KPMG

Mutuals Industry Review 2023

Challenges for a purposeful future

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Contents

Introduction

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The 2023 financial year saw the Mutuals increase net assets by 4.2 percent to $11.7 billion (2022: increase of 8.7 percent). At the same time, overall operating profits before tax increased by 27.0 percent (2022: 10.6 percent decrease) to $769.3 million (2022: $605.7 million). The increase in operating profits before tax was largely driven by the impact of increased interest rates and the flow through impact on Net Interest Margins as well as continued loan growth. This has had a positive impact on the Mutuals' cost-to-income ratios which for the sector as a whole decreased to 73.7 percent (2022: 81.2 percent).

The last three years have seen unprecedented disruption for the Mutuals to navigate, from the impacts of Covid in 2020 and 2021 to the impact of the climate-weather events in 2022. These challenges continued into 2023 with softening economic conditions, high inflation levels contributing to further interest rate increases and the cost-of-living pressure continuing to have an impact on customers.

Economic uncertainty both globally and nationally continues to put pressure on local communities. Supporting these communities is a core purpose for the Mutual sector as unlike investor-owned banks, the profits of customer-owned banks are not paid to shareholders but are reinvested into meeting customers' needs.

Notwithstanding this, the Mutual sector operates within the broader banking ecosystem which provides multiple challenges for a purposeful future.

The operating environment

As interest rates continue to rise in response to high inflation, the resulting cost-of-living pressures means members need more from the Mutuals than ever before. The performance of the sector has been impacted by:

- a slowdown in mortgage lending performance
- increased competition from both traditional and new market entrants
- the continuing challenge of housing affordability as house prices continue to rise, albeit more moderately
- interest rates at 10 year highs resulting in the average mortgage holder paying significantly more than prior to the rate increases commenced
- low rental vacancy rates
- loan repayments slowing down as a higher proportion of mortgage payments go to interest repayments rather than to principal reduction
- a reduction in the growth of deposits impacting the sector's costs of funds.

The current year saw the sector need to manage the impact of the 'fixed rate mortgage cliff' with the first wave of fixed rate loans from 2020 and 2021 needing to be refinanced. Whilst this has not had a significant impact on loan performance, the concentration of residential lending within the sector means that this will continue to be a focus into 2024.

Many of the sector-wide challenges that the Mutuals have been facing, such as the need to continue to invest in digital transformation, innovation and meeting the increasing regulatory compliance, whilst true for all banks, continues to impact the Mutuals disproportionally due to their relatively small size.

Finally, consolidation remains a major topic in the sector, with two significant mergers completed during the year. However, there are many different strategies for growth being considered by the Mutual sector, both organic and inorganic. These include a continued focus on customer service and engagement, product diversification and geographic expansion, through to strategic alliances and joint ventures.

Financial

The interest rate increases that commenced in 2022 have continued into 2023 with rates now at a 10 year high. Low rental vacancy rates, rising property prices and high employment continued to drive mortgage lending growth for the Mutuals albeit at more moderate levels. These same dynamics also contributed to continued low levels of loan losses and loan loss provision levels consistent with 2022.

Although during the year the Mutual sector remained at 2.7 percent of the total assets across all authorised deposit-taking institutions, Net Interest Margin saw a notable improvement compared to the downward trend in recent years.

A key area of focus for the sector is the cost-to-income ratio and 2023 saw a significant improvement, reducing to an average of 73.7 percent, compared to 51.4 percent for the Majors. This has seen the gap between the average cost-to-income ratio of the Mutuals and the Majors reduced by 960bps from 31.9 percent to 22.3 percent.

The challenge is how to maintain and continue to close this gap. The response to this issue is for Mutuals to seek the benefits from organisational simplicity, sector utilities (for instance for payments services) and investment in productivity-enhancing technology – as well as through consolidation.

During the year we saw two significant mergers completed, between Greater Bank and Newcastle Permanent (renamed Newcastle Greater Mutual Group) and between Heritage Bank and People's Choice Credit Union (renamed Heritage and People's Choice). This has had a significant impact on the shape of the top 10, including for the first time in many years two new entrants, Qudos Bank and Bank First.

The result of the mergers has seen a threefold increase in the number of Mutuals with in excess of $20 billion in total assets. Of the survey respondents, the majority indicated that the focus of consolidation will continue. However, it is pertinent to note that there are a number of strategic growth pathways available.

Challenges for a purposeful future

It has been a positive year for the Mutuals sector, with their commitment to a purposeful future being fundamental to their success. Supporting members and their communities is part of the sector's DNA, with profits reinvested into pursuing this objective. Whilst there is an absence of investor demands on capital from shareholders, the Mutuals do operate within the broader banking ecosystem, facing multiple challenges in meeting these demands, including:

- increased threat of fraud and cyber incidents
- risk and regulation
- investing for the future through digitisation and modernisation
- data protection
- competition driving downward pressure of NIM
- access to talent
- new competitors.

Responding to these challenges in a cost-effective manner will be critical to a sustainable future. A key advantage of the Mutuals sector is the ability to be nimble in responding to these challenges.

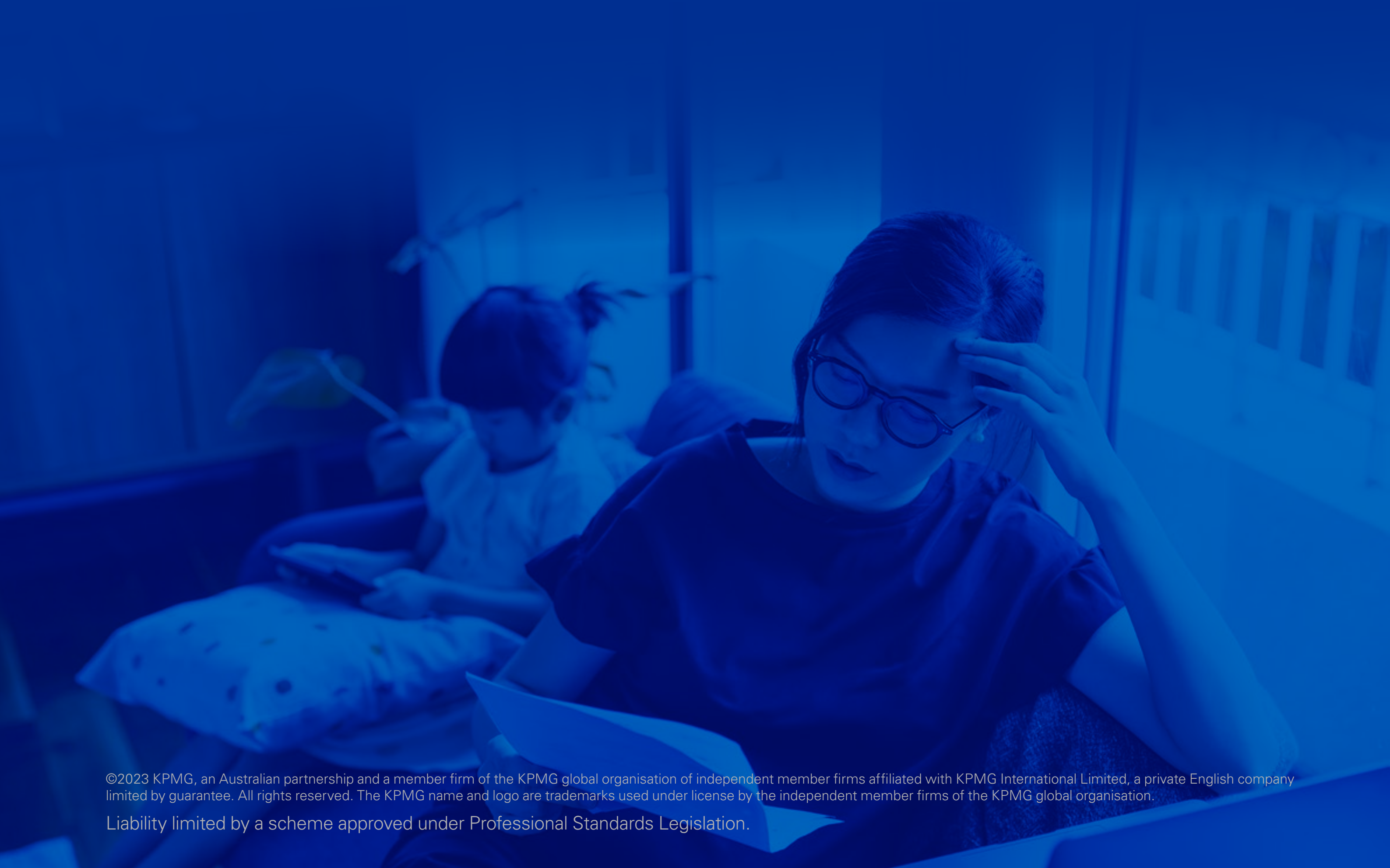
The challenge to a purposeful future is maintaining the current year's results in the face of increasing demands from your members as they navigate the impact of sustained high inflation and significant cost-of-living pressures, demands from the regulator, and demands from community expectations on ESG and data protection.

Mutuals that embrace these challenges and see opportunities through leveraging the strong connection to the community, sense of purpose and ability to embrace the possibilities of generative AI will continue to grow sustainably. We have highlighted a number of focus areas for the Mutuals in a series of articles covering:

- Opportunities for growth
- Managing the cyber threat
- Preparing for climate-related reporting
- Generative Artificial Intelligence (Gen AI)
- CPS 230 operational risk management.

Through these articles we explore the key considerations for the Mutual sector and some practical approaches to meeting these challenges and embracing the opportunities they present.

We trust that you find this publication insightful. KPMG looks forward to supporting the sector meet the challenges for a purposeful future.



Year in review – 2023 highlights

27.0%

Operating profit before tax increased by 27.0% to $769.3m
(2022: $605.7m)

6.1%

Lending grew by 6.1% to $129.4b
(2022: $121.9b)

4.4%

Deposits grew by 4.4% to $131.1b
(2022: $125.6b)

17.0%

Non-interest income decreased by 17.0% to $317.1m
(2022: $381.8m)

18bps

Net interest margin increased 18bps to 2.00%
(2022: 1.82%)

749bps

Cost-to-income ratio decreased by 749bps to 73.7%
(2022: 81.2%)

204bps

Average capital adequacy ratio increased by 204bps to 18.25%
(2022: 16.21%)

$23.6m

Increase in credit provisions of $23.6m
(2022: write back of credit provisions of $10.8m)

2

2 mergers completed
(2022: 2)

Key highlights from our 2023 Mutuals Survey

Top 3 contributors for growth:

76%
Better product pricing

54%
Customer centricity and offering new/tailored products

49%
Better customer service

Top 3 priorities for the next 3 years:

86%
Maintaining profitable and sustainable growth

54%
Digital transformations

27%
Managing margin and interest rates

Top 3 biggest risks:

92%
Information Technology, including cyber risk

43%
Compliance and regulations

30%
Attracting and retaining talent

What do you see as the key technology challenges* in the next 3 years:

54%
Data integrity

43%
Innovation

41% **(these 3 options were equal 3rd in ranking from the survey)**
Cost reduction, productivity improvement and reskilling the workforce

What do you consider your greatest competitor:

51%
Big 4 banks

32%
Banks in general (other banks)

11%
Other Mutuals

73%
of respondents feel confident about the 3 year growth prospects for Mutuals compared to 75% in 2022

* Note: Rankings are based on overall responses among the top 5 choices in this question.

81%
consider themselves prepared for a cyber event

19%
anticipate being involved in merger activity during 2023
(2022: 26%)

19%
are considering the possibility
(2022: 22%)

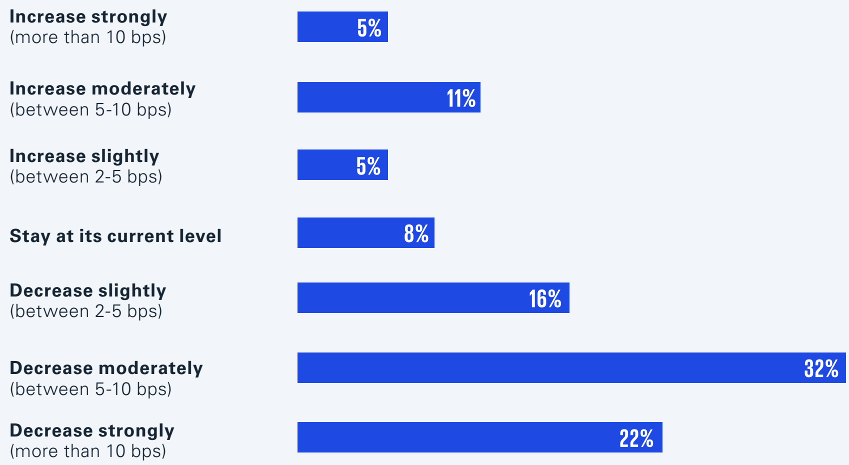
What are seen as key differentiators?

