CHAPTER 8

CREDIT UNIONS, BUILDING SOCIETIES AND COMMUNITY BANKS

8.1 In withdrawing from some country towns or downgrading their level or quality of service, the major banks have opened up the opportunity for other financial service providers to fill a void. Credit unions, building societies, and community banks are increasingly presented with the chance to provide banking services where banks have departed from a locality or where such services did not previously exist. This chapter looks at the potential for these various institutions to step forward and take the place of the major banks in offering over-the-counter banking services in country Australia. It considers:

- the new regulatory regime incorporating credit unions and building societies under the one framework for ADIs;
- credit unions—their tradition, membership, range of services and the barriers they experience in entering new markets;
- building societies—their history, membership and the constraints they have in endeavouring to expand their services into country Australia;
- community banks—their potential to fill the vacuum left by the major banks, the contribution they are currently making to regional banking, and the problems they experience in establishing a presence.

A new regulatory regime for ADIs

8.2 On 1 July 1999, regulatory responsibility for credit unions and building societies was transferred from the states and territories to the Commonwealth. This move brought the regulation of credit unions and building societies as non-bank authorised deposit-taking institutions into line with the banks. It was envisaged that this new regime would be less cumbersome and would enable the non-bank deposit-taking sector to provide a more effective source of competition for the banks in the retail market. Now, under Commonwealth jurisdiction, credit unions and building societies are ADIs licensed by the Australian Prudential Regulation Authority (APRA) under the *Banking Act 1959*. They operate under the same rules as banks and are prudentially regulated by APRA and regulated as companies by the Australian Securities and Investments Commission (ASIC).[1]

8.3 A major step toward the implementation of a uniform regime for ADIs took place on 20 September 2000 when APRA issued a set of harmonised prudential

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1 Mr Joe Hockey, Minister for Financial Services and Regulations, *House Hansard*, 29 March 1999, p. 4623.

standards for authorised deposit-taking institutions. According to Mr Jeffrey Carmichael, APRA, these standards brought the regulatory framework for banks, building societies and credit unions 'into full alignment for the first time'. He concluded:

> In a sense it marked the coming of age of the smaller institutions, from a fragmented and inadequate regulatory system in the 1980s, through the harmonised state-based FI scheme in the 1990s, to full regulatory parity with banks in 2000.[2]

8.4 Although credit unions and building societies are presented with the opportunity to move into areas abandoned by the banks, they face the same competitive forces that influenced the banks' decision to withdraw their over-the-counter services in regional Australia.

8.5 As with banks, these institutions must balance the commercial interests of their shareholders, the demands of their customers and the needs of the community. Although credit unions, building societies and community banks are involved in the community, and have a closer relationship with their shareholders, in the cases of credit unions and building societies they are also the members, their success depends ultimately on their economic viability.

8.6 In 2001, APRA noted that over the previous five or so years, credit unions and building societies had faced mounting pressure to expand their operations so as to achieve economies of scale and to compete in an increasingly technology-driven market. According to APRA, this situation resulted in a steady process of consolidation, industry exit, and in the case of building societies, some conversion to bank status. By 2001, the number of credit unions had declined by 28 per cent since June 1995 (from 291 to 209), and the number of building societies had declined by 36 per cent over the same period (from 28 to 18).[3] The number of credit unions stood at 196 as at June 2001 while building societies stood at 16.

8.7 APRA explained, however, that despite the decline in the number of institutions, both the credit union and the building society sectors continued to show asset growth which, it asserted, 'reflects the fact that most of the decline in the number of institutions has been due to consolidation (eg mergers) rather than pure exits from the industry'.[4]

8.8 Of interest to the Committee is the number of branches operated by these institutions. In June 2001, Credit Union branches stood at 1028 but had dropped to 939 by June 2003. Over the same period branches belonging to building societies had fallen from 328 to 308.[5] The following table shows the distribution of credit unions

2 Jeffrey Carmichael, 'APRA—the Way Forward', speech, 22 November 2002.

3 APRA *Insight, 3rd Quarter 2001*, p. 16.

4 APRA *Insight, 3rd Quarter 2001*, p. 16.

5 APRA, *Points of Presence, Summary of Branches,* 30 June 2001 and 30 June 2002.

and building society branches and other face-to-face service channels in 2001, 2002 and 2003.

Table 8.1—Credit Unions and Building Societies—Level of Service, 2001, 2002 and 2003[6]

Points of Presence Category Comparing 2001 and 2002							
Industry	**ARIA Category**	*Branch level of service*			*Other face-to-face*		
		2001	**2002**	**2003**	**2001**	**2002**	**2003**
Building Societies	*Highly Accessible*	228	205	197	86	110	127
	Accessible	55	58	59	46	54	61
	Moderately Accessible	33	35	37	58	60	70
	Remote	6	8	9	13	12	13
	Very Remote	5	7	6	3	1	3
	(blank)	1			5	1	
	Total	**328**	**313**	**308**	**211**	**238**	**274**
Credit Unions	*Highly Accessible*	743	687	670	161	167	171
	Accessible	184	177	173	54	59	57
	Moderately Accessible	58	53	57	42	39	37
	Remote	16	15	15	15	16	15
	Very Remote	21	24	24	20	21	18
	(blank)	6	1		3		286
	Total	**1028**	**957**	**939**	**295**	**302**	**584**

6 APRA, *Points of Presence,* Summary of changes from 2001 to 2002, ARIA Breakdowns and Movements, 2001 , 2002 and 2003 http://www.apra.gov.au/statistics/pop/ARIABreakdownsandMovements.xls, 2003. APRA in its Explanatory Notes states that 'some postcodes do not have ARIA indexes, and for these the ARIA category is shown as a blank. This applies to postcodes for islands (other than Tasmania). Nonetheless, the number of Credit Union outlets offering other face-to-face services is given as 286 which appears extremely high for the category 'blank'. APRA informed the Committee that of these 286 new channels, 177 belong to the TAB Credit Union. It should be noted that CUSCAL disputes APRA's statistics. It informed the Committee the level of 'branch level service' outlets, according to APRA's definition, is more accurately reported as 1,008. CUSCAL's data shows that there has not been any significant variance in branch level services offered by credit unions in any particular area. Louise Petschler, CUSCAL, correspondence to the Committee, 22 December 2003.

Credit Unions

8.9 Credit unions are mutual organisations and as such hold the interests of their members paramount. They are not-for-profit, democratic, member-owned financial institutions whose services are directed to improve the economic and social well-being of all their members who are also their customers.[7] On joining a credit union, a member pays a nominal amount which entitles him or her to an equal say in the running of the organisation. Credit unions focus on delivering benefits to members who share a common set of values and ethics which governs the organisation's operation.[8]

8.10 Although small compared to the traditional banking sector, the credit union sector is characterised by 'diversity, with large credit unions operating on a national scale and smaller locally-based ones serving targeted communities'.[9] CUSCAL informed the Committee that credit unions offer an extensive range of banking and financial services to members, including face-to-face services, internet and telephone banking, ATM and EFTPOS access, investment and savings accounts, personal and home loans, credit and debit cards.[10] Many credit unions also offer investment advice, financial planning services, managed funds and insurance products.

8.11 According to CUSCAL, Credit unions have a strong tradition of delivering services to country Australia. Their membership now extends to all but six postcodes in Australia, and is not restricted by geography, community or affluence.[11] CUSCAL explained that:

> Credit unions are particularly well represented in country Australia, with a high market penetration. Over 70 credit unions base their activities in primarily non-metropolitan areas, with industrially bonded credit unions also serving members outside city areas…
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> In towns such as Narromine, Broken Hill, Georgetown, Naracoorte, Moe, Morwell, Armidale, Narrabri, Tamworth, Yarrawonga, Wauchope, Orange, Mount Gambier and Lithgow, more than 40% of the local community are members of a credit union.
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> In smaller communities such as Trangie, Woodburn, Evans Head, Werris Creek and Mungindi over 75% of the local population are credit union members.[12]

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7 International Credit Union Operating Principles, Appendix A, *Submission* 109.

8 *Submission* 109, pp. 4–5.

9 *Submission* 109, pp. 4–5.

10 *Submission* 109, p. 4.

11 *Submission* 109, p. 8.

12 *Submission* 109, p. 8.

