2024

Customer Owned Banking Impact Report

CUSTOMER OWNED BANKING ASSOCIATION

Prepared for COBA by
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Introduction

Customer-owned banks are also known as mutual banks, credit unions and building societies. They are owned by their customers who are members of the bank. In general, profits made are reinvested into better products and services for members, instead of being distributed to investors.

As at June 2024, there are 56 customer-owned banks, representing 73% of the 77 Australian-owned Authorised Deposit-taking Institutions (ADIs) in the Australian market. Of these, 55 are COBA members.

The sector serves more than five million customers, compared to the collective 50.5 million for the so-called 'Big Four' banks – Commonwealth Bank of Australia (CBA), Westpac (WBA), National Australia Bank (NAB), and Australia and New Zealand Banking Group (ANZ).[1]

Despite holding only 8% of household deposits and just 2.9% of total asset market share, customer-owned banks are giving back to their communities at a rate nearly nine times higher than the major banks.

They also offer more competitive rates and better services, as this unique model allows reinvestment of profits for the direct benefit of members.

Despite its strong customer base and its particular importance to serving its members and communities, the sector's impact is not often well-understood.

This report, commissioned by COBA, serves to highlight the sector's contribution to Australia's economic, social and environmental wellbeing. It also draws attention to the critical role customer-owned banks play in supporting competition in Australia's banking sector, delivering better outcomes for all Australians.

ABOUT THE REPORT AND AUTHOR

The Customer Owned Banking Association (COBA) has commissioned Nicki Hutley to conduct an assessment of the impact of the customer-owned banking sector financially and economically as well as on members, staff and its wide communities. Nicki is a highly experienced economist, with broad-based expertise in both macroeconomics and microeconomic policy gained over more than three decades in financial and investment markets and in economic consulting. She is particularly interested in the intersection of economy, society and environment. Nicki also serves as COBA's Chief Economic Adviser.

1 Analysis of 2023 major bank annual reports.

Customer-owned banks a snapshot

size

$178bn

2.9% share of assets

$271m

taxes

$4bn

operating income

3.3% of ADI income

$1.6bn

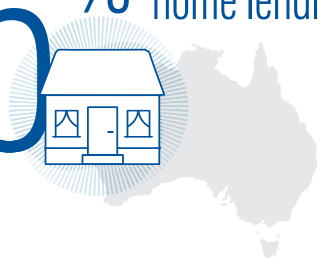
in wages and personnel costs

$651m

net profit

1.6% of $39.4bn profit

5% of total home lending



0.42%
non-performing loans
compared to 0.95% for all banks

On average
0.4
percentage points lower than major banks' mortgage rates[2]

11,500
people employed

Largest regional branch network

$7.10
per customer community contribution

- compared to the Major banks' per customer cash contribution of $4.10
- 5.2% community contribution of all profit for customer-owned banks, compared with 0.6% for major banks

89.5%
customer satisfaction for the customer-owned banking sector as a whole compared to 75.4% for the Big Four

15%
of all B-Corp certified banks globally are Australian customer-owned banks

2 Desktop analysis conducted on major bank and customer-owned bank owner occupied home loan variable rates, based on a $635,000 loan with 80% LVR on a 30 year term. Conducted on 17 July and 9 October 2024. Note: Individual variable rates vary between customer-owned banks.

2

Enhancing competition

Customer-owned banks within the Australian banking landscape

According to recent OECD research, Australia fares particularly poorly when it comes to market competition across multiple sectors of the economy, including financial services in general and banking in particular. This poor performance is considered to be the result of historical policy and regulation and comes in spite of the recommendations made from previous reviews into Competition Policy: the Hilmer, Dawson, and Harper Reviews, completed in 1993, 2003. and 2015 respectively.

In announcing the most recent Competition Review in 2023, the Australian Treasurer observed:

> *Greater competition is critical for lifting dynamism, productivity and wages growth, putting downward pressure on prices and delivering more choice for Australians.*

In addition to these broader reviews of competition, there have been specific inquiries into the Australian Financial System, such as the Productivity Commission (PC) 2018 Inquiry into the financial system, and the ACCC's reviews into home loan pricing (2020) and retail deposit products (2023).

2.1 Features of a competitive market

A highly competitive market (sometimes called a 'perfect' market) has three main features:

1. There are many buyers and sellers, and no single entity, or group of entities, dominates the market.
2. Comparable products are offered, and supply is responsive to demand
3. There are low barriers to entry.

Perfect markets rarely exist outside of theory, although foreign exchange markets are often considered to be close.

The banking market in Australia meets some, but by no means all, of these conditions, as discussed in the following section.

2.2 How competitive is Australian banking?

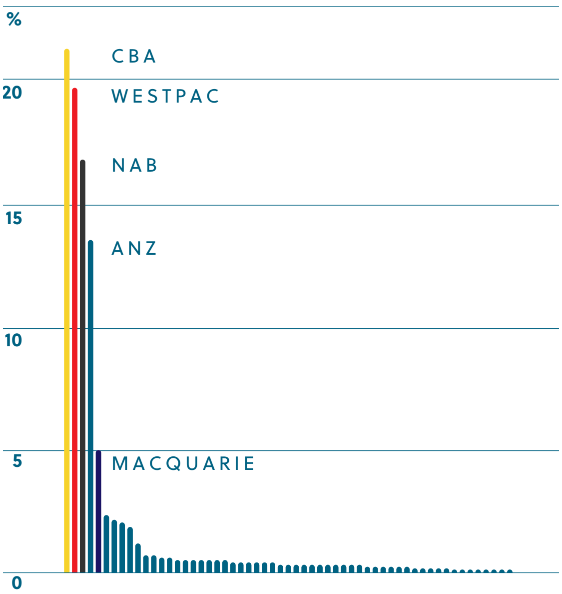
Examining each of the above issues gives insights into the lack of competitiveness in Australian Banking.

2.2.1 MARKET CONCENTRATION

While there are large numbers of buyers (customers) and sellers (ADIs), there is a high level of concentration evident in Australia's retail banking sector, which is dominated by the Big Four banks.

These banks hold a significant share of the market across various financial services, including housing loans, personal deposits and credit and debit card issuance, as shown in Figure 1 below. For comparison, the largest customer-owned bank, People First Bank, is less than 3% the size of Australia's largest Bank, CBA.

FIGURE 1 **BANK SHARE OF ASSET ON DOMESTIC BOOKS (AT MAY 2024)**



Source: APRA Monthly ADI Statistics, May 2024

The PC Inquiry observed that major banks' market power derives from a number of factors, and in particular:

- Longevity, scale and the associated perception that they are safe compared to smaller players, because they are 'too big to fail'. This perception does not reflect the reality that the Government's Financial Claims Scheme protects customers of all institutions, whether large or small.
- Regulatory arrangements, which often disadvantage smaller players. In particular, the cost of capital for funding and regulatory compliance is lower for larger institutions.
- Vertical and horizontal integration – larger banks have been able to cross-subsidise and bundle products.
- Information failure, which leads to consumer stickiness – 50% of people still bank with the first bank they had an account with. Switching becomes even less likely once consumers have a home loan.

The concentration of market power among the major banks has led to higher interest margins on lending products and lower rates on savings accounts, when compared to other Australian-owned banks[3]. Major banks' margins are also well above the average for comparable high-income countries, and around two and a half time those of mutuals and other smaller Australian banks.

3 Productivity Commission, 2018, Competition in the Australian Financial System P.9 Figure 3

2.2.2 COMPARABLE PRODUCTS

While products such as deposit accounts and home loans are intrinsically similar across providers and can be differentiated by price, as noted above, consumers tend to be sticky even when choice is available due to lack of information and/or time.

Other factors, such as the RBA cash rate and compliance costs put a floor under mortgage interest rates. Nevertheless, COBA members standard headline rates on variable home loans are on average 0.4 percentage points lower than major banks' rates[4]. This is consistent with the findings from the 2022 Customer Owned Banking Impact Report, which showed an average of 0.3 percent lower market interest rates for customer-owned banks[5].

Competition is most obvious in markets for products such as credit cards, where consumers can hold multiple products from different providers.

To address the issue of stickiness, the Treasurer announced in June this year that it will work with banks across a range of measures to encourage consumers to get better deals through switching.

2.2.3 BARRIERS TO ENTRY

The Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) regulate the banking sector. Recent regulatory measures have aimed to increase competition, such as making it easier for new entrants to obtain banking licenses and promoting open banking. However, even while there have been some new entrants to the market in recent years, particularly in the digital banking space, we see evidence of the large barriers. For example, Australia's first neobank, Volt, handed back its license in 2022, while Xinja also handed back its license in 2020 due to an inability to access sufficient funding. Others, such as uBank and 86 400, have been bought out by larger banks.

Overall, the regulatory environment is considered to hamper competition at present. For example, high capital adequacy ratios, and liquidity and risk management requirements which are complex and add to costs. Regulatory compliance and reporting also add to costs.

Other factors which impede new entrants include:

- Access to capital
- Economies of scale enjoyed by dominant players
- Technology requirements e.g. secure IT systems, online banking platforms, and robust cybersecurity measures
- Brand recognition – new entrants need to invest heavily in marketing and customer acquisition.

As a result of these barriers, the number of ADIs has steadily declined over the past 20 years, from 239 in 2004 to 129 today.

The recent announcement of a Regulatory Grid is welcome, as is the inquiry into the impact of regulation on smaller banks.

4 Desktop analysis conducted on major bank and customer-owned bank owner occupied home loan variable rates, based on a $635,000 loan with 80% LVR on a 30 year term. Conducted on 17 July and 9 October 2024. Note: Individual variable rates vary between customer-owned banks.

5 https://member.customerownedbanking.asn.au/storage/KPMG-Community-Impact-Report/coba-kpmg-report-digital-1678767256ONmIN.pdf

2.3 Balancing competition with stability

Financial system functioning is of critical importance to the smooth functioning of the economy. The Global Financial Crisis demonstrated the perils of poorly regulated financial markets. Closer to home, the Hayne Royal Commission into Misconduct in Banking, Superannuation and Financial Services (2017-2019) demonstrated the need for clear regulatory systems to protect both consumers and the trust in financial institutions, which is an important pillar of stability.

However, regulatory compliance and its associated costs can impede competition. Indeed, in its review of the financial system, the PC notes that in Australia there has been a tendency by regulators to emphasise "stability over competition". The PC emphasised the importance of balancing these two objectives:

> *"Since the global financial crisis there has been a focus on requiring prudentially regulated institutions to be unquestionably strong. It is important to ensure that the essential role of competition in economic growth is not eroded by having stability as the default regulatory position, to the exclusion of competition. Competition can support stability, checking irresponsible behaviour of providers and improving outcomes for consumers, and must be allowed to flourish."*

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It is critical that Government and regulators continue to work with ADIs to ensure stability without compromising competition, noting the important role the customer-owned banking sector plays in ensuring the latter.

3

Economic contribution of customer-owned banks

The customer-owned banking sector has a significant economic footprint across Australia, contributing $2.5 billion to the economy through wages, taxes and profits.*

3.1 Financial impact

For the year-ended March 2024:

- Total assets of the sector were $178 billion, or 2.9% of total ADI assets.
- The total operating income of the customer-owned banking sector was $4.0 billion, or 3.3% of all ADI income.
- Net profit after tax for the sector was $651 million, or 1.6% of the $39.4 billion total for all ADIs.

The sector paid $271 million in taxes and $1.6 billion in wages and related personnel costs.

For their size, mutual ADIs lend proportionately more to housing, accounting for $125.8 billion in loans, or 5.0% of total lending for housing across ADIs in the March quarter of 2024. Despite this stronger focus on home lending, prudential compliance ensures a low risk profile. Residential property non-performing loans are consistently low, with just 0.42% at 90 days or more past due, compared to 0.95% for all ADIs.

* Economic Footprint is calculated for the year ended June 2023.

3.2 Employment

Sector employment is over 11,500 of full-time equivalent employees across Australia. The wide variation in scale of customer-owned banks means the largest employ close to 2000 staff, while the smallest employ under 20.

Earlier work by KPMG estimates that there is an implied economic multiplier across customer-owned banks for employment of 1.9, indicating total direct and indirect employment of just under 34,000 for the sector.

COBA members also have a strong regional presence (discussed in more detail in Section 4.1 below), not just of branches but of head office operations also, providing opportunities for a skilled workforce.

Skilled roles include senior management, board directors, a range of professional finance roles including accounting risk and data and risk analysis, as well as IT and HR professionals.

To support staff, customer-owned banks spend around 0.5% of their total operating costs on training and development.

COBA members are also actively working towards diversity and inclusion goals for employees. The 2024 WGEA wage gap data shows that, for those members that reported, the median wage gap for the sector was 23.8%. While above the industry-wide average, the performance was better than the financial services sector as a whole, at 26.1%. Importantly, many members are taking steps to adopt core WGEA policies such as implementing, maintaining and reporting transparent performance processes.

4

Social impact of customer-owned banks

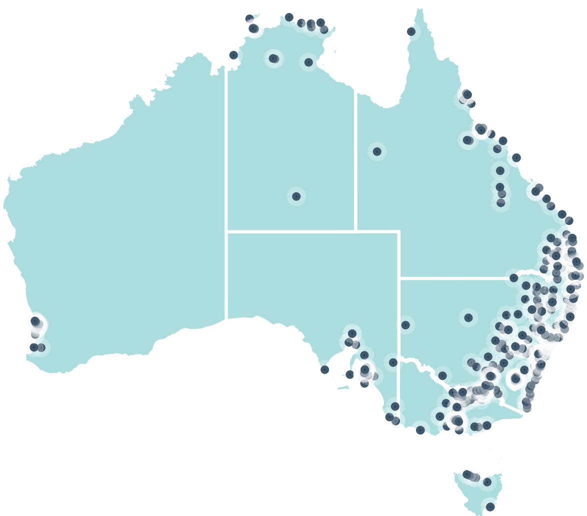
Customer-owned banks pride themselves on serving their communities through both their core operations but also additional wider contributions.

4.1 Branch presence

The banking sector is digitally transforming at a rapid pace, driven by consumer preferences. Use of cash has decreased from 70% of payments in 2007 to just 13% in 2022 , while cheque usage continued to decline, down by 33.4% in the year to May 2024[6] and accounting for less than 0.1% of total non-cash transactions in 2023.[7]

Despite the industry's shift towards digital banking, customer-owned banks collectively have a disproportionate branch presence, with the largest branch footprint in regional Australia.

FIGURE 2 **CUSTOMER-OWNED BANKING BRANCH PRESENCE, APRA POINTS OF PRESENCE - JUNE 2023**



6 https://www.rba.gov.au/speeches/2023/sp-gov-2023-12-12.html

7 https://www.rba.gov.au/statistics/frequency/retail-payments/2024/retail-payments-0524.html

Closure of bank branches is not a new phenomenon in Australia, particularly as customers have on the whole shown a preference for digital services and customer foot traffic has fallen. However, branch closures tend to have a bigger impact on those in regional and rural Australia as they have fewer accessible physical options for banking and have a larger proportion of digitally excluded individuals.

4.2 Community & charity contributions

In FY2023, COBA members contributed a total of $38.4 million[8] to community and charitable organisations. This equates to an average contribution of $7.10 per customer, compared to the Major banks' per customer cash contribution of $4.10[9]. This works out to be 5.2% of all profit for customer-owned banks, compared with 0.6% of profit for major banks.

Of the total, $25.8 million was in direct cash contributions, $1.3 million in volunteer time, $2.0 million in other in-kind contributions and $9.4 million in other costs while engaged in community investment programs and activities.

FIGURE 3 REGIONAL BRANCHES, **APRA POINTS OF PRESENCE - JUNE 2023**

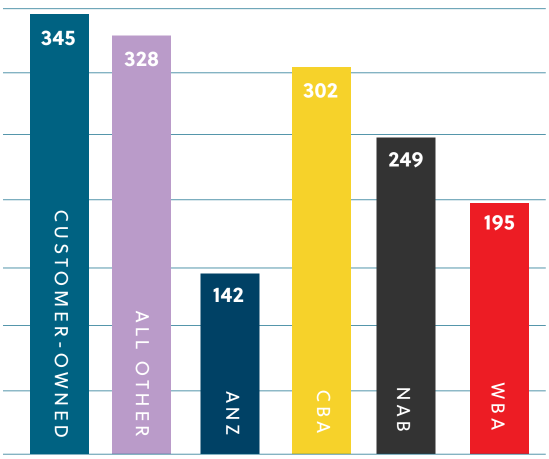
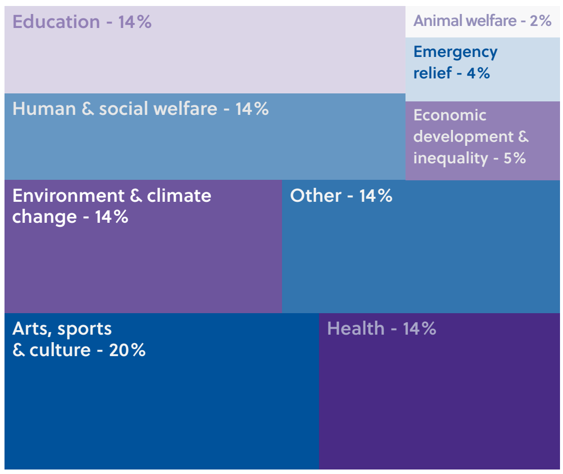


FIGURE 4 **TARGET ISSUES FOR COBA CONTRIBUTIONS**



8 Based on survey response for 34 organisations representing 84.5% of total sector annual operating income.

9 Analysis of 2023 major bank annual, sustainability and ESG reports.

Contributions made support a wide range of issues, with Arts, Sport and Culture accounting for 20% of total contributions, while Education, Health, Environment and Climate Change, and Human Social Welfare each account for 14% of contributions.

Hundreds of different organisations are supported across the above issues, from primary schools to community gardens, from local transport to LGBTQI+ organisations, from local emergency services groups to recycling centres, and from disability support groups to Men's Sheds.

The vast group of organisations supported has an impact on hundreds of thousands of people across communities around the country (and animals too). This report cannot capture the full extent of their social impact. However, we know that many not-for-profit organisations, such as those supported by COBA member organisations and their staff, deliver substantial returns on investment. For example, Orange Sky Laundry which supports the homeless, has a social return on investment (SROI) of 2x, and supported more than 44,000 people around Australia in 2022-23. Foodbank, supporting families in need, has an SROI of 3.2x. The RSPCA runs animal support programs for the homeless, those going into aged care and those facing domestic violence – these programs have an SROI of between 5.8x and 10x.

So, every dollar of support from COBA members has the potential to create a significantly larger impact in the community through the work of supported organisations.

4.3 Customer trust and satisfaction

Trust is a hard-won commodity. The 2024 Edelman Trust Barometer shows a worrying trend of declining trust in institutions and organisations across 28 countries. However, with its focus clearly on customers, the customer-owned banking sector has bucked this trend.

A recent survey of customers, undertaken by Roy Morgan in May 2023, shows a higher aggregate Net Trust Score than that of the Big Four banks, and higher than any individual key banking brand.

The survey feedback reflected comments such as;

> *I find they have retained the philosophy they had as a credit union to always put the customer at the centre of all their transactions.*

"I find they have retained the philosophy they had as a credit union to always put the customer at the centre of all their transactions."

These findings follow on from the May 2024 Roy Morgan Customer Satisfaction survey which showed COBA members had significantly higher scores than the Big Four [9] – 89.5% for the customer-owned banking sector as a whole, compared to 75.4% for the Big Four. The highest rated customer-owned bank saw a satisfaction score of 95%.

9 Customer Satisfaction Rating for main financial institution.

4.4 Reconciliation

Many customer-owned banks have also developed a RAP to better understand how they can support Aboriginal and Torres Strait Islander people. Some examples include the following.

BANK AUSTRALIA

Bank Australia was the first customer-owned bank to create a RAP in 2010, which it has since broadened to encompass justice, reconciliation and self-determination.

The bank describes recognition and reconciliation with First Nations people as a "fundamental responsibility" and plans to achieve its goals by 2030. Its actions include building relationships, partnerships and trust with First Nations people through its banking activities and in the community. For example, it is focused on developing culturally appropriate products and services and passing lessons it has learnt on to customers.

GREAT SOUTHERN BANK

Great Southern Bank (GSB) launched its second RAP, Innovate, last year. It is focused on helping the bank "embody reconciliation" in its everyday activities.

GSB envisions a country "where First Nations people can find a place to call home and achieve the financial independence to pursue their dreams", it stated in its RAP.

One of the ways the bank is achieving its reconciliation goals is by providing its staff cultural awareness training. GSB is also focused on finding solutions to getting more First Nations people into affordable and sustainable housing.

TEACHERS MUTUAL BANK

Teachers Mutual Bank's first RAP, Reflect, was released in 2022 and focused on understanding past injustices and how to change for the future.

The bank is trying to create "honest conversations, deep learning and practical actions" through its RAP.

Some of its activities include building relationships, cultural-competency training, supporting Aboriginal and Torres Strait Islander businesses and finding roles within the organisation for Indigenous people.

These three short case studies are a snapshot of just a small portion of the work being done in the customer-owned banking industry. More of the progress is expected to be made by COBA member banks make in the next few years.

5

Sustainability initiatives of customer-owned banks

5.1 Recognition of sustainable practices

B Corp certified companies have been certified for having high standards of environmental and social performance, accountability, and transparency assessed across five areas: workers, customers, governance, environment and community. Businesses must also embed stakeholder governance into their company's constitution, which holds directors accountable for making decisions that consider the long-term impacts on communities, employees, and the environment.

As reported in Section 4.2, customer-owned banks contribute substantially to their communities and charitable organisations, well above the industry standard.

Employee satisfaction is measured by staff retention, with an average length of tenure 7.5 years in FY2022 (up from 7.3 years the previous year).This is more than double the national average of 3 years and 4 months, according to the Department of Employment.

A rigorous process is involved and only 56 deposit banks globally have been certified, which represents less than 0.1% of the number of B Corps worldwide. An impressive 15% of these are Australian – and all 8 of them are customer-owned banks.

Beyond Bank was the first Australian bank to be certified in 2015. Since then, they have been joined by Teachers Mutual Bank, Summerland Bank, Bank Australia, Australian Mutual Bank, People First Bank, BankVic and, just this year, Great Southern Bank.

5.2 Emissions reduction

The customer-owned banking sector, by the nature of its business, has comparatively low Scope 1 (direct) and Scope 2 (indirect from purchased energy) emissions.

For the customer-owned banking sector, 93% of loans are funded by deposits and this determines the nature of lending. Unlike major banks, business lending is minimal, with funding aimed at home lending rather than investments in companies which may have large emissions footprints, such as fossil fuels or tobacco.

Scope 3 emissions (all other emissions in the value chain) are therefore concentrated in the households that the sector lends to.

Due to the large range in size of members, with the ten largest institutions accounting for 76% of annual revenues, leadership on emissions reduction currently comes from the biggest members who not only have larger numbers of home loans and therefore environmental footprints, but also have the necessary resources to focus on Scope 3.

A number of these organisations offer competitive rates, and sometimes discounted rates, for members who add environmentally friendly features to their homes, including solar panels, water tanks and insulation, as well as for the purchase of low emissions vehicles.

Improvement of reporting and measurement of all emissions across the sector over time will help to improve performance.

5.3 Environment initiatives

Customer-owned banks also support a wide range of environmental initiatives, such as:

- A unique program spearheaded by Carbon Landscapes and supported by First Option Bank is helping to protect the Mallee Emu-Wren and other native species. The project involves managing more than 800 hectares of private Mallee woodland and removing predators to help the little birds reestablish populations and thrive.
- BankWAW plants a tree for every new customer who opens an account or takes out a loan. In 2023 alone, over 1,000 seedlings were planted in the annual Banking on Trees Community Event in the bank's local region of Albury-Wodonga, which brings the locals together to help the planet.
- Gateway Bank works with the community organisation Reverse Garbage, which collects items that would otherwise go into landfill and reuses them for new products.

Other environmental organisations supported by COBA members include (but are not limited to): resource Smart Schools Awards, Landcare Broken Hill, Carbon Landscape, Trust for Nature, Good360, community gardens, an EV expo, recycling, school greenhouse project and Reforest Now.

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