38%
Personalised member service/experience

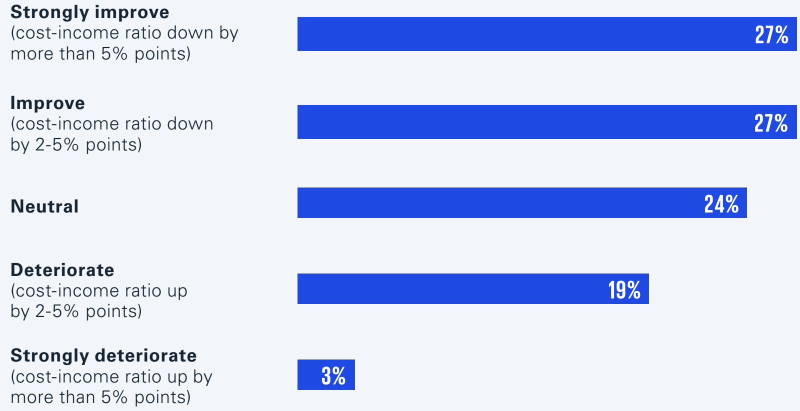
18%
Community involvement

19%
Knowing your target sector

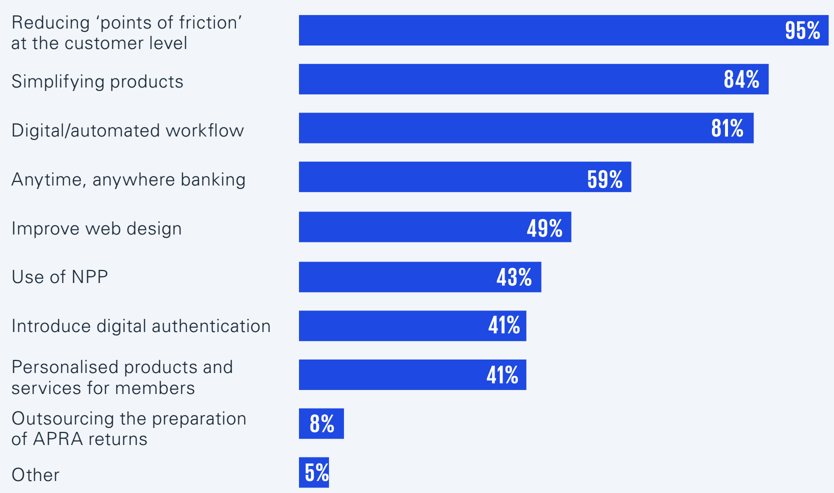
Future net interest margin expectations in the next 3 years



Cost efficiency development expectations in the next 3 years



Strategies to improve customer experience and costs



Preface

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 45 Mutuals for the 2023 financial year (2022: 47 Mutuals), which represents over 98 percent (2022: 99 percent) of the Mutual sector by total assets. The financial information, analysis and observations have been compiled from publicly available financial reports, APRA statistics and includes information from the prior year. In certain circumstances, data has 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 the industry being exposed to. This year we had a response rate of 70 percent (2022: 70 percent). This reflects the Mutual sector's eagerness to come together, leverage experiences and operate in unity.

For the purposes of reporting we have often grouped the Top 10 Mutuals by total assets (the Top 10) as well as 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, support and contribution to this report.

The KPMG Mutuals Insights Dashboard

The KPMG Mutuals Insights Dashboard which accompanies this report contains interactive charts and graphs that are underpinned by the publicly available 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.

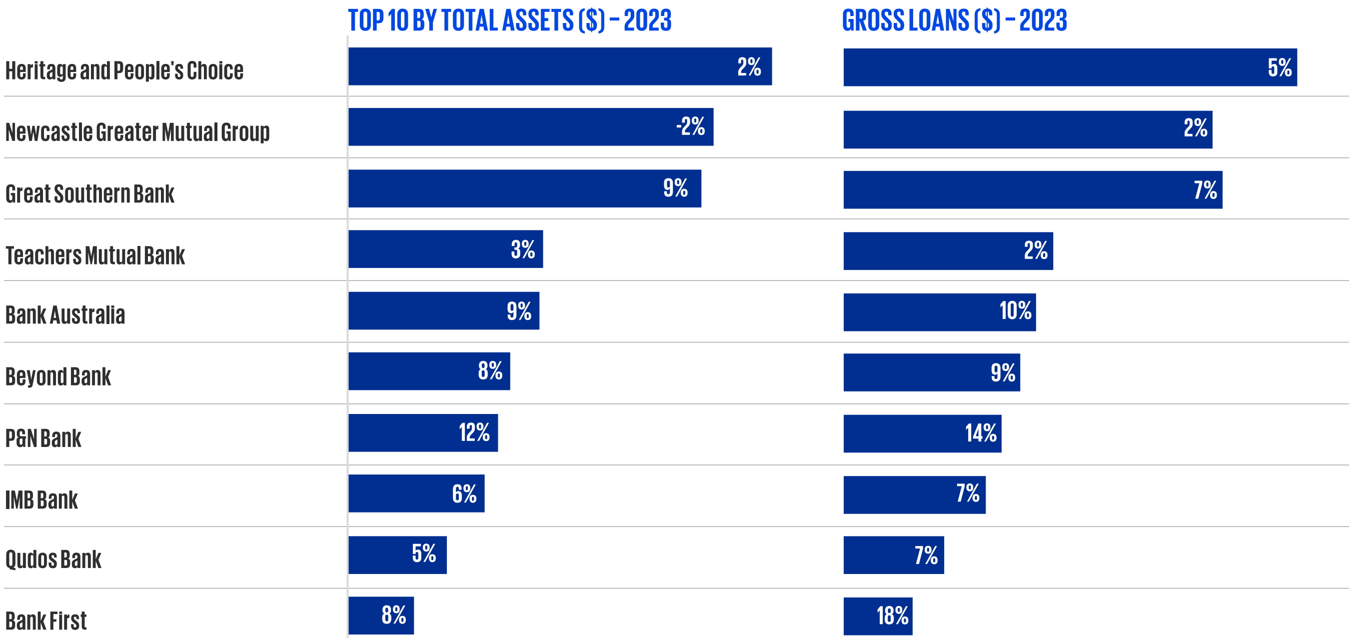
The dashboard can be accessed via our website.

2023 Financial Results

Assets

2023 saw two significant mergers of existing Mutual banks, specifically between Greater Bank and Newcastle Permanent (renamed Newcastle Greater Mutual Group) as well as between Heritage Bank and People's Choice Credit Union (renamed Heritage and People's Choice). Please note that for the purposes of preparing comparatives and year-on-year metrics, where mergers have occurred we have combined the separate historical financial data of the merged entities from the respective years.

As a result of merger activity, we have observed a change in the Top 10 Mutuals, by total assets, for the first time since 2016. Please note that asset growth for the Mutual sector as whole (2.5 percent) has been lower than loan growth (6.1 percent) and that the asset growth ranking therefore does not wholly reflect lending growth performance.



Total assets for the Mutuals increased by 2.5 percent (2022: 8.4 percent) to $163.1 billion in 2023 (2022: $159.1 billion), reflective of a competitive lending market that continues to be subject to uncertain economic conditions, rising interest rates, high inflation, digital disruption and an evolving regulatory and compliance landscape.

In 2023 the Australian economy faced the continued challenge of high inflation resulting in significant cost-of-living pressures which contributed to increased numbers of households facing mortgage stress. The Mutuals' commitment to maintaining a strong focus on their customers and their communities was identified by our survey respondents as a key contributor to remaining competitive within the broader banking industry.

Based on APRA data, the Mutuals comprise 2.7 percent (2022: 2.7 percent) of total assets across all authorised deposit-taking institutions (ADIs) in Australia at 30 June 2023. As total asset growth for Mutuals slowed in 2023, the static market share reflects the strong competition in the mortgage lending market.

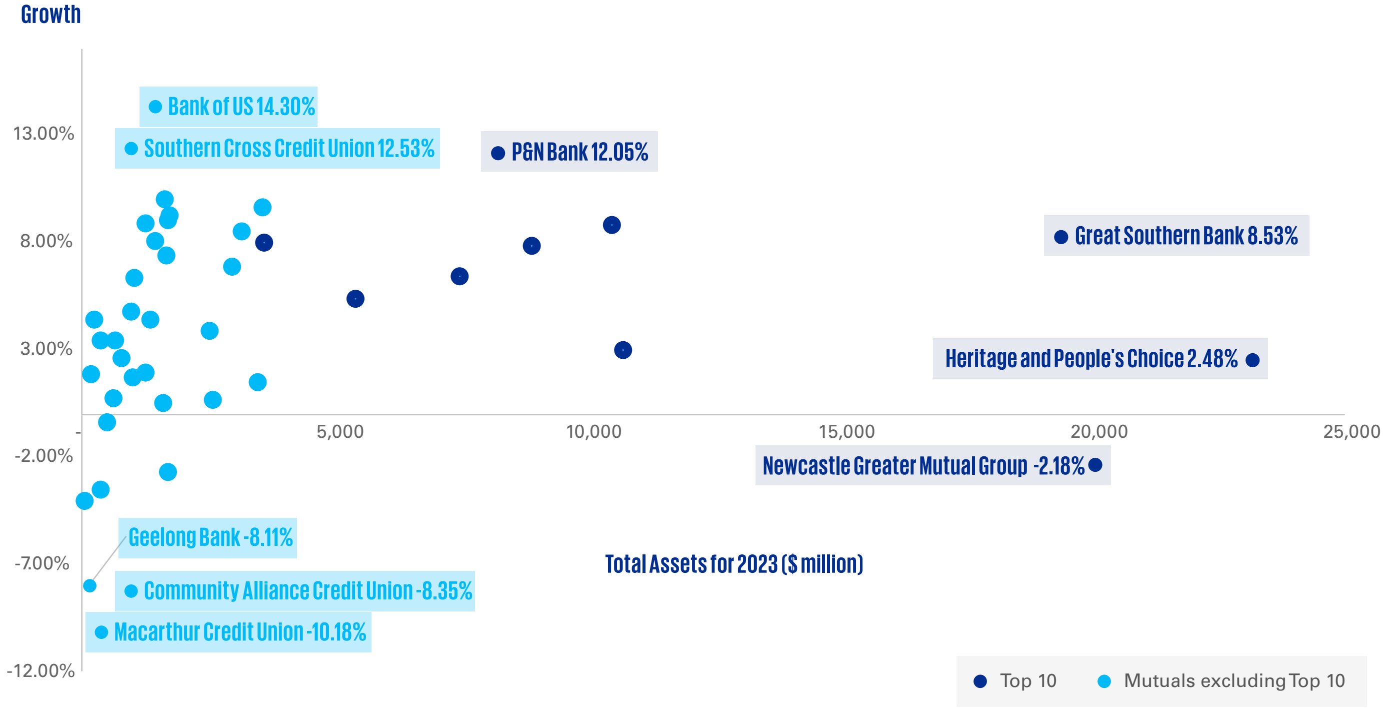
To remain competitive with the broader banking industry, the Mutuals maintain a strong focus on supporting customer needs in the current economic environment. This is evident with 76 percent of our survey respondents identifying better product pricing as the key contributors to growth in 2023.

The sector outlook remains positive in the face of ongoing market and economic uncertainty, with 73 percent of survey respondents revealing they feel confident in their 3 year growth prospects (compared to 75 percent in 2022).

