Mutuals industry review 2019

Maintaining trust and transforming for the future

How You Grow Matters

November 2019

KPMG.com.au

Foreword

This report examines the performance and trends of Australia's mutual banks, building societies and credit unions (together, the Mutual sector) as regulated by the Australian Prudential Regulation Authority (APRA).

It includes the financial results of 44 Mutuals for the year ended 30 June 2019 (2018: 48 Mutuals), which represents over 95 percent of the Mutual sector by total assets and profit before tax.

The financial information, analysis and observations have been compiled from publicly available financial reports, APRA statistics and also includes information from the prior year. In certain instances, data has also been obtained directly from survey participants.

This report also includes the results of our qualitative survey, which asked Mutuals to share their views on the risks, challenges and opportunities they see facing the industry. We had an excellent response rate this year of 93 percent, which continues to demonstrate the Mutual sector's desire to come together and leverage experiences and operate in unison in the highly competitive banking market.

For the purposes of preparing our charts and analysis, KPMG has disclosed the results of the Top 10 Mutuals by total assets (the Top 10) together with the results of the remaining Mutuals (Mutuals excluding the Top 10). We have also made reference to the financial results of the Australian major banks (the majors).

We would like to thank the survey respondents for their time and contribution to this report. Please visit our **website** for access to the following materials that accompany this report:

- **Webinar:** An overview into the key findings from our report. This covers both analyses of financial results, and of key responses to our qualitative survey. A recording of the webinar is available.
- **Mutuals insights dashboard:** Interactive charts and graphs of the financial data collected, which can be filtered based on preferences. An introduction into the dashboard's capabilities is included in the webinar recording.
- **Spark Videos:** These short video clips provide highlights of the key themes from our report. Please watch our report contributors speak to their respective observations in the Mutual sector and the broader banking sector overall. We hope these spark your interest.
- **Financial datasheet:** This details the financial information collected.

Contents

The KPMG Mutuals Insights Dashboard

The KPMG Mutuals Insights Dashboard which accompanies this report contains interactive charts and graphs that are underpinned by the financial data collected from Mutuals surveyed. This dashboard enables you to filter the data based on your own preferences and view the financial metrics for a particular year or segment of the Mutual sector. You can also view metrics for an individual Mutual in comparison to a peer group.

The dashboard can be accessed via our website at **KPMG Mutuals Insights Dashboard**

Year in review – 2019 highlights

24bps

Average capital adequacy ratio decreased by **24 bps to 16.73%**

6.1%

Operating profit before tax decreased by **6.1%** to **$593m**

5bps

Net interest margin dropped **5 bps** to **1.99%**

8.5%

Deposits grew by **8.5%** to **$98.97b** (2018: **$91.19b**)

3.2%

Non-interest income decreased by **3.2%** to **$533m**

3

2 mergers completed (2018: **5**)

0.04%

Impairment expense remained flat at **0.04%** of Loans to members

7.3%

Residential lending increased by **7.3%** to **$95.50b** (2018: **$89.00b**)

69bps

Return on equity decreased to **4.51%** (2018: **5.20%**)

6 Current and emerging topics

1 Transformation and simplification

How can Mutuals transform and grow by simplifying customer experiences and focusing on core capabilities?

2 Preserving trust in Mutuals

Why does trust continue to drive the organisational context, and what framework can Mutuals utilise to demonstrate and foster trust? Can trust drive innovation and transformation?

3 Increasing focus on Environmental, Social and Governance (ESG)

How can a Mutual respond to emerging climate risks? How does a Mutual build sustainable finance models into their current offerings?

4 Member experience

How can a Mutual design products that are centred on customers and get these to market quickly? What are regulatory authorities focused on and how is it shaping the banking industry?

5 Open Banking

Open Banking deadlines in Australia are fast approaching. How is the sector approaching Open Banking regulation and what strategies can a Mutual utilise in their implementation journey?

6 Operational resilience

How do Mutuals remain operationally resilient in an ever-changing market?

Fresh off the press:

Protecting the Mutuals industry from money laundering and terrorism financing

What are the observations and learnings from AUSTRAC's recent report on AML/CTF as it relates to the Mutuals? How can Mutuals respond to the report?

These questions are here to stay and not addressing them head-on opens the opportunity for others to take the lead in the fight for growth, customers and returns.

Introduction

The 2019 year saw Mutuals perform well, with balance sheet (net assets) growth of 4.3 percent (2018: 5.6 percent) to $9.2 billion. However, overall operating profit before tax fell by 6.1 percent (2018: grew by 4.7 percent) to $593.3 million (2018: $631.8 million). This reflects the squeeze on net interest margin (NIM), and increased spending on people and technology costs.

The Mutuals' performance has been underpinned by their continued effort to invest in people and technology in order to facilitate the streamlining of operations. The focus has been on enhancing the customer experience whilst maintaining pricing discipline, and in some cases, merging to gain economies of scale.

Also impacting these results is a business environment characterised by low interest rates, strong competition and stalling property prices. Coupled with this, the industry is also feeling the impact of technological innovation, new sources of competition and evolving customer preferences.

The backdrop to all of this is a broader financial services industry that is facing unprecedented political, regulatory and media scrutiny.

Banks now operate in an environment where doing much of the same thing year on year cannot maintain 'status quo'. Rather, transforming simply, efficiently and with a focus on the customers' needs is required. This will also be important to achieve compliance in this environment of significant regulatory change.

Many Mutuals have been wondering whether there is a single paramount priority to address. The pertinent considerations for Mutuals right now is how best to leverage their member and community based trust and agility to:

- remain resilient in the face of competitive and regulatory change and
- transform the business around the customer.

Successful Mutuals will be those that can balance between, and adapt to, these priorities.

This report explores a number of similar considerations and aims to provide insight into what priorities are in the mix for a Mutual when it comes to **'maintaining trust and transforming for the future'.**

Starting with simplification, we explore six current and emerging topics for the sector:

1. Transformation and simplification
2. Preserving trust in Mutuals
3. Increasing focus on Environmental, Social and Governance (ESG)
4. Member experience
5. Open Banking
6. Operational resilience

Refer to page 3 for more details.

As noted on page 3, we also explore "Fresh off the press: Protecting the Mutuals industry from money laundering and terrorism financing"

These topics represent a strategic imperative for all financial institutions, however, the Mutual sector is well positioned to meet these challenges, particularly with the continued strong bond the Mutuals have with their customers and stakeholders. We explore how the Mutuals may achieve these strategic initiatives and the key areas we feel should be front of mind.

These topics are here to stay and not addressing them opens the opportunity for others to take the lead in the fight for growth, new customers and value for members.

Mutuals must take ownership of their transformation journey. They also must remain proactive in adapting their organisation to simple, technology-focused business strategies. All this whilst meeting regulatory expectations and always preserving alignment with member interest and values.

Their success lies in the ability to retain the Mutuals strong branding as 'purpose-driven organisations' providing value to the community and to members alike. Providing clear solutions to address the primary pain points and financial wellbeing of members has never been more front of mind.

We hope that you find this publication insightful and we look forward to having further discussions with the sector in the coming year.

Brendan Twining
National Sector Leader, Mutuals
KPMG Australia

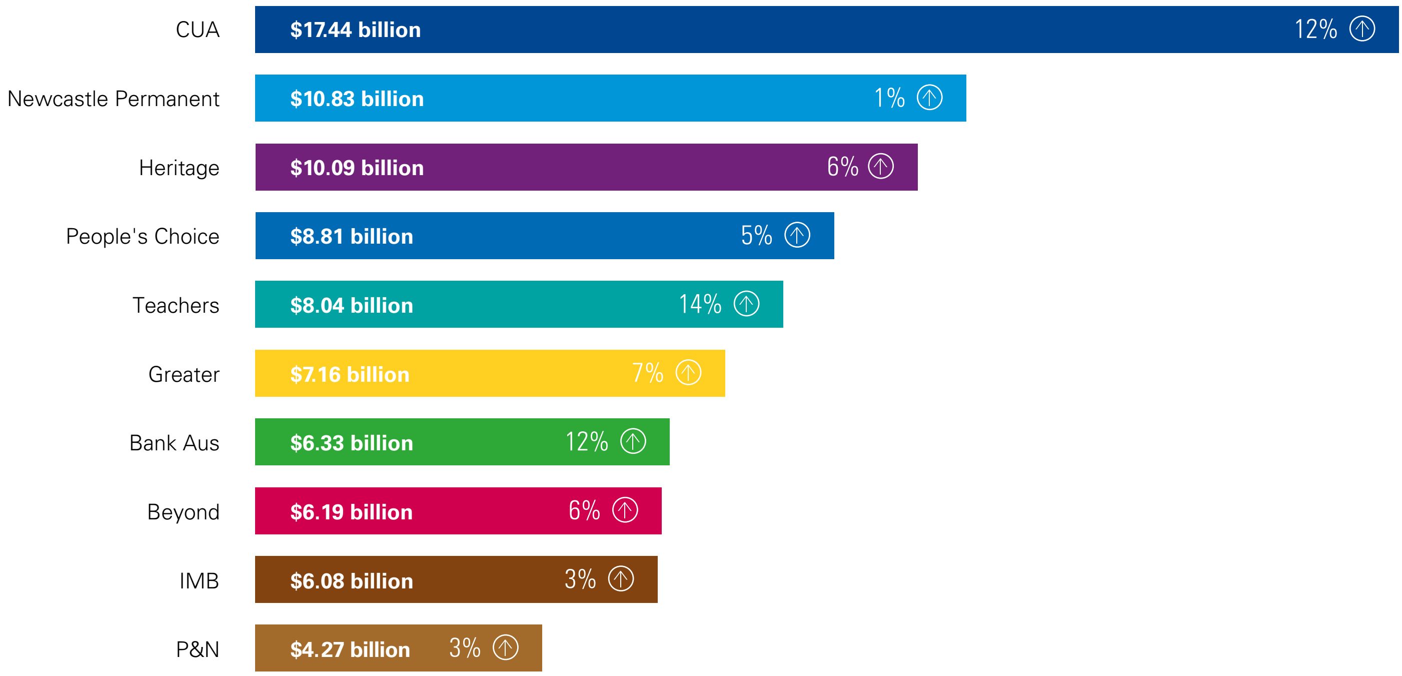
2019 financial results

The 2019 financial year saw Mutuals record higher growth in total assets relative to previous years as the Industry continues to gain from its customer focus, in a post-Royal Commission era. In the analysis below, we have highlighted some of the key financial results observed across the sector as well as the Top 10 Mutuals (by total assets).

Assets

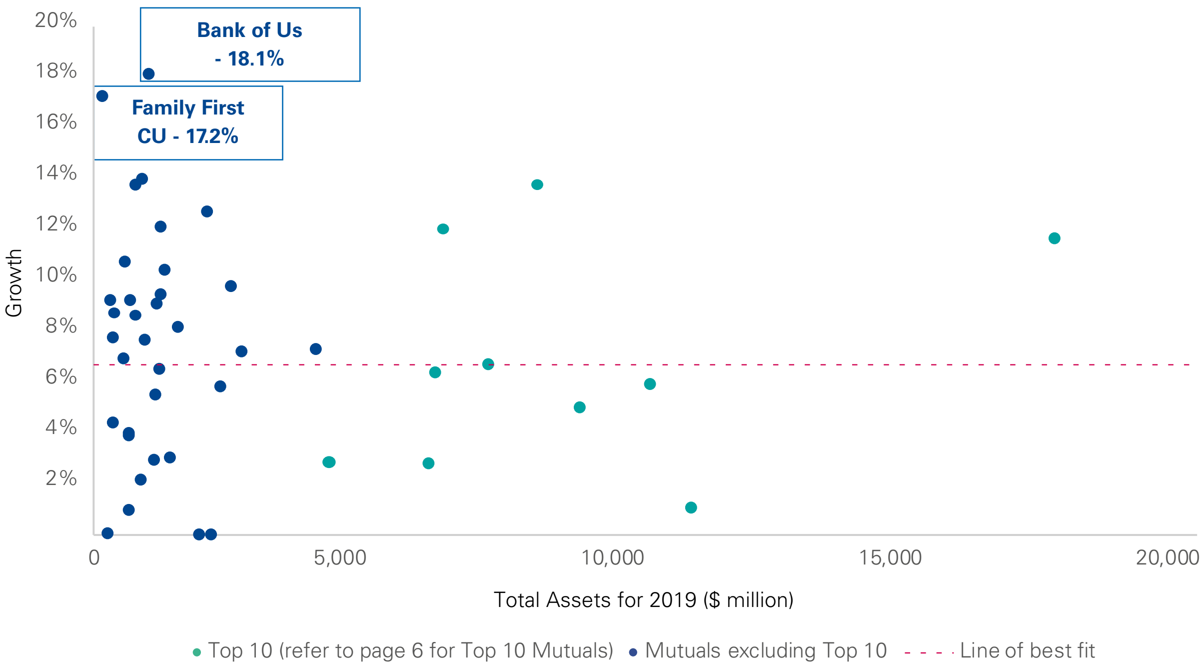
The Top 10 Mutuals by total assets have continued to maintain their presence in this ranking since 2016. All Mutuals remain ranked the same this year, with the exception of Bank Australia and IMB Bank who swapped rankings during 2019.

Top 10 by total assets ($)—2019



Total assets for Mutuals increased by 7.6 percent (2018: 5.2 percent) to $124.8 billion in 2019 (2018: $116.0 billion), despite a continued low interest rate environment which put pressure on margins, heightened regulatory focus and an industry on the verge of organisational transformation. Maintaining trust in the financial services industry remains a challenge to address head on. Despite these factors, Mutuals continue to be seen as an attractive proposition to consumers, with the sector comprising 2.6 percent (2018: 2.5 percent) of total assets across all authorised deposit-taking institutions (ADIs) in Australia at 30 June 2019. However, 47 percent of the responses to our survey indicated the majors still remain the dominant competitive force, and 41 percent of the remaining responses indicated other banks in general are a source of increased competition, including the presence of new market entrants (i.e. digital or neo banks). This is evidenced by the fact that while the Top 10 grew their combined assets by 7.1 percent (2018: 5.1 percent), the majors experienced an increase of 3.0 percent in total assets.

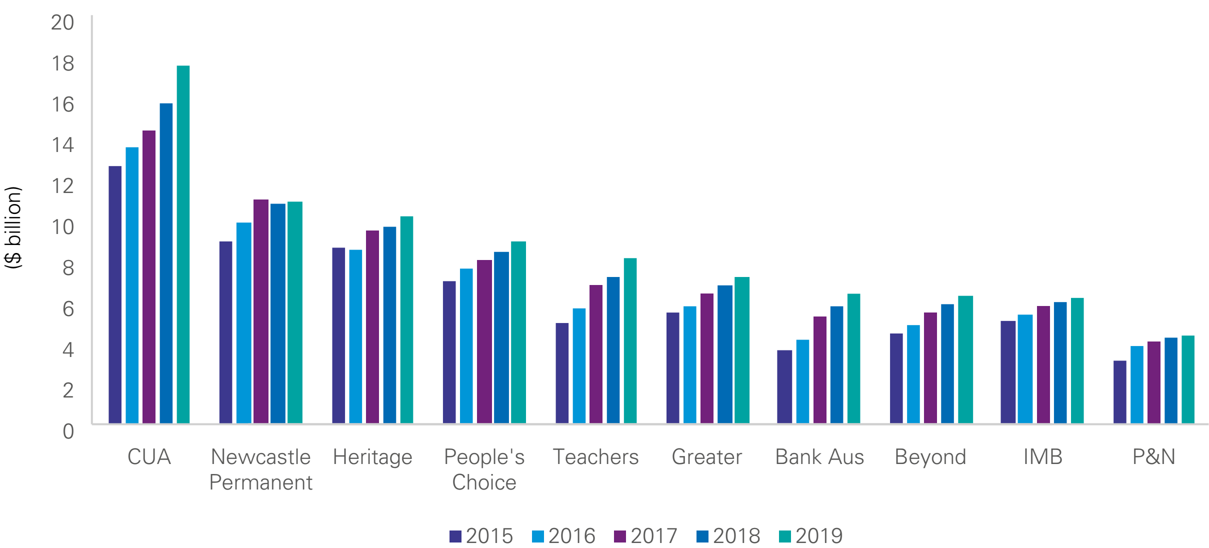
Growth in Total Assets (%)—2019



Some Mutuals exhibited double-digit growth in FY19 driven in some instances through digital transformation initiatives which decreased turnaround time and improved customer engagement in the lending process. For example, Bank of Us has implemented a new electronic loan processing system to handle 30 percent more loans with no additional resources.

Of the Top 10 Mutuals, all Mutuals experienced an increase in total assets with Credit Union Australia (11.6 percent), Teachers Mutual Bank (13.8 percent) and Bank Australia (12.0 percent) achieving double-digit growth.

Top 10 Total Assets (2015–2019)



Factors driving growth in total assets are further analysed in the following sections.

