



NATIONAL AUSTRALIA BANK SUBMISSION

Council of Financial Regulators

Review of Small and Medium-sized Banks

February 2025

Introduction

National Australia Bank (**NAB**) welcomes the opportunity to provide feedback to the Council of Financial Regulators (**CFR**) in consultation with the Australian Competition and Consumer Commission (**ACCC**)’s Review into Small and Medium-sized Banks.

NAB’s submission is guided by the questions in the Issues Paper and does not address some questions that are specifically for small and medium banks. Some responses address multiple questions.

Executive Summary

Australia is recognised as having one of the most secure and stable banking systems in the world. This security is underpinned by the Australian Prudential Regulation Authority (**APRA**) framework. Striking the appropriate balance between safety and protections for deposit-holders, the stability of the overall system and ensuring competition at times requires trade-offs between these important objectives.

Competition in the banking sector is important to drive innovation and ensure the best outcome for consumers. Small and medium banks play an important role in competition. Australian banks compete not only with each other, but also with FinTechs, mortgage brokers, Buy Now Pay Later (**BNPL**) providers, and international financial institutions. The ACCC’s 2023 Retail Deposits final report noted that over the past decade, the number of authorised deposit-taking institutions (**ADI**) in Australia holding retail deposits has increased, and the share of household deposits held by the major banks has decreased slightly.¹ The ability to hold and switch deposits and the low (or zero) cost of holding a savings account means customers often “multi-home” across multiple financial institutions to take advantage of different product features. Customer preference, and the ability to move money almost instantly between accounts held with different financial institutions, allows Australians to take advantage of different product features and offers. This ability drives competition and innovation in the sector, including between big banks and smaller institutions. Improvements in technology and innovation in the payments sector (including the New Payments Platform (**NPP**)) both responds to, and further facilitates the trend.

While rebalancing regulatory and supervisory frameworks can assist small and medium banks to remain competitive, many of the challenges faced by these institutions are not necessarily regulatory and are often more inherent to smaller organisations. For example, as noted in the Issues Paper, cyber security is a key threat for large and small banks, so less stringent requirements are not appropriate.² The cost of addressing risks such as these is rising and the availability of talent to manage and mitigate them may be harder and more expensive to find. Industry initiatives, such as the establishment of Australian Financial Crimes Exchange (**AFCX**), can mitigate these challenges and help small and medium-sized banks keep their customers safe.

On the proportionality of regulation, APRA’s prudential framework differentiates between obligations for Significant Financial Institutions (**SFIs**) and non-SFIs, considering size, complexity, and systemic significance. Changes to the ADI licensing framework, such as the 2018 introduction

¹ACCC’s 2023 Retail Deposits final report found ‘major banks have maintained a relatively stable share of retail deposits over the past 2 decades... collective share peaked at 81.5% in 2015 and decreased to 73.0% in June 2023’.

APRA Monthly ADI statistics, September 2023, showed the number of ADIs in Australia has increased over the period 2019-2023, and the share of household deposits held by the major banks has steadily decreased while the share of household deposits held by the non-major ADIs has increased from 19% to 27%.

² Issues Paper, p15.

of the 'Restricted ADI' licensing pathway³, have reduced regulatory barriers to entry. While there are some areas where further refinement of the prudential framework could lessen the regulatory burden on small and medium banks, this must be carefully balanced against the stability of the system. The failure of a small bank may be less impactful at a system level but its impact on customers and depositors would be significant. NAB supports the continued focus on high resilience requirements, as any bank failure(s) will have widespread impacts on the reputation of Australian banks, perceptions of regulatory effectiveness, and customer confidence in the system.

Proportionality in regulation

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

Banks have significant reporting obligations to APRA, the Australian Securities and Investments Commission (ASIC), and the Reserve Bank of Australia (RBA). APRA's prudential framework differentiates between obligations for SFIs and non-SFIs, in acknowledgement that the burden of regulatory compliance can be more significant for small and medium banks. A current example of proportionality in regulatory obligations is prudential standard CPS900, Resolution Planning, which does not automatically apply to non-SFIs, as noted in Figure 1 of the Issues Paper.

Prudential standard CPS230, Operational Risk Management, is an example of an obligation which requires considerable time and resources from banks to ensure compliance, which may disproportionately burden small and medium banks. Changes to this prudential standard, effective 1 July 2025, such as a 12-month extension on certain requirements for non-SFIs may reduce its additional compliance challenge for small and medium banks. In addition to giving non-SFI's more time to comply with regulatory changes, consideration could be given reducing or removing some CPS230 obligations for non-SFIs, as asking these institutions to undertake the same degree of operational risk management as an SFI may not be proportionate.