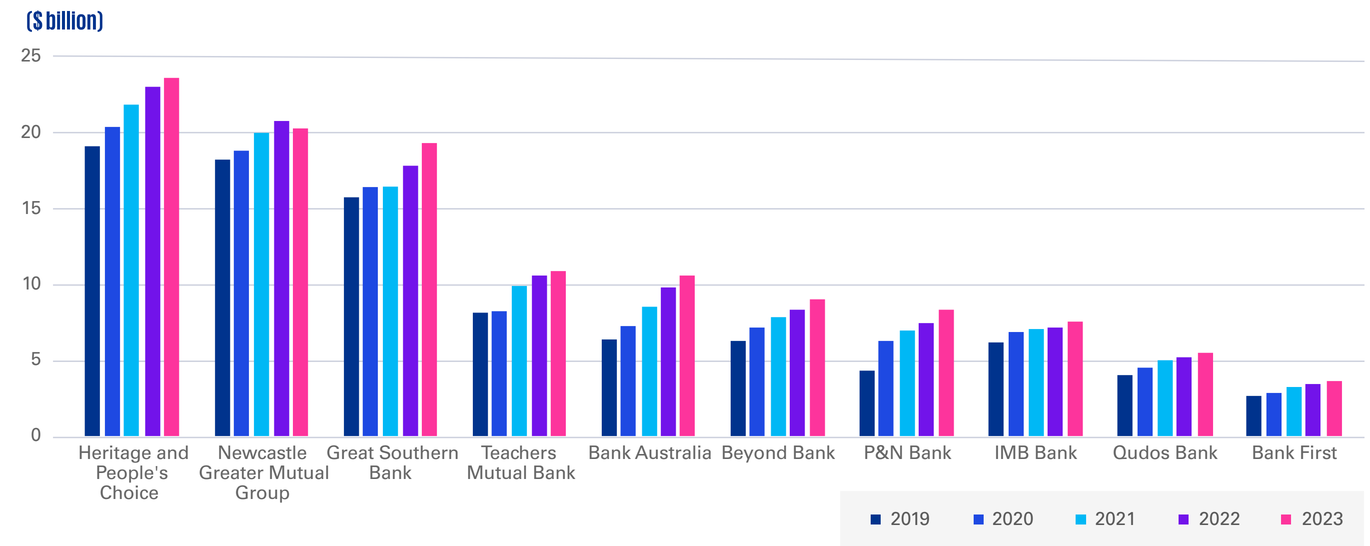
Total asset growth across the sector was primarily driven by lending growth. The Top 10 as a collective experienced continued growth in Total Assets at an average rate of 1.6 percent (2022: 7.2 percent), compared to the Majors who grew 2.9 percent (2022: 9.3 percent).

The differing levels of asset growth achieved across the sector is reflective of varied approaches adopted by the Mutuals in addressing market conditions.

TOTAL ASSET GROWTH IN 2023



TOP 10 TOTAL ASSETS (2019 – 2023)



Loan portfolio

The Mutuals outperformed the broader banking sector in 2023, reaching total gross loans of $129.4 billion (2022: $121.9 billion), a 6.1 percent increase (2022: 9.5 percent) compared to total loan growth across ADIs of 4.8 percent (2022: 8.7 percent).

Residential lending market

The high concentration on residential lending across the Mutuals remains consistent in 2023, with 93.6 percent (2022: 93.2 percent) of their portfolio comprising residential loans at 30 June 2023.

In fact, survey respondents ranked increasing residential lending as the biggest driver of growth with the digitisation of banking services and deposit growth identified as second and third respectively. Notably, the lower levels of loan growth in the Mutual sector is in line with the observed cooling of house prices. Based on data from the ABS, the average property price in Australia decreased by 0.9 percent in 2023 compared to 11.7 percent growth in 2022.

Competitive pricing to meet the needs of members

In a year of heightened economic uncertainty, with Australian communities feeling the impacts of rising interest rates and the cost of living, the Mutuals sector shares a common focus achieving sustainable growth whilst meeting member's needs. In pursuing this, the Mutuals face the challenge of balancing the value provided to members against the costs of operating in an increasingly complex environment.

In fact, 76 percent of our survey participants indicated that competitive pricing was a main contributor to their financial performance and market share growth in 2023.

The sector continues to pursue innovative initiatives through continued investment in digitisation. The rise of generative AI over the course of 2023 creates further opportunities to innovate.

LOAN PORTFOLIO GROWTH (2019-2023)

Commitment to the community

The Mutuals also maintain powerful bonds with their members and the communities that they support, which continues to be a strength of the sector. In line with this there is a continued focus on growth that is not only sustainable, but also environmentally and socially responsible.

As evidence of the Mutuals' commitment to their community, a total of 31 Mutuals contributed stories in 'Banking with purpose' published by COBA.

Did you know...?

2023 Canstar Award winners include:

Customer Owned Bank of the Year
Qudos Bank

Home Lender Outstanding Value Award
Bank First, G&C Mutual Bank, Hume Bank & Qudos Bank

Fixed Home Lender Outstanding Value Award
Beyond Bank, Heritage Bank, IMB & MOVE Bank

Customer Owned Bank – First Home Buyer Award
G&C Mutual Bank

Customer Owned Bank – Savings Award – Savings Award
Great Southern Bank

Customer Owned Bank – Digital Banking
Beyond Bank

Asset quality

Asset quality has remained stable during 2023 with the sector observing a provision for doubtful debts to gross receivables ratio of 0.15 percent in 2023 (2022: 0.14 percent). Whilst reduced from 2021, provision levels remain slightly elevated compared to pre-Covid periods.

The significant increase in interest rates observed since May 2022, combined with high inflation is expected to cause pressure on asset quality in the medium to long term.

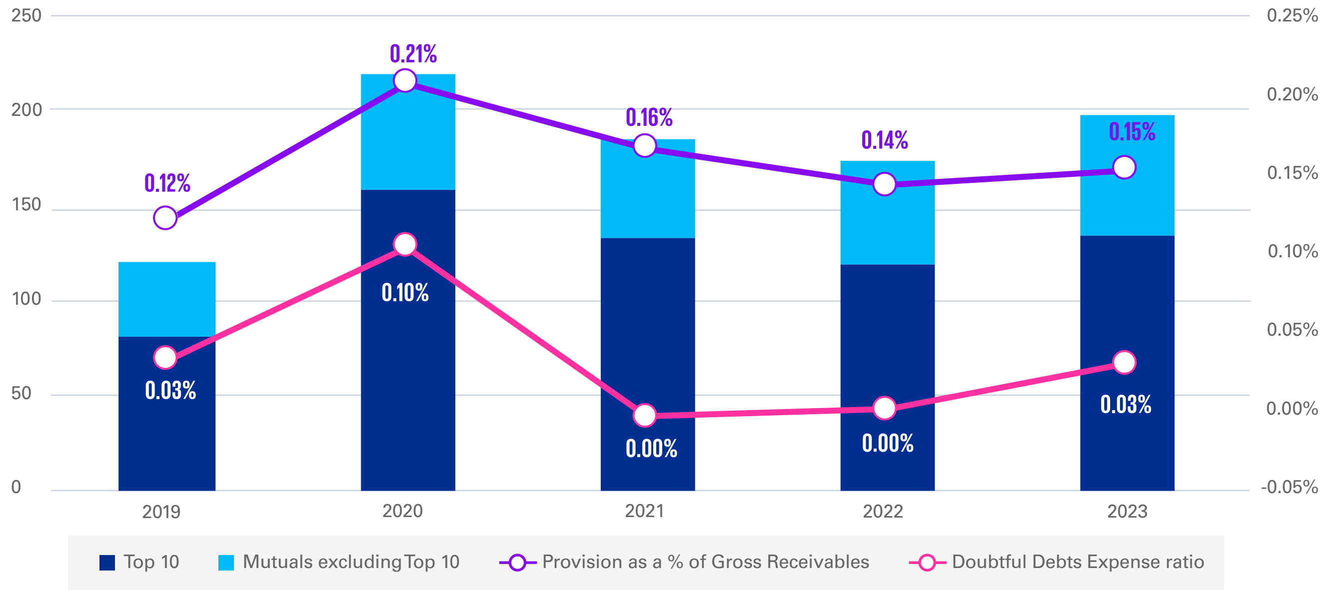
Provisioning and asset quality

In addition to any specific provisions, accounting standard AASB 9 requires the estimation of a forward looking general provision called the 'expected credit loss' (ECL).

In 2023 the Mutuals collectively observed a net increase in provisions of 13.7 percent (2022: 5.9 percent decrease).

Based on publicly disclosed information of a sample of the Mutuals, we observed that collective impairment charges formed 92 percent of the total provisioning at the end of 2023 (2022: 89 percent).

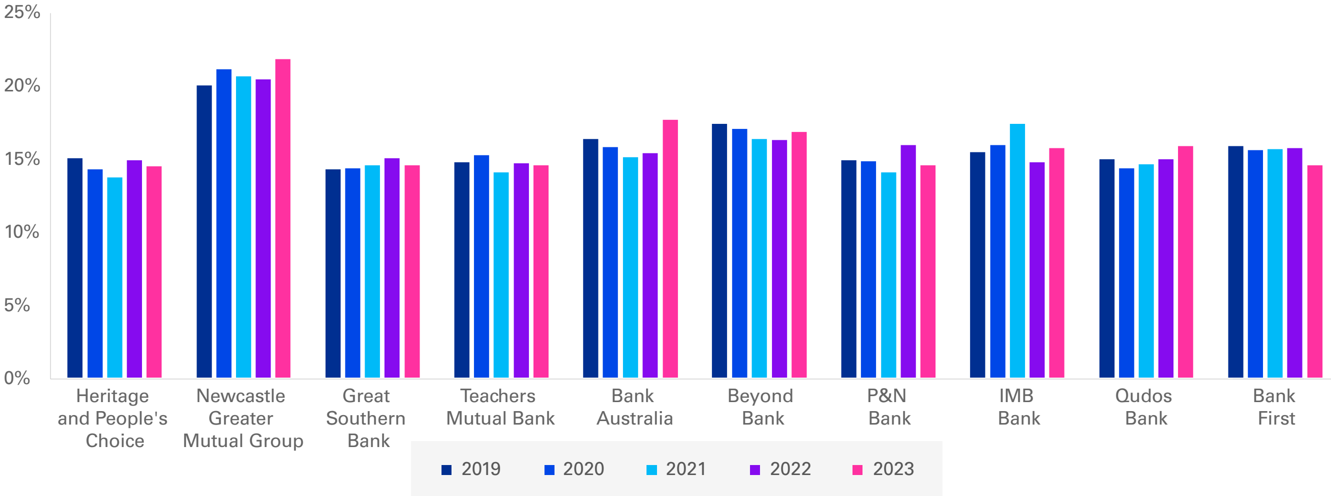
IMPAIRMENT PROVISIONS (2019 – 2023)
($ millions)



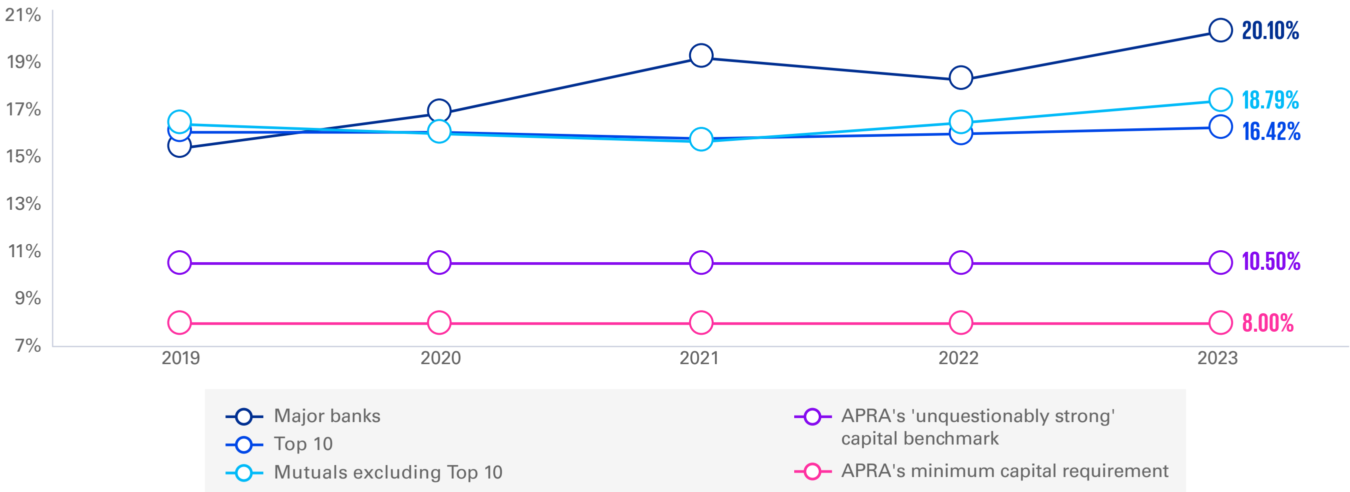
Capital

The Mutual's average capital adequacy ratio increased by 204bps to 18.25 percent[1] (2022: 16.21 percent). Improved interest margins resulting from increased interest rates combined with asset growth has acted to stabilise and improve capital positions compared to the decline seen in recent years.

