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Council of Financial Regulators
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By electronic submission

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Review into Small and Medium Sized Banks (“The Review”)

We welcome the review by the Council of Financial Regulators into the competitive issues faced by small and medium banks.

Revolut Payments Australia Pty Limited (Revolut Australia) has applied for status as a full Australian Deposit Taking Institution (ADI) and is currently proceeding through APRA's application process. Upon receipt of a banking licence we expect to be classified as a “small bank” in terms of assets and liabilities with aspirations to become a “medium” bank. As such, we are highly interested in policy and regulation relating to this sector of the industry.

About Revolut Australia

Revolut Australia is part of the global Revolut group (Revolut), a financial technology group of companies offering a range of financial services to retail and business customers in over 40 countries. Revolut was founded in 2015 in the UK and now has over 50 million retail customers and 10,000 employees globally. Revolut is one of the UK's fastest growing technology companies. Revolut operates as a bank within the European Zone, supervised by the European Central Bank and is in the process of operationalising its UK bank licence which was granted (with restrictions) by the Bank of England in 2024.

Revolut Australia received its Australian Financial Services Licence in May 2020 and launched to the public in August 2020. Revolut Australia also holds an Australian Credit Licence. We currently offer a range of financial services including payment, foreign exchange, investments in stocks, commodities and crypto, and personal loans. Overall, we have in excess of 500,000 Australian customers.

Although we do not yet have bank status, our management team and directorship consists of individuals with many years of banking experience across banks of various sizes.

Revolut's vision is to reinvent how the world does money by building the world's first truly global financial superapp. We believe in empowering our customers by giving them financial freedom.

Response to Discussion Paper

We have addressed only those questions where we have a particular view or knowledge which we think may be of interest to the Council.

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

We believe that Australia has achieved a generally good balance of regulation within the banking sector which compares well with the other jurisdictions in which Revolut operates. Although banking is subject to more individual regulators in Australia than many overseas jurisdictions, there is relatively little duplication and overlap and each regulator has strong expertise in its own domain. Within the overall structure there are always elements that could be reviewed and improved.

We have noted a particular emphasis in recent years on the expectations placed on Bank directors and the personal liabilities which they are subject to, including disqualification, under the Financial Accountability Regime. While there is no doubt that directors of a bank need to accept high responsibility, we are concerned about the continued attractiveness of directorship, particularly amongst smaller banks where the reward to risk proposition we think has become unevenly balanced. We would urge the Government and the Council's members to be mindful of this in the formulation of future regulation so that directors do not become further exposed. To encourage professional directorships of small banks the Government could consider, for example, a cap to the liability of directors of Non Significant Financial Institutions (Non-SFIs).

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?

We see a general acceptance amongst regulators and law makers that a one size fits all approach is not an efficient means of regulating banking. In some areas of regulation (e.g Money Laundering and Privacy) this is achieved through principle based regulation that allows market participants to choose appropriate policies or work systems to their scale, while in others the expectations of different sized organisations are more prescriptive (e.g many APRA standards and Corporations Act provisions.) Small and Medium sized organisations can struggle with interpreting regulatory expectations where regulations are principles based. For those regulators we would encourage more guidance, transparency and even partnership with participants with smaller organisations to communicate those expectations.

We think that the division of SFI's and non SFI's within APRA standards is a very useful recognition of the respective risks. While all ADIs have a high duty as the custodian of customer

deposits (and any loss of funds by customers would be equally devastating to individuals regardless of the institution's size) the small and medium banks clearly have lower risk of disrupting the financial system or causing contagion risk. We would encourage APRA in its future reviews of Standards to consider additional areas where categorisation could relieve excessive burden on smaller banks without increasing systemic risk.

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

We believe that the current levels of consumer protections strike an appropriate balance. All banks are subject to compliance with consumer protections that derive either from their status as a bank (Banking Act and APRA standards) or from the product and service relationships which they have with customers. Since the late 2000's consumer protections have been significantly strengthened (through for example the National Credit Protection Act and the Future of Financial Advice amendments to the Corporations Act). The Royal Commission made it clear that despite the existence of such regulations, behaviour by some banks still led to poor customer outcomes. As a result, more emphasis is now placed on governance and individual accountabilities through the Financial Accountability Regime. We have also seen recognition that customers should not be expected to be legal experts or have the inclination to read long disclosures which has resulted in the introduction of Target Market Determinations and regulatory interventions which aim to rectify that balance. Our credit laws even put the onus on lenders to restrict lending to customers who deliberately lie about their financial means and resources. Where regulation is breached, customers have easy and free access to an independent and free complaints service / tribunal through the Australian Financial Complaints Authority.

Revolut Australia believes that the current framework of protection and redress is now adequate and there is no requirement for additional consumer protections. The focus should now be on ensuring that the current regulations are adhered to. Banks should not be required to compensate for every risk, error of judgment and even misrepresentation made by consumers. To that effect, we strongly support the government's proposals in respect of scam losses such that banks which take reasonable measures to protect their customers should not be liable. This policy position recognises that consumers still need to take some responsibility for their actions (particularly if they are warned of the scam).

