23 December 2021

The Honourable Michael Sukkar MP
Assistant Treasurer and Minister for Housing
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: prebudgetsubs@treasury.gov.au

Dear Minister

The Government's 2022-23 Pre-Budget Submission Process

COBA welcomes the opportunity to make a submission to the Government's 2022-23 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 more than 4.5 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. Like all ADIs, customer-owned banks are subject to regulation from multiple regulators.

The increasing pace, volume and complexity of regulatory change is a challenge for all regulated entities but has a disproportionate impact on smaller ADIs such as customer-owned banks who have more limited risk and compliance resources. Better coordination and mapping of regulation can help to reduce this burden.

COBA is not alone in highlighting this problem and proposing a solution. Other industry associations representing much larger financial institutions, such as the ABA and ICA, have made similar calls for better coordination across financial regulators on regulatory change.[1]

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

The regulatory environment will continue to evolve

The rapid pace of change is the only constant in today's world as the financial sector digitises, innovates and responds to emerging risks. This pace is likely to remain higher than in the past. While regulators have started to map out their individual regulatory agendas,[2] the key issue for regulated entities is that they are subject to regulatory change from a multitude of policymakers, legislators and regulators.

It is time for a change in the way policymakers and regulators as a collective communicate about regulatory change.

While the financial sector continues to navigate the current perfect storm of Royal Commission regulatory measures and ongoing regulator priorities (e.g. APRA, ASIC and Treasury's pre-RC agendas), as well as COVID-related work, emerging risks and technology are creating more regulation and/or increased regulatory expectations.

Recent developments have shown an increasing demand for regulation in environment, social and governance areas, a new payments reform regulatory agenda and steps toward a regulatory response to digital finance.

APRA Chair Wayne Byres recently provided some comment on this pace of change:

> "Regulation rarely keeps pace with the leading edge of innovation (and nor should it be expected to): more typically, the regulatory frameworks and supervisory methods we use today are a product of the financial institutions of yesterday. That may not be too concerning if the pace of change is relatively sedate. But the pace of change today seems extremely rapid."[3]

With innovation being a potential driver of change, we would expect regulation to continue to change with it. The regulatory communication and coordination system should be modernised to manage this change in a more efficient manner.

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

[3] APRA Speech - Remarks to the AMF-BCBS-FSI High-level meeting on the post COVID-19 banking system

United Kingdom's Regulatory Grid

In the UK, regulators and policymakers have established a Financial Services Regulatory Initiatives Grid that reveals in one document the regulatory pipeline over the next 2 years. This document allows the financial services sector and other stakeholders to understand and plan for the continual change that will bring significant cost and operational impacts. The Grid is provided by the Financial Services Regulatory Initiatives Forum (FSRIF). The FSRIF is a similar grouping of financial sector regulators to Australia's Council of Financial Regulators (CFR).

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 decision on the timing of regulatory initiatives.[4] 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."[5]

The Grid includes information on each initiative including:

- name, lead agency and links to public information on it,
- estimates of operational impact such as whether it is higher impact, lower impact or has an 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 retail consumer impact as a flag to consumers and consumer organisations.

Now in its fourth 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.

[4] 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."

[5] See September 2020 FSRIF meeting minutes.

An Australian Regulatory Grid

The Government should fund a pilot of an Australian Regulatory Initiatives Grid. The Grid should be produced by Treasury given its role as the 'line agency' for the financial sector, utilising the CFR as the coordinating body.

Priority regulators on this Grid 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 begun discussions on improving regulatory coordination.[6]

Recommendation

Provide the funding to pilot a regulatory initiatives grid like that seen in the United Kingdom to assist regulators and policymakers to coordinate regulatory change and assist industry to plan and map out responses to regulatory change. This would be developed in continuing consultation with the financial services sector and other relevant stakeholders.

If you wish to discuss any aspect of this submission, please contact Mark Nguyen (mnguyen@coba.asn.au) or Luke Lawler (llawler@coba.asn.au).

Yours sincerely

MICHAEL LAWRENCE
Chief Executive Officer

[6] 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

Background Paper

A whole-of-system approach to regulatory change

Summary

Existing regulation of financial services is labyrinthine and complex. Activities such as the ALRC review[7], individual regulator initiatives and changes such as the proposed responsible lending simplification reforms will help reduce the burden of the existing regulation. However, these initiatives will not address the cumulative impact of the increased pace, volume and complexity of new regulation flowing from multiple regulators, policymakers and legislators.

While regulators are demonstrating greater sensitivity to the “should we” (decision for new regulation), the “how we” (proportionality) and the “when we” (timing) of new regulation at an individual level, the degree of coordination between creators of new regulation as a collective is far from clear.

All significant regulatory policy decisions must be considered at a ‘whole of system’ level to acknowledge the reality that financial sector firms are subject to multiple layers of regulation and multiple regulatory bodies.