8.12 CUSCAL further noted that in the first six months of 2002, credit union branches had opened in many locations where the major banks had withdrawn their branches including Golden Grove, Joondalup, Sunbury, Violet Town, Ganmain, Coolaman, Murrurundi, Coonamble, Walgett and Brewarrina.[13]

8.13 According to the Wagga Mutual Credit Union, it has been at the vanguard of development in returning financial services to country towns abandoned by the banks. It went on to state that 'Credit Unions per se, have been instrumental in providing banking services to country towns since starting-up in Australia after the Second World War'.[14]

8.14 Credit unions also embrace new technology to provide services to their customers. CUSCAL informed the Committee that due to a smaller branch network than the major banks:

> Credit unions…have utilised innovative service delivery channels throughout their operation. The credit union industry has been at the leading edge of innovative developments in technology—Australia's first ATM was installed by a Queensland credit union in 1977, the first pilot EFTPOS facility in Australia was conducted by a credit union in 1981, and credit unions were early pioneers of telephone and other remote access banking.[15]

8.15 They also have mobile service centres operating across communities and workplaces, volunteer representatives working through communities and workplaces and information kiosks and service options through workplaces/community centres.[16] The reach of credit unions into country Australia was facilitated under the former CreditCare program (see chapter 10 for details on this program).

Building societies

8.16 Building societies have existed in Australia since 1850. On 1 July 1999, after being under state legislation for 140 years, building societies became authorised deposit-taking institutions.[17] As noted earlier, they are now licensed under the *Banking Act* to undertake the business of banking.

8.17 The modern building society is a community-based institution that provides banking and financial services, with special skills in housing finance, to many Australians.[18] With only 16 institutions, building societies hold a small share of the retail banking market. Nonetheless, according to the Australian Association of

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13 *Submission* 109, p. 9.

14 *Submission* 39, p. 1.

15 *Submission* 109, p. 4.

16 *Submission* 109, p. 13.

17 http://www.aapbs.com.au/about.htm (8 January 2003).

18 http://www.aapbs.com.au/about.htm (8 January 2003).

Permanent Building Societies (AAPBS), its members are located in key regional cities in Australia.

8.18 As a financial co-operative they engage in financial deposit taking and lending to members. The majority of building societies are mutuals and while profitability is important to them they are 'not readily comparable with the major banks whose first objective is profit maximization'. Mr Jim Larkey, Executive Officer, AAPBS, explained that 'mutual building societies do not pay dividends but 'pass back benefits in either or both lower mortgage rates and higher deposit rates'.[19]

Barriers to entry

8.19 As noted earlier, the decision to provide banking and financial services to a rural or regional community is ultimately a commercial one for financial institutions. They weigh up the costs of providing the service against the expected returns. Although credit unions and building societies are member-owned and not necessarily driven primarily by the need to make high profits, they are a business and if not commercially viable will fail.

8.20 Small ADIs face a number of issues in operating their businesses in rural and regional Australia. The following section examines some of the obstacles faced by credit unions and building societies in establishing themselves in country Australia which include:

- high start-up costs;
- portability and banking practices;
- prudential regulations;
- requirements under the Financial Services Reform Act;
- their status as non-bank ADIs; and
- experience in servicing the needs of country Australians.

Start-up costs

8.21 Start-up costs are a significant barrier to credit unions and building societies seeking to enter new areas in regional Australia. The CreditCare experience clearly showed the costs involved in moving to areas seen as 'non-commercial' by other providers as a major stumbling block (see chapter 10, paragraphs 10.3–10.8).[20] The new entrant is expected to provide face-to-face services that are expensive to deliver. The main costs associated with establishing a facility involve the initial feasibility

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19 Press Release, 'Industry Criticism of KMPG "2001": Financial Institutions Performance Survey', 29 June 2001, http://www.aapbs.com.au/Press%20Release%20-%20KPMG%20 Survey%2029%20Ju…(8 January 2003).

20 Dr Gary Lewis, 'Laughing All the Way to the Credit Union': The CreditCare Experience in 'No Bank' Towns 1995–2000, ACCORD, University of Technology, Sydney, November 2001, pp. 34, 76.

studies and planning, the hiring and training of teller staff, renting premises in a convenient locality, IT connection, fitting out the premises and providing security.[21]

8.22 Credit unions are particularly constrained by their limited opportunities to raise capital. Mr Lovney, CUSCAL, explained:

> By definition, credit unions cannot raise capital from the marketplace, so a new institution has to have an amount of capital sufficient to meet its regulatory requirements and sustain its operations until it can start to support itself. There are not very many small institutions or groups of people with the wherewithal to do that. More commonly, large credit unions or credit unions that are relatively well capitalised will make a decision to open a new branch and employ some of that capital. It is notoriously difficult to start a new credit union. For just that reason, we have seen very few places—a handful of them—in the last decade or so where new credit unions have opened.[22]

Credit unions have made known to the Committee that they would welcome a review of support options for providers moving into no-bank towns.[23]

Portability and banking practices

8.23 The process of establishing an over-the-counter banking facility may be further frustrated in towns where a major bank has closed its doors but still seeks to retain its valued customers.

8.24 According to CUSCAL, credit unions have experienced the ‘sharp end’ of banking practices where they have opened services in areas where banks have left town. It drew attention to some bank practices that create difficulties for a new entrant in establishing its customer base. In brief, CUSCAL maintained that when withdrawing services, ‘the banks have taken steps to keep more lucrative customers through bundling of services, fixed term loans, and maintaining remote ‘personal bankers’.[24] Dr Gary Lewis described this practice as banks ‘creaming off’ profitable activities which leaves credit unions with expensive transaction business.[25] He wrote:

> Banks sought particularly to ‘lock borrowers in’ by offering attractive rates on loans. Business owners, in particular, were used to being wooed by the banks and often expected a credit union to be more competitively aggressive

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21 See for example, Timothy White, CPS Credit Union (South Australia) Ltd, *Committee Hansard*, 12 March 2003, p. 375.

22 *Committee Hansard*, 25 February 2003, p. 173.

23 *Submission* 109, p. 15. See also Timothy White, CPS Credit Union (South Australia) Ltd, *Committee Hansard*, 12 March 2003, p. 377.

24 *Submission* 109, p, 16.

25 Dr Gary Lewis, ‘Laughing All the Way to the Credit Union’: The CreditCare Experience in ‘No Bank’ Towns 1995–2000, ACCORD, University of Technology, Sydney, November 2001, p. 35.

> to attract their business. Many elderly people, who had banked with a particular institution all their lives, 'remained loyal' to that bank for major banking purposes and used a credit union only for simple transactions.[26]

8.25 This practice of 'creaming off' or 'cherry picking' the products or customers where the margins are highest was also referred to in chapter 5.[27] In CUSCAL's view such practices affect the viability of the alternative provider.[28] It explained:

> In some areas new institutions have been left with transaction based (and less profitable) business—effectively subsidising new services from members in other communities. As mutuals and not-for-profit institutions, a credit union's capacity to extend this support is limited.[29]

8.26 The Electricity Credit Union of Queensland provided a practical example of how a bank withdrawing its branch from a locality can thwart the endeavours of a new entrant to attract patronage particularly highly valued customers. The credit union was proposing to establish a facility in the small town of Blackbutt where the National had closed its branch. Mr Geoffrey Maudsley, Chairman, Electricity Credit Union, informed the Committee that the National approached local businesses and offered a better deal than the credit union such as EFTPOS machines at reduced rates. He explained:

> They knew that the credit union was trying to get EFTPOS facilities. It was no secret that they were refusing to sign interchange agreements and trying to squeeze the credit unions out of that situation. That is why the businesses have not come on board.[30]

8.27 Consequently, all the credit union is dealing with is 'the mums and dads and the pensioners'. Mr Brittain told the Committee that the local council subsidises the service to keep it going.[31] The Traditional Credit Union in the Northern Territory experiences the same problem only in its case, the major banks 'openly encourage' their less valued and more costly Indigenous customers to switch to the Credit Union.[32]

8.28 The Committee appreciates the problems faced by smaller ADIs attempting to enter the market where the major banks are courting the more profitable customers. As long as the market practices of the banks, however, are fair and proper the Committee

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26 Dr Gary Lewis, 'Laughing All the Way to the Credit Union': The CreditCare Experience in 'No Bank' Towns 1995–2000, ACCORD, University of Technology, Sydney, November 2001, p. 39.

27 See Chapter 5, paragraphs, 5.3–5.

28 *Submission* 109, p. 16.

29 *Submission* 109, p. 16.

30 *Committee Hansard*, 22 May 2003, p. 482.

31 *Committee Hansard*, 22 May 2003, p. 480.