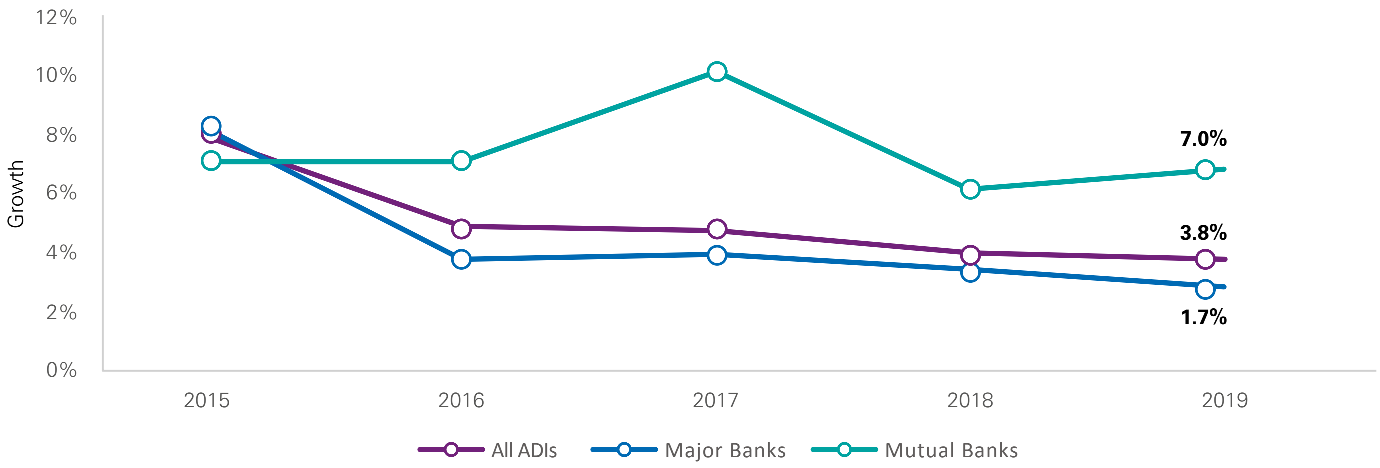
Loan Portfolio

The total loan portfolio for Mutuals in 2019 was $101.9 billion (2018: $95.3 billion), a 7.0 percent increase from 2018 (2018: 6.2 percent). Whilst a strong outcome, the growth rate was impacted by the tighter APRA lending restrictions in the early part of the financial year and increased competition, particularly from the majors and non-bank lenders.

The Mutuals loan portfolio grew significantly more than the ADI sector including the majors, at 7.0 percent, while the Majors and ADI sector reported growth rates of 1.7 percent (2018: 2.8 percent) and 3.8 percent (2018: 4.0 percent) respectively. This performance reflects the Mutuals' disciplined approach to building their customer bond and community involvement, a topic which 67.4 percent of the respondents to our survey agree is important to their success.

This continues to reflect our view from 2018 that the Mutual sector's reputation and grass roots approach to community lending (following the Royal Commission) remains relatively unscathed, and positions them well to build their business and transform for the future.

Loan portfolio growth (2015–2019)



The Mutuals' loan book remained concentrated on residential lending with 93.7 percent (2018: 93.4 percent) of their portfolio comprising residential loans at 30 June 2019.

The ABS reports that Australia is experiencing a continued increase in population, having reached the milestone of 25.3 million people in mid-2019. This, coupled with economic policies to redirect and incentivise populations to inhabit various areas across Australia, are all affecting the strong increase in the residential loan portfolio.

In the face of competition, Mutuals have aimed to grow market share through continued competitive pricing, putting further pressure on margins. In fact, 67.4 percent of our survey participants indicated that competitive pricing was one of the main contributors to their financial and market share growth in 2019.

Apart from pricing strategies, Mutuals have tried to differentiate the home loan experience through better customer service and product offerings, as well as increasing investment in technology.

During 2019, it was observed that innovative concepts are beginning to make their way into the Mutuals space, resulting in a continued strengthening of the customer 'centric' experience.

With the average property price decreasing considerably by 7.4 percent in 2019 (per Australian Bureau of Statistics (ABS) data), compared to the strong growth in prior years, the risk of further market correction needs to remain front of mind.

Did you know…?

2019 Canstar Award winners include:

- Customer Owned Institution of the Year—Bank Australia
- Fixed Rate Home Loan Award—Greater Bank
- Most Satisfied Customers—Home Lender Award—People's Choice Credit Union
- Innovation Excellence award—Bank First for 'First Start Shared Equity Agreement', Nexus Mutual for 'Home Saver', and P&N for 'Instant card provisioning/Virtual card controls'

Asset Quality

Quality of Assets

The Mutual sector continued to appropriately manage asset quality with the doubtful debts expense as a percentage of loans and advances remaining flat. This is despite the impact of accounting standard AASB 9, which significantly changed the basis on which doubtful debt provisions are calculated.

The Mutual sector's loan book continues to consist predominantly of residential loans (2019: 93.7 percent; 2018: 93.4 percent). The quality of residential loans has remained strong, which is reflected in the stable bad debt expense ratio in 2019 being 0.04 percent (2018: 0.04 percent).

Although current government policy seeks to stimulate customer spending, the risk of a price bubble in the Australian residential property market remains. Coupled with the current subdued economic conditions, and concerns around global political, social and economic factors, a focus on asset quality and credit risk must remain front of mind.

The AASB 9 effect

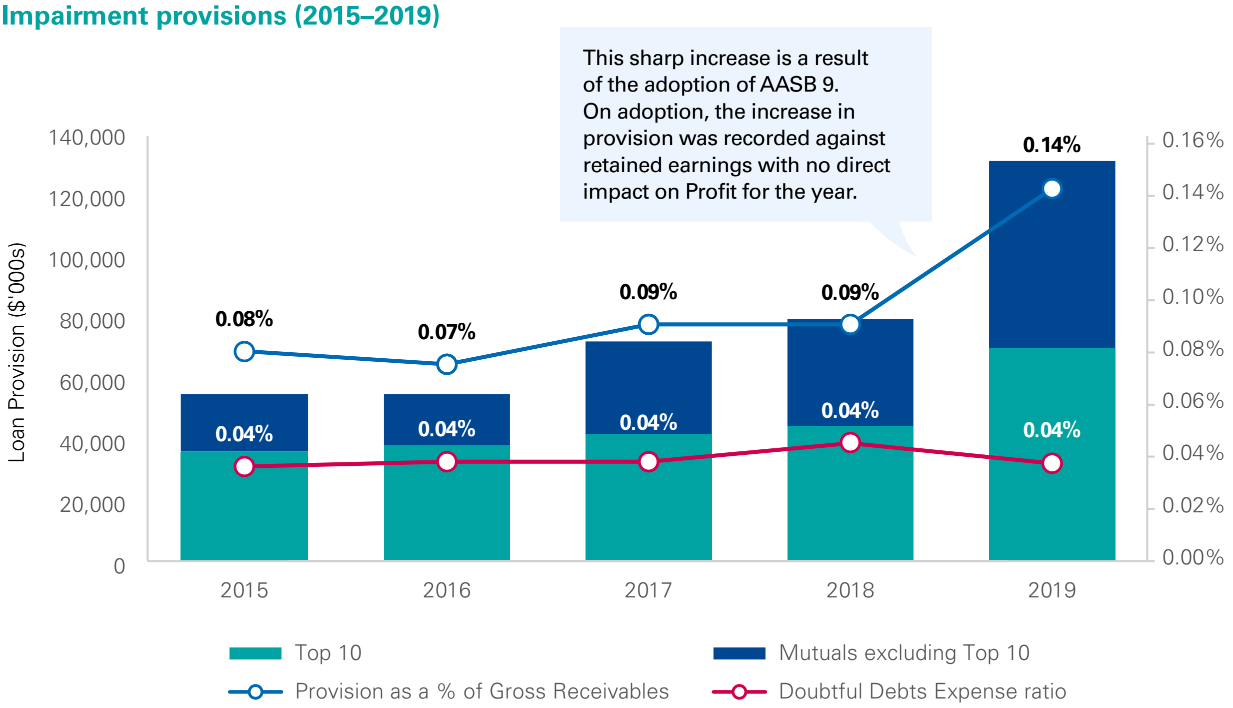
The current financial year saw the initial adoption of accounting standard AASB 9.

AASB 9 changes the approach to calculating the provision for impairment, coupled with more detailed disclosure requirements in the financial statements.

The new standard requires Mutuals to calculate an expected credit loss (ECL) model when estimating loan provisions. The ECL model not only takes into account historic events, but requires a prospective assessment of expected default rates. The model also requires classification of loan portfolios into stages with progressively riskier loans grouped together (increasing from stage 1 to 3). Based on disclosures in 2019, 59 percent of loan provisions were stage 1, whereas stage 2 and 3 were 17 percent and 24 percent respectively.

The Mutual sector experienced an increase in the provision for loan impairment of 69.2 percent to $135.6 million under AASB 9 (2018: $80.1 million under AASB 139). The 69.2 percent increase under AASB 9 in 2019 is approximately 30 percent higher than the original transition impact projected in 2018, but it is not entirely unexpected when compared to the AASB 9 impact on the major and regional banks.

Impairment provisions (2015–2019)



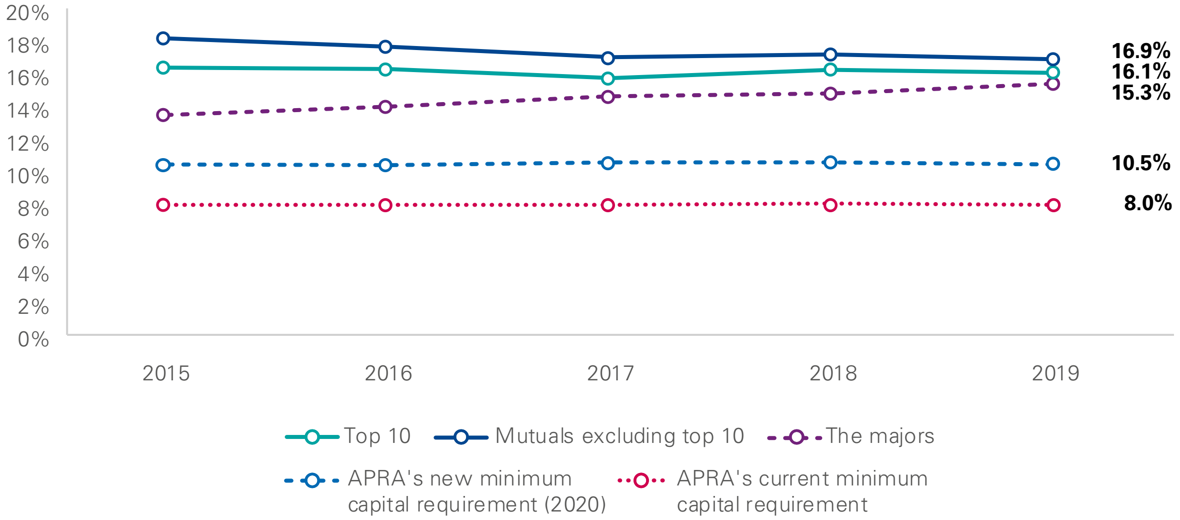
Capital

Current position

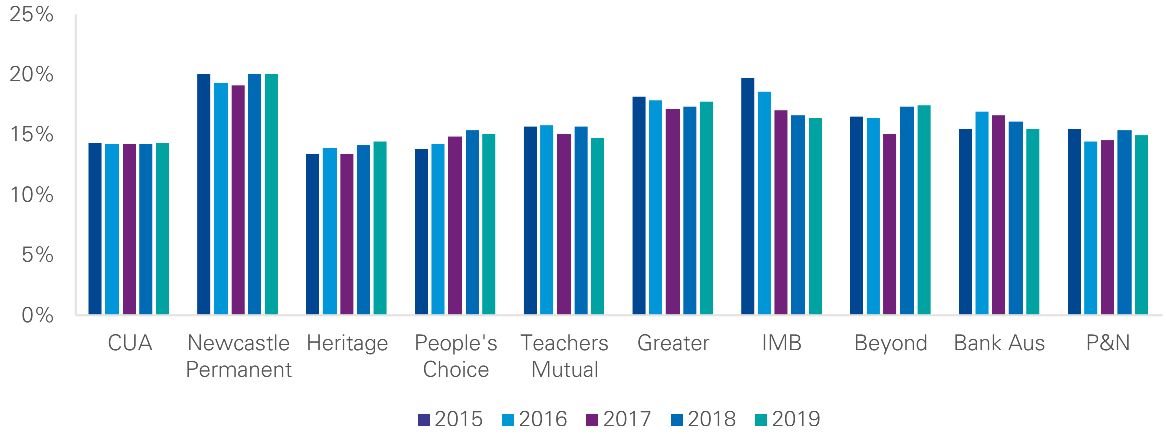
The Mutuals have observed a slight decrease in their weighted average capital adequacy ratio by 24 bps to 16.73 percent (2018: 16.97 percent). This was largely attributable to the Top 10 who have decreased by 16 bps to 16.07 percent (2018: 16.23 percent). Moreover, the weighted average capital adequacy ratio for the remaining Mutual sector dropped 26 bps (2018: increased by 17 bps) to 16.92 percent (2018: 17.18 percent) in 2019.

The industry has maintained capital levels significantly in excess of APRA's minimum Prudential Capital Requirements of 8 percent, and the Mutuals are well positioned to meet APRA's benchmark CET1 ratio of 10.5 percent by 1 January 2020. This is consistent with the current position of the majors.

Average total capital adequacy ratio (2015–2019)



Top 10 capital adequacy ratio (2015–2019)



Capital journey ahead

Policy and regulatory developments in the Mutual sector, and the banking industry more broadly, have focused on building levels of competition and growth through initiatives such as providing Mutuals with access to additional capital sources. As Mutuals continue to focus on transformation and innovation, with customers and member interest at the heart of this, Mutuals may look to shift focus towards leveraging their capital base to drive this. To facilitate change in the industry, steps taken by the Government and APRA to support Mutuals have come in the form of legislative reform from the Government and amendments to APRA's prudential framework for ADIs. The most recent steps include the below.

The Government's steps

The Treasury Laws Amendment (Mutual Reforms) Bill 2019 is a step forward leading to changes in the Corporations Act aimed at facilitating growth and innovation. This Bill introduces a mutual entity definition into the Corporations Act and clarifies the operative provisions of demutualisation legislation, thus permitting Mutuals to issue Mutual Equity Instruments (MEIs) (including removing uncertainty for Mutuals seeking to raise capital without losing their Mutual status).

After acknowledging four recommendations in the Senate Committee Report on the 'Cooperative, Mutual and member-owned firms', the Australian Government approved the bill into legislation on 6 April 2019, enabling Mutuals to further compete in the lending markets.

APRA's steps

MEI: Effective from 1 January 2018, Mutuals can directly issue MEIs as Common Equity Tier 1 capital instruments. However this requires pre-approval from APRA along with legal documentation supporting that this will not trigger a demutualisation provision in the Corporations Act. Based on our review of the financial statements of the participants in our survey, Mutuals are yet to take up the issuance of MEIs. However, as Mutuals focus on their transformation journey over the coming years, traditional capital tools such as retained earnings and deposits, in an environment of sustained 'new normal' low interest rates, will only stretch so far. The flexibility of additional capital through MEI will be a useful tool in any Mutual's 'back pocket'.

Objectives of APRA's revised capital framework

APRA has released for consultation draft standards APS 112, APS 113, and APS 115 aimed at clarifying APRA's expectations for regulatory capital to be held by banks.

Objectives of these amended APSs include:

— addressing the structural concentration in residential mortgages, including embedding improved serviceability assessments in the capital framework and targeting higher risk residential mortgages;

— ensuring appropriate relative capital outcomes between the internal ratings-based (IRB) and standardised approaches; and

— improving the transparency, comparability and flexibility of the capital framework.

Higher risk-weighted asset floor: In May 2018, APRA agreed that it will include a risk-weighted asset floor for banks using the internal-ratings based approach in its revised capital framework, with a proposed implementation date of 1 January 2021.

This will see the majors apply a mandatory minimum risk weighting to their loan portfolios, thereby requiring them to increase their capital position to support the loans that they currently carry at lower, internal risk weighted amounts.

New minimum capital requirements: Another favourable change for the Mutuals is APRA's requirements for the major banks to recalibrate to a higher minimum capital requirement by approximately 150 bps compared to a lower increase of 50 bps for ADIs that utilise the standardised approach (such as the Mutuals) with the implementation date of 1 January 2021 currently under review.

