funds away from other priorities that are more relevant to their customers.

While regulatory costs can be reduced through more targeted and proportional regulation,[2] the volume of regulatory change continues to grow as the risk environment becomes more complex and dynamic.

To reduce the impact of regulatory change, the Australian Government should implement a new regulatory coordination and transparency mechanism (an Australian Regulatory Roadmap) similar to the United Kingdom's Regulatory Initiatives Grid. This roadmap would outline regulatory change across multiple financial services regulators to support better decision making from regulators, industry and other stakeholders (see **Appendix A**).

Customer owned banking as a different model

Our sector's main point of difference is our ownership model – our customers are also the owners of our institutions. This model removes the motive to undertake the 'profit before people' behaviour examined in the recent Banking Royal Commission. Our model better aligns the incentives of customers and their bank and reduces the risk that the bank's purpose will create issues that drive the need for more regulation.

Investor-owned banks currently dominates the banking market. This can lead to 'group think' given the dominance of the shareholder profit earning incentive. COBA's view is that diversity of business

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[1] RBA Governor Philip Lowe, Hansard, Senate Select Committee on COVID-19, 28 May 2020.

[2] See COBA's 2022 Policy Agenda page 7.

models is part of achieving more competition and innovation in both banking and the broader financial services industry. In this context, the customer-owned banking sector and its customer owned ethos is a critical pillar of the Australian banking system.

Explicitly recognising corporate diversity in regulator mandates will entrench it as a default consideration when designing regulation.

This will ensure Australia does not end up with a regulatory environment that assumes the default of an investor-owned business model. These clauses will support a stronger customer-owned banking sector that gives consumers a strong alternative (see **Appendix B**).

Please do not hesitate to contact Mark Nguyen if you have any questions about our submission.

Yours sincerely

MICHAEL LAWRENCE
Chief Executive Officer

Appendix A

A whole-of-system approach to regulatory change

Summary

The current financial services regulatory landscape is convoluted and complex. The burden of the current legislation will be lessened by initiatives like the ALRC review and actions taken by specific regulators. These initiatives would not, however, address the overall effects of the accelerated pace, volume, and complexity of new regulations coming from several regulators, legislators, and policymakers.

Regulators are becoming more sensitive to the "should we" (choice to enact new regulations), the "how we" (proportionality), and the "when we" (timing) of new regulations on an individual basis, but it is unclear to what extent they are coordinating as a group.

A whole-of-system approach to regulatory change in the financial sector is needed to ensure that regulatory change is proportionate, orderly, and coordinated. This will reduce the impact that regulatory change has on financial system competition and efficiency and on customers in terms of cost and opportunity cost.

Background

A tsunami of regulatory change

Over a decade ago, financial services regulation, while complex, did not have the same pace and volume of regulatory change. While banking was subject to increasing consumer and prudential regulation, since then a global financial crisis response, various inquiries, a Royal Commission, exponential technological change, and a global pandemic have created wave after wave of regulatory change.

The depth and breadth of financial regulator mandates are relentlessly expanding. Regulators, consumers, and other stakeholders' expectations of banks only continue to grow. In 2021, while APRA was putting the finishing touches on its credit risk capital framework, i.e., 'traditional' banking regulation, it was also consulting on climate change guidance, increasing supervisory intensity on cybersecurity, piloting new data collection methods and expanding its GCRA[3] work. ASIC's mandate is also expanding with continually increasing consumer protection regulation, piloting new data reporting requirements and activity in the GCRA space as well. It will assume new responsibilities under the upcoming Financial Accountability Regime. The ACCC is the regulator of Australia's complex, new and continuously evolving Consumer Data Right (CDR) regime. Regulators such as the RBA, ATO and AUSTRAC are also increasing their activity. The significant community interest in financial services has led to a deluge of inquiries, each with its own set of potential improvements to the system. Regulator mandates are increasingly starting to overlap into each other's jurisdiction such as in the GCRA, cybersecurity and lending space.

Regulator staffing growth matches this 'on paper' growth in regulation. Regulators are getting more resources and regulated firms are spending more time interacting with regulators. The information collected by regulators is increasing and will continue to increase with new technology. This tsunami of

[3] Governance, Remuneration, Culture and Accountability.

regulatory change is increasing operational risk in financial services and regulatory change programs now comprise a significant proportion of regulated entities' investment budgets.

This sentiment is not just limited to smaller banks such as customer-owned banks. UK Finance states that:

> "Even the best-resourced firms have only so much financial, technical and strategic capacity to deliver and oversee change while managing the resilience of the system."[4]

This compulsory investment is crowding out funds that could also be used for customer, innovation, digital and growth initiatives. The 'drop-dead dates' for regulatory projects are pushing higher value projects aside.