32 See Chapter 16, paragraphs 16.32–16.33.

accepts that the difficulties created for the smaller ADIs stem from competition in the market place. Nonetheless, it is another matter should such practices be anti-competitive. Chapter 4 dealt at length with the difficulties experienced by customers in switching accounts—costs involved in closing and transferring loans and 'the rigmarole the bank makes them go through in changing accounts'.[33] At that stage in the report, the Committee was looking at branch closures and the problems encountered by customers in transferring accounts to a new service provider. In summary, it found that customers were unwilling to switch accounts because of:

- loyalty to and familiarity with their bank;
- difficulties in transferring details of accounts from one institution to another;
- difficulties and penalties associated with unbundling their package of accounts; and
- costs related to closing and opening various accounts especially mortgage arrangements which appear to be the main impediment to changing service providers.[34]

8.29 The Committee now turns to look at the problems of portability from the view of the service providers. According to CUSCAL, the obstacles which consumers face in transferring funds between financial institutions stifles competition and inhibits the capacity for non-bank ADIs to move into new markets. It is referring to structural impediments to the transfer of accounts concerned with direct debits through to periodic payments of other types, payroll issues and the transfer of information from one institution to another. CUSCAL noted:

> When we look at the banking sector in the UK, we see that the major banks there have taken initiatives that are about assisting consumers to move between institutions much more easily. They have introduced customer mandates that enable information to be transferred between financial providers, and they also guarantee to meet certain time frames in ensuring, for example, that direct debits are wound up quickly and transferred to an institution.[35]

8.30 CUSCAL wondered whether competition could be improved by putting in place mechanisms to make it easier for customers to shift from one banking institution

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33 Chapter 4, paragraphs 4.66–4.71.

34 See Chapter 4, paragraphs 4.52–4.71.

35 *Committee Hansard*, 25 February 2003, p. 166. Mr Lovney told the Committee 'customers do need to do a fresh 100-point check every time they move institutions. They need to change their payroll arrangements. If they have direct debits for their invoices and bills, they need to move those as well. They also have to take into consideration credit cards and stamp duty.' See p. 170.

to another.[36] It recommended that ASIC convene an industry working group to review banking practices in this area of portability of accounts.[37]

8.31 Indeed, the United Kingdom Competition Commission recently produced a comprehensive report on the supply of banking services to SMEs which found a reluctance on the part of SMEs to switch banks because of perceived complexity of transferring for little financial benefit, the perceived significance of maintaining relationships with a particular bank and 'the ability of the existing bank to negotiate lower charges or otherwise respond if there is a threat of switching'.[38] It referred to the 'nightmare' of switching and the 'hassle factor' of transferring business from one bank to another.[39] It made a number of recommendations to remove barriers to entry including, *inter alia*, requiring banks:

- to complete a substantial percentage of all account switching within five working days where no borrowing is involved and in all but the most exceptional cases ten working days if borrowing is involved (in the absence of security), with compensation if those timescales are not met;
- (as part of the previous point), to publish their performance objectives and their efficiency in achieving them;
- to examine ways to allow more rapid transfer of security and publish a report on this within nine months of publication of this report; and
- to provide a portable credit history on request to a timescale and format to be approved…[40]

8.32 The Committee recommended in chapter 4 that a clause be inserted in the bank branch closure protocol that makes a clear statement of intention that a bank closing a branch will facilitate the transfer of accounts to another institution of the customer's choice. This undertaking was to include the timely and orderly transfer of information and documentation. Since this recommendation was in the limited context of a branch closure, the Committee makes a further recommendation dealing with the broader problem of impediments to the transfer of accounts. It regards this as a competition issue and believes that the ACCC would be the appropriate regulator to investigate the matter.

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36 *Committee Hansard*, 25 February 2003, p. 170.

37 *Committee Hansard*, 25 February 2003, p. 166.

38 Competition Commission, *The supply of banking services by clearing banks to small and medium-sized enterprises*, A report on the supply of banking services by clearing banks to small and medium-sized enterprises within the UK, presented to Parliament by the Secretary of State for Trade and Industry and the Chancellor of the Exchequer by Command of Her Majesty, March 2002, p. 3.

39 ibid., p. 29.

40 ibid., pp. 145–6. The report made 13 recommendations in all on this matter.

Recommendation 5

The Committee recommends that the ACCC convene an industry working group that would include consumer associations to review current practices in the transfer of accounts from one financial institution to another. The group's objective would be to determine whether there are impediments to the switching of accounts and, if so, to formulate best practice guides that could be used as a model to facilitate the transfer of accounts to be incorporated in the Banking Code of Practice.

This process would:

- provide ADIs with the opportunity to review their policies and practices, especially in light of the findings of the United Kingdom's Competition Commission;
- inform consumers about the costs involved in switching accounts;
- identify any practices that unnecessarily place a cost on consumers and are barriers to new entrants;
- promote a more open and competitive industry; and
- encourage ADIs to adopt current best practice.

8.33 It should be noted that the Banking Code of the British Bankers' Association contains a provision that the bank will co-operate with customers deciding to move their account so that the transfer is made as efficiently as possible.[41]

Prudential regulations

8.34 Credit unions have indicated their desire to expand their services into rural areas but believe that they are constrained by their limited ability to generate a profit margin. As noted earlier they come under the same regulatory umbrella as the major banks and are required to meet the same obligations as their larger competitors. Some smaller ADIs see the prudential regulations as a significant brake on their ability to establish new outlets. [42]

8.35 The Wagga Mutual Credit Union agreed with the view that the credit unions' lack of capital inhibits them from taking up more opportunities to expand services to country towns. It noted that 'regulators require all Approved Deposit taking Institutions to hold a minimum level of capital against risk-weighted assets in their balance sheet'.[43]

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41 British Bankers' Association, *The Banking Code,* January 2001, para 7.2, p. 11.

42 See for example, *Submission* 59, pp. 3–4.

43 *Submission* 39, p. 2.

8.36 The Australian Centre for Co-operative Research and Development (ACCORD), in particular, was concerned that there may be a number of legal and regulatory obstacles to the creation of banking and financial institutions. In its opinion, these impediments are most evident in 'the near impossibility of forming new locally-based credit unions' because of the demanding nature of current capital adequacy and prudential requirements imposed on large and small ADIs.[44]

8.37 It recommended that full consideration be given to the extent to which existing financial institutions serve local and regional business needs, with the view to expanding available services for business and community enterprise finance in regional and remote communities.[45] It also called for a thorough investigation into the effect that existing financial and banking regulatory requirements have on the establishment of new financial institutions in meeting the needs of business and community enterprises.[46]

8.38 APRA acknowledged that capital remains one of the challenges for smaller ADIs. It told the Committee:

> Unlike non-mutual organisations that can raise external capital—for example, by way of share issue—credit unions are unable to raise share capital on this basis. It is their very mutual structure that creates this problem. The industry has for some time been looking to develop a viable tier one capital instrument that will not trigger demutualisation, but has yet to achieve this. APRA is more than happy to consider industry proposals, but in the interests of depositors these must meet the fundamental criteria for recognition as tier one capital.[47]

8.39 In explaining the capital adequacy requirements for ADIs, APRA told the Committee that the minimum capital ratio is eight per cent which, according to Mr Brandon Khoo from APRA, is 'sacrosanct' and cannot be breached.[48] A higher ratio can be determined depending on the risk exposure of the institution. In regard to credit unions, Mr Stephen Glenfield informed the Committee that APRA's average capital adequacy requirement for credit unions was about 15 per cent with the banks averaging 10 per cent.[49] He stated:

> There would be few allowed to operate at that level [the minimum 8 per cent], because of the size of the capital base and the risk of a particular bad loan tipping you under. What we say to them is, 'The minimum is eight per cent. We would expect the board to set a reasonable prudential buffer over

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44 *Submission* 80, p. 2.

45 *Submission* 80, p. 2.

46 *Submission* 80, p. 2.

47 Brandon Khoo, APRA, *Committee Hansard*, 25 February 2003, pp. 180–1.

48 *Committee Hansard*, 25 February 2003, p. 189.

49 *Committee Hansard*, 25 February 2003, pp. 188–9.

> that to allow for the sorts of write-offs that we might not be aware of today.'[50]

Dr Roberts added:

> Even if the credit union board were incredibly conservative and prudent, it would still be exposed to the range of uncertainty and the vagaries of the economic climate, so some small margin or some margin above eight per cent is, in our view, the absolute rock bottom for even the best-run credit union.[51]

8.40 The Committee understands the difficulties that credit unions have as mutual organisations in raising capital and the limitations that the capital adequacy requirements place on these institutions in expanding their business. Nonetheless, it accepts the importance of having in place sound prudential practices designed to protect the interests of depositors and endorses APRA's approach.

Recommendation 6

The Committee notes APRA's willingness to examine proposals to 'develop a viable tier one capital instrument that will not trigger demutualisation'. It recommends that APRA in consultation with credit unions and building societies explore this proposal.

