27 January 2023

The Hon Stephen Jones MP
Assistant Treasurer

Via email: prebudgetsubs@treasury.gov.au

Dear Minister

2023-24 Pre-Budget Submission

COBA welcomes the opportunity to make a submission to the Government's 2023-24 Pre-Budget process.

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has more than $150 billion in assets and 5 million customers. Customer owned banking institutions account for around two thirds of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition and market leading levels of customer satisfaction in the retail banking market.

Customer-owned banks are significantly smaller than their ASX-listed peers, in particular Australia's major banks. Our members range from around $100 million to less than $20 billion in assets with an average asset size of $2.7 billion compared to the smallest major banks who have assets of more than $650 billion. Customer-owned banks are disproportionately burdened by any fixed costs of regulation which in turn inversely impacts competition. Like all ADIs, customer-owned banks are subject to regulation from multiple regulators.

The challenge of regulatory change

Regulatory change is a challenge for regulated entities, but this difficulty has been particularly felt by small customer-owned banks. These institutions have fewer risk and compliance resources available to them, making it even harder to keep up with the changing rules. Better coordination and mapping of regulation can help reduce this burden.

Recommendation

Fund a Regulatory Roadmap pilot covering the major financial services regulators.

This Roadmap would be like the Regulatory Grid in the United Kingdom. The Roadmap would assist regulators and policymakers to coordinate regulatory change and assist industry to plan and map out responses to regulatory change. It should be developed in continuing consultation with the financial services sector and other relevant stakeholders.

COBA is not the only one to point out the issues about regulatory coordination. The ABA and ICA,[1] two industry associations representing large financial institutions, have echoed this decision with their own concerns and proposals.

An Australian Regulatory Roadmap

The Government should allocate and prioritise resources to pilot an Australian Regulatory Roadmap. Treasury, as the main agency responsible for overseeing the financial sector, would be ideal for producing this grid with the CFR being in charge of coordinating activities related to it. This regularly produced roadmap would detail regulatory change over the next few years.

Priority regulators on this Roadmap should be the ACCC, APRA, ASIC, AUSTRAC, RBA and Treasury. More regulators and policymakers can be added over time.

Treasury is the key policy body and adviser to the Government on financial system regulation. Treasury hosts the Government's detailed policy announcements on regulatory reform, including reform implementation timetables, and undertakes consultations, reviews and inquiries on regulatory policy matters.

We acknowledge and welcome that the CFR has discussed improving regulatory coordination.[2]

Future of regulatory change

The Government must build a system that is able to support efficient regulatory change.

As the financial sector digitises, innovates, and responds to new risks, the only thing that stays the same is how quickly things change. As new technologies and risks come up, the industry expects that regulations will continue to change. It is critical that this is done efficiently across the system to ensure that we take advantage of other opportunities.

Regulators have started to make plans for their own regulatory agendas, but the biggest problem for regulated entities is that they are subject to changes in regulations from many policymakers, legislators, and regulators.

To better handle this change, the way regulators as a group communicate and coordinate this change needs to be modernised through a Regulatory Roadmap.

We have attached background information (**Appendix A**), benefits information (**Appendix B**) and UK Grid example (**Appendix C)** to this submission.

If you wish to discuss this submission, please contact Mark Nguyen (mnguyen@coba.asn.au).

Yours sincerely

MICHAEL LAWRENCE
Chief Executive Officer

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[1] See ABA and ICA submissions to PM&C's Regulator Performance Framework consultation.

[2] See CFR Quarterly Statement June 2021: "Members also discussed Government and Reserve Bank reviews of the payments system, progress on a new cross-agency response protocol for cyber security incidents, lessons from the recent exit of a small ADI, and regulatory coordination."

CUSTOMER OWNED BANKING ASSOCIATION

Appendix A

A whole-of-system approach to regulatory change

Summary

The current financial services regulatory landscape is convoluted and complex. The burden of the current legislation will be lessened by initiatives like the ALRC review and actions taken by specific regulators. These initiatives won't, however, address the overall effects of the accelerated pace, volume, and complexity of new regulations coming from several regulators, legislators, and policymakers.

