CFR Review into Small and Medium Sized Banks Secretariat
Banking Review Unit
Banking Review, Investment and Financial Advice Branch
Financial System Division
Markets Group
Treasury

Via email: CFRReview@treasury.gov.au

Bendigo Bank Submission to the Council of Financial Regulators Review into Small and Medium Sized Banks

Introduction

We thank the Council of Financial Regulators (CFR), in consultation with the Australian Competition and Consumer Commission (ACCC) and Secretariat staff, for the development of the Issues Paper on the Review into Small and Medium Sized Banks. We take this opportunity to expand on matters raised in the Australian Banking Association's (ABA) submission which are of particular importance to Bendigo Bank.

Bendigo and Adelaide Bank Limited (ASX: BEN) is one of Australia's largest banks, with around 8,000 employees supporting more than 2.6 million customers to achieve their financial goals, online and in person, at over 425 branches across Australia. We are an ASX top 100 company, with assets of more than $100 billion and a market capitalisation of approximately $7.61 billion.

Bendigo Bank's (the Bank) operations are spread across two distinct customer aligned business areas:

- Consumer Banking: Servicing our consumer customers through our branch network (including Community Banks), Up digital bank, mobile relationship managers, third party banking channels and wealth services.
- Business and Agribusiness: Servicing our business and agribusiness customers through our branch network and via our business and agribusiness bankers, relationship managers and brokers.

Executive Summary

Our submission presents several themes that reflect our views across the three chapters of the Issues Paper – Proportion in regulation; Funding and Entry, Scale and Exit. More broadly, we support the ABA submission on the Issues Paper.

Key Themes

The key themes from our responses to the questions raised in the Issues Paper submission are outlined below.

Proportion in regulation
In general, non-major banks (excluding Macquarie) are subject to significant incremental capital requirements and proportionally higher costs associated with regulatory compliance. This impedes our ability to compete in the market and, by extension, adversely impacts consumers and businesses.

Some specific areas that might be considered by the CFR to increase competition and provide better outcomes for Australian consumers and businesses by improving the proportionality of regulation include:

- The CFR considers opportunities to reduce the significant capital advantage enjoyed by larger banks using the Internal Ratings Based (IRB) approach for determining risk weighted assets (RWAs) relative to banks on the Standardised approach. The existing capital differential inhibits competition and reduces shareholder returns for small and medium-sized banks, thereby making it more difficult for those banks to attract the capital needed to invest and grow, which ultimately harms Australian households and businesses. These settings contribute to the major banks' return on equity advantage which, on average, sits comfortably above that of regional banks. In other words, the result of current arrangements arguably benefits the shareholders of major banks rather than customers of all banks.

- Making some adjustments to Financial Claims Scheme (FCS) requirements in APS 910 to consider extending the timeframe for capturing alternate ADI account data beyond the current 24-hour period for existing electronic banking users. An extension would facilitate a smoother transition away from reliance on cheque payments and promote the adoption of electronic payment methods, to drive efficiencies in payment processing. Expanding payment options outside of the two methods of payment – electronic funds transfer (EFT) and cheques might also be considered.

- Fully implementing the objectives of the Regulatory Initiatives Grid (RIG).

Funding
Access to funding could be improved for small and medium-sized banks in a way that increases competition and produces better outcomes for households and businesses by:

- Increasing the covered bonds limit from 8% to 12% of Australian assets (for all banks);
- Making some allowance for covered bonds to be classified as eligible High Quality Liquid Assets (HQLA) for the purpose of the Liquidity Coverage Ratio (LCR) requirements in APS210; and
- Considering re-introduction of the RBA committed liquidity facility (CLF) for small and medium-sized banks.

Entry, scale and exit

We see the role of small and medium sized banks as crucial in providing competition in the delivery of quality and differentiated products and services to consumers, small businesses and rural and regional communities. The present level of consolidation and increased concentration continues to inhibit competition in the banking sector.

Proportion in regulation

Question 1: Do the regulatory and supervisory frameworks strike an appropriate balance between safety, stability, and competition? Please provide examples.

1.01 We believe there is scope for the CFR to enhance three key regulatory and supervisory frameworks to better achieve the appropriate balance between safety, stability and competition. These are:

Capital differentials

- Australia's regulatory capital framework leads to outcomes whereby the largest, most complicated ADIs whose potential failure poses the greatest risk of harm to Australia's financial system are allowed to hold approximately 20% less CET1 capital than smaller, less complex ADIs whose potential failure poses far lower risks to the financial system.

Internal Ratings-Based (IRB) and Advanced Internal Ratings-Based (AIRB) Accreditation Process

- The costs incurred by applicant banks to achieve AIRB accreditation are more able to be borne by larger banks and represent a significant barrier to IRB accreditation by smaller entities.

Major Bank Levy

- We are concerned that if our Bank grows into the levy, being the first non-major bank to do so other than Macquarie, it would not align with the policy intent set by Parliament.

Capital differentials

1.02 Key regulatory and supervisory frameworks result in Standardised banks holding significantly higher amounts of Common Equity Tier 1 (CET1) capital relative to IRB banks.

