ESG CONSIDERATIONS FOR MUTUALS

IMPLICATIONS FOR THE MUTUALS' DIFFERENTIATION OF INCREASING ESG FOCUS IN THE REST OF THE FINANCIAL SERVICES INDUSTRY

As the global COVID-19 pandemic began to unfold in 2020, many predicted that progress on key Environmental, Social and Governance (ESG) issues would take a back seat. World leaders had no choice but to react swiftly – placing an acute focus on crisis management and providing support to their economies. The reality, however, has been quite different. Stakeholders across the landscape including policy makers, regulators, investors, corporates, consumers and communities – are embracing a greater sense of responsibility to tackle the ESG agenda and are demanding more action from financial institutions[B]. And over the last 12 months, as momentum built to COP26 in November and off the back of the Intergovernmental Panel on Climate Change's Sixth Assessment Report[1], ESG has gone from a fringe topic of interest to a large part of the working week for the Boards and Executive teams of financial institutions[A].

It is with this backdrop that financial institutions are revisiting their purpose – beyond delivering shareholder or member returns – to one that genuinely recognises the important role Sustainable Finance plays in addressing some of society's greatest challenges. As the appreciation lands that this is as much about commercial success as it is about doing good – leaders are embedding ESG within their business strategy as a point of differentiation. This will bring some of the major banks and other new entrants into the purchasing considerations of customers who would normally only consider mutuals.

FACING INTO THE ACCELERATING ENVIRONMENTAL AGENDA

Despite being largely deposit taking and lending institutions, the physical risks associated with their books should not be ignored. Mutuals will need to be seen to be taking action to understand the impact of climate change on their business in the future – by:

- **ADDRESSING PHYSICAL RISK – MORTGAGE EXPOSURE:** building capability now to manage and mitigate the impact of credit losses associated with extreme weather events will be critical in the long term – particularly for mutuals with large concentrations of customers in certain geographic areas that are prone to these events.
- **OFFERING GREEN PRODUCTS & SERVICES TO BUILD CLIMATE RESILIENCE:** Members are now paying increased attention to what their bank stands for and their green credentials. Providing green loans which are linked to ESG targets, incentivising insurance discounts for protection against climate events or encouraging members to purchase products such as solar panels will also enable them to play their part in the transition to net-zero whilst supporting households to become more resilient to physical threats.

> "What will happen to the 30-year mortgage — a key building block of finance — if lenders can't estimate the impact of climate risk over such a long timeline, and if there is no viable market for flood or fire insurance in impacted areas?"
>
> **Larry Fink**
> **CEO, BlackRock**

THE 'S' – SUPPORTING THE COMMUNITIES THEY SERVE - A GATEWAY TO FINANCIAL SERVICES

The mutuals value proposition has always been around offering targeted customer segments with the basic banking services they need, one centred around trust, purpose, community and personalised customer service. Whether its their commitment to the physical branch network in regional communities or tailoring their offering to support under-banked migrant communities, mutuals have often been a gateway to financial services for these consumers. This will continue to be a core part of their value proposition moving forward, however, the need to innovate and keep pace with changing customer expectations means they will need to:

- **BRIDGE THE GAP TO ACCESSING DIGITAL SERVICES:** whilst digital service provision is revolutionising the industry, and how consumers interact with it, it is leaving some consumer segments behind (e.g. remote communities; disabled customers; migrant communities where English is not their first language; or those who are digitally illiterate). Bridging the gap to allow these consumers to access digital services via in branch services, or in-app translation services presents an opportunity for mutuals.
- **THE GROWING DIVIDE:** Property prices have soared by an average of 22.5 percent across Australia's capital cities over the last year[4] and the significant upfront commitment of a deposit continues to grow as a barrier for new home buyers entering the housing market. An opportunity exists here for mutuals to support new homeowners entering the market – for example, by allowing their parents to access equity they have already saved but is otherwise tied up in the family home.

THE 'G' – RECOGNISING THE LINK BETWEEN PURPOSE AND GOVERNANCE

Trust is a hard thing to win and an easy thing to lose. Over the last 4 years, we have seen the impact on customer and community trust when an organisation fails to live up to the purpose and values it espouses. Good corporate governance is not just about the decisions you make, it's about how you make them – and it is about how you explain these to your stakeholders. As the sector faces into a period of significant change they must continue to:

- **ALIGN CORE PURPOSE WITH GROWTH AMBITIONS:** As M&A activity increases in the sector, mutuals must carefully consider the risks that come with scaling and the impact to members and communities. This means being transparent and striking the right balance between remaining competitive and continuing to serve member's needs. Implications span across merging brands, converging values and impacts to services (e.g. digital channels and branch consolidation).
- **COMBAT FINANCIAL CRIME AND FRAUD:** The ACCC have reported an 89 percent increase in financial scams over the last year, primarily impacting vulnerable communities. Indigenous Australians have experienced a 172percent increase in losses totalling $2.2million compared to 2020[5]. Focusing on enhancing financial crime practices will be essential to maintaining the confidence of members.
- **FOCUS ON CYBER SECURITY:** As the threat and incidence of cyber and ransomware attacks increase, members will only bank with providers who can guarantee the safety of their assets and information. This means making digital security a top priority to ensure business continuity, uplift operational resilience and enable effective management of third-party risk.

KPMG CONSUMER RESEARCH HAS REVEALED THE MOST VALUABLE INITIATIVES FOR BANKS TO SUPPORT:

50% DISASTER RELIEF	46% EMERGENCY SERVICES	45% MENTAL HEALTH AND SUICIDE PREVENTION PROGRAMS
44% POVERTY AND HOMELESSNESS PREVENTION	40% ENVIRONMENTAL PROTECTION	30% SUPPORTING INDIGENOUS COMMUNITIES

While mutuals – with members and purpose at their core – are well placed to weather the storm, they need to be aware that customer expectations continue to change. Having a feel good purpose is no longer enough, customers want to do business with those who can amplify the impact they, individually, can have on key social and environmental issues. Mutuals value propositions will need to continue to evolve to ensure they can remain relevant competitive.

NOTES

A:

KPMG's 2021 CEO Outlook identified Climate change – and the risks that this posed to their growth – was top of mind[2]

2021*

RANK

#1 Cyber security risk

#1 Environmental / climate change risk

#1 Supply chain risk

B:

The customer/supplier relationship is no longer transactional with consumers looking for a partner to support them in making a societal difference. Our recent 'Me, My Life, My Wallet' recently found that 80 percent want to purchase from a brand that reflect their values and 90 percent said they would be willing to pay more to an ethical company[3].

Changing priorities

80% of consumers prefer buying from and into the brands whose actions align with their beliefs and values

37% are now prioritizing sustainable products or services more than before COVID-19

90% of consumers are willing to pay more to an ethical retailer or brand that gives back to society

Sources

1 Sixth Assessment Report — IPCC

2 KPMG CEO Outlook 2021 (home.kpmg)

3 Me, my life, my wallet (assets.kpmg)

4 CoreLogic RP Daily Home Value Index: Monthly Values – 30 September 2021

5 https://www.abc.net.au/news/2021-09-28/phone-scams-exploding-vulnerable-australians-new-data/100496496

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