

Competition within the Australian banking sector

Abacus – Australian Mutuals Limited

30 November 2010

Submission to the Senate Economics References Committee's inquiry into competition within the Australian banking sector.



Abacus
Australian Mutuals

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Executive Summary

Credit unions and building societies are important participants in the Australian retail banking market. Serving 4.5 million members across Australia, credit unions and building societies give Australians choice in how they do their banking. Mutuals offer consumers a different model of banking - a model where the customers own the credit union or building society. This allows credit unions and building societies to put their customers first, without the conflict that listed banking institutions face in providing shareholders with dividends at the expense of customers.

Credit unions and building societies believe that more competition in banking is required. We also believe that credit unions and building societies are ideally placed to provide some of that additional competition. With existing branch, payments and network infrastructure and considerable financial strength, the mutual sector is the most likely source of competition to the major banks in the short term. After the big four banks, we are the next largest holders of household deposits in Australia and are writing around 10% of all new mortgages.

Credit unions and building societies are already providing a great alternative and are ready to increase competition, but government policy change is required to allow us to more effectively compete. Abacus is seeking Government support to improve funding diversity for smaller banking institutions and to raise consumer awareness about their banking choices and how they can exercise that choice.

We think this support can be provided by:

- Retaining the existing retail deposit guarantee with the existing \$1 million threshold;
- Improving access to wholesale debt funding by introducing a flat fee wholesale guarantee for smaller lenders;
- Stimulating the securitisation market by considering:
 - Broadening the investment mandate of the AOFM to include the purchase of B notes on transactions by non-major bank lenders;
 - Providing liquidity in the secondary market through a limited Government repurchase facility;
 - Increasing the AOFM's investment in securitisations by non-major bank lenders.
- Improving consumer understanding of prudentially regulated lenders by changing the terminology applying to Authorised Deposit-Taking Institutions (ADIs) to Authorised Banking Institutions (ABIs);
- Investigating the ability to improve the ease of account switching;
- Investigating savings incentives aimed at increasing ADI deposits, including:
 - broadening and bringing forward proposed taxation relief on deposits;
 - considering mechanisms to allow mutuals to release franking credits to members.
- Easing the anti-competitive impact of GST input taxing on mutuals.

Detail on the impact and benefits of these proposals are provided in this submission.

Abacus acknowledges the important role that public debate over the past month has played in raising banking competition as an important issue for government and consumers. We also acknowledge the engagement of the Government, Opposition, minor parties and independents in this important public debate.

We look forward to the Government's announcement expected in coming weeks of its package of banking reforms and hope that at least some of the above measures form part of that package.

Most importantly, credit unions and building societies look forward to better banking outcomes for Australian consumers. We are ready to increase our competitive pressure on much larger institutions and ambitious about proving the value of the customer-owned banking model.

What we seek is simple – a more level playing field in banking policy and regulatory settings that maintain the integrity, safety and security of credit unions, building societies and banks. These settings need to work for smaller, more community focused banking providers as well as our very profitable large banks. Competition means choice, and choice means consumers can make decisions that give them a better deal and the best chance of financial independence.

We look forward to the outcomes of the Committee's inquiry.

List of recommendations

Recommendation 1

The Government guarantee of deposits should be maintained at its existing threshold of \$1 million to reduce the perception advantage enjoyed by the big banks' "too big to fail" status.

Recommendation 2

The Government should improve the ability of non-major bank competitors to source competitive funding by introducing a flat fee wholesale guarantee at a reasonable benchmark.

Recommendation 3

The Government should work with industry on mechanisms to stimulate the securitisation market, including broadening the mandate of the AOFM to include the purchase of B notes, building liquidity in the secondary market through a limited repurchase facility, and increasing the AOFM's direct investment in securitisation transactions by non-major-bank lenders.

Recommendation 4

The Government should reject the Cooper Review recommendation to phase out RSAs and recognise these accounts as a viable and effective investment choice for some consumers.

The Government should encourage savings by amending the four year qualifying period for First Home Saver Accounts to make these accounts more attractive for consumers.

Recommendation 5

The Government should improve consumer understanding of prudentially regulated lenders by changing the terminology applying to Authorised Deposit-Taking Institutions (ADIs) to Authorised Banking Institutions (ABIs).

Recommendation 6

The Government and industry should investigate ways to reduce actual or perceived impediments to switching accounts. The Government should also fund an awareness campaign that reduces consumers' misconceptions about the difficulty of switching.

Recommendation 7

The Government should bring forward and enhance its proposed taxation incentives on ADI deposits to promote household savings.

Recommendation 8

The Government should consider the introduction of a mechanism to allow mutual ADIs (or all ADIs) to release franking credits to members investing in deposit, or deposit-like, products.

Recommendation 9

The Government should update the GST RITC item "Credit Union Services" to cover mutual building societies.

Recommendation 10

Regulators should take a positive approach to the mutual sector's aggregation proposals designed to achieve economies of scale and access new sources of funding.

1. Overview of the mutual banking sector

Abacus – Australian Mutuals is the industry body for the mutual banking sector. We represent regulated banking institutions that are owned by their customers. Credit unions and building societies are Authorised Deposit-taking Institutions (ADIs) under the *Banking Act 1959* and are subject to the same regulatory oversight and the same strict prudential standards as banks.

The mutual banking sector has:

- 4.5 million members;
- 104 credit unions and 9 mutual building societies;
- around 11.5 per cent of the household deposits market;
- around 9 per cent of new home loans;
- a significant share¹ of the transaction account market;
- the second largest financial institution-owned ATM network for surcharge free ATM access, or access via Westpac to its nationwide network surcharge free;
- more branches than the Commonwealth Bank; and
- a strong presence in regional Australia.

Credit unions and building societies are strongly capitalised and have the lowest non-performing loan ratios compared to major and regional banks. KPMG's annual survey² of the mutual banking sector reports another year of strong performance, increasing profitability, balance sheet growth and low bad debt costs. Moody's industry outlook³ for Australia's credit union sector is "stable", with the sector supported by low-risk loan books, conservative business models and a loyal (and highly satisfied) customer base.

The customer-owned status of the mutual banking sector is reflected in market leading customer satisfaction ratings. The number one promise in the *Mutual Banking Code of Practice* is: "We will always act honestly and with integrity, and will treat you fairly and reasonably in all our dealings with you." Customer-owned banking institutions are not motivated to maximise profits or engage in irresponsible lending to drive up returns to shareholders.

Credit unions and building societies offer the full range of consumer banking products, services and access channels, including a long list of market-leading and award-winning offerings (see attachment *Market Leading Products*).

Credit unions and building societies are focused on consumer banking but many mutual banking institutions, particularly those based in regional areas, also compete in the small business market.

In addition to APRA's prudential regulation framework, credit unions and building societies are subject to regulatory regimes administered by ASIC, the ACCC, the RBA and AUSTRAC (see attachment *Regulatory Environment*).

This submission will focus on terms of reference (a), (f), (g) and (j) but we will also comment on other terms of reference.

¹ ACCC in 2008 estimated 17% share of NSW/ACT market and 24 per cent of SA market.

² Building Societies and Credit Unions: 2010 Financial Institutions Performance Survey, KPMG Nov 2010

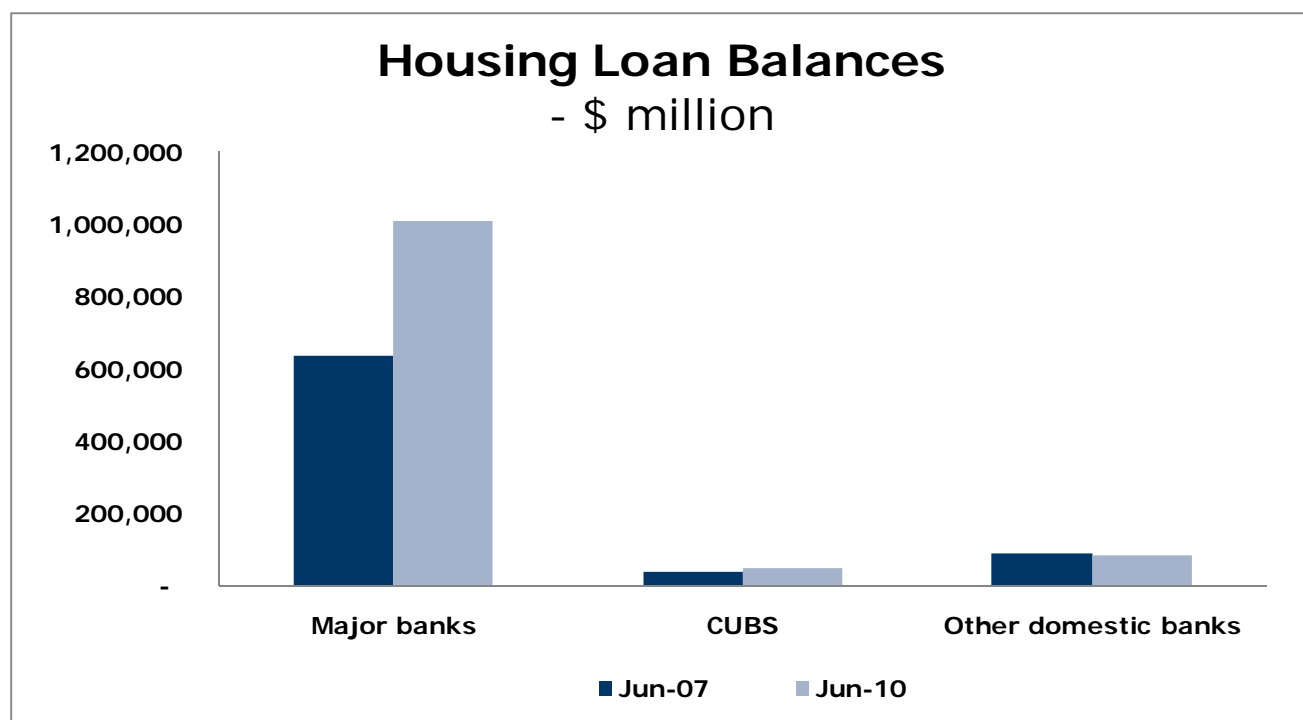
³ Moody's Investors Service, Industry Outlook – Australia Credit Unions, July 2010.