Regulators and policymakers must work together to ensure that this change is proportionate, orderly, and coordinated.

Better coordination among policymakers and regulators would also improve decision-making in cases where potentially competing objectives may be in play, such as competition versus stability, consumer protection versus consumer convenience and fighting money-laundering versus digital finance innovation.

The Regulatory Initiatives Grid – charting a clear course for regulators and industry

In the UK Government's 2020 Budget, the Chancellor of the Exchequer announced a proposal to improve regulatory coordination through the introduction of the Financial Services Regulatory Initiatives Forum (FSRIF) and the Regulatory Initiatives Grid. The Financial Services Regulatory Initiatives Grid reveals in one document the regulatory pipeline over the next two years. This document allows the financial services sector and other stakeholders to understand and plan for the continual change that will have significant cost and operational impacts. FSRIF is a similar grouping of financial sector regulators to Australia's Council of Financial Regulators (CFR).

The Grid includes information on each regulatory initiative including:

- name, lead agency and links to public information on it,
- estimates of operational impact (higher impact, lower impact or unknown impact),
- any expected key milestone dates and any changes to these milestone dates,
- whether the initiative is a newly announced initiative, and
- whether the initiative is expected to have a consumer impact to flag to consumer organisations.

The Grid's development has been an iterative process with financial sector stakeholders and continual calls for feedback. For example, "In response to the feedback received in the Call for Evidence that consultations, data requests and new requirements all contribute to the administrative burden on firms, the Grid will include all publicly announced supervisory or policy initiatives that will, or may, have a significant operational impact on firms." The evolution of the Grid has been impressive and now includes an online dashboard and a spreadsheet.

While COBA greatly appreciates recent moves by regulators and policymakers to increase the transparency of their workplans,[5] these individual workplans without demonstrated consideration of broader regulatory change do not deliver the most efficient outcomes. COBA accepts that regulators

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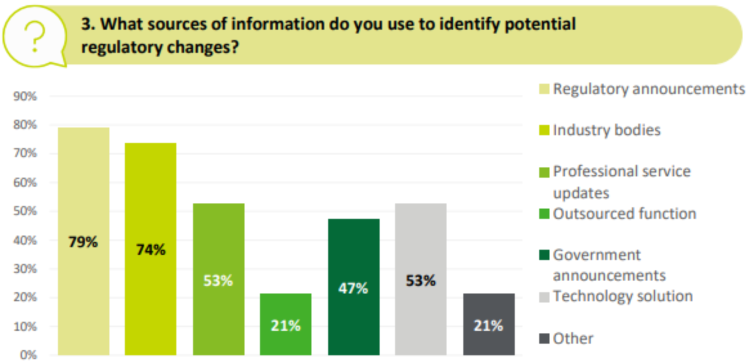
[4] UK Finance Response to Call for Evidence: Regulatory Coordination.

[5] Example: see APRA's Policy and Supervisory Priorities, ASIC's Regulatory Developments timetable and Treasury's Royal Commission roadmap.

do endeavour to coordinate this change, e.g., via discussion at the CFR of big ticket items, but industry needs transparency about this coordination.

COBA previously produced a Regulation Outlook document as an internal member product to assist our members in navigating this change, particularly on regulatory consultations. Many professional services firms, industry associations and commercial entities do the same (see below). However, while these products address industry's 'roadmap' need from a visibility perspective, they do not address the need for greater regulatory and policymaker coordination or provide regulators with an overview of regulatory change to provide more complete information for their decision-making. A roadmap will reduce some economy-wide inefficiencies in regulatory scanning and allow resources to be focused on regulatory compliance or other projects.

Graph 1: Identifying potential regulatory changes



Source: [Deloitte, Managing Regulatory Change in the Australian Financial Services Industry, 2022.]

Importantly, participating in this Forum and Grid does not interfere with individual regulators' powers on sequencing of regulation but rather provides them with more information to make informed decisions on the timing of regulatory initiatives.[6] The FSRIF has also noted that "the Grid planning process may highlight potential synergies between the various regulatory initiatives and agreed to consider further how these may be best be identified and exploited."[7]

Now in its sixth edition,[8] the Grid has continuously evolved over this period based on stakeholder feedback and FSRIF discussion. Recent updates have included: adding new regulator members and their initiatives, including a flag on consumer interest, including an annex of changes, developing an interactive online tool, and highlighting key examples of closely interconnected initiatives to help stakeholders more readily identify them.

Such a document and its underlying processes would be invaluable in the Australian context to help the financial sector navigate the current pace, volume and complexity of change.

