

# Review into Small and Medium-sized Banks

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Report to Government by the Council of Financial Regulators, in  
consultation with the Australian Competition and Consumer Commission

July 2025

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## Glossary

ACCC	Australian Competition & Consumer Commission	FCS	Financial Claims Scheme
ADI	Authorised Deposit-taking Institution	FDIC	Federal Deposit Insurance Corporation (US)
AFS	Australian Financial Service	FSCS	Financial Services Compensation Scheme (UK)
APRA	Australian Prudential Regulation Authority	FSI	Financial System Inquiry (2014)
AML	Anti-money Laundering	FSSA	<i>Financial Sector (Shareholdings) Act 1998</i>
APS	Australian Prudential Standard	FSSSA	Financial System Stability Special Account
ASIC	Australian Securities and Investments Commission	FSTRA	<i>Financial Sector (Transfer and Restructure) Act 1999</i>
BCBS	Basel Committee on Banking Supervision	GDP	Gross Domestic Product
CCA	<i>Competition and Consumer Act 2010</i>	GFC	Global Financial Crisis
CDIC	Canada Deposit Insurance Corporation	HQLA	High-Quality Liquid Assets
CDR	Consumer Data Right	IRB	Internal ratings-based (approach to credit risk)
CET1	Common Equity Tier 1 Capital	LCR	Liquidity Coverage Ratio
CFR	Council of Financial Regulators	Major Banks or Majors	The 4 largest banks in Australia: ANZ (Australia & New Zealand Banking Group) CBA (Commonwealth Bank) NAB (National Australia Bank) WBC (Westpac Banking Corporation)
CHT	Canada Housing Trust	MEI	Mutual equity interest
CMB	Canada Mortgage Bonds	MSS	Multi-seller Securitisation
CMHC	Canada Mortgage and Housing Corporation	National Credit Act	<i>National Consumer Credit Protection Act 2009</i>
COB	Customer-Owned Banks, also known as building societies, credit unions and mutual banks	NHA	<i>National Housing Act (RSC, 1985, c. N-11) (Canada)</i>
COBA	Customer Owned Banking Association	NIM	Net Interest Margin
CPS	Consolidating prudential standards	RBA	Reserve Bank of Australia
CUBS	Credit Unions and Building Societies	RIG	Regulatory Initiatives Grid
CUFFS	Credit Union Financial Support System	ROA	Return on Assets
D-SIB	Domestic Systemically Important Bank	ROE	Return on Equity
EFT	Electronic Funds Transfer	RMBS	Residential mortgage-backed security
ELA	Exceptional Liquidity Assistance	SFI	Significant financial institution
ESA	Exchange Settlement Account	SME	Small and medium-sized enterprises
FATA	<i>Foreign Acquisitions and Takeovers Act 1975</i>	T2	Tier 2 Capital

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## 1. Executive summary

The Treasurer asked the Council of Financial Regulators (CFR), in consultation with the Australian Competition and Consumer Commission (ACCC), to examine small and medium-sized bank competition. This report responds to the Terms of Reference for the Review by examining:

- the role and state of the small and medium-sized banking sectors in providing competition
- the regulatory and market trends affecting their competitiveness
- current and potential sources of and barriers to competition from these sectors.

The role and state of the small and medium-sized banking sectors in providing competition – including regulatory and market trends affecting their competitiveness – is primarily examined in ‘Chapter 4: Competition in the banking sector’. The current and potential sources of, and barriers to, competition in these sectors are mainly considered in subsequent chapters of this report, which set out proposed changes to support competition.

The CFR makes 9 recommendations for the Government and sets out 9 actions for agencies involved in this Review. These actions will be independently taken forward by regulators. Collectively, the CFR considers that this suite of complementary proposed changes would assist with improving the competitiveness of small and medium-sized banks. Consistent with the Issues Paper, ‘small and medium-sized banks’ refers to those authorised deposit-taking institutions that are not the four major banks.

### 1.1 Competition in the banking sector

A competitive and dynamic banking sector is critical to promoting better outcomes for households, businesses, the economy and society. Competition drives innovation. It encourages overall value for customers according to their evolving needs and preferences. It can also play an important role in enhancing productivity.

Banking products are critically important to the welfare of Australians. Consequently, there is a need for robust regulation of the sector. This includes conduct regulation, which is required to ensure market integrity and to protect consumers and investors, and prudential regulation, which underpins financial safety and stability of the sector and the broader economy. Safe banks promote customer and investor confidence, which supports competition.

This regulatory environment, along with the high fixed-costs banks incur to operate in the market, tends to favour banks with economies of scale. The CFR has therefore assessed the banking sector against the features of ‘workable’, rather than ‘perfect’, competition.

The CFR considers there are features of workable competition apparent in Australia’s core banking product markets to varying degrees, although none show all the features to a high degree.<sup>1</sup> In banks’ largest lending market, residential mortgages, stakeholders generally indicated that competition had

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<sup>1</sup> The term ‘workable competition’ is defined on page 23.

intensified in recent years – in this market, certain features of workable competition are evident. In general, small and medium-sized banks are providing competitive pricing in their core products. They are also an important source of non-price competition, including access to services such as branches in rural areas.

While the major banks continue to dominate the banking sector, making up nearly three-quarters of total banking assets, their market share in key markets has fallen by around 5-10 percent from its post-Global Financial Crisis (GFC) peak. For example, in mortgage lending, medium-sized banks have picked up market share, including due to Macquarie's expansion, while small banks have generally maintained their market share. However, the reduction in the market share of major banks has been partially offset by ANZ Bank's 2024 acquisition of Suncorp Bank. By international standards, the major banks' market share remains broadly comparable to those of large banks in other international markets.

For small and medium-sized banks, the fixed costs they incur are spread across a smaller number of customers relative to the major banks, meaning they typically operate with higher cost-to-income ratios and lower profitability. This can create pressures on their ability to invest in future growth and resilience. For example, despite an increase in new entrants in recent years, most domestic entrants have subsequently exited the industry. There has also been continued consolidation and reduction in the number of small and medium-sized banks.

This Review analysed the market and regulatory trends affecting small and medium-sized banks' competitiveness. On the whole, the CFR considers that the main challenges for small and medium-sized banks' competitiveness are market-driven. Small and medium-sized banks face a similar operating environment and competitive challenges as the major banks, including increasing digitisation, changing customer preferences and the growing complexity of risks that need to be managed. The nature of small and medium-sized banks' business models can mean the impact of these challenges can be more pronounced. Their responses to these drivers will be the main influence on their long-run competitiveness.

In the CFR's view, the existing regulatory framework for small and medium-sized banks is broadly fit for purpose. There are, however, some areas where regulation could be adjusted to assist the sector in adapting to market-based challenges. As set out below, the outcomes from this Review do not seek to directly counter underlying market trends affecting the sector, but rather seek to support small and medium-sized banks in adapting to them.

## 1.2 Proportionality in regulation

The CFR identified several areas where the regulation of small and medium-sized banks could be streamlined or simplified, without compromising the protection of consumers and broader financial stability. Doing so would make regulatory frameworks more proportionate, reduce costs for small and medium-sized banks, and help to improve their overall competitiveness.

The CFR recommends that CFR agencies and the ACCC regularly review their reporting requirements to ensure they remain fit-for-purpose. It also recommends due consideration be given to challenges faced

by small banks when setting reform implementation approaches, including approaches to staged implementation. Further, the CFR made several recommendations to Government to narrow the scope of reporting requirements administered by ASIC across breach reporting, annual compliance certificates and internal dispute resolution reporting, either by reducing their frequency or limiting their breadth.

While the Australian Prudential Regulatory Authority (APRA) already differentiates its prudential requirements of banks according to size and complexity, APRA plans to formalise a three-tiered bank framework in its prudential standards to allow for further proportionality. APRA also plans to improve the way it communicates its decisions on adjustments to banks' minimum capital requirements, to help banks understand the actions they need take to lower certain capital adjustments. These adjustments can be a key driver of differences in capital requirements across banks. While the CFR considers that the differences between standardised and internal-ratings based (IRB) approaches to capital are appropriate, APRA plans to review its IRB accreditation process with the aim of providing a more transparent and flexible pathway for small and medium-sized banks who wish to use an IRB approach.

### 1.3 Entry, exit and scale

A healthy sign of competition is a flow of new entrants into, and existing firms out of, the sector. In banking, it is important that exits can occur in a safe and orderly way, given the harm that disorderly bank failures can cause to individuals and the economy.

The CFR supports APRA's plans to make its licensing framework more streamlined and transparent. The CFR also recommends that Government provide additional flexibility for start-ups with large initial investors. The CFR recommends that consolidation approvals also be streamlined for small banks, while the ACCC will provide greater clarity around its processes when banks seek to collaborate. Collectively, these actions aim to better support the entry and growth of small banks.

The ability of regulators to manage the exit of failing banks in a safe and orderly manner is an important driver of competition. The CFR has recommended that changes be made to the Financial Claims Scheme (FCS), unclaimed deposits and the unclaimed moneys regime to make sure these are fit for the future. In CFR's view, these improvements are an important enabler of other actions outlined in this report, and would ensure that competition could take place in a safe financial system.

### 1.4 Funding

Australian banks use a mix of funding sources. Smaller banks primarily use retail deposits, with the range of wholesale funding types and providers typically increasing with the size of the bank.