2. Competition in retail banking

There are fewer competitors in the retail banking market compared with prior to the global financial crisis and the major banks have increased their market share (see graph below).

In its report on bank mergers last year, this Senate Committee concluded that the market is “now, by some criteria, the most concentrated it has been for a century”⁴.

Major banks have increased their dominance and are able to exercise market power.



(Source: APRA)

The major banks’ multi brand strategies create an illusion of more competition than actually exists. For example, Westpac’s portfolio of brands includes St George and Bank SA.

ACCC chair Graeme Samuel concedes that “generally when you’ve got less competition you’ll have higher prices being charged.”⁵

The UK’s Independent Commission on Banking commented recently that competition “can be quite strong in quite concentrated markets and weak in markets that are not highly concentrated. There is nevertheless a tendency, all else being equal, for markets to be less competitive when more concentrated.”⁶ The Commission also noted that so long as there is a perception that systemically important financial institutions are too big to fail “their management, investors and counterparties are likely to believe that these institutions effectively operate with implicit state support.”

We acknowledge the critically important role of the *Guarantee Scheme for Large Deposits and Wholesale Funding* in ensuring the flow of credit in the Australian economy during the global

⁴ Senate Economics References Committee, Report on Bank Mergers, September 2009

⁵ Graeme Samuel interview, ABC TV *Inside Business* 6 December 2009

⁶ Independent Commission on Banking – Issues Paper Call for Evidence, September 2010 (UK)

financial crisis. However, the scheme's unfair fee structure meant that the scheme disproportionately benefited the major banks.

The fee for major banks was 70 basis points compared to 150 basis points for other regulated banking institutions. The RBA has confirmed that the differential in the fee structure was "relatively large by international standards" and that the fee paid by the major banks was "at the low end of the international range."⁷

The major banks were able to raise \$130 billion in guaranteed wholesale funding. An Abacus member ADI with wide funding experience says some of these funds were provided "to smaller ADIs via whatever arrangements generated the highest ROE."

Major banks provide a range of balance sheet services to the mutual sector, including standby arrangements, securitisation warehouse facilities, and swaps for risk management purposes.

"The costs of these facilities have increased dramatically since the GFC commenced. Although home loan borrowers have not seen a dramatic increase in margins, commercial borrowers (including smaller ADIs) have seen massive increases in the margins being demanded by major banks for the provision of balance sheet funded solutions. This is a by-product of the lack of competition for commercial borrowers, something that is rarely politicised but which indirectly also has an effect on retail competition," the Abacus member ADI says.

"The most intimidating practices were in relation to securitisation and the pricing renegotiations that used to occur annually, but which took place six-monthly during the worst of the crisis. The attitude adopted could generously be described as a 'take it or leave it' approach. There was a recurring theme for us to justify why we should be allowed to continue receiving the benefit of the support they were providing. This was driven by the credit departments within these organisations that were restricting the use of capital, and as such required each relationship manager to justify the provision of support to, in some cases, long-standing customers. To continue the relationship the majors demanded a greater proportion of total business, in essence to make promises that related to future business that would/may drive income flows. I am hesitant to label it predatory pricing, but I do not believe this was fair. These events were taking place concurrent with the provision of the wholesale funding guarantee, which they were using excessively to fund their businesses."

⁷ RBA Bulletin, March Quarter 2010

3. Proposed Policy Reforms

Given that the wholesale funding guarantee disproportionately benefited the biggest players in the banking market, one option for boosting the capacity of non-major ADIs would be to reopen the Guarantee scheme on a limited basis with a flat fee.

Mutual banking institutions are holding their own against their much bigger competitors, providing consistently better rates over any reasonable comparison period and demonstrating consistent asset and deposit growth exceeding bank averages⁸. However, they are capable of significantly increasing their competitive impact given the right conditions. It is an extraordinary achievement that the mutual banking institutions, dwarfed by the major banks, can offer not just better service but in very many cases better prices. The sector's current performance indicates significant future promise.

The keys to improving our sector's competitive capacity are:

- securing, growing and diversifying our funding;
- increasing our profile and empowering consumers to exercise choice; and
- improving our efficiency through aggregation and co-operation.

Fees flowing to the Government from the Wholesale Funding Guarantee Scheme are estimated to total \$5.5 billion. Diverting a small fraction of this windfall revenue to pro-competitive measures, such as a public awareness campaign about the prudential regulatory framework and the FCS, would strongly boost competition in retail banking.

Abacus recommends the following measures to enhance competition in retail banking:

Securing and diversifying funding

- (a) Maintain the FCS with the existing cap at \$1 million;
- (b) Take further action to support the RMBS market;
- (c) Facilitate access to wholesale funding markets and support liquidity;
- (d) Take further action to ease the heavy taxation burden on deposits; and
- (e) Rule out the Cooper Review recommendation to abolish Retirement Saving Accounts (RSAs) and further enhance First Home Saver Accounts (FHSAs).

Empowering consumers

- (a) Change the regulatory term for regulated banking institutions from "Authorised Deposit-taking Institution" (ADI) to "Authorised Banking Institution";
- (b) Promote greater awareness of the prudential framework, its coverage and the role of the Financial Claims Scheme (FCS) for all ADIs;
- (c) Promote account switching; and
- (d) Allow broader use of the term "bank" by regulated banking institutions, subject to APRA approval.

Improving efficiency

⁸ APRA data released 30 November 2010, <http://www.apra.gov.au/Statistics/upload/CUBS-Q-Pub-Sep-10.pdf>.

Consistently better rates based on a 10 year comparison of standard variable home loan rates conducted by Canstar Cannex in 2010.

- (a) Ease the anti-competitive impact of GST input taxing on mutuals; and
- (b) Encourage APRA, ASIC and the RBA to respond positively to industry aggregation proposals.

3.1. Securing and diversifying funding

Financial Claims Scheme

Recommendation 1

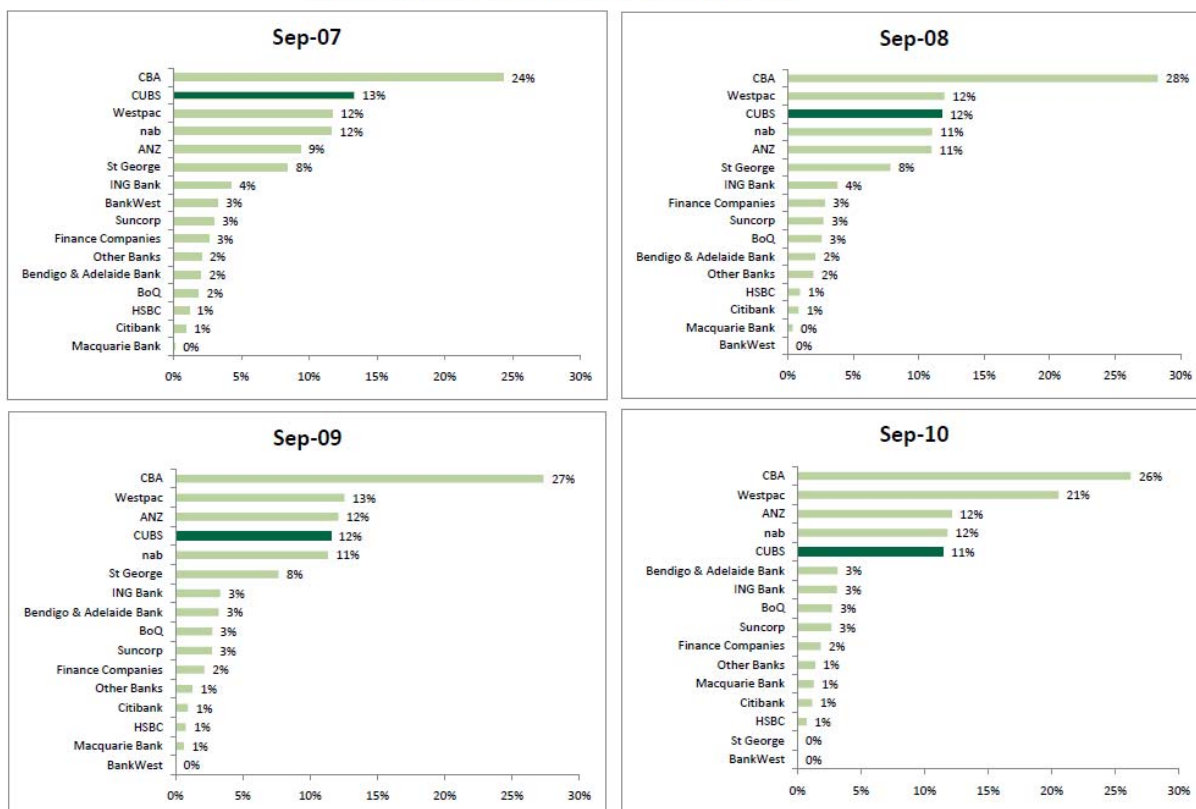
The Government guarantee of deposits should be maintained at its existing threshold of \$1 million to reduce the perception advantage enjoyed by the big banks' "too big to fail" status.

The guarantee of deposits of up to \$1 million under the FCS was a decisive and welcome intervention by the Government in 2008 and remains a pro-competitive measure that has delivered peace of mind to depositors and stability to the core of the financial system. It has also helped smaller banking institutions to defend their share of the deposits market from the major banks.

Credit unions and building societies have always been predominantly funded by retail deposits. According to APRA statistics released on 30 November 2010⁹, deposits funded 87.1% and 81.2% of credit union and building society lending respectively. These proportions have risen since before the global financial crisis as a result of the closure of the securitisation markets, however household deposits have always represented a very significant component of the mutual sector's funding.

While credit unions and building societies have been able to grow their deposits, bank mergers and stronger growth by the major banks has seen the mutual banking sector's market share slip from second place in 2007 to fifth place today.

Market Share in Household Deposits



The per-depositor cap for FCS should be maintained at \$1 million indefinitely. The deposit guarantee poses no risk to the taxpayer because:

1. the prudential regulatory framework ensures that it is highly likely that the remaining assets of a failed institution will be sufficient to recover funds paid out under the FCS to depositors; and
2. in the unlikely event of there being a shortfall, regulated banking institutions will be levied to make up the difference.