Regulators are becoming more sensitive to the "should we" (choice to enact new regulations), the "how we" (proportionality), and the "when we" (timing) of new regulations on an individual basis, but it is unclear to what extent they are coordinating as a group.

A whole-of-system approach to regulatory change in the financial sector is needed to ensure that regulatory change is proportionate, orderly and coordinated. This will reduce the impact that regulatory change has on financial system competition and efficiency and on customers in terms of cost and opportunity cost.

Background

A tsunami of regulatory change

A decade ago, financial services regulation, while complex, did not have the same pace and volume of regulatory change. While banking was subject to increasing consumer and prudential regulation, since then a global financial crisis, various inquiries, a Royal Commission, exponential technological change and a global pandemic have created wave after wave of regulatory change.

The depth and breadth of financial regulator mandates are relentlessly expanding. Regulators, consumers and other stakeholders' expectations of banks only continue to grow. While APRA was putting the finishing touches on its credit risk capital framework, i.e. 'traditional' banking regulation, it was also consulting on climate change guidance, increasing supervisory intensity on cybersecurity, piloting new data collection methods and expanding its GCRA[3] work. ASIC's mandate is also expanding with continually increasing consumer protection regulation, piloting new data reporting requirements and activity in the GCRA space as well. It will assume new responsibilities under the upcoming Financial Accountability Regime. The ACCC is the regulator of Australia's complex, new and continuously evolving Consumer Data Right (CDR) regime. Regulators such as the RBA, ATO and AUSTRAC are also increasing their activity. The significant community interest in financial services has led to a deluge of inquiries, each with their own set of potential improvements to the system. Regulator mandates are increasingly starting to overlap into each other's jurisdiction such as in the GCRA and lending space.

Regulator staffing growth matches this 'on paper' growth in regulation. Regulators are getting more resources and regulated firms are spending more time interacting with regulators. The information collected by regulators is increasing and will continue to increase with new technology. This tsunami of regulatory change is increasing operational risk in financial services and regulatory change programs now comprise a significant proportion of regulated entities' investment budgets.

[3] Governance, Remuneration, Culture and Accountability.

This sentiment is not just limited to smaller banks such as customer-owned banks. UK Finance states that:

> "Even the best-resourced firms have only so much financial, technical and strategic capacity to deliver and oversee change while managing the resilience of the system."[4]

This compulsory investment is crowding out funds that could also be used for customer, innovation, digital and growth initiatives. The 'drop-dead dates' for regulatory projects are pushing higher value projects aside.

Regulators and policymakers must work together to ensure that this change is proportionate, orderly and coordinated.

Better coordination among policymakers and regulators would also improve decision-making in cases where potentially competing objectives may be in play, such as competition versus stability, consumer protection versus consumer convenience and fighting money-laundering versus digital finance innovation.

The Regulatory Initiatives Grid – charting a clear course for regulators and industry

In the UK Government's 2020 Budget, the Chancellor of the Exchequer announced a proposal to improve regulatory coordination through the introduction of the Financial Services Regulatory Initiatives Forum (FSRIF) and the Regulatory Initiatives Grid. The Financial Services Regulatory Initiatives Grid reveals in one document the regulatory pipeline over the next two years. This document allows the financial services sector and other stakeholders to understand and plan for the continual change that will have significant cost and operational impacts. FSRIF is a similar grouping of financial sector regulators to Australia's Council of Financial Regulators (CFR).

The Grid includes information on each regulatory initiative including:

- name, lead agency and links to public information on it,
- estimates of operational impact (higher impact, lower impact or unknown impact),
- any expected key milestone dates and any changes to these milestone dates,
- whether the initiative is a newly announced initiative, and
- whether the initiative is expected to have a consumer impact to flag to consumer organisations.

The Grid's development has been an iterative process with financial sector stakeholders and continual calls for feedback. For example, "In response to the feedback received in the Call for Evidence that consultations, data requests and new requirements all contribute to the administrative burden on firms, the Grid will include all publicly announced supervisory or policy initiatives that will, or may, have a significant operational impact on firms." The evolution of the Grid has been impressive and now includes an online dashboard and a spreadsheet. It has now released five editions with the sixth being on hold as the UK awaits a major financial services reform bill.