A whole-of-system approach to financial sector regulatory change 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[8] 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, consequently, regulated firms are spending more time interacting with regulators. The

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[7] Review of the Legislative Framework for Corporations and Financial Services Regulation

[8] Governance, Remuneration, Culture and Accountability.

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 entity's investment budgets.

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."[9]

It is notable that UK Finance represents the UK financial services sector and counts globally significant banks amongst its membership – banks that dwarf Australia's major banks.

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 as a collective must work together to ensure that this change is proportionate, orderly and coordinated – as an armada of ships sailing in the same direction.

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

As noted by APRA's UK counterpart, prudential regulation can exhibit a 'complexity problem' when the same requirements are applied to all firms.[10]

> "This problem exists if the costs of understanding, interpreting, and operationalising prudential requirements are higher relative to the associated public policy benefits for smaller firms than for larger firms.
>
> "The complexity problem arises because there are economies of scale to understanding, interpreting, and operationalising prudential requirements, or because the factors driving smaller and larger firm distress are different, but the requirements have been designed with larger firms in mind. This problem could have adverse effects on PRA objectives because it could both reduce the resilience of small firms and diminish effective competition."

COBA supports action being taken by APRA to tackle this problem in the Australian regulatory framework. However, the complexity problem is not limited to prudential regulation. One of the most challenging regulatory compliance projects for small ADIs has been implementing the CDR regime. This is a major regulatory change which at the same time is a significant technology transformation project.

Implementation of this project has been occurring against a backdrop of a global pandemic and many other non-CDR regulatory change projects. This has proved challenging to all stakeholders, including banking institutions, their key technology suppliers and the ACCC.

UK moves to coordinate regulation in a flood of new regulation

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 and the Regulatory Initiatives Grid.

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

[10] UK PRA A strong and simple prudential framework for non-systemic banks and building societies

Regulatory Coordination

The Financial Services Future Regulatory Framework Review was announced at Mansion House 2019, with the first phase launching a call for evidence on regulatory coordination in July. The government is publishing a response to the call for evidence alongside Budget and setting out the next steps in the review. This response announces a new forum, bringing together government and regulators, to provide industry with a forward-look of upcoming regulatory initiatives. This forum will be made up of the Bank of England, Prudential Regulation Authority, Financial Conduct Authority (FCA), Payment Systems Regulator and Competition and Markets Authority, with HM Treasury as an observer member.[11]

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

As part of the Forum's work, they successfully piloted a Regulatory Initiatives Grid ("the Grid") over the COVID year (see Figure 1). The Grid sets out financial services regulators' planned regulatory workplan over the next two years in one document. The grid outlines key milestones for various financial services regulation, supervisory and data initiatives. It also classifies them according to perceived operational impact on firms and flags any that may be of interest to consumers. The Grid allows regulators to better consider the cumulative impact and timing of regulation.

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 is now up to its fourth edition with releases in May 2020, September 2020, May 2021 and November 2021.

While COBA greatly appreciates recent moves by regulators and policymakers to increase transparency of their workplans, [12] 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 produces a Regulation Outlook document as an internal member product to assist our members to navigate this change, particularly with respect to contributing to upcoming regulatory consultations and many professional services firms and industry associations do the same. However, while these products address the industry 'roadmap' need from a visibility perspective, they do not address the need for greater regulatory and policymaker coordination or provide regulators with an overview of regulatory change to provide more complex information for their decision-making.

Financial Services Regulatory Initiatives Forum – coordinating regulatory change

This UK Forum was launched in 2020 to strengthen regulatory coordination between members. It is made up of representatives of the Bank of England, Financial Conduct Authority, Prudential Regulation Authority, Payment Systems Regulator, the Competition and Markets Authority, the Information Commissioner's Office, The Pensions Regulator and the Financial Reporting Council. HM Treasury is an observer member.

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[11] UK 2020 Budget: Delivering on our promises for the British People, Page 100

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

"The existence of the Forum has prompted a clearer focus on coordination of those initiatives at an early stage in their development – including identification of opportunities for joint work and de-duplication." [13]

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.[14]

Recent Australian Experiences

The Australian financial sector has just come through significant period of regulatory change colloquially referred to as "Big October" (see Figure 2).

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 challenge.