The FCS reduces the risk of a 'run' on a banking institution because depositors do not have to fear losing their funds. The price of entry to the FCS for the banking institution is an extremely tough prudential regulatory regime. Entities that wish to compete on a level playing field with banking institutions are welcome to submit to the same requirements on capital, liquidity, risk-management, reporting, auditing and governance.

Prudentially-regulated banking institutions also meet the cost of this "first line" of depositor protection because they pay the costs of regulation via ordinary industry levies. APRA chair Dr John Laker assured this Committee in October 2008 that APRA's "supervisory intensity will be as strong, if not stronger, now with the government guarantee in place as it was beforehand."¹⁰

Most importantly, as discussed above, the perception that major banks are too big to fail is an anti-competitive factor in the banking market.

The FCS levels the playing field for large and small banking institutions and is a pro-competitive factor. Any reduction in the FCS cap from \$1 million will benefit the four major banks to the competitive detriment of other regulated banking institutions. Rather than being seen as a risk to the taxpayer, the FCS should be seen for what it is – an early access facility for depositors' funds in the event of an institution failing.

Importantly for competition in retail banking, the \$1m cap is reassuring for larger depositors, e.g. local government and non-government organisations, that are important sources of funding for smaller banking institutions. APRA and others have noted from recent experience that 'runs' are generally not caused by depositors with very small amounts.¹¹

Households, that is conservative and unsophisticated investors, will from time to time have much larger amounts held in regulated banking institutions. The vast majority of these depositors are extremely unlikely to have the skills and capacity to be able to assess and monitor the prudential standing of a financial institution.

Investors with more than \$1 million to deposit are more likely to be able to contribute to the market discipline necessary for an effective deposit insurance scheme. Setting the cap at that level, though relatively high by international standards, gives credibility to the limits of the scheme.

Market discipline will also continue to be imposed by creditors not covered by the FCS and by shareholders. The deposit guarantee protects depositors, not shareholders. Excessive risk-taking by profit-maximising banking institutions is constrained by a combination of market discipline and prudential regulation. Unlisted mutual banking institutions do not have the same

¹⁰ John Laker, Senate Economics Committee Hansard 23 October 2008

¹¹ Evidence by APRA executive Keith Chapman, 28 July 2009, and FSI member Ian Harper, 14 August 2009, Senate Economics Committee inquiry into bank funding guarantees.

motivation to maximise profits as listed banks, so there is not the same incentive to take excessive risk in our sector. The focus of mutual banking institutions is demonstrated by their market-leading customer satisfaction ratings and their long track record of responsible lending.

A cap lower than \$1 million is less likely to be taken seriously as a genuine limit. This is particularly valid in the Australian context because of the long-standing 'implicit' deposit guarantee arrangements that applied until October 2008.

The Council of Financial Regulators took the view prior to the global financial crisis that this system, rather than an explicit FCS, was more likely to be subject to moral hazard.¹²

RBA research in 2006 showed that 60 per cent of respondents were of the view that there was a guarantee of deposits or that it was likely (or highly likely) that the Government would step in to ensure either full or partial repayment of the funds in their main deposit account. Only 10 percent were of the opinion that their main deposit account was not guaranteed and that, in the event of a failure, the government was unlikely to step in.¹³

Unfortunately Australian consumers do not recognise that non-major banks and mutual ADIs are covered by the same standards (see Attachment A for further detail).

The GFC has served to entrench these views, with real international examples of governments stepping in to rescue large banks.

Setting the cap at a credibly high level is important to a successful permanent transition away from the pre-existing implicit blanket guarantee.

The RBA's 2006 survey asked respondents to identify the supervisor of banks, building societies and credit unions from a multiple choice list. Only 14 per cent correctly said that APRA was the supervisor, slightly more than the 10 per cent who thought it was the Australian Bankers' Association.

The OECD has observed that effective consumer protection requires that the public properly understand existing arrangements and is aware of the extent of and limits to existing compensation arrangements and that simplicity is valuable in promoting public understanding.¹⁴

A relatively high cap of \$1 million¹⁵ for the FCS is not only stark and simple, it is also a credible limit on the 'early access' dimension of the depositor safety net.

Abacus notes that major banks and non-ADI industry bodies have argued for a lower cap.

Major banks are seeking to preserve the competitive advantage they obtain from depositor misconceptions that they are safer simpler because they are bigger than their competitors.

Non-ADI industry bodies have argued that financial products that are "close substitutes" to deposits are disadvantaged by being outside the FCS. However, such products are not direct

¹² *Financial Stability Review* RBA Sep 2006

¹³ *Financial Stability Review* RBA Mar 2006

¹⁴ *Financial Turbulence: Some Lessons Regarding Deposit Insurance* Sebastian Schich OECD 2008

¹⁵ In the USA the cap is US\$250,000. (<http://www.fdic.gov/news/news/press/2010/pr10161.html>) In the UK, the cap is £50,000. The European Commission is proposing a cap of €100,000 to harmonise a patchwork of 40 schemes across the EU. (http://ec.europa.eu/internal_market/smn/smn58/docs/financial_services_en.pdf).

competitors with deposits if issuers of such products are not subject to prudential supervision and requirements on capital, liquidity, risk-management, reporting, auditing and governance.

Any reduction of the \$1 million cap, eg. to \$500,000, should be implemented with a recognition of its anti-competitive impacts and only with safeguards to minimise negative impacts on stability and competition. These would include a transition period with an effective public awareness campaign about the prudential regulatory framework and the scope of the FCS.

According to the *Core Principles for Effective Deposit Insurance Systems*, public awareness of deposit insurance, its existence and how it works (including the level and scope of coverage and how the claims process operates), plays a significant role in underpinning a sound deposit insurance system.

Access to wholesale funding

Recommendation 2

The Government should improve the ability of non-major bank competitors to source competitive funding by introducing a flat fee wholesale guarantee at a reasonable benchmark.

Access to cost-effective wholesale funding markets is challenging for credit unions and building societies, as it is for regional banks and wholesale-funded credit providers.

The ability of credit unions and building societies to more strongly push for market share is hampered by the absence of diverse funding sources. As noted above, mutuals have traditionally relied on household deposits for the majority of their funding. However, to be able to grow more strongly, additional sources of funding must be identified and facilitated.

Wholesale funding can basically be raised in two ways by credit unions and building societies:

- through wholesale debt issues
- through securitisation.

Securitisation was more often used by credit unions and building societies prior to the GFC, however these markets remain subdued. As noted by one Abacus member ADI, the wholesale market activity remains difficult for credit unions and building societies, in part because of the anomalous behaviour of investors in the market.

"There is too much money flowing into superannuation that is being invested inefficiently or into riskier asset classes in offshore markets.

"No fund manager will look at a BBB ADI but (they) are happy to invest 20 per cent of their portfolios in offshore or emerging markets equities. This is not sensible for banking competition. The Government's own Future Fund will not consider investing in a debt issue by a highly regulated mutual ADI with a BBB rating, but will take an equity stake in an underperforming listed public company. If the Government wants to promote RMBS, the market needs to develop a link to a more significant investor base, i.e. the Australian superannuation funding pool."

A wholesale funding debt issue generally must be at least \$300 million to meet investors' liquidity requirements and therefore only the largest credit unions and building societies are in this market directly raising wholesale funding. Other smaller mutuals seek to access wholesale markets through aggregation, making a range of Government responses important.

Another hurdle is that wholesale debt funding issues by mutual banking institutions are relatively novel and therefore investors require a premium.

Establishment costs are high, including legal costs, credit rating costs, and manager/arranger costs. These costs can be spread by aggregation vehicles involving multiple participants but such vehicles also have a cost in increased complexity and regulatory approvals.

We acknowledge the critically important role of the *Guarantee Scheme for Large Deposits and Wholesale Funding* in ensuring the flow of credit in the Australian economy during the global financial crisis. However, the scheme's unfair fee structure meant that the scheme disproportionately benefited the major banks.

The fee for major banks was 70 basis points compared to 150 basis points for other regulated banking institutions. The RBA has confirmed that the differential in the fee structure was "relatively large by international standards" and that the fee paid by the major banks was "at the low end of the international range."¹⁶

Illogically the market was pricing for institutional profile regardless of the guarantee. As a result, the combination of the guarantee premium and the market's premium meant that the cost of wholesale funding for smaller lenders was simply prohibitive.

The major banks were able to raise approximately \$130 billion in guaranteed wholesale funding – almost 2.5 times the total deposit base of credit unions and building societies – at significantly lower cost than their competitors. The competitive advantage taken by the majors as a result of this funding source cannot be underestimated and, in our view, must now be addressed.

Abacus also notes that the mutual sector is looking to facilitate funding through aggregation projects. Two innovative projects are currently underway in the mutual banking sector to facilitate access by credit unions and building societies to the wholesale funding market.

The Australian Mutual Group (AMG) is undertaking a number of initiatives by pooling resources to tap wholesale debt and capital markets. The AMG has a record of innovation, having issued Tier 1 and Tier 2 capital instruments, and is now seeking to issue unsecured term debt to diversify the funding base of participating credit unions.

The Aggregated Balance Sheet (ABS) group of credit unions is investigating a ground-breaking new model of centralised asset and liability management. Under this model, the centralised balance sheet would be a new ADI with capacity to access wholesale markets and economies of scale (see attachment *Aggregated Balance Sheet*.)

Both of these schemes would benefit from better access to wholesale funding markets.

¹⁶ RBA Bulletin, March Quarter 2010

Stimulating the securitisation market

Recommendation 3

The Government should work with industry on mechanisms to stimulate the securitisation market, including broadening the mandate of the AOFM to include the purchase of B notes, building liquidity in the secondary market through a limited repurchase facility, and increasing the AOFM's direct investment in securitisation transactions by non-major-bank lenders.

Securitisation was an important source of funding for home lending by mutual banking institutions, facilitating growth in home lending and allowing room for other funding to be used for other forms of lending.

An Abacus member ADI commented that the securitisation market was a market *"where funding was based on loan quality – a strength for mutuals – rather than on balance sheet size."*

The global financial crisis shut down securitisation markets and, despite some encouraging signs, this source of funding for Australian lenders is yet to recover.

Investing in B notes

Abacus appreciates the Government's support to date for the RMBS market, which includes investments by the Australian Office of Financial Management (AOFM) in RMBS issues by five Abacus members: Credit Union Australia, Australian Central Credit Union, Police and Nurses Credit Society, Greater Building Society and IMB.