Issuance of covered bonds can help mitigate differences in institutional funding costs between medium and larger banks, by providing banks with lower credit ratings the ability to issue highly rated debt. This partially mitigates the differences in institutional funding costs compared to larger banks. Covered bonds also provide a source of liquidity in times of market turbulence. The CFR has recommended that the Government consider an increase in the cap on covered bonds from 8 to 12 percent of Australian assets. This seeks to balance competitive benefits against the potential increased risk of losses for

depositors and Government, in the event of the issuer failing. If changes to the covered bond limit are introduced, APRA will consider whether these assets should count towards regulatory high-quality liquid assets (HQLA) and whether any supplementary limits on a bank's overall level of asset encumbrance would be required.

Globally, there are various models of government support in institutional funding markets, typically involving a transfer of risk from institutional investors to government. While the CFR acknowledges some potential benefits of publicly backed funding markets, there are also large inherent risks to taxpayers and a risk of entrenching public support. On the back of a healthy and efficient Residential Mortgage-Backed Securities (RMBS) market in Australia, the CFR recommends that the Government should not introduce a government-backed RMBS program.

Similarly, given the complexity, operational costs and uncertain benefits of multi-seller securitisation, the CFR recommends against the Government providing ongoing support for these programs.

## 1.5 Going further

To further enhance competition and dynamism, the Government could consider its appetite for a material reduction in prudential regulatory settings for very small banks (a 'Tier 4' regime). While this would reduce regulatory costs for very small banks, it would also increase the riskiness of the sector. The CFR considers that a Tier 4 regime would only be appropriate if additional safeguards were introduced, through additional changes to the FCS (beyond those set out in Chapter 6) and consideration of liquidity support measures.

These changes would represent a material change in how the community experiences Australian banks and in risk-appetite settings for the Government. A higher rate of orderly bank failure could increase risks to the Government's budget from greater use of the FCS, as well as potentially exposing uninsured depositors and other creditors to greater losses.

CFR agencies will work with industry to explore ways to improve operational arrangements for very small banks' access to private and public liquidity support. The strength of liquidity support measures would inform how APRA would set its requirements for very small banks.



## Guide to the review for small and medium-sized banks

### Competitive landscape

Australia's small and medium-sized banks compete with major banks on price and non-price attributes and face similar opportunities and challenges. The CFR considers that there are features of workable competition apparent in all of Australia's core banking products markets to varying degrees, although none show all the features to a high degree.

The CFR considers that regulatory requirements can affect small and medium-sized bank competitiveness, but market factors, particularly the economies of scale, are the main challenge that small and medium-sized banks need to overcome. Lack of scale results in higher costs, narrower funding access and lower profitability, reducing the ability to invest in resilience, innovation and growth.

### Recommendations and actions

The CFR presents a suite of complementary changes to assist small and medium-sized banks to meet challenges identified, including an option to go further in support of competition.

#### Improve proportionate regulation



Empower banks to compete by better ensuring regulation reflects risks and adjusts to industry requirements

Formalisation of a three-tiered regulatory framework

Transparency in pillar 2

Streamline reporting requirements

Proportionate implementation

Review of IRB accreditation process

#### Improve entry, exit and scale



Promote competition and dynamism by addressing impediments to market entry, exit and incumbents gaining scale

Modernise the Financial Claims Scheme (FCS)

Reform the unclaimed moneys and unclaimed deposits regimes

Better communication and guidance on collaboration

Increase transparency and efficiency in licensing

Simplify large investments in start-ups

Streamline approvals for consolidation

#### Improve access to funding



Enable small and medium banks to compete by adjusting regulatory limitations on funding and capabilities for support during crises

Relax limitations on covered bond funding

### Going further to promote competition



Design a fourth tier of regulation for small banks, conditional upon the Government's appetite for rebalancing regulatory settings

This pathway would be conditional upon more rapid activation of FCS to mitigate disruption from small bank failures

Refinement of liquidity support

Key:    Impacts    ■ Very small, small and medium banks    ■ Medium banks    ■ Very small and small banks

## 1.6 List of recommendations and actions

### Recommendations and actions targeted at more proportionate regulation

**Action 1:** APRA will formalise a three-tiered approach to proportionality in its prudential framework for banks (and consider a fourth tier if appropriate safeguards are put in place – see Chapter 8).

**Action 2:** APRA will review its IRB accreditation process, making its expectations of applicants more transparent and introducing further flexibility, where appropriate. APRA will consider adjusting its processes to:

- a. Streamline the accreditation process.
- b. Further simplify staged-accreditation expectations.
- c. Provide additional guidance to applicant banks, including on engagement models.

**Action 3:** APRA will improve its communications to banks on its decisions on minimum capital requirements, clearly explaining the basis for the decision, and what risks need to be addressed for certain capital adjustments to be removed or lowered.

**Recommendation 1:** The Government should remove small banks from the requirement to automatically report certain breaches to ASIC, unless they are assessed as being ‘significant’, as per the relevant Act.

The CFR notes that extending this proposal to other Australian financial services licensees and credit licensees that are subject to the regime is outside of the Review’s Terms of Reference. However, the Government may wish to consider whether this should occur. It may also wish to consider whether broader changes to simplify reportable situations reporting are warranted.

**Recommendation 2:** The Government should replace the requirement for banks to lodge the annual compliance certificate with ASIC with a simplified ‘responsible manager’ form.

The CFR notes that extending this proposal to other credit licensees is outside of the Review’s Terms of Reference. However, the Government may wish to consider similar changes for non-bank credit licensees who are subject to annual compliance certificate requirements.

**Action 4:** ASIC will reduce the reporting frequency of internal dispute resolution reporting requirements for small banks from 6 months to 12 months.

The CFR notes that extending this proposal to other small Australian financial service licensees and credit licensees is outside of the Review’s Terms of Reference. However, the Government may wish to consider similar changes for other smaller licensees that are subject to the IDR reporting regime.

**Action 5:** APRA, ASIC, the Reserve Bank of Australia (RBA) and the ACCC will adopt ongoing processes to review regulatory reporting requirements within the scope of this Review to ensure they remain fit for purpose.

**Recommendation 3:** The Government and regulators should seek to give due consideration to how future policy changes will affect smaller banks relative to their larger peers, including the impacts of different implementation approaches. This should include consideration of different options for staging commencements, having regard to organisational size and capabilities.

## Recommendations and actions to help overcome barriers to entry and to facilitate sustainability and scale

**Action 6:** APRA will make changes to its licensing framework, with the aim of making its expectations more transparent and its processes more efficient. This includes introducing formally defined and explicit timeframes for licensing assessments.

**Recommendation 4:** The Government should expand the eligibility to use the current streamlined test for *Financial Sector (Shareholdings) Act 1998* approvals for bank start-ups by extending the life of streamlined approvals from 2 years to 5 years in duration; and increasing the maximum total resident assets limit from \$200 million to \$500 million.

**Recommendation 5:** The Government should introduce a streamlined notification and clearance regime for *Financial Sector (Shareholdings) Act 1998* (FSSA) and related approvals. This should apply to banks with less than \$10 billion in assets.

Additionally, existing delegations to APRA to grant FSSA and related approvals should be raised from currently applying to acquisitions with less than \$5 billion of assets to at least a \$10 billion threshold.

**Recommendation 6:** The Government should modernise the FCS by facilitating a more continuous depositor experience, enabling more timely FCS intervention, providing for more flexible use of FCS funds and ensuring supporting operational arrangements remain fit-for-purpose.

**Recommendation 7:** The Government should address gaps with unclaimed moneys and unclaimed deposits associated with banking exits by:

- a. enabling ASIC to receive and deal with unclaimed deposits in relation to banking exits, including unclaimed FCS payments.
- b. providing ASIC with the ability to repay unclaimed moneys from inactive accounts to a claimant in circumstances where the bank is no longer carrying on a banking business and has not sold or disposed of the business.

If the Government adopts the recommendation above, this would support the removal of the expectation that future new entrants bear the cost of dealing with unclaimed deposits.

**Action 7:** The ACCC will communicate its openness to considering proposals involving collaboration between small banks, including:

- being willing and open to having early discussions with small banks and/or relevant industry representatives about their proposals for collaboration, and to help them understand whether an exemption may be available; and

- having discussions and providing clear guidance about small banks' options and processes available under the *Competition and Consumer Act 2010*.

## Recommendations and actions to increase funding access

**Recommendation 8:** The Government should consider increasing the amount of Australian assets that can be committed to covered bond cover pools from 8 to 12 percent.

**Action 8:** As part of a broader future review of its liquidity policy, APRA will consider whether:

- a. covered bonds should qualify as High-Quality Liquid Assets under the Liquidity Coverage Ratio; and
- b. total asset encumbrance limits should be introduced.

## Recommendations and actions if the Government wants to go further

**Recommendation 9:** The Government should consider its openness to APRA taking a lighter-touch approach to the regulation of very small banks, to support their improved dynamism and competitiveness.

In CFR's view, a lighter touch prudential regime for very small banks would only be appropriate if corresponding adjustments were implemented by Government to protect depositors and financial stability – this includes delegation of FCS triggers to APRA for this cohort.

**Action 9:** CFR agencies will work with the industry to assess whether refinements could be made to improve operational arrangements for small banks' access to private and public liquidity support. Any improvements to liquidity safeguards should be considered by APRA when setting requirements of small banks.

## 2. Introduction

On 8 July 2024, Treasurer Jim Chalmers asked the Council of Financial Regulators (CFR), in consultation with the Australian Competition and Consumer Commission (ACCC), (for brevity, referred to as ‘the CFR’), to conduct a review of competition in the small and medium-sized banking sectors. This report is the culmination of a comprehensive review informed by extensive consultation and analysis that outlines actions and makes recommendations aimed at supporting a fair, competitive, safe, and innovative banking sector for Australians. The CFR thanks all stakeholders for their constructive engagement and contributions throughout the process.