TOP 10 CAPITAL ADEQUACY RATIO (2019-2023)



AVERAGE TOTAL CAPITAL ADEQUACY RATIO (2019-2023)



1 Average capital adequacy ratio excludes a Mutual as an outlier.

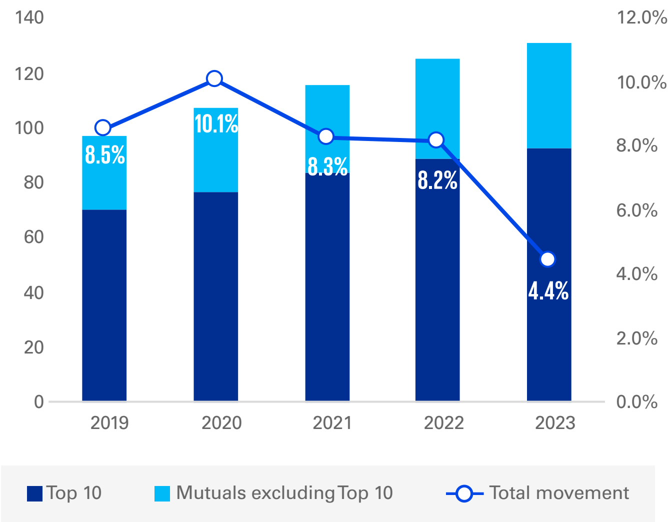
Deposits

Deposits continue to be the most significant source of funding for Mutuals, with a deposit-to-loan ratio of 101.3 percent in 2023 (2022: 103.0 percent).

While still positive, deposit growth slowed significantly in 2023 compared to previous years. The Top 10 Mutuals had a deposit growth of 4.2 percent (2022: 6.3 percent), compared to Mutuals outside the Top 10 which experienced growth of 5.1 percent (2022: 13.0 percent).

Total deposits increased by 4.4 percent (2022: 8.2 percent) which is slightly above the growth experienced by the major banks (3.2 percent). This brings total deposits for the Mutuals sector to $131.1 billion (2022: $125.6 billion).

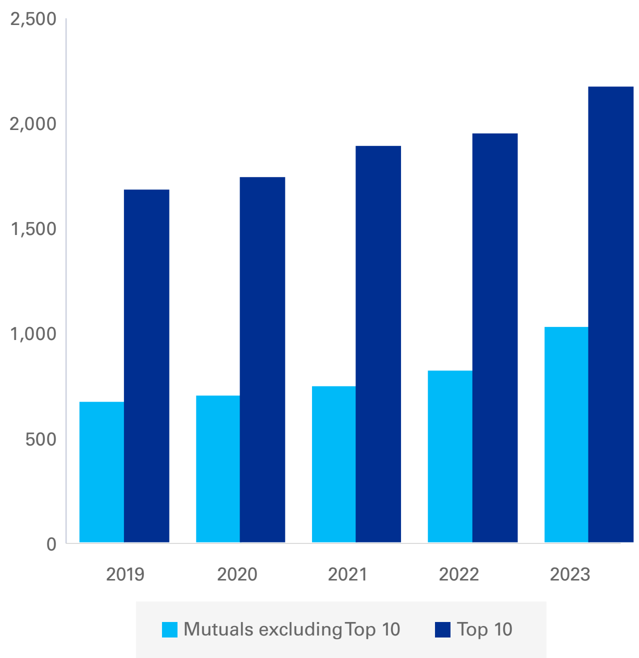
TOTAL DEPOSITS AND GROWTH IN DEPOSITS (2019-2023)
($ billion)



Net interest income (NII)[2]

In 2023, the Mutuals reported an increase in NII of 16.2 percent to $3,226.9 million (2022: $2,777.5 million), driven by growth in the underlying loan book. Of this, 67.8 percent was earned by the Top 10 (2022: 70.4 percent).

NET INTEREST INCOME (2019-2023)
($ million)



2 Where mergers have occurred we have used the amounts as reported in the financial statements of the merged entities. In line with financial reporting requirements, the reported income statement amounts include the full year balances of designated 'acquirer' entity and the balances of the 'acquiree' entity from the merger date. For reference, when the industry results for 2023 are adjusted for the impact of merger accounting:

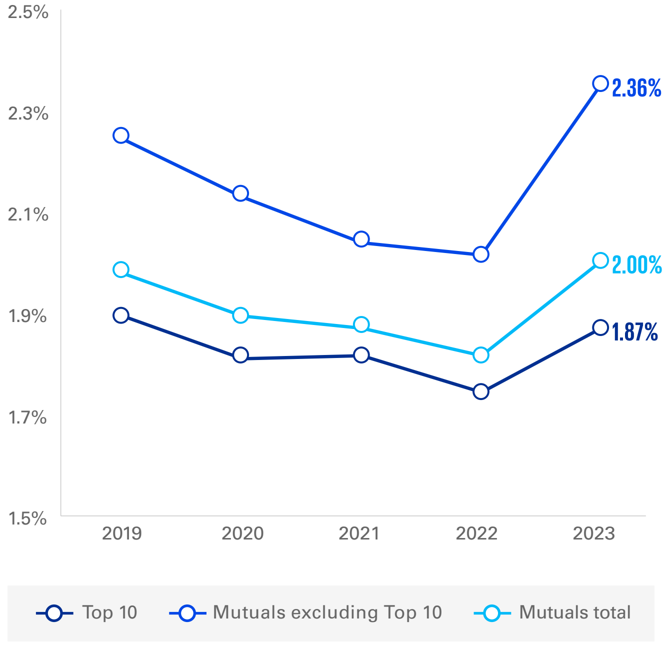
- NII for the Mutuals grew 27.4 percent
- NIM for the Mutuals was 2.16 percent
- Non-interest income decreased 8.7 percent
- Total operating costs grew 13.0 percent

Net interest margin (NIM)[2]

In 2023 the market observed the first full year impact of the interest rate increases that started in May 2022. This led to a notable improvement in NIM compared to the downward trend of recent periods.

The NIM for the Top 10 Mutuals increased by 13bps to 1.87 percent (2022: 1.74 percent) compared to the broader Mutuals group which saw an increase of 34bps to 2.36 percent (2022: 2.02 percent).

NET INTEREST MARGIN (2019-2023)
(Based on year-end total assets)

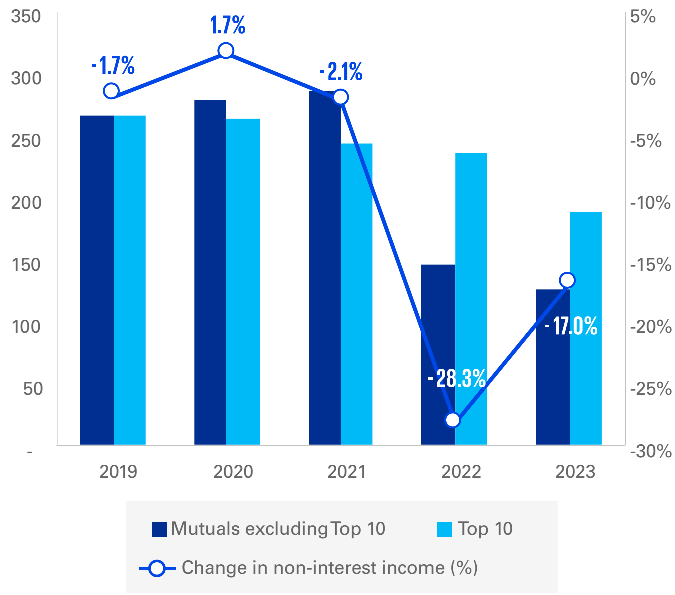


Non-interest income [2]

Non-interest income in the Mutuals sector is heavily reliant on transaction and services fees.

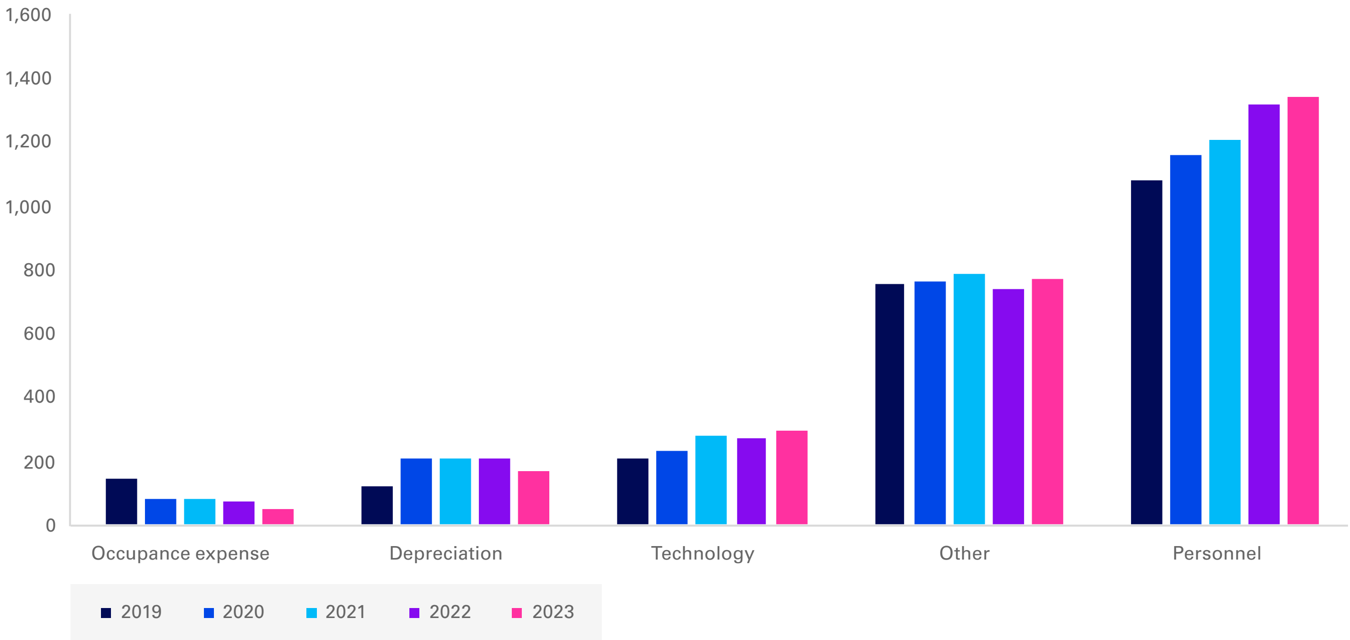
Total non-interest income decreased by 17.0 percent (2022: 28.3 percent decrease) to $317.1 million (2022: $381.8 million).

NON-INTEREST INCOME (2019-2023)
($ million)



Cost[2]

GROWTH IN COSTS (2019-2023)
($ million)



Total reported operating costs for Mutuals increased in 2023 by 1.6 percent to $2.61 billion (2022: $2.57 billion).

Whilst the sector observed an improved cost-to-income ratio of 73.7 percent (2022: 81.2 percent), this was predominantly due to the growth in NII resulting from 425bps of interest rate increases by the Reserve Bank of Australia since May 2022.

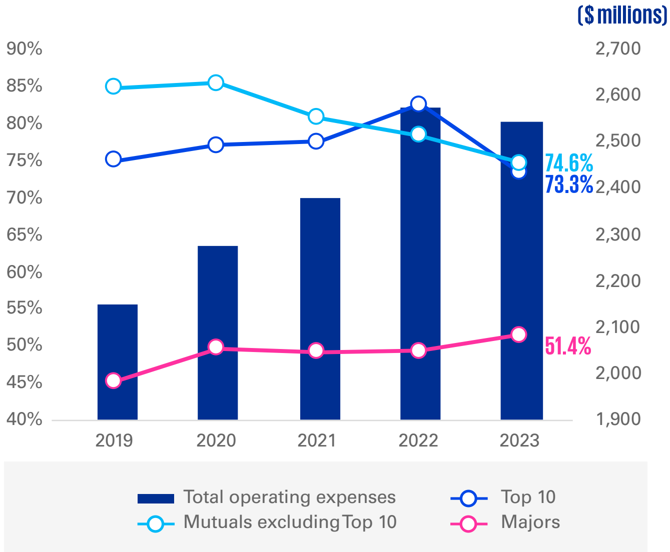
Cost management remains a critical challenge for achieving sustainable growth and a purposeful future.

Personnel expenses continue to account for the majority of operating costs at $1.34 billion (2022: $1.31 billion). With continued low unemployment the hunt for talent remains highly competitive and a key focus for Mutuals. In fact, survey respondents identified attracting and retaining talent as the third biggest risk for their organisation.