Any adjustment or lightening of regulatory requirements for different tiers of financial institutions should be carefully weighed against maintaining the stability of the overall system.

- 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.**

In some instances, it may be appropriate for large banks to report more regularly than small and medium banks. An example of this is the CPS330 disclosure requirement, which could potentially be lightened for non-IRB (**internal ratings based**) SFIs. Regulators could evaluate how reporting from all participants is utilised, in the context of the burden it is placing on the reporting entity to provide it. Regulators may wish to consider where monthly reporting can be reduced to quarterly, or quarterly to semi-annual, especially for small and medium banks.

³ APRA, 2018, 'APRA finalises new Restricted Authorised Deposit-taking Institution licensing framework'.

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

As noted in the Issues Paper, a core protection for Australian consumers is the Financial Claims Scheme (FCS), a government-backed safety-net for deposits of up to \$250,000 per account holder per ADI. NAB supports the current scope of the FCS. Regarding potential improvements raised in the Issues Paper, such as the speed of access to funds, there may be future opportunities for refinement granted technology improvements (such as the NPP). NAB considers that changes to the FCS to ensure customers continue to be adequately protected over time would provide greater benefit than a slight reduction in payment times.

One potential improvement that should be considered is the annual indexation of the \$250,000 per account holder per ADI threshold. While a static cap is reasonable for a set period, the impact of higher inflation (particularly in recent years) means that the consumer protection is reducing in real terms.

Another way to ensure the FCS continues to adequately protect consumers could be a review mechanism of the FCS threshold, for example every three or five years or in response to another trigger. The last review was conducted over ten years ago,⁴ which means that the unchanged threshold does not currently offer the same level of protection in real dollar terms.

NAB does not support pre-funding the FCS. As noted in the Issues Paper, this would impose a significant cost on banks, in particular small and medium banks. This weakened competitive pressure, combined with the likelihood some of this cost may be passed on to depositors, would produce a worse outcome for consumers.

Funding

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?**

As noted in the Issues Paper, since 2017 there has been little difference in the implied funding cost for the major banks and small to medium banks.⁵ Scale and complexity deliver some benefits to major banks, such as the ability to access funding, but equally imposes additional costs, such as higher technology costs, costs associated with regulatory obligations, and additional imposts such as the major bank levy.⁶ The funding mix for different sized banks is influenced by a complex range of factors and commercial decisions, as well as prudential regulation.

APRA's capital requirements and risk weights differentiate between IRB and non-IRB banks (standardised banks). While on a headline level, small to medium banks have higher risk weights ascribed to their assets, there are offsetting aspects within the capital framework that significantly reduce this capital differential, including materially higher capital buffers (now increased post APRA reforms to Additional Tier 1 capital), additional risk types (i.e., Interest Rate Risk in the Banking

⁴ 'The Inquiry recommends maintaining the current ex post funding model for the FCS, while noting that the cap of \$250,000 is relatively high compared to other countries', 2014, Financial Systems Inquiry Final report.

⁵ Issues paper, p10.

⁶ Issues paper, p12.

Book) and loss absorbing capacity requirements. Taking a holistic view of the capital costs yields little difference between the small and medium banks and the major banks, with all very strongly capitalised within an international context.

While NAB supports in principle reducing the burden of regulatory compliance, this is on the basis that the banking system continues to be supported by robust capital levels. Caution should be taken when considering any changes to the current capital framework that reduce its risk sensitivity or that make assumptions on the relative credit quality of portfolios across banking institutions.

One possible change that has been put forward to improve access to funding for small and medium banks is to increase the issuance limit for covered bonds. Increasing the issuance limit for covered bonds from 8% to 12% of total assets could result in increased access to liquidity, including for small to medium banks, as well as potential decrease in price of borrowing for customers.

A trade-off of this proposal is that increasing the cap could be considered a deviation from APRA's position that ADIs are expected to prudently diversify their funding sources. Implications to the Net Stable Funding Ratio and interactions with liquidity provisions should be carefully considered.

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?

Beyond changes to CPS230 discussed in response to question two, APRA is intending to consult on APS 210 Liquidity in 2025, presenting an additional opportunity to reduce or lighten the regulatory burden on small and medium banks. Potential revisions to this prudential standard include broadening the definition of high-quality liquid assets (HQLA) to include covered bonds and other AAA rated instruments, thereby allowing Liquidity Coverage Ratio (LCR) banks to hold such assets as part of their HQLA portfolio to meet APRA's liquidity requirements. This in turn will deepen the domestic market for, and support small banks' issuance of, such instruments.