However, we believe some changes to the AOFM's approach, particularly to improve liquidity for investors, would be valuable in contributing to the recovery of this important market.

One mechanism that should be considered is to broaden the investment mandate of the AOFM to include the purchase of B notes on securitisation transactions of smaller lenders. Currently, most securitisation transactions have at least two classes of notes – highly rated (more than AA, often AAA) A class notes and subordinated (but still highly rated) B class notes. Investors and ratings agencies prefer securitisation transactions structured in this way and smaller lenders have little scope other than to comply.

However, there is little investor demand for the 'B' class notes, despite their high rating. As a result, these notes must either be sold at extremely high costs (often uncommercial) or held by the originating ADI. Where the B notes are held by the originating ADI, APRA requires the holding to be deducted from the capital of the ADI, thus diminishing the overall effectiveness of the transaction.

Changing AOFM's mandate to allow it to purchase subordinated lower rated securities in securitisations by non-major ADIs would be an effective tool in ensuring the ongoing viability of this market for smaller lenders.

Supporting liquidity

There is also a need to ensure that all arms of Government, and specifically APRA and Treasury, are aligned in supporting the recovery of the securitisation market.

As the Australian Securitisation Forum has noted, investors do not doubt the creditworthiness of Australian RMBS but there are issues with liquidity and a need to attract more investors into primary and secondary RMBS markets.

One of the issues for the future of the securitisation market is the fact that the major banks are critical suppliers in that market, as providers of warehouse facilities, but are also retail competitors to lenders using securitisation for funding.

The withdrawal of foreign banks as competitors to the major banks in warehouse provision has left securitisers dependent on the major banks. As noted above, major banks have behaved ruthlessly in exercising market power.

One mechanism to improve investor demand for Australian RMBS would be for the Government to provide better liquidity in the secondary market through a Government repurchase program or similar. Currently some investors are unwilling to invest in Australian RMBS because of doubts about the ability to resell that investment before the expiry of the investment term. The presence of the Government as a repurchaser (in circumstances to be controlled and prescribed) would provide greater certainty to investors thus stimulating demand in the market.

Abacus recommends that such a facility be considered by Government as part of its package to support smaller lenders.

Direct investment

As noted above, the Government intervention through the AOFM to directly invest in the securitisation market was a welcome initiative with direct positive funding impact for credit unions and building societies.

Hopes for the recovery of the securitisation market have not yet been realised however and Government may need to consider further investment in the market through the AOFM.

Covered Bonds

Some industry participants are calling for the regulatory regime to be altered to allow ADIs to issue covered bonds. Those participants have noted that the lack of covered bonds means that Australian ADIs are not able to compete for funding in an active international covered bond market and that covered bonds are pro-competitive.

Abacus is not philosophically against the allowance of covered bonds by Australian ADIs, although we note that that depositor protections currently in the Banking Act would be diminished by such a change and should be carefully considered.

Abacus strongly rejects however the notion that covered bonds are pro-competitive. There is little doubt that the major banks will be able to source additional lower cost funding through covered bonds, however it is unlikely that many smaller regional banks, credit unions or building societies would be able to access funding through such an instrument.

Furthermore, the promise that the issue of covered bonds will have flow on effects for other lenders because of reduced competition in other funding markets seems to be illusory. It seems unlikely to Abacus that a major bank will let go of one source of funds simply because it has found another source of funds. A more likely proposition is that the additional funds will be used to strengthen the position of those banks that issue covered bonds, to the detriment of other participants in the market.

If covered bonds are to be allowed, credit unions and building societies hope that corresponding support is provided to smaller lenders for whom the covered bond market will be largely closed.

Other measures – RSAs and FHSAs

Recommendation 4

The Government should reject the Cooper Review recommendation to phase out RSAs and recognise these accounts as a viable and effective investment choice for some consumers.

The Government should encourage savings by amending the four year qualifying period for First Home Saver Accounts to make these accounts more attractive for consumers.

Retirement Savings Accounts

Abacus strongly objects to the Cooper Superannuation Review recommendation to phase out retirement saving accounts (RSAs). Abacus has asked the Government to categorically rule out this recommendation when it responds to the Cooper Review by the end of 2010.

The recommendation is based on flawed assumptions and amounts to a denial of consumer choice.

The Cooper review found that RSAs “seem not to meet the low-cost objective for which they were originally intended” when in fact credit union RSAs are very low cost, with very few fees and very low fees.

Banks appear uninterested in RSAs, with only one bank on APRA’s list of RSA providers, while customer-owned banking institutions see the product as viable and in demand. In addition to the 8 credit unions listed on APRA’s website a large regional building society, a regional credit union and two industrial credit unions are poised to enter the RSA market, with a wider group of mutual banking institutions indicating interest in the product. The Cooper recommendation on RSAs has put these business decisions on hold.

The most recent entrant into the market, Defence Force Credit Union, has experienced strong growth in RSAs and sees a growing demand for the product from its members.

Currently, guaranteed returns of up to 6.25 per cent are available on credit union RSAs. Such returns compare extremely well with other forms of superannuation.

Other benefits of RSAs to consumers include:

- choice of investment options between variable interest rate or fixed rate or a combination of both;
- an easily understood and transparent product without advisory fees; and
- ease of transition to retirement with account based pensions.

Benefits of RSAs to providers and their communities include:

- diversifying the funding base of customer-owned ADIs, enhancing their capacity to provide competition and choice in the retail banking market;
- access to retirement savings to fund home lending, personal lending and small business lending; and
- regional capital is invested in the region instead of being drained away from regional communities to fund managers in Sydney or Melbourne.

FHSAs

First Home Saver Accounts (FHSAs) have proved a disappointment and some further changes are needed to improve the product and achieve the policy objective of more young Australians saving a deposit for their first home.

According to APRA, as of June 2010, there are 22,600 FHSAs holding \$114 million. Compare this with the Government's estimate in 2008 that FHSAs would hold savings of around \$6,500 million after four years.

The FHSA idea has significant potential to assist first home buyers to save for a deposit. A larger pool of FHSAs would also potentially increase competition in home lending by augmenting access to funding by competitors to the major banks. Of the 19 ADI FHSA providers listed on APRA's website, 15 are Abacus members.

The Government's 2010 Budget announcement of measures to improve the flexibility of FHSAs was welcome. Allowing FHSA savings to be paid into an approved mortgage after the end of the minimum qualifying period rather than requiring the savings to be paid into superannuation is an improvement. However, some further action is needed to remove the key obstacle to consumer acceptance of the product.

Given that an individual who makes a contribution of \$5,500 to their FHSA will be eligible for a Government contribution of \$935 and FHSA earnings are taxed at 15 per cent, why isn't this product more successful? Why aren't first home savers queuing up to get into a guaranteed investment with a guaranteed return of 20-23 per cent and a concessional tax rate?

We have no doubt that the key problem with FHSAs is the four-year minimum qualifying period. The most consistent issue that appears in feedback to Abacus from credit unions and building societies about FHSAs is that the four-year 'lock-up' requirement is too long and is the single most important disincentive for savers.

Abacus recommends removal or reduction of the period of time during which savings in FHSAs can't be withdrawn. The Government contribution is incentive enough to ensure that savers contribute over a number of years. A minimum period is an unnecessary disincentive and penalises savers who have the opportunity to buy a house within the 'lock-up' period.

3.2. Empowering customers

There is persistent evidence that major banks continue to benefit from entrenched misconceptions about the regulatory framework and the scope of the FCS (see attachment A *Consumer Perceptions*).

Consumer surveys consistently reveal profound ignorance about the prudential regulatory framework and the prudential standing of regulated banking institutions.

During the GFC numerous “experts” engaging in public debate about the safety of customer deposits were frequently and alarmingly wrong about the Australian prudential regulatory framework for deposit-taking institutions. Given that these public commentators did not understand the prudential status of ADIs, the general public’s level of understanding is a matter of significant concern. If consumers are not informed they can’t make informed choices about where to seek a home loan or a competitive return on a deposit.

Just this month a professor of economics and finance was on ABC radio in Victoria telling listeners that “banks are probably safer than credit unions” and “I would be very surprised if you would find a building society in Australia today.”

This sort of “expert” commentary perpetuates the misconception that big banks are safer than other ADIs and that there is no real choice in the banking market outside major banks.

If entrenched misconceptions are not effectively addressed, the community is tolerating market failure in a market that touches every consumer.

Abacus proposes a number of measures to empower consumers and therefore increase competition in retail banking.

“Authorised Banking Institutions”

Recommendation 5

The Government should improve consumer understanding of prudentially regulated lenders by changing the terminology applying to Authorised Deposit-Taking Institutions (ADIs) to Authorised Banking Institutions (ABIs).

All ADIs - credit unions, building societies and banks - are subject to the same strong prudential regulatory regime, with the same set of strict, legally-enforceable prudential standards covering capital, liquidity, risk management and governance.

All ADIs are subject to rigorous and close supervision by APRA, which requires the ADI to comply with a range of requirements contained in Prudential Standards and provide comprehensive data to APRA under its reporting standards. APRA has a range of powers it can exercise should an ADI not comply with any of the requirements imposed by APRA.¹⁷

“Banking business” is defined in the *Banking Act 1959* as both taking money on deposit (otherwise than as part-payment for identified goods or services) and making advances of money.

This is what all ADIs do.

¹⁷ How to apply for ADI authority APRA website <http://www.apra.gov.au/ADI/ADI-authorisation-applications.cfm>

However, using its powers under s66 of the Banking Act, APRA restricts use of the terms 'bank' and 'banking' to a minority of ADIs. ADIs that have at least \$50 million in Tier 1 capital can apply to call themselves banks.¹⁸

The \$50 million hurdle has been in place since 1992 and was seen by the RBA, APRA's predecessor as banking prudential regulator, as a "means of discouraging unsuitable shareholders from attempting to gain a banking authority."¹⁹ The RBA's 1996 submission to the Financial System Inquiry (FSI) said that in "a world where financial institutions of doubtful pedigree are always scouting for opportunities, the minimum capital requirement for a bank is an excellent screening device."

The RBA at that time also took the view that to "provide the relatively broad range of services expected of banks requires sufficient capital to acquire the necessary expertise and technology, and to generate the required degree of confidence."