Administration, marketing, communication, transaction and distribution costs were the next major cost. These increased to $767 million in 2023 (2022: $735 million).

Technology spend has increased to $290 million (2022: $268 million), reflecting the continued investment in technology and digitisation.

COST TO INCOME RATIO (2019-2023)



Investment in technology

The increase in public cyber security incidents, as well as advances in digital banking and disruptive AI technology highlight the importance of continued investment in technology by the banking industry. In fact, 92 percent of survey respondents identified Information Technology as one of the top 5 risks facing their organisation.

Based on our survey, the largest contributors to technology spend in 2023 related to lending origination, cyber security and data analytics.

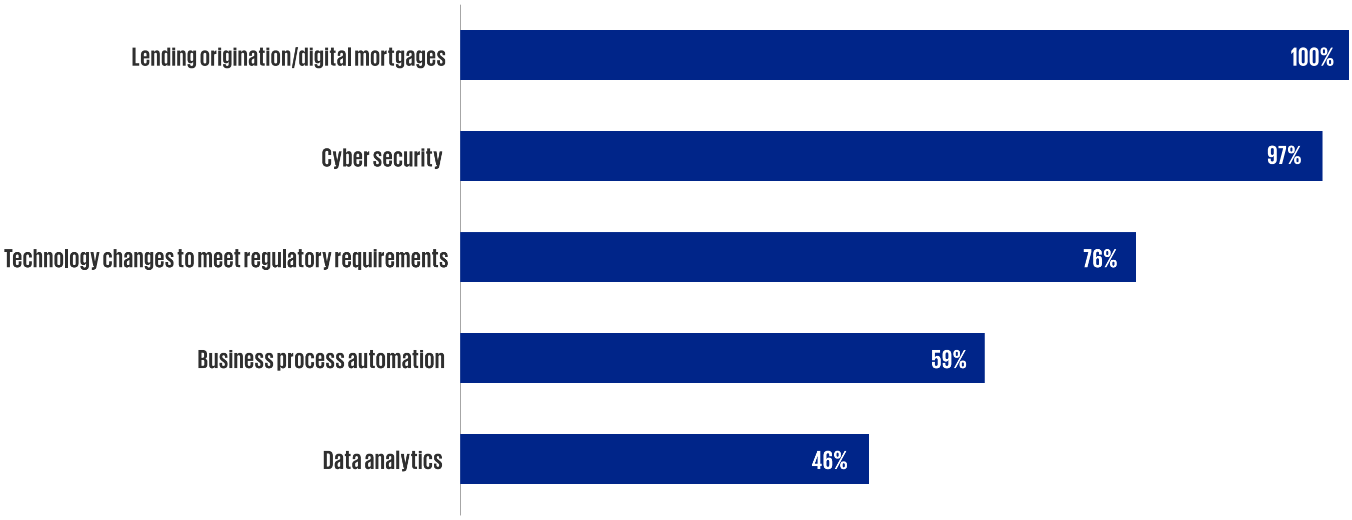
Additionally, 27 percent of survey respondents indicated that a quarter or more of their IT budget was allocated to technology enhancements and business transformation.

We note that 30 percent of survey respondents are planning to increasing investment and 27 percent are planning to invest the same amount as the prior year. The key areas of investment are expected to continue to be lending origination and data analytics.

According to KPMG's global research, cost management is rated a 'top concern' by global financial institutions, with 61 percent saying that cost reduction has become a higher strategic priority since the pandemic. Even though two-thirds of respondents set a cost savings target of more than 10 percent of their cost base between 2021–2024, they also conceded that such aims may be hard to achieve; less than half felt their organisations had achieved previous cost goals.

VINCY NG
Partner, Customer & Operations Advisory
KPMG Australia

TOP 5 AREAS OF TECHNOLOGY CAPITAL INVESTMENT IN THE NEXT YEAR



Composition of costs

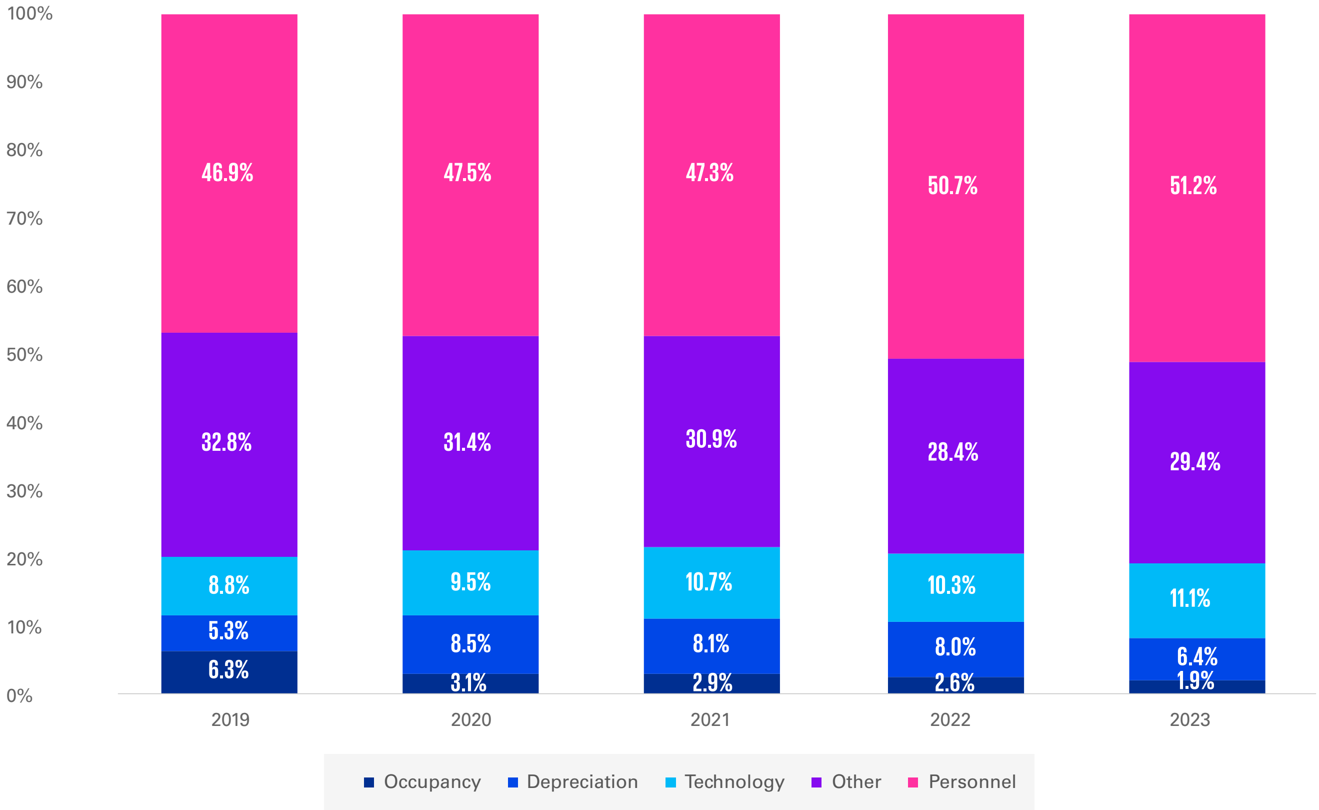
Previously we had discussed the impact of AASB 16, effective from 1 July 2019, and the resulting shift away from 'occupancy' and 'other operating expenses', which have traditionally included any head office and branch leases.

Under AASB 16, these costs are now reflected in amortisation/depreciation charge and interest expense.

The graph below reflects this from 2020, with the drop in occupancy costs, offset by an increase to depreciation and amortisation.

This continues to be the case in 2023, with the composition of costs remaining relatively unchanged year-on-year.

COMPOSITION OF COSTS (2019–2023)



Profits

In 2023 profits before tax (PBT) for the Mutuals increased by 27.0 percent (2022: 18.1 percent decrease) to $769 million (2022: $606 million). The increase in PBT is largely reflective of the full year impact of increased interest rates and flow through effect on NIM as well as continued loan growth.

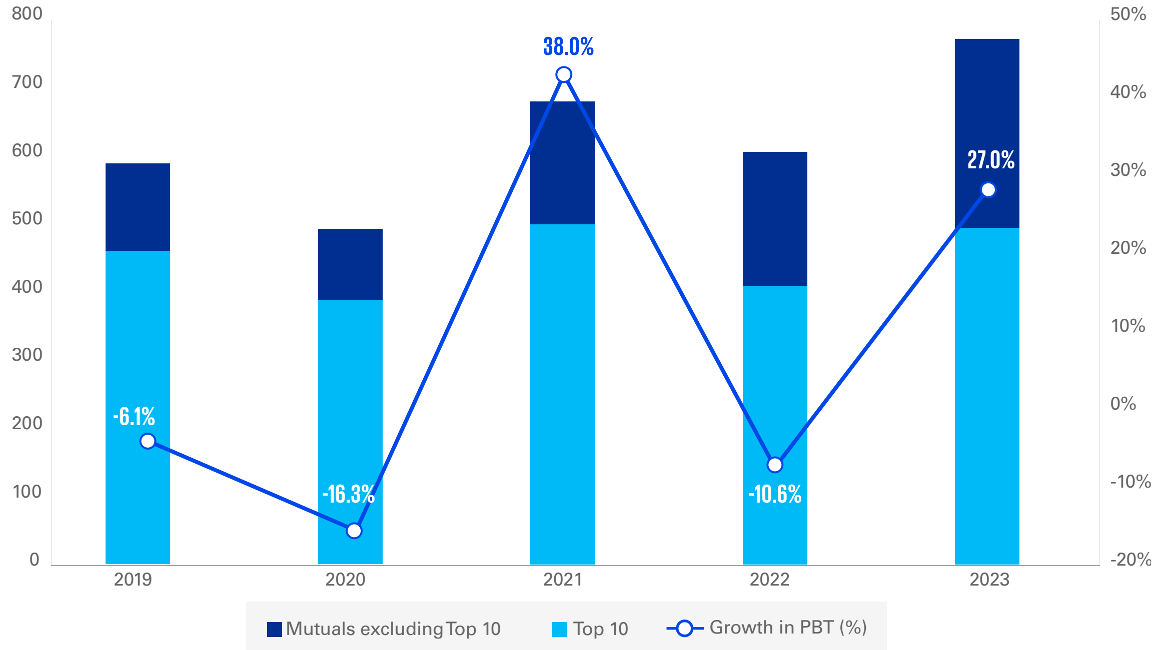
The Top 10 Mutuals saw PBT increase by 20.8 percent (2022: 18.1 percent decrease) compared to the 39.8 percent growth for Mutuals outside of the Top 10 (2022: 10.0 percent).

Did you know...?

