17 May 2017

Mr. Greg Hammond OAM
Review Chair
Reforms for cooperatives, mutuals and member-owned firms

By email: coopsandmutualreview@treasury.gov.au

Dear Mr. Hammond

RE: REFORMS FOR COOPERATIVES, MUTUALS AND MEMBER-OWNED FIRMS

We are delighted with your appointment to facilitate the reforms for cooperatives, mutuals and member-owned firms and that you will be consulting with stakeholders to assist the Government in further developing its response to the Senate Economic References Committee Report *Cooperative, Mutual and Member-owned Firms*.

Please accept this letter as our submission on the matter.

About Qudos Bank

We are a mutual, Authorised Deposit Taking Institution (ADI), with over 90,000 members, assets over $3.4 billion and approximately 200 employees.

Previously known as Qantas Credit Union, we've been in banking for over 55 years with an investment grade credit rating and a full range of banking products including home loans, credit cards, personal loans and saving accounts.

The inquiry, independent review and BCCM/COBA briefing notes

We agree with the recommendations of the Senate Economic References Committee that mutuals and cooperatives should have more options to raise capital. We support the Business Council of Co-operatives and Mutuals (BCCM) and the Customer Owned Banking Association (COBA) in their objective to petition the Federal Government and regulators to ensure they act with greater urgency to increase the capital raising options for the mutual sector.

To avoid repetition of matters previously raised, we refer to the Joint Briefing Note BCCM/COBA dated May 2017 (copy attached) and support the proposals to:

- amend the prudential standards to allow mutual ADIs to directly issue Mutual Equity Interests (MEI), with some modifications to the existing MEI definition to make it more consistent with Regulatory Guide 147; and

- amend the Corporations Act 2001 by including a definition of a ‘mutual enterprise’ and the creation of a new capital instrument which can be directly issued by such entities.

We would like to emphasise that these two proposals are not mutually exclusive, and that both have merit for mutual ADIs. In any scenario, regulatory approval will be necessary for new capital instruments and they will also need to be attractive to the investment market.

The maximum range of options would help to facilitate greater strategic choice for the Boards of mutual ADIs and thus facilitate competition from mutuals in a sector that is widely recognised to be highly concentrated.

Regulatory and legislative barriers to accessing capital

It is not viable for Qudos Bank to issue Common Equity Tier 1 (CET1) capital as:

- it is unlikely that the regulator will recognize any ordinary share capital issued as CET1; and
- there is a risk that demutualisation provisions may be triggered if ordinary share capital is issued.

Mutual ADIs do not currently have options for capital raising that avoid the risk of demutualisation. We note that legislation in other jurisdictions supports the issuing of mutual-specific capital instruments and this should also be available in Australia.

Should legislation permit such mutual instruments to be issued in Australia, we recognise the need for a legal definition of those mutual firms that will be within the scope of the new legislation.

Impact of capital constraints

To maintain relevance and competitiveness in the Australian banking market, we have recently begun a digital transformation project to implement a new generation of technology.

The material cost of this project will be deducted from our CET1. Given our inability to raise CET1, we have been forced to restrict lending growth over the medium term to maintain capital levels above prudential requirements.

In effect, we have restricted lending growth to below the industry average and experienced lower revenues and profitability in order to make an essential investment in the business.

This contrasts with investor owned competitors who commonly issue additional CET1 (in the form of ordinary shares) to facilitate investments and growth in their businesses.

Yours sincerely

S. King

Scott King
CEO
Qudos Bank

JOINT BRIEFING NOTE BCCM/COBA

Raising Capital in Co-operatives and Mutuals

Overview
Mutuals and co-operatives are a strong component of the Australian economy. In an increasingly competitive business environment they need adequate access to capital to fund their growth and development.

The structure of co-operatives and mutuals means there are fewer capital raising options than investor owned companies. Capital options need to be consistent with their member-owned business model and which enhance their competitive capacity.

Issuing ordinary shares like a listed company would undermine their mutual status and their commitment to serving their member-owners.

Alternative structures for raising capital are necessary, and will require regulatory or legislative action. BCCM and COBA believe the Federal Government and regulators should act with greater urgency to increase the capital raising options for these firms and BCCM and COBA are working together to achieve this outcome.

The Senate Economic References Committee Inquiry
The Senate Economic References Committee agreed with the above view and recommended that mutuals and co-operatives should have more options to raise capital.