The FSI's final report in 1997 adopted the position that a "continuing distinction between banks and other DTIs remains relevant in an international setting and in distinguishing those entities large enough to maintain an exchange settlement account with the RBA from other, smaller DTIs."²⁰ The FSI said "authority to use the word 'bank' in its brand should be reserved for licensed DTIs which meet two additional conditions: satisfy a minimum capital requirement as prescribed by the [APRA] from time to time (the Committee suggests retention of the current \$50 million): and, have an exchange settlement account with the RBA."

Abacus argues that in 2010 the continuing restrictions around the term 'bank' and 'banking' that exclude the majority of regulated banking institutions have long outlived their original rationale. Allowing only a minority of regulated banking institutions free use of the terms 'bank' and 'banking' is unjustified and anti-competitive.

The original distinction between 'banks' and other deposit-taking institutions, based on an arbitrary level of capital and a vague concept that a 'relatively broad range of services [is] expected of banks', was never well-founded and is now clearly anachronistic.

The RBA's successor as prudential regulator, APRA, has a much wider and stronger array of powers to screen out "doubtful" and "unsuitable" applicants for a banking licence. These include prudential standards on governance and 'fit and proper' requirements for directors and senior managers.

With regard to exchange settlement accounts (ESAs), smaller banking institutions, such as credit unions and building societies, do not need to hold an ESA with the RBA because they can access settlement services and the payments system through central ADIs owned by the sector with specialist expertise such as Cuscal, Indue and ASL. However, a number of Abacus member banking institutions have exercised their option to become ESA holders.²¹

¹⁸ ADI authorisation guidelines APRA website <http://www.apra.gov.au/ADI/upload/ADI-Guidelines-11-4-08.pdf>

¹⁹ RBA submission to Financial System (Wallis) Inquiry, 1996

²⁰ Financial System Inquiry Final Report March 1997 (Wallis Report).

²¹ Greater Building Society, Heritage Building Society, IMB Ltd, Police Department Employees Credit Union.

Credit unions and mutual building societies, as customer-owned institutions, obviously value their distinct identity from banks but the reality is the terms “bank” and “banking” are well understood in the community. The term “ADI” is not well understood a decade after it entered the statute books. The term is barely used even in Government publications:

- the Report on Australia’s Future Tax System released on 2 May 2010 recommends a tax cut for interest income but refers to “*bank accounts*” and “*bank deposits*”;²² and
- ASIC’s June 2010 updated regulatory guide on advertising of debentures and unsecured notes refers throughout to “*bank deposits*”²³.

ADIs that do not have the option of describing their activities, in well understood commonly used terms, are at a competitive disadvantage. They must comply with an intrusive, constantly-evolving, burdensome regulatory regime to engage in the business of banking but they are denied the full competitive benefit of achieving compliance.

A simple step to improving market awareness of the prudential standing of all regulated banking institutions - and therefore contestability, competition and choice – would be to replace the term “Authorised Deposit-taking Institution” with “Authorised Banking Institution”.

This change would be a simple tool to allow credit unions and building societies the opportunity to have their prudential standing better understood by consumers. It is clear that ongoing lack of information and misconceptions are inhibitors to consumers exercising choice and leaving one banking institution for another.

Changes to the language of banking regulation are far from merely cosmetic. Consumer perceptions about security and prudential standing are critical factors in the banking market. The changes we propose increase the capacity of smaller banking institutions to deliver simple, cut-through messages to the market that they are subject to the same regulatory standards as major banks and that their depositors are covered by the FCS.

“Mutual Banks”

There are 27 mutual ADIs that have at least \$50 million in Tier 1 capital (though as far as Abacus is aware, none have to date opted to apply to call themselves a “bank”). The majority of mutual ADIs are currently ineligible, due to APRA policy, to apply to use the term “bank”. Credit unions and building societies have APRA’s express consent to use the term “banking”. They may use the term “banking” in relation to “the banking activities of the building society or credit union if the word is not used in a misleading or deceptive way.”²⁴

However, new uncertainty about the scope of this consent was raised last year when APRA indicated to one Abacus member ADI that a complaint had been lodged about the ADI’s use of the word “banking” in its marketing material and that the ADI could be in breach of section 66.

APRA should allow all ADIs the non-compulsory option of marketing themselves as “banks”. This would enable Abacus members to exercise the option of marketing themselves as “mutual banks” to the market generally or to market segments where the terms “credit union” or “building society” are less effective.

²² Australia’s Future Tax System, Report to the Treasurer, Part One, Overview, December 2009

²³ ASIC Regulatory Guide 156

²⁴ Guidelines – Implementation of Section 66 of the Banking Act 1959. APRA January 2006.

<http://www.apra.gov.au/ADI/upload/Guidelines-Implementation-of-Section-66-of-the-Banking-Act-1959.pdf>

These changes to the Banking Act and APRA's approach would give mutual banking institutions greater capacity to cut through misconceptions that they are not as safe as listed banks and that they are not covered by the FCS.

It is unlikely that many mutual banking institutions will embrace the term "mutual bank". Indeed in the current market, it is likely that credit unions and building societies would choose to differentiate themselves from the majors. Abacus members with very strong brand strength in their regional areas and other market niches have no need or desire to use the term bank in their core markets.

The objective of the change is to enable all regulated banking institutions, whether listed or customer-owned, to effectively promote their status as prudentially-regulated entities covered by the FCS.

Genuine regulatory neutrality does not mean any loss of diversity in the banking market. The key distinguishing factor of mutual banking institutions is their strong customer focus, as demonstrated by their consistent market-leading performance in customer satisfaction surveys.

Prior to 1998, building societies seeking to become "banks" were required to demutualise. Most building societies that converted to banks in the 1980s and 90s have since merged with other banks and disappeared completely or continue to exist only as part of a major bank's brand strategy. These include St George Bank, Advance Bank, Challenge Bank, Bank of Melbourne, Tasmania Bank, Metway Bank, and Adelaide Bank.

The Productivity Commission reflected on the term "bank" in its August 2010 research report²⁵ on regulatory burdens on business.

"Historically banks in Australia have usually been larger businesses than building societies or credit unions and might, therefore, be thought to offer a greater level of security and a wider range of services. But that is not always the case. The largest building societies and credit unions (such as Credit Union Australia, Heritage Building Society, Newcastle Permanent Building Society and IMB) are larger than, or of similar size to, the smallest Australian owned banks (Members Equity Bank and AMP Bank). The largest mutuals are also significantly larger than a number of the foreign subsidiary banks operating in Australia.

"It would seem, *prima facie*, that there is little beyond the name 'bank' to distinguish some credit unions and building societies from banks. It would be useful to remove any unnecessary restrictions which limit the ability of building societies and credit unions to compete with banks on a level playing field. The current restrictions on the use of terms such as 'bank' by other ADIs could be reconsidered," the Productivity Commission said.

Account switching

Recommendation 6

The Government and industry should investigate ways to reduce actual or perceived impediments to switching accounts. The Government should also fund an awareness campaign that reduces consumers misconceptions about the difficulty of switching.

Customer mobility is fundamentally important to competition in consumer banking services.

²⁵ Annual Review of Regulatory Burdens on Business: Business and Consumer Services. August 2010 Research Report, Productivity Commission

A number of barriers can be removed or reduced to make switching easier. Abacus member ADIs have pointed to two factors that could be improved for borrowers wanting to switch lenders:

- having to pay a new lender's mortgage insurance (LMI) premium on the new loan (where applicable) without obtaining a rebate on the LMI premium on the previous loan; and
- long delays in discharge and settlement by the current lender.

The February 2008 account switching protocol is a significant improvement in making it easier to switch transaction accounts but consumers still think switching is too hard.

A November Newspoll²⁶ survey conducted for consumer group Choice found that only 7.6 per cent of Australians had switched accounts in the past two years.

A more recent poll, conducted in November by Essential Research on behalf of Abacus, found that 40 per cent of respondents said they had considered changing their main bank at some point in the last five years, but two-thirds of this group ended up sticking with their current bank. Of those that wanted to change but didn't:

- 41 per cent said it was too difficult;
- 23 per cent there were fees and charges attached to shifting; and
- 28 per cent said there was no point as all banks were the same.

The transaction account switching protocol should be promoted more effectively to overcome customer misconceptions. A 2008 study by the UK Office of Fair Trading (OFT) of transaction accounts found that "despite the concerns that customers have about switching, many of those who do switch find it relatively easy and trouble free."²⁷

As noted above, trust and perceptions of safety are still important factors that influence a decision to switch providers, particularly for those consumers who hold a high level of savings.

The UK OFT, in a paper out this month, found that "consumers' willingness to consider a new or unfamiliar personal banking [provider] is low. The lack of trust in unknown brands may make some consumers reluctant to switch to new entrants despite the financial benefits these brands may be offering. The highest proportion of consumers willing to consider an unfamiliar provider was found for loan product providers, which may reflect consumers being more comfortable borrowing money from unfamiliar names than depositing money with them."²⁸

Further measures that reduce the time and effort associated with switching should be explored in consultation with industry. One of the main problems is the administration associated with it, such as the need to undergo identity checks with the new institution and lingering difficulties with direct payments. Account number portability is an idea that should be examined, but the legal and compliance hurdles, along with their associated costs, are likely to be considerable, particularly for smaller mutual institutions.

"The concept of a portable account number or indeed a portable mortgage sounds promising," says an Abacus member ADI, "however, there are a number of challenges, including that the sheer scale of the Big 4 means that any solution requires them to participate and will be designed to suit their purposes more than smaller participants."

²⁶ <http://www.choice.com.au/media-and-news/media-releases/2010%20media%20release/choice%20launches%20better%20banking%20campaign.aspx>

²⁷ Personal current accounts in the UK – An OFT market study. UK Office of Fair Trading. July 2008.

²⁸ Review of barriers to entry, expansion and exit in retail banking. UK Office of Fair Trading. November 2010

Credit unions and building societies support the Government investigating ways to reduce actual or perceived barriers to switching.

3.3. Saving incentives

Taxation of deposits

Recommendation 7

The Government should bring forward and enhance its proposed taxation incentives on ADI deposits to promote household savings.

ADI deposits are the simplest, safest savings vehicle for Australian households and the most important source of funds for home lending but deposits are the most heavily taxed savings vehicle.