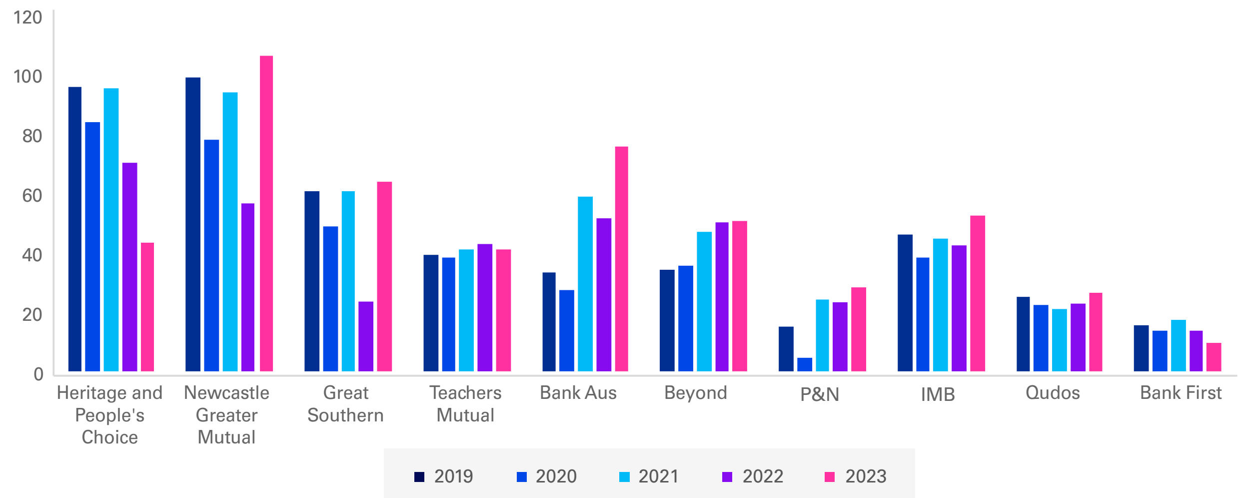
The three biggest opportunities identified by our survey for the Mutual sector to improve performance are:

1. Technology and transformation of business
57%
2. More collaboration with peers
19%
3. Improving efficiency – doing more with less
11%

PROFIT BEFORE TAX (2019-2023)
($ million)



TOP 10 TOTAL PROFIT BEFORE TAX (2019 - 2023)
($'000)

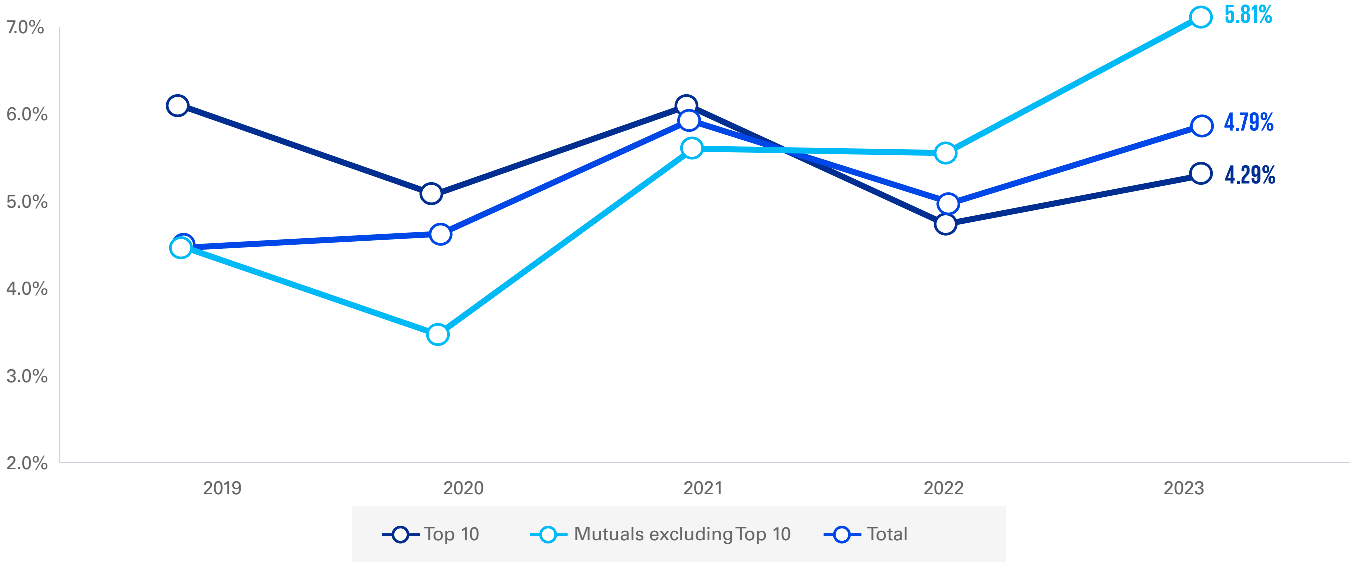


Return on equity (ROE)

While not a key metric for the sector, total ROE increased by 73bps (2022: 82bps decrease) to 4.74 percent (2022: 4.01 percent).

The ROE of the Top 10 was slightly below the overall sector at 4.29 percent (2022: 3.82 percent). For the remainder of the sector, the ROE grew by 135bps to 5.81 percent (2022: 4.46 percent).

RETURN ON EQUITY (2019 – 2023)



KPMG insights on key topics

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ARTICLE TOPIC: GROWTH

Pathways to a sustainable and customer-centric future

The era of 'buyer beware' is gone and an emphasis on good consumer outcomes has taken its place. Australian and overseas regulators are increasingly shifting the onus of consumer protection onto financial services providers and focusing on the delivery of better consumer outcomes. This transformative shift is exemplified by the UK Financial Conduct Authority's recent implementation of a new 'Consumer Duty' for financial services. From this perspective, mutual banks have a unique competitive advantage that's hard for other banks to replicate: ownership by customers and the reinvestment of profits to generate value for their customers.

However, despite this unique customer-centric model, Mutuals aren't immune to the sustainability challenges facing the broader banking industry. To maximise, protect and future-proof the value they generate for their customers, Mutuals must proactively tackle challenges such as increasing regulatory complexity, evolving customer expectations, intensifying competition, growing profitability pressures and a lack of capital and scale hindering operational efficiency.

This article explores the strategies, both organic and inorganic, that Mutuals can use to maximise the value they generate for their customers and safeguard their long-term future.

Current competitive challenges for mutual banks

Higher cost of capital

Traditionally, mutual banks have been limited by their access to equity capital markets due to the customer-owned model and restrictions of the 'one member, one share, one vote' principle. This has meant that for most mutual banks, retained profits have traditionally been the core part of Common Equity Tier 1 capital. This has necessitated reliance on debt capital markets for funding both operational and growth initiatives, which occasionally may be impacted by the lower credit ratings that most mutual banks enjoy vis-a-vis other larger banks.

Additionally, many mutual banks face challenges in higher cost-to-income ratios, lower net-interest margins and consequently, diminished profitability compared to the major banks. In FY 23, Mutuals averaged a 73.7 percent cost-to-income ratio, significantly higher than the 51.4 percent for the major banks. In turn, this has impacted their retained profits, which flow through to less-than-optimal use of regulatory capital.

Risk optimisation

A number of factors, such as smaller scale and lack of diversified capabilities, means many mutual banks have traditionally adopted lower risk appetites in relation to some classes of risk like strategic and credit risk. For some mutual banks, as a counterpoint to the inherently higher cost of capital, this has previously resulted in relatively comfortable buffers in regulatory capital ratios.

While this appears to be a prudent outcome, in some cases it may also indicate that the mutual bank isn't optimising the amount of risk it takes and could be leaving growth potential on the table.

Customer experience and technological innovation

Although the core customers of Mutuals traditionally prioritise high-touch service models, there's a growing expectation for more innovative products and digital services, even amongst the mature customer segments that often are highly represented in mutual banks. Many mutual banks are still using legacy core banking and loan origination platforms, as well as operational and regulatory reporting systems, which may not be easily updated to incorporate customer and regulator expectations. Some of these platforms may be nearing the end of their support lifecycles, adding urgency to the need for technological upgrades.

Cyber risk is increasing for all banks, but is particularly pronounced in the case of older, less supported systems. These systems could make mutual banks 'soft targets' for cyber criminals.

Demonstration of value

There's a global push from both regulators and customers for all financial services firms to demonstrate value to customers. This is particularly magnified in the case of mutual banks, who have traditionally relied on the principle of 'people before profits' and the claim that profits go back to members.

Regulatory complexity

The pace of regulatory change shows no signs of abating, with upcoming deadlines including APRA's Prudential Standards CPS 190 (Recovery and Exit Planning), CPS 230 (Operational Risk Management) and APS 210 (Liquidity) as well as the increased regulatory scrutiny on cyber resilience, ESG and greenwashing.

The increasing regulatory complexity requires the continuous enhancement of governance, risk and compliance frameworks. Management needs to forward-plan to meet the increasing financial, technical and human resourcing needs of the business. This poses a persistent challenge, especially for smaller organisations with limited investment capital.

Responding to sustainability pressures

Given the challenges to sustainability, mutual banks will be under ongoing pressure – including from APRA – to achieve sufficient scale to optimise their financial performance and strengthen their balance sheets to maintain the resilience of Australia's broader financial system. Mutuals have two primary avenues for achieving long-term sustainability: organic or inorganic growth.

Organic growth opportunities

Customer service and engagement

Customer service intimacy is often a key source of differentiation for mutual banks. Through delivering exceptional customer service both face-to-face and via digital touchpoints, mutual banks can seek to attract new customers, retain existing customers and grow their existing customer relationships through incremental product sales. However, this is not a fast route to growth given the narrow customer base traditionally targeted by mutual banks. Achieving sustained growth through this strategy requires ongoing investment, which can be a challenge with limited sources of capital funding.

Product diversification

Expanding the range of financial products and services offered to members enables mutuals to cater to diverse member needs. Mutual banks have shown the capacity for product innovation. For example, they were early adopters of the National Payments Platform, offering reverse mortgage products to assist retirees and creating family home guarantee finance solutions to help young adults take out home loans without a cash deposit. Product diversification can attract new customers and increase the share of wallet of existing customers; however, as a growth pathway, this may be slow and resource-intensive.

Geographic expansion

Mutuals may consider expanding to adjacent regions or nationally, either physically or through digital channels. Identifying underserved or unsaturated pockets of customers that align with the Mutual's mission can create significant opportunities for a mutual to acquire new customers and grow market share. However, like the other organic growth pathways outlined above, this can be resource, time and capital-intensive, all of which may heighten short-term sustainability pressures.

Inorganic growth opportunities

There are a number of inorganic growth strategies available to mutual banks that may give them access to the benefits of scale in terms of increased operational efficiency, higher retained profits and the resulting increase in capital to invest in further innovation and growth. Some of these strategies are discussed below.

Strategic alliances

A strategic alliance between Mutuals may provide a way to realise some scale benefits while maintaining legal separation and independence of the mutual alliance partners. Through a strategic alliance, mutual banks may explore and share any scale benefits they can extract from leveraging their combined bargaining power in their negotiations with a rationalised set of common service providers and suppliers.

Moreover, strategic alliances can foster synergies, allowing mutual banks to tap into specialised resources, share risks and navigate regulatory complexities more effectively. For example, a large regional bank joined forces with four mutual banks to create a strategic alliance, which freed them from regulatory capital requirements while maintaining their independence and local identity.

Joint ventures

In a sense, a joint venture structure is a more formalised version of a strategic alliance. Joint ventures can be used where, for example, two or more Mutuals use a common operating platform where they need to formalise the governance and map out the sharing of benefits, costs and risk associated with their shared platform.

Joint ventures can also be a very useful vehicle for mutual banks who may want to explore cost-sharing opportunities (for example, procurement) without undertaking a merger. This legal relationship can be used where there's an imperative and desire to merge, but there are legal, tax, regulatory, capital or timing constraints to undertaking a merger of the joint venture partners.

Mergers

Mergers are an increasingly important strategic option for Mutuals to sufficiently scale to maximise and protect the value they generate for their customers.

While there's a possibility for a Mutuals to merge with (and be subsumed by) a much larger institution, Mutuals generally prefer a merger that allows the continuation of their customer-owned structure and the retention of the connection with their customers and stakeholders.

Like other M&A transactions, a merger between Mutuals will generally include a market scan of potential merger partners, entering into a memorandum of understanding with a potential merger partner and undertaking due diligence on each other.

However, unlike other M&A transactions, mutual banks can complete a merger using a statutory transfer mechanism under the *Financial Sector (Transfer and Restructure) Act 1999* (Cth). Under this mechanism, the business (including the members, assets and liabilities) of one mutual can be transferred to another mutual (being the go-forward merged entity). In a merger of Mutuals, it is also unlikely for there to be any exchange of money between the parties as consideration for the transfer of business.

Accordingly, the logical starting position would be to look for a merger partner that shares similar corporate and social values.

In deciding on a merger partner, the ultimate objective should be to create a go-forward entity that has sufficient scale, complementary capabilities, access to a broader customer base and additional capital to grow a sustainable business.

Generally, the increased size of the merged organisation should be expected to enhance operational efficiencies through reduced costs-per-member, optimising the Mutual's financial performance and reinvesting more of its profit back into the business for the benefit of its combined customers.

However, as a call to action, it's important to reflect on the sustainability challenges facing many mutual banks, which is the focus of our concerns. A failure to take action now could expose many mutual banks to increasing regulatory, customer and competitive pressures that significantly threaten their viability in the near future. This could compel a Mutual to eventually merge with a partner that does not align with their values, or worse yet, lead to acquisition by a significantly larger bank on a demutualised basis, resulting in mutual members losing their voice and influence on the future direction of their bank.

What should a Mutual be considering?

Mutual merger transactions require careful planning, project management, appropriate due diligence, additional resourcing and specialist knowledge and skills to support your Board and management team in navigating the issues, risks and challenges that mergers entail.

A strategic review of the sustainability of a mutual banking business and the viability of different organic growth strategies may include a consideration of cost-out programs, strategic alliances, innovative product and service offerings, systems upgrades and geographic or national expansion.