- In contrast to the view presented in Chapter 3 of the CFR Issues Paper that non-major banks are subject to lower CET1 requirements compared to major banks, the reverse is in fact true when capital is measured on a like-for-like basis.
- For example, our Bank is required to hold approximately **20%** more CET1 capital relative to the four major banks (measured consistently on a Standardised basis). Refer to Appendix 1 for more detail.
- Comparison of regulatory minimum capital requirements or credit risk weighted assets (CRWA) in isolation is not sufficient as this fails to consider the higher Pillar 2 capital adjustments applied to Standardised banks. Comparison of publicly disclosed Board-minimum capital targets is needed to fully understand the impact of differing regulatory capital requirements between banks.

1.03 The differential in CET1 capital requirements between Standardised and IRB banks is primarily driven by higher CRWA that Standardised banks must apply to lending relative to the lower CRWAs IRB banks apply for essentially the same risks using outputs from accredited credit models.

- APRA advise that the average CRWA applied to residential mortgage lending for Standardised banks is proportionally **63%** higher than for IRB banks[1].
- Various safeguards and other differences in capital requirements[2] reduce the overall differential in CET1 capital between us and major banks to around **20%.**
- IRB banks are subject to a higher Capital Conservation Buffer (CCB, which forms part of minimum CET1 requirements). However, publicly stated minimum capital targets for each bank indicate that this is broadly offset by differences in Pillar 2 adjustments[3].
- Our analysis indicates that this capital differential equates to a **25bps** pricing headwind for the Bank in mortgage lending markets, on average, relative to major banks (much higher than APRA's **5bps** estimate[4]). The pricing headwind is significantly higher (up to **80bps**) for the highest quality mortgages. Further details are contained in Appendix 2.

1.04 A key question in the Issues Paper is:

> Taking into account financial system stability, competition and outcomes for Australian consumers and businesses, what is the 'right level' of capital differentiation between Standardised and IRB banks?

1.05 APRA notes that the Standardised approach is conservative and justifies higher CRWAs for Standardised banks on the basis that Standardised CRWAs are "less precise, apply to a wide range of banks and aim to ensure that standardised banks are adequately capitalised on an overall basis".

1.06 We believe that the additional CET1 capital that we are required to hold relative to the major banks should be reviewed because:

- The benefit to consumers is not being realised due to conservative regulatory capital requirements which result in approximately 20% higher CET1 capital requirements for us relative to the major banks. This limits our Bank's ability to

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[1] Figures presented by APRA to the ABA on 30 January 2025: average residential mortgage loan risk weight is 35.6% for Standard banks and 21.8% for IRB banks.

[2] For example, IRB banks are subject to an RWA floor of 72.5% of Standardised RWA's – noting that: 1) APRA view the floor as a backstop that is not expected to be a consistently binding constraint on IRB banks; and 2) latest disclosure indicates that the floor applies to only one of the four major banks (RWA adjustment is c.1% of total RWA in that instance). IRB banks are also required to hold capital for Interest Rate Risk in the Banking Book (IRRBB); Standardised banks are not. It is important to note that the CET1 capital differential between BEN and the major bank average is c.20% after application of these 'safeguards'.

[3] Prudential Capital Requirements (PCR) incorporating Pillar 2 adjustments are not able to be publicly disclosed. However, they can be broadly estimated using published data.

[4] The driver of the difference between BEN's 25bps estimate and APRA's 5bps figure is assumed minimum CET1 capital requirements: BEN uses each bank's disclosed minimum CET1 target (excluding D-SIB buffer) whereas APRA uses regulatory minimum CET1 requirements for Standardised and IRB banks respectively. APRA's approach implies that Standardised banks' minimum CET1 requirement would increase by 1.25% upon receiving IRB accreditation (via increase to the Capital Conservation Buffer (CCB)) and assumes no reduction in Pillar 2 requirements. Under APRA's approach, the benefit of lower CRWA from obtaining IRB accreditation is therefore largely offset by an increase in minimum CET1 requirements. This has the effect of embedding existing competitive disadvantages for small and medium-sized banks – which we believe is inconsistent with the principle of proportionate regulation.

effectively compete in markets for our products for comparable economic returns. At present, we compete directly against the major banks which operate on an IRB basis providing them with up to an **80bps** pricing advantage for residential mortgage lending. A differential also exists for other consumer products such as credit cards, small business lending and lending to family farming businesses.

- It reduces shareholder returns which in turn limits our ability to attract capital needed to invest and remain competitive for the benefit of our customers and communities.[5]

1.07 We consider that these outcomes are detrimental to Australian consumers, businesses and the economy and are inconsistent with the principle of proportionate regulation.

1.08 For example, in the Residential Mortgage portfolio the lowest risk weight achievable for a Standardised bank is 20%. In contrast, the lowest risk weight disclosed in Pillar 3 reports for multiple IRB banks is approximately 6%. Similarly, from these disclosures some major banks have over 60% of their portfolio below the 20% risk weight.

1.09 This suggests that an IRB bank can compete for otherwise high-quality loans on a price/ROE basis at levels more favourable than a standardised bank can.

1.10 One alternative for the Standardised bank is to bid at a price that provides a substandard ROE (which weakens the bank's profitability and hence ability to compete). Another alternative is to compete for higher-risk loans where the pricing provides a good ROE for both banks (which exposes the standardised bank to adverse selection in that the lending book might be made up of mainly lower-quality loans). Both alternatives are problematic.

1.11 To facilitate more effective competition in a way that is beneficial to consumers, the CRWA required to be held against relatively 'vanilla' loans with largely homogenous characteristics across the industry – such as high-quality residential mortgages – could be set as broadly the same regardless of the originating bank. Of course, this is simply one option to deal with the broader issue.