While COBA greatly appreciates recent moves by regulators and policymakers to increase the transparency of their workplans, [5] these individual workplans without demonstrated consideration of broader regulatory change do not deliver the most efficient outcomes. COBA accepts that regulators do endeavour to coordinate this change, e.g. via discussion at the CFR of big ticket items, but industry needs transparency about this coordination.

COBA previously produced a Regulation Outlook document as an internal member product to assist our members in navigating this change, particularly on regulatory consultations. Many professional services firms, industry associations and commercial entities do the same (see below). However, while these products address industry's 'roadmap' need from a visibility perspective, they do not address the need for

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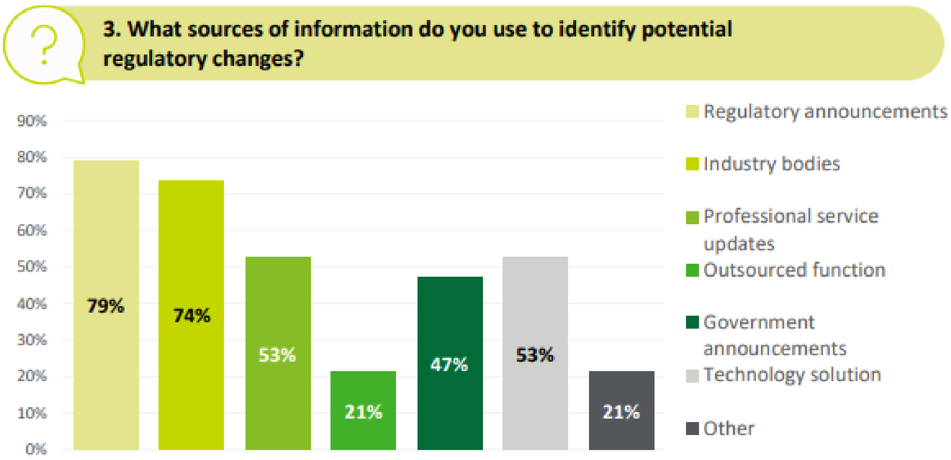
[4] UK Finance Response to Call for Evidence: Regulatory Coordination

[5] Example: see APRA's Policy and Supervisory Priorities, ASIC's Corporate Plan and Treasury's Royal Commission roadmap

greater regulatory and policymaker coordination or provide regulators with an overview of regulatory change to provide more complete information for their decision-making. A roadmap will reduce some economy-wide inefficiencies in regulatory scanning and allow resources to be focused on regulatory compliance or other projects.

Graph 1: Identifying potential regulatory changes



Source: [Deloitte, Managing Regulatory Change in the Australian Financial Services Industry, 2022]

Importantly, participating in this Forum and Grid does not interfere with individual regulators' powers on sequencing of regulation but rather provides them with more information to make informed decisions on the timing of regulatory initiatives.[6] The FSRIF has also noted that "the Grid planning process may highlight potential synergies between the various regulatory initiatives and agreed to consider further how these may be best be identified and exploited."[7]

Now in its sixth edition, the Grid has continuously evolved over this period based on stakeholder feedback and FSRIF discussion. Recent updates have included: adding new regulator members and their initiatives, including a flag on consumer interest, including an annex of changes, developing an interactive online tool, and highlighting key examples of closely interconnected initiatives to help stakeholders more readily identify them.

Such a document and its underlying processes would be invaluable in the Australian context to help the financial sector navigate the current pace, volume and complexity of change.

Australia's CFR already plays a similar role to the Forum. The CFR is the coordinating body for Australia's main financial regulatory agencies. Our proposed whole of system approach to regulation clearly fits into the CFR's "effective and efficient regulation" objective.

In arguing for an 'air traffic control' approach to regulatory coordination, UK Finance outlines Australia's CFR as an established mechanism to improve coordination of financial services regulation.[8]

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[6] As noted by the September 2020 FSRIF meeting minutes: "Decisions were reserved to the relevant members. Operation of the Forum was intended to ensure that members' decisions result in a fully and appropriately coordinated regulatory pipeline."