Requirements under the FSRA

8.41 CUSCAL submitted that the implementation of the *Financial Services Reform Act* (FSRA) was currently causing a major diversion of resources away from credit union member services into regulatory compliance. It argued that in relation to deposits and non-cash payment products, the FSR regime had introduced a significant new compliance burden with little benefit for consumers.[52]

Policy Statement 146

8.42 The AAPBS reinforced the views of CUSCAL that the FSRA creates difficulties for ADIs in rural and regional Australia and cited in particular the problems in providing basic well-understood banking products. It submitted that the training requirements under ASIC's Policy Statement 146 (PS146) in relation to basic

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50 *Committee Hansard*, 25 February 2003, p. 189.

51 *Committee Hansard*, 25 February 2003, p. 189.

52 *Submission* 109, p. 17. See also *submission* 4 to the Inquiry into Corporations Amendments Regulations 2003, (No. 1), Statutory Rules 2003 No. 31. CUSCAL stated in this submission that 'It is simply a fact that regulatory compliance is a heavier burden for smaller entities because they are less likely than their larger competitors to be able to devote full time resources to the function.'

products and non-cash payments facilities were 'onerous, overly prescriptive and, in our view, unnecessary'.[53]

8.43 Under the FSRA, all credit unions and building societies require an AFS licence to deal in and advise on deposit and payment products. Before granting a licence, ASIC must be satisfied, among other things, that an applicant will be able to comply with its statutory obligations, including those relating to training and competency. PS146 sets out minimum standards to be met by people who provide financial product advice to retail clients. ASIC has prescribed the lower Tier 2 level of training for basic deposit products, related non-cash payment facilities and most general insurance products.[54]

8.44 The Committee dealt with this matter in its *Report on the Regulations and ASIC Policy Statements Made Under the Financial Services Reform Act 2001* tabled in October 2002.[55]

8.45 On 22 January 2003, ASIC released a number of updates to PS146 which took into account requests from industry for further clarification and the findings of this Committee in its report. They address concerns about costs and unnecessary training. According to ASIC, the revisions provide greater flexibility to licensees in the development and assessment of training courses for basic deposit products (BDP) and

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53 *Submission* 2, p. 1 to the Parliamentary Joint Committee on Corporations and Financial Service's inquiry into the regulations and policy statements under the Financial Services Reform Act.

54 According to some in the industry, the lower Tier 2 level was an 'unnecessary and counter productive standard for what are simple, straightforward and capital assured deposit products'. CUSCAL was not alone in arguing that these training requirements placed a significant compliance burden on ADIs. It was critical of PS146 for not being clear and straightforward; for failing to recognise the unique status of 'basic deposit products' and related payment products in the Act; and for categorising deposit products that are not basic deposit products in Tier 1 instead of Tier 2. Bendigo Bank Ltd echoed these same sentiments and outlined the adverse effects that PS146 would have on the provision of banking services in regional, rural and remote Australia. Refer to submissions from the Australian Association of Permanent Building Societies, Bendigo Bank Ltd and CUSCAL, nos. 2, 8 and 9 respectively to the Parliamentary Joint Committee on Corporations and Financial Service's inquiry into the regulations and policy statements under the Financial Services Reform Act.

55 Parliamentary Joint Committee on Corporations and Financial Services, *Report on the Regulations and ASIC Policy Statements Made Under the Financial Services Reform Act 2001,* October 2002, p, 26. It recommended that: ASIC urgently review the training requirements in PS146 so they take into account the special features of basic deposit products and related non-cash payment facilities. Also, that ASIC consider amending PS146, as far as possible—and without compromising consumer protection—to: provide a framework for more cost-effective reviews of ADIs' current in-house training requirements; to ensure training costs—whether in-house or external—are more proportionate to envisaged consumer protection gains; and to cater for the training challenges presented by agencies and small branches, particularly in regional and remote areas. The Report by the Labour members of the Committee offered some support for the recommendations that ASIC review the training requirements in PS146 and that it consider amending PS146 in the manner recommended in the majority report subject not to compromising consumer protection. p. 82.

related non-cash payment products. It removes the need for BDP training courses to be assessed by an authorised assessor and placed on the ASIC Training Register. ASIC said that this change would relieve licensees of having to arrange a course assessment by a registered training organisation.[56]

8.46 CUSCAL, one of the main critics of PS146, believed that the revised version went some way to addressing the problems that had arisen through the interpretation of PS146. It concluded:

> Our principal concern with 146 as it was written was that it enabled training providers to, in effect, have the whip hand themselves, and they were dictating what requirements institutions needed to fulfil. I think the advantage in the new model is that it allows institutions to make some of those training decisions for themselves and to make an assessment of how they want to train their staff.
>
> …Equally, the streamlining provisions that have been proposed offer considerable benefit and flexibility to small institutions but, in effect, do no more than reinforce what was in fact the government's original intention when the bill was passed…[57]

8.47 The Committee acknowledges the work of ASIC in arriving at a satisfactory resolution on this matter of training. While PS146 is concerned with training, other concerns remain about the compliance costs associated with the current regulatory regime.

Disclosure requirements and other compliance issues

8.48 Although CUSCAL welcomed the recent changes to PS146, Mr Lovney still felt concern over the resources that small institutions were having to expend to comply with new requirements under FSR for products 'which are essentially capital guaranteed'. In summary, he stated:

> We think the changes have gone some way toward ameliorating some of those risks but we think the FSR regime is still a significant impost for some institutions which are in effect just deposit and loan providers.[58]

8.49 While CUSCAL supports legislative and non-legislative measures aimed at protecting consumers of banking and financial services products and services, Mr Lovney noted that as an industry the credit unions often find themselves facing complex and overlapping sets of requirements.[59] He cited in particular disclosure

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56 ASIC, Information Release, Wednesday, 22 January 2003. The amendment reads—'Training courses covering advice on basic deposit products and related non-cash payment products (BDPs) are no longer required to be assessed by the licensee as meeting Tier 2 standard'.

57 Adrian Lovney, *Committee Hansard*, 25 February 2003, p. 168.

58 *Committee Hansard*, 25 February 2003, p. 169.

59 These include measures such as the uniform consumer credit code, the FSR in principle, the Centrelink code of practice and the electronic funds transfer code of conduct.

requirements which in his opinion 'would benefit from a more holistic understanding and appreciation of how they impact, particularly in the case of smaller institutions, where they have a disproportionately large impact on costs and compliance costs'. He explained further:

> Disclosure obligations for financial services customers are regulated by the Commonwealth by ASIC, through the EFT code. ASIC also requires that credit unions have a code of practice which regulates disclosure. The Financial Services Reform Act lays on top of that another system of disclosure relating to financial services generally. The uniform consumer credit code sets out disclosure requirements in relation to the provision of consumer credit, and we have just seen amendments to that in some jurisdictions, most notably New South Wales, that overlay further disclosure requirements for the provision of consumer credit under fixed term contracts.[60]

8.50 The AAPBS raised similar concerns. It stated that building societies accept their fair burden of compliance with prescriptive legislation and regulation. It noted, however, that smaller ADIs 'feel these costs (per customer) more than the majors.' As a consequence, it concluded:

> …the mounting imposition of costs originating from government regulation will necessarily impede the provision of new services and the continuation of existing services which may be marginal for institutions because of the location of those services in regional and rural Australia.[61]

8.51 The Traditional Credit Union (TCU) provides an example of the heavy costs incurred by a small financial institution, especially one working in the more remote areas of Australia, in meeting regulatory requirements. It should be noted that this institution provides services for Indigenous communities where English is not always the first language and where languages differ from community to community. Ms Bev McMillan from the TCU set out in detail some of the costs associated with complying with the regulations:

> The Financial Services Reform Act has brought about a lot of changes in our documentation, to start with. Previously, for the sake of our members, we have kept all our product information very basic so that it is easy for them to read and understand, but with these FSRA requirements we have to have a two-page product disclosure statement on every product, we have to have a full product service. In other words, every time we sign on a new member we have to give them an inch thick of paperwork with all the regulatory requirements of using our services and the products, their rights of reply, the Privacy Act, code of conduct, and terms and conditions of use.
>
> …

60 *Committee Hansard*, 25 February 2003, p. 165.

61 *Submission* 122, p. 3.

