AUSTRALASIAN MUTUALS INSTITUTE

Submission to the

Senate Economics Reference Committee

relating to

The role, importance, operation and overall performance of co-operative, mutual and member-owned firms in the Australian economy

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1. **Purpose of this Submission**

This submission has been prepared by the Australasian Mutuals Institute (AM Institute) and will focus on the need for access to funding from the Federal Government's Business Industry Skills Fund. It acknowledges that the unique structure of the Customer Owned Banking Sector is being constantly disadvantaged through a lack of understanding and awareness across many aspects of its business operations but will focus specifically on the opportunity to access funding via the Australian Government's Business Industry Skills Fund.

The submission should be read in conjunction with the more comprehensive submissions that will come from the following two sector representing associations:-

- Customer Owned Banking Association (COBA)
- Business Council of Co-operatives & Mutuals (BCCM)

AM Institute will in this submission focus specifically on the challenges for adequately funding skills development across the sector and will rely heavily on the submissions of COBA and BCCM together with submissions from individual co-operatives and mutuals to address the matters referred to the Committee for inquiry and reporting on.

Notwithstanding this approach there will be a need for AM Institute to draw upon some of its own experiences to provide an overview of the business context in which this case for skills development funding is being made.

2. **Alignment of Purpose Between Industry Bodies Representing the Sector**

The Customer Owned Banking Association (COBA) is the peak body for customer-owned banking institutions: credit unions, building societies and mutual banks. Collectively the sector has $92 billion in assets and has the largest share of the household deposits market outside the four major banks. The customer-owned banking sector comprises 75 credit unions, 12 mutual banks and 6 mutual building societies serving more than four million Australians.

The Australasian Mutuals Institute (AM Institute) is a professional association serving the training, education, professional development and networking needs of the directors, managers and staff that work within the Customer Owned Banking Sector. AM Institute works in the interests of its members and the sector generally and in close alignment with COBA in instances such as this submission.

The Business Council of Co-operatives and Mutuals (BCCM) is the national association, led by the chief executives, of Australia's leading co-operative and mutual businesses. Formed in 2013, the BCCM represents the first time the CEOs of member-owned businesses have come together with the single, common objective of increasing awareness of co-operative and mutual businesses and their contribution to the national economy and community development of Australia.

As the only organisation uniting the entire, diverse range of member and customer owned businesses including grain handlers, dairy producers, motoring organisations, mutual insurers, health funds, customer owned banks and credit unions, building societies, member-owned retailers, purchasing and marketing co-operatives, housing developers, and farmerowned agribusiness, the BCCM provides a unique platform for business networking and commercial collaboration within the sector. Raising awareness of our business models is not a stand-alone activity. The BCCM provides leadership in the important areas of education, research, promotion and advocacy, necessary to build a strong sector.

Both COBA and AM Institute work closely with BCCM in areas of common interest.

3. Focus of the Submission Relative to the specific matters referred by the Senate to the Economics Reference Committee

This submission will focus on the following matters referred to the Committee for inquiry:

b) the operations of cooperatives and mutuals in the Australian economy, with particular reference to:

- *economic contribution,*
- *current barriers to innovation, growth, and free competition,*
- *the impact of current regulation.*

4. Disaffection and disadvantage experienced through the lack of understanding and accommodation for the Customer Owned/ Member Owned Enterprise (CME).

Customer Owned/Member Owned Enterprises sit in between the investor owned business model and the not for profit business model.

Like the investor owned model the customer or member owned enterprise seeks to make a profit but rather than siphon off the profits to separate investors the CME distributes the profits for the benefit of the customer/owners either through better priced services or a financial dividend.

It is because of the intrinsic values that exist within credit unions, building societies and mutual banks that the tensions between stakeholder objectives, which can drive perverse outcomes such as seen in the financial advice, are not present.

However from a political, legislative, regulatory, administrative, association and education system perspective this fundamental difference is either not appreciated nor valued sufficiently leaving CMEs to be forced into systems and frameworks designed for either the investor owned or the not for profit enterprise.