The Henry Review found that the real effective marginal tax rate on a “bank account” could be as high as 80 per cent.²⁹

The impact over the long term of this tax treatment is the steady decline of deposits as a share of domestic savings.

In 1990, around 29 per cent of the total value of financial asset holdings of Australian households was held in the form of deposits with Australian ADIs. By mid-2007 that share had fallen to 18.5 per cent. This steady downward trend was interrupted by the global financial crisis with the figure increasing to 23.9 per cent in March 2010. However, the favourable taxation treatment of superannuation is likely to see the long-term trend resuming.

Measures to ease the taxation burden on household deposits would increase the size of the deposits ‘pie’ for all ADIs and lower funding costs.

The Henry Review recommended a 40 per cent savings income discount to individuals for non-business related net interest income.

The Government announced in the 2010 Budget that it would introduce a 50 per cent tax cut on interest income, but capped the eligible amount at \$1000. It has been estimated the measure would deliver a maximum tax cut of \$232 for a taxpayer in the highest tax bracket. The measure was originally due to commence in 2011-12 but has been deferred until 2012-13 and the cap reduced to \$500. The cap will be lifted to \$1000 from 2013-14.

This measure is a welcome step in the right direction but is too modest to change the long term trend against saving in deposits.

“The tax discount on interest earned is a correct solution that will assist to address the gap in retail funding versus retail lending, but the current \$1,000 threshold is completely inadequate to make any difference to the mindset of Australian investors,” comments an Abacus member ADI.

Those bearing the brunt of the high real tax rates on interest earnings on ADI deposits are not those Australians with the greatest capacity to pay tax. They are disproportionately lower-middle to middle income Australian working families and Australian households headed by a

²⁹ Australia’s Future Tax System, Part Two, Volume 1. December 2009

person who is near or above 60 years of age – holding a modest overall level of wealth but financially risk averse.

Mutuals & franking credits

Recommendation 8

The Government should consider the introduction of a mechanism to allow mutual ADIs (or all ADIs) to release franking credits to members investing in deposit, or deposit-like, products.

Mutual ADIs pay company tax just like listed banks but mutuals do not have the same capacity to distribute franking credits.

Listed banks distribute franking credits to shareholders via dividends. Mutuals provide benefits to their shareholders (i.e. their customers) in the form of pricing and service. Should a mutual choose to provide an additional benefit in the form of a cash dividend attached to a security, the level and type of the dividend is tightly constrained by ASIC Regulatory Guide 147.

Mutual ADIs continue to accumulate franking credits but are unable to readily distribute them.

Mutual ADIs would like to explore with Treasury ways to unlock franking credits for the benefit of their members, including options to attach franking credits to deposit, or deposit-like, products.

Introduction of a mechanism to allow mutual ADIs to release franking credits would strengthen the attraction of the mutual model by delivering a significant new tangible benefit to membership – one that members have effectively already paid for through the corporate taxation of the mutual's profit.

Such an amendment could be more broadly applied to non-mutual ADIs that chose to return benefits to members rather than shareholders.

3.4. Improving efficiency

Anti-competitive impact of GST input taxing

Recommendation 9

The Government should update the GST RITC item “Credit Union Services” to cover mutual building societies.

The Henry Review confirmed that GST “input taxation” of financial services “gives large, vertically integrated businesses an advantage over smaller competitors.”

Credit unions and building societies globally operate aggregated systems that support the efficient and prudent operation of mutuals. The development of ‘central’ ADIs with specialist payments and wholesale funding expertise as well as aggregated core system support is a feature of every credit union system operating globally. In the vast majority of jurisdictions this mutual system structure is recognised in regulations and taxation systems. However, Australian credit unions and building societies operate with limited recognition in these areas.

As Henry recognised, big banks have the capacity to ‘self-supply’ goods and services to reduce their tax burden.³⁰ Credit unions and building societies rely on outsourcing to obtain economies of scale and therefore carry a heavier GST burden than the major banks.

A specific measure introduced to counter this anti-competitive impact of the GST in financial services is becoming redundant and urgently needs updating.

GST reduced input tax credits (RITCs) were introduced to address the bias creating by GST input taxing to in-source certain acquired inputs. Treasury reviewed the RITC framework last year but to date has not indicated support for our submission, lodged in July 2009, to amend the existing RITC item 16 “Credit union services” so that the item covers mutual building societies as well as credit unions.

Abacus’ services to its credit union and mutual building society owners include:

- government and regulator relations;
- media representation;
- regulatory compliance systems and support;
- legal advice;
- business advisory services;
- research and market intelligence; and
- systems to fight fraud and financial crime.

A large bank can self-supply these services and reduce its GST burden and therefore can gain a competitive advantage on smaller competitors whose business models and industry structures have always involved significant outsourcing.

Since the RITC framework was enacted the consumer banking market has undergone significant change, including continuing consolidation among mutual ADIs and the rationalisation of industry support bodies. These changes include the prospect of mergers between credit unions and mutual building societies.

³⁰ Australia’s Future Tax System, Part Two, Volume 1. December 2009

What has not changed is the self-supply bias of GST input taxing.

The policy intent of RITC item 16 is not being fulfilled due to the narrow definition of the item and the evolution of the mutual ADI sector. Services provided by Abacus to mutual ADIs that assist mutual ADIs to compete with major banks carry the full GST burden whereas the same services provided in-house by a major bank do not bear this burden. This further tilts the playing field in favour of big banks.

Regulator support for aggregation proposals

Recommendation 10

Regulators should take a positive approach to the mutual sector's aggregation proposals designed to achieve economies of scale and access new sources of funding.

The attitude of key regulators is an important factor in the capacity of the mutual banking sector to continue to deliver competition and choice and to develop a vibrant and diverse banking market.

APRA is the most important regulator for banking institutions and is, in effect, a gatekeeper for innovative proposals such as those undertaken by the AMG and proposed by the ABS group.

APRA is single-minded about stability and financial safety but the mutual banking sector would like to see this powerful regulator take a more pro-active approach to its statutory obligation to take into account efficiency and competition.

APRA's Act requires the regulator to "to balance the objectives of financial safety and efficiency, *competition, contestability and competitive neutrality*."³¹

The corporate regulator ASIC has the capacity to promote a more competitive banking market by engaging positively with aggregation proposals that involve corporate restructuring.

ASIC can also make an important contribution by prioritising banking consumers when exercising its consumer education responsibilities and by making a renewed effort to enable consumers to exercise real choice. Informed consumers are empowered and motivated consumers.

³¹ *Australian Prudential Regulation Authority Act 1998*, Section 8(2).

Additional comments on terms of reference

(a) the current level of competition between bank and non-bank providers.

(See above)

(b) the products available and fees and charges payable on those products.

(See attachment *Market Leading Products*)

(c) how competition impacts on unfair terms that may be included in contracts.

Abacus notes concerns about “unfair” exit fees on mortgages. A recent University of Melbourne study found that credit unions and building societies have on average the lowest exit fees in the market. Abacus does not support banning exit fees. Such a ban would have its most severe impact on wholesale funded lenders who have much higher exit fees on average.

ASIC has recently issued some regulatory guidance about how it will enforce new laws that ensure that exit fees cannot be excessive. ASIC has strong powers under the credit laws and under the ASIC Act to crack down on unconscionable and unfair fees.

(d) the likely drivers of future change and innovation in the banking and non-banking sectors.

Consumer demand and technology are likely to be the main drivers of change and innovation.

Online banking is becoming faster and more convenient and migrating to mobile devices. A number of ADIs, including Community First Credit Union, have iPhone banking apps, allowing their customers to replicate most things they can do on a PC.

Qantas Staff Credit Union and Victoria Teachers Credit Union have recently launched real-time online identity verification processes in a move that appeals to younger, more technology-literate customers and makes switching financial institutions easier.

Innovation in retail banking has mostly been limited to products, services and markets. Arguably there has been little in the way of ‘radical innovation’, defined by the IBM Institute for Business Value as “*Totally new things for new markets and/or customers*”³².

A wider scope of innovation covers business models and operational processes. Focusing on product innovation tends to serve only as a temporary differentiator because customers can imitate. Examples of business innovation include financial institutions:

- without their own products;
- that enter new markets without a local presence (using direct internet banking); and
- that provide health and wealth related offerings (such as savings bonds for nursing homes) to an ageing population who need help managing these overlapping needs.

Consumers today want a more personalised banking experience and products that are tailored to their specific needs. For example, a 2009 survey by US IT research and advisory company, Gartner Inc, found that consumers ranked highly the ability to set up a separate account to

³² Solving the innovation puzzle, a framework for consistent innovation in banking & insurance, IBM Institute for Business Value, October 2010

save for a specific goal and valued the ability to customise their online banking experience.³³ Mutuals are leaders in providing a more personalised and customised banking experience and are well placed to respond to these trends.

(e) the ease of moving between providers of banking services.

(See above)

(f) the impact of the large banks being considered 'too big to fail' on profitability and competition.

(See above)

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

(See above)

(h) opportunities for, and obstacles to, the creation of new banking services and the entry of new banking service providers.

(See above)

(i) assessment of claims by banks of cost of capital.

The RBA regularly comments on banks' funding costs.

(j) any other policies, practices and strategies that may enhance competition in banking, including legislative change.

Comprehensive credit reporting

Introduction of more comprehensive credit reporting (CCR) should be prioritised.

CCR gives all lenders the capacity to compete on a more equal footing. Consumers will be less reliant on existing institutional relationships to obtain credit. More comprehensive reporting promotes competition in credit markets by reducing information barriers for small or new credit providers.

The Australian Law Reform Commission, in an August 2008 report, recommended the introduction of CCR, including repayment history information, subject to the introduction of responsible lending obligations on lenders.³⁴

Responsible lending obligations have subsequently been legislated as part of the consumer credit reforms. A draft bill to introduce CCR is expected to be released by the end of the year but implementation of CCR is still at least 18 months away on the currently indicated timetable.

³³ Top Five Online Banking Features Address Communication and Personalization, Gartner Inc, July 2009

³⁴ <http://www.alrc.gov.au/publications/report-108>

(k) comparisons with relevant international jurisdictions.

Australia has a large mutual banking sector in international terms. Australian credit unions are the third largest globally based on assets (\$50.6bn), ranking behind Canada (\$229.7bn) and the United States (\$896.8bn)³⁵.