1.12 Additionally, under current regulatory rules, our Bank is required to report a CET1 ratio on a Standardised basis that is more than 100bps lower than the CET1 ratios reported by the major banks on an IRB basis. This is despite the fact that our CET1 ratio is more than 180bps (or around **20%**) higher than the average CET1 ratio of the major banks when measured consistently on a like-for-like Standardised basis. This creates additional headwinds for Standardised banks when accessing wholesale funding and capital markets.

1.13 We would support considering potential options for eliminating or significantly reducing the CET1 capital imbalance between Standardised and IRB banks to level the competitive playing field, thereby enabling small and medium-sized banks to better serve Australian consumers and businesses.

1.14 Some potential options may include:

- Reducing CRWA applied to residential mortgage lending for non-internationally active banks on the Standardised approach in a way that harmonises Pillar 1 CRWA requirements between Standardised and IRB banks. This may involve applying more granularity to Standardised CRWA requirements to better reflect

[5] It is estimated that institutional investors represent c.55% of major bank share registries vs c.43% for BEN as at January 2025.

the broad range of loan types and borrower characteristics[6] in the market. This approach would be relatively straightforward, cost effective and timely to implement. Australia would continue to comply with Basel standards (which only apply to internationally active banks).

- Removing the requirement for small and medium-sized banks to hold RWAs for Interest Rate Risk in the Banking Book (IRRBB) when IRB accreditation for CRWAs is obtained. APRA has previously accredited our Bank as an advanced bank for IRRBB without requiring the Bank to hold additional RWAs specifically for IRRBB. Given that we are already managing interest rate risks in a manner that is consistent with APRA's expectations for advanced banks, requiring additional RWAs to be held for IRRBB when IRB accreditation for CRWAs is obtained would serve no practical purpose. An alternative would be to only apply IRRBB RWA requirements when full accreditation for CRWA is achieved.

Internal Ratings-Based (IRB) and Advanced Internal Ratings-Based (AIRB) Accreditation Process

1.15 The costs incurred by applicant banks to achieve AIRB accreditation are more able to be borne by larger banks and represent an effective barrier to IRB accreditation to smaller entities.

1.16 In particular a significant barrier for Standardised banks to become IRB accredited is that small and medium sized banks need to meet the current or near current standards as the existing AIRB banks, with no proportionate option available, reflecting a similar level of standards achieved by AIRB banks when they were originally accredited.

1.17 We encourage the CFR to consider potential options to make the process for obtaining and maintaining IRB CRWA accreditation simpler, quicker and cheaper for small and medium-sized banks. We recommend that the following potential options are considered:

- Providing greater flexibility for banks to obtain IRB CRWA accreditation for selected portfolios without requiring a pathway to full accreditation.
- Simplifying APRA's 'model use and experience' requirements which currently are pre-requisites for IRB CRWA accreditation.[7]

Major Bank Levy

1.18 The Major Bank Levy (the Levy) has been in force since 1 July 2017 and imposes a levy on ADIs with total liabilities greater than $100 billion indexed with GDP (currently $151.1 billion).

[6] Standardised banks are currently required to apply the same CRWA to a given loan regardless of the customer's credit quality, whereas IRB banks are able to model customer credit quality when determining CRWA requirements. This provides IRB banks with an unfair advantage relative to Standardised banks and allows them to offer lower rates to customers with stronger credit quality. A way to address this situation would be to incorporate some consideration of customer credit quality at origination into the methodology used to ADIs determine Standardised CRWA's.

[7] This is a requirement that outputs from an IRB models are embedded in its credit risk management practices – for example, having risk-based pricing, incorporating advanced portfolio metrics in executive remuneration scorecards etc. It is challenging for a bank managing its capital on a standardised basis to imbed advanced metrics. A potential solution would be to relax the initial requirements for IRB accreditation and cap the RWA benefit until an ADI can demonstrate it is meeting those requirements.

1.19 The Levy is imposed at a rate of 0.015% on a quarterly basis. The rate is set according to certain liabilities of the ADI that are reported to APRA. Commonwealth Bank, Westpac, ANZ, NAB and Macquarie are all currently subject to the levy.

1.20 It would be appropriate to ensure the Levy threshold only captures domestically systemically important banks (D-SIBs). This is because, in practice, the major banks and Macquarie pay less in wholesale funding costs due to the upgrades they receive from rating agencies as they are considered "too big to fail".

1.21 The ratings agencies assign them a higher rating because they have formed the view these banks are implicitly guaranteed by the Australian government.

1.22 Through ongoing dialogue with the ratings agencies, our Bank has established it is very unlikely that a similar upgrade would be provided to our Bank even in the event that our Bank grows above the Levy threshold.