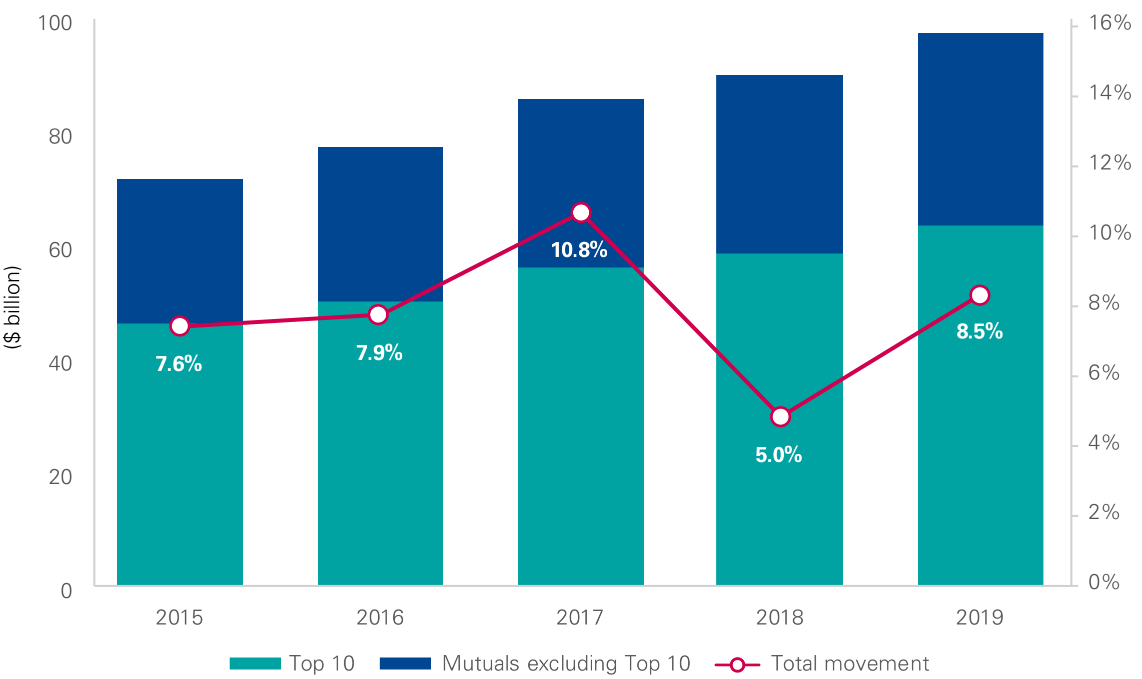
Together, these regulatory and legislative changes have increased the ability of the Mutuals to gain access to capital, and enhance their ability to compete in the market.

Deposits

Deposits continue to be the most significant source of funding for Mutuals. However, the growth in total deposits across the entire banking sector has been impacted by the sustained low interest rate environment. Growth in 2019 has however come from Mutuals continuing to position themselves as a customer focused alternative to banks.

Growth in deposits rebounded from last year at 8.5 percent (2018: 5.0 percent) which brought the total to $98.97 billion (2018: $91.19 billion). The Top 10 grew their deposit base by 8.5 percent (2018: 4.4 percent) which was above majors' growth of 2.8 percent. This continues to reflect another year where Mutuals have been able to grow their customer base by focusing on trust and a continued emphasis on transforming business operations. Our survey respondents indicated deposits as only their fourth biggest driver of growth, with a greater focus on digitisation of banking services and increasing residential lending. This highlights the continued weight placed on a broader customer centric experience as the main way to grow market share.

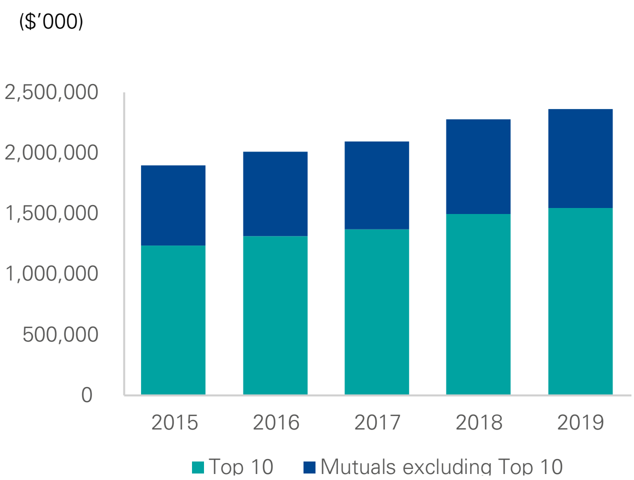
Total Deposits and growth in deposits (2015–2019)



Net interest income

In 2019, Mutuals reported an increase in net interest income of 3.8 percent to $2,393.1 million (2018: $2,304.7 million), driven by the underlying growth in the loan book. Of this, 65.3 percent was earned by the Top 10 (2018: 65.6 percent).

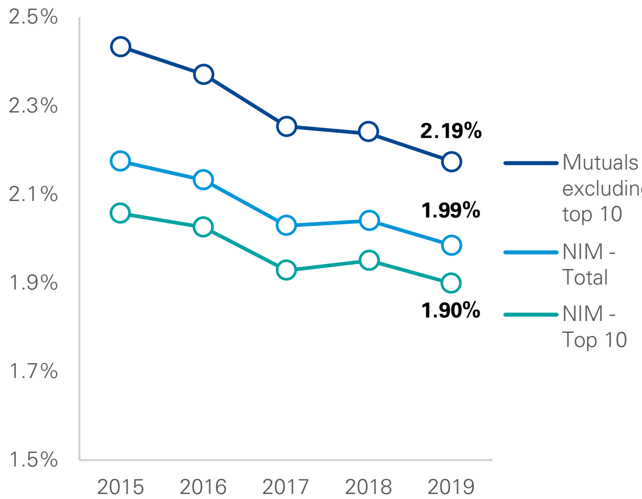
Net interest income (2015–2019)



Net interest margin

Pressure on margins becomes apparent in a sustained low interest rate period and a highly competitive market. With the RBA considering quantitative easing measures to supplement the already low interest rates, the pressure on margins has never been more pronounced. Mutuals will need to consider how they, along with the wider banking sector, respond to the RBA's change in monetary policy. The NIM for Mutuals—excluding the Top 10—continued to decrease with a NIM of 2.19 percent (2018: 2.25 percent). The Top 10 experienced a decrease in NIM of 5bps to 1.90 percent (2018: increase by 2bps to 1.95 percent).

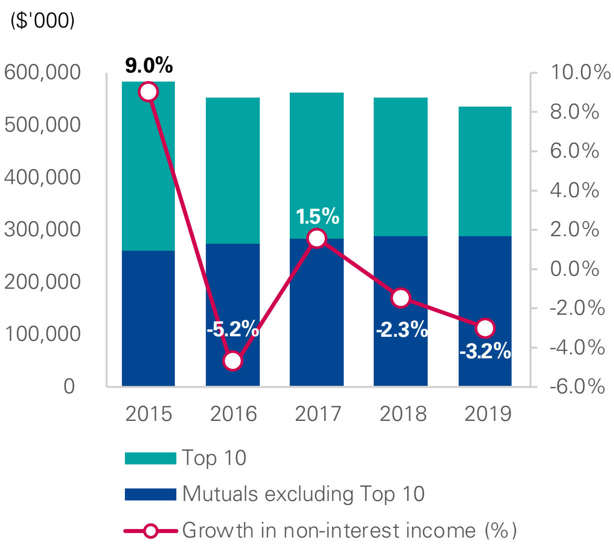
Net interest margin (2015–2019)



Non-interest income

In 2019, total non-interest income fell by 3.2 percent (2018: decreased by 2.3 percent) to $532.9 million (2018: $550.3 million). The Top 10 reported a steeper decline of 6.5 percent (2018: 4.9 percent). This drop is consistent with the drop observed by the majors as the ADI sector continues to face competitive pressure and increased scrutiny from regulators and customers on fees and commissions. Mutuals excluding the Top 10 reported a slight decrease of 0.1 percent (2018: growth of 0.3 percent).

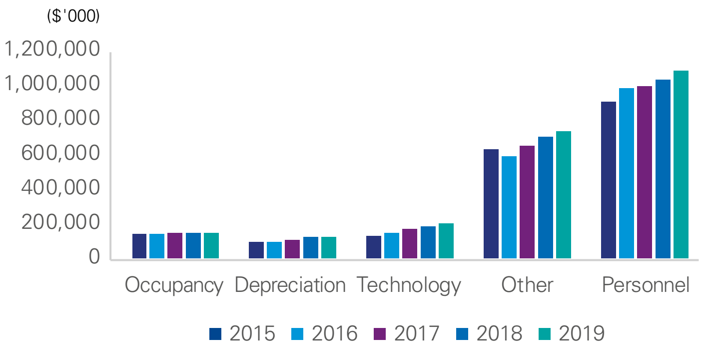
Non-interest income (2015–2019)



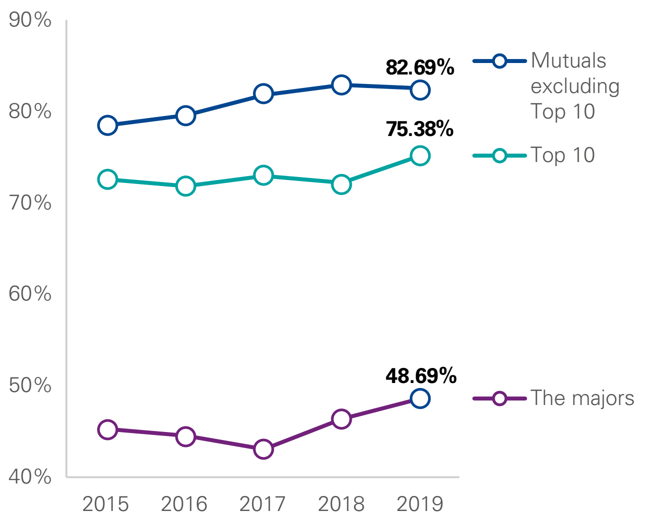
Costs

2019 saw total operating costs for the Mutuals rise by 4.9 percent to $2,287.2 million (2018: $2,180.6 million). This increased the Cost-to-income ratio to 78.2 percent for the Mutual sector (2018: 76.4 percent). This was driven by the Top 10, who increased their spend on technology and personnel expenses. This reflects the transition of Mutuals as they embark on, and look to embed, their medium to longer term strategy of moving towards more agile operations.

Growth in costs (2015–2019)

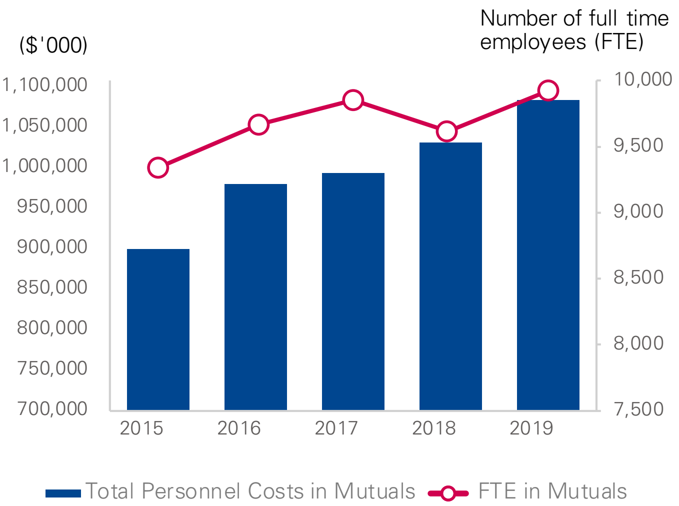


Cost to income ratio (2015–2019)



Personnel expenses continue to be the majority of the operating costs for Mutuals at $1,058.0 million in 2019 (2018: $1,008.0 million). This reflected an increase of 5.0 percent (2018: 3.6 percent) which was partially driven by the 3.4 percent increase in employee numbers (from 9,571 in 2018 to 9,897 in 2019) and the continued shift towards higher skilled, more expensive labour as the banking industry continues to transform its operations and pursue a broad-based digital services agenda.

Personnel expenses (2015–2019)



Other expenses, mainly consisting of administration costs, marketing and communication fees, transaction and distribution costs, was the next major cost, which rose by 5.5 percent to $739.0 million (2018: $700.7 million).

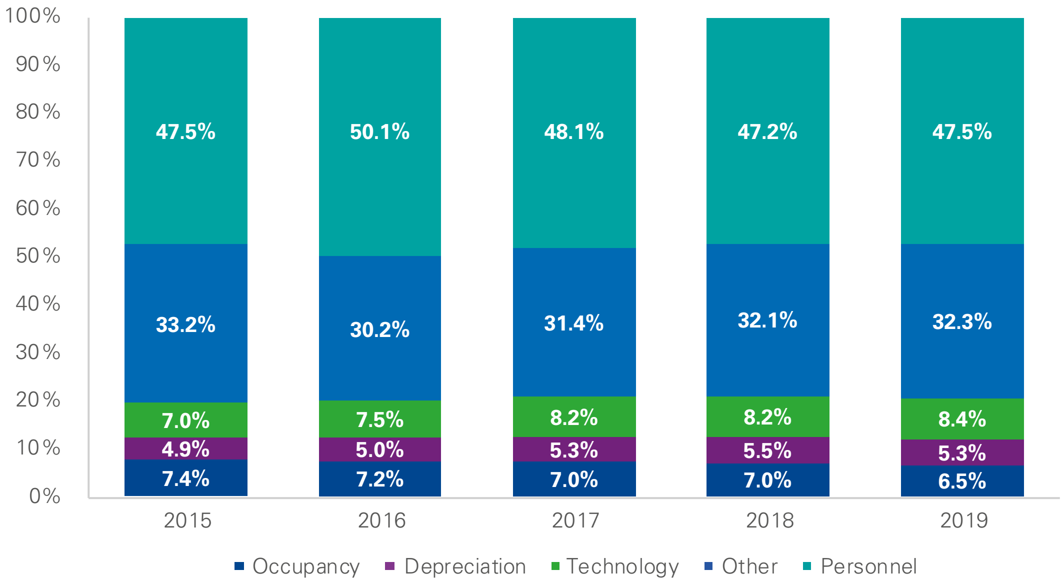
In addition, $192.4 million was spent on technology expenses, which rose by 7.9 percent in 2019 again reflecting the continued investment in technology across all the Mutuals.

While actively pursuing reduced costs appeared lower in responses to our survey, Mutuals continue to build on their longer term transformation strategies. This has seen Mutuals focusing on simplifying product offerings, improving customer experience and passing longer term cost-savings back to their stakeholders.

AASB 16 lens on costs

In the next financial year we expect to see a shift in the composition of costs with the introduction of AASB 16 Leases which comes into effect for 30 June 2020 financial reports. The impact of AASB 16 will likely see a shift away from 'occupancy' and 'other operating expenses'. Before July 2019, occupancy costs have traditionally included any head office and branch leases entered into. From 1 July 2019, this will shift towards an increased annual amortisation/depreciation charge and a gross-up for lease assets and liabilities on the balance sheet. There may also be a shift in some costs from 'Technology' due to the requirement for Mutuals to consider potential embedded leases in Software as a Service (SaaS) arrangements and other related outsourced or IT partnering arrangements. Consistently, the majors reported an expected shift in their cost composition as noted in KPMG's Major Australian Banks Full Year 2019 research analysis.

Composition of costs (2015–2019)



Profits

Profits before tax (PBT) fell by 6.1 percent (2018: grew by 4.7 percent) to $593.3 million (2018: $631.8 million), while the majors saw profits before tax fall by 12.6 percent (2018: grew by 0.9 percent). This was driven by heightened margin pressure, as the sustained low interest rate environment impacted on net interest margins, and increased costs as the Mutual sector continued investment spend to transform the business. The impact of low interest rates will continue to be a major factor, with 69.6 percent of survey respondents identifying the low interest rate environment as the biggest risk for their organisation.

The relatively small increase in total income of 2.5 percent (2018: increase of 5.9 percent) is commensurate with the low margin environment, driven by an increased asset base, but offset by non-interest income which fell by 3.2 percent.

However, Mutuals are also beginning to realise the benefits from previous mergers as they move towards achieving economies of scale to gain a competitive advantage.

