

Friday 7 February 2025

[REDACTED]
CFR Review into Small and Medium Banks
Treasury
Canberra ACT 2600

Via email – CFRReview@treasury.gov.au

[REDACTED]

ING's submission on the Council of Financial Regulator's (CFR) Review into Small and medium-sized banks

ING Bank Australia Ltd (IBAL) appreciates the opportunity to provide a response to the CFR's Review into small and medium-sized banks and we value the engagement we have had with the CFR as part of this review.

As a digital bank pioneer, IBAL has always prioritised customer focused innovation to meet the financial needs of Australians. Over the past quarter of a century, more than two million Australians have trusted us with their banking needs.

We are proud of the way our differentiated business model changed the competitive landscape of 'at call' savings in Australia. Similarly, previous reviews into mortgages have suggested IBAL, as a medium-sized bank, has also helped to drive competition across the mortgage landscape via its broker-led distribution approach.

In this paper we offer observations and ideas to ensure small and medium-sized banks can continue to offer choice to consumers and continue to change the competitive dynamics in the Australian market. Within the terms of reference, we do this against the assertion that there is more to be done to ensure proportionate regulatory settings:

*"The review seeks to include the CFR and ACCC's views on how competition and dynamism in these sectors can be better supported. As well as what steps may be taken to improve regulation to ensure increased proportionality and an appropriate balance between competition, innovation and stability."*¹

The following submission highlights the regulatory challenges faced by banks like IBAL along with recommended solutions to create a playing field that is proportionate, fair and delivers better outcomes for consumers within a stable system. We urge policy makers to adopt competition-enhancing policies that reflect the diverse operating models within Australia's banking industry and continue to encourage new banks to enter – as IBAL did in 1999.

We welcome any further engagement on these matters.

Kind regards,

[REDACTED]

Section 1: Proportionality in Regulations

Small and medium-sized banks are vital for driving competition in banking, which ultimately

¹ Small and medium-sized banks Review – terms of reference

delivers better outcomes for Australian customers.

While current regulatory frameworks are critical in maintaining the safety and stability of the financial system, they impose a disproportionate burden due to the fixed costs of compliance, particularly when building new technology and processes. Due to the high burden of fixed costs to develop and build, we assert small and medium-sized banks are investing disproportionate amounts of profit compared to that of larger banks.

Despite the government announcing a commitment to proportionality, we are yet to see anything in practice. The Regulatory Initiatives Grid published in December 2024 is silent on this as an approach.

Current Challenges and Possible Solutions

CPS230

CPS230 is a multi-disciplinary standard with the aim of ensuring APRA-regulated entities are resilient to operational risks and disruptions. The requirements apply equally to all regulated entities, without any distinction between SFIs (significant financial institutions) and non-SFIs.

Recommended Solution:

Different thresholds and timeframes for small and medium-sized banks would make it more efficient and cost effective. For example, enabling major banks to complete their documentation and assessment for shared third parties first (e.g. Telstra, Optus, Google, and Adobe) would reduce duplication and make the process more efficient for small and medium-sized banks.

Compliance across multiple jurisdictions: CPS230 and the Digital Operational Resilience Act

As a member of an international banking group, IBAL is also required to meet regulations imposed by other jurisdictions. ING operates in Australia with full acceptance of the extra requirements involved. However, we do want to make Australian regulators aware of the similarities across the jurisdictions.

For example, the Digital Operational Resilience Act (DORA) issued by the European Banking Authority prescribes obligations aligned to CPS230.

Recommended Solution:

On occasion, the implementation of global regulations coincides with local regulatory obligations, resulting in extra resourcing and costs. Consideration should be given to extending timelines for banks operating across jurisdictions, with the obligations imposed by global regulators providing a degree of assurance of compliance with Australian regulations and market practice.

APS220 Credit Risk Management

Streamlining digital onboarding and credit decision processes is a priority for banks, as it will help keep costs down, improve the customer experience and enhance the overall ease of doing business. APS220 (paragraph 40) encourages this by enabling scalable and flexible approaches to credit assessments. Conversely paragraphs 53-57 describe traditional techniques to assess credit risk, focusing more on personnel than systems.

Recommended solution:

In March 2020 the ABA issued a request to APRA recommending the inclusion of a provision for ADIs to utilise an automated decision engine to determine credit applications.

While we note that feedback was taken onboard by APRA and changes were made to the accompanying Prudential Guide APG220, the guidance requires further clarification to make the references to automated decisioning models clearer.

IBAL recommends APRA revisit this guidance, returning to the first principles of scalability and flexibility outlined in paragraph 40 of APS220.

Competition as an area of focus

If the CFR endorses the need for competition beyond the four pillars in the Australian banking system, it seems unusual that the ACCC is not a member of the CFR. Competition should be seen as an important outcome of a highly regulated industry creating significant profits.

Recommended solution:

The ACCC join the CFR with a focus on bringing a competition lens to discussions.

Section 2: Funding

For context, IBAL is the only bank outside of the major banks with IRB accreditation for the purpose of calculating capital adequacy.

IBAL commends APRA for phasing out the use of Additional Tier 1 (AT1) capital requirements. This is an excellent example of how a regulator has considered the impact on smaller banks when implementing regulatory changes.

Through this change, non-Domestic Significant Important Banks (D-SIBs) can meet Tier 1 capital requirements entirely through CET1. This simplifies processes and reduces the need for additional, costly capital instruments.