> But we are not just talking about basic deposit facilities; we have to take the education of Aboriginal people further so that they know how to use modern products. That alone costs us a lot of money. The legal costs would probably be between $30,000 and $60,000 to get the licence through. A requirement of FSR is that we have to have a full network system and that also has to be available in our remote branches. So we have to upgrade our networking system and we have to provide printers into every single branch because when a new member signs up we have to be able to guarantee that we have the latest updated documentation. It has to be live online to print off as required. That is going to cost us in the vicinity of $40,000.
>
> We have to upgrade the training of our staff, which is the major issue. Before, our staff just had to understand and advise on depositing and withdrawing, but now they have to have a full understanding of all our products and what they do. So we have to upgrade and give them a higher level of achievement in their training. To do that we have to upgrade the training course. We convert all nationally accredited training into a language and a product that is user-friendly for our Aboriginal staff who still have English as their third or, sometimes, fourth language. So that is another cost. We have to employ a new full-time remote training officer to incorporate that additional training. It does not take long to get to $200,000-plus.[62]

8.52 The Northern Territory Government acknowledged the TCU's argument and commented:

> Small credit unions face compliance with the Banking Act, Corporations Act, Consumer Credit Code, Privacy Act, internal and external audit and regular inspection by the Australian Prudential Regulatory Authority. While regulation is essential, existing restrictions on credit unions, the TCU claim, are more appropriate to much larger urban-based organisations.[63]

8.53 Together with the high costs of complying with the requirements of the regulatory regime, the TCU carries the additional costs entailed in providing services to small, dispersed and remote communities. The Traditional Credit Union is discussed in detail in chapter 16.

8.54 Clearly, there is strong evidence that the current regulatory regime places an onerous burden on smaller ADIs in their endeavours to establish a presence in rural and regional Australia and more particularly in remote areas. The Committee fully acknowledges the importance of having a robust regulatory regime that will protect the interests of consumers. It believes, however, that the regime should be flexible enough to facilitate new entrants into a market where there is an obvious need for services.

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62 *Committee Hansard*, 21 July 2003, p. 527.

63 *Submission* 128, p. 7.

Recommendation 7

The Committee supports the objectives of the *Financial Services Reform Act 2001* and recommends that the Government monitor its implementation and related regulations.

Specifically, the Committee recommends that APRA and ASIC consult with CUSCAL, smaller ADIs and other interested parties about the impact of the regulatory regime on the ability of ADIs to meet the banking and financial services needs of Australians living in rural, regional and remote communities. The Committee further recommends that following the consultation, the two regulators prepare a report for government on the costs of compliance under the current regulatory regime, its effect on competition, and whether and how the costs could be minimised without compromising consumer interests or prudential standards. The report is to be tabled in Parliament.

The Committee also recommends that the consultation and report process give particular attention to the delivery of banking and financial services to Indigenous communities in remote Australia.

Status of non-bank ADIs

8.55 A field worker with the project CreditCare, Mr Tom Watson, observed that one of the most significant hurdles that had frustrated credit unions in competing effectively with banks in the retail banking industry was that:

> …by and large, government and semi-government bodies were not permitted to bank with so-called non-banks. One by one, we managed to get that legislation changed in all states.[64]

8.56 The Hawker Report also noted that most states had moved to remove restrictions that prevented government bodies from using credit unions or building societies for some of their business transactions. Residual bias against credit unions, however, seems to have persisted.[65] Indeed, CUSCAL felt strongly that, despite the removal of many statutory barriers which had prevented them from competing with banks, credit unions still suffered from lingering prejudices. It maintained:

> Regulated bodies and the wider community need information and education about the 'ADI' concept to promote competition and choice in banking services. We seek the support of legislators and regulators in overcoming entrenched attitudes that discriminate in favour of banks.[66]

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64 Dr Gary Lewis, 'Laughing All the Way to the Credit Union': The CreditCare Experience in 'No Bank' Towns 1995–2000, ACCORD, University of Technology, Sydney, November 2001, p. 95.

65 Report from the House of Representatives Standing Committee on Economics, Finance and Public Administration, *Regional Banking Services: Money too far away,* March 1999, p. 41.

66 *Submission* 109, p. 19.

8.57 CUSCAL cited the example of Victoria's Legal Practice Board which it claimed has refused to approve any credit union to hold solicitors' trust funds since the relevant State legislative barrier was lifted on 1 January 1997. It told the Committee that in the case of the Legal Practice Board:

> …we have a number of solicitors in regional and rural areas where there are no banks who want to bank with their local credit unions. But the Legal Practice Board says, 'It doesn't matter what APRA says; it doesn't matter what the government says. We don't think that credit unions are safe, and we require people who hold funds on behalf of legal practitioners to have a Standard and Poor's rating or a Moody's rating of AAA or above.'[67]

8.58 CUSCAL also mentioned the Victorian Health Promotion Foundation which informed CUSCAL that it would only invest with banks and bodies where there was 'full recourse to a bank or government guarantee or indemnity'. CUSCAL had no doubts that credit unions and building societies were being discriminated against and denied opportunities to support local businesses.[68]

8.59 In response to the statements made by CUSCAL, the Legal Practice Board of Victoria advised the Committee that it is required under the Legal Practice Act to 'discriminate' in its approval of institutions associated with receipt of trust account money. It noted that 'as is prudent, from time to time the Board reviews the basis on which it exercises its discretion'. The Board reviewed its policy in late 2002 which now explicitly rules out of consideration for approval, only one category of institution—foreign bank branches. The policy stipulates that an ADI is required to have a minimum long-term rating of A (S&P/Moodys) and a minimum short-term rating of A-1. It states further that 'any ADI with a rating lower than the determined short and long term minima will only be considered where the Board believes that special circumstances apply'. In looking specifically at regional and rural Victoria, the Board told the Committee that it had specifically considered the matter:

> Hence its approval of Bendigo Bank and its associated Community Banks for the receipt of Trust Account Monies. This approval is despite Bendigo Bank not meeting the ratings criteria set out in the Board's policy. The Board has taken the view that the exercise of its discretion based on access to service is of relevance.[69]

8.60 The Committee appreciates both CUSCAL's view and that of the Victorian Legal Practice Board. It understands the frustration of the credit unions in not being able to service particular sectors because of perceived risks. It also sees merit in trustees acting with caution in meeting their fiduciary duties. The Committee believes that CUSCAL is right in raising its concerns about discrimination and that the Legal

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67 *Committee Hansard*, 25 February 2003, p. 165.

68 *Committee Hansard*, 25 February 2003, p. 165.

69 Correspondence received as Additional Information, Legal Practice Board to Committee, 16 September 2003.

Practice Board is equally right in reviewing its policies, taking account of its responsibilities and exercising its discretion in determining the institutions it deems appropriate for the receipt of trust account monies. Clearly, under the new regulatory regime credit unions will have the opportunity to build on their reputation and extend their range of transactions.

Lack of experience in servicing the financial needs of farmers

8.61 A number of financial commentators suggested that credit unions are not equipped to deliver the full range of financial services that banks provide. In particular, they noted that credit unions are not experienced in rural sector farm and business lending.[70]

8.62 Mr Fraser Read-Smith, Chief Executive, Heritage Building Society, explained that the Society had recently entered into the business lending market but not rural lending. He explained:

> It is certainly not a lack of demand in an area like this, but it could be lack of experience. This is a very conservative organisation and our board has taken the view that we should stick with our knitting. Going into rural lending would require a different culture and a different type of banking expertise from what we have as an organisation. I would not rule it out as something that we might venture into in the future, but our latest movement in that respect has been into business banking. We have gone from being just a retail banker to now becoming a business banker. That is certainly enough for us to handle in the foreseeable future.[71]

Instead the Heritage has referral arrangements with other organisations for customers who require rural loans.[72]

8.63 The Committee accepts that commercial and rural lending are not the core business of credit unions and building societies and that sensibly they are careful about entering areas of banking where they do not have experience or expertise. The Heritage shows that while they are prepared to expand their areas of activities they are doing so gradually and with caution. In the meantime, they are prepared to work with other organisations to ensure that their customers' needs are met.

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70 Greg Walker, *Finance Industry Restructuring: Implications for Regional Australia,* Paper presented to CAFI Workshop, Brisbane, 12 November 1998, p. 10; Tom Murphy, Director, Western Research Institute Ltd, 'The Rise of Regional Financial Institutions', in conference report and proceedings, 'Efficient Equity and Credit Financing for the Rural Sector', August 2001, p. 59; Siobhan McDonnell and Neil Westbury, *Giving Credit where it's due*: *The delivery of banking and financial services to Indigenous Australians in rural and remote areas*, Centre for Aboriginal Economic Policy Research, Discussion Paper, No. 218/2001, June 2001, p. 17.

71 *Committee Hansard*, 23 May 2003, p. 499.