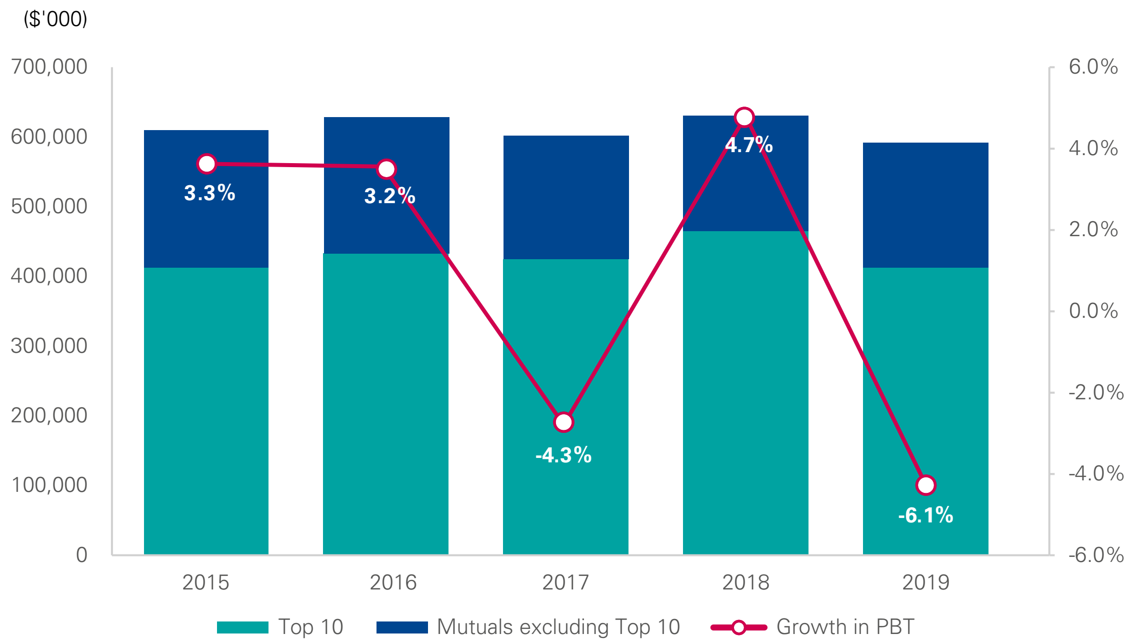
The Top 10 Mutuals experienced a significant decrease in PBT in 2019 of 11.4 percent (2018: 9.8 percent increase). This was driven by continued margin pressure as well as an increase of 10.3 percent in technology expenses and an increase of 4.5 percent in personnel expenses. Together, these charges have supported the Top 10 in their journey to transform through innovation around the customer. The Top 10 continue to invest in automation of the banking process, with personnel expenses increasing as they hire highly skilled employees to help execute this strategy.

Did you know…?

The three biggest opportunities identified by our survey for the Mutual sector to improve performance are:

1. Technology and transformation of business (41.3 percent)
2. Improving efficiency—doing more with less (21.7 percent)
3. More collaboration with peers (19.6 percent)

Profit before tax (2015–2019)

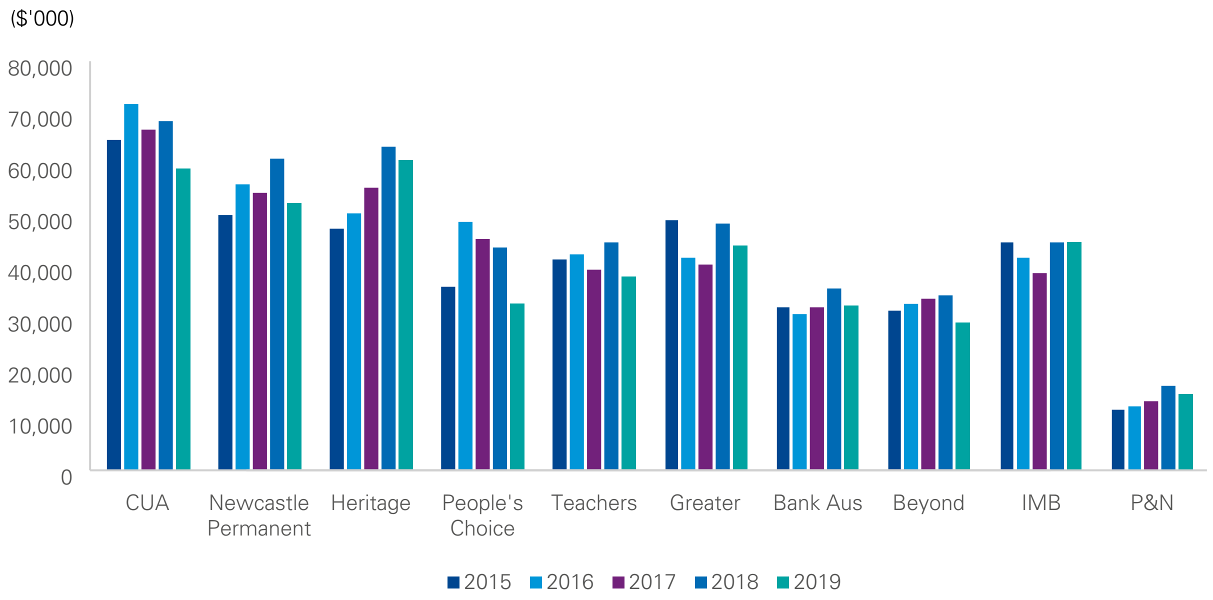


Return on equity (ROE)

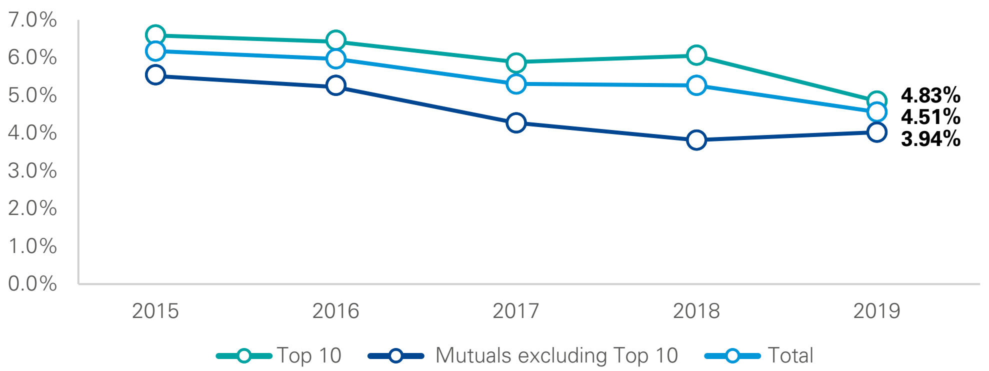
While not a key metric of the sector, total ROE marginally decreased by 69bps (2018: fell by 10bps) to 4.5 percent (2018: 5.2 percent). The Top 10 performed better than the sector, with ROE of 4.8 percent (2018: 6.0 percent), with Mutuals excluding the Top 10 reporting a 10bps increase in ROE to 3.9 percent (2018: 3.8 percent). The gap between the Top 10 and the Mutuals (excluding the Top 10) has narrowed due to the Top 10 exhibiting higher technology and personnel costs compared to previous years. Historically, the Top 10 have had higher levels ROE due to higher financial leverage contributing to the result.

> *"Just as people cannot live without eating, so a business cannot live without profits. But most people don't live to eat, and neither must businesses live just to make profits."*
>
> **John Mackey**
> CEO, Whole Foods

Top 10 Total Profit before Tax (2015–2019)



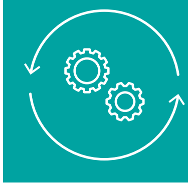
Return on equity (2015–2019)




Six in
the mix

01 Transformation and simplification

Hessel Verbeek, Partner, Banking, KPMG Strategy
John Critchley, Director, Banking, KPMG Digital Strategy



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Mutuals have focused on value to their members

In general, Mutuals have chosen to focus on value to customers through service and pricing. This is reflected in our survey where 'customer service' and 'pricing' are ranked highest by at least 20 percent, as drivers for growth.

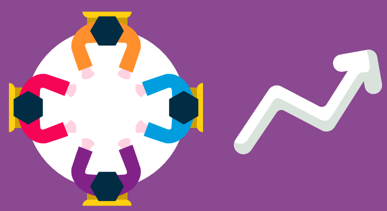
Strikingly, less than half of respondents see technology and innovation as key drivers for their growth, contrasting with investment trends in other competitors.

Being customer-centric and community-focused has led to the Mutuals achieving higher customer satisfaction ratings compared to their competitors.

Evolving customer expectations and market conditions are forcing Mutuals to look outside their existing members for growth

The ubiquity of digital and digital augmentation of traditional customer interactions, coupled with the rise of 'digital natives' as significant consumers of financial services, is driving customer expectation for omni-channel banking services.

Digitisation is one of the top organisational priorities in the next three years amongst our survey participants.



Our survey participants identified the following as the main contributors for growth:

1. Better pricing
2. Better customer service
3. Increased investment in technology and introduction of digital banking capabilities

Complementing the shift to digital is the implementation of Open Banking that will make pricing more transparent and switching between providers for products and services easier. Customers will be able to discriminate on a product level, thus loosening ties at the financial institution level. Mutuals have an opportunity to tap into markets outside their traditional catchments by offering competitive products and compelling customer service to segments that match their value proposition.

The Mutual sector is also showing clear signs of continuing its consolidation trend. Significantly, 41 percent of respondents in our survey indicated that a merger presented a viable growth opportunity in the medium term.

In short, the Mutual sector is now looking at alternative sources of growth to drive member value beyond their traditional catchments or satisfied customers.

However, Mutuals are finding the path to growth obstructed by challenges linked to complexity

Three challenges are obstructing the path to growth for many Mutuals:

Efficiency: Cost to income (CTI) ratio is higher for Mutuals (2019: 78.17 percent) compared to the majors (2019: 48.4 percent). Although scale is a factor for CTI, the disparity can't be fully explained by the benefits of scale for larger banks; unlocking efficiency makes value available for other investment, such as in growth. This is recognised by sector leaders, where 21 percent of survey respondents identified efficiency as the biggest opportunity to improve sector performance next year. Since unlocking value from improved efficiency can fund growth, and complexity is often a factor for efficiency, inherent complexity could challenge the growth aspirations of the sector.

Scalability: Limited budget for innovation has meant that processes and technologies are generally outdated and complex. For example, 65 percent of sector leaders identified limitations of current IT systems as the biggest challenge to digitisation, and 41 percent point to technology as the biggest opportunity for the Mutual sector to improve performance next year. Complexity in processes and technology limits the ability of businesses to scale, consequentially eroding value from growth.

Regulatory Change: Historically, regulatory change-driven implementations (such as upcoming EFS) have resulted in overlapping fixes and increased complexity in processes and technology. With the pace and scope of regulatory change likely to increase, these implementations could make organisations less agile by incrementally adding complexity.

Since regulatory compliance is a necessity to survive, investment in growth is again likely to be constrained, compounded by the increased cost of change.

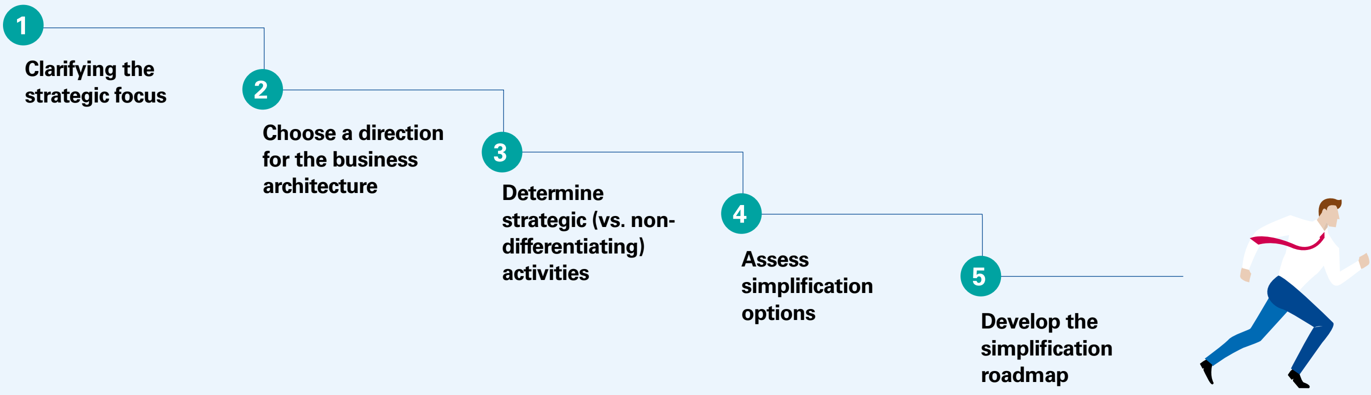
Simplification and reducing customer friction points are top priorities for our survey respondents to improve customer experience and reduce cost.

By simplifying their enterprise, Mutuals could free up capacity from managing complexity to driving growth and value to members.

There are three clear benefits from simplification for Mutuals:

- Simplified banks can adapt to market changes more quickly than those that are bogged down in managing the complexity of change.
- Simplified banks can scale better, where variable costs are minimised and a standardised fixed cost base (e.g., shared services) is offset by every dollar of new revenue without significant additional cost.
- Simplified Mutuals have inherently lower risk profiles, and lower maintenance costs—as systems and processes are easier to unpick to resolve issues or patch or maintenance is driven by service partners.

5 steps that lead the way to simplification for Mutuals:



Given these benefits, incorporating simplification strategies across the organisation becomes increasingly important. Five key steps imperative to transforming are:

1. **Clarifying the strategic focus**—this involves making clear choices around the purpose of the organisation, customer-centricity, role in the banking sector and a Mutual's value proposition.

   Mutuals can benefit by defining synergies between their existing value proposition that has won in the market and growth opportunities for untapped markets.

2. **Choose a direction for business architecture**—the next step involves identifying core capabilities that are interconnected and necessary to implement the strategy, and transform those capabilities that can be standardised.

   Mutuals can benefit by using their smaller scale and tighter focus to increase market agility, coordinated with a blueprint designed for efficiency and clarity on implementation priorities.

3. **Determine strategic vs. non-differentiating activities**—next, focusing on which activities are critical and provide Mutuals with a competitive advantage which is consistent with their selected strategy.

   Distinguishing activities would help Mutuals make better decisions to drive competitiveness (i.e., where to be unique vs. standardised to drive efficiencies).

4. **Assessing simplification options for each strategic and non-differentiating activity**—the next step faced by a Mutual would be to apply an option or method to apply simplification across all activities.

Four main options or methods must be considered for each strategic or non-differentiating activity, including:

— Creating Centres of Excellence to leverage current capabilities and focusing on performance of activities;

— Transformation—transforming existing capabilities and assets that are not bound by legacy systems;

— Developing replacement capabilities—building new unconstrained capabilities that transform too many legacy issues (e.g. full replacement of data and analytics at a bank by a central hub); and

— Third party partnering and outsourcing solutions—non-strategic activities that are not high performing (e.g. ATM network operation) that can reduce complexity, rigidity or risk in the organisation in addition to productivity, can be given to third-parties.

5. **Developing the simplification roadmap**—a bespoke roadmap tailored to a Mutual's strategy, taking into account various dependencies, provides a clear path to simplification.

Conclusion

Is every Mutual's simplification journey the same? Certainly not. Different starting positions, strategic activities and priorities will lead to different journeys.

Mutuals should commence planning for simplification sooner rather than later. It is critical to involve management and the Board of Directors, and determine the Mutual's long-term strategic focus, whilst concurrently completing a maturity assessment of its existing activities. This planning process will also facilitate identification of priority areas for a Mutual towards simplification.

Ultimately, the simplification approach will allow Mutuals to arrive at a 'connected enterprise'.

02 Preserving trust in Mutuals

Rita Fentener van Vlissingen, Associate Director, KPMG Banarra
Dr. Nicole Gillespie, KPMG Chair in Organisational Trust;
Professor of Management at UQ Business School

Trust is about relationships. Mutuals have an opportunity to build on, and leverage, their unique position in the market and their reputation for trustworthiness.

Last year, we acknowledged that Mutuals were well placed to maintain stakeholder trust in a challenging environment for the financial services sector in Australia.

Being customer-owned, the aligned interests that Mutuals have with their customers provide a strong pillar for trust. Mutuals also continue to focus on maintaining a reputation for integrity and fairness in a fast-changing landscape, sustaining higher than average customer satisfaction ratings compared to the majors[1], and the loyalty and trust of their members.

Mutuals haven't suffered the crisis of confidence which has significantly impacted other parts of the financial services sector since the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

However, Directors and Senior Executives—for profit or not—are now being held to higher standards by regulators and the public, as seen by recent comments by the ASIC Chair which found the urgent need for active and accountable participation by Directors and officers in monitoring non-financial risks[2].

This is consistent with an increased focus on accountability, with BEAR for Mutuals effective from 1 July 2019. This is leading to a greater appreciation of the wide range of stakeholders, including the community and civil society, that organisations need to engage with meaningfully and be trusted by.

At the same time, the ability to identify, mitigate and resolve non-financial risks is becoming an important management tool to prevent trust violations and maintain trust.

Stakeholders trust organisations that they believe are trustworthy.

Significant changes are impacting the financial sector, including the Open Banking Regime and technology-driven innovation. This provides both challenges and opportunities for the Mutual sector in how they maintain and strengthen stakeholder trust. Research demonstrates that stakeholders' trust organisations that they perceive to have three key characteristics[3]: **'Ability', 'Humanity', and 'Integrity'.**

How can Mutuals demonstrate these three characteristics?