[7] See September 2020 FSRIF meeting minutes.

[8] COBA agrees with this view and the CFR is well placed to coordinate regulatory change and assist in providing time and *space for larger regulatory projects.*

Recent Australian Experiences

Last year the Australian financial sector came through a significant period of regulatory change colloquially referred to as "Big October".

October 2021 saw the commencement of five key regulatory regimes within a one-week window:

- The **new deferred sales model for add-on insurance**, to introduce a mandatory four-day pause between the sale of a principal product and the sale of "add-on" insurance products
- **Expanded prohibitions on the hawking of financial products**, to apply when a consumer is being offered a financial product during or because of unsolicited contact
- An **enhanced breach reporting regime**, imposing obligations on credit licensees and imposing a range of new regulatory obligations on financial services licensees
- The **new design and distribution obligation (DDO)** requiring issuers and distributors of financial products to develop and maintain effective product governance arrangements across the lifecycle of financial products, and
- **Enhanced internal dispute resolution (IDR)** obligations that require financial firms to have a dispute resolution system that consists of IDR procedures that meet the standards or requirements made or approved by ASIC.

In addition to this, Phase 1 of the Consumer Data Right (CDR) commenced for non-major banks in July 2021, with Phase 2 commencing in November 2021.

While some commencement dates were delayed due to COVID-19, the implementation of multiple, complex new regimes within such a compressed timeframe posed considerable compliance challenges for COBA members.

In addition, critical elements of the new regimes were not finalised until extremely close to commencement, exacerbating the planning, resource-allocation and compliance challenges.

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Appendix B

Regulatory Roadmap Benefits

Summary

COBA believes that the extensive benefits of a regulatory roadmap outweigh the costs. Benefits will easily exceed the costs given the hundreds of millions spent on regulatory change each year and the likelihood that costs are limited to additional Treasury staffing. While there may be concerns that a roadmap reduces individual regulators' ability to respond to issues, this would not be the case but rather it would provide them with a better set of information for a proportionate, prioritised and coordinated response.

Costs of a lack of coordination in regulation

UK Finance[9] outlines the "different manifestations and consequences" below of the financial services regulatory coordination problem:

- incoherent duties and objectives;
- failures to consider a policy issue in the round;
- misalignments of prudential and conduct requirements and initiatives;
- revisiting or front-running existing reforms;
- cannibalising common implementation resources;
- lack of coordination with other regulated sectors;
- infeasible consultation periods;
- infeasible implementation timescales; and
- infeasible implementation dates

These issues then present themselves as additional costs outlined below.

Surge costs of additional FTE to deal with regulatory change projects

COBA members predominately use internal resources that is sometimes supplemented by external resources when dealing with regulatory change. These include lawyers, consultants, professional services firms. Use of internal resources detracts from other project work (noting that COBA staff may not be as specialised as major bank staff) while funding for external resources diverts resources from other projects.

With simultaneous regulation often requiring similar resourcing capability (IT staff), personnel expenses increase as more staff must be hired to do the similar roles. This has an opportunity cost as these expenses do not translate into better consumer outcomes.

Poor implementation caused by rushed regulation

The aggressive and dynamic implementation program is the Consumer Data Right in banking has produced significant compliance challenges for ADIs. These include postponement of other projects that are more important for customer service, competitiveness and risk management.

A planned and coordinated approach via a Roadmap may have allowed more time to pre-emptively work through the issues below:

- A reasonable and orderly release schedule of rules, standards and other requirements.
- An improved exemptions process.

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[9] UK Finance Response to Call for Evidence: Regulatory Coordination

- A central location for rules, decisions papers and guidelines.
- Better co-ordination between all regulators and policymakers (ACCC, Data Standards Body, Treasury & Office of the Australian Information Commissioner).
- A timely, accessible and effective testing environment.