72 Fraser Read-Smith, *Committee Hansard*, 23 May 2003, p. 491.

Levy on industry

8.64 The AAPBS also raised an issue not touched on by the credit unions—the matter of the levy structure which funds APRA. The levies paid by prudentially regulated financial institutions are intended to cover the costs of APRA, the consumer protection functions of ASIC and the ATO.[73] AAPBS told the Committee:

> As smaller institutions look at options for perhaps taking up a service, the inequity of the levy imposed by the Treasurer on building societies depositors vis-à-vis those of the major banks, understandably rankles with directors and managers seeking to respond positively in rural Australia.[74]

8.65 In 2000, the chairman of Heritage Building Society stated that the society paid supervisory levies that were 30 times the level of the National Australia Bank and 20 times the 'other majors' when expressed as a percentage of total assets.[75]

8.66 Mr Jim Larkey, Executive Officer, AAPBS, after the announcement of the 2000/2001 ADI levies, claimed that they 'perpetuate the gross unfairness of the funding system on middle sized ADIs'. He maintained that, among other things, the distortions and inequities arising from the levy legislation and the future funding of APRA 'warrant an urgent change to the currently unfair Australian approach to funding APRA's supervision of ADIs'.[76]

8.67 APRA believed that the main concern by smaller ADIs was that major banks have a maximum impost which is set at $1.125 million, which means in effect that on a pro rata basis banks are paying proportionately less. In other words, the smaller ADIs hold the view that they pay too much and the large banks, in particular, pay too little. APRA argued, however, that a very small institution still requires a minimum amount of supervision and a very large institution requires less than $1.125 million worth of supervision. It believed that the setting of the minimum and maximum

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73 See Garry West, 'Heritage Building Society hits "inequitable levy system"', *Australian Financial Review,* 19 October 2000.

74 *Submission* 122, pp. 3–4.

75 See Garry West, 'Heritage Building Society hits "inequitable levy system"', *Australian Financial Review,* 19 October 2000.

76 Press Release, 18 July 2001, http://www.aapbs.com.au/Press%20Release%20-%20Levies%2018%20 July%2001.htm (8 January 2003).

amount is fair to the smaller part of the industry.[77] Mr Khoo noted that the overall levy structure is currently under review by the Government.[78]

Recommendation 8

The Committee recommends that the Government in its review of the levy structure give close consideration to the concerns of the smaller ADIs with a view to easing this burden. Further that the matter be included in the concerns to be taken up by APRA and the industry in the review of compliance costs mentioned in recommendation 7.

Community Banks

8.68 A number of communities faced with reduced banking services have considered establishing a community bank. This model of banking has gained ground steadily in Australia and earned widespread acceptance.[79]

8.69 Many submissions expressed support for the creation of community banks.[80] They appreciate that a community bank reflects the priorities of members of the local district and brings additional benefits to a community. The Edenhope and District Community Bank Steering Committee saw the establishment of a community bank as the solution to its financial services problem and pointed out that half of the profits of the bank are returned as community dividends.[81] It stated that 'no wonder community banks are opening up throughout the country at a rapid pace.'[82] Indeed, a key to the success of community banks is their close connection with local residents in that they use local investment to establish market share quickly and create customer loyalty.[83]

8.70 The following section briefly discusses two community bank models—the Bendigo Bank and the Heritage Building Society.

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77 Darryl Roberts, *Committee Hansard*, 25 February 2003, p. 182. Mr Brandon Khoo, APRA, explained the operation of the levy system—'The legislation provides for levies to be calculated on a set percentage of assets per sector, subject to a dollar minimum and maximum per institution. The rate for credit unions and other ADIs is currently 0.01 per cent, down from 0.013 per cent in 1999–2000, with a minimum of $500 per institution and a maximum of $1.125 million, which is up from $1 million in 1999–2000'. *Committee Hansard*, 25 February 2003, p. 181.

78 *Committee Hansard*, 25 February 2003, p. 181.

79 See for example, the Shire of Kellerberrin which stated that 'Community banks in Western Australia namely the Bendigo Bank have started to mushroom and those communities are now seeing the immense benefits delivered from a bank located within the community,' *Submission* 52, p. 1. See also *Submission* 100, p. 2.

80 *Submission* 52, p. 1.

81 *Submission* 81, p. 2.

82 ibid.

83 *Submission* 107.

The Bendigo Bank model

8.71 In June 1998, Bendigo Bank opened the first community bank franchise in Australia at Rupanyup and Minyip, Victoria. This experimental branch provided a model for the successful development of a network of community banks throughout Australia. Community bank branches now operate in 110 communities located as far north as Queensland's Sunshine Coast, south to Geeveston and Dover in Tasmania, the eastern seaboard's East Gosford and Collie in the West.[84] Bendigo Bank reported in September 2003 that it had been a significant year for their community bank enterprise. It noted the following milestones:

- opening of the 100th Community Bank® branch in San Remo, Victoria;
- opening of Tasmania's first two Community Bank® branches;
- more than $1.2 million in Community Bank® profits returned to communities in both dividends to shareholders and community projects;
- National Community Bank® network achieving $3 billion in banking business; and
- opening of the 250,000th Community Bank® account.[85]

8.72 Bendigo Bank's community banking model with its community empowerment and self-help focus has much in common with the philosophy underpinning credit unions. Even so, it has some characteristics that set it apart from the credit union model. The most distinctive features of the community bank under the Bendigo Bank model are:

- It is a franchise of Bendigo Bank—a company is established to raise the capital required for the start up and ongoing maintenance through local investment. Capital required varies but can involve up to $750,000.
- It involves the local company employing staff and providing infrastructure costs. Bendigo Bank bears credit risk and provides ongoing support for operators, including use of the bank licence and name.
- Not all customers are shareholders, and the drive for return on equity may see costs for some customers increased or service benefits unevenly shared.[86]
- It is not an easy option, and it may be difficult for disadvantaged rural towns to contribute to the start-up costs required.[87]

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84 Bendigo Bank web site, News, September 2003, 'Locals join National Community Bank Conference, http//www.communitybank.com.au/public/media_file/news.htm

85 Bendigo Bank web site, News, September 2003, 'Locals join National Community Bank Conference, http//www.communitybank.com.au/public/media_file/news.htm

86 *Submission* 109, p. 14.

87 *Submission* 109, p. 14.

- Respondents are prepared to accept minimal returns (the majority did not expect any return) which could only be explained as a contribution to establish a bank branch.[88]

8.73 The research report by KPMG, *Small Business Banking in Australia,* noted the work being done by the Bendigo community banks which are offering investment products such as the Regional Investment Fund to promote small business growth in the regions.[89]

The Heritage Building Society model

8.74 The Bendigo community bank concept, although the best known, is not the only model. The Heritage Building Society has developed its own distinct version of a community-based bank that is gradually growing in popularity. The genesis of this model sprang from an active and enthusiastic community group in the small town of Crows Nest north of Toowoomba that was determined to see better banking and financial services in their district. The town has a population of approximately 2,000 with a catchment area taking this figure to 6,000. This group, the Progressive Community Crow's Nest Ltd, (PCCN) explored many options but finally entered a partnership arrangement with Heritage Building Society. Mr Howard Littleton from the PCCN explained:

> The Heritage community banking model we settled on made the most sense to our community. It was a great deal less expensive to start, (less than half the cost of the other main community banking model) and, once the doors were open, more money stayed here.[90]

8.75 They needed an initial outlay of $60,000 but decided to set a goal of raising $100,000. The group started a company which allowed them to raise the money. Membership was $10 which entitled a member to contribute to the capital of the company by depositing money with the company of between $100 and $5,000. Members were asked to keep the money with the bank for three years but in hardship conditions the money would be returned.

8.76 From the very beginning the company was keen to generate broad community support and placed a limit on the contribution at $5,000. Pensioners and children are among its members.

8.77 After exploring many options, the company approached the Heritage Building Society with a proposal. They presented the Society with a wish list of requirements they regarded as important such as sensible trading hours. The company also placed a high priority on the employment of a senior manager—someone in the community,

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88 *Submission* 107.

89 KPMG Consulting, *Small Business Banking in Australia,* A Research Report, February 2002, p. 26.

90 Howard Littleton in Heritage Building Society, *Information for Communities Considering Community Banking with Heritage Building Society.*

who understood the full range of people's needs from residential through to commercial and business banking activities and would make himself available to the community.

8.78 Following further negotiation, the company entered a joint venture with the Heritage Building Society. The branch has performed better than anticipated with the $100,000 outlay recouped and the branch now making profits. The PCCN has announced the first distribution from its share of the community branch profits in the form of community grants totalling $46,000 to a number of local community projects.[91] The initiators of the scheme cannot understand why more communities have not taken a similar route.