1.23 We are concerned that if our Bank grows into the Levy, being the first non-major bank to do so other than Macquarie, not only would it impede our competitiveness, but it would also not align with the policy intent set by Parliament. In the Second Reading speech to the House of Representatives in 2017, the Treasurer made clear the Levy is designed to level the playing field for smaller banks in noting:

> *"Importantly, it will also support competition in the financial system by providing a more level playing field for smaller banks and other providers of financial services who compete with the larger banks who enjoy cheaper costs of funding.*
>
> *Australia's five largest banks are highly profitable – earning more than $30 billion a year after tax – and benefit from a regulatory system that has helped to embed their dominant position in the market. For example, the major banks are accredited to use internal ratings-based models that allow them to reduce the amount of capital that they must hold, lowering their funding costs relative to the smaller banks who rely on standardised risk weights.*
>
> *They also contribute to systemic risk through their scale and concentration to the financial system—risks that ultimately fall on the broader Australian community."*[8]

1.24 We recommend the threshold be reset at a higher level to ensure our Bank does not grow into it without benefitting from the wholesale costs reductions enjoyed by D-SIBS given the founding rationale for charging the Levy should continue to apply.

Question 2: Are regulators' approaches to regulation and supervision (including tiering and implementation approaches) suitably proportionate, efficient and effective, having regard to the size, complexity and risks associated with different segments of the banking sector?

2.01 We recognise the importance of ensuring Australia's financial system continues to be strong, trusted and reliable for all its stakeholders. The quality of our regulatory system is a public good and the role it plays in protecting the financial sector makes it one of Australia's most important assets.

[8] Commonwealth. *Parliamentary Debates*. House of Representatives. 30 May 2017. Retrieved from: https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22chamber%2Fhansardr%2F1193e673-a44e-49cb-8d25-79a2a354a02a%2F0004%22

2.02 In general, as a non-major bank, the costs associated with regulatory compliance take up a greater share of our expense base than our larger peers. This leaves less investment available for product and service innovation, technology development, and digitisation – all placing greater strain on our ability to compete. This has implications for competition in the sector and ultimately our customers.

2.03 In particular:

- Requirements for new regulation are mostly uniform, regardless of the size or complexity of an authorised deposit-taking institution (ADI). For smaller ADIs, such as Bendigo Bank, this results in substantial implementation and compliance costs relative to the major banks. For example, the majority of initiatives contained in Edition 1 of the Regulatory Initiatives Grid (RIG) are set to take place in the first half of 2025 which may well result in the skills market for staff qualified to implement and respond to initiatives contained in the RIG being dominated by the major banks.

- Over the past couple of years, the volume, complexity, and pace of regulation impacting the financial sector continues to grow. Increased regulatory requirements means increased expenditure on regulatory focused technology solutions, redirected focus of boards and senior management as well as the hiring of additional compliance, IT and legal staff. This is particularly the case if there is not careful sequencing of reforms between regulators. Further coordination and sequencing via the RIG would achieve competitive benefits by reducing skills shortages in key areas and allowing a greater focus on the customer's 'user experience' for banking products and services.

- The impact of the Consumer Data Right (CDR) is a relevant example of the unintended consequences. Mid-tier, international and regional banks have spent more than $600 million implementing CDR regulation allowing data recipients to receive customer banking data.[9] This is despite consumer uptake of the CDR remaining below 0.5% of bank customers. On other measures, the investment to deliver CDR also shows to be similarly relatively higher for mid-tier banks – CDR costs are 2 – 3x higher as a share of both overall costs and revenue – requiring difficult investment trade-offs to be made. The higher costs incurred for mid-tier banks, such as the CDR, is generally the case for all regulation when compared to the major banks.

Supervisory and Reporting framework

2.04 We believe regulatory, supervisory and reporting frameworks would benefit from being proportionate to the size and risk of the ADI. ADIs should be tiered on a systemic risk basis and the tiers should be consistently applied in regulatory, supervisory, and reporting frameworks. These could potentially be based on APRA's existing supervisory tiers. This is discussed further in our response to Question 3.

2.05 We believe a proportional approach to regulation will protect competition in the financial services sector without compromising consumer outcomes and safety or financial stability.

Impact of civil penalty provisions

[9] Analysis prepared by the Australian Banking Association

2.06 As another example, recent approaches to civil penalties (e.g. in the *Privacy and Other Legislation Amendment (POLA) Bill 2024*) may lessen competition due to small and medium sized banks being required to operate with the risk that an administrative-based compliance error might cause a proportionately greater financial impact in comparison to the same error being made by a larger ADI.

2.07 This can create a more risk averse mindset in small and medium sized ADIs.

Question 3: Are regulators' data collections and reporting requirements proportionate? If not, please provide specific examples of requirements that could be adjusted (e.g. frequency) or removed.

3.01 Overlap on data reporting and collection requirements can be subject to duplication both within regulators and between regulators.

3.02 Our experience as an ADI is similar to the findings made in the Financial Regulator Assessment Authority's (FRAA) 2023 report: *Effectiveness and Capability Review of the Australian Prudential Regulation Authority* which assessed the effectiveness and capability of APRA's supervision and resolution of the superannuation industry.

3.03 The review found:

> *"APRA should invest in systems and processes to promote better internal collaboration and coordination between frontline supervision and specialist teams to ensure data and information requests issued to regulated entities have a well-defined purpose. This will help to reduce duplicative data collections, and to the extent appropriate, minimise regulatory burden. APRA will need to ensure its internal systems and processes support collaboration and coordination and address existing issues such as limited integration of different systems, and constrained tracking of workflows and status updates across functional areas"*[10].

3.04 We are of the view that similar benefits could be achieved through greater internal collaboration and coordination between frontline banking supervision staff and specialist teams. Further benefits might be obtained through greater regulatory coordination (e.g. via the RIG) or information sharing of information between regulators on regulatory topics that overlap. For example, the overlap between work on problems loans, customer vulnerability and financial hardship issues being undertaken by APRA, the BCCC and ASIC respectively.