The revamped breach reporting regime has also created unnecessary regulatory burden. COBA members report significant increases in costs since the expanded Reportable Situations Regime commenced in October 2021. This is drawing scarce resources away from other priorities in COBA member businesses, such as projects that could directly benefit customers. The expanded regime has caused significant increases in the number of breaches that must be reported to ASIC. COBA members are critical of a lack of clarity and insufficient guidance around definitions as well as the inflexibility of the reporting portal.

A roadmap to plan out consultation and implementation milestones across responsible agencies (Treasury and ASIC) may have alleviated some of the unnecessarily burdensome aspects.

It is no surprise that both examples provided here involve multiple agencies with both policy and operational elements.

Overall impact on economic growth

At the highest-level, reduced productivity, increased costs and misallocated resources for inefficient regulatory change can have an adverse impact on economic growth as resources have been allocated to less productive purposes.

Benefits of a regulatory roadmap

Higher productivity from improved regulated entity planning	• Regulated entities will have a better view of regulatory change and will be able to increase productivity in implemenation programs.
Better regulation from more engaged industry and consumer stakeholders	• Stakeholders can better plan engagement to provide considered feedback assisting policymakers to meet policy goals and reducing unintended consequences.
Higher productivity from regulator coordination	• Regulators will be able to see where other regulators could be doing similar things to create potential synergies on project planning, staffing and research costs.
Reduced search costs for regulatory developments	• Regulated entities will use fewer resources finding regulatory developments and more resources on helping to meet regulator goals.
Better regulatory environment from a comprehensive view	• Regulators and legislators will be able to make decisions with a more complete and common set of information.
Greater transparency on regulatory updates	• Regulated entities will more transparently receive regulatory timeline updates rather than rely on private and unverified information.

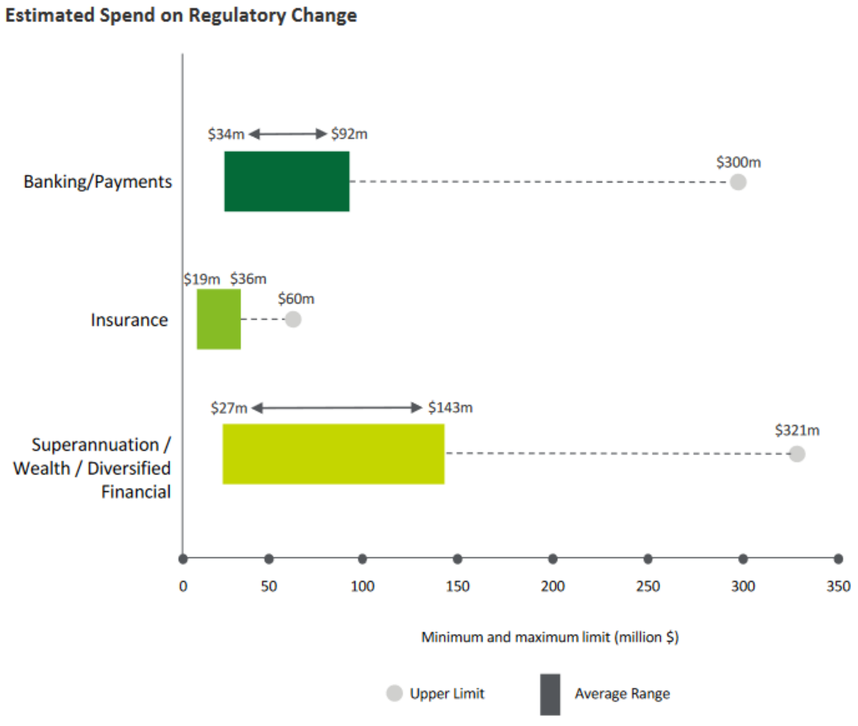
COBA has listed some of the Roadmap's benefits in the above graphic. In terms of costs, given the coordinating mechanism exists (CFR) and it already coordinates some regulatory change, Roadmap costs are expected to be limited to staffing and publishing costs. This is likely to be less than $1 million.