NAB's response to the 2024 RBA consultation on the Future System of Monetary Policy Implementation proposed establishing an intermediate layer of liquidity provision (referred to as 'prudential liquidity provision') which falls between the existing RBA open market operations (maximum term of 28 days) and the recently introduced Exceptional Liquidity Assistance (ELA). The purpose of prudential liquidity provision is to enhance financial stability, with such a facility designed to remediate or prevent a temporary shortage of prudential liquidity becoming a situation where ELA may be required. This proposal may support the objective of having the right balance between safety, stability, and competition in the overall regulatory framework.

Entry, scale, and exit

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

Without the scale to compete as full-service banks across all products and capabilities, small and medium banks adopt various strategies to differentiate themselves, which ultimately supports competition and choice for consumers. This often results in high customer satisfaction referrals (for example 41% of ING and 52% of Up customers are referred by existing customers, as compared to 20% for CBA, 23% for ANZ, 21% for NAB 21% and 17% for WBC).⁷

⁷ Bain NPS Prism, 2024 'Consumer Banking Survey Q2 2023 to Q1 2024'.

Many small and medium banks use price-led strategies to attract customers, promoting competitive pricing across the industry. Particularly for retail products, small and medium banks will typically have some of the most competitive rates in market.

Small and medium banks also play an outsized role in serving and providing competition to regional and rural communities and promoting/driving competition through geography-based strategies. Bendigo Bank's community banking model is an example of this strategy, however several other small and medium banks, particularly those with history as regional credit unions, focus on serving particular parts of regional Australia (e.g. Heritage and People's Choice/People First Bank, Great Southern Bank Queensland Country Bank).

Other small and medium banks have targeted strategies driving competition and choice for customers (e.g. Bank of Queensland (BOQ) Specialist – a tailored offering for medical practitioners, or Rabobank's agribusiness offering). Further, small and medium banks may also focus on developing specific product policies such as Lender's Mortgage Insurance waivers (which form part of People's Choice and ME Bank's essential service worker propositions).

Finally, some small and medium banks have also driven competition through capability/innovation-led strategies such as Macquarie's home lending platform.

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.

NAB faces significant and continuing competitive pressure to obtain and retain retail deposits. Over the past decade, the number of ADIs in Australia holding retail deposits has increased and the share of household deposits held by the major banks has continued to decrease.⁸ NAB competes for retail deposits with major and regional banks, overseas banks, wealth companies, mutuals and Fintechs. The entry of ADIs and the growth of their market share of retail deposits is facilitated by the increasing ease with which consumers can switch between or open deposit accounts.

Retail banking (home lending, consumer deposits, credit cards) is the primary focus for most small and medium banks (58% of ADIs, excluding majors, have lending to households while 68% hold deposits) and all non-international banks have a higher exposure to households than their international counterparties.⁹

SME banking is offered by fewer banks, but remains a focus for banks such as Bendigo, BOQ, Macquarie, and Rabobank, and is the primary focus of Judo Bank. Non-bank lenders are another source of competition; in 2023 the RBA found that "non-bank lending in Australia has grown rapidly since 2015, driven mostly by mortgage lending where growth has averaged almost 15 per cent on a six-month annualised basis – more than twice the rate recorded by banks".¹⁰

⁸ ACCC, 2023, Retail Deposits final report.

⁹ The exception is Judo Bank, although greater than 50% of their liabilities are to households.

¹⁰ RBA, 2023, 'Non-bank Lending in Australia and the Implications for Financial Stability'.

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

Third party distribution (as highlighted in the Issues Paper) in both home lending and increasingly in SME lending has increased the distribution access and competitiveness of small and medium banks. The rise of private credit (i.e. sources of capital outside the banking system) could have mixed impacts to small and medium banks by providing additional sources of capital but in turn potentially increasing the complexity of these smaller institutions.

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

There are a range of characteristics which can indicate high levels of competition in the banking sector including:

Customer switching - Customers can move money between accounts held with different ADIs, in pursuit of certain product features. The ABA's customer trends for 2023 showed that 1 in 6 Australians switched their main bank account, with 48% citing competitive pricing or value for money as the main driver, indicating the presence of healthy competition in the sector.¹¹

Usage of brokers (consumer and business lending) - Mortgage and commercial finance brokers have facilitated customer switching in the lending market and continue to facilitate switching for SME customers.

Amount of choice for consumers - A wide range of choice is available to customers across factors that are important to them e.g. product features, points of presence, customer service, price.

Innovation and improved customer offerings - significant ongoing investment from banks in meeting their consumer's preferences, i.e. for a seamless digital banking experience, suggest the presence of strong competition for customers between the banks, and subsequent pressure on delivering the best customer experience.