There are numerous examples of this that will be well articulated in the other submissions so this submission will focus on the inflexible application process that fails to recognise the sectors co-operative support structures, that has been preventing the sector from accessing the Australian Government’s Business Industry Skills Fund and a fairer share from its predecessor the National Workplace Development Fund.

5. The Role, Importance and Overall Performance of the Customer Owned Banking Sector in the Australian Economy

People helping people and supporting their communities – it is in our DNA. Building societies and credit unions both in Australia and throughout much of the world were formed by ordinary citizens during the 19th & 20th centuries to respond to market imperfections that served to prevent them from accessing credit to purchase their homes and the various consumer items that they needed to support their aspirations for a better life.

In Australia a highly regulated financial system proscribed specific roles for trading and savings banks and classified other potential competitor organisations as non-banks with limited scope to challenge the dominance of the banks. This was a time when the banks would only lend to the well off and access to credit on reasonable terms for ordinary "mums and dads" was simply not available. Credit was of course obtainable on less favourable terms through the dominance of finance companies and payday lenders with a number of the finance companies actually partly or fully owned by the banks.

Deregulation of the banking sector during the 1980's ushered in a whole new banking environment which saw trading and savings banks merge and building societies and credit unions grow their market share to a point where working families now had access to credit for whatever their needs at reasonable rates. There was also an expansion in the non-banks bringing the benefits of the securitised funding model to Australia that began to drive down high interest rate margins on home loans further expanding access and choice with the added benefit of better pricing for consumers.

Since the early 1990's there have been building societies that have converted to listed bank status and more recently both credit unions and building societies that have taken up the option provided by the Federal Government in its ***Competitive and Sustainable Banking Reform Package*** launched in December 2010 to convert to mutual bank status. One of the more significant objectives of the Government's reform package was to support the evolution of the mutual (customer owned) banking sector into the fifth pillar of banking competition in Australia.

Today the Customer Owned Banking Sector is currently made up of 75 x credit unions, 12 x mutual banks and 6 x building societies with $92B in assets serving 4 million members and holding 11.3% of household deposits and 8.4% of the new home loan market and around 5% of the total home loan market. Mutuals provide access to competitive banking services across metropolitan, regional and rural areas throughout Australia and are held in particularly high regard by Members of Parliament from all parties for their long term commitment to regional and rural Australia when the major banks were withdrawing their services.

6. The Customer Owned Banking Sector Operating Model – Current Barriers to Innovation, Growth and Free Competition - Impacts from Current Regulation

The Global Financial Crisis (GFC) back in 2008/2009 has had a significant and enduring impact on the competitive landscape allowing the major banks unprecedented opportunity to grab a stranglehold on market share, the trade-off being evidenced is less 'banking' competition to the detriment of consumers. In the darkest days of the unfolding crisis Governments around the world were understandably fixated on financial system stability regardless of the market competitiveness trade-offs and in Australia the major banks enjoyed the benefits of an unlevel playing field. Some examples of the transactions and events that unfolded during this time include:-

- Competition from the Foreign Owned Banks dried up as they were forced to return their capital to support the recovery operations of their parent companies.
- In the case of HBOS this provided the opportunity for CBA to acquire one of the second tier (or regional) banks namely BankWest.
- The highly competitive business model, based on funding from securitisation rather than retail deposits used by many of the non-banks, broke down and once again the major banks took advantage with CBA acquiring initially 30% of Aussie Home Loans and Westpac acquiring 100% RAMs. Since then CBA has increased its ownership to at least 80% of Aussie.
- Westpac acquired St George Bank (previously building society) itself an amalgam of previously merged building societies.
- Westpac has acquired a further three regional banks (ex building societies) along the way and today utilises a multi brand strategy to access customers that would prefer not to bank with one of the majors.
- The major banks have in more recent times been acquiring large slices of the finance and mortgage broking distribution channel together with financial planning and wealth management businesses.

So in 2015 just four major banks have more than 80% and in some case 90% market share of banking business whilst a greatly reduced number of regional banks compete alongside mutual banks, credit unions and building societies for the remaining small share of the market.

The launch of the Federal Government's ***Competitive and Sustainable Banking Reform Package*** in December 2010 was a clear acknowledgement that the field had been tilted too far towards stability at the expense of a truly competitive market.