Key points

- Australian and overseas regulators are increasingly shifting the onus of consumer protection onto financial services providers and focusing on the pursuit of better consumer outcomes.
- From this perspective, mutual banks have a unique competitive advantage that's hard to replicate by other banks: ownership by customers and the reinvestment of profits to generate value for their customers.
- Even so, mutual banks face a number of sustainability challenges that threaten their viability into the future, including:
  - higher cost of capital, higher cost-to-income ratio and lower NIM
  - how to take more risk, prudently, in order to optimise capital
  - legacy platforms and associated cyber risks
  - how to visibly demonstrate giving benefits back to members increasing regulatory compliance costs.
- Some of the ways to address these challenges are:
  - exploring alternative capital models (including MCI/MEI)
  - exploring cost-sharing models such as common platforms or JVs
  - maturing credit risk models and reviewing risk appetite statements
  - increasing transparency and uplifting governance reporting to members
  - undertaking mergers to increase scale and enhance competitiveness.
- As a call to action, it's important to reflect on the sustainability challenges facing many mutual banks, which is the focus of our concerns with Mutuals. A failure to take action now could expose many mutual banks to increasing regulatory, customer and competitive pressures that significantly threaten their viability in the near future.

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ARTICLE TOPIC: CYBER

Managing the cyber threat

The Mutual sector in Australia stands at a pivotal juncture. The essence of ‘purpose in banking’ takes centre stage, emphasising decisions that have clients’ best interests at heart. In the ever-evolving landscape of financial services, the mutual banks are redefining their mission to align with the changing demands of their clients. However, a looming challenge casts a long shadow on this noble pursuit: the escalating cyber risks that threaten the integrity of the institutions and the trust of their clients.

In our view, the statistics underscore a critical reality: cyber threats are on the rise at an alarming rate in Australia. Smaller Australian mutual banks are increasingly in the crosshairs of cybercriminals due to their perceived vulnerabilities. As the data shows, the first quarter of 2023 witnessed a 13 percent increase in cybercrime reports in Australia, accompanied by a 14 percent rise in the cost per report. These are not mere numbers; they represent real threats to client trust and financial stability as well as Mutuals' reputation and standing in market.

In navigating the treacherous waters of cyber risk, mutual banks in Australia should consider a strategic approach to cyber threats while ensuring it's in line with their risk appetite and available budgets. The path towards a purposeful future in banking, where client interests are paramount, necessitates a proactive stance in managing cyber security challenges.

Here are some critical considerations for mutual banks as they face the evolving cyber threats and risks:

1. Cyber risk assessment and cyber strategy: start by conducting comprehensive cyber risk assessments. Identify the unique risks your bank faces and prioritise them based on their potential impact. Develop and implement mitigation strategies that are not only robust but also flexible to adapt to emerging threats. Develop a cyber strategy aligned to business and IT strategy.
2. Strategic investments: allocate resources judiciously, ensuring that your investment in digital and cloud initiatives is balanced with cyber security spend. Avoid the trap of 'cyber debt' where the pace of technological adoption outstrips security measures, leaving vulnerabilities unaddressed.
3. Talent acquisition and training: recognise the scarcity of cyber skills globally and take active steps to address this challenge. Invest in your in-house cyber security team's training and development while being prepared to compete for talent in the broader industry. Or, partner with industry leader in cyber services and work with them to uplift your capabilities.
4. Collaboration and information sharing: establish robust collaborative networks with industry peers, regulatory bodies and other financial institutions. Sharing insights and best practices can bolster your collective defence against cyber threats and contribute to a more resilient financial ecosystem.
5. Regulatory compliance: stay attuned to evolving regulations and guidelines pertaining to cyber security in the financial sector. The Australian Prudential Regulation Authority's tripartite review is an opportunity for mutual banks to enhance their defences by leveraging the feedback and insights provided.
6. Customer education: empower your members with knowledge about cyber security risks and best practices. Educated members are more likely to contribute to their own safety and be understanding in the event of a security incident.
7. Incident response plan and business continuity: develop and regularly test a comprehensive incident response plan. Having a well-defined strategy in place can significantly mitigate the impact of a cyber attack and preserve client trust. Ensure that your business continuity plan is relevant and takes current cyber events into consideration.
8. Cyber insurance: Explore cyber insurance options as a safety net for potential financial losses and liabilities resulting from data breaches or other cyber incidents.

As mutual banks in Australia embrace their commitment to 'purpose in banking', the successful navigation of the cyber risk landscape is critical. The Mutuals must evolve from merely reacting to cyber threats to proactively shaping their cyber security future. By adopting a holistic advisory approach that focuses on cyber risk assessment, cyber strategy, cyber investments, talent development, collaboration, regulatory compliance, member education, incident response, BCP and cyber insurance, mutual banks can safeguard the interests of their clients while ensuring their place in a secure and purposeful banking landscape.

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ARTICLE TOPIC: ESG

Closing the gap on sustainability reporting

Sustainability reporting

This year has been full of increasing regulation and focus from members on sustainability reporting for the Mutual sector. Over the year, we've seen the introduction of the International Sustainability Standards Board's (ISSB) final standards; the release of the second Treasury consultation paper for mandatory climate-related reporting in Australia; and a stronger focus from APRA on the need for financial institutions to assess their financial risks due to climate change.

In light of the upcoming reporting requirements, much of the mutual sector still has several gaps in their current sustainability reporting, despite historically being set up to drive sustainable outcomes focused on social purpose.

What has been released?

The ISSB published the first two IFRS® Sustainability Disclosure Standards (IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures) on 26 June 2023. These standards are effective from 1 January 2024 – however, they won't be mandatory unless regulated by jurisdictions.

Coinciding with this major milestone in sustainability reporting – and with an option for organisations to adopt a 'climate-first' approach – the Australian Treasury released its second consultation paper on climate-related financial disclosure. This builds on the previous discovery consultation in December 2022 and proposes more definitive positions to facilitate standardised reporting requirements that align with international standards.

As a result, we expect climate-related financial disclosures to apply in Australia as soon as 30 June 2025 for some entities, which could include the largest Mutuals if the proposed timeline as outlined by Treasury, and the Australian Sustainability Reporting Standards Exposure Draft (issued in October 2023) is undertaken, with coinciding assurance requirements over climate-related reporting.

Addressing the challenges

In our experience working with Mutuals, we've found that sustainability reporting and upcoming requirements pose several common challenges:

1. Understanding where to start in identifying and reporting material sustainability information, particularly for smaller Mutuals.
2. Assessing gaps in current sustainability reporting in alignment with the ISSB and the Australian Sustainability Reporting Standards Exposure Draft (issued in October 2023).
3. Collecting data for reporting on areas such as financed emissions and climate-related financial risks, along with the need for in-house expertise.

To address these challenges, Mutuals should consider the following steps.

1. **Undertake a materiality assessment/refresh:** Mutuals should begin by considering IFRS's S1 requirement for an updated evaluation of sustainability risks and opportunities. This process should involve Mutuals actively engaging with their members and the communities they serve to gain a profound understanding of critical sustainability concerns. Such concerns may include the physical impacts of climate change on their mortgage portfolios, customer vulnerability or financial inclusion. Undertaking this assessment not only ensures compliance with S1 but also directs resources towards areas where Mutuals can make the most substantial impact. It simultaneously enhances member engagement and attracts new members without Mutuals spreading themselves too thinly across a range of possible sustainability issues.
2. **Conduct an ISSB gap assessment:** this should be undertaken across current corporate reporting to understand the extent to which existing disclosures meet the disclosure requirements in ISSB across both S1 and S2. This assessment should be carried out across the four key pillars of ISSB: Strategy, Governance, Risk Management, and Metrics & Targets, while also considering industry-specific guidance for commercial banks and mortgage finance provided by S2.
3. **Start the data collection process early and consider pre-assurance:** the upcoming reporting requirements are a big jump for many Mutuals based on current reporting and in-house technical knowledge. However, in many cases the first step is starting. Take, for example, financed emissions using the Partnership for Carbon Accounting Financials (PCAF) methodology: while the highest data score looks to use actual data, acceptable methodologies start with estimation in relation to key data inputs such as estimation of energy consumption from homes.

We therefore encourage Mutuals to start with estimation and look to improve their data quality score each year through collaborating with data providers and industry and working with technical consultants where the in-house knowledge isn't available. The benefit of an improved data score is that it can assist with emissions reduction targets and improve strategic decisions in relation to product development focused on emissions-intensive areas of the Mutual's portfolio.

With this year-on-year improvement in data, which we expect to increase, there is also a benefit for Mutuals to undertake pre-assurance over any non-financial metrics being reported. This will help identify gaps in the processes and controls surrounding sustainability reporting ahead of moving to assurance when assurance requirements come in.

Future focus: climate change modelling

In 2021-2022, APRA conducted a Climate Vulnerability Assessment (CVA), carried out by Australia's five largest banks, to assess their potential financial risks due to climate change. This year, APRA is conducting a similar exercise with general insurers.

APRA have stated they'll take the experience from this exercise to consider how it can be applied to other APRA-regulated industries and climate-related challenges, potentially targeting Mutuals at a later stage.

IFRS S2 also sets out the requirements for using climate-related scenario analysis to assess the resilience of the entity's strategy and business model against climate-related changes, developments and uncertainties.

Considering APRA's interest in expanding the number of industries and entities required to undertake climate change scenario modelling, and the upcoming IFRS S2 requirements relating to this, it's strongly recommended that Mutuals begin to build capability in this area. Developing a strategy and processes to meet these upcoming requirements, commensurate with a Mutuals size and product portfolio, will be critical to maintain a focus on a purposeful future.

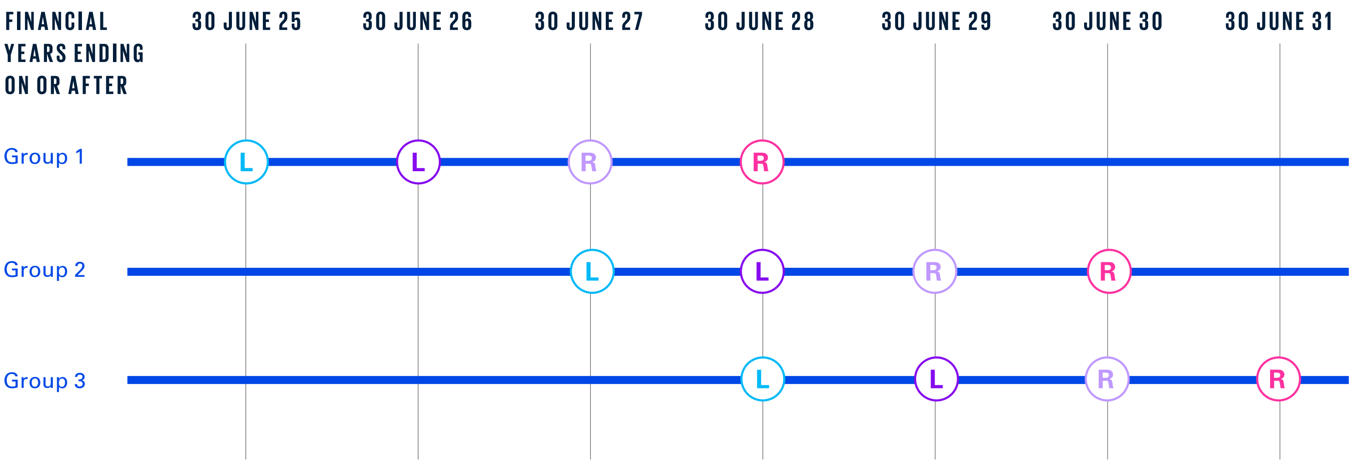
Reporting entities and phasing

Three-phased approach if it meets prescribed size thresholds and required to lodge financial reports under *Chapter 2M of the Corporations Act 2001.* NGER reporters are considered separately.

	ENTITIES REQUIRED TO REPORT UNDER CHAPTER 2M			
	Meet two of three thresholds:			
	Gross assets	**Revenue**	**Employees**	
Group 1 2024/25 onwards	$1 billion or more	$500 million or more	> 500	'controlling corporation' under NGER Act **and** meet NGER publication threshold1
Group 2 2026/27 onwards	$500 million or more	$200 million or more	> 250	
Group 3 2027/28 onwards	$25 million or more	$50 million or more	> 100	'controlling corporation'[3] under NGER Act

Assurance requirements and timeline

Assurance plays a crucial role in enhancing the credibility of climate-related disclosures. Phasing and scaling of assurance requirements are proposed to ensure sufficient time for capability uplift in meeting the throwing demand for climate-related assurance services.