The costs of compliance involve fixed costs (e.g. minimum personnel, compliance and legal review of all collateral, development of compliance systems) and variable costs (e.g. responsible lending reviews of each credit application and AML checks). The fixed costs must be incurred before any sort of scale is reached - making compliance cost per customer very high for small banks and new entrants. (see comments under question 21 relating to Scale.)

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?

The FCS has been extremely important in producing some levelling of the playing field in

competition for deposits between smaller and larger banks. Without the government guarantee we expect that smaller banks would now struggle to raise deposits as consumers would move to the perceived safety of the larger banks.

We note that the \$250,000 guarantee has now been in place for 16 years without indexation. While \$250,000 no doubt protects the majority of depositors and would allow savvy depositors to split their deposits between institutions, there are some instances where a deposit needs to be pooled into one bank account (such as accumulating funds for a property purchase or receiving settlement funds.) We would encourage the Council to review the current level of deposits over \$250,000 held by ADI's and consider whether a higher or indexed level may be appropriate or whether there could be certain types of accounts (e.g. where risk cannot be dispersed between multiple banks) where a higher amount could be guaranteed.

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?

The Council's report rightly points out the adverse effect of lower credit ratings of smaller banks in the cost of wholesale credit. We note the S&P comments that credit ratings are impacted by *"constrained business positions, less access to diverse and stable funding sources, and lower expectations of government support as drivers of lower credit ratings for smaller banks."* This is somewhat circular, as the lower credit ratings themselves impact access to diverse and stable funding. Most credit rating formulas are backward looking and favour high capital ratios while failing to account of banks' internal investment, meaning that credit ratings favour banks who do not invest in building operational resilience. This is likely to be counter-productive, particularly for smaller banks where the cost difference in wholesale funding between lower credit grades can encourage a short term focus at the expense of long term investment in risk management. The Council's analysis of the Implied Funding Costs emphasises the importance of the FCS in allowing the smaller banks to retain a high deposit to loan ratio in order to remain competitive.

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?

We think that the APRA could further refine its differentiation of its standards and expectations applicable to large and small banks. We think that recent amendments that differentiate between SFIs and Non SFIs is a good start, but that more could be done. For example, new entrants are typically required to hold capital at several hundred basis points above their established competitors. While this may appear a prudent approach to the risk of an unproven bank entrant, it also makes it harder for that entrant to raise capital and achieve profitability, thereby increasing the risk of failure.

Furthermore, small to medium-sized banks do not have the resources to apply for "Advanced Bank" status, with the potential for the capital reduction achievable by the major banks through

that status. This means that new entrants are unlikely to ever be on a level playing field in respect of required capital ratios.

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

We believe that the small and medium banks play a crucial role in providing competition. Industries with few competitors are characterised by low innovation and generally low levels of price competition between incumbents as they adopt oligopolistic behaviors. We think New Zealand (where we have recently applied for a bank licence) provides a useful case study of a banking industry where little competitive pressure over decades has led to low innovation and high consumer costs.

When Revolut entered the Australian market in 2020 (albeit as a payment provider, rather than a bank) foreign exchange was an area where banks were making exceptional profits by charging both fees and exchange rate mark ups.¹ Through the services of Revolut, Wise and other fintechs operating in the FX space, not only have customers had access to world leading currency exchange processes (in terms of ease and speed of transactions) but we have seen the larger banks respond by reducing their fees across a range of foreign exchange services, such as international remittance and international card transaction fees.²

Increasing competition in the banking industry will continue to provide opportunities for new entrants to create innovative services and to offer lower prices and transaction costs. To retain customers, the large banks will also be forced to innovate and reduce prices. This can only result in benefit to customers.

11. How has consolidation in the banking sector impacted competition?

The number of Retail ADI's has decreased by over 30% in the last decade as a result of consolidation, in particular amongst the smaller mutual banking sector. We expect further consolidation in the industry as digitisation has largely removed the need for physical branches, which was a large driver of community banking. There are still around 80 banks competing for the 20% of the retail market left by the big 4 banks. Consolidation amongst the smaller banks should provide the additional scale which is needed to operate a sustainable bank in the 21st century. The alternative to consolidation is the market exit of those participants that cannot achieve scale. The reduction in the number of competitors should therefore sustain what would otherwise be a continuing reduction in competition. Of course there would come a point where consolidation led to a small number of large banks which would ultimately inhibit competition, but the industry is currently far from that point.

¹ See ACCC Foreign Currency Conversion Services Inquiry - [Final Report 2019](#)

² See ACCC [media release](#) and Report of July 2024.

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, nonbank financial institutions, payment providers, expansion of major tech companies and platforms in payment services and financial services)?