The market dominance of the four majors was also a hot topic amongst submissions to the Financial System Inquiry (FSI) and earned considerable response among the recommendations in the report to Government.

Submissions to the FSI also shone a light on the considerable competitive disadvantage that regional banks and customer owned banks now suffer under the Australian implementation of the Basel III Capital & Liquidity Framework. There was also commentary around the propensity of the prudential regulator to continue to focus disproportionally on that part of its mission that talks about financial stability whilst largely ignoring the other components of market efficiency and competitiveness.

In summary there has been a continual flow of outcomes post the GFC that has advantaged the major banks and disadvantaged regional banks and customer owned banking institutions competitive position in the market thereby reducing important choice for the Australian consumer. This has been further exacerbated for the customer owned banking institutions by the prudential regulator's approach to Basel III implementation which has served to severely limit their access to capital instruments that align to mutuality.

One other strategic move by the major banks in particular that is having a big impact in the market has been the taking of effective control by various tactics including acquisition of the finance and mortgage broking sector as a key distribution channel for the banks products particularly mortgage secured loans. With there now being more than 50% of all new mortgage secured loans running through brokers in a market characterised by the lowest interest rates on record and a subdued demand for credit it has become a hugely challenging market for customer owned banking institutions to grow their business.

We are also seeing the resurgence of 'pay day lenders' which it can be argued is linked to reduced competition within the banking sector. This style of lending is in conflict with the sector's history of responsible lending and pricing policies.

Added to all this, there are the market disruptors that are harnessing technology to construct new business models that threaten to 'cherry pick' parts of the banking business whilst avoiding the heavy regulation and costs of being a licensed authorised deposit taking institution.

The answer of course lies in the customer owned banking sector's capacity to innovate both within the individual mutual and collectively across the sector.

One of the founding principles of the co-operative sector generally and the customer owned banking sector specifically is the principle of "co-operation among co-operatives". By way of example the growth of the credit union movement here in Australia from the first registration of a credit union in 1947 through to the $92B in collective assets held today is a tribute to the sector's innovation in both the product offering and the capacity to aggregate services to gain access to economies of scale.

7. Need and Desire to Strengthen the Sector's Foundations through a Well-Targeted Investment in Skills Development

The customer owned banking sector remains under considerable market pressure for all the reasons set out in Section 6 of this submission. This creates a fundamental challenge at the individual mutual level about how best to effectively compete for business in such a challenging market.

In recognition of these realities and the responses under way in other parts of the financial services industry eg mortgage and finance broking, financial planning; AM Institute has been working its way through a significant repositioning of its professional services model designed to provide stronger leadership in the articulation of professional and competency standards for the sector.

For the customer owned banking sector the key lies in making a well targeted investment in the skills of our staff to provide consumers with an increasingly professional banking service tailored specifically to the needs of the customer rather than driven by a staff member's need to maximise their commissions or the banking institutions return on equity targets to satisfy shareholders.

This reality is consistent with key arguments presented by the BCCM Blueprint in November 2014 and the work in the COBA Strategic Vision about the critical importance of education and training.

This skills development task for mutual banking institutions is more complex and difficult to achieve in the frontline staff as the competencies around effective sales skills in todays' environment must be blended with the mutual philosophy that ensures that we are all there to act in the best interests of our customers – not because it may be a regulatory requirement in some instances – but because it is our reason for existence.

Of course a skills development program focused only on sales and customer service skills cannot be effective on its own. There needs to be programs focused on leadership skills, in key areas of credit provision and financial advice, on the ground coaching and in the core competencies of banking.

We know that the major banks have been investing in the skills of their staff and the mortgage brokers particularly from the larger groups have significantly raised the bar in terms of the training and coaching investment in their brokers.

The customer owned banking sector has a great track record for investing in the training of their staff but in recent years the amount available has been seriously diminished by the incredible squeeze on interest rate margins flowing from the lowest level of interest rates on record coupled with a diminished level of demand for consumer credit. And what is still available is mostly applied to technical and compliance training in one of the most prescriptive and heavily regulated industries in Australia leaving very little for investment in the all-important "soft skills".