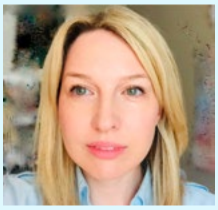
L — Limited assurance Scope 1 and 2 emissions. Reasonable assurance of governance disclosures

L — Reasonable assurance Scope 1 and 2 emissions. Limited assurance Scope 3 emissions, scenario analysis and transition plans (specific requirements – process/ methodology/assumption assurance)

R — Reasonable assurance Scope 1 and 2 emissions and other climate disclosures. Limited assurance Scope 3 emissions, scenario analysis and transition plans (full quantitative assurance)

R — Reasonable assurance all climate disclosures

[3] Regardless of size 'controlling corporation' under NGER Act would be in scope



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Key Facts

71%
of survey respondents believe AI regulation is required

61%
of respondents are wary about trusting AI systems

85%
of IT experts agree that customers prefer companies that can explain how their AI is built, managed and used*

* IBM Global AI Adoption Index 2022

Source: https://ai.uq.edu.au/project/trust-artificial-intelligence-global-study
Trust in Artificial Intelligence: A Global Study 2023 University of Queensland

ARTICLE TOPIC: AI

AI introduces a new series of risks as well as opportunities

How do we explain the new AI risk landscape?

AI has the potential to transform the way we live. There are immense potential and realised benefits in using AI in fields such as health, financial services, and manufacturing.

Yet, the rapid development of AI technology combined with our drive for more data (including personal data) presents significant risks. In early 2023, key innovators of AI have warned of the risks it could pose on humanity. For instance, in May 2023, the 'Godfather of AI', Geoffrey Hinton, cautioned of the serious harms presented by the technology. After resigning from Google earlier this year, Hinton argued, 'I don't think they should scale [AI] up more until they have understood whether they can control it.'

OpenAI, the parent organisation of ChatGPT, now markets its generative AI as 'creating safe [Artificial General Intelligence] that benefits all of humanity'.

Notwithstanding this, in May 2023 OpenAI CEO Sam Altman called for greater government regulation of AI. Altman alerted a US Senate Committee that 'if this technology goes wrong, it can go quite wrong ... we want to be vocal about that'.

Altman is not alone. In September 2023, CEOs from the Tech Giants, including Mark Zuckerberg, Elon Musk, Sundar Pichai and Bill Gates met on Capital Hill to discuss regulating AI. Reportedly, there was a consensus reached by the Tech Titans for greater regulation. Indeed, Musk warned US Senators of the 'civilisational risk' AI poses to humanity and argued that a 'referee' was required for AI.

This sentiment is not limited to the creators and innovators of technological advances in AI. A recent survey published by the University of Queensland (UQ), entitled Trust in Artificial Intelligence: A Global Study 2023, found that 61 percent of interviewees were cautious of AI and 71 percent believed AI regulation was needed. The study also indicated the majority of respondents wanted AI to aid decision, but not replace human decisioning. The study was based on 17,193 respondents from 17 countries, including the US, China, Brazil, Germany, South Africa, Australia and the UK. The UQ study highlights an opportunity to provide guidance on AI design practices and risk management.

> **'Artificial intelligence (AI) has the potential to transform the way we live. Yet, the rapid development of AI technology combined with our drive for more data (including personal data) highlights significant risks.'**
>
> Excerpt from: *Regulating artificial intelligence: How the EU just got us closer, The Lowy Interpreter*

So how can we prepare for this new risk landscape and enjoy the benefits of AI while mitigating the unintended consequences?

How to manage the new AI risk landscape

There are a number of ways to manage the risk of AI, including generative AI for businesses and how it may impact customers and the community more broadly.

1. **AI should aid, but never replace human decisioning**
   AI adoption should start with a practical and conceptual understanding of its limits. With an augmented AI program at work, it should be clearly defined at all levels of the organisation that AI can be used to assist in the process of forming simple or complex decisions, but never to replace human decisions. In this respect, humans are ultimately accountable for decisions, irrespective of whether an AI or automated system is used.

2. **Develop an AI ethics policy**
   An AI ethics policy provides clear guardrails for how AI should and should not be used within the organisation. It outlines rules for accountability for each AI system, ensures there is an established risk management practice for AI and enforces a standard of care for the use of AI systems, including outlining zero tolerance for causing harm to members and staff, particularly those most vulnerable.

3. **Develop an AI design practice to assess and manage the risks of AI**
   Developing a comprehensive responsible AI assurance framework enables ongoing assessment and management of AI systems. This includes developing AI Risk Assessment and Management Plans to mitigate the risk of each AI system, and to ensure it is transparent, explainable and accountable to members and regulators alike.

4. **Establish an ethical AI practice Board**
   Ensuring that each AI system is evaluated independently for technical and ethical aspects will provide an ongoing mechanism to support best practice, ensure the efficacy of the AI system and allow an interdisciplinary team to challenge the ethical dimensions of the AI system.

5. **Supporting a responsible AI culture**
   Building a culture that's sufficiently confident and competent to challenge and assess AI systems across the organisation is imperative, from the Board all the way to member level. Members must have a recourse to know when AI is used and have the capacity and the option to challenge an AI decision.

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ARTICLE TOPIC: RISK

CPS 230 Operational Risk Management

In recent years, the financial world has experienced unprecedented shifts and challenges, creating a pressing need for a robust risk management framework. The APRA CPS 230 standard, particularly relevant to Mutuals, mandates a structured approach towards identifying, assessing, monitoring, and mitigating operational risks. While compliance might seem burdensome at first, delving deeper reveals the hidden potential for Mutuals to reimagine their operational strategies.

The standard and the accompanying draft Prudential Practice Guide (CPG) reflect many aspects of better practice across leading entities in the industry, and the challenge Mutuals face is how to achieve compliance with this standard.

Collaboration among industry peers, engaging with regulatory guidance, and learning from best practices are essential. Mutuals can benefit from sharing knowledge and experiences within the sector, allowing for a collective understanding and approach toward meeting CPS 230 compliance effectively.

The foundation of CPS 230 compliance lies in a comprehensive understanding of the standard and Mutuals must conduct an in-depth review of the guidance provided by APRA, recognising the significance of governance, culture, and risk identification in aligning with these regulations. This will support the identification of required uplifts and support the build-out of your plan to compliance.

Achieving compliance

Compliance with the APRA CPS 230 Operational Risk standard is crucial for Mutuals. The approach to achieving compliance involves several key steps, which must include:

- Thoroughly understand the requirements and principles outlined in the APRA CPS 230 standard. This involves a comprehensive review of the guidance documentation.
- Evaluate the existing risk management framework and operational processes. Identify the gaps between the current state and the requirements outlined in the CPS 230 standard.
- Conduct a detailed gap analysis to identify areas where improvements are needed to meet the standard. Develop a comprehensive action plan that outlines the steps necessary for compliance.

CPS 230 TIMELINE

JULY 2022	APRIL 2023	JULY 2023	MID JULY 2024	END 2024	1 JULY 2025	1 JULY 2026
APRA consults on draft CPS 230	APRA announces revised implementation timetable	APRA releases Final CPS 230*	Material service providers / critical operations identified*	Entities positioned to set tolerance levels set*	CPS 230 commences*	Transition ends for existing contracts with service providers

* Proactive transition period, regulated entities prepare for new requirements

- Implement a robust risk identification and assessment process. This involves identifying, assessing, and quantifying operational risks across all aspects of the operations. This includes technology, processes, people, and external factors.
- Develop and enhance the risk management framework, including policies, procedures, and controls to address operational risks effectively. Ensure that risk management practices are aligned with the CPS 230 standard.
- Implement mechanisms for continuous monitoring, reporting, and review of operational risks. Regularly review risk management practices to ensure they remain effective and aligned with the evolving regulatory requirements.

Additionally, the guidance emphasises the need for Mutuals to consider the size, nature, and complexity of their operations while implementing these principles.

APRA's guidance serves as a roadmap for Mutuals, offering a structured approach to strengthen risk management practices. It provides insights into the industry's best practices and expectations, enabling Mutuals to align their strategies and practices with regulatory requirements effectively.

Compliance with this guidance not only ensures adherence to the standard but also enhances the Mutuals resilience and ability to manage operational risks effectively.

Critical operations

The identification of critical operations is a pivotal step. Documenting a sound and robust approach to identifying these operations is essential. The approach should provide a systematic method to identify and assess functions crucial to the bank's operations, customer service, and financial stability.

Mutuals must recognise the importance of considering the market and geography they serve. The unique characteristics of their market, customers, and geographical risks directly impact the assessment and management of operational risks.

Documenting the process of identifying critical operations is not just a compliance necessity; it's a strategic tool for risk management. It aids in continuity planning, resource allocation, and fostering transparency and accountability.

Critical operations are those activities, processes, or services that are essential for the Mutuals functionality, reputation, and ability to serve customers. Determining what qualifies as critical operations involves a careful and comprehensive assessment of various factors, these include:

- Identify operations that are directly related to the provision of essential banking services. These might include customer transactions, account management, payment processing, and lending operations.
- Consider operations that have a substantial impact on the Mutual's financial health and stability.
- Operations that are crucial for compliance with regulatory standards and legal obligations should be considered critical. These might include anti-money laundering procedures, data protection measures, and reporting requirements.

Upon identifying critical operations, Mutuals should implement robust risk management strategies, create contingency plans, and establish resilient systems to ensure the continuity of these critical operations, especially during unforeseen disruptions or crises. Regular testing, review, and updates of these plans are crucial to maintaining operational resilience and ability to serve its customers without interruption.

Understanding your critical operations

Documenting an approach to understanding critical operations within an organisation is incredibly important, particularly in the context of CPS 230 operational risk management. Here's why it's crucial:

- Documenting an approach to identify critical operations provides a structured method to identify and assess these operations. This allows for a systematic evaluation of which functions are crucial to the operations, customer service, and financial stability.
- CPS 230 mandates a thorough understanding of critical operations. Documenting the process used to determine critical operations demonstrates the Mutual's commitment to compliance with regulatory standards.
- Identifying critical operations is pivotal for continuity planning. Documenting this process ensures a clear roadmap in place to maintain essential operations during disruptions or crises.
- Understanding critical operations helps in allocating resources effectively. By documenting the approach, you can identify areas that require more investment, attention, or support to ensure the smooth functioning of these critical processes.
- By having a documented approach, Mutuals can regularly review and update their understanding of critical operations. This ensures the ongoing relevance and accuracy of the identified critical functions.

Documenting the approach to understand critical operations is a fundamental part of a robust risk management framework. It not only assists in compliance with regulatory requirements but also serves as a strategic tool for the Mutuals to fortify its operations, minimise risks, and ensure business continuity in the face of challenges.

Customer harm

Assessing impact tolerances within the context of the market and geography served by a Mutual is vital. It involves setting thresholds for acceptable levels of harm to customers. These tolerances can vary based on the specific needs and risks present in a particular market or geographic location.

By considering the customer base, local practices, regulatory differences, and the potential impact on customers, Mutuals can better tailor their risk management strategies and policies. This enables them to set appropriate impact tolerances that reflect the reality of the markets they serve and help in preventing customer harm. It also assists in creating tailored strategies to mitigate risk and deliver services that resonate with the specific needs of their customer base, ultimately fostering trust and loyalty.

The opportunity for Mutuals

The implementation of CPS 230 is not merely a regulatory obligation; it is an opportunity for Mutuals to gain a competitive edge. By proactively addressing operational risks, Mutuals can bolster their resilience, enhance customer trust, and attract investors seeking stability and prudence in their investments. This compliance journey, if approached strategically, can serve as a catalyst for growth and sustainability.

However, the road to compliance and reconfiguration won't be without its challenges. Mutuals will need to invest in technology, expertise, and robust frameworks to meet the CPS 230 standard's requirements. This transformation demands commitment, resources, and an organisational shift to a risk-conscious culture.

The APRA CPS 230 standard signifies a pivotal moment for Mutuals, urging them not merely to comply but to leverage this opportunity to transform their operational landscape. It's not just about meeting regulatory demands; it's about embracing change, fostering resilience, and redefining themselves as leaders in the financial industry.

It's an opportunity for Mutuals to fortify their operations, enhance resilience, and align themselves with best practices in the financial industry. Understanding critical operations, in tandem with a comprehensive approach to compliance, sets the stage for Mutuals to thrive in an environment marked by operational excellence and resilience.

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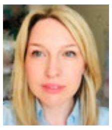

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December 2023. 1154238425FS