The United Kingdom also has a large mutual banking sector but this is dominated by building societies rather than credit unions, with the UK having the largest sector globally. There are 50 UK mutual building societies. The dominant player is Nationwide, which accounts for more than half the sector in terms of assets. The sector holds approximately £245 billion of savings. Credit unions have around £1.4 billion assets and more than a million people are members of credit unions, which are local and restrict their membership to particular criteria such as geography or workplace.³⁶

Mutual financial institutions are well supported globally, particularly in Europe, and Abacus believes Australia could take a similar lead in principle. Some key international facts include:

United Kingdom

- In September 2009, the UK Government established an expert group of key stakeholders to advise HM Treasury on the strategic issues affecting building societies, including shared operating models and capital raising;³⁷
- In 2010, the Cameron Government launched details of its “Big Society Bank” concept, a wholesale bank which, among other things, would support co-ops, mutuals, charities and social enterprises; and
- The concept of ‘re-mutualisation’ of large financial institutions gained significant traction in the United Kingdom between 2008 and 2009 following the nationalisation of a failing Northern Rock bank.³⁸

North America:

- All US credit union members are protected by a government backed ‘share insurance’ scheme of \$250,000 per member;
- Many Canadian credit unions are covered by unlimited government guarantees explicitly designed to support their growth and competitiveness;
- US credit unions are tax exempt entities;
- Small Canadian credit unions pay reduced income tax, whereas the larger entities pay the same rate as banks;
- Recent changes announced in March 2010 by the Canadian Government will allow credit unions to enter a new, federally regulated system, which would in turn allow them to expand outside their provinces and unrestricted use of the term ‘bank’.

Whilst North American and European banks suffered the brunt of the global financial crisis, credit unions and building societies fared reasonably well, so much so that there is a groundswell of public support in the UK for ‘remutualising’ failed banks that were once mutuals themselves.³⁹ In fact, mutuality achieved a renewed focus in the United Kingdom in the wake of the global financial crisis, with HM Treasury noting, in its July 2009 report *Reforming Financial Markets*:

³⁵ World Council of Credit Unions, 2009 Statistical Report, as at 31 December 2009, www.woccu.org . APRA statistics released November 2010.

³⁶ Independent Commission on Banking – Issues Paper Call for Evidence, September 2010 (UK)

³⁷ HM Treasury, *Reforming Financial Markets*, July 2009, Page 133 (9.67)

³⁸ <http://www.guardian.co.uk/commentisfree/2008/nov/21/comment-building-societies-remutualise>

³⁹ <http://www.nebusiness.co.uk/business-news/latest-business-news/2010/11/04/poll-backs-mutual-future-for-northern-rock-51140-27599179/>

9.41 *Another way of encouraging choice and competition is to encourage and support alternative business models.*

9.42 *The Government has a long-standing aim of supporting the UK mutual sector to thrive and serve a wider section of the community.*

9.44 *...it is the Government's view, however, that the traditional mutual model has, on the whole, stood up well. The Government believes that financial mutuals can provide a robust alternative to financial services companies in the future. In order to have this strength for the future, it is important that the mutual sector has: good corporate governance; a modern legislative and regulatory framework; and, access to capital and funding through modern markets.*

Recognising the characteristics of mutuals in regulation

Australian credit unions are the only credit unions globally to operate under a fully harmonised regulatory environment that makes no accommodation for the different capital structure and national support system built by the sector. We are also the only system to operate under a fully Basel compliant framework – a system designed for large internationally operating banks.

The Basel Committee has recently made its first formal recognition of the lower risk and different capital models of mutuals, and in most comparable jurisdictions a more targeted compliance regime that reflects the simpler operating model of member-owned banking institutions.

We strongly encourage consideration of effective and targeted compliance regimes that reflect the relevant risks and support the mutual system mitigants in Australian regulation.

(l) the role and impact of past inquiries into the banking sector in promoting reform.

Abacus has addressed similar issues and made similar recommendations to those contained in this submission to the following Parliamentary inquiries:

- Senate Economics Committee inquiries into Bank Mergers, Bank Funding Guarantees and Access of Small Business to Finance;
- House Economics Committee inquiry into Competition in the banking and non-banking sectors;
- House Infrastructure, Transport, Regional Development and Local Government Committee inquiry into the GFC and regional Australia.

(m) any other related matter.

(See above)

Attachment A: Consumer perceptions

Major banks benefit from consumer misconceptions that they have a higher prudential standing than other regulated banking institutions.

Recent research by Brand Central⁴⁰ found that major banks are seen as stronger and more reliable than smaller banking institutions.

The survey found that bank customers believe credit unions and building societies behave more responsibly than the major banks, but they are still more likely to take their business to the big four lenders because customers think the major players will be around longer. (This is despite the fact building societies have been around for more than 100 years and credit unions for more than 60 years.)

A key finding of a June 2009 survey⁴¹ of consumer attitudes about the guarantee of “bank deposits” was that 15 per cent of adults were not aware of the guarantee.

The other key findings of the IFSA survey provided to the Senate Economics Committee into the deposit and wholesale funding guarantees were:

- When asked how long the guarantee would last, only 8 per cent stated it would last 2.5 to 3 years, 50 per cent for a shorter duration, 6 per cent thought it would last longer and 18 per cent said they didn't know;
- Only about a quarter (28 per cent) correctly said that the guarantee covers \$1 million, 29 per cent thought it covered a smaller amount and 14 per cent a larger amount; and
- 30 per cent say they would feel comfortable investing money in banks with no guarantee after the global financial crisis has passed.

Research by CoreData⁴² reported in March 2010 indicated that “mutuals are considered the least secure segment for retail deposits in Australia”. The research indicated that only 13.7 per cent of respondents consider deposits held by credit unions and building societies to be ‘very secure’ while 13.9 per cent considered mutual deposits to be ‘somewhat not secure’. In contrast, 49.5 per cent of respondents considered a deposit with a big four bank as ‘very secure’ and only 4.5 per cent considered deposits with the big four ‘somewhat not secure’.

“It's clear from these results that Australians have not understood the deposit guarantee, perceiving safety based on the size and awareness of a banking brand,” CoreData said.

According to findings by Sweeney Research⁴³ for the current national industry promotion campaign for credit unions and building societies, negative associations for credit unions and building societies include the perception that they are not backed by the Federal Government guarantee. Key barriers to switching to a credit union or building society include “many consumers are hesitant to move beyond the security of the Big 4 banks” and “overcoming the perception that credit unions and building societies are not being backed by the Federal Government guarantee.”

⁴⁰ *Stability attracts customers* Australian Financial Review 16 April 2009

⁴¹ *IFSA: The Government's Guarantee on Bank Deposits* Investment Trends, June 2009

⁴² *Misunderstood Mutuals* Burningpants, CoreData, March 2010 <http://www.burningpants.com/2010/03/misunderstood-mutuals/>

⁴³ *Advertising Concept Testing – Credit union and building society group*. Sweeney Research, October 2009

“Credit unions and building societies are generally better regarded than banks on most of the attitudinal measures included for testing. However, perceptions of accessibility, financial expertise and the security of credit unions and building societies are clearly inferior to banking institutions,” according to the Sweeney Research work.

According to a Datamonitor survey⁴⁴ of depositors’ reasons for choosing their main account provider, depositors rank safety and stability ahead of other factors such as service, location of branches, and recommendations by friends and colleagues.

⁴⁴ Datamonitor survey, Market Scan 2010, Abacus, March 2010

Attachment B: Market leading products

AB+F Awards 2010

- Credit Union of the Year - CUA
- Building Society of the Year - Heritage Building Society

AFR Smart Investor Blue Ribbon Awards 2010

Basic Loan

Finalist - mecu
Winner - Greater Building Society

Variable-Rate Loan

Finalists - BankWest, Greater Building Society
Winner - CUA

Low-Rate Card

Finalists - ME Bank, Sydney Credit Union
Winner - mecu

Fixed-Rate Home Loan

Finalist - Greater Building Society

Premium Banking Packages

Finalist - Newcastle Permanent Building Society

Line of Credit

Finalist - Newcastle Permanent Building Society

Term Deposit (30 Days to 330 Days)

Finalist - B&E

Mozo People Choice Awards 2010

Best Credit Unions

Rating out of ten

- | | |
|-----------------------------------|------|
| 1. Victoria Teachers Credit Union | 8.93 |
| 2. Police Credit Vic | 8.73 |
| 3. Teachers Credit Union | 8.61 |
| 4. Police Credit Union NSW/ACT | 8.50 |
| 5. Queenslanders Credit Union | 8.47 |

(All of the above have higher rating than ME Bank and Bendigo Bank)

Best Home Loan

Rating out of ten

- | | |
|------------------------------|------|
| 1. ME Bank | 8.59 |
| 2. Greater Building Society | 8.56 |
| 3. CUA | 8.46 |
| 4. Heritage Building Society | 8.36 |
| 5. Bendigo Bank | 8.33 |

Best Savings Accounts

Rating out of ten

1. UBank	8.91
2. ING DIRECT	8.85
3. Teachers Credit Union	8.75
4. RaboDirect	8.72
5. Newcastle Permanent	8.52

Money Magazine Best of the Best 2010

- Maitland Mutual Building Society – Best Online Savings Account
- Maitland Mutual Building Society – Best Savings Account
- Gateway Credit Union – Best Everyday Accounts (branch access)
- Gateway Credit Union & MyState Financial – Best Everyday Accounts (electronic transactions)
- Cairns Penny Savings & Loans – Best Kids' Savings Accounts
- Holiday Coast Credit Union – Best Pensioner Deeming Accounts
- FCCS & Maitland Mutual Building Society – Best DIY Super Savings Accounts
- Capricornia Credit Union – Best Term Deposits (short term)
- B&E – Best Term Deposits (long term)
- Satisfac Credit Union – Cheapest Credit Cards
- Credit Unions – Cheapest Balance Transfer Credit Cards
- First Option Credit Union – Cheapest Personal Loans
- Teachers Credit Union – Cheapest Car Loans
- Heritage Building Society – Cheapest Home Loan Packages
- Heritage Building Society – Cheapest Flexible Home Loans
- Satisfac Credit Union – Best Three-Year Fixed Home Loans
- BCU – Best Line of Credit Loans
- Savings & Loans Credit Union – Cheapest Business Transaction Accounts
- Newcastle Permanent Building Society – Cheapest Small Business Term Loans