So notwithstanding all the important issues that COBA and BCCM will raise in their submissions to the Senate Inquiry it is AM Institute's strong contention that on the basis of all the factors covered in Sections 6 & 7 in this submission that the customer owned banking sector needs some Government support for a well-targeted skills development program to add much needed momentum to competition and choice in banking services.

8. Inability to access Federal Government funding programs for sector wide skills development

AM Institute has tried valiantly for almost three years now to access funding for skills development on behalf of the customer owned banking sector but has been thwarted by the design of the program's criteria, an unforgiving and disinterested administration system and the complexities of the interplay between Federal and State Government policy and distribution processes.

Our research commenced around May 2013 in collaboration with our RTO business partner Institute of Strategic Management (ISM). ISM had previously collaborated with the Mortgage and Finance Brokers Association Australia (MFAA) in their successful funding grant of $1.3m in 2013 to drive a mandatory minimum qualification of Diploma for all brokers affiliated with the MFAA.

On the face of it AM Institute was exceptionally well placed to prepare an application that would meet the criteria for funding from the Federal Labour Government's National Workplace Development Fund (NWDF). This fund invited applications both from individual entities and from industry/professional associations on behalf of multiple organisations – the approach that we were seeking to take.

In accordance with the criteria we prepared a strong rationale for the funding (limited to 800 words) and secured a letter of support from COBA together with a highly credible and suitably qualified RTO partner in ISM and a list of some 15 mutuals keen to access funding as soon as it became available.

However there was one criterion that we could not meet on face value – the requirement to include a comprehensive workforce plan for the sector – because our sector at that time was made up of 100 separate legal entities with workforce planning naturally taking place within each of the individual entities.

And so in consideration of the spirit as to why this requirement would have been built into the criteria for the program we prepared the ground to offer the following undertakings:-

- To identify the specific qualifications that would be the focus for the investment in the skills development of the workforce.
- To benchmark, as a condition of their participation in this skills development program, the qualifications of the staff from every one of the mutuals that wished to gain access to the funding for training of their staff prior to any allocation of funding.
- That AM Institute would take responsibility for conducting annual benchmarking surveys across the sector to report back to the administrators of the NWDF on how the funding had been applied to lifting the qualifications of staff in the sector.
- Agreement to the percentage of contribution that each entity would need to contribute towards the further skilling of each of their staff to access the funding in accordance with the table in the criteria eg smaller mutuals entitled to two thirds of the cost, medium mutuals to 50% and larger mutuals to one third.

From this position we thought it prudent to try to engage with the administrators of the fund for their guidance on how best to submit the funding application rather than trigger all the costs on the sector to launch the skills benchmarking process and <u>this is where we ran in to administrative system road blocks and the whole process stalled for many months</u>. There is also a catch all criteria in these types of funds that says no application will be accepted unless it fully meets the criteria as laid down.

The dilemma was that although the NWDF was a Federal program the application process specified that organisations seeking to participate in the program must work with the relevant Industry Skills Council (in our case Innovation & Business Skills Australia or IBSA) to submit an application to the Department of Education, Employment and Workplace Relations or DEEWR). IBSA a state government body had jurisdiction over the Financial Services Training Package which prescribes the vocational qualification requirements for our sector. <u>And therein lay a deep seated problem for us.</u>

IBSA ignored our requests for a meeting to get some guidance which in turn meant that we could not submit our application. We then came to understand that the IBSA view of the world was that the Federal Government had not given them adequate resources to administer the fund and so they didn’t have the means from their own resources to provide any guidance to potential applicants.

From there we heard about industry consultants that worked with IBSA and so we engaged with one of these who certainly tried to be helpful. In fact at one stage we committed well over four hours of our time at the behest of this consultant to work through a recently developed software system to cater for on line applications that was in the “user acceptance” testing phase but in the end not even with the consultant’s help could we break down the determination of IBSA to avoid helping us in any way.

There were many views about why IBSA remained deliberately inaccessible the most likely being that they felt they were under siege from reviews going on at both levels of Government that might threaten their existence. Avoiding all contact with potential clients would hardly seem the way to defend their territory though.