Question 4: Are current financial system protections for consumers appropriate? Are there any steps that could be taken to improve consumer outcomes?

4.01 Consumer outcomes could be improved by granting permanent membership of the ACCC to the CFR. Granting the consumer protection agency a seat on the CFR ensures that competition is formally considered during decision-making about regulation and supervision of the financial sector. More formally incorporating competition matters into prudential decisions has the potential to support the smaller banks, ultimately benefiting consumers.

4.02 We also note some key financial system protections for consumers do not apply to non ADIs. This can create an unlevel playing field. For example, as the Productivity Commission noted:

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[10] Financial Regulator Assessment Authority (2023). *Effectiveness and Capability Review of the Australian Prudential Regulation Authority.* Page 59, Paragraph 3.123. Retrieved from: https://fraa.gov.au/sites/fraa.gov.au/files/2023-07/apra-assessment-report-2023.pdf

"The FCS (Financial Claims Scheme) does not extend to deposit-like products issued by non-ADIs to retail investors".[11]

4.03 Non-ADIs also operate in a gap in existing regulatory policy settings that can impact consumer protection and financial stability. As noted by Treasury:

"ASIC is the primary regulator of non-ADI lenders, but it does not have a financial stability mandate. While APRA has the appropriate mandate (financial stability), it has little direct influence over non-ADI lenders (that are RFCs (Registered Financial Corporations)) and only a limited indirect influence in respect of other non-ADI lenders."[12]

Question 5: Are there changes that could be made to resolution tools (including the FCS) that would enhance the balance between safety, stability and competition in the overall regulatory framework?

Pre-funding the FCS

5.01 We refer to the ABA's position outlined in their submission around pre-funding.

Expanding payment options

5.02 To align with the broader transition away from cheque-based payments by 2028, an expansion of payment options to include more modern and widely accepted payment alternatives such as the New Payments Platform or bank transfers should be considered. This would not only ensure alignment with an evolving banking sector but also better meet customer expectations for convenience and efficiency in payment processing. We would also welcome an extension of the timeframe for capturing alternate ADI account data.

Funding

Question 6: What are the key funding issues faced by the small and medium banks sector? What are the most important to you and why? Are there any further issues that you would like to raise?

6.01 Our Bank has a strong and well diversified funding profile. The cornerstone of our funding profile is our large portfolio of customer deposits – comprising transaction accounts, savings accounts, term deposits and mortgage offset accounts – which represent approximately 76% of our total funding. Our deposit franchise is complemented by wholesale funding programs that are diversified by tenor, product, investor type and location (domestic and offshore markets).

6.02 Perhaps the most significant impediment we face from a funding perspective is the view held by some credit rating agencies that the major banks would benefit from higher levels of government support during a crisis relative to non-major banks. This contributes to significant disparities in long term credit ratings between major banks and non-major banks which in turn:

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[11] Productivity Commission, 'Competition in the Australian Financial System – Inquiry Report', 29 June 2018, at page 186. https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system.pdf

[12] Treasury, Regulation Impact Statement Treasury Laws Amendment (Banking Measures No.1) Bill 2017– Non-ADI Lender Rules, October 2017. Retrieved from: https://oia.pmc.gov.au/sites/default/files/posts/2017/11/non-authorised_deposit-taking_institutions_adi_lender_rules_-ris.pdf

- limits access to wholesale funding markets (due to investor mandates which place greater restrictions on investments in lower rated credits compared to higher rated credits); and

- increases funding costs (for example, the Bank is currently required to pay 25 to 30bps of additional credit spread to investors relative to major banks).

6.03 Combined, these factors impede our ability to compete and grow.

6.04 We continue to highlight to credit rating agencies the fiscal, monetary and regulatory support provided by Australian policymakers during prior periods of market stress (notably, the 2008/09 global financial crisis and the 2020/21 COVID period) – emphasising that we are not aware of an instance where government support has been provided to major banks only and the disconnect to rating outcomes.

Question 7: What steps could industry or the government take to improve access to funding for small and medium banks to increase competition in, and the competitiveness of, the Australian banking sector? What are the costs and benefits of these, including for bank customers?

7.01 See our response to Question 8.

Question 8: What changes could be made to existing regulations to contribute to a more competitive funding market? What are the risks and benefits of such changes? How would customers benefit from such changes?

8.01 We would welcome the following changes to improve access to funding for small and medium-sized banks in a way that increases competition and produces better outcomes for households and businesses:

- Increase the covered bonds limit from 8% to 12% of Australian assets (for all banks);

- Make some allowance for covered bonds to be classified as eligible High Quality Liquid Assets (HQLA) for the purpose of the Liquidity Coverage Ratio (LCR) requirements in APS210; and

- Consider re-introducing the RBA Committed Liquidity Facility (CLF) for small and medium-sized banks.

8.02 Increasing the covered bond limit from 8% to 12% of total Australian assets would allow greater access to the benefits of this funding source. The incremental funding capacity provided by increasing the issuance limit to 12% could be used to support additional lending growth. We note that there are many countries in Europe where there is no legislative limit on covered bonds issuance, including the UK, France, Germany, Sweden, Denmark and the Netherlands.