The CFR considers that different banking products contain some features of workable competition to varying levels, but none have all the features to a high degree. The majors remain the dominant presence in most lending and deposit markets, but have collectively lost market share since the end of the GFC. For example, medium-sized banks have been the key driver of the major banks’ loss of market share in mortgage lending, in part driven by Macquarie Bank’s expansion. In this market, certain features of workable competition are evident. Small and medium-sized banks are also playing a role in providing access to in-branch services, with a relatively large proportion of Australia’s branch network.

Stakeholders generally were of the view that the most pressing challenges for small and medium-sized banks were driven by the need for scale, and by market dynamics, rather than regulatory factors. Stakeholders highlighted particular challenges associated with the need to invest in technology to meet changing customer preferences and respond to evolving risks, as well as higher funding costs. Stakeholders also noted areas where regulatory settings could be adjusted, to better support competition.

In conducting this review, the CFR sought to develop regulatory actions and policy recommendations with consideration for stakeholder views and in the long-term interest of the Australian public.

The CFR has aimed to identify areas of regulation within the remit of the CFR agencies and the ACCC where changes could be made to improve proportionality and better balance the objectives of promoting competition, innovation, safety and stability. Consideration of proportionality in regulation has benefited from an acknowledgement of the impacts of scale in enabling sustained competition. Where markets appear to be working well, the CFR found against interventions that would seek to support small and medium-sized banks through risk transfers to, or subsidies from, the Government.

The CFR expects that recommendations to Government and actions by agencies stemming from this review will provide some support to competition, but market-driven challenges are likely to remain the more pressing influence on the sector’s overall competitiveness. The CFR’s proposals acknowledge the deep underlying market trends affecting the industry and seek to support adaptation to them. Like other areas of the economy, small and medium-sized banks will need to adjust to the impact of digitisation, changing customer preferences and the growing complexity of risks that need to be managed.

Further, the CFR considers that changes to certain regulatory settings could be made to improve competition, without compromising risks to the community. Broadly, these changes aim to increase proportionality in regulation, provide greater flexibility and streamline certain settings. This report outlines the CFR's findings and identifies actions to be progressed by regulators and recommendations to Government addressing:

- the regulatory framework and its proportionality;
- issues related to banks' ability to enter and grow in the Australian banking sector;
- banks' funding arrangements; and
- options to introduce further, more material regulatory proportionality.

Collectively, the CFR expects that its proposals would reduce costs for small and medium-sized banks, helping them to better compete with larger banks.

During the process of the Review, stakeholders raised concerns about issues such as the Consumer Data Right (CDR) and anti-money laundering (AML) laws, which are explicitly outside of the scope of the Review's Terms of Reference. These issues need to be examined through other current or future processes, if the Government is minded to do so.

### 3. Stakeholder response summary

The CFR released the Issues Paper on 3 December 2024 inviting stakeholder feedback on a range of questions related to competition in the small and medium-sized banking sectors.<sup>2</sup>

The Review received a total of 27 submissions, including 4 confidential submissions.<sup>3</sup> Respondents represented a range of stakeholders, including the banking industry, industry associations, other market participants and individuals. In addition to receiving submissions, the CFR engaged in discussions with stakeholders. By taking this approach, the CFR sought to ensure that the Review had a high degree of stakeholder input. This chapter summarises the main views and recommendations put forward in submissions and discussions.

#### 3.1 Competition

Submissions highlighted the importance of small and medium-sized banks in driving competition for better consumer outcomes, including product pricing, innovation, choice and the quality of services received. Submissions also discussed the importance of smaller banks for servicing specific community segments, such as regional customers and the provision of branches in regional areas. The CFR notes other work in progress by the Government to address regional banking issues.

Competition was seen as strongest in the residential mortgage market, with mortgage brokers playing a large and growing role in supporting consumers exercising choice in residential mortgages. Some respondents noted that competition was weaker in other product segments. Others suggested there had been a general strengthening of competition over time. This was evidenced by falling returns on equity (ROE), higher levels of customer switching between banking providers driven by mortgage brokers and improved technology that supports multi-banking, and new entrants in the market.

Scale was highlighted as a key driver of competitiveness in banking, allowing more efficient operations, lower funding costs and greater profitability. Perception of an implicit government guarantee was cited as contributing to funding cost advantages for the large banks. Structural changes in the sector were highlighted as creating viability challenges for the business models of some smaller banks. These challenges include the need to invest in digital banking offerings and meet customer expectations of flexible, timely and safe access to their banking products. As part of the shift to digital offerings, banks need to invest in responses to emerging threats (such as scams and cybercrime). Larger banks can spread these investments and other costs, such as regulatory compliance, across a larger revenue base. One submission said consolidation among smaller banks has improved the level of competition in the industry, by improving scale.

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<sup>2</sup> CFR (2024), *Review into small and medium-sized banks - an Issues Paper by the Council of Financial Regulators, in consultation with the Australian Competition and Consumer Commission*, CFR, accessed 24 June 2025.

<sup>3</sup> The submissions, other than those marked confidential, will be available at <http://www.cfr.gov.au>.

## 3.2 Reforms recommended by stakeholders

Consistent with the scale challenges that small and medium-sized banks face, stakeholders' proposals focused on areas where regulators and the Government could help them lower costs. This was primarily through reducing their regulatory compliance costs and through direct public sector support. The main themes are discussed in further detail.

### Proportionate regulation

A majority of submissions advocated introducing greater proportionality into regulatory frameworks. For example, in the prudential framework, some submissions were of the view that regulatory requirements for small banks were not sufficiently scaled to reflect their lower impact on system financial safety and stability risks. Some submissions cautioned that any reductions in regulatory requirements for small and medium-sized banks should ensure that financial safety and stability are not compromised.

Proposals to enhance proportionate regulation included:

- expanded tiering across regulators' frameworks, with several submissions supporting moving from the current two-tier to a formal three-tier model for prudential regulation. This would support greater differentiation in requirements between small, medium and large banks;
- addressing perceived differences in capital requirements between the standardised and internal-ratings based (IRB) approaches to credit risk;
- a simpler, clearer and more flexible pathway to IRB accreditation;
- staged implementation of policy reforms, with longer timelines for smaller banks, alongside better coordination across regulators and government;
- greater transparency on the rationale for significant regulatory decisions, such as adjustments to individual bank minimum capital requirements, and more consistent use of cost-benefits analysis on policy decisions;
- a more efficient bank licensing process and capital requirements for newly licensed banks that are similar to those faced by comparable small banks; and
- increased application of 'substituted compliance' for foreign banks that meet near equivalent requirements in other jurisdictions.

Several submissions also proposed reduced data reporting for smaller banks across the regulators, for example through lower reporting frequency or less granularity. Some submissions also identified specific areas of data reporting that they considered excessive or which overlapped other regulatory reporting.

Chapter 5 out the CFR's response to the proposals. In many areas, CFR are supportive of stakeholders' suggestions and Chapter 5 sets out agencies plans for taking actions forward. A key exception is



industry's proposal to address perceived differences in capital requirements between the standardised and IRB approach – on this issue, the CFR considers that current differences are appropriate.

### Entry, exit and scale

Submissions supported regulators playing a more active role in facilitating collaboration between banks, for example through regulatory sandboxes. There was also support for the ACCC to permit banks below a certain threshold to collaborate and share information on back-office and middle-office operational considerations and better enabling of joint assurance reviews of service providers. Beyond supporting collaboration, some submissions called for more direct government support to facilitate technology development for smaller banks, for example, through innovation grants or the provision of shared infrastructure.

The Issues Paper sought feedback on the FCS, including the potential for stronger resolution tools to support greater proportionality in ongoing prudential requirements. In response, some submissions called for an increase in the FCS limit, for example to \$500,000. However, submissions generally opposed using industry levies to pre-fund the FCS, suggesting the cost would be passed on to depositors through lower deposit interest rates.

Chapter 6 sets out the CFR's response to these suggestions. While the CFR has not endorsed industry's suggestion for more direct government support, the chapter sets out planned changes to better support competition.

### Funding costs

While there were differing views on whether it is appropriate for the government to intervene in funding markets, there were a range of proposals for public sector support to reduce small and medium-sized banks' funding costs. Suggestions included:

- increasing the legislated cap on covered bond issuance of 8 percent of a bank's total Australian assets, with proposals ranging between 10 percent and 15 percent;
- considering government support for RMBS issuance, for example a government backed RMBS facility similar to Canada, or government guarantees for AAA-rated securities;
- considering government support for multi-seller securitisation (MSS) issuance;
- reintroducing a small Committed Liquidity Facility (CLF) allocation, with some arguing this should apply only to smaller banks;
- investigating whether APRA's prudential requirements for securitisation warehouse providers limit the use of warehouses by small and medium-sized banks;
- maintaining preparedness for government purchases of securitisation assets to support funding markets in a crisis, for example through schemes like the Australian Business Securitisation Fund (ABSF) or the Structured Finance Support Fund (SFSF); and

- treating AAA covered bond and AAA securitisation paper as eligible Level 2 HQLA.

Chapter 7 sets out the CFR's response to these suggestions. While Government may wish to consider raising the covered bond limit, the CFR was not supportive of other proposals to increase government involvement in bank funding markets.

### Other proposals

There were also calls for regulators to increase their focus on competition. Proposals included changes to regulator mandates, enhanced accountability mechanisms (such as more frequent Financial Regulator Assessment Authority [FRAA] reviews), and the inclusion of the ACCC as a permanent member of the CFR. Changes to the CFR charter were considered outside the Terms of Reference for the Review.