8.79 The Nanango Shire Council adopted the Heritage community bank model and opened its branch in December 2001. Although still in its infancy it is 'very effective and well supported'.[92]

The advantages offered by a community bank

8.80 As established in chapter 3, local residents and businesses value the presence of a bank branch in their town. It means that they are able to conduct their banking in convenient, safe and familiar surroundings and can seek advice from staff with local knowledge. Indeed, the benefits of a community bank extend far beyond simply providing basic bank transactions. The following section looks at some of the broader benefits offered by a community bank.

Reinvigorate the economic life of a community

8.81 Mr Gregory Gillett, Bendigo Bank, noted that the development of a community bank creates opportunities to boost economic activity in the community. He stated:

> What we like about the community banking side of things, with the 700 directors et cetera, is that it has created a lot of new aspirations in these areas. Many of these people have never been on a board before, so we have an obligation to teach them about the duties of directors and about running companies. In a lot of those locations, it is the first new business that has actually been established in 50 or 100 years…what you invariably get is a rush of enthusiasm, excitement and a bit of aspiration happening, which seems to feed on itself and create renewed confidence and enthusiasm in these areas.[93]

8.82 The Nanango Shire Council provides an example of the process followed and the motivation needed to establish a community-based bank. It informed the Committee that the Westpac and Commonwealth banks closed their branches in

91 Fraser Read-Smith, *Committee Hansard*, 23 May 2003, p. 490.

92 *Submission* 10, p. 1. See also 'Start your own Bank', *Choice¸* June 2002, p. 18.

93 *Committee Hansard*, 27 February 2003, p. 334.

Nanango and left an in-store agency in a pharmacy and access to some services through the Post Office. Through the dedication of a steering committee, a community bank was established with the aid of Heritage Building Society.[94]

8.83 Mrs Wendy Zerbst explained that the main motivation in the community pursuing the community bank model in Nanango was 'not just having our own financial services but maintaining the levels of service within this town so that it continues to grow rather than decline, because when services are withdrawn people go away'.[95] The desire to keep businesses in the local area was also the motive behind the new Lockhart Community Bank.[96]

8.84 The added advantage in establishing a community bank stems from the involvement of local people and the focus on developing and promoting the commercial life of the district. Mr Gillett told the Committee:

> …we want to see our communities regain control of the capital flows within their areas and regain control of the economic destiny of their areas, rather than seeing the capital outflows we see today through superannuation, managed investments and all those sorts of things…whilst there is certainly a cooperative spirit to what we are doing, there is very much a commercial edge to the way it is set up.[97]

8.85 He stated that these centres start as bank branches but then evolve into community enterprises as time goes by. They become the centre for managing all the economic enterprise in that district.[98] The very process requires the community to take the initiative:

> They raise anywhere between \$350,000 and \$500,000—usually between \$400,000 and \$500,000—for this particular venture. They have to prove a business case which has sufficient banking volume in it to pay back that sort of capital investment. They then have to marshal, engage and unite all the people in that town to come together as a buying group to make it a successful model.[99]

94 See comments by Wendy Zerbst, 'Start your own Bank', *Choice,* June 2002, p. 18. The community company has 164 members who each pledged between \$200 and \$5,000, making a total of \$160,000. Their stated intention was not to make money but rather to get the service 'up and running'. The members are not shareholders but members who will receive interest on their money. According to a spokesperson for the Nanango Progressive Society, 'the rest of the profits will go to a trust fund to be distributed to community projects'.

95 *Committee Hansard*, 22 May 2003, p. 478.

96 *Submission* 25, p. 2.

97 *Committee Hansard*, 27 February 2003, p. 334.

98 *Committee Hansard*, 27 February 2003, p. 335.

99 *Committee Hansard*, 27 February 2003, pp. 339–340.

Dividends for the community

8.86 Local leaders have high expectations of what a community bank can achieve in their town. Mr Samuel Smith, President, Gladstone Community Development and Tourism Association and Member, Rocky River Community Bank Steering Committee, conveyed his community's hopes in pursuing the establishment of a community bank in their locality. He told the Committee:

> We felt there was a real need. We were losing control of what was going on in our country towns, and we felt the community bank concept that Bendigo Bank was offering had so much to offer. We felt we would be empowered communities with some control over our own destiny. Following the opening of the first community bank in Australia at Minyip-Rupanyup in western Victoria there was talk of $100,000 profit a year, which would go straight back to the community…It was real money; it was better than trading tables, sausage sizzles and things like that. It was money that you could really do things with. The other big thing was, while the banks used to employ school leavers from our high school, that stopped about 10 years ago. So we felt that we could have control over employment also.[100]

8.87 The Director of the Cummins and District Financial Services, Mr Jeffrey Pearson, also suggested that there are 'real rewards for communities that set out on a deliberate course of self-help'.

> We are retaining 50% of the profits generated from banking business transacted by members of our community, that will, in the near future, be made available to assist in the multitude of genuine financial demands in a typical rural community.
>
> …
>
> As a direct result of establishing our bank we have two new families living in our district and because they are employees of Cummins and District Financial Services their allegiance is to this area rather than to some remote banking entity.[101]

Establishing a community bank

8.88 Communities endeavouring to form a community bank share many of the difficulties experienced by credit unions seeking to establish a new presence in a country town. They face the problems of galvanising community support for the enterprise, of the high start-up costs involved in conducting feasibility studies, devising a business case, covering costs while building the business, and overcoming embedded attitudes about the soundness of ADIs that are not established banks.[102]

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100 *Committee Hansard*, 13 March 2003, p. 428.

101 *Submission* 132.

102 *Submission* 107.

8.89 In particular, the initial planning period is a crucial and time consuming stage in establishing a community bank. The following sections look in greater depth at the obstacles faced by communities attempting to set up a community bank.

Community support, commitment and determination

8.90 The message from those who had been successful in establishing their community bank was unambiguous—the venture must be community driven and the undertaking is not easy. Mrs Zerbst echoed the experiences of others involved in establishing a community bank:

> …there needs to be a driving force. When it is a community venture and a joint venture, it cannot be driven by the company, it cannot be driven by Heritage, because the success remains in getting the community behind it, and there is difficulty finding people within a small community that have the expertise and the drive to get it done.[103]

8.91 From the banking side of the partnership, the Heritage Society Building endorsed this view. Mr Read-Smith told the Committee:

> We are not in the business of selling community branches to communities. Our business is that, if they determine they have a need and they want to work at it, we will assist them in every way we can to bring it about, but we are not about thrusting these things down the throats of communities. Our view is that it is the community that has got to make the running, have the impetus, and then we will work with them and do all we can.[104]

Leadership and business skills

8.92 Determination alone to see the establishment of a community bank will not bring success; there must be suitably qualified people available to assist and to run the venture. As with most community groups embarking on this venture, the Crows Nest community group relied on community leaders and drew heavily on the generosity, skills and experiences of professional people in their community to launch the project on a shoestring.

Start-up costs

8.93 Aside from leadership, organisation and commitment, the community needs capital to establish the bank.[105] According to the Managing Director, Bendigo Bank, the path to opening a community bank can 'be long and arduous'. He explained that in most small country towns, you need 50 to 60 per cent of the population to use the

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103 *Committee Hansard*, 22 May 2003, p. 479.

104 *Committee Hansard*, 23 May 2003, p. 493.

105 Ivor Ries, 'Small town bank', *Bulletin* with NewsWeek, vol. 120 (6340), 3 September 2002, pp. 56–7.

facility if it is to work. The branch will need to generate at least $250,000 a year in profits if it is to remain viable.[106]

8.94 In 1999–2000, the Huon Valley Council began talks with the Bendigo Bank with regard to the community banking model they had developed. At first, it determined the level of support from the community by obtaining pledges. Although it required a minimum of 250 pledges, it received 400 with a monetary value of $346,000. Even so, the Bendigo Bank advised the Council that this amount was insufficient.

8.95 The Council then conducted a feasibility study for which it received a $10,000 grant. It employed a consultant to survey the community and to visit the municipality to assess its suitability. Finally, it developed a business plan.

8.96 According to the Local Government Association of Tasmania it has taken two years for the Council to simply determine whether a community bank is a viable option. The capital outlay was in excess of $25,000 with at least as much again in 'in kind' effort. It stated that:

> Huon Valley Council has advised that this system has been a long and arduous process and the benefits of the alternative arrangement are yet to be proven. Huon Valley Council has relied heavily on the support from the community and the dedication of its elected members. Without community backing (financial and in kind) and a whole of community approach, such an alternative arrangement for banking services in rural or regional areas of Australia would not be possible.[107]

The efforts of the community were finally rewarded with the opening of the Geeveston and Dover Community Bank, which is a franchised business of Bendigo Bank Ltd, on 8 May 2003.