8.03 These benefits could be further amplified if covered bonds were eligible for inclusion in banks' high quality liquid assets (HQLA holdings):

- Covered bonds are highly resilient in times of stress and secondary market liquidity has improved since covered bonds were first introduced in Australia 2011.

- Allowing covered bonds to be held in banks' HQLA holdings would provide an additional market for these assets.

- Importantly for non-major banks, this would provide additional funding opportunities in the domestic market, reducing their reliance on offshore markets.

8.04 Re-introducing the RBA CLF for small and medium sized banks would reduce funding requirements for those banks, enabling them to better compete and grow.

- The CLF operated effectively while in operation over the period 2015 to 2022.
- It enabled banks to meet HQLA requirements in accordance with APS210 requirements at a time when there were insufficient government bonds on issue to satisfy bank requirements.
- Bank funding requirements increased when the CLF was removed (incremental funding needed to be sourced to purchase additional government bonds).
- Reintroducing the CLF would allow that funding to be used to grow customer lending to the benefit of Australian households and businesses.

Entry, scale and exit

Question 9: What is the role and impact of the small and medium banks in providing competition? How does this benefit consumers?

9.01 Small and medium banks can offer a physical presence in regional and metropolitan communities at a time when larger banks are focusing more on online services. Importantly, our Bank remains the last branch in town for around 125 communities - with many of these locally owned and operated Community Bank branches. We see strong benefits in our physical branch presence that provides in person banking services benefits to our customers and communities, particularly in regional and rural Australia.

9.02 Smaller and medium sized banks can also be more agile and innovative. In fact, in many instances innovation is necessary given price competition against major banks is challenging for the reasons set out in this submission. Our Bank has also been an innovator for the benefit of customers, increasing competition in the sector. Our innovation track record includes:

- Several key firsts:
    - Australia's first mortgage offset account in 1990.
    - Australia's first financial institution to launch a Visa debit card in 1992.
    - Australia's first Farm Management Deposit (FMD) Offset account, the first of its kind in the market, in 2016.
- First Australian bank to offer a digital home loan application and assessment process under its own brand, BEN Express, using Tiimely Home technology under a white label partnership.[13]

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[13] BEN, 'Bendigo Bank to offer TIC:TOC technology to Australian consumers', 16 November 2018: https://www.bendigobank.com.au/media-centre/bendigo-bank-to-offer-tictoc-technology-to-australian-consumers/; BEN, 'Bendigo Bank hits $100 million BEN Express target', 23 November 2022: https://www.bendigobank.com.au/media-centre/bendigo-bank-hits-$100-million-ben-express-target/.

- Our digital bank, Up, which operates as an independent brand of Bendigo Bank and has grown to more than 1 million customers since it launched in 2018.[14] One of Up's underpinning objectives has been to improve financial literacy by helping young Australians save effortlessly and spend wisely.[15]

- We also offer innovative white label home loan products. For example, in February 2023 Qantas has begun offering a digital home loan product[16] with the loan product and funding provided by Bendigo Bank[17]

Question 10: How does the nature and extent of competition differ across different banking products and market segments (e.g. mortgages, credit cards, small business lending)? Please provide examples.

10.01 In our experience, customers will benefit from a more level playing field and healthy competition across all products. We have drawn out further examples in relation to mortgages and agribusiness lending below.

Mortgages

10.02 As noted in our earlier responses the requirement for small and medium sized banks to hold more capital impacts our ability to provide competitive lending rates to customers that compete with major banks and other AIRB accredited banks.

Agribusiness

10.03 Agribusiness is a specialist segment in Australian banking, which requires tailored management and solutions to support farmers with their specific financing needs over the longer term. A specialist approach is required as agribusiness is subject to significant volatility, particularly in respect of seasonal and regional conditions, international trade flows, commodity prices and natural disasters. The cyclical and volatile nature of agribusiness requires farming customers and their financiers to adapt and adopt a tailored approach to the sector to provide flexibility and stable long-term funding.

10.04 There are considerable barriers to entry and expansion in the agribusiness banking markets for the following reasons:

- **Expertise Gap:** Providing effective agribusiness banking requires deep industry knowledge, not just traditional financial expertise. Banks need dedicated relationship managers who understand the nuances of farming businesses in the context of the region and industries in which they operate. Cultivating this specialised and geographically diverse workforce demands substantial investment, making it challenging for new entrants to compete with established players.

- **Relationship Capital:** Agribusiness customers prioritize long-standing relationships with their bankers, often spanning generations. This strong preference for

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14 Up, 'Up Home: Everything you love about Up, in a home loan", 20 July 2022: https://up.com.au/press-releases/up-home-everything-you-love-about-up-in-a-home-loan/.
15 See more about Up here: https://up.com.au/about/.
16 Qantas Money, 'Qantas Money Home Loan': https://www.qantasmoney.com/home-loans.
17 Banking Day, 'Bendigo and Adelaide backs Qantas Money home loan', 7 February 2023: https://www.bankingday.com/bendigo-and-adelaide-backs-qantas-money-home-loan.

established relationships creates a significant barrier to entry, as new banks struggle to build trust and credibility within the agribusiness community.

- **High Initial Investment:** Beyond the expertise gap, entering the agribusiness banking market requires substantial upfront investment in technology, infrastructure, and risk management models and systems tailored to the sector's unique needs. This initial cost burden further discourages potential entrants.

Question 11: How has consolidation in the banking sector impacted competition?