Two recommendations from the inquiry specifically addressed this issue, being:

> ***Recommendation 16***
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> *The committee recommends that APRA set a target date for the outcome of discussions with the co-operative and mutuals sector on issues of capital raising and bring those discussions to a timely conclusion.*
>
> ***Recommendation 17***
>
> *The committee recommends that the Commonwealth Government examine proposals to amend the Corporations Act 2001 to provide co-operative and mutual enterprises with a mechanism to enable them access to a broader range of capital raising and investment opportunities.*

Recommendation 16 is specifically concerned with regulatory capital (i.e. capital instruments that qualify as regulatory capital within APRA’s prudential framework) for APRA regulated entities such as mutual ADIs.

Recommendation 17 requires legislation for an entirely new Mutual Capital Instrument (MCI) designed to be used as working capital, that any Federally registered mutual may issue.

A summary of what these two recommendations mean

1. Implementing Rec 16: CET1 instruments for mutual ADIs

Mutual ADIs are permitted under APRA's prudential standards to issue capital instruments that qualify as Additional Tier 1 (equity) or Tier 2 (debt) but are not currently permitted by APRA to directly issue the highest quality capital instruments, Common Equity Tier 1 (CET1).

The mutual sector is discussing with APRA some amendments to the prudential standards to allow mutual ADIs to directly issue CET1 instruments.

The potential basis for a mutual ADI CET1 instrument already exists in the prudential framework: the Mutual Equity Interest (MEI) concept (see Attachment K, APS 111). The MEI concept has been part of the prudential framework since 2014 and is consistent with principles of mutuality set out in ASIC Regulatory Guide 147 *Mutuality: Financial institutions.*

MEIs can currently only be created if a mutual ADI issuing Additional Tier 1 or Tier 2 capital experiences a 'trigger event' (e.g. APRA declaring the ADI non-viable) that causes the AT1/T2 security to convert to an MEI.

However, the proposal is to amend the prudential standards to allow mutual ADIs to **directly issue MEIs**, with some modifications to the existing MEI definition to make it more consistent with Regulatory Guide 147.

Mutual ADIs are public companies under the *Corporations Act 2001* and already have capacity under the Act to issue equity and debt instruments, depending on their individual constitutions. Some mutual ADIs issued equity instruments that qualified as regulatory capital prior to APRA's changes to the prudential framework in 2012.

Our objective, under this Recommendation, is to maximise flexibility for mutual ADIs to directly issue CET1 instruments to retail or wholesale investor markets in accordance with their own governance and strategic objectives. This proposal requires amendment of the APRA prudential standards but does not require legislative change.

2. Implementing Recommendation 17: Mutual Capital Instrument (MCI) to apply to all Federally registered mutuals

The intention of this proposal is to permit **all** mutuals or co-operatives federally registered under the Corporations Act, to issue a capital instrument that may be used to raise additional working capital for business development and growth. Such an instrument could be created through an amendment to the Corporations Act 2001. It will be available as an option that mutuals registered as companies limited by shares, limited by guarantee, and limited by shares or guarantee could issue.

The MCI will be an 'equity like' security in that will be permanent, loss absorbing, investment capital. It would have certain minimum characteristics (e.g. rank behind all creditors) but that each mutual would be able to determine other features to suit their business. This will enable APRA regulated mutuals to design terms that will qualify MCI as CET1 and others to be more flexible in their approach.

The new capital instrument will mirror similar provisions that exist in Canada, UK and the Netherlands, bringing Australian law into line with these jurisdictions. MCI will retain features consistent with the mutual purpose of such a business by limiting voting rights, to ensure that member control is maintained.

A collective effort

BCCM and COBA are working together to achieve positive outcomes for the sector and are committed to collaborating on the initiatives, sharing skills and information and to supporting all of the Senate Inquiry recommendations equally.

BCCM and COBA believe it is important to pursue the legislative and regulatory outcomes concurrently and are working together to this end. COBA is a member of BCCM's capital project as a funding partner to strengthen collaboration on this important work. BCCM and COBA are committed to working closely together on the Hammond Inquiry to ensure we maximise the opportunity provided by this review.

BCCM and COBA are committed to a growing and thriving co-operative and mutual sector, to narrowing the regulatory gaps between our members and investor-owned firms, and to championing the benefits for Australia of a strong co-operative and mutual sector.

May 2017