In February 2014 with the help of an experienced person from MEGT we finally went ahead and made a submission which was never ever assessed. Some months later we received an email advising that the NWDF had been closed.

In NSW the State Government has introduced from January 2015 their “Smart & Skilled” Program and we are endeavouring to work out how we might be able to harness some funding from there but it is complex, highly prescriptive and difficult to decipher. In any case it looks to be on a small scale and not well suited to our national coverage.

In January 2015 the Australian Government launched the ***Business Industry Skills Fund (BISF)*** which would seem to be a replacement program for the NWDF. A review of the published merit assessment guide suggests that it would once again take us an enormous amount of time to pull together the information and evidence required to meet the specified criteria. And even then there would be gaps that we could not meet because of how the criteria have been structured without contemplation of an application coming from a professional association. In reality any organisation making an application under this program would need to be well resourced to start with. The Merit Assessment Guide is provided below:-

ISFGrowthStream-M
eritAssessmentGuide.

Once again there is the upfront catch all criteria that in this case says:-

When an application is received which is complete and meets all eligibility requirements, it will be assessed based on the level of information and evidence provided to support each merit criteria.

The ISF has five Merit Criteria which are equally weighted. A summary of the ISF Merit Criteria and how they are used to assess applications is provided in the Merit Assessment Guide.

9. Concluding Remarks

The customer owned banking sector has made an invaluable contribution for almost 70 years now to the economic well-being for a significant number of Australians as well as the communities in which they live and work. There are many MPs from all political parties that will attest to the valuable contribution that mutuals have made and continue to make.

The sector has grown and moved into the mainstream of the retail financial services industry in Australia and brings a unique and much needed alternative approach to banking services by serving the customers' interests rather than staff reliant on big sales commissions or shareholders looking for capital and financial dividend growth.

The business model of a mutual is therefore different in nature to that of an investor owned banking institution yet the legislative and regulatory environments have been designed to accommodate the investor owned entity and in many cases are non-accommodating and disadvantageous to co-operative and mutual entities.

There is also a lack of understanding at the political, regulatory and administrative levels about the critical importance of "co-operation among co-operatives". The co-operative system has enabled mutuals to build aggregated services bodies such as Cuscal, COBA and AM Institute to overcome economies of scale challenges that individual mutuals so often face in maintaining competitiveness with the bigger players and in continuing to grow their business and scope of product and service offering to their owners.

This co-operative system is in fact a unique support structure with significant capacity to deliver sector solutions to benefit the most important stakeholder – the consumer. Why not use the power and integrity of the co-operative system to enable critical change designed to promote competition in the banking industry.

The marketplace for banking services in Australia is particularly challenging in 2015 partly due to global forces flowing from the GFC and partly due to the unprecedented market share that the four major banks have acquired due to the global turmoil and have cleverly exploited since.

The customer owned banking sector is in fact a well-organised collection of small businesses with sophisticated governance and management capability derived by the standards required for all authorised deposit taking institutions but with determination and a zeal to always act in the best interest of our customer owners. What's more mutuals operate effectively in metropolitan, regional and rural communities and serve the interests of the communities in which they operate.

We have the plans and the motivation to respond positively to the challenges that the market presents us with and simply ask that the political, regulatory and administrative systems be recalibrated to fully recognise the legitimacy of our business model both at the individual mutual and at the sector level.

We are not asking for charity or handouts but just some assistance to gain access to skills development funding programs that have been provided to support businesses like ours but have been denied to the sector for the reasons outlined above.

Australian consumers need and deserve a truly competitive financial market with a vibrant customer owned banking sector fulfilling the role of an honest broker, setting standards in customer service and offering genuine value across the full suite of banking products and services.

In more practical terms this submission suggests that support at an appropriate level be provided to this sector so as to facilitate the development and submission of an application to the Industry Skills Fund that has every liklihood of succeeding in gaining access to funding.

A funding investment in the upskilling of the customer owned banking sector can really make a significant difference in supporting and strengthening a more competitive banking service proposition for all Australians.

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