During technological transformation, Mutuals can demonstrate **Ability** by smoothly and competently transitioning their customers to new payment platforms and digitising their services in a way that delivers convenience, efficiency and meets evolving customer expectations around seamless customer service.

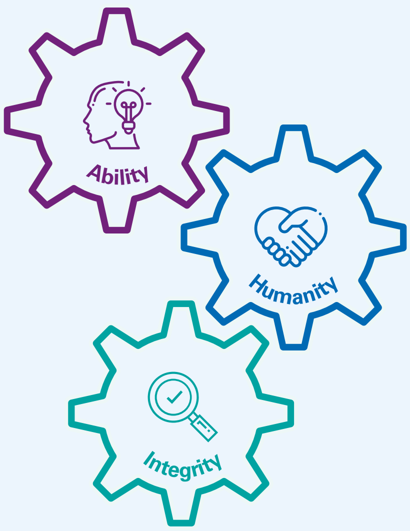
Humanity is shown through demonstrating a 'duty of care' to stakeholders and ensuring services have a positive impact on them. This can take the form of understanding stakeholders' interests and showing genuine concern for the issues that impact customers, such as housing affordability, managing debt, and supporting vulnerable customers and communities during difficult times. Mutuals must keep front of mind that their service offerings have wider and broader impacts. This involves considering how their business responds to and provides sustainable financing in their communities.

This also involves ensuring all products, services and operations—and their social impact—are fundamentally aligned to and supporting the organisation's purpose and trustworthiness.

For Mutuals, **Integrity** can be demonstrated by living by their values and 'walking the talk'. For example, ensuring that digitisation and other transformations to their business model or processes—including automation and artificial intelligence—continue to put customer outcomes first and treat them fairly. This may require extra attention to ensure digitisation does not unintentionally discriminate against particular groups.

Operating with integrity and humanity also requires meeting evolving regulatory and stakeholder expectations around ethical data management, data privacy and protecting customers from cyber-attacks. These emerging non-financial risks pose a significant threat to trust and require investing in appropriate controls which can be a challenge for smaller ADIs.

Organisations that embed trustworthiness—ability, humanity and integrity—into their culture, leadership practices and everyday decision making, earn sustained reputations of trust with their stakeholders. The challenge Mutuals face is how to embed trust in all levels of decision making and customer interaction within their organisation.



Ability relates to the collective knowledge skills and competencies that enable the organisation to function reliably and effectively in delivering its products and services and meeting its goals and responsibilities.

Humanity is about exercising benevolence and a 'duty of care' to those affected by the organisation's operations, products and services, and at a minimum 'doing no harm'. Humanity involves having a positive orientation towards stakeholders, beyond profit motives.

Integrity is about an organisation's consistent adherence to commonly accepted ethical principles and moral values, such as honesty, fairness, promise fulfilment, taking responsibility for one's actions, and operating within the law.

Trust is critical to innovation

New technologies and business models are creating pressure around how organisations create growth. In an increasingly competitive landscape, where customers and employees are bombarded with choice and expect more from business, building and maintaining a trusted organisation and brand is more important than ever.

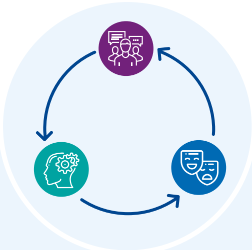
Failure to preserve trust in the market has consequences for launching new products and services; if an organisation wants to innovate and embrace new technology and markets, they first need to be trusted.

Trust requires proactive management during transformation

Trust is crucial to organisational agility and transformation; it helps organisations to embrace and navigate disruption, whether it be from technology, economic shocks or climate related risks.

Research shows that employee trust directly enhances an organisation's capacity to adapt to change. Trust facilitates constructive responses to, and engagement with, change processes and reduces change resistance. Trust also acts as a filter that influences employees' and other stakeholders' interpretations of change.

However, significant change often results in a loss of employee trust, as it heightens uncertainty, perceived vulnerability and strain. As the Mutual sector adapts and transforms itself on multiple fronts, through consolidation, increased competition and rapid technological change, preserving employee trust requires proactive and ongoing management.



Recent case study research identifies three practices that Mutuals can consider to help preserve internal trust during transformation.

Cognitive bridging focuses on connecting the organisation's transformation agenda—'the future'—with the organisation's past and present. Communication continuity in the organisation's core purpose and values across time, and making clear how the change enables this continuity, helps employees to make sense of and navigate change, and maintain commitment and engagement throughout the process.

Inclusiveness is about enabling participation and voice through the transformation. Creating mechanisms that enable meaningful consultation and voice in decisions that affect staff signals that 'we are in this together' and is central to perceived fairness that underpins trust. This may take the form of senior leaders purposefully making themselves available to listen and respond to staff, and having rather than avoiding the difficult conversations.

Working with emotions is about recognising that disruption and change often evokes a range of emotions, particularly when organisational restructure is envisaged. Rather than shutting these emotions down, organisations can preserve trust by creating safe spaces for talking about and working through these emotions, and structures to support the coping capabilities of their leaders and staff. This is a strong demonstration of humanity and integrity towards staff during difficult times.

03 Increasing focus on Environmental, Social & Governance (ESG)

Mark Spicer, Director, Sustainability
Julie Vasadi, Associate Director, Sustainability
Samantha Bayes, Senior Consultant, Sustainability

PLAY VIDEO

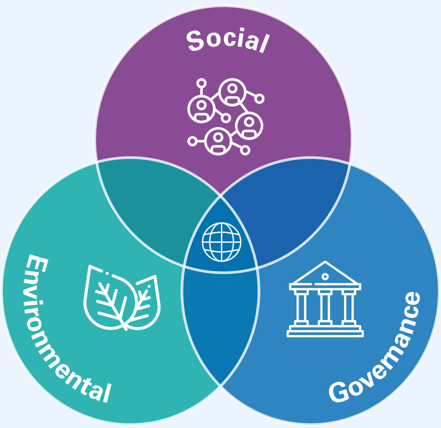
Globally the environmental and social discussion has gained traction over the years, so much so that customers are embedding consideration of ESG issues when selecting service providers. The consideration of ESG performance in investment decisions is growing both in terms of adoption and importance. Many industry commentators now consider that ESG is no longer "nice to have", but rather critical to financial returns, management of longer term risk, and meeting the expectations of both beneficiaries and customers.

For the finance industry there are two specific issues that are at the front of mind when considering ESG factors:

1. The first is managing financial risks and opportunities stemming from climate change and demonstrating alignment with commitments as set out in the Paris Climate Agreement[4]. The Task Force on Climate related Financial Disclosure (TCFD) has developed a widely adopted framework to help identify and report climate risks and opportunities.
2. The second is social licence and social impact. As societal expectations change, there is an increasing need for the Mutuals to be transparent and clear about how their products and services impact their customers as well as contribute to the achievement of the global Sustainable Development Goals[5].

The UN Principles for Responsible Investment ('UN PRI') defines Responsible Investment (RI) as
"an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns".

ESG factors can be defined as follows:



Enviromental criterion looks at how an investee company performs as a steward of the natural environment.

Social criterion examines how a company manages relationships with its employees, suppliers, customers and the communities in which it operates.

Governance criterion is concerned with a company's leadership, executive pay, internal controls, externals audits and shareholder rights.

Australian Sustainable Finance Initiative

The Australian Sustainable Finance Initiative (ASFI) is an industry response to ensure that financial institutions contribute to the achievement of the Paris Agreement and support progress against the Sustainable Development Goals.

ASFI is a collaboration between executives from Australia's major banks, superannuation funds, insurance companies, financial services peak bodies and academia. Regulators APRA and ASIC have oversight through observer roles.

ASFI is tasked with delivering an Australian Sustainable Finance Roadmap in 2020 which will provide recommendations for the industry to contribute more systematically to sustainability goals, and effectively "embed" ESG considerations into all aspects of the financial system. Recommendations of the Roadmap will include changes to Australian policy, legislation, regulation, as well as industry codes, practices and/or tools.

Impact on Mutuals

Sustainable finance and responsible investing should be front of mind. Expectations stemming from ASFI and other finance initiatives will inevitably cascade down to local and regional Mutuals. Given increasing focus on ESG by international and local regulators, standard setters and civil society, it is expected that both major and mutual banks will be subject to an increasing set of expectations and reporting requirements relating to ESG factors.

Coupled with increasing investor and customer demands, those Mutuals with highly-developed sustainable investment processes are more likely to develop an offering that resonates with the preferences of customers and will likely gain competitive advantage over their peers. The ability of Mutuals to be agile in the manner in which they operate and their ability to transform to adapt to these changes may provide additional avenues for Mutuals to distinguish themselves in the broader market.

Recent KPMG research has shown that the majority of Australian retail investors would accept lower financial returns if it meant companies they invested in always behaved ethically towards customers, employees, and the community. Further, KPMG's SuperInsights report showed that superfunds that offer ESG/RI products have experienced an increase in member numbers.

Mutuals' response to ASFI

Given the increasing opportunities open to the financial sector to adopt sustainable finance initiatives and responsible investing practices, the following should be prioritised:

- Consider becoming a signatory to the Principles of Responsible Banking or UNPRI.
- Develop a systematic approach to ESG to better inform financial decision-making, manage investment risks and to enhance disclosures and transparency.
- Continue to innovatively develop sustainable finance solutions. **For example:**
  - A number of green personal, car or home loans are available in the market which provide customers with discounted rates or cash back incentives for green initiatives which encompass projects such as energy efficiency upgrades, LED installations, insulation, rainwater tanks, battery storage, solar hot water systems and electric vehicles.
  - Sustainability linked loans have been issued recently by Australian banks with the interest rate charged linked to performance against ESG criteria—linking management of ESG risk to returns.

Example of Green products offered by Mutuals:

- Green loan product from Endeavour Mutual Bank for solar appliances, Tesla power wall, and energy efficient lighting.
- Green loan product from Police Bank for solar hot water systems, rainwater tanks and green vehicles.

Climate risks

In September 2019, Moody's, the global credit ratings agency, released a report exploring how climate change is increasing the frequency of natural disasters impacting Australia. Moody's warns of the economic consequence to banks due to an increasing risk of mortgage delinquencies and defaults due to climate-related events. When Cyclone Debbie hit Queensland in 2017, the number of home loans at least 30 days behind repayment increased by 15 percent and it took 8 months for the delinquency rate to fall back to pre-Debbie rates. While these impacts were temporary, the frequency of natural disasters and resulting economic loss is trending upwards. 2017 saw the highest recorded yearly global insured economic losses from natural disasters of USD 144 billion, losses in 2018 were the fourth highest on record at US$76 billion (reported by Swiss Re).

APRA considers climate risks as distinctly foreseeable, material and financial in nature and demonstrably one of the most prominent ESG issues for Banks in 2019. ASIC, APRA, and the RBA are in striking alignment on the material and financial impact of climate change, and the recommended risk management integration and disclosure of climate-related risks and opportunities in order to meet Directors' fiduciary duties under Section 180 of the Corporations Act 2001.

More intense and frequent heatwaves, fire, floods, severe storms and storm surges are predicted to affect Australia in scenarios where global warming continues on its current trajectory[6]. Customers in high-risk locations throughout Australia face increasing climate change-related property damage. In 2018, the Australian Competition and Consumer Commission found customers in Northern Australia have experienced insurance premium increases of 130 percent over 10 years, compared to 50 percent for the rest of the country, as insurers priced themselves out of these markets. It was also found that insurers were often operating at a loss in these areas. Together, these factors contribute to the climate-related risks faced by banks through: increasing credit risk from rising customer financial stress and risk of default; deteriorating property and underlying asset values; and capital illiquidity through the deterioration of traded financial assets such as mortgage-backed securities (MBS); which together threaten financial stability. Clearly, excluding large geographical areas from target markets, especially those built around communities, does not strategically align to Mutuals' community-oriented strategies.

Climate risks and opportunities

The Task Force on Climate-related Financial Disclosures (TCFD) has become the accepted framework for addressing and reporting organisations' exposure to climate-related risks and opportunities. The recommendations of the TCFD provide a framework for organisations to report consistent, comparable and voluntary disclosure to assist financial markets to understand material climate-related risks and opportunities.

Mutuals' response to climate risk

Given the risk that climate change poses to the Mutual sector, the following should be front of mind:

- Adopting the TCFD's recommendations and progressing towards alignment of climate-related risk reporting.
- **Consider exposure of mortgage portfolio to:**
  - Regions that are heavily dependent on emissions intensive industries
  - Physical risks of climate change
- Develop socially responsible climate risk strategies that support vulnerable customers through climate transition.
- Consider how corporate loan portfolios could be better positioned to mobilise capital to support emerging climate-related opportunities.

04 Member experience

Faith Forster, Director, KPMG Strategy
Tyson Rose, Associate Director, KPMG Upstart

PLAY VIDEO

Innovation can only be facilitated when Mutuals understand both their customers' needs and how the industry is shaping. In other words, understanding where the industry is moving towards is also key to improving the overall member experience.

Differentiating yourself around the customer

Financial Services have been ranked as the second highest performing industry sector for customer experience, driven by strong performance of major financial brands, banks with nimble brands and fintechs[7].

Meanwhile, Mutuals continue to face challenges with respect to innovation, having fewer resources to spend on their digital offerings than the big banks and more constraints on their business operations than new digital banks and fintechs.

In a post-Royal Commission world however, the tide seems to be turning in favour of organisations like Mutuals that focus efforts on three critical factors:

— the reduction in trust in the big banks

— the growing macro consumer trend back toward community-led brands[8]

— many Mutuals having commenced their journey towards implementing more agile technology platforms.

When you combine these factors with the opportunities surrounding the New Payment Platform (NPP) and Open Banking, the playing field for Mutuals has never been this level. Today Mutuals have the same opportunities as their peers (including the majors) to distinguish themselves through the development and delivery of superior customer experiences, keeping the customer at the centre and innovating around them.

Attributes of innovation

In order to capitalise on these current and future opportunities, Mutuals must master three key attributes of a modern, innovative business:

1 Hiring and training for future skills

Customers aren't the only ones who are changing. The World Economic Forum (WEF) anticipates that by next year, 35 percent of the top skills needed by employees across any industry to compete will have changed from just five years ago[9]. The three skills climbing the ranks the fastest are: emotional intelligence, creativity and critical thinking. While the three skills which have been reprioritised to furthest down the list are: negotiation, quality control and service orientation.

What this means is that the skills that got you to where you are today, won't get you to where you need to be tomorrow. In order to bridge this widening capability gap, Mutuals need to create hiring policies which promote these new skills and invest in programs that continually develop these skills among their team.

"Once upon a time CBA used to market their rates, it now seems the majority of their communication focuses on new features in their mobile app. Like most industries, the new competitive playing field is the customer experience delivered. In banking, mobile is the centrepiece of CX between customers and brand."

Damien Mair
Co-Founder FUSION

Our survey respondents believe that the Top 3 attributes of impediments to digitisation are:

1. Limitations of current IT systems
2. Lack of critical skills internally
3. Uncertainty as to where to start/invest most heavily

2 Creating and enhancing a culture of experimentation

Having less money than larger competitors means prioritising investments has never been more important. This doesn't mean that you should put all your eggs in one basket. Quite the opposite. Creating a culture of rapid and deliberate learning through experimentation is the best form of insurance that you can employ against the misallocation of money. The idea is to generate many options and to rule out as many of them as possible, as quickly as possible. This is done by getting your propositions in the hands of real customers and using that data to make smart, future-investment decisions.

In addition, having more constraints on your business operations than digital banks and fintechs means that you must get creative about how you do this. Waiting until you have a finished, enterprise grade, digital product does not leave room for innovation or building agility in the organisation. Accordingly, Mutuals have the most to gain by creating a culture of experimentation within their organisation.

The challenge then for Mutuals is how do you embed this culture of experimentation throughout the organisation?

Some practical ways Mutuals would benefit include thinking about how you might articulate your ideas in low fidelity ways and simulate customer interactions with as little investment as necessary to answer the questions you have or validate the assumptions you've made about your product or service idea.

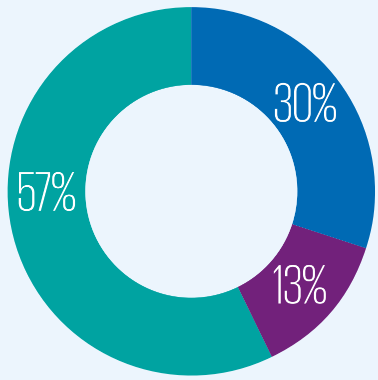
3 Delivering tangible outcomes at pace

Technology and connectedness are driving the pace of change at an exponential rate. We are now living in a time where a company can go from not existing to being worth over USD$1 Billion in less than six months[10]. In the financial services sector specifically, Rong360, a Chinese fintech providing customised financing and loan services online, reached a valuation of USD$1 Billion over just seven months in 2015.

Companies that can increase their speed to market are seeing exceptional results while others who fail to adapt to this pace are being left behind.