The annual costs of regulatory change are between $500 million to $1 billion based on our estimates below. Given its limited costs, the Roadmap would only need to deliver a productivity benefit on this subset of entities' regulatory change programs of 0.1% to 0.2% to break even across the economy. We believe this should be easily achievable given our *very conservative* cost estimates. If the true costs are higher, then the required productivity improvement would be lower.

Estimates of regulatory change costs

Graph 2 shows annual spending estimates from 20 of the largest financial services firms from a recent Deloitte survey. For our sector, a large COBA member estimates they annually spends $2 million on regulation projects (i.e. excluding BAU).

Graph 2: Annual Spend on Regulatory Change



Source: [Deloitte, Managing Regulatory Change in the Australian Financial Services Industry, 2022]

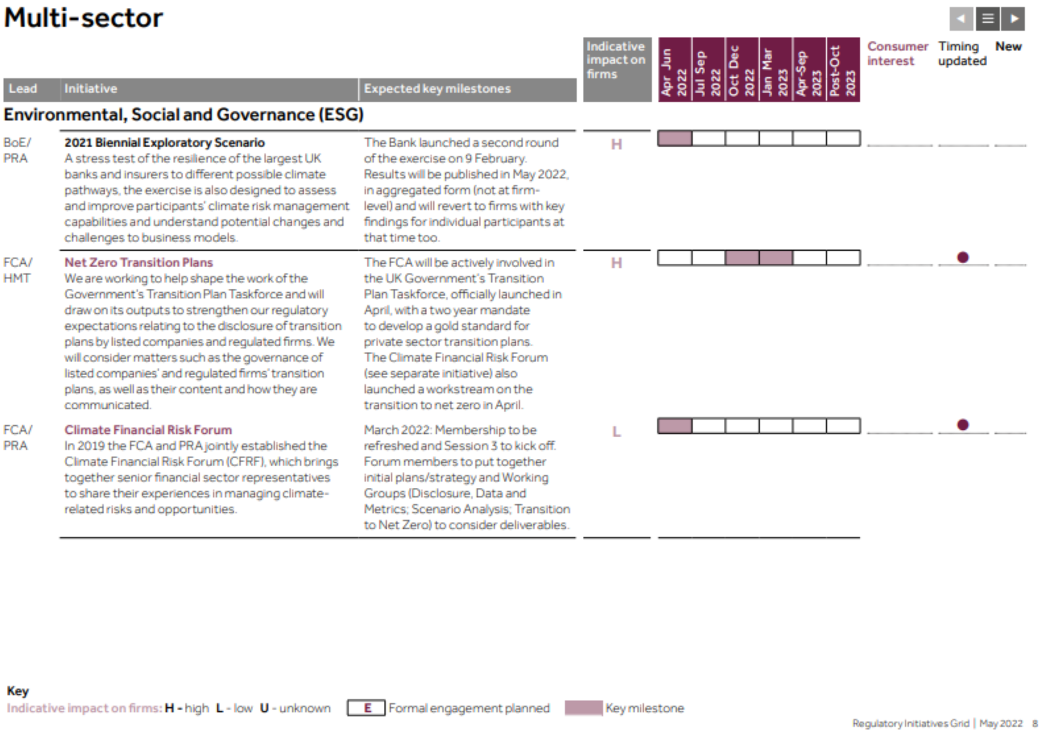
We *very conservatively* estimate that the cost of the regulatory change is $500 million to $1 billion based on this information (Table 1). We base this estimate on the minimum and average range data from the above graph combined with assuming our largest ten members are also subject to a cost of $2 million a year each.[10] Alongside our very conservative parameter choice, these estimates only cover 30 financial institutions, so the true number is larger.

Table 1: Estimates of regulatory change costs across the sector

	Number	Min ($m) each	Avg Range ($m) each	Total (Min) ($m)	Total (Avg Range) ($m)
Banks	7	34	63	238	441
Insurers	6	19	27.5	114	165
Super	6	27	85	162	510
COBA Largest 10	10	2	2	20	20
Total				534	1,136

[10] In line with the larger COBA member estimates..