8.97 The East Gippsland Shire Council acknowledged that community banks are an option for larger towns. It stated that the level of community financial commitment required to set up a 'bank' is substantial and in most cases beyond the resources of small rural communities.[108] This was the experience of the Rocky River Community Bank Steering Committee in South Australia, which found that despite community enthusiasm, the proposal to establish a community bank had to be abandoned. Mr Samuel Smith explained to the Committee:

> …it was found fairly early in the piece from the discussions with Bendigo Bank that Gladstone on its own was not big enough but, because Wirrabara, Laura and Georgetown did not have any bank branches, it was thought they may be interested…They welcomed it with open arms, and we set up a

106 Ivor Ries, 'Small town bank', *Bulletin* with NewsWeek, vol. 120 (6340), 3 September 2002, pp. 56–7.

107 *Submission* 43, p. [4].

108 *Submission* 75, p. 3.

> committee of 23 people, which covered those four communities. We worked very strongly together for the 14 months we were operating. The immediate response from the community was overwhelming, and that response was maintained right through to the extent that, when we actually made the decision not to go ahead, there were a lot of disappointed people and it took a bit to pull the communities back into it.
>
> …When we first looked at it, the level of shareholder capital that Bendigo Bank believed we needed was $250,000. By the end of 12 months, it was $450,000. The ball game had changed…To come into our small community of 2,500 people was going to be hard work and involved some risk for them [Bendigo bank]. It could have been a number of years down the track before profits could be made, whereas they already had 144 branches around Australia.[109]

8.98 The Heritage community banking model has attempted to address this problem of high start-up costs. Mrs Zerbst found the Bendigo Bank proposal very expensive. In her view, less cost was involved with Heritage and by not imposing a lot of fees such as an annual franchise fee it offered the better option.[110]

8.99 The model clearly sets down the financial responsibilities of each party to the alliance as set out below.

Table 8.2—The Heritage Building Society Community Banking Model[111]

Responsibilities of each party	
Community	**Heritage**
Provides suitable branch premises by way of property ownership or lease.	Is responsible for covering costs to equip the branch office with IT and computer facilities, communication lines and equipment, possibly an ATM, office furniture, marketing material, security facilities and signage, etc.
Covers the cost of fitting out these branch premises to Heritage's agreed standard.	As an Authorised Deposit-taking Institution, provides the authority under the Banking Act for the community branch to operate. Heritage is also responsible for all financial and credit issues.

109 *Committee Hansard*, 13 March 2003, pp. 428–9. Mr Smith explained that the increase from $250,000 to $450,000 was to do with the three different outlets and the costs of setting them up—the buildings, signage, carpets etc. *Committee Hansard*, 13 March 2003, pp. 445–6.

110 *Committee Hansard*, 22 May 2003, p. 472.

111 Heritage Building Society, *Information for Communities Considering Community Banking with Heritage Building Society,* p. 8.

Makes a financial commitment to meet its share of any expected operating deficit until profitable operations are achieved.	Is responsible for providing and training appropriate staff, together with all necessary systems and procedures, as well as extensive operational support.

8.100 Overall, a number of factors combine to create an environment conducive to the establishment of a community bank. Mr Read-Smith observed that there has to be the right community, with the right leadership and level of community support—'it is a question of finding the right communities that have the critical mass, the leadership and the community impetus to make these ventures work'.[112]

8.101 The Committee accepts that some communities will not be able to garner the support or raise the capital required to establish their own bank. It can see a role for government particularly in assisting communities overcome some of the initial obstacles to establishing a community bank. For example, the Government could take a central role in supporting communities to explore options and to put together a business plan. This matter will be discussed further in the following chapter on the CreditCare and RTC programs.

Failure or take-over

8.102 At the moment the success of the community bank model is widely acknowledged. Nonetheless, Mr Tim Moore, who has conducted research in the area of community banks, worried about the long term credibility of such institutions. To his mind the fact that not one community bank has closed has the potential to lead to an unrealistic picture of their future. He suggested that for many banks there will come a time when the benefits they provide are outweighed by the costs of keeping them operating. He was concerned that the closure of community bank branches has the potential to have a more detrimental impact than the closure of other bank branches because of residents' money being tied up in the operation itself. He stressed the importance for communities to consider this possibility in their decision-making.[113]

8.103 Others saw problems arising from their success that could leave community banks vulnerable to takeovers. The Lockhart Shire Council argued that as the community bank model becomes more popular and gains wider acceptance it will begin to eat into the profits of the major banks. It asserted that 'They must not be allowed to simply buy out the competition and then embark on another round of closures of branch or agency closures'.[114] Likewise, the Narrandera Shire Council was concerned about takeovers and noted that consideration needs to be given to

112 *Committee Hansard*, 23 May 2003, p. 494.

113 *Submission* 107, p. 5.

114 *Submission* 25, p. 3.

legislative safeguards for community banks to protect the franchise institution from large corporate takeovers.[115]

8.104 A member of the Community bank at Crows Nest accepted that at some stage other models such as the Bendigo Bank one may be susceptible to a takeover from one of the major banks leading to a cycle of downgrading services. It noted that their joint venture model with Heritage, allowed them to seek another partner if Heritage wanted to 'bail out'.[116]

8.105 The Committee accepts that the community bank is a relatively new development and is proving successful. It is also conscious of the concerns about the damage that could be caused to the image of such institutions should one fail or conversely should it be taken over in the case of its success. Such warnings only highlight the importance of local commitment and on-going local involvement with the enterprise to ensure that it remains a genuine community facility.

Committee view

8.106 The Committee acknowledges the work being done by community banks. They not only provide basic banking transactions but answer the growing need for country people to have access to local staff with a strong connection to the district. They provide an attractive option for communities not well served by the traditional banks.

8.107 Their ability to extend their reach into areas in need of banking and financial services, however, is severely curtailed by the limited resources found within many communities. High start-up costs, the importance of community leadership and the need to make the venture a profitable undertaking, means that not all communities have the wherewithal to support such a facility. Evidence has shown that a commitment to and enthusiasm for the establishment of a community banking facility is not enough to make it a viable option. There must be a substantial capital base upon which to build a community bank.

Owner-managed branches

Before leaving this section on community banks, the Committee briefly mentions a model that has a close community focus but where the branch is owned by the manager.

115 *Submission* 36, p. 2. The Country Women's Association of Western Australia also mentioned the possibility of community banks being 'swallowed up by the more established banks where they demonstrate substantial competition…' *Submission* 100, p. 2.

116 Based on notes taken during Committee's site inspection of the Crows Nest community bank, 22 May 2003.

Bank of Queensland

8.108 The Bank of Queensland operates a number of owner-managed branches where the branches are privately owned. Under this model, the owner-manager, after making an initial outlay to cover upfront costs, enters a profit-sharing arrangement with the Bank of Queensland. The owner-managed branches are located in bank premises and staffed by non-bank employees.[117] They offer a broad range of banking services including cash/cheque deposits and cash withdrawals, lending and the maintenance of accounts to both personal and business customers.

8.109 The focus of the owner-managed model is on community engagement and strengthening the customer-manager relationship. They have flexibility in terms of staffing, opening hours and local marketing. The Bank of Queensland hopes to attract managers with a strong local connection able to relate to the community and its needs. Because the manager owns the branch, there is a strong incentive for him or her to develop close links with customers.[118] At the opening of an owner-managed branch in Murgon, the Bank of Queensland's General Manager Retail, stated that:

> These branches are not only allowing us to expand while other banks are reducing their networks, but ensure we are more flexible and responsive to the local community.[119]

8.110 This model presents the same advantages as the community bank in restoring banking services to communities abandoned by the major institutions and in rallying the local economy. The identical problems, however, of start-up costs and building an adequate capital base limit the opportunities for such a model to expand into some areas of rural, regional and remote Australia.

Conclusion

8.111 Unfortunately, some communities, as shown in this chapter, even with determined commitment, cannot generate the level of support or finance needed to establish and sustain a credit union or building society branch or a community bank. In some cases, a town simply cannot support a fully operational facility offering traditional over-the-counter services. This means that communities without access to satisfactory banking and financial services and unable to attract a credit union or establish their own bank, must rely on other means to gain access to such services.

8.112 ADIs, both bank and non-bank, have implemented strategies to help compensate for this lack of banking services. The following section looks at the steps taken by financial institutions to provide an alternative means of delivering banking

117 APRA, Points of Presence , Raw data, 2002.

118 Paul Syvret, 'At your service', the *Bulletin* with Newsweek, 19 November 2002, vol. 120, no. 6351, pp. 54–5.

119 Bank of Queensland, Media Release, 7 May 2003.

and financial services to areas of regional, rural and remote Australia that cannot support a fully operational branch.