For more information, please see COBA's 2023-24 Budget Submission.

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[6] As noted by the September 2020 FSRIF meeting minutes: "Decisions were reserved to the relevant members. Operation of the Forum was intended to ensure that members' decisions result in a fully and appropriately coordinated regulatory pipeline."

[7] See September 2020 FSRIF meeting minutes.

[8] https://www.bankofengland.co.uk/report/2023/sixth-edition-of-the-regulatory-initiatives-grid.

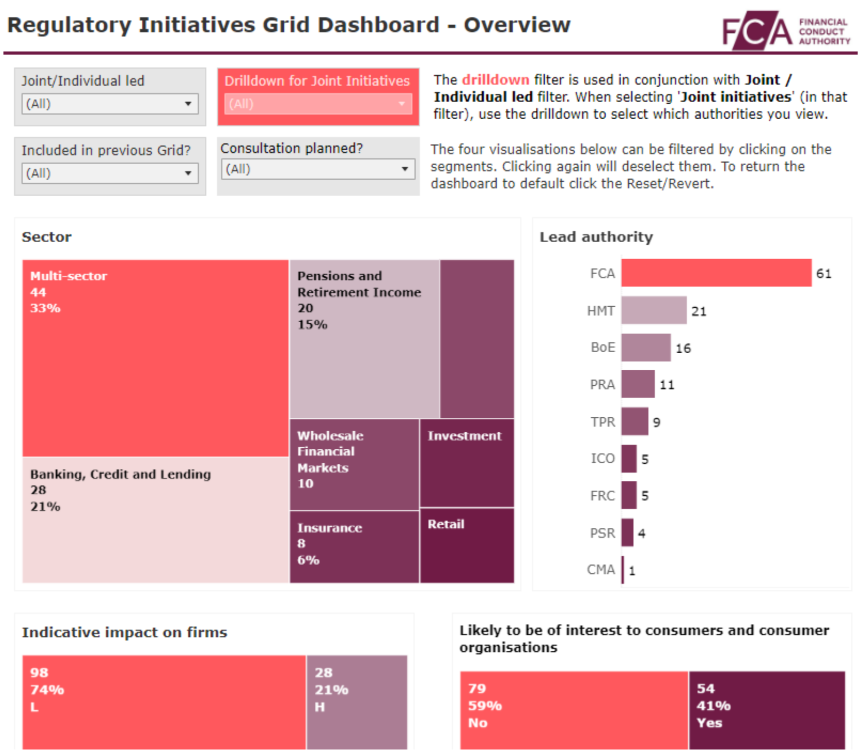
UK Regulatory Initiatives Grid

Multi-sector

Lead	Initiative	Expected key milestones	Indicative impact on firms	Apr-Jun 2022	Jul-Sep 2022	Oct-Dec 2022	Jan-Mar 2023	Apr-Sep 2023	Post-Oct 2023	Consumer interest	Timing updated	New
Environmental, Social and Governance (ESG)												
BoE/ PRA	**2021 Biennial Exploratory Scenario** A stress test of the resilience of the largest UK banks and insurers to different possible climate pathways, the exercise is also designed to assess and improve participants' climate risk management capabilities and understand potential changes and challenges to business models.	The Bank launched a second round of the exercise on 9 February. Results will be published in May 2022, in aggregated form (not at firm-level) and will revert to firms with key findings for individual participants at that time too.	H									
FCA/ HMT	**Net Zero Transition Plans** We are working to help shape the work of the Government's Transition Plan Taskforce and will draw on its outputs to strengthen our regulatory expectations relating to the disclosure of transition plans by listed companies and regulated firms. We will consider matters such as the governance of listed companies' and regulated firms' transition plans, as well as their content and how they are communicated.	The FCA will be actively involved in the UK Government's Transition Plan Taskforce, officially launched in April, with a two year mandate to develop a gold standard for private sector transition plans. The Climate Financial Risk Forum (see separate initiative) also launched a workstream on the transition to net zero in April.	H								●	
FCA/ PRA	**Climate Financial Risk Forum** In 2019 the FCA and PRA jointly established the Climate Financial Risk Forum (CFRF), which brings together senior financial sector representatives to share their experiences in managing climate-related risks and opportunities.	March 2022: Membership to be refreshed and Session 3 to kick off. Forum members to put together initial plans/strategy and Working Groups (Disclosure, Data and Metrics; Scenario Analysis; Transition to Net Zero) to consider deliverables.	L								●	

Key
Indicative impact on firms: **H** - high **L** - low **U** - unknown E Formal engagement planned Key milestone

Regulatory Initiatives Grid | May 2022 8



Source: [https://www.fca.org.uk/publications/corporate-documents/regulatory-initiatives-grid.](https://www.fca.org.uk/publications/corporate-documents/regulatory-initiatives-grid)

Appendix B

Corporate diversity to promote the customer-owned model

Explicitly recognising corporate diversity in regulator mandates will entrench it as a default consideration when designing regulation. This will ensure Australia does not end up with a regulatory environment that assumes the default of an investor-owned business model. These clauses will support a stronger customer-owned banking sector that gives consumers a strong alternative.