Although the vast majority of bank profitability derives from credit products, consumers' daily interaction with their banks is based primarily around payment products. Those products have significant costs attached to them, although customers have come to expect free or cheap access to such services. Banks typically make little or no profit from these services but they can be a significant differentiator in attracting customers. In recent years there has been significant changes in the delivery of payment services. Some companies, like Revolut and Paypal have been able to achieve sustainable models based on consumer payments by offering specific user experiences at such a scale that small individual transaction fees with low costs can still result in profits. Payments profitability is much more difficult to achieve in jurisdictions which limit bank interchange, and hence Australia has seen significantly fewer competitors in payments than the USA where interchange is much higher.

As financial services become fully digitised and Millennials and subsequent generations of consumers (who only want to engage digitally) become a larger proportion of banking customers, the user experience of financial apps will become increasingly important. Small banks will no longer have the internal resources to develop their own digital systems as they will not have the scale to recover the fixed development costs. Their choices will be either to merge with other banks or to outsource their technology. In the last several years we have seen the entry of new businesses based on the concept of "banking as a service" which can supply the platforms needed to compete in the digital age including the full suite of payment services. Recent entrants include Constantinople, Starling Bank and Shaype. We think that these type of entrants will have a significant impact on retaining existing competition by decreasing the scale which would otherwise be required to operate a bank into the next decade.

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?

Banking in Australia does, and should, have high barriers to entry. The important question is whether the barriers are too high to facilitate healthy competition. For new banking entrants the key barriers are:

1. The raising of sufficient capital; and
2. The ability to achieve a banking licence.

Both of these factors weigh on each other. We note that changes have occurred in the last decade in an effort to encourage new entrants, including a reduction of start-up capital and the introduction of the Restricted ADI (RADI) pathway in 2018. A key driver of the RADI process was to make fund raising easier for banking startups since investors could see a likely pathway to bank licensing at an earlier stage. The number of applicants who have begun the RADI process is not public, but of the successful RADI applicants, 3 of the 5 have rescinded their licence due to an inability to continue to raise sufficient capital. We are therefore doubtful that

the RADl process on its own will achieve the intended purpose of encouraging competition.

The pathway to full bank licence in Australia is a long one. Although APRA suggests it is achievable within 18 months, that is a best case scenario and we are not aware of any recent applications being concluded close to that target. While part of those delays are due to the readiness of applicants, a significant part also appears due to resourcing constraints within APRA. In the period between lodging a licence application and achieving a full licence a start up bank must fund its start-up costs and employ all the resources needed to run a bank. Typically this would require a minimum of around 100 personnel. In that period the applicant may choose to commence payment services (under an AFSL) and may commence lending (under an Australian Credit Licence), however, there is little ability to operate profitably on thin payment margins and wholesale funding for start-up lenders is very difficult to achieve at any significant scale. This means that start up banks typically have very high cash burn rates for 3 or more years before achieving a bank status. Consequently, they require significant capital input from investors even before raising the minimum capital required by APRA at bank commencement.

Revolut Australia has had the advantage of being part of a global well capitalised business that has supplied our local capital and has a proven business model operating at global scale which has allowed us to minimise cash burn during the application process. Although the opportunity still exists for other local entrants which have business models that can sustain a lengthy licence application process, more entrants could be encouraged if the licence applications process were significantly shortened.

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.

We have discussed the increased utilisation of third parties under question 15.

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

Requirements already exist within APRA standards covering governance and controls relating to third parties. These are being brought together under a more holistic framework covering operational resilience with the forthcoming commencement of CPS 230. We believe that CPS 230 provides an appropriate framework of standards for the oversight and governance of third party relationships which will be needed by most new entrants to achieve a profitable scale. We note that CPS makes provision for ADI's to develop systems and processes which are appropriate to the size of those organisations and has allowed Non-SFI's an extra year to comply. While this is useful for new entrants and smaller banks it remains quite hard to interpret what APRA's expectations are for different scales of ADI. We think it would be useful for APRA to consider an SFI / Non SFI distinction in future iterations of the standard.

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.)?

If a start up full-service, digitally based retail bank were to attempt to insource all of its IT systems, processes and payments connections from the outset, then we expect, based on our experience, that it would need to be operating with a customer base in the millions in order to achieve a profitable scale. No recent entrants we have seen have attempted this. Revolut Australia’s strategy is to leverage its group “TechCo” (internal service provider) for the provision of technical services. This provides scale advantage that new local players may not have access to. Our TechCo serves multiple jurisdictions covering over 50 million customers globally. Even then, Revolut Australia still uses local partners in certain areas such as local payments connectivity.

We do not think there is any magic number of customers or scale that makes a bank profitable and sustainable. Rather, the scale requirement is entirely dependent on a bank entrant’s business model. A new small bank may be able to outsource many functions (including core ledger, payments, APP UX, AML monitoring) providing it can do so at a reasonable gross margin. This will likely mean it will need to concentrate on high margin revenue streams rather than trying to provide all services to all customers.

We trust that these comments have been of use to the Council’s deliberations. If you would like any further information or elaboration, please contact [REDACTED]

Regards

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