Some submissions emphasised the importance of Lenders Mortgage Insurance (LMI) in supporting high loan-to-value ratio (LVR) lending and in managing risks for smaller lenders. There were proposals to support the viability of LMI providers, including ensuring that the impact on LMI providers is considered when implementing policy. Some stakeholders highlighted the differences in risk weights between mortgages covered by LMI and the Government's Home Guarantee Scheme. Issues relevant to LMIs were shared with relevant agencies but were not considered directly within the scope of this Review.

Other submissions argued that targeted tax reforms were required to promote a level playing field for customer-owned banks and foreign branches. The Review considers that change to tax policy settings need to be carefully considered having regard to the broader tax system, tax integrity issues and the government's fiscal position. As a result, the CFR has elected not to make recommendations in relation to these submissions.

Submissions also raised some topics that are out of scope of this Review, for example the Consumer Data Right (CDR). Some submissions also called for the benefits of the Regulatory Initiatives Grid (RIG) to be better realised through increasing its use as a coordination tool for different initiatives across regulators.

## 4. Competition in the banking sector

Competitive and dynamic markets, including banking markets, are critical to the welfare and prosperity of Australians. They encourage greater innovation and efficiency, as well as more attractive pricing and quality for consumers.<sup>4</sup>

The Australian banking sector has \$2.4 trillion on loan to households and \$1.1 trillion to businesses,<sup>5</sup> compared to current annual GDP of \$2.7 trillion.<sup>6</sup> Banks support the broader functioning of the economy and society through the provision of services such as retail deposits, mortgage lending, personal credit and business banking.

There are distinctly different cohorts within the banking sector, including the major banks, small customer-owned banks, digital start-ups, regional banks, and foreign branches and subsidiaries. Throughout this report, the CFR will broadly refer to all authorised deposit-taking institutions outside of the major banks as ‘small and medium-sized banks’. Chapter 3 of the Issues Paper provides a detailed overview of the sector.

This chapter provides an overview of the key observations of the CFR on the state of competition in the small and medium-sized banking sectors and assesses the extent to which small and medium-sized banks are currently exerting competitive pressure in the Australian market.

### 4.1 Key observations

Key observations in this chapter include:

1. The CFR considers there are features of workable competition apparent in Australia’s core banking product markets to varying degrees, although none show all the features to a high degree.
2. Small and medium-sized banks are generally providing competitive pricing, at least in the core markets of deposits and mortgages, with prices broadly similar to major banks.
3. Small and medium-sized banks are also active in non-price competition, including on scope and quality of service offerings, trust and security (including protections against cybercrime and fraud), and convenience and accessibility (including branch networks and digital banking).
4. Major banks remain the dominant presence in the banking sector. However, small and medium-sized banks have collectively been successful in gaining market share in household deposits and mortgage lending markets since the end of the GFC. Macquarie Bank has been a key source of growth in mortgage lending, while gains by other banks have been more modest. The small and medium-sized banking sectors’ overall growth has been partially offset by ANZ Bank’s 2024 acquisition of Suncorp Bank.

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<sup>4</sup> ACCC (2023), [Inquiry into promoting economic dynamism, competition and business formation – Submission 34](#), ACCC, accessed 24 June 2025.

<sup>5</sup> Total stock of lending. APRA (2025), [Monthly authorised deposit-taking institution statistics – April 2025 \(released 30 May 2025\)](#), APRA, Sheet ‘Table 2’, sum of cells E130:H130 and cell B130 respectively, accessed 24 June 2025.

<sup>6</sup> ABS (2025), [5206.0 Australian National Accounts: National Income, Expenditure and Product - Table 3. Expenditure on Gross Domestic Product \(GDP\), Current prices](#), ABS, Sheet ‘Data1’, sum of cells DX270:DX273, accessed 24 June 2025.

5. Switching and the credible threat of switching can provide competitive pressure and improved consumer outcomes. Mortgage switching rates have increased, but the extent to which this has been driven by temporary factors (such as higher interest rates) or by structural changes (such as expansion of broker channels and digitisation) is unclear. There is limited information on switching for products outside of mortgages and deposits products.
6. New entrants can increase competitive pressure on major banks. In recent years, there has been entry from foreign branches and domestic start-ups. However, most domestic entrants exit within a few years, either by winding down or acquisition by incumbents.
7. The long-term trend of consolidation and reduction in the number of small and medium-sized banks is continuing.
8. While small and medium-sized banks' net interest margins are comparable to major banks, on average they have lower profitability. Small banks have even lower profitability than medium-sized banks. This can reduce small and medium-sized banks' resilience to shocks, capacity to invest in technology, and ability to grow.
9. Small and medium-sized banks' lower profitability derives from relatively higher costs, largely due to a lack of scale. Barriers to achieving scale (or overcoming the disadvantages of a lack of scale) are the major impediments to competing against major banks. These barriers are mainly market driven, but the CFR has identified some areas where regulation could be adjusted to better support small and medium-sized banks.
10. Small and medium-sized banks face a similar operating environment, and competitive opportunities and challenges as the major banks. These include increasing digitisation, evolving cyber threats and scams, changing customer preferences, and changing distribution channels. However, the nature of small and medium-sized banks' business models and their relatively lower profitability can make the impacts of these challenges more pronounced.
11. The competitiveness of small and medium-sized banks is reduced by limited and more expensive access to wholesale funding. It also affects their ability to fund the rapid expansion of their businesses.

## 4.2 Workable competition

Within the banking sector, competition occurs within the boundaries of acceptable risks to government and society, and the regulatory structures that manage those risks. Given banks' special role in the economy, and unique risks, this includes conduct regulation, which promote market integrity and protects consumers and investors; and prudential regulation, which focuses on the financial safety and stability of Australia's banking sector.<sup>7</sup>

Meeting multiple objectives for the operation of the banking sector, including competition, conduct and prudential goals, requires decisions from policymakers about the appropriate balance between them.

Financial stability and competition can be mutually reinforcing. However, there can also be tension between these two objectives. At its extreme, competition can result in banks inappropriately pricing risk or unintentionally accepting excessive risk to retain or gain market share.<sup>8</sup> At the other extreme, an excessive focus on safety and stability can result in less innovation and economic efficiency, which in the long term may also be significantly detrimental to the industry, users of banking services, the economy and society. The perceived stability and underlying strength of the banking sector – and individual banks – is important for consumers' willingness to place their funds in a bank, particularly when considering switching banks.

Banking also has relatively high fixed costs and low marginal costs, which supports a tendency towards fewer larger firms in the long run, with potential consequential impacts on levels of competition in the sector.

For these reasons, and other factors, the CFR considers that the banking sector is never going to be perfectly competitive. This is consistent with the views expressed in the Productivity Commission's *Competition in the Australian Financial System* inquiry.<sup>9</sup>

However, the Australian banking sector should be 'workably competitive'. A workably competitive market occurs where competitive pressures, despite imperfections, constrain market power.

The CFR's assessment of workable competition is guided by the Productivity Commission's principles on the key features of workable competition in Australia's financial system (see Box 4.1 for the CFR's approach).<sup>10</sup>

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<sup>7</sup> The Review acknowledges that there are relevant regulatory boundaries that sit outside the scope of this review, such as Anti-Money Laundering and Counter-Terrorism Funding regulation.

<sup>8</sup> APRA (2017), *Submission – Productivity Commission – Competition in the Australian Financial System*, Productivity Commission, p.6, accessed 24 June 2025.

<sup>9</sup> Productivity Commission (2018), *Competition in the Australian financial system inquiry report – Productivity Commission Inquiry Report No.89*, Productivity Commission, p.70, accessed 24 June 2025.

<sup>10</sup> Productivity Commission (2018), *Competition in the Australian financial system inquiry report – Productivity Commission Inquiry Report No.89*, Productivity Commission, p.36, accessed 24 June 2025.

#### **Box 4.1: The CFR's view on the features of workable competition in the banking sector**

The CFR considers the following features necessary for the Australian banking sector to be 'workably competitive':

- **The variety of products banks offer is responsive to consumer demand and meets consumer needs over time.** This does not mean that every bank needs to offer a full suite of products. Banks providing services that target a particular cohort of consumers can be valuable to those customers. Banks can use a variety of ways to meet consumer needs, including through innovation.
- **Those products are offered at competitive prices.** Competitive prices would allow banks to recover their costs of providing services to customers, as well as a rate of return that reflects the relevant risks involved. This would ensure that banks do not receive excessive profits, which would be reflected in higher prices paid by consumers and/or reduced quality of service.
- **Barriers to entry and expansion are sufficiently low to allow new or expanding banks to exert competitive pressure on the market.** The CFR notes that some barriers are necessary to ensure the resilience of the banking system but should be within the boundaries of acceptable risk.
- **There is enough directly usable information for consumers to make well-informed decisions about both the products and the banks offering those products.** This includes ensuring that information is easily accessible and allows consumers to easily compare products.
- **Consumer switching costs are low, and switching takes place.** Switching costs cover a broad range of activities, such as the time required for customers to find and complete appropriate forms, and moving direct debits when changing transaction accounts. The CFR notes the importance of both the credible threat of switching and actual switching as competitive constraints.

Submissions to the Review on the characteristics of a high level of competition in the sector were generally consistent with the features of workable competition in Box 4.1.

Observation 1: The CFR considers there are features of workable competition apparent in Australia's core banking product markets to varying degrees, although none show all the features to a high degree.

Government and regulators should continue to aspire to supporting a workably competitive banking sector. The recommendations in this report are directed towards that aspiration.

