Competition in Australia's Financial System inquiry
Productivity Commission
GPO Box 1428
Canberra City ACT 2601
Via: online submission portal

20 March 2018

Dear Commissioners

Submission to the Productivity Commission inquiry into Competition in the Australian Financial System

The Business Council of Co-operatives and Mutuals (BCCM) welcomes the opportunity to make a submission in response to the Productivity Commission's draft report.

We welcome the Commission's acknowledgement in the draft report that, due simply to funding constraints, customer owned ADIs could be limited in their ability to further compete on lending rates. To that end, the Commission's focus on the need for regulatory reforms to enable access to funding and thereby enhance competition in the financial system, is welcome.

This submission outlines how and why legislative reform for customer owned ADIs will also aid competition and consumer choice. The submission is structured as follows:

1. **Greater corporate diversity in banking positively benefits markets and should be a policy objective:**

    a. The business purpose of customer owned ADIs aids competition and choice
    b. A wider range of differently owned banks with distinctive corporate objectives aids economic resilience and sustainability
    c. The productivity of customer owned banks is consistent and stable in comparison to investor owned banks

2. **Action should be taken to facilitate increased competition from the customer owned sector:**

    a. Customer owned ADIs need equitable access to working capital to drive their ability to compete
    b. In many countries, mutual banks do not face the same restrictions on raising capital as in Australia
    c. The Federal government should legislate to improve corporate law for

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Australian mutuals, including customer owned banks

d. Mutual enterprises should have the option of legal protection from hostile takeover

We have included information about co-operative and mutual enterprises and about the BCCM as appendices.

The BCCM welcomes the opportunity to provide further information or comment on any aspect of this submission.

Yours faithfully

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Business Council of Co-operatives and Mutuals

1. Greater corporate diversity in banking positively benefits markets and should be a policy objective:

‘A financial system populated by a diversity of ownership and governance structures, and alternative business models, is likely to be more competitive, systemically less risky and conducive to more growth than one populated by a single model.’[1]

Customer owned ADIs actively contribute towards corporate diversity because their reason for existence – their business purpose – is different to that of publicly listed businesses.

a. The business purpose of customer owned ADIs aids competition and choice

Because they are differently owned, customer owned ADIs provide extra competition and choice in the market place.

Since they are not driven by profit-maximising, short-term expectations of shareholders or financial analysts, mutuals and co-operatives are able to pursue business strategies aimed at long-term sustainability. This offers wider choice for consumers through enhanced competition that derives in part from the juxtaposition of different business models.

Enabled by their ownership structure, these mutuals pursue business strategies aimed at long-term sustainability, contrasting with listed companies that require shareholder-focused, short and medium-term business strategies.

They frequently offer products which differ from those of their competitors and can focus on different parts of the market.

[1] Investigating Diversity In The Banking Sector In Europe, Centre for European Policy Studies, 2010. Ayadi et al. http://aei.pitt.edu/32647/1/70._Investigating_Diversity_in_the_Banking_Sector_in_Europe.pdf

b. A wider range of differently owned banks with distinctive corporate objectives aids economic resilience and sustainability

The shock caused to many economies during the global financial crisis has had far reaching consequences for the performance of financial services businesses; it has to be a responsibility of governments to protect their nations from similar economic shocks.

The evidence from the global financial crisis is that mutual banks have generally been more resilient than publicly listed businesses.[2]

The existence of corporately diverse financial services markets helps to significantly de-risk markets and protect economies from reliving the experience of 2008.

It follows that efforts should be made to encourage competition from these customer-owned banks.

Customer owned ADIs can counter-balance the short-termist pressure of the capital market by operating longer term, customer focused business strategies.

The member ownership of mutuals creates corresponding diversity in forms of corporate governance; risk appetite and management; incentive structures; policies and practices; as well as behaviours and outcomes.