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[13] Regulatory Initiatives Grid - May 2021

[14] 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.*

Figure 1: UK Regulatory Initiatives Grid Example

Banking, credit and lending

Lead	Initiative	Expected key milestones	Indicative impact on firms	Oct Dec 2021	Jan Mar 2022	Apr Jun 2022	Jul Sep 2022	Oct 2022 Mar 2023	Post-Mar 2023	Consumer interest	Timing updated	New
Financial resilience												
BoE/ PRA	**Leverage ratio review** The FPC and PRC reviewed the UK leverage ratio framework in light of revised international standards. The changes will take effect on 1 January 2022, and 1 January 2023 as set out in PS 21/21	1 January 2022: changes to the definition of Leverage Exposure Measure; and reporting and disclosure changes except where related to firms that are newly brought within scope of the leverage ratio minimum requirement. 1 January 2023: changes to scope and level of application of the minimum requirement, buffers, and related additional reporting and disclosure requirements for firms that would be newly brought into scope of the leverage ratio minimum requirement.	L									
BoE/ HMT/ PRA	**Updating the UK's prudential regime for credit institutions (incorporating elements of CRR II)** The EU is implementing a number of Basel 3 standards, and other prudential regulations, via CRRII, which applies in the EU from June 2021. The UK therefore intends to update the prudential regime for UK credit institutions and ensure the FPC's powers are aligned with this.	Q4 2021: Parliamentary processes are completed and PRA rules made 1 January 2022: Requirements apply.	H									
BoE/ HMT/ PRA	**Implementation of the remaining Basel 3 banking standards (Basel 3.1)** Consultation on the UK implementation of the reformed Basel 3 banking standards (also known as Basel 3.1).	H2 2022: Consultation Paper 1 January 2023: Basel implementation deadline.	H				E	E				

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

Regulatory Initiatives Grid | November 2021 26

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

Figure 2: October 2021 reforms & case for Regulatory 'Grid'

Convergence of regulatory deadlines in 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
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October reforms – Royal Commission

Deferred sales model
Anti hawking
Breach reporting

Financial Sector Reform (Hayne Royal Commission Response) Bill passes Parliament. Contains deferred sales model (DSM), expanded breach reporting, anti hawking

Bill consulted on in Jan to Mar 2020, delayed by COVID. Introduced into Parliament Nov 2020, passed by Dec 2020

Treasury consultation on DSM regulations for regime and exemptions

ASIC consultation on draft DSM guidance (RG 275)

Treasury consultation on breach reporting regulations for regime and exemptions

ASIC consultation on revised breach reporting guidance (RG 78)

Treasurer's statement on exemptions for anti hawking and DSM

ASIC consultation on revised hawking guidance (RG 38)

ASIC publishes final RG 275

Treasury consults further on DSM exemptions

Breach reporting regulations published

Anti-hawking regulations published

DSM regulations published

ASIC publishes final RG 79

ASIC publishes final RG 38

Legislative instrument published

DSM, expanded anti hawking and breach reporting regimes commence

Dec 20 | Jan 21 | Feb 21 | Mar 21 | Apr 21 | May 21 | Jun 21 | Jul 21 | Aug 21 | Sep 21 | Oct 21

October reforms – DDO, IDR, CDR

Design and Distribution Obligation (DDO)
Internal Dispute Resolution (IDR)
Consumer Data Right (CDR)

CDR Bill passed in Aug 2019

ACCC consults on rules and accreditation guidelines

CDR rules commence

Product reference data for loans available (*majors*)

ACCC consultation on timetable for participation by *non majors*

Treasury inquiry into future direction of CDR

CDR launches

Phase 1 launches for *majors*

CDR expansion amendment Rules 2.0 consultation

Phase 2 launches for *majors*

Phase 3 launches for *majors*

CDR joint accounts consultation

Phase 1 launches for *non-majors*

ACCC publishes rectification schedule

CDR Rules 3.0 consultation

CDR strategic assessment consultation

Phase 2 launches for *non-majors*

Phase 3 launches for *non-majors* in Feb 2022

Bill introducing IDR reforms introduced in Sep 2017, passed in Feb 2018

ASIC consultation on revised guidance (RG 165) Mar to Aug 2019

ASIC releases responses to consultation on revised RG 165

ASIC seeks further feedback on IDR reporting requirements

ASIC publishes IDR data dictionary for testing in pilot

ASIC publishes new RG 271

Revised IDR regime commences 5 October 2021

Pilot testing for data dictionary, will become mandatory in 2022

DDO bill introduced in Sep 2018, passed in Apr 2020

Consultation on regulations from Sep to Oct 2019

ASIC consults on draft DDO guidance RG 274

ASIC delays DDO commencement from Apr to Oct 2021

ASIC publishes final RG 274

DDO regulations come into force, part 7.8A Corporations Act

ASIC publishes instrument t0 amend regime per Treasury's directions

DDO regime commences 1 October 2021

<2020 Q1 2020 Q2 2020 Q3 2020 Q4 2020 Q1 2021 Q2 2021 Q3 2021 Q4 2021 >2022

Regulatory ‘Grid’

A whole-of-system approach to financial sector regulatory change is needed to ensure that any 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.

The UK’s Regulatory Grid sets out financial services regulators’ planned regulatory workplan over the next two years in one document.

The Grid outlines key milestones for various financial services regulation, supervisory and data initiatives. It also classifies them according to perceived operational impact on firms and flags any that may be of interest to consumers. The Grid allows regulators to better consider the cumulative impact and timing of regulation.