### **4.3 Previous reviews on banking competition**

Since the GFC, 3 substantial reviews have included analysis and commentary on the state of competition in the banking sector. While they have drawn different conclusions on the level of competition present, as the market has evolved and recommendations were implemented, some common issues were cited

as limiting competition. This included funding and operational cost advantages resulting from scale, vertical integration, regulatory settings that favour larger banks, customer inertia, and barriers to entry.

The **2014 Financial System Inquiry** (FSI) concluded that competition in the financial sector was generally adequate, but pointed to high concentration and vertical integration as factors that might limit the benefits of competition in the future.<sup>11</sup> The FSI's recommendations were directed at removing impediments to competition, including through seeking to improve the competitive neutrality of regulation, ensuring regulators balance competition against their core objectives and supporting innovation and new entrants.

The FSI recognised the benefits of a resilient financial system in minimising costs from financial crises to taxpayers, government and the broader economy. It also made recommendations that increased resilience (including on unquestionably strong capital ratios and loss absorbing capacity). In making recommendations that increased resilience, the FSI noted that these would reduce (but not eliminate) perceptions of implicit government guarantees which can distort competition by providing a funding cost advantage to the largest banks.

The **2018 Productivity Commission inquiry** into competition in the Australian financial system found the Australian economy has generally benefited from having a strong, innovative and profitable financial system.<sup>12</sup> However, it also concluded that the largest banks have used their market power to the detriment of customers, including through sustained prices above competitive levels and the provision of inferior quality products to some groups of customers. This market power had been sustained through:

- established presence;
- regulatory arrangements;
- funding advantage and operational efficiency;
- integration; and
- consumer inertia.

Furthermore, it found that smaller institutions in the banking sector had generally behaved as market 'followers' that mirror major bank pricing decisions. Mutual banks were an exception as they do not face the same shareholder pressures. However, their scope to further lower lending rates was more limited than other banks because of their narrower sources of funding.

Most recently, the House of Representative's **2024 inquiry into promoting economic dynamism, competition and business formation** found that despite being concentrated, there were signs of competitive tension in the banking industry.<sup>13</sup> These include falling net interest margins (NIMs) and

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<sup>11</sup> The Australian Government the Treasury (2014), [Financial System Inquiry - final report](#), Treasury, accessed 24 June 2025.

<sup>12</sup> Productivity Commission (2018), [Competition in the Australian financial system inquiry report – Productivity Commission Inquiry Report No.89](#), Productivity Commission, accessed 24 June 2025.

<sup>13</sup> House of Representatives Standing Committee on Economics (2024), [Better competition, better prices - Report on the inquiry into promoting economic dynamism, competition and business formation](#), Parliament of Australia, accessed 24 June 2025.

return on equity (ROE), increased rate of customer churn in the previous 18 months, and innovative product offerings and services from smaller and customer-owned banks. It noted that some stakeholders raised concerns about the significant difference in profitability between the major and smaller banks, with the major banks having the scale to potentially squeeze out competitors to the detriment of consumers. It also noted that regulatory compliance obligations could force smaller banks to direct resources away from areas of natural competitive advantage, such as customer service, innovation, and attractive product pricing. The report included 3 broad strategies to improve competition in Australia's banking sector:

- removing barriers for new entrants;
- increasing consumer churn and switching; and
- facilitating products that provide good outcomes for disengaged consumers.

In addition to the sector-wide reviews, the **ACCC has recently conducted 2 inquiries** into specific bank product markets.

The ACCC completed its home loan price inquiry in 2020.<sup>14</sup> It found evidence of impediments to customers switching lenders, which allowed lenders to sustain higher interest rates for existing home borrowers than offered to new borrowers. Opaque pricing, including the use of discretionary discounts, made it difficult for borrowers to compare products across lenders. The process for switching lenders was also found to be difficult and lengthy.

The ACCC published its report on retail deposits in 2023.<sup>15</sup> It found instances of price competition from smaller competitors seeking to grow their market share, but little evidence of aggressive broad-scale price competition, particularly from larger banks. Instead, banks used strategic pricing practices to retain higher-value customers, taking advantage of consumer inertia and other biases to reduce the overall cost of deposit funding. There had been some limited entry and expansion of banks offering retail deposit products, but new entrants and smaller competitors were constrained by their scale in competing for retail deposits. The ACCC made recommendations to reduce frictions in the switching process.

The Australian Competition Tribunal also recently published its determination on the acquisition of Suncorp Bank by ANZ Bank.<sup>16</sup> The Tribunal considered the home loans market moderately concentrated and conducive to coordination. However, the conditions for coordination have recently reduced and are likely to continue to reduce in the foreseeable future.

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<sup>14</sup> ACCC (2020), [Home loan price inquiry – Final report](#), ACCC, accessed 24 June 2025.

<sup>15</sup> ACCC (2023), [Retail deposits inquiry – Final report](#), ACCC, accessed 24 June 2025.

<sup>16</sup> Australian Competition Tribunal (2024), [Applications by Australia and New Zealand Banking Group Limited and Suncorp Group Limited \[2024\] ACompT 1](#), Australian Competition Tribunal, accessed 24 June 2025.



## 4.4 Assessment

The following does not purport to include all information and analysis supporting key observations but does provide indicative findings. The CFR has also had regard to confidential submissions and data sets it is not at liberty to publish.

### Price competition

Observation 2: Small and medium-sized banks are generally providing competitive pricing, at least in the core markets of deposits and mortgages, with prices broadly similar to major banks.

The CFR focused on mortgage and deposit products that form the greater part of the assets and liabilities on the balance sheets of small and medium-sized banks.<sup>17</sup>

Overall, the CFR finds that similar prices to those of the majors are offered for like products, albeit there are some minor pricing differences between different cohorts of banks and products.

The CFR has not determined whether small and medium-sized banks are *following* the pricing trends set by the majors, as previously found by the Productivity Commission.<sup>18</sup>

Some illustrative pricing information is provided below.

### Mortgages

The average variable rates paid by borrowers taking out new mortgages since 2019 have been fairly similar across banks, with the major banks typically charging a little more than smaller banks (Graph 4.1).

This is contrary to the expectation that major banks have some ability to charge less due to their larger scale and funding advantages. The lack of any significant spread between major banks and smaller banks rates could reflect a mix of factors, such as different credit-risk appetites in lending, customer demographics and use of pricing power.

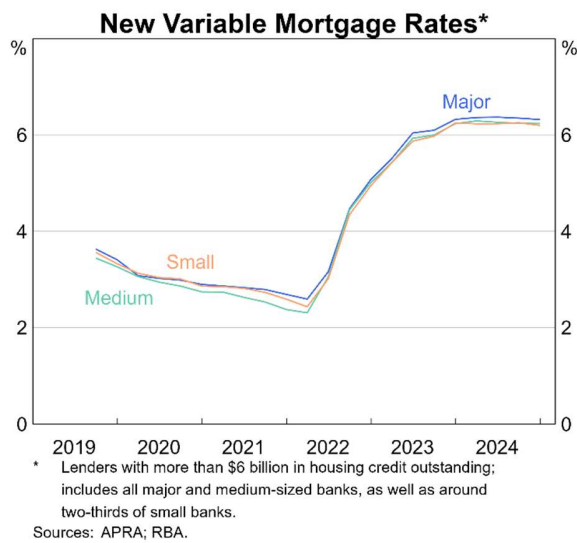
Patterns in the spread between rates on outstanding mortgages (the back book) and new mortgages (the front book) have also been broadly similar across different sizes of banks (Graph 4.2). While there has historically been a material gap in pricing between new and existing mortgages, this gap has narrowed in recent years. In 2022, existing mortgages were around 50 basis points higher than new mortgages; latest data suggests that this gap had narrowed to be around 10 basis points with little difference across banking groups.

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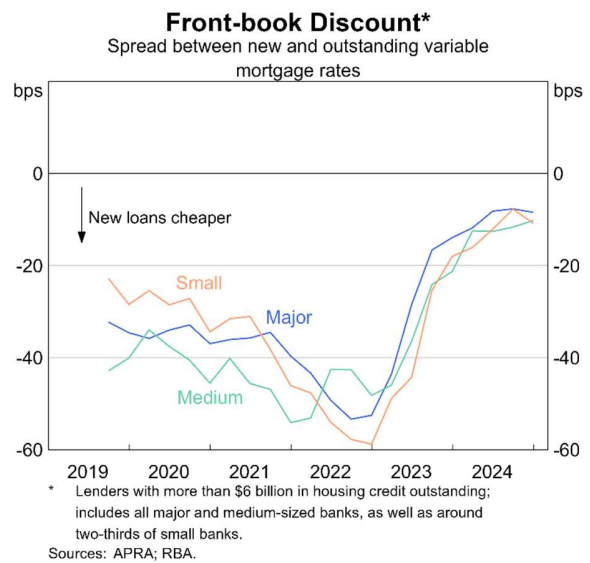
<sup>17</sup> While we also examined business lending pricing, given the diversity of product types and customer markets for this category, it is difficult to draw any reliable conclusions from comparing aggregate data.

<sup>18</sup> Productivity Commission (2018), [Competition in the Australian financial system inquiry report – Productivity Commission Inquiry Report No.89](#), Productivity Commission, p.37 accessed 24 June 2025.

**Graph 4.1**



**Graph 4.2**



## Deposits

The CFR has found broadly similar trends in deposit pricing by small and medium-sized banks to those of the major banks. The average outstanding rate on household deposits is similar across bank sizes (Graph 4.3), though there is more variation in the specific deposit products offered by banks.