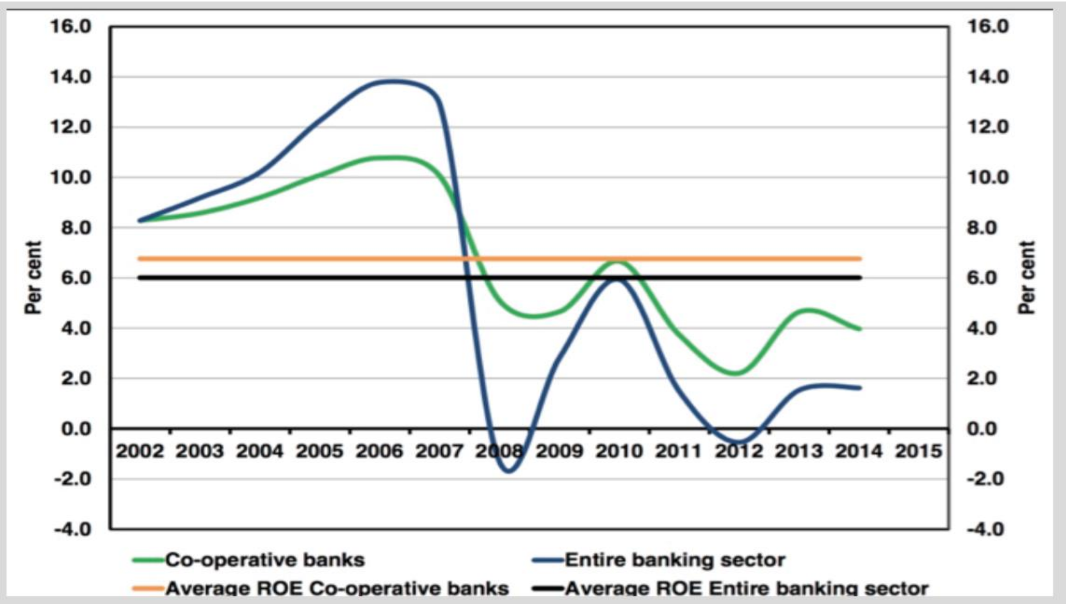
This is more than a matter of regulation of the industry; the structural danger posed by similarly owned firms following similar business strategies must also be addressed. The need to ensure diversity of corporate ownership must be a positive policy objective, with co-operatively and mutually owned firms able to play a full part in financial services markets.

[2] Resilience of the Co-operative Business Model in Times of Crisis, United Nations, ILO, 2009 Birchall et al. http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_108416.pdf

c. Productivity of customer owned banks is consistent and stable in comparison to investor owned banks

The economic performance of customer owned banks since the beginning of the global financial crisis contrasts starkly with that of their publicly listed competitors, as the following graph representing European markets shows.[3]

Return on equity of co-operative banking groups and entire banking sector



The orange and black lines represent the average return on equity respectively, of co-operative banks and the entire banking sector over the time span 2002-2014. Before and during the global financial crisis, the average return on equity for co-operatives exceeded that of the average of the entire banking sector.

Moreover, the co-operative banking sector experienced less extreme swings in its fortunes over this period, adding to the case for its greater resilience as a corporate form:

> *'Reports indicate that during the economic turmoil, savings and credit cooperatives, credit unions and cooperative banks have experienced an increase in almost every facet of their business including: increase in assets*

[3] Source: calculations by TIAS based on data from cooperative banking groups, the European Central Bank and the Swiss National Bank.

and deposits; increased volume of lending; increase in membership; a better rate of interest; and greater stability.'[4]

2. Action should be taken to facilitate increased competition from the customer owned sector:

Whilst these businesses remain a strong component of the Australian economy, it is clear that mutuals need appropriate legislation, regulation and policy to be able to compete on equal terms with other types of financial institution.

a. Customer owned ADIs need more flexibility in accessing working capital

Like all businesses, co-operatives and mutuals need access to working capital to fund their growth, innovation and development. However, the way that their capital is raised - through retained earnings - presents particular challenges to their ability to operate as flexibly as their investor owned competitors do.

This is a function of the lack of legal options available for federally registered co-operatives and mutuals; the Corporations Act does not currently provide for them to issue securities to investors without risking their mutual status.

By accessing additional capital without altering the business purpose of the mutual, firms will be able to invest, innovate, expand and therefore compete on a level playing field with investor owned firms.

b. In many countries, mutual banks do not face the same restrictions on raising capital as in Australia

Although facing the same natural limitations on raising capital as Australian customer owned banks, mutuals across the world raise additional capital in a variety of different ways. Some types of capital raised in Europe are available to institutional investors, whilst others are raised directly from members.

We refer to the appendices to our previous submission to this inquiry where we

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[4] Resilience of the Co-operative Business Model in Times of Crisis, United Nations, ILO, 2009 Birchall et al. http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_108416.pdf

provided examples of successful international businesses that have, for many years, raised funds from their members and investing institutions, because this is permitted in the jurisdictions in which they operate.

In the UK, where similar barriers have existed to those in Australia, new legislation has been passed to enable mutual banks (building societies) to issue securities, which fit within the ethos and purpose of these mutually owned businesses.

c. The Federal government should legislate to improve corporate law for Australian mutuals, including customer owned banks

Currently, the only mention of mutuals in the Corporations Act 2001 refers to the procedure under which they may be demutualised.

There is no statutory definition for a mutual in Australia: those businesses that describe themselves as mutuals do so voluntarily as an expression of their business purpose, rather than as a statement of corporate form.