While this is a step in the right direction to achieve proportionality, IBAL (and other small and medium-sized banks) face higher costs and limited access to wholesale funding markets compared to larger banks. This is due to the majors' size, credit rating and expectations of government support.

Wholesale markets provide diversification in funding and are a vital tool for smaller banks to grow. That said, this is a more expensive form of funding than retail deposits and this growth comes at a higher marginal cost.

To improve competitiveness, small and medium banks need greater access to cheaper forms of wholesale funding such as covered bonds and parent funding.

Recommended Solution:

1. Broaden the Domestic Covered Bond Market.
 - a. Increase the issuance limit for covered bonds from 8% to 12% to a 15% of a bank's Australian assets, allowing more issuance by small and medium-sized banks
 - b. Classify covered bonds as High-Quality Liquid Assets (HQLA) level 2 to expand the investor base and satisfy banks' regulatory liquidity requirements
2. Remove Withholding Tax

- a. Eliminate withholding tax to grant small, medium-sized and international banks greater access to offshore wholesale deposit markets. This would result in savings for customers as it would enable foreign banks like IBAL to access offshore markets through their parent at a lower cost.

While not applicable to IBAL, given IRB accreditation, we support the notion that achieving accreditation in entirety, or in some form is critical for other small and medium-sized banks currently without accreditation. We support a scaled model and more clarity if the industry can lower the cost of capital and achieve better outcomes for customers.

Section 3: Competition

The CFR’s review into small and medium-sized banks arises in the context of broader concerns regarding the competitiveness of Australian financial services markets which are dominated by a limited number of large participants. It is noteworthy that the Treasurer’s announcement of the CFR Review also referred to the Government’s response to the ACCC’s *Inquiry into retail deposit products* completed in 2023 and the ACCC’s *Inquiry into home loan pricing* completed in 2020. IBAL broadly agrees that there are regulatory, structural, and behavioural aspects of relevant Australian market settings which may limit the ability of small and medium-sized banks to compete to a greater extent.

IBAL recognises the public interest in an appropriate regulatory regime. That said, IBAL encourages the CFR in the context of this review, and more broadly, to consider the competitive impact of its recommendations and whether these promote competition for the benefit of consumers. IBAL submits that the ‘one size’ or ‘face neutral’ rules and regulations which do not account for differences in business models may limit competition on the merits of each offering and impose additional costs on smaller market participants to the detriment of the market overall. Of particular concern to IBAL would be any proposals which, in effect, transfer benefits to dominant market participants.

Small and medium-sized banks often adopt more aggressive pricing strategies to attract customers, leading to better deals, innovative practices, and other unique market solutions. Inquiries into the competitive nature of the banking system by the ACCC have confirmed that small and medium-sized banks are important in upholding the benefit of a competitive market for all Australians. For example, the ACCC’s *Inquiry into home loan pricing* highlighted that IBAL’s approach to home loan pricing had a positive impact on competition in the market.

The charts below show alternative business models have led to a more competitive market structure. The business models of small and medium-sized banks have provided choice to customers and Australians have benefited from price, service and product competition.



In recent years, the market has experienced several failures or acquisitions by larger players (e.g. Suncorp, Citibank, Xinja, 86,000, Nano and Volt). Reported reasons behind these mergers/failures have included:

- Capital treatment that favours larger banks, which have more sophisticated risk models for calculating risk-weighted assets.
- Ongoing increases in fixed costs, including regulator and compliance costs, technology investments, vendor expenses and personnel costs.
- Difficulty accessing affordable funding sources, putting their margins under greater pressure.

Banks that cannot cover the cost of capital, cannot grow in a manner acceptable to shareholders and as evidenced, are forced to exit the market. Regulatory settings need to appropriately consider and respond to existing barriers of growth.

Recommended Solutions:

We encourage Treasury and the CFR to consider adopting a tiered regulatory framework. New Zealand's Proportionality Framework is a good example of an approach that would help small and medium sized banks efficiently manage their regulatory obligations while continuing to drive competition.

We endorse the proposal put forward by the ABA that would see three tiers of regulation:

- Tier 1 institutions with domestic assets greater than \$200 billion and/or institutions that are more complex in structure and business practice.
- Tier 2 institutions with domestic assets between \$20 billion and \$200 billion. These institutions are larger than the non-SFIs but do not approach the size or complexity of the larger institutions.
- Tier 3 institutions with domestic assets below \$20 billion. This would reflect the existing non-SFI pool (notwithstanding the upcoming review of the SFI definition, there remains a distinction between the nature of the smallest institutions and the existing mid-tier of banks).

In the context of promoting competition, regulators should consider how different ADI business models improve consumer choice and outcomes in the banking market. For example, a digital only business model might lessen the need for regulation in certain areas.

The adoption of different business models should be seen as evidence of market innovation and competition because success or otherwise will be determined by customer choice. It should not be seen as an unfair advantage that needs to be levied through regulation or, most concerningly, through transfers of value from smaller participants to the dominant providers in circumstances where additional costs will have a real impact on competitive outcomes.

Solutions minded

For 25 years IBAL has brought innovative and attractive banking services to more than 2 million Australians. For the sake of maintaining competition in banking and promoting customer choice, we encourage Treasury and the CFR to consider the recommendations in this response and apply a more proportionate approach to regulating the industry.

Ends