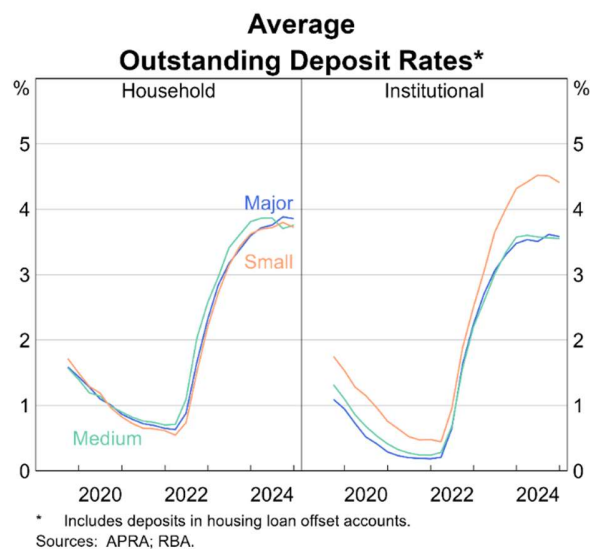
This is broadly consistent with the ACCC's findings in its Retail Deposits Inquiry, in which it noted that new entrants and smaller competitors often compete aggressively on price to gain new customers.<sup>19</sup> Established banks tend not to respond with broad price competition, but with limited price competition such as short-term bonus interest rates.

For institutional deposits, smaller domestic banks pay higher rates than major banks across both at-call and outstanding term deposits (aggregate rates in Graph 4.3). Banks generally pay higher rates on institutional term deposits relative to those by households.<sup>20</sup>

<sup>19</sup> ACCC (2023), *Retail Deposits Inquiry – Final Report*, ACCC, p.7, accessed 24 June 2025.

<sup>20</sup> Cole D, De Zoysa V and Schwartz C (2025), *Bank Funding in 2024*, RBA, accessed 24 June 2025.

**Graph 4.3**



## Non-price competition

Observation 3: Small and medium-sized banks are also active in non-price competition, including on scope and quality of service offerings, trust and security (including protections against cybercrime and fraud), and convenience and accessibility (including branch networks and digital banking).

Small and very small-sized banks generally focus on household and small business banking services. Medium-sized banks focus on services to these customers and to larger businesses. Major banks service the broadest range, including institutional customers. Foreign branches focus on non-retail businesses while non-bank lenders provide services that cover a broad spectrum of personal and business customers.<sup>21</sup>

While there is some differentiation in relation to niche markets, small and medium-sized banks are largely competing with the major banks and each other on like-for-like products in core product areas.

Different bank cohorts may focus more on specific communities, such as regional and underserved communities. Often this is a result of history but can also be due to conscious strategic positioning of the organisations. Customer-owned banks have a relatively larger presence outside of metropolitan Australia in comparison to the major banks and play a important role in serving regional communities.

Specific banks may target particular consumer cohorts, such as agribusiness or high-income professionals, to differentiate themselves from the major banks. For example, the most successful domestic bank start-up in recent years, Judo, focuses on small business lending. More broadly, this

<sup>21</sup> For lending only, as they are precluded from offering deposits.

targeting can occur by narrowing customer engagement channels to mainly digital, targeting specific loan characteristics (such as low LVRs), or by other means including increased data driven targeting of customers. The move to targeting more profitable customer groups may clash with societal expectations of banks maintaining service to all communities.

Digitisation of banking has increased markedly over the past 20 years, driven by changing customer preferences, improved technology and firms seeking operational efficiencies. Some small and medium-sized banks face significant challenges in making sufficient investments in information technology to meet this shift. For others, including some new entrants, this is their primary advantage. Most customer engagement with banks is now through digital channels. Consistent with this, the efficiency of interactions with customers was identified by stakeholders as a driver of competition. Banks have invested in technology to speed up loan applications processes (anecdotally referred to as the 'time to yes').

APRA points-of-presence data shows that banks have reduced the number of branches across Australia from 5,694 as of 30 June 2017 to 3,360 as of 30 June 2024, a reduction of 41 percent. This includes a reduction by major banks of 1,634 branches (46 percent) and a reduction by other banks of 700 branches (33 percent). It also includes a reduction in major cities of 1,487 branches (44 percent) and a reduction in regional and remote locations of 847 branches (36 percent).

The relatively smaller reduction of bank branches in regional and remote locations may reflect higher demand for face-to-face services, given regional and remote locations have populations which, for various demographic reasons, place a higher importance on maintaining physical access to branches. It may also reflect that customers and businesses in these locations face greater travel distances to access alternate branches.

The costs of operating a bank branch can be significant. For some small and medium-sized banks, the disproportionately higher number of branches compared to their customer base can contribute significantly to their disproportionately higher operating costs.

How banks provide face-to-face and cash services to businesses and consumers continues to change. For example, some banks are moving to more streamlined formats without over-the-counter/teller cash services and only dispense cash through ATMs. These shopfront formats may provide access to more specialised lending services via video conferencing from the branch. The ability of some small and medium-sized banks for innovative face-to-face services is constrained by resourcing and technological capacities to move services to digital channels.

Another area of non-price competition is trust and security. This includes a consumer's perception about the safety of their funds, protection against scams and fraud and the reputation of a bank. Emerging threats to trust and security may pose more challenges to smaller banks because of their disproportionate impact on costs and profitability.

## Market share

Observation 4: Major banks still dominate the banking sector. However, small and medium-sized banks have collectively gained market share in household deposits and mortgage lending since the end of the GFC. Macquarie Bank has been a main source of growth in mortgage lending, while gains by other banks have been more modest. The small and medium-sized bank sectors' overall growth has been partially offset by ANZ Bank's recent acquisition of Suncorp Bank.

Current market shares across the whole banking sector indicate that the major banks continue to dominate the market (Table 4.1). While the major banks' market share is somewhat below their post-GFC peak, it is within the 60-80 percent range observed since banking deregulation in the 1980s, and broadly comparable to market shares of large banks in other international markets.

**Table 4.1: Market share by banking cohort, March 2025**

Bank cohort <sup>22</sup>	Number	Total resident assets (AUD bn)	Market share
Major banks	4	3,927	72%
Medium-sized banks	5	687	13%
Foreign branches	49	534	10%
Small	67	330	6%

Source: APRA; Note: market share values have been rounded to the nearest whole number resulting in a total of 101%.

While it is possible for a bank with a small share of the overall market to exert competitive pressure, in general a bank with a larger market share and strong balance sheet is likely to be able to exert more competitive pressure than a bank with a relatively smaller market share. Both entry into the banking market and the ability to expand market share over time are, therefore, important competition drivers.

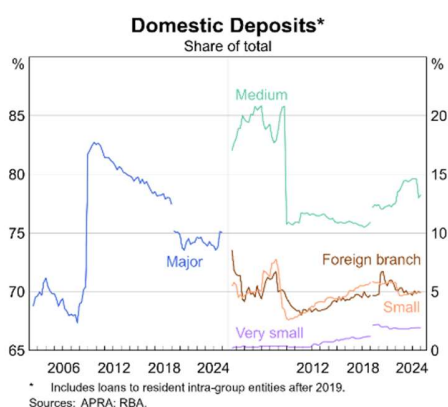
The major banks have lost some market share in all key lending and deposit markets since the GFC (Graphs 4.4 to 4.7), only partly offset recently with ANZ Bank's acquisition of Suncorp Bank. Trends for small and medium-sized banks have differed across product markets:

- In deposit markets, small and medium-sized banks have gained share from the major banks, particularly in the market for household deposits (Graph 4.5).
- In mortgage lending, medium-sized banks have gained share (Graph 4.7), driven significantly by Macquarie Bank's expansion, while small banks' market share has been broadly steady.

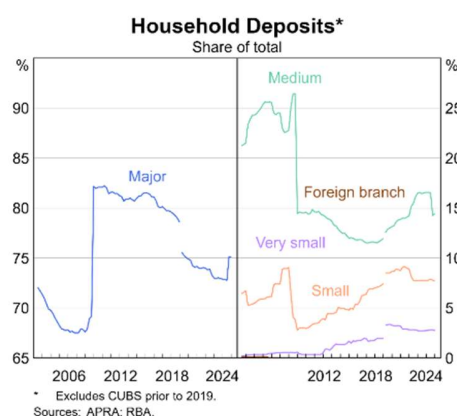
<sup>22</sup> APRA (2025), [Monthly authorised deposit-taking institution statistics – April 2025 \(released 30 May 2025\)](#), APRA, accessed 24 June 2025. Bank cohorts as defined in CFR (2024), [Review into small and medium-sized banks - an Issues Paper by the Council of Financial Regulators, in consultation with the Australian Competition and Consumer Commission](#), CFR, accessed 24 June 2025.