As such, mutuals will typically register under Federal law as a company under the Corporations Act 2001. This means that mutuals may be a public company limited by shares, a company limited by guarantee, or a company limited by shares and guarantee.

The Hammond Review[5] has recommended the amendment of the Corporations Act to define a 'Mutual Company,' and the creation of a new capital instrument for mutual businesses that currently have no permanent investment capital. By implementing these legislative reforms the Federal Government would enable mutuals to attract additional working capital to fuel the development of their businesses.

Such an option will enable customer owned ADIs to maintain their mutual business structure, whilst supplementing their capital base by issuing new mutual securities. This will facilitate their ability to compete with listed firms, whilst preserving their mutual business model. Competition in the financial system as a whole will be enhanced when mutuals are able to compete *as* mutuals.

[5] Reforms for cooperatives, mutual and member-owned firms – Commonwealth of Australia, 2017 (Hammond Review) https://treasury.gov.au/publication/p2017-t235882/

d. Mutual enterprises should have the option of legal protection from hostile takeover

A major difference between the legislative frameworks prevalent in many EU states and Australia, is a significant issue of principle; in Europe, the principle of 'disinterested distribution' exists as the norm among mutuals. This acts as a legal barrier to demutualisation by removing the incentive for current members to cash-out the value of the business. In effect, on a solvent winding up, assets and reserves in a mutual entity may only be transferred to another such body pursuing similar aims or to other general interest purposes. The assets cannot be transferred to a different corporate body such as a PLC or private company, or distributed to members.

This type of provision is commonly applicable to co-operatives across many EU jurisdictions, but not available through legislation to Australian co-operatives or mutuals. As a consequence, Australian mutuals and co-operatives have constructed sometimes elaborate defenses against demutualisation in their constitutions. Demutualisations that have occurred have been brought about by current members seeking to cash out the value of the organisation (or a proportion of its value) against its intended purpose.

Demutualisations in the financial services industry have had negative effects on competition, choice and value. Such events have been avoided in other countries by the consistent application of the principle of disinterested distribution.

Legislation should be amended to permit Australian Federally registered mutuals to amend their constitutions to adopt a permanent mutual status.

Appendix A: About co-operatives & mutuals in Australia:

a. Co-operatives and mutuals are part of Australia's corporate bio-diversity

Among policy makers, a new awareness has emerged of the importance of spreading risk in economies by ensuring the presence of a plurality of business types. Along with listed investor owned firms and family owned enterprises and charities, co-operatives and mutuals have an important part to play in the biodiversity of our economy.

A vibrant economy requires businesses of all types to be able to compete, regardless of corporate form. This means that appropriate legislative frameworks are required that do not restrict particular types of firm from being able to access the finance capital that they need to facilitate their growth and development.

b. Co-operatives and mutuals are important Australian owned businesses

Co-operatives and mutuals are businesses owned by or on behalf of their customers, employees, a group of like-minded producers or a combination of these. They exist in every State and Territory of the Commonwealth. Australia has more than 2,000 co-operatives and mutuals with a combined membership base of more than 14.8 million. Co-operatives and mutuals are owned by Australians, pay their taxes in Australia and contribute to our nation's prosperity.

Co-operative and mutual enterprises (CMEs) exist when groups of individuals come together to achieve an objective that they could not achieve alone. They are a rational alternative to investor owned business when the objective is different from that of maximising return to shareholders.

Broadly speaking, there are three types of co-operative and mutual enterprise – customer owned, worker owned and producer owned.

Customer owned: The objective is service quality and price, rather than profit maximisation. Examples of these businesses exist in banking, (e.g. CUA, Heritage Bank, P&N Bank) insurance, (HCF, RT Health) food retail (The Co-op - Barossa) and motoring clubs (RACQ, NRMA, RACWA, RACV).

Worker owned: The objective is high quality employment that incentivises employees, provides work place democracy and shares wealth. An example is non-residential aged care provider, The Co-operative Life.

Producer owned: The objective is to enable groups of small businesses to work together to operate in markets that would otherwise be dominated by large investor owned firms. Many such co-ops exist in agricultural production, where co-ops enable smaller producers to combine their efforts to compete. Well known examples are Co-operative Bulk Handling (CBH) and Norco, and in automotive purchasing, Capricorn Society.

Appendix B: About the BCCM

The BCCM is the peak body for Australian co-operatives, mutuals and member-owned businesses. The BCCM represents a diverse range of businesses operating in sectors including agriculture, finance and banking, insurance, motoring services, health services, aged care, disability employment, education, indigenous services, social housing and retail.

The BCCM advocates for recognition of the sector and for measures that create a level playing field between co-operatives and other businesses, including implementation of the recommendations of the Senate Economics References Committee report into Cooperative, mutual and member-owned firms.[6]

[6] http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Cooperatives/Report