Appendix C: UK Regulatory Initiatives Grid



Multi-sector

Lead	Initiative	Expected key milestones	Indicative impact on firms	Apr Jun 2022	Jul Sep 2022	Oct Dec 2022	Jan Mar 2023	Apr-Sep 2023	Post-Oct 2023	Consumer interest	Timing updated	New
Environmental, Social and Governance (ESG)												
BoE/ PRA	**2021 Biennial Exploratory Scenario** A stress test of the resilience of the largest UK banks and insurers to different possible climate pathways, the exercise is also designed to assess and improve participants' climate risk management capabilities and understand potential changes and challenges to business models.	The Bank launched a second round of the exercise on 9 February. Results will be published in May 2022, in aggregated form (not at firm-level) and will revert to firms with key findings for individual participants at that time too.	H									
FCA/ HMT	**Net Zero Transition Plans** We are working to help shape the work of the Government's Transition Plan Taskforce and will draw on its outputs to strengthen our regulatory expectations relating to the disclosure of transition plans by listed companies and regulated firms. We will consider matters such as the governance of listed companies' and regulated firms' transition plans, as well as their content and how they are communicated.	The FCA will be actively involved in the UK Government's Transition Plan Taskforce, officially launched in April, with a two year mandate to develop a gold standard for private sector transition plans. The Climate Financial Risk Forum (see separate initiative) also launched a workstream on the transition to net zero in April.	H									
FCA/ PRA	**Climate Financial Risk Forum** In 2019 the FCA and PRA jointly established the Climate Financial Risk Forum (CFRF), which brings together senior financial sector representatives to share their experiences in managing climate-related risks and opportunities.	March 2022: Membership to be refreshed and Session 3 to kick off. Forum members to put together initial plans/strategy and Working Groups (Disclosure, Data and Metrics; Scenario Analysis; Transition to Net Zero) to consider deliverables.	L									

Key
Indicative impact on firms: **H** - high **L** - low **U** - unknown E Formal engagement planned Key milestone

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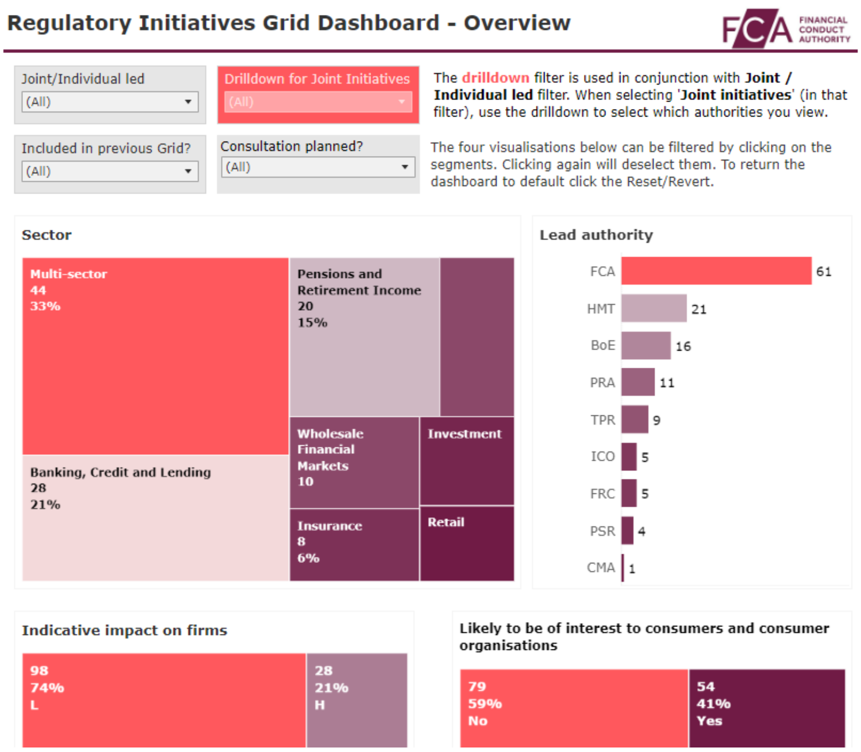

Source: https://www.fca.org.uk/publications/corporate-documents/regulatory-initiatives-grid

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