In order to keep pace with the wave of start-ups that are flooding the market, Mutuals need to embrace agile work principles and employ design thinking and lean-start-up practices, like intensive product development sprints.

How agile are Mutuals in the digital economy?



Of the Mutuals in our survey:

- 57 percent believe they are flexible
- 30 percent were seeking new ways to collaborate and business models to stay competitive
- 13 percent believe that they are not agile enough to compete in the digital economy

KPMG's Innovation Accelerator—mLabs 2020

In early 2020, KPMG will be assisting Australian Mutuals to develop their innovation capability and capitalise on the current commercial context by running the next instalment of our corporate innovation accelerator—mLabs 2020. We will be taking the best from design thinking, lean startup methodologies and corporate innovation and compressing it into an intensive 8-week program covering ideation, concept testing, prototyping, an in-market pilot, business case development, pitch coaching and much more.

At the end of the accelerator program, your organisation will have:

— A validated concept with a clear value proposition that is ready to scale

— Tangible assets (e.g. branding and marketing collateral)

— Data from in-market testing with real customers to inform further investment

mLabs 2020 is currently taking applications and will be capping participation at eight Mutuals. To find out more and reserve your place, please contact Tyson Rose (trose1@kpmg.com.au) from KPMG Upstarts to arrange a meeting.

How is the industry shaping: shift in regulator considerations

Alongside the focus on agile technology platforms, the release of the APRA Capability Review Report in June 2019 and its recommendations surrounding the consideration of competition is expected to facilitate market development amongst the Mutual sector. APRA's consideration of market pressures and the impact of their decisions are aimed at generating better customer outcomes such as a wider range of financing choices, and improving access and quality of products in a more diversified market place.

As a result, both regulators and market participants will hold greater accountability to consumers where the industry will subsequently be under more scrutiny for inappropriate conduct that does not align with the customers' interest. Mutuals are well positioned to leverage their operational roots of being 'customer-centric' in the market.

The Treasurer's recent announcement in October 2019 to request the Australian Competition and Consumer Commission (ACCC) to conduct an inquiry into home loan pricing amongst all ADIs (since 1 January 2019) will further provide Mutuals with the opportunity to understand the pricing mechanisms of their competitors. This comes in addition to Open Banking legislation which can be utilised by Mutuals to obtain the data required to understand the broader market better.

Key focuses of the ACCC Mortgage Price Inquiry 2019:

— Prices charged for mortgages for both new and existing customers;

— How pricing decisions are made including passing on movements in the cash rate; and

— Investigating barriers which prevent borrowers from switching to other lenders.

The interim report on the ACCC's findings is due by 30 March 2020 and the final report is due to be released by end of September 2020.

05 Open banking

Brett Watson, Partner, Management Consulting
Ivan Vaptzarov, Manager, Management Consulting
Jackson Luff, Manager, Management Consulting

PLAY VIDEO

Introduction

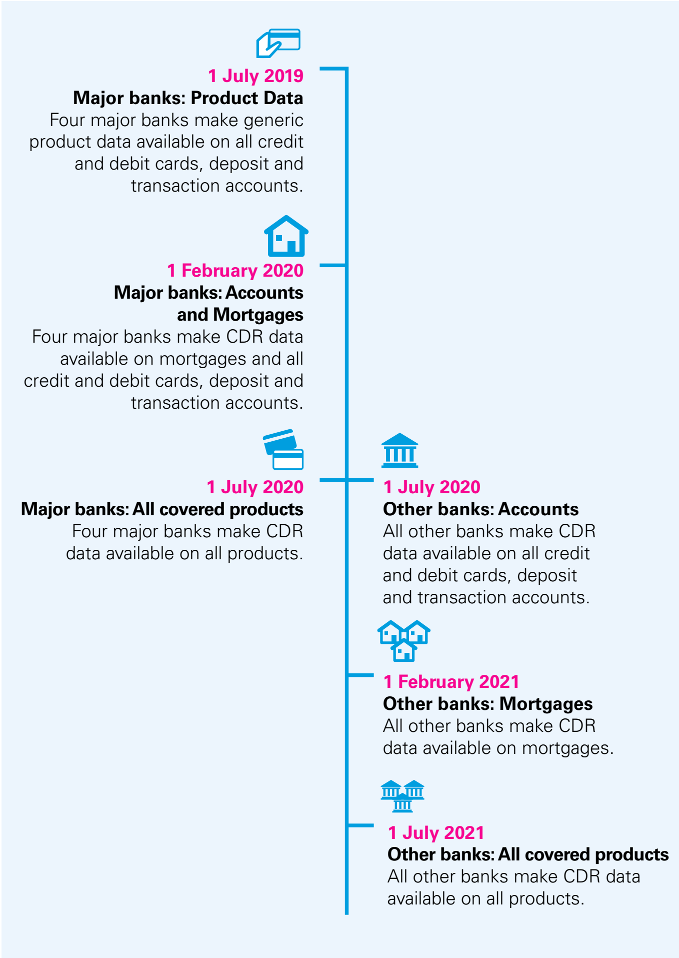
Open Banking, or Consumer Data Right (CDR) legislation in the banking sector, is intended to promote increased competition between banks by enabling smaller market players, such as fintechs and challenger banks, to design and provide financial products and services leveraging on customer data traditionally held exclusively by banks. The application of this legislation will enable customers to authorise accredited third party service providers to access and use their personal data for their benefit.

Implementation timelines—Australia & Global

Over the past year a lot has happened to turn open banking from a concept into a reality. Initial implementation timelines have been revised (in late December 2018), with a delay of implementation for the majors by seven months from July 2019 to February 2020. Revised timelines are included in the figure on the right. Parliament passed the Consumer Data Right (CDR) legislation in August 2019 and the ACCC issued 'lock-down' rules and requirements for organisations to register to be a data recipient in September 2019. The ACCC began testing this open data ecosystem with the major banks and 10 future accredited data recipients in October 2019.

On a more global stage, Open Banking has continued to grow and we are seeing strong signs of adoption in the UK with monthly Application Programming Interface (API) calls increasing from 3 million in July 2018 to 138.5 million in September 2019. This continues to grow at 20–30 percent month-on-month[11].

Figure 1—Australian Open Banking Implementation timeline



Source: https://www.kwm.com/en/au/knowledge/insights/consumer-data-right-law-passed-open-banking-starting-in-au-20190731

With the rules now set and the majors just months away from going live with their Open Banking capabilities, Mutuals need to be preparing to implement their own solutions with participation strategy and future opportunity front of mind. Open Banking can be seen by Mutuals as either a compliance story or an opportunity to leverage personal data, fintech partners and customer-centric digital experiences to compete head-on with existing and new competitors. Mutuals should consider how to build or access the new capabilities required to achieve their chosen strategy within their capital budgets.

What strategies are available to Mutuals to implement Open Banking?

Comply
Our immediate priority is compliance to Open Data obligations. We will consider new products and services as they emerge in the market.

Compete
We will aim to provide consumers with the services they expect in an open data world.

Innovate
Open data will allow us to bring brand new solutions to market, and disrupt/overtake our competitors.

Comply: Focus on the foundations

Although all ADIs must comply with the Open Banking legislation, there are decisions to be made to find the balance between solely achieving compliance and the potential to invest heavily on innovative systems.
Compliance costs alone can place a significant burden on smaller institutions, presenting Mutuals with the choice of whether a build or partner strategy is the most efficient method to achieve compliance. Mutuals need to consider how this new business requirement will fit in with their current technological capabilities.

The key advantage of a compliance only approach is that it limits upfront and ongoing capital expenditure and reduces investment risk, allowing financial institutions to focus on other business priorities. However exposing data for the rest of the industry while not capitalising on the potential new product offerings through expenditure on technology and innovation can have its downsides. This can lead to a structural disadvantage as competitors continue to look to win customers and lower their costs by using consumer level data to price smarter, improve customer experience, stream line acquisitions, and bring new solutions to market.

Compete: Level the playing field

Increasing competition is a key pillar of Open Banking and the availability of personalised data creates opportunities for all organisations. For Mutuals the availability of the majors banking data provides an opportunity to create services and experiences that are on-par or exceed those available from the major banks.

In the UK and elsewhere we have observed personal financial management (PFM) applications and capabilities becoming a standard feature in mobile banking applications. These services include PFMs, streamlined and automated product applications (account opening, lending, etc.), intelligent credit assessment and other capabilities. These capabilities are targeting both consumers and business customers.

There are challenges for Mutuals to build these solutions themselves, however technology providers, aggregators and fintechs have a direct focus on building these capabilities and can utilise scale (by partnering with Financial Institutions) to provide their services to Mutuals due to their greater agility in adopting new technology.

What are some of the latest trends in the fintech space?

KPMG's Pulse of Fintech H1-2019 report says globally the investment trends to look out for include…

— Payments (as seen in the US markets)

— Cybersecurity

— Regtech

— B2B platform services

Innovate: Change the game

Open Banking is just the latest wave looking to disrupt banking—mobile, artificial intelligence, automation and big data are all changing how banks operate and could change what their bank means to customers. Whilst some banks and others are choosing to build, many are looking to service providers and partners to provide not only foundational capabilities as above but also to offer capabilities and connectivity beyond compliance, enabling disruptive solutions by leveraging Open Banking alongside other emerging technologies.

For example in Europe ING Bank is evolving into a banking platform that sells its own products alongside third party products, allowing it to leverage personal data to find a tailored product to suit an individual's needs and circumstances[12].

Investing in new and disruptive products creates greater risk that must be balanced with the potential to offer significant pay-off as a first mover in an industry that is facing an ever-growing wave of disruptions. Mutuals are well placed to be at the forefront of emerging technologies in the banking sector off the back of Open Banking legislation, by utilising their agile organisational structures to dynamically respond to innovation and continue to put the customer first.

CDR mandates greater transparency of service and value which facilitates better informed consumer choices. For further details on the opportunities for businesses, benefits for customers, risks and critical success factors surrounding CDR, refer to the **Open Data video insights.**

Conclusion

Open Banking presents an opportunity to compete head-on with the majors and other banking sector participants in Australia and potentially create new and innovative solutions to grow customers and revenue. However, implementing this new regime, whether looking to comply, compete or innovate, will be cost-intensive and require significant uplift to banking capabilities throughout the organisation. Mutuals need to identify how they want to participate in Open Banking and the CDR more broadly. An important next step is to consider finding the right partners to support your immediate and ongoing compliance as well as provide the capability and connectivity to support future aspirations.

What could the future of banking look like…?

In our recent report on the Future of Digital Banking, we observed…

The banking industry of the future will look very different from what it looks like today – some of what we see will be evolutionary and some will be radically different. The market-leading banks of tomorrow will understand that technology will not limit what is possible. Instead they will harness digital capability to put the customer firmly in control of their destination and preferred model for dealing with their bank and other service providers.

This is not one-size fits all.

Find the link to KPMG's Future of Digital Banking report **here**

06 Operational resilience

Banjo Anderson, Associate Director, Societal and Organisational Resilience
Michelle Licuanan, Manager, Management Consulting

As financial institutions face increased scrutiny over their capital resilience, there is also a need to improve their operational resilience.

Previous eras of organisational resilience narrowly defined measures for enhancing organisational responses to emergent incidents, rather than posturing the organisation as a whole to withstand and overcome acute shocks and chronic stressors. Now, Operational Resilience aims to address a shared, systemic risk across sectors and industries by consolidating and re-orienting efforts towards mitigating impacts to customers; and, increasing accountability across the financial services ecosystem beyond regulated institutions, to include the third and fourth parties they rely on.

The continued adoption of new digital technologies, fintechs and the proliferation of outsourcing core processes has set an expectation of customers to receive cheaper, more immediate financial products and 'around the clock' banking. This has come with increasing consumer dependency on 24/7 services. In 2019, the RBA & APRA estimate a total of ~1,800 hours of interruption across the industry in retail payment facilities. Outages such as these are now recognised as directly harming customers and members given the rise in dependency on technology-enabled banking services.

In Australia, the need to enhance operational resilience in the financial services industry has been emphasised by ASIC, RBA and APRA with current public discussions considering the 'next wave' of operational resilience benchmarks as a yardstick to measure retail banking payment capabilities. Recently, APRA has sought to engage a Head of Operational Resilience to champion these efforts—consistent with banking colleagues globally, and particularly across the US, UK & Hong Kong where an intense focus on building operational resilience across the industry has triggered major organisational transformations across the Financial Services Industry.

Local standards, including CPS 234 *Information Security,* have reinforced APRA's intent to better manage systemic risk by binding regulated entities to higher levels of assurance over critical third parties. This is expected to continue with the update of APRA's CPS 232 *Business Continuity* in the near future.

The pillars of Operational Resilience extend beyond traditional notions of business continuity and IT disaster recovery. The newly cast premise seeks to combine disparate operating models for IT Resilience; Cybersecurity; People Resilience; Third Party Resilience; Continuity and Incident Management; and, Asset Resilience into a cohesive approach and integrated part of Business As Usual operations.

It is not just business planning done correctly, it is about understanding the entire business, considering where there are opportunities for innovation, simplification—and the potential for failure of a critical resource. A Mutual's size may allow them to implement resilience measures quicker than the majors, however their limited resources and concentrated reliance on a limited number of third parties can also make them more susceptible to prolonged operational disruption.

KPMG's Mutuals Survey indicated that the top technology spends for the next year are:

1. Cybersecurity
2. Mobile Banking
3. Payment Software and Services (NPP)

Adapting to a shifting environment

In an industry that is becoming increasingly agile, the ability to continue to adapt and transform with market developments will set a financial institution apart from its peers. While there are costs to meeting these changing requirements there is also opportunity for institutions to ultimately develop a greater understanding of their end-to-end processes and establish better systems, which will increase value for members.

Clearly, customer satisfaction and experience is critical. Interruption of services can lead to damage of trust and reduced customer confidence in the base banking products they rely on daily. Trust is a unique differentiator for the Mutuals, and one they must maintain. Investment in operational resilience now can minimise the cost of 'making good' with customers in the future should a service disruption occur.

The ability to consistently assess areas for potential operational resilience risks can also lead to efficiencies and possible streamlining of business processes. An example of the need for quick responses to disruption is the NPP. As a payment platform, it facilitates 24/7 instant payment reconciliation across over 90 institutions, over half of which are Mutuals. Maintaining these services goes beyond IT risks, requiring the management of a broad range of interconnected non-financial risks.

Is there a one size fits all approach to achieving Operational resilience?

Certainly not, instead there is a need to assess individual preparedness through strategy, risk management and preparedness for failures—regardless of perceived likelihood.

A balanced approach

As with all business processes that aim to keep up with changing market conditions, balance is key. Putting in place the best preventative tools to avoid disruption doesn't guarantee you'll be able to address issues if they arise. Likewise, exhausting resources on what to do if an issue arises doesn't prevent issues in the first place. After all, prevention is better than cure. A balance can only be struck when Mutuals understand their operations deeply, and can integrate operationally resilient practices into their processes.

One of the common challenges that has emerged with the prevalence of outsourcing is stress testing potential problems throughout the service provider value chain. This means even these fourth and fifth parties need to be assessed. Mutuals will need to work together to compel centres of risk to meet member-derived tolerances for outage, a stark shift from organisationally set appetites and service level agreements. This often means breaking down long-established siloes and legacy systems, both internally and externally, to determine which business services and resources require investment and / or reform.

Operational resilience requires both proactive and reactive processes to not only limit possible issues, but also rapidly address those that can't be avoided, without compromising critical business and customer operations.

So what's the next step?

As the financial industry continues to evolve around the world, there is urgency for organisations to change or risk being left behind. On the next page are some building blocks to operational resilience for Mutuals to consider in their implementation processes.

How can KPMG help…?

KPMG's Resilience professionals work with clients to analyse, enhance and test their operational resilience against industry better practices. Its services include Enterprise Wide Operational Resilience benchmarking, operating model design, and, implementation.

Building blocks for enterprise-wide operational resilience

1 Board-down

Operational resilience must be driven from the Board and aligned with the broader strategic agenda.

2 Measured

Boards should set clear tolerances and ensure systematic management, measurement and reporting against appetite.

3 Front-to-back

Resilience should be understood and built across front-to-back key business services, within and beyond your perimeter.

4 Failure-centric

Organisations should adopt a failure-centric resilience mind-set, assuming that incidents will, rather than might, occur.

5 Multi-faceted

Mangagement will need to ensure that the design and build of resilience is based on a broad spectrum of strategies.

Protecting the Mutuals industry from money laundering and terrorism financing

FRESH OFF THE PRESS

Tim Goodrick, Associate Director, Forensic, Audit, Assurance and Risk Consulting

PLAY VIDEO

AUSTRAC releases its Money Laundering and Terrorism Financing Risk Assessment for the Mutual sector.

The risk of money laundering and terrorism financing (ML/TF) is rising in today's financial ecosystem. This, coupled with regulators around the world, including AUSTRAC in Australia, is driving enforcement action to counter ML/TF. As a result, boards and senior management across the banking sector are increasing their focus on AML/CTF as they seek to enhance their controls.