The Australian banking sector is dominated by investor-owned companies. This dominance leads to a view of 'investor owned' by default in policy and decision-making. The customer-owned banking model provides a powerful counterpoint and difference to the investor-owned banking model. For examples, please see our recent KPMG Sector impact assessment of Customer Owned Banking in Australia.[9]

It is critical that our counterpoint is recognised and all regulator staff who develop policy understand the model to ensure that policy can promote a diversity of business models in financial services.

The systemic benefits of greater diversity include:[10]

(i) Systemic stability by virtue of having institutions that manage risks differently (and through the lower risk-appetite of mutual and co-operative banks).
(ii) Enhanced competition via different business models.
(iii) Mutual and co-operative banks tend to be less prone to short-termism via the pressure of maximising shareholder value over a short time horizon.
(iv) Mutual and co-operative banks are more likely to be locally based.

The *Financial Services and Market Act 2000* (UK) (FSMA) requires UK regulators (PRA and FCA) to consider "mutual societies" (i.e. more broadly mutuals) through their regulatory principles.[11]

> 3B Regulatory principles to be applied by both regulators
>
> (1) In relation to the regulators, the regulatory principles referred to in section 1B(5)(a) and 2H(2) are as follows—
>
> (f) the desirability where appropriate of each regulator exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons (including different kinds of person such as mutual societies and other kinds of business organisation) subject to requirements imposed by or under this Act;

[9] KPMG Sector impact assessment of Customer Owned Banking in Australia.

[10] Measuring corporate diversity in financial services: a diversity index (2022), p.9.

[11] *Financial Services and Market Act 2000* (UK) s 3B.

Additionally, the FSMA[12] requires regulators to provide opinions on whether proposed rules will have a "significantly different" impact on mutual societies compared to others.

> 138K Consultation: mutual societies
>
> (1) Subsection (2) applies where a regulator proposes to make a rule ("the proposed rule") which would apply both to—
>
> (a) authorised persons which are mutual societies, and
>
> (b) other authorised persons.
>
> (2) The regulator must prepare a statement setting out—
>
> (a) its opinion whether or not the impact of the proposed rule on persons within subsection (1)(a) will be significantly different from its impact on persons within subsection (1)(b), and
>
> (b)if so, details of the difference.

An example of one of these statements is below in relation to the PRA's recent Strong and Simple Framework consultation.[13]

> PRA Impact on mutuals
>
> 1.18 The PRA has a statutory obligation to give an opinion on the impact of its proposals on mutual societies (s138K FSMA), hereafter 'mutuals', which refers to building societies, friendly societies, co-operative, and community benefit societies. For the purpose of this Consultation Paper (CP), all references to 'mutuals' refer to building societies, which are the only group of mutuals within the proposed scope of application as set out in Chapter 2 of this CP.
>
> 1.19 FSMA requires that the PRA assess whether, in its opinion, the impact of the proposed rules on mutuals will be significantly different from the impact on other firms, and if so, provide details of the difference. The PRA anticipates the proposed scope for the simpler regime would capture a significant number of building societies, which would benefit from a simpler prudential regime. For the Net Stable Funding Ratio proposals, the proposed approach may require mutuals to calculate the Retail Deposit Ratio (RDR) in addition to the funding limit present in the Building Societies Act (BSA). The PRA considered whether it would be more proportionate not to apply any funding standard to such firms, given this existing limit. However, the PRA decided to consult on applying the RDR framework to mutuals as the BSA funding limit is designed to place a restriction on the nature of mutual societies, and not as a mitigant for funding risk. As such the BSA limit does not include all sources of funding in its calculation. For all other proposals, the PRA considers that the impact of the proposed rule changes on mutuals is expected to be no different from the impact on other firms.

While Australian regulators have positive steps regarding mutuals over recent years, embedding it into their mandates will ensure accountability as well as longevity in these considerations. Embedding the knowledge of this valuable alternative model into regulator decision-making will benefit the broader population through greater diversity in financial services offerings.

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[12] *Financial Services and Markets Act 2000* (UK), s 138K.

[13] CP4/23 - The Strong and Simple Framework: Liquidity and Disclosure requirements for Simpler-regime Firms.