- In personal lending, small and medium-sized banks have generally lost share to non-bank lenders, similar to major banks (Graphs 4.7).
- In business lending, foreign branches have been the main source of growth, with small and medium-sized banks' market shares generally changing little (Graph 4.7).
- The changes in market share for business and personal lending since the GFC may reflect different trends from those in residential home loans and retail deposits, including changes in the risk appetite of banks in specific product lines.<sup>23</sup>

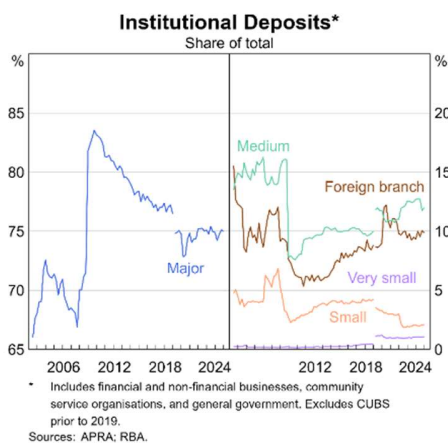
**Graph 4.4**



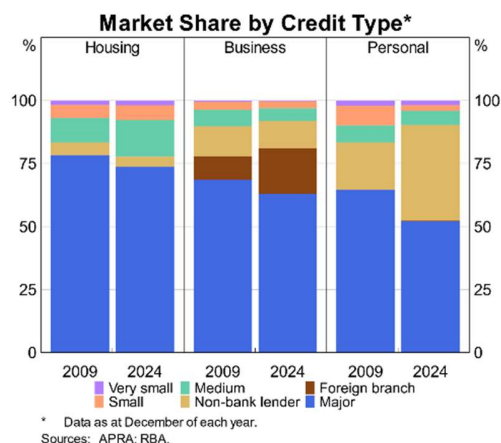
**Graph 4.5**



**Graph 4.6**



**Graph 4.7**



<sup>23</sup> RBA (2018), [Financial Stability Review- Recent trends in personal credit](#), RBA, accessed 24 June 2025.

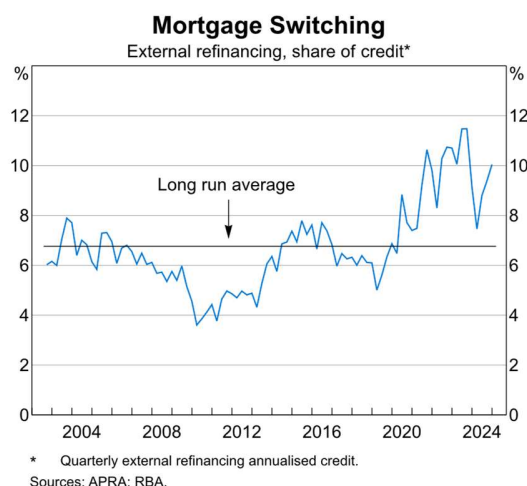
## Switching activity

Observation 5: Switching and the credible threat of switching can provide competitive pressure and improved consumer outcomes. Mortgage switching rates have increased, but the extent to which this has been driven by temporary factors (such as higher interest rates) or by structural changes (such as expansion of broker channels and digitisation) is unclear. There is limited information on switching outside mortgages and deposits products.

The fact that consumers can switch (or credibly threaten to switch) between banking products encourages banks to innovate and continually improve their products.<sup>24</sup> Banks can ensure they attract and retain customers through innovation and continuous improvement. Increased switching rates (or increased threat of switching) may allow small and medium-sized banks to gain market share from major banks.

Since the ACCC's 2020 Home Loan Price inquiry, there has been an increase in the share of existing mortgage borrowers switching lenders (Graph 4.8). This has coincided with a period of rising interest rates. The volume of mortgages that refinance annually with another lender has risen to the equivalent of around 10 percent of the current stock of mortgage lending. It is unclear whether these elevated switching rates will persist if pressures on households are further alleviated by further reductions in interest rates.

**Graph 4.8**



<sup>24</sup> ACCC (2020), [Home loan price inquiry – Final report](#), ACCC, p.vii, accessed 24 June 2025; ACCC (2023), [Retail Deposits Inquiry Issues Paper](#), ACCC, p.10, accessed 24 June 2025.

The CFR has observed several market developments that could support more convenient and efficient switching for particular products. These include increased use of mortgage brokers, greater use of digital banking and a rise in banking transaction data use by banks.

The rise of mortgage brokers provided a channel for origination that supports a more competitive marketplace for mortgages. This has occurred in part due to brokers' role in mitigating the impacts of various obstacles to switching and the threat of switching:

- **Lack of access to information** – inaccessibility of pricing and features information in usable and non-misleading forms, information complexity, and information overload.
- **Cognitive and behavioural biases** – affecting the level of customer engagement with switching processes, approaches to comparison, quality of decision making, and inclinations to action to give effect to decisions.<sup>25</sup>
- **Capability deficits** – financial and other forms of illiteracy, other shortfalls in capability to effectively assess options and give effect to decisions.
- **Convenience** – non-financial costs to customers of engaging with switching.

However, use of brokers can add to the cost-base of lending, given the associated rates and fees paid by the lender to the broker. Concerns regarding conflicts of interest have somewhat decreased following reforms in response to the Banking Royal Commission.<sup>26</sup>

Small and medium-sized banks disproportionately benefit from mortgage broker origination channels, with 38 percent of brokers' loan portfolios being with banks outside of the majors and their sub-brands.<sup>27</sup> However, most small and medium-sized banks are not on mortgage aggregator lending panels.<sup>28</sup>

The increased use of digital banking allows customers to more easily take up better value products with other providers without changing their primary banking relationship (often referred to as 'multi-banking'). Many banks are positioning themselves as secondary banking providers. This highlights a trend of switching products only rather than entirely changing providers. There is limited statistical data on the extent and effect of multi-banking on switching rates.

The increased use of banking transaction data by banks is also supporting greater efficiency in providers' commercial and regulatory customer acquisition processes.<sup>29</sup> This can help improve analytics and decision-making support for customers, and makes customer onboarding processes more convenient and streamlined. This should support greater switching and increase the credibility of the threat that customers may switch.

The CFR acknowledges that the switching process is not frictionless. There are currently reforms to switching mortgages and retail deposit products underway to reduce some of these frictions. These

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<sup>25</sup> For example, choice overload, commitment bias, hyperbolic discounting, status quo bias.

<sup>26</sup> [Misconduct in the Banking, Superannuation and Financial Services Industry | Royal Commissions](#), accessed 24 June 2025

<sup>27</sup> MFAA (2025), [The Value of Mortgage and Finance Broking 2025 – Final Report](#), Deloitte, p.37, accessed 24 June 2025.

<sup>28</sup> MFAA (2025), [The Value of Mortgage and Finance Broking 2025 – Final Report](#), Deloitte, p.34, accessed 24 June 2025.

<sup>29</sup> For example, through form filling, income and expense verification, credit worthiness assessments.



reforms follow on from recommendations made by the ACCC in its inquiries into retail deposits and home loans. They are discussed in Chapter 6.

## Entry and exit

Observation 6: New entrants can increase competitive pressure on major banks. However, most domestic entrants have exited within a few years, either by winding down or by being acquired by incumbents.

There have been 17 new entrants into the Australian banking market since APRA introduced a new licensing framework in 2018. This has provided some boost to the level of competition in parts of the sector.

The main source of new entrants has been foreign branches (9 branches). This sector has grown its share of business lending to a little less than 20 percent, compared to about 10 percent in the decade prior – although little of this has come from the new branches.

The other main source of new entrants has been domestic start-ups (8 start-ups). While one start-up has emerged as a significant player in lending to small and medium-sized businesses, most have exited or been acquired by incumbents. Acquisition of new entrants by incumbents can have positive impacts by promoting adoption of new technologies and business models. However, it also removes potential sources of competition, including by potentially removing related business activities such as banking-as-a-service offerings.

Chapter 6 contains the CFR's proposed measures to improve pathways for new entrants to the sector.

## Consolidation

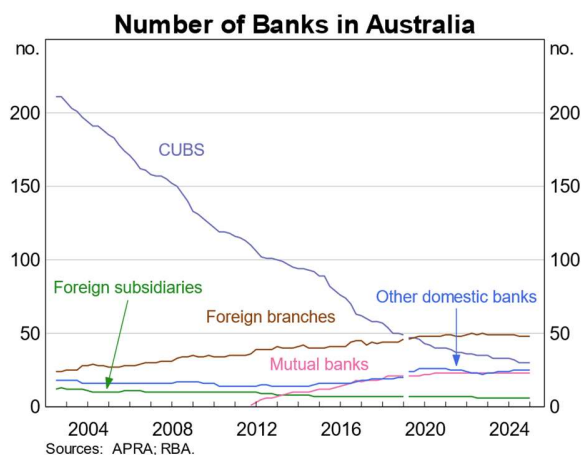
Observation 7: The long-term trend of consolidation and reduction in the number of small and medium-sized banks is continuing.

As detailed in the Issues Paper, the number of banks in Australia has reduced significantly in the last 20 years as credit unions and building societies (CUBS) merged. This reduction was only partially offset by a small increase in the number of other domestic banks and foreign branches. The overall trend of consolidation mirrors peer jurisdictions.<sup>30</sup>

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<sup>30</sup> See for example, the United Kingdom ([de-Ramon, Francis and Milonas 2017](#)), the United States ([FDIC 2025](#)) and the euro area ([Figueiras et al 2021](#)), accessed 24 June 2025.

**Graph 4.9**



Consolidation is in part driven by the need for increased scale and scope. The CFR does not see these pressures abating, with various ongoing trends likely to further amplify the advantages of scale. These include ongoing digitisation and technology adoption, emergence of new threats and, to some degree, increasing regulation.

Consolidation, when it occurs in a safe way, may benefit consumers by allowing more vigorous competition among small and medium-sized banks.

The CFR has proposed measures to facilitate (or at least not unduly obstruct) consolidation between small banks in Chapter 6.

### Profitability and costs

Observation 8: While small and medium-sized banks' net interest margins are comparable to major banks, on average they have lower profitability. Small banks have even lower profitability than medium-sized banks. This can reduce small and medium-sized banks' resilience to shocks, the sustainability of their competitiveness, their capacity to invest in technology, and their ability to fund organic growth.

Observation 9: Small and medium-sized banks' lower profitability derives from relatively higher costs, largely due to a lack of scale. Barriers to achieving scale (or overcoming the disadvantages of a lack of scale) are the major impediments for small and medium-sized banks looking to compete against major banks. These barriers are mainly market driven, but the CFR has identified some areas where regulation could be adjusted to better support small and medium-sized banks.