Canstar Cannex Awards 2010

First Home Buyer Awards – Non-bank

- ACT & NSW: IMB
- NT & SA: Australian Central Credit Union
- QLD: Heritage Building Society
- TAS: MyState Financial
- VIC: Hume Building Society
- WA: Police & Nurses Mutual Banking

Car Loan Awards – 5-star Ratings

• Community First Credit Union	Green Loan
• Companion Credit Union	New Car Loan
• Holiday Coast Credit Union	New Car Loan Variable
• Horizon Credit Union	New Car Loan Variable
• Illawarra Credit Union NSW	New Car Loan Sec BOS
• Illawarra Credit Union NSW	Variable Rate Car Loan
• Macquarie Credit Union	New Car Loan <12 months
• Macquarie Credit Union	Secured Personal Loan
• Maleny & District Community	Green Star Car Loan 1
• Memberfirst Credit Union	Personal Loan Sec BOS<3yrs

• NSW Teachers Credit Union	Secured New Car Loan
• Police Credit	New Car Loan
• Police Credit	Used Car Loan
• Qantas Staff Credit Union	Car Loan
• Qantas Staff Credit Union	Personal Loan Sec6mthIntro
• Qld Police Credit Union	New Vehicle Super Sav Loan
• SERVICE ONE Members Bank	Fixed Rate Car Loan
• Satisfac Credit Union	4 Cylinder Car Loan
• Satisfac Credit Union	Car Loan Fixed
• Savings & Loans Credit Union	Discounted Personal Loan
• Savings & Loans Credit Union	Discounted Variable Perl
• Savings & Loans Credit Union	Green Car Loan
• Unicom Credit Union	New Car Loan Secured BOS
• Unicom Credit Union	Variable Rate Car Loan
• Victoria Teachers Credit Union	New Car Loan

Transaction Accounts (High Transactor-Full Service) – 5-star Ratings

• Holiday Coast Credit Union	Payroll Plus Account
• Holiday Coast Credit Union	Save More Savings A/c S2
• IMB	Everyday Unlimited (III, SC)
• IMB	Everyday Unlimited (SYD, ACT)
• Unicredit-WA	On Call Savings S1
• Unicredit-WA	Visa Access S5

Owner occupied Variable Home Loans – 5-Star Ratings

• ECU Australia	Premium Variable Home Loan
• ECU Australia	Premium Variable Home Loan (PV Loyalty Plus Pkg 250+)
• Holiday Coast Credit Union	Home Sweet Home Ln\$250k+
• IMB	Budget Home Loan
• Newcastle Permanent	Premium Plus Pkg <\$500k
• Newcastle Permanent	Real Deal Home Loan
• Qantas Staff Credit Union	Home Plus Honeymoon 1yr
• Qld Police Credit Union	Classic Home Loan
• Qld Police Credit Union	Standard Variable (Classic Plus Pkg \$250k+)
• Savings & Loans Credit Union	Discount Variable \$250k+
• Select Credit Union	Super Mortgage Loan

Attachment C: Fees and charges

Personal Transaction Accounts

Of the 131 personal transaction account products surveyed by Canstar Cannex, 74 of them do not have account keeping fees. Of the 74 who do not charge account keeping fees, 60 (or 81%) are credit unions and building societies.

Mortgage Exit Fees

The University of Melbourne has published a paper reviewing exit fees, or the fees charged by financial institutions for early termination of a variable rate mortgage.

Key results are as follows:

1. Non-ADI home loan providers have not altered their exit fees – they remain at around \$1,900.
2. Neither have credit unions and building societies altered their exit fees – they remain at around \$400, relatively lower.
3. Large banks have reduced their exit fees from \$1,081.25 to \$678.95. This represents a decrease of 37%.
4. Other banks have also decreased their exit fees by 16.3% from \$703.33 to \$588.71.

Over the period 2008 to 2010, the highest exit fees continued to be charged by non-ADI home loan providers and the lowest exit fees continued to be charged by credit unions and building societies.

However, the trend is that the non-ADI home loan providers are now more of an outlier in 2010 than two years ago, as banks have reduced their exit fees.

Among the lenders, banks and other non-ADI lenders have the highest proportion of products with early termination fees.

Early termination fees (ETFs) by lender type

\$250,000 variable rate/loan terminated within 3 years 2010

Lender		ETF	
Large bank		\$ 678.95	
Other bank		\$ 588.71	
Credit union/building society		\$ 419.38	
Non-ADI		\$1,900.65	
Type of Lenders	No. of loan products	No. of loan products with ETFs	% of loan products with ETFs
Large bank	19	15	78.95%
Other bank	31	21	67.74%
CUBSSs	93	38	40.86%
Non-ADI	55	40	72.73%
TOTAL	198	114	57.58%

(Source: Centre for Corporate Law and Securities Regulation, The University of Melbourne)

Attachment D: Accessibility

ATMs

With more than **3,500 machines**, rediATM which is used by many credit unions and building societies is Australia's second largest ATM network, offers direct charge free transactions.

Institutions	Number of ATMs
CBA + BankWest	3,733
rediATM	3,500
Westpac + St George	2,808
ANZ	2,649

(Source: APRA, Cuscal)

Branches

Institutions	No. of Branches as at June 2010
WBC + St George	1,244
CUBS	1,167
CBA + BankWest	1,147
CBA	1,009
ANZ	816
Nab	741

(Source: APRA)

Attachment E: Regulatory environment

Apart from the Banking Act and the APRA Standards, credit unions and building societies are subject, in respect of the products and services they provide, to the same regulatory requirements as the largest financial institutions under:

- the AML/ CTF legislation,
- the National Consumer Credit legislation;
- the Financial Services provisions (chapter 6) of the Corporations Act;
- general consumer protection obligations under the ASIC Act;
- the Cheques Act;
- general/ common law principles as they relate to banking, finance, and securities;
- credit reporting requirements under the Privacy Act, and Credit Reporting Code of Conduct.

In addition, credit unions and building societies subscribe to:

- the Electronic Funds Transfer Code of Practice;
- the Mutual Banking Code of Practice;
- either the Financial Ombudsman Service or the Credit Ombudsman Service (and as subscribers credit unions and building societies must comply with scheme Terms of Reference)

In addition, credit unions and building societies are subject to:

- privacy law obligations, including the National Privacy Principles;
- general corporate law obligations under the Corporations Act and related legislation;
- state and commonwealth taxation laws, including those specific to financial institutions;
- the Fair Work Act, industry Awards and other regulation as employers.

Attachment F: Aggregated balance sheet

Introduction

Over the past decade, the mutual sector has been continually confronted with funding and capital challenges which have been compounded by the increasingly stringent regulatory environment, and further intensified from the effects of the global financial crisis, which has permanently shifted the operating environment of this sector. In the search for scale and continued viability, continuing merger activity risks undermining the niche focus which differentiates credit unions from other market participants.

The Aggregated Balance Sheet (ABS) project investigates whether a different structure exists to facilitate credit unions to access funding more efficiently, access the benefits of scale, and reduce the regulatory compliance burden. The objective is to retain brand, identity and niche focus around specific industry, regional or other bonds, and retain pricing and credit decision-making at the credit union to leverage off existing niches, competitive advantage and customer knowledge.

The proposal

Under the proposed structure, the financial liabilities, assets and supporting capital of participating credit unions will relocate to a central aggregated balance sheet. The centralised balance sheet will be a new ADI, and will have the primary responsibility of asset and liability management via risk-adjusted transfer pricing, as well as risk management, treasury and compliance.

Participating credit unions would retain their AFSL licenses, but would not be ADIs. They will remain as stand-alone entities, complete with their unique brand, boards of directors and management teams responsible for the day-to-day running of their business and the majority of member contact, as well as being responsible for localised pricing, marketing, community management, growing membership, and the identification of new products and services required by their members.

Subject to shareholder agreement, Cuscal Limited⁴⁵ may also similarly transfer aspects of its wholesale balance sheet into the ABS entity, enabling this capability to more sustainably and adequately support the funding needs of credit unions than it can in its current form.

Participating credit unions will remain mutuals, owned by their members, whilst the ABS entity will be owned by participating credit unions.

Merits of the model

For participating credit unions, this approach represents the most efficient utilisation of capital, niche markets, core skills to provide value for credit union businesses and their members. The ABS model provides an avenue to obtain more diverse forms of funding and capital to enable credit unions to grow their business at a pace that takes back market share. It would enable them to access wholesale capital markets in ways that they cannot today. It liberates participating credit unions from the increasing regulatory and compliance burden associated with an ADI status, and an opportunity to maximise the capabilities of streamlining processes and innovative product development.

⁴⁵ Cuscal provides transactional banking, liquidity and capital management products and superannuation solutions to the majority of credit unions and is operator of the rediATM network.

For credit union members and future members, the ABS model provides a sustainable, banking alternative. The capital now retained for prudential purposes can be more efficiently used by centralising regulatory requirements and allowing excess capital to be redirected to member needs and product innovation, including better pricing and services.

Work to date

Preliminary model results from the feasibility study undertaken in Phase One indicate that the ABS model is capable of supporting above-system growth, substantial aggregated benefits for the ABS system, improved return on equity, and access to wholesale and capital markets. An iterative feedback process was undertaken between the participants, the Oversight Steering Group and the project team, whilst advisory, consultation and validation of this work was provided by Cuscal, Deloitte, Blake Dawson, and other independent advisors.

The project has met with, and held a number of meetings with key stakeholders such as APRA, ASIC and Treasury to discuss the proposal in depth and this engagement process will continue throughout the next phases of the project.

Next steps

Phase Two will be focused on further testing and validation of assumptions, a multi-lateral due diligence process between all participating credit unions, development of an independent experts' report, and the application process for ADI and AFSL license requirements.

Subject to support from participants, Phase Two is expected to commence by early January. A joint venture vehicle will be formally established to guide and provide governance the work of this phase.

Concluding comments

The ABS project is an industry-led and an industry-funded initiative. The quantum of work, industry discussion and the momentum and energy observed demonstrates that credit unions are willing to consider substantial structural change to strengthen their operations and step up to provide more competition in the market. This project has the real potential to contribute to the ongoing relevance of the mutual sector.