The focus has now shifted to Mutuals with the release of AUSTRAC's risk assessment into the Mutual sector. There is a regulatory requirement that Mutuals take into account this Report to update their AML/CTF Program. This, combined with proposed regulatory changes, means that Mutuals must now more than ever ensure that their AML/CTF risk assessments and programs remain adequate and up to date.

AUSTRAC's ML/TF risk assessment overview

On 30 October 2019, AUSTRAC released its ML/TF Risk Assessment for Australia's Mutual Banking Sector which concluded that Mutuals are at **'medium risk'** of being misused.

This Report is part of a series of initiatives being developed by AUSTRAC following receipt of $5.1 million in July 2018. This Report has been long anticipated, and other risk assessments into the banking, remittance and gambling sectors are currently underway, results of which may further heighten regulatory focus.

Key findings of the Mutuals ML/TF Risk Assessment include:

- **The number of suspicious matter reports (SMRs) continues to increase.** AUSTRAC based the assessment on an analysis of SMRs and consultation with industry. The number of SMRs continues to increase in all regulated sectors, in part due to enforcement action. The Report noted that Mutuals submitted 8,284 SMRs in the 2-year period from 1 July 2016 to 30 June 2018.
- **The ML/TF risk associated with the criminal threat environment is medium.** Money laundering risk was assessed as medium risk and predicate offences were assessed as high risk. The most common predicate offences in SMRs were fraud (including identity and welfare fraud), scams and tax evasion. Terrorism financing was rated as medium risk, as there is some evidence that terrorist financiers may be turning to Mutuals.
- **The ML/TF risk associated with vulnerabilities is high.** The nature of the banking products offered by Mutuals, including cash-based products and international remittances, increases the level of vulnerability. This is not specific to Mutuals but also applies to the broader banking sector.
- **The consequences of ML/TF activity is moderate.** Significant consequences include potential loss of revenue for Mutuals from fraud, increased criminal offending in the community, and reduced government revenue from tax evasion. Clearly, these can impact how the members and community trust them.

The Report provides valuable insights for the Mutual sector. Based on our survey, Mutuals view mergers as a viable growth opportunity. Contrasting to this, the AUSTRAC report found that the consolidation of industry, which has led to fewer, but larger, Mutuals, has increased the Mutual sector's exposure to financing crime risks as its products and services are increasingly varied.

New Payment Platform & Open Banking

AUSTRAC found that:

- The new payments platform (NPP) has increased the level of ML/TF risk as customers can transfer funds faster, allowing criminals to layer and integrate illegal proceeds before detection.
- Open Banking may also increase the level of ML/TF risk in the Mutual sector as it may lead to a disaggregation of transactions across multiple financial service providers, increasing the complexity of the market and making it more difficult to identify suspicious transactions.

  Regular monitoring of the NPP, and conducting a ML/TF risk assessment on the changes to come from Open Banking, are necessary steps for Mutuals to effectively manage their ML/TF risks associated with these changes.

  Mutuals must balance the benefits of NPP and Open Banking with these emerging risks.

What does this mean for Mutuals?

AUSTRAC's Report is a useful resource for Mutuals to focus their AML/CTF efforts which must now include reviewing and updating their AML/CTF risk assessments and programs.

At a minimum, Mutuals will need to review their AML/CTF Programs, including their ML/TF risk assessments, to take into account the AUSTRAC Report findings. This will likely lead to a refresh of ML/TF training materials, customer risk rating models, and transaction monitoring programs.

The first step is to get the ML/TF risk assessment right. The risk assessment is vital to set the foundation for an effective risk-based approach program. In its Report, AUSTRAC notes that use of 'off-the-shelf' risk assessment tools need to be tailored. In our work with the Mutual sector, we have seen how important sound, entity-specific ML/TF risk assessments are to develop and operate effective AML/CTF programs. The ML/TF risk assessment is not a matter of 'set and forget'. It must be reviewed and updated regularly to the changing nature of ML/TF. The release of this Report provides the perfect opportunity to conduct a detailed review and ask 'have we got everything covered?'.

How can KPMG help…?

KPMG Forensic helps clients understand how money launderers and the financiers of terrorism could be exploiting vulnerabilities in their organisations. KPMG's AML/CTF professionals work with clients to identify, manage and mitigate their AML/CTF risk exposures in line with legislative requirements and industry better practice. Its services include:

- AML/CTF risk assessments
- AML/CTF program design, build and execution
- Independent reviews of the AML/CTF program
- Selection of AML/CTF customer due diligence solutions and transaction monitoring software
- Design and delivery of AML/CTF training

This is the time to address AML/CTF issues. AUSTRAC has now given clear direction to the Mutual sector on the ML/TF risks it faces and it expects them to be managed. We anticipate that Reporting Entities that do not consider this ML/TF Risk Assessment risk will be found to be non-compliant by AUSTRAC. The enforcement trend will also continue, particularly as Australia comes into focus internationally from the Financial Action Task Force (FATF). The FATF is visiting Australia before the end of 2019 to assess the effectiveness of the AML/CTF regime, with a public report due in 2020.

AML/CTF independent reviews are important for Boards and senior management to understand the effectiveness of their programs. There is a requirement to perform a regular independent review of an AML/CTF program. While this is a regulatory requirement, we are observing Boards and Senior Management asking 'when did we last have an Independent Review?' and 'is our AML/CTF Program effectively managing our risks?'. Independent Reviews provide Boards and Senior Management with an independent and objective lens.

Other AML/CTF changes are coming

On 17 October 2019, the Government introduced the AML/CTF Tranche 1.5 Bill into Parliament. The purpose of the Bill is to enhance Australia's AML/CTF framework and address deficiencies identified by the FATF in 2015 and the AML/CTF Statutory Review in 2016.

For Mutuals, key changes include:

- **Customer Due Diligence (CDD):** Prohibiting the provision of a designated service when CDD has not been conducted, and allowing a wider range of circumstances for CDD reliance.
- **Correspondent banking:** Requiring further due diligence in the correspondent banking space.
- **'Tipping off' offence:** Expanding the exceptions to the 'tipping off' laws to allow reporting entities to share SMRs with other parties such as independent reviewers.

These are positive changes to further protect Australia from money laundering and terrorist financing, and aimed at reducing compliance costs by up to $3.1 billion over 10 years.

The CDD reliance change is a step forward. This will help to optimise CDD and improve customer relationships—two issues we have identified as critical in the successful CDD transformation are focused on compliance and efficiency[13]. A balance has also been struck on 'tipping off'. While the 'tipping off' laws remain vital, the change will allow the sharing of SMR information to reviewers for the purposes of a review of an AML/CTF program.

Mutuals should monitor this to ensure their AML/CTF programs remain current when they are effective.

Regulatory Roadmap 2019

Quang Dang, Director, Audit, Assurance and Risk Consulting
Jeremy Dunn, Director, Managment Consulting

PLAY VIDEO

Reforms in the banking sector are significant and focused on enhancing the security of data and building structures of accountability and using remuneration structures to impact change.

Mutuals would need to consider how they respond. Whether they should focus on maintaining compliance or innovate their capabilities as a differentiator in the market.

Mutuals that are focused on simple and most efficient ways to achieve their desired strategy of compliance or innovation will be able to stand out from peers. A roadmap of upcoming changes are summarised below.

1 July 2019 **BEAR implementation deadline**

CPS 234 Info Security (July 2019)

CPS 234 *Information Security* aims to ensure that an APRA-regulated entity takes measures to be resilient against information security incidents (including cyber-attacks) by maintaining an information security capability commensurate with information security vulnerabilities and threats, minimising the likelihood and impact of information security incidents on the confidentiality, integrity or availability of information assets, including information assets managed by related parties or third parties.

It is clear that the Mutual sector has responded to CPS234, our survey says:

— 20 percent of Mutuals ranked cyber security as a tech spend focus area.

— 38 percent of Mutuals ranked cybersecurity as a top priority.

— Over 60 percent of Mutuals are prepared for a cybersecurity event.

How should you respond?

— Focus on implementing any remediation strategies to achieve compliance.

— Understand how any future strategic relationships with third party providers may require reporting to you on governance.

— Align board responsibilities, organisational priorities and testing control environment effectiveness.

EFS (July–November 2019)

Being customer centric means also knowing your customer-driven data. APRA has replaced 'domestic books' data collection with enhanced data definitions and reporting standards with EFS.

EFS not only focuses on enhanced types of data but also the governance structure to support that data to make informed macro-economic decisions in the Australian economy.

EFS is coming in phases with Phase 1 effective from July 2019 reporting periods and Phase 2 currently underway.

Mutuals will need to have the following priorities:

— Granularity of data—the increase in complexity of required information and detailed definitions from APRA in relation to EFS requires additional granular data points which Mutuals would need to identify and report.

— Data quality focus—high priority will need to be placed on the design, implementation and ongoing monitoring of the controls and any assumptions used in the preparation of the data that goes into the APRA submissions.

— Notification of reporting errors—entities will be expected to not only notify APRA of any errors, they will be expected to review their data quality processes and controls to prevent future errors.

— Data Governance Structure—an integrated approach supporting transparency of data lineage, controls surrounding that data and data quality is crucial.

Mutuals should consider and assess the capabilities of their systems to meet these requirements.

1 July–November 2019

July 2020

APS Credit Quality—July 2020

A well-functioning credit risk management systems (CRMS) is fundamental to the safety and soundness of any ADI. This CRMS is especially important for an industry to grow. Mutuals in our survey weighted 63 percent of growth to a focus on increase in residential lending and commercial lending (55 percent and 8 percent respectively).

This draft APS220 will be effective from 1 July 2020, and prescribes APRA's requirements, including:

- A Mutual must have a Credit Risk Appetite Statement and Credit Risk Management Strategy.
- The role of the Mutual Board in setting Credit Risk Management goals.
- Heightened focus on credit risk from different origination channels as well as monitoring brokers.
- Gaining deeper understanding of the risk profile of borrowers.

What should you do now?

- Assess current risk management framework for gaps and identify credit process improvement opportunities.
- Conduct due diligence on exposures originated through third parties' online platforms.

Building on APRA's BEAR (1 July 2019) and considering CPS511 Remuneration

BEAR has been in effect for Mutuals since July 2019. BEAR requires Mutuals to consider and identify accountable persons (APs) in their organisations, analyse AP's roles and allocate responsibilities. Mutuals have had to consider their Accountability Maps in the absence of prescriptive guidelines and demonstrate reasonable steps taken to achieve compliance.

Since its implementation, Mutuals have had to focus on how to maintain their focus on accountability and build a strong accountability culture throughout the organisation.

CPS511 Remuneration builds on the BEAR framework and may be effective from as early as 2020. For instance, BEAR introduced the consideration of deferring an AP's variable remuneration to ensure alignment of behaviours to the ADI's long term interests.

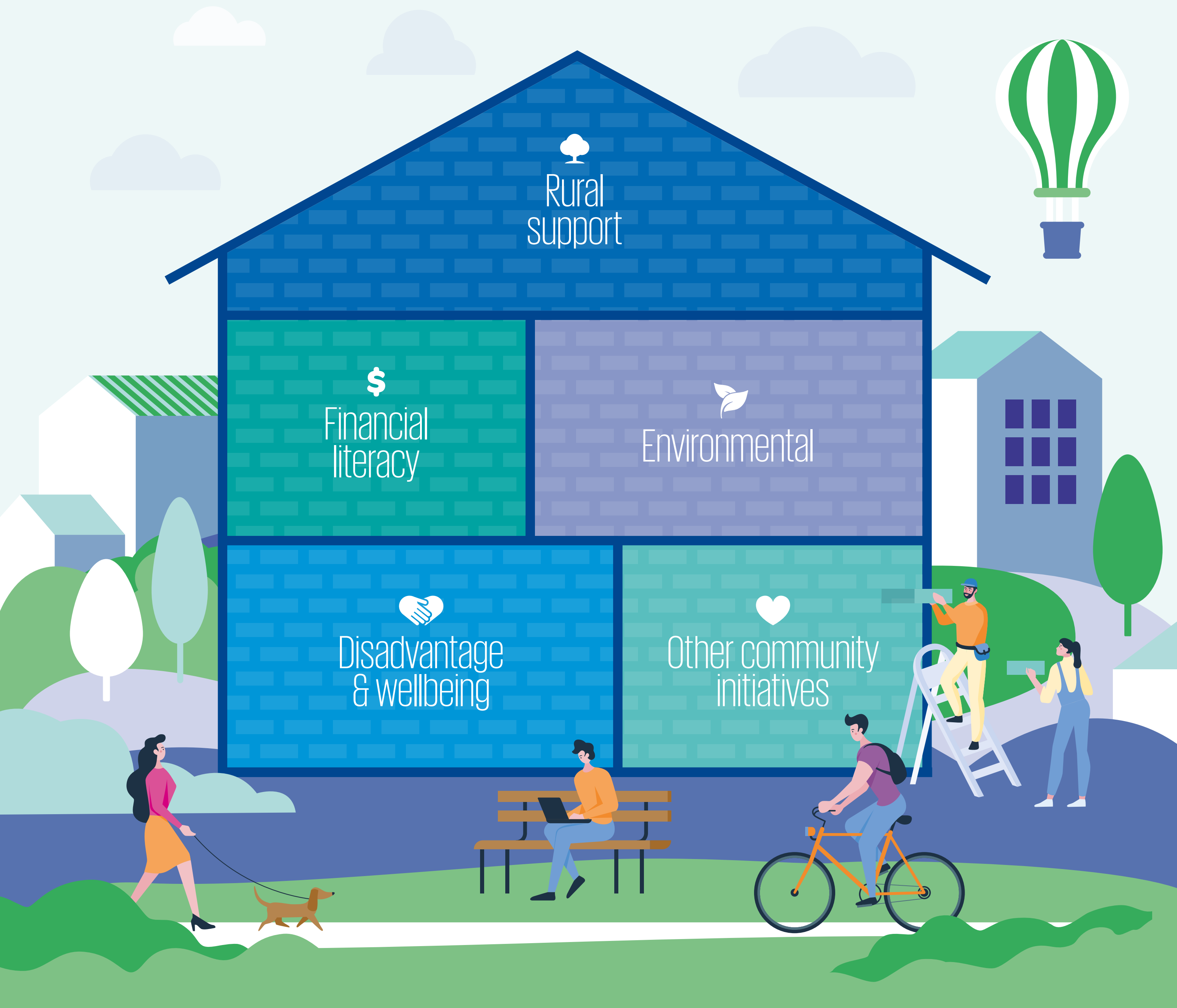
CPS511 is more prescriptive and impacts reward design and governance at any bank. Mutuals will need to consider how this will impact:

- All levels of remuneration and not just executives.
- Adequate board oversight.
- Prescriptive requirements on allocation of weightings to financial KPIs (up to 50 percent) and individual capped at 25 percent.
- Focus on managing outcomes through interaction of financial and non-financial KPIs.

January 2020

APS 112, 113 & 115
Refer to page 9

Community highlights



Building the community together, brick by brick

15
Mutuals operate their own charities or foundations

$20.5m
In donations and fundraising raised for 2019

67.4%
Of Mutuals believe community involvement is a key differentiator to their business

618
Community events were supported

920
Community organisations were supported

Rural support

Beyond Bank Australia pledged $30,000 to provide emergency aid relief to farmers and their families across New South Wales suffering from the effects of severe drought.

Newcastle Permanent Building Society raised over $16,000 for the '200 Bales' charity for drought impacted farmers and their families via staff participation in the CommmunityAssist program.

The Capricornian opened a new branch in Springsure (QLD) in 2019, an unbanked regional community with limited access to the internet.

$ Financial literacy

IMB continues to promote financial literacy through 'The Money Tree' and School Banking program. Both programs grew, with the school program now implemented in 27 primary schools, and The Money Tree growing 36 percent this year.

Credit Union Australia has begun a collaboration with Good Shepherd Microfinance, an organisation that works closely with corporate institutions to reduce financial exclusion and hardship amongst low income Australians, especially women and girls.

Bank First developed 'First Start' Shared Equity Agreement, a home deposit assistance product that helps to formalise the monetary contributions parents often make to their children when purchasing their own home.

Environmental

Community First Credit Union continues to take a leadership role in its offering of low interest Green Loans (grew 12 percent in the year), which give members affordable funding choices to make environmentally friendly home and lifestyle purchases.

Bank Australia are dedicated to a Clean Money commitment, lending money to create a positive impact, and has committed to not make any loans to industries that do harm such as fossil fuel, live export, tobacco and gambling.

Additionally, each Bank Australia customer is part-owner in a Conservation Reserve of Australian bushland which has been protected and restored over the past nine years.

Teachers Mutual Bank has obtained certification on all new mortgages and deposits as responsible investments by the external body Responsible Investment Association Australasia (RIAA).