Observation 10: Small and medium-sized banks face a similar operating environment and competitive opportunities and challenges as the major banks, including increasing digitisation, evolving cyber

threats and scams, changing customer preferences and changing distribution channels. However, the nature of small and medium-sized banks' business models and their relatively lower profitability means that the impacts of these challenges can be more pronounced.

### *Returns on assets and equity, net interest margins*

The returns on assets (ROA) and equity (ROE) of small and very small banks remain comparatively low, although most are operating under a not-for-profit model and, therefore, not under the same pressure to maintain commercial rates of return. Medium-sized banks have typically had lower ROA and ROE than the major banks, but not as low as small and very small banks (Graph 4.10).

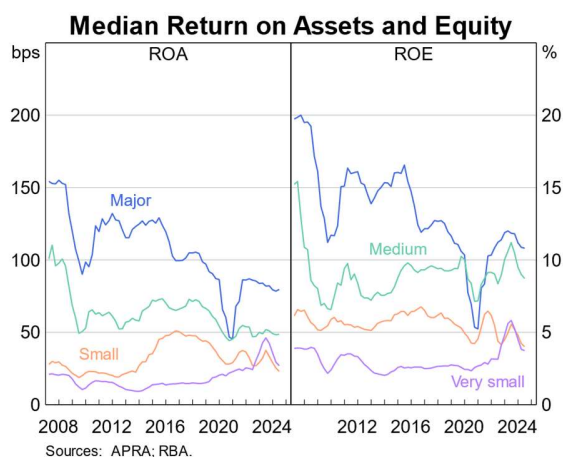
The gap in ROE and ROA compared to the majors has narrowed in recent years, in part because the major banks' capital requirements have increased proportionally more and due to changes in the composition of their businesses following the GFC and Banking Royal Commission.

Low ROE impacts a bank's resilience, capacity to sustain competition and ability to sustain higher rates of organic growth. Recent international comparisons show that Australian major Bank ROEs are now approximately equivalent to developed market peers.<sup>31</sup>

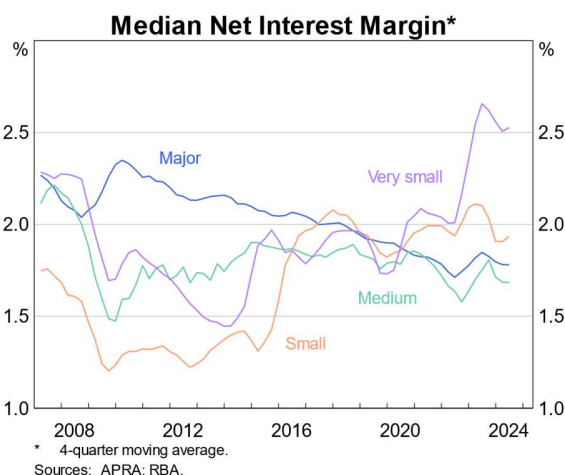
NIMs have been narrowing for medium-sized and major banks in recent years, but not for small and very small banks. While small and very small banks had a somewhat higher NIM than the major and medium-sized banks in recent years (Graph 4.11), the impact on overall profitability has been more than offset by their higher operating costs.

Various submissions to the Review have asserted that lower ROE and NIM over time may be indicative of competition in the sector. While this may be the case, NIM can be affected by other factors.<sup>32</sup> The relationship between competition and NIMs is unclear.<sup>33</sup>

**Graph 4.10**



**Graph 4.11**



<sup>31</sup> IMF (2024), [Australia: staff report for the 2024 Article IV consultation](#), IMF, p.36, accessed 24 June 2025.

<sup>32</sup> Such as changes in the risk associated with banking assets and market driven changes in funding costs.

<sup>33</sup> ACCC (2023), [Retail Deposits Inquiry Final Report](#), ACCC, p.48, accessed 24 June 2025.

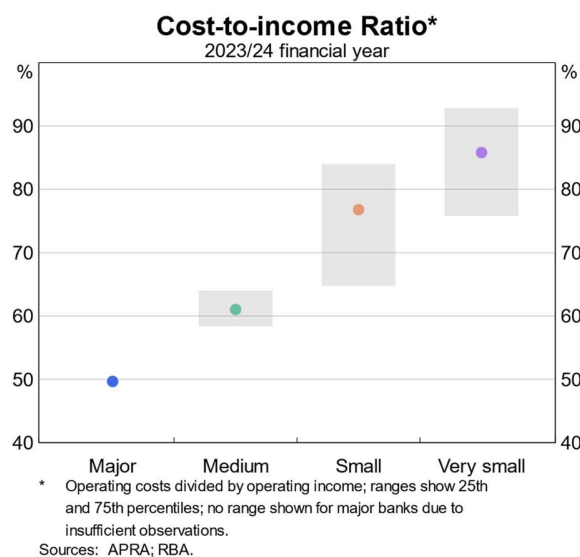
The low profitability and relatively high fixed operational costs of small and medium-sized banks, in addition to the funding models used, can slow their potential for growth. This is particularly the case for small and medium-sized banks as they tend to rely more on retained earnings to fund their growth.<sup>34</sup>

A detailed assessment of differing capital requirements for different banks, including differences resulting from the standardised and IRB approaches, together with commentary on their impacts on competitiveness is set out in Chapter 5.

### ***Operating costs***

Banking markets exhibit strong economies of scale, with relatively high fixed costs and lower variable costs. Smaller banks, therefore, have higher cost-to-income ratios (Graph 4.12).

**Graph 4.12**



The benefits of scale are increasing due to a range of commercial trends including digitisation, evolving cyber threats and scams, customer preferences and changing distribution channels. Increasing regulation also disproportionately impacts firms with less scale.

Current and emerging challenges for small and medium-sized banks vary depending on each operating model, but they include:

- sustaining a high share of operationally expensive physical branches;
- investing in technology, including replacing ageing infrastructure, and meeting changing customer expectations of digital engagement;
- Protecting against emerging risks including scams and cyber threats; and

<sup>34</sup> CFR (2024), [Review into small and medium-sized banks – an Issues Paper by the Council of Financial Regulators, in consultation with the Australian Competition and Consumer Commission](#), CFR, Graph 16 Sources of New Capital, accessed 24 June 2025.

- cost of regulatory compliance.

Regulatory costs are only one component of operating costs.<sup>35</sup> The CFR has sought to identify opportunities to simplify and streamline regulatory obligations to help reduce pressures on small and medium-sized banks' operating costs. While some of these opportunities apply to all banks, it should be noted that regulatory obligations can have a disproportionate impact upon small and medium-sized banks. These are discussed in Chapter 5.

The CFR has explored options to help small and medium-sized banks gain the benefits from scale in Chapter 6.

### Access to funding

Observation 11: Small and medium-sized banks have more limited and more expensive access to wholesale funding, which reduces their competitiveness. It also impacts their ability to fund rapid expansion.

As noted in the Issues Paper, there has been little difference in the implied funding costs for the major banks and small to medium-sized banks over the last couple of years. The major banks have historically had lower funding costs than other banks, though this gap closed around 2017.

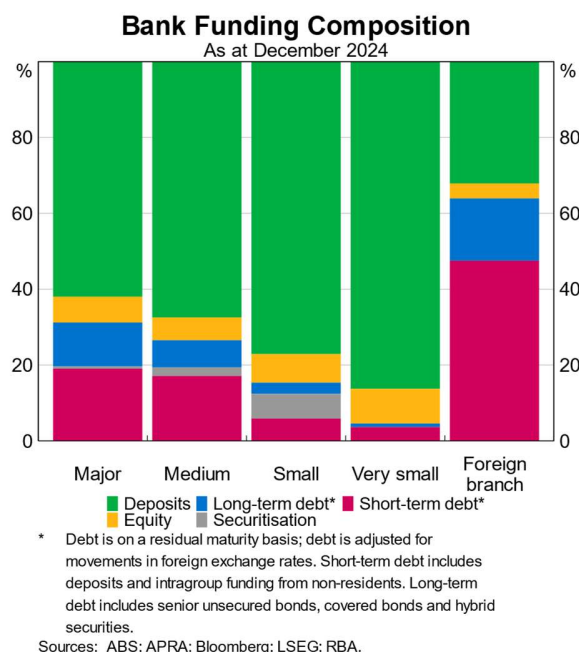
Funding costs also vary significantly within bank cohorts. Some smaller banks have costs comparable to those of the larger banks, while others face higher funding costs. This is largely driven by funding mixes (Graph 4.13). Small banks rely more upon cheaper deposit funding and major banks have a cost advantage in raising funding in wholesale markets, largely due to their higher ratings with independent credit assessment agencies. Their lower perceived risk profiles may be driven partially by perceptions that government would intervene to stop their failure due to their systemic importance, but also due to commercially driven perceptions of risk as a result of their size and financial health.

Outside deposit funding, small and medium-sized banks generally have fewer funding alternatives than major banks. Where small and medium-sized banks can source alternative sources of funding, it tends to be more expensive than for major banks.

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<sup>35</sup> Personnel is the largest category of operating expenses for banks, comprising roughly half of total expenses. The next largest category is technology costs. All banks have spent a larger share of total expenses on technology over time.

**Graph 4.13**



The non-major banks are relatively larger issuers in securitisation markets (Graph 4.14). The major banks rely less on securitisation given they actively target a broad and diversified funding base. Smaller banks may see more value in securitisation as an additional source of funding diversification that allows access the AAA-rated RMBS investor base.