11.01 In its financial stability assessment of Australia, the International Monetary Fund (IMF) stated:

> *"Each of the major banks has consolidated group assets that rank them among the top 50 banks worldwide, but their businesses are not global and generally focus on the domestic and New Zealand markets".*[18]

11.02 Consolidation in the banking sector has impacted competition in the banking sector by:

- Increasing the market concentration in the hands of the major banks. For example, the majority of higher profile ADI acquisitions in recent years have been by major banks including Suncorp Bank, Citi and 86400, amongst others.
- Further entrenching structural impediments to growth by smaller banks facilitated by increased scale.
- Impeding non-major banks (such as ours) to achieve scale that would provide further efficiencies and enable us to more vigorously challenge the dominance of the major banks by providing a stronger differentiated offering to win market share.

Question 12: What are the regulatory, consumer and market trends affecting small and medium banks' competitiveness?

12.01 We refer to the Australian Banking Association's submission.

Question 13: What specific barriers and challenges have entities experienced when trying to increase their competitiveness?

13.01 We refer to the Australian Banking Association's submission.

Question 14: What would be the characteristics of high levels of competition in the banking sector?

14.01 We see the characteristics of high levels of competition in the banking sector as a greater focus on customer outcomes leading to a higher level of customer satisfaction; more innovation and agility in developing customer focused services and products; and greater overall trust in the sector.

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[18] International Monetary Fund (IMF), 2019, *Australia: Financial System Stability Assessment,* IMF, Washington, page 58. Retrieved from: https://www.imf.org/en/Publications/CR/Issues/2019/02/13/Australia-Financial-System-Stability-Assessment-46611

14.02 Our Bank is consistently recognised as Australia's most trusted bank,[19] and has received many industry awards for its customer service and home loan offerings.[20]

14.03 We believe we could benefit consumers even further with a more level playing field.

Question 15: What competitive pressures from sectors outside, or adjacent to, the banking sector are impacting the competitiveness of small and medium banks (e.g. mortgage brokers, non-bank financial institutions, payment providers, expansion of major tech companies and platforms in payment services and financial services)?

15.01 We refer to the Australian Banking Association's submission.

Question 16: Are there barriers to entry (including inefficiencies in licensing frameworks), expansion, and exit? If so, what are these barriers and how could they be removed?

16.01 We refer to the Australian Banking Association's submission.

Question 17: Are there private sector led initiatives that could address some of the issues being faced by the small and medium banking sector? Please provide examples.

17.01 We refer to the Australian Banking Association's submission.

Question 18: How can the risks and benefits of utilising third-party providers be appropriately balanced when being used to achieve scale?

18.01 Our Bank sees utilisation of third-party providers as an important mechanism to achieve scale and compete with the major banks.

18.02 In our view the benefits of third-party providers are:

- The ability to source customers via a large network of product distributors such as loan brokers, which mitigates geographic risk with a broker network spread across Australia.
- Less fixed cost burden, particularly for non-major banks like ours.
- Greater access to a range of credit risk appetites and product offerings.

Question 19: What regulatory or supervisory changes and/or initiatives could be made to assist small and medium banks in gaining benefits from scale?

19.01 Please see our responses to Questions 1-5.

[19] Roy Morgan, 'Roy Morgan Trust Brand Awards 2022: Australia's most trusted financial services firms', 2 November 2022. Retrieved from: https://www.roymorgan.com/findings/9083-trusted-brand-awards-financial-companies.

[20] DBM, 'DBM Australian Financial Awards 2022', March 2022. Retrieved from: https://www.dbmconsultants.com.au/dbm-australian-financial-awards-2022/; RateCity, 'RateCity Home Loan Gold Award Winners', 14 February 2023: https://www.ratecity.com.au/home-loans/awards.

Question 20: How have customer trends relating to multi-banking changed over time? How does multi-banking affect the ability for banks to compete in the provision of different banking products?

20.01 We refer to the Australian Banking Association's submission.

Question 21: Is there a minimum scale of bank necessary to compete effectively whilst meeting customer expectations with respect to a safe, "always on", efficient digital environment (e.g. minimum downtime, effective scam mitigation, cyber risk mitigation, AML protections etc.)?

21.01 Yes. At present our Bank is executing on a significant digital transformation to enable us to build scale and remain competitive as part of meeting our customer needs across multiple business channels and sectors across the community.

21.02 In 2020, our Bank was running eight core banking systems and set clear and ambitious targets to simplify, consolidate and modernise. We have since consolidated to three core banking platforms; halved the number of business systems/IT applications; and shifted 56% of applications to the cloud.

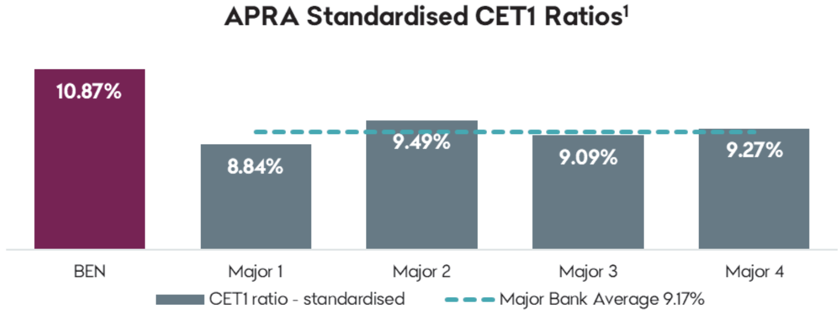
21.03 In particular, we have created strategic partnerships and invested in Australian FinTechs and digital businesses as part of creating scale for our own business, while also doing the same for others such as Qantas and IAG Group through the white labelling of services as a third party provider.

21.04 Our strategic technology partners are key to our approach. They help us expand our technology services to support growing demand, as well as enable greater resilience across our critical business services, while also strengthening Security to protect our Customers, the Community, as well as our systems and data from the likelihood of scams and fraud.

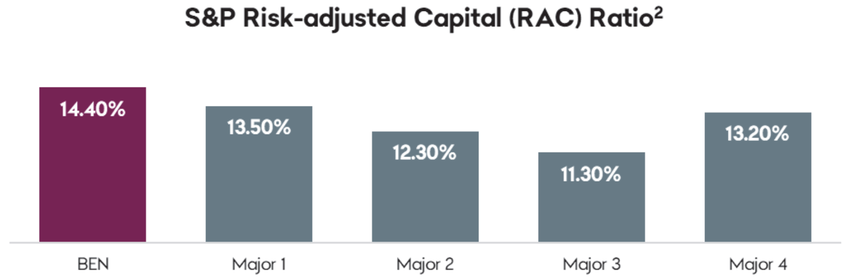
21.05 The investment needed to achieve these outcomes is very considerable for an entity our size. For example, our Bank continues to make large investments to ensure the same level of protection of our customers from fraud as a major bank. Notwithstanding this, we have a smaller revenue base against which we can spread these costs compared to the majors.

Bendigo Bank

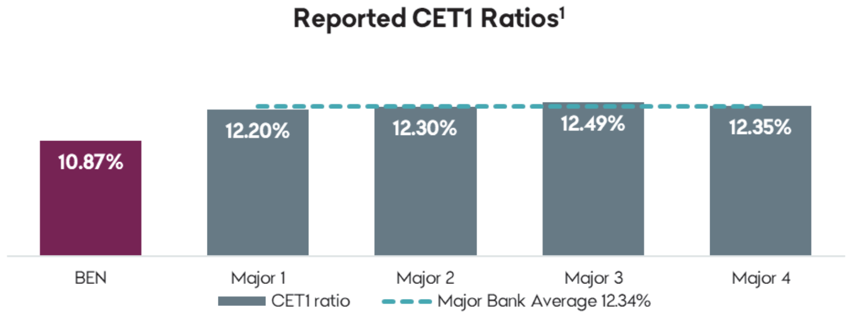
Appendix 1: Comparison of Capital Ratios: BEN vs Major Banks



BEN CET1 ratio is **170bps** or **c.20%** higher than major bank average when measured on a like-for-like basis …



These relativities are supported by S&P's methodology … BEN's Risk-Adjusted Capital (RAC) ratio is **182bps** or **c.15%** higher than major bank average.



… yet our reported CET1 ratio is **147bps** or **c.12%** lower than major bank average.

1. Peer comparisons sourced from Sep-24 Pillar 3 disclosures, with exception of Major 2 sourced from Jun-24 disclosures.
2. S&P Risk-adjusted Capital (RAC) Ratio: Majors 1, 3 and 4 as at Mar-24. Major 2 as at Dec-23. BEN as at Jun-24.

Appendix 2: Comparison of BEN and APRA Mortgage Pricing Calculations

The table below shows key assumptions used by BEN and APRA when determining the impact of differences in capital requirements between Standardised and IRB approaches on mortgage pricing.

	APRA		BEN	
	Std	*IRB*	*Std*	*IRB*
CET1 Capital Target	8%	9.25%	10%	10%
Average Residential Mortgage RWA	35.6%	21.8%	35.6%	21.8%
Expected Loss adjustment	Nil	1.7%	Nil	Nil
Credit Conversion Factor for Undrawn Amount	40%	100%	40%	100%
IRRBB Adjustment	Nil	5% of RWA	Nil	5% of RWA
Pricing Differential	**5bps**		**25bps**	

The driver of the difference between BEN's 25bps estimate and APRA's 5bps figure is assumed minimum CET1 capital requirements:

- BEN uses each bank's publicly reported minimum CET1 target (excluding D-SIB buffer) as this represents each bank's binding constraint for capital management purposes. The D-SIB buffer is excluded on the basis that it applies to banks whose distress or failure would cause significant dislocation in the financial system and adverse economic consequences due to their size, market importance and interconnectedness. None of the Standardised banks are classified by APRA as systemically important financial institutions, therefore it is appropriate to exclude the D-SIB buffer from this analysis.
- APRA uses regulatory minimum CET1 requirements for Standardised and Advanced banks respectively.

APRA's approach implies that Standardised banks' minimum CET1 requirements would increase by 1.25% upon receiving Advanced accreditation (via higher Capital Conservation Buffer (CCB)) without any reduction in Pillar 2 requirements - in which case, the benefit of lower CRWA from obtaining Advanced accreditation is broadly offset by an increase in minimum CET1 requirements.

This has the effect of embedding existing competitive disadvantages for small and medium-sized banks and we believe is inconsistent with the proportional regulation objective.

BEN excludes the Expected Loss adjustment on the basis that only one of the four major banks have this adjustment applied as at latest reporting date and it is immaterial (c.0.5% of CET1 capital). It has an immaterial impact on the pricing outcome.