Profitability - Understanding and comparing profitability across jurisdictions (using metrics such as net interest margin (NIM) or return on assets and equity) can be an indicator of the level of competitive pressure in a banking system. As noted in the Issues Paper, the profitability of Australian major and medium banks is comparable with large banks in other jurisdictions.

Number of new entrants to the market - examples of new entrants include Judo Bank, which offers a range of term deposit products, and Alex, which is a digital bank offering both savings and term deposit accounts.

Market share - As noted in the consultation paper, several small and medium banks have increased their market share in the past five years, and the major banks' share of lending markets has declined from its peak in 2009.¹²

¹¹ Australian Banking Association, 2023, 'Bank on it: Customer Trends 2024 report'.

¹² Issues Paper, p5.

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)?

Banks face increasing competitive pressure from FinTechs and emerging digital platforms, including BNPL products. The emergence and rapid growth of the BNPL sector is an example of innovation giving consumers increased choice. In 2023, the RBA found that “almost one-third of Australians had used a BNPL service in the past year, up around 8 percentage points from 2019”.¹³

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.

Small and medium banks can benefit from sector-led initiatives funded by the major banks. Industry wide initiatives, tools or data sharing arrangements create economies of scale, which can mitigate potential disadvantages faced by smaller institutions.

An example of this is the AFCX, an independent, not-for-profit organisation that was formed by the four major banks to centralise and share intelligence to combat financial crime. It operates independently of government, law enforcement and its members, although is member funded.

Joining the AFCX gives members access to an active threat library, knowledge centre, and incident management capabilities. Members include the Australian Taxation Office (ATO), and recently Meta has announced a partnership with the AFCX to pilot a dedicated scam reporting channel.¹⁴ This is an example of a private sector led initiative, funded by the major banks, which gives smaller banks or other institutions access to the same level of data and threat detection, potentially mitigating issues they may face due to their size or more limited resources.

Another example of an industry initiative which can enable and facilitate a more competitive and dynamic banking industry is the development of the NPP. Since its launch in 2018, this fast payment infrastructure has delivered enhanced security, greater flexibility, and richer transaction data to customers. It also enables FinTechs and other digital banking services to leverage the open access ecosystem and enhanced payment infrastructure and provide new and innovative banking products. Currently, over 100 banks, credit unions, FinTechs and other organisations use the platform.¹⁵

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?

The trend towards multi-banking, also called the ‘unbundling’ of banking, refers to the consumer trend towards holding accounts or products across multiple financial institutions.¹⁶ This trend is underpinned by improved technology and payment infrastructure, removing friction for customers, and facilitating them to take advantage of a broad range of product offerings, by tailoring the mix of features and account types that fit their specific needs.

¹³ Livermore T., Mulqueeny J. Huyen T and Watson B., November 2023 ‘Research Discussion Paper: The Evolution of Consumer Payments in Australia: Results from the 2022 Consumer Payments Survey’, RBA

¹⁴ Stephen Jones, Anna Bligh, Heidi Snell, 2024, ‘Press conference on the expansion of the AFCX scams intelligence loop’

¹⁵ Australian Payments Plus, ‘Delivering more value to Australia- Revolutionising the flow of money’

¹⁶ Verschuere B., Jul 2023, ‘The Great Unbundling of Banking’, Forbes

This change in behaviour is in turn driving banks to innovate and offer new products to meet this demand. One example of this is NAB's digital only bank, Ubank, who's mobile app function which allows customers to view a summary of their balance, spending habits, and upcoming direct debit payments across multiple accounts held with up to 140 available financial institutions.¹⁷ Ubank also allows customers to input their pay cycles, view predicted bill amounts (e.g. utilities), and categorise transactions into spending categories. In addition to transaction accounts, customers can also integrate some investment and superannuation accounts into this feature.

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.)?

As discussed in question nine, small and medium banks may specialise in a more targeted offering or market position, which allows them to compete effectively.

For some of these more specialised offerings, the consumer demand for 'always on' service may be less significant, compared to other products such as deposit and transaction accounts.

However, scam and cyber risk mitigation presents an ongoing threat across the financial sector. While some initiatives, such as the AFCX may assist small and medium banks by providing access to data and monitoring from larger banks, less resourcing, and the reduced availability of specialist talent in these fields may render small and medium banks less equipped to meet these challenges and protect their customers. This is a challenge inherent in a small organisation and is difficult to fully mitigate while ensuring a high level of protection to customers.

Conclusion

NAB welcomes the opportunity to provide this submission to the CFR and is happy to discuss any aspect of our response in further detail.

¹⁷ 'Why our app- see your money more clearly', Ubank website.