Disadvantage & wellbeing

Greater Bank partnered with BackTrack to help 1,000 disadvantaged young people since 2014 reconnect to education and training, and prepare for employment. Greater Bank has provided $300,000 in funding since 2014.

P&N Bank's foundation 'Helping &nds' have supported disabled or disadvantaged Western Australians by assisting with the purchase of nursing uniforms for a single mother of five completing her nursing studies to help family and community.

Regional Australia Bank provided a $105,000 Mental health research scholarship, in collaboration with Suicide Prevention Australia, which undertakes research into identifying reasons that can lead some rural and regional Australians to take their own life.

Other community initiatives

Heritage Bank has partnered with Woolworths as the financial administrator for the $30 million Woolworths Organic Growth Fund, to support investment in Australian organic farming projects to eligible Australian farmers.

Bank First continues to support their Teaching Initiatives Program to fund learning and community development projects, with over $600,000 donated since 1993 and with 22 schools supported during the year.

Police Bank initiated their 'Giving 4 Giving' sponsorship program aimed at supporting the Policing community, and during the year has contributed more than 12 percent of their net profit into the community.

People's Choice Credit Union 'Community Lottery' initiative has raised more than $19 million since its inception in 1984.

Appendix

Financial results: 2019 survey participants

The following table contains key financial data[14] of the Mutuals included in our report.

Company Name	Period[15 16]	Net Assets[17] $'000	Total Assets $'000	Total Deposits[18] $'000	Operating Profit Before Tax[19] $'000	Capital Adequacy Ratio[20] %	Return on Equity[21] %	Cost to Income Ratio[22] %
Australian Military Bank Limited	**30-Jun-19**	**95,783**	**1,387,315**	**1,239,955**	**5,845**	**15.21%**	**4.39%**	**79.79%**
	30-Jun-18	93,443	1,346,248	1,233,865	7,473	15.07%	5.71%	73.14%
Australian Unity Bank Limited[23]	**30-Jun-19**	**65,148**	**886,022**	**811,160**	**3,602**	**16.07%**	**3.93%**	**81.57%**
	30-Jun-18	62,603	777,441	708,593	3,932	17.55%	4.49%	67.52%
B&E Ltd	**30-Jun-19**	**72,511**	**993,179**	**753,985**	**3,167**	**15.87%**	**3.24%**	**84.43%**
	30-Jun-18	69,810	840,784	645,816	2,326	17.51%	2.30%	88.15%
Bank Australia	**30-Jun-19**	**533,218**	**6,332,262**	**5,275,948**	**32,778**	**16.39%**	**4.37%**	**72.85%**
	30-Jun-18	510,174	5,652,030	4,640,757	36,262	16.64%	5.25%	69.23%
Bank First[24]	**30-Jun-19**	**221,432**	**2,690,195**	**2,448,483**	**15,522**	**15.90%**	**5.15%**	**74.95%**
	30-Jun-18	205,689	2,509,173	2,281,609	17,014	15.58%	5.97%	72.79%
BankVic[25]	**30-Jun-19**	**185,636**	**2,062,823**	**1,850,261**	**16,054**	**18.50%**	**6.20%**	**70.40%**
	30-Jun-18	177,632	1,830,317	1,595,735	17,909	19.70%	7.38%	65.3%
Beyond Bank Australia	**30-Jun-19**	**509,127**	**6,196,006**	**4,672,672**	**29,322**	**17.43%**	**3.90%**	**80.59%**
	30-Jun-18	486,908	5,823,060	4,360,412	34,801	17.34%	5.54%	76.63%
Community First Credit Union	**30-Jun-19**	**92,810**	**1,097,498**	**994,652**	**1,433**	**15.10%**	**1.32%**	**94.02%**
	30-Jun-18	88,843	1,066,278	966,072	2,932	15.40%	2.59%	88.44%
Coastline Credit Union Ltd	**30-Jun-19**	**41,063**	**537,962**	**490,669**	**4,505**	**14.09%**	**8.34%**	**70.32%**
	30-Jun-18	38,065	503,031	458,517	4,243	14.16%	8.49%	69.73%
Illawarra Credit Union[26]	**30-Jun-19**	**45,322**	**644,412**	**593,043**	**1,638**	**17.73%**	**2.64%**	**88.99%**
	30-Jun-18	44,193	619,716	570,166	2,090	15.26%	3.35%	87.18%
Credit Union SA Ltd	**30-Jun-19**	**105,788**	**1,281,111**	**1,065,309**	**5,327**	**17.98%**	**3.70%**	**82.22%**
	30-Jun-18	100,583	1,160,080	945,510	5,676	18.78%	4.33%	81.39%
Credit Union Australia Limited	**30-Jun-19**	**983,084**	**17,435,211**	**10,587,500**	**59,845**	**14.30%**	**4.02%**	**73.47%**
	30-Jun-18	961,407	15,617,933	9,231,009	69,469	14.25%	5.58%	71.15%
Defence Bank Limited	**30-Jun-19**	**179,243**	**2,500,301**	**2,092,438**	**14,346**	**14.30%**	**5.76%**	**73.08%**
	30-Jun-18	169,418	2,277,826	1,953,896	13,961	14.80%	5.95%	72.94%
Endeavour Mutual Bank Ltd	**30-Jun-19**	**87,648**	**645,654**	**548,675**	**2,575**	**26.74%**	**2.19%**	**85.90%**
	30-Jun-18	82,724	639,250	545,366	3,061	25.83%	2.70%	82.98%
Family First Credit Union Limited	**30-Jun-19**	**12,290**	**157,329**	**139,564**	**1,022**	**15.80%**	**6.28%**	**79.37%**
	30-Jun-18	11,377	134,209	119,683	848	16.80%	5.58%	81.60%
G&C Mutual Bank	**30-Jun-19**	**110,480**	**1,193,999**	**1,022,537**	**9,316**	**17.11%**	**6.07%**	**64.68%**
	30-Jun-18	104,760	1,120,680	957,737	6,804	18.18%	4.68%	69.43%

Company Name	Period[15][16]	Net Assets[17] $'000	Total Assets $'000	Total Deposits[18] $'000	Operating Profit Before Tax[19] $'000	Capital Adequacy Ratio[20] %	Return on Equity[21] %	Cost to Income Ratio[22] %
Gateway Bank Ltd	**30-Jun-19**	**104,849**	**1,122,905**	**858,182**	**3,011**	**19.10%**	**2.01%**	**78.28%**
	30-Jun-18	103,544	1,064,121	746,395	3,692	20.36%	2.44%	76.15%
Greater Bank Limited	**30-Jun-19**	**548,264**	**7,161,631**	**6,141,175**	**44,740**	**17.77%**	**5.92%**	**73.83%**
	30-Jun-18	515,124	6,711,157	5,757,508	48,925	17.36%	6.87%	71.34%
Heritage Bank Ltd	**30-Jun-19**	**575,726**	**10,088,482**	**7,738,886**	**61,708**	**14.42%**	**7.80%**	**71.54%**
	30-Jun-18	533,399	9,524,363	7,149,791	64,213	14.11%	8.82%	70.58%
Holiday Coast Credit Union Ltd	**30-Jun-19**	**45,340**	**631,459**	**578,771**	**2,295**	**14.66%**	**3.59%**	**88.61%**
	30-Jun-18	44,145	607,657	556,556	3,196	14.48%	5.18%	82.82%
Horizon Credit Union Ltd	**30-Jun-19**	**26,210**	**375,148**	**344,165**	**1,868**	**14.53%**	**5.37%**	**84.25%**
	30-Jun-18	24,427	345,005	313,955	1,729	14.96%	5.82%	85.06%
Hume Bank Limited	**30-Jun-19**	**80,848**	**1,208,275**	**1,112,521**	**6,913**	**14.38%**	**6.40%**	**77.61%**
	30-Jun-18	75,776	1,104,110	1,016,352	6,013	14.48%	5.67%	79.89%
IMB Limited	**30-Jun-19**	**362,708**	**6,077,077**	**5,266,418**	**45,401**	**15.50%**	**8.98%**	**66.14%**
	30-Jun-18	343,687	5,912,182	4,993,265	45,184	16.10%	9.37%	65.65%
Macarthur Credit Union Ltd	**30-Jun-19**	**25,317**	**253,844**	**225,869**	**195**	**20.03%**	**0.62%**	**88.98%**
	30-Jun-18	24,744	253,733	227,111	433	19.63%	1.20%	91.25%
The Mutual Bank[27]	**30-Jun-19**	**49,678**	**764,494**	**647,308**	**6,491**	**15.17%**	**11.03%**	**72.17%**
	30-Jun-18	44,483	672,078	583,695	3,499	15.57%	5.66%	76.35%
MOVE Bank[28]	**30-Jun-19**	**65,508**	**671,203**	**603,904**	**2,348**	**20.66%**	**2.68%**	**79.03%**
	30-Jun-18	63,264	614,446	549,283	1,305	21.46%	1.49%	85.09%
Newcastle Permanent Building Society Ltd	**30-Jun-19**	**982,670**	**10,832,330**	**8,478,794**	**53,178**	**20.10%**	**3.68%**	**71.67%**
	30-Jun-18	954,293	10,716,100	8,242,302	62,041	20.10%	4.62%	67.47%
Nexus Mutual (EECU)	**30-Jun-19**	**19,599**	**348,335**	**325,139**	**1,589**	**13.95%**	**6.07%**	**77.57%**
	30-Jun-18	18,515	323,252	301,618	1,715	14.29%	6.95%	74.96%
Northern Inland Credit Union Ltd	**30-Jun-19**	**39,357**	**313,542**	**267,586**	**1,417**	**22.85%**	**2.72%**	**86.91%**
	30-Jun-18	36,177	287,128	245,429	1,532	22.00%	3.02%	86.19%
P&N Bank[29]	**30-Jun-19**	**290,645**	**4,268,098**	**3,176,461**	**14,907**	**14.93%**	**3.60%**	**82.05%**
	30-Jun-18	285,815	4,149,210	2,970,662	16,783	15.44%	4.33%	77.91%
People's Choice Credit Union[30]	**30-Jun-19**	**618,829**	**8,810,188**	**6,421,521**	**33,126**	**15.07%**	**3.45%**	**85.35%**
	30-Jun-18	603,042	8,390,573	6,113,791	44,200	15.34%	5.48%	80.71%
Police Bank Ltd	**30-Jun-19**	**203,190**	**2,017,446**	**1,690,526**	**4,361**	**19.12%**	**1.20%**	**90.17%**
	30-Jun-18	200,247	1,910,898	1,599,182	12,109	19.40%	4.40%	76.85%
Police Credit Union Limited	**30-Jun-19**	**83,314**	**1,135,104**	**1,039,990**	**6,931**	**14.04%**	**6.00%**	**76.03%**
	30-Jun-18	78,469	1,040,734	953,661	6,342	14.68%	5.90%	76.20%
QBANK (QPCU Limited)	**30-Jun-19**	**80,656**	**857,887**	**730,571**	**3,579**	**20.71%**	**3.28%**	**82.20%**
	30-Jun-18	78,255	839,711	735,298	4,607	19.93%	4.51%	78.99%
Qudos Bank	**30-Jun-19**	**268,337**	**4,038,284**	**3,606,457**	**24,931**	**14.99%**	**6.73%**	**66.18%**
	30-Jun-18	255,949	3,763,343	3,363,502	2,053	14.39%	0.55%	96.69%
Queensland Country Credit Union	**30-Jun-19**	**254,796**	**2,294,391**	**1,991,576**	**11,548**	**16.16%**	**3.12%**	**93.32%**
	30-Jun-18	245,187	2,167,525	1,881,212	7,893	15.82%	2.08%	95.21%

Company Name	Period[15,16]	Net Assets[17] $'000	Total Assets $'000	Total Deposits[18] $'000	Operating Profit Before Tax[19] $'000	Capital Adequacy Ratio[20] %	Return on Equity[21] %	Cost to Income Ratio[22] %
RACQ Bank	**30-Jun-19**	**159,407**	**2,122,558**	**1,797,838**	**-13,929**	**15.36%**	**-6.59%**	**131.63%**
	30-Jun-18	166,139	1,748,409	1,475,377	-13,418	17.90%	-5.76%	131.25%
Regional Australia Bank	**30-Jun-19**	**124,821**	**1,517,596**	**1,372,558**	**12,539**	**15.82%**	**7.35%**	**73.76%**
	30-Jun-18	116,330	1,403,108	1,269,157	12,915	16.20%	8.23%	71.35%
Southern Cross Credit Union	**30-Jun-19**	**56,243**	**578,014**	**515,770**	**4,321**	**19.00%**	**5.87%**	**58.49%**
	30-Jun-18	52,752	521,961	463,631	4,342	19.32%	5.98%	58.97%
The Summerland Credit Union Limited	**30-Jun-19**	**61,567**	**748,489**	**653,836**	**4,550**	**16.47%**	**5.34%**	**79.00%**
	30-Jun-18	59,094	689,150	598,864	4,235	16.83%	5.38%	79.64%
Sydney Mutual Bank	**30-Jun-19**	**87,369**	**933,985**	**833,583**	**2,192**	**17.33%**	**1.76%**	**88.33%**
	30-Jun-18	80,659	867,529	771,619	5,385	16.86%	4.92%	78.65%
Teachers Mutual Bank Limited	**30-Jun-19**	**548,549**	**8,041,748**	**6,570,030**	**38,649**	**14.81%**	**5.04%**	**76.88%**
	30-Jun-18	525,385	7,068,765	5,813,647	45,211	15.65%	6.25%	71.66%
The Capricornian Ltd	**30-Jun-19**	**25,137**	**348,084**	**319,676**	**2,267**	**14.03%**	**6.80%**	**77.80%**
	30-Jun-18	23,902	333,437	306,555	2,000	13.88%	6.09%	76.33%
Unity Bank Limited[31]	**30-Jun-19**	**109,855**	**1,222,335**	**1,073,067**	**5,909**	**16.50%**	**4.04%**	**82.95%**
	30-Jun-18	100,744	1,090,505	977,658	4,840	17.11%	4.20%	85.09%

Endnotes

1. Building Society and Credit Union customer satisfaction? You can bank on it, Roy Morgan, October 2019.
2. Director and officer oversight of non-financial risk report, ASIC Corporate Governance Taskforce, October 2019.
3. Gillespie, N., & Dietz, G. 2009. Trust repair after an organisation-level failure. Academy of Management Review, 34(1): 127–145; Mayer, R. C., Davis, J. H., & Schoorman, F. D. 1995. An integrative model of organisational trust. Academy of Management Review, 20(3): 709–734; Schoorman, F. D., Mayer, R. C., & Davis, J. H. 2007. An Integrative Model of Organisational Trust: Past, Present, and Future. Academy of Management Review, 32(2): 344–354.
4. The United Nations Climate Change, The Paris Agreement. **Link here.**
5. United Nations, About the Sustainable Development Goals. **Link here.**
6. ARS Synthesis Report: Climate Change 2014—Intergovernmental Panel on Climate Change.
7. Customer Experience Excellence Report 2019, KPMG, 2019.
8. Customer Experience Excellence Report 2019, KPMG, 2019.
9. The skills you need to succeed in 2020, Forbes, August 2018.
10. Fleximize, The Speed of a Unicorn. **Link here.**
11. Open Banking APIs Performance. **Link here.**
12. Transformation update, ING, March 2019
13. Frontiers in Finance—Issue 60, KPMG, March 2019. **Link here.**
14. Information has been extracted from published annual reports (at a consolidated level where applicable). Parent numbers have been used in limited cases where they are a better reflection of results. In limited cases, KPMG has adjusted a number of balances to reflect a significant one-off event.
15. All figures for the current and prior year are reported under AIFRS and in Australian dollars.
16. All of the results reported in the report were for a 12-month period.
17. Net assets include other equity interests.
18. Total Deposits is taken from the balance sheet and includes all deposits, such as retail, non-retail and other deposits.
19. Operating profit before tax is before outside equity interests.
20. Capital adequacy ratio has been calculated under the APRA's risk based measures.
21. Return on equity has been calculated as profit after tax as a percentage of average net assets.
22. Cost-to-income ratio has been calculated as operating expenses as a percentage of operating income.
23. Prior to October 2018, Australian Unity Bank Limited was registered under the name Big Sky Building Society Limited.
24. Prior to December 2017, Bank First was registered under the name Victoria Teachers Mutual Bank.
25. Registered name is Police Financial Services Limited (formerly Police Association Credit Cooperative Limited).
26. Community Alliance Credit Union Limited trading as Illawarra Credit Union.
27. Maitland Mutual Limited trading as The Mutual Bank.
28. Railways Credit Union Ltd—trading as MOVE Bank.
29. Formerly known as Police & Nurses Credit Society Ltd.
30. People's Choice Credit Union, a trading name of Australian Central Credit Union Ltd.
31. In December 2018, Central Coast Credit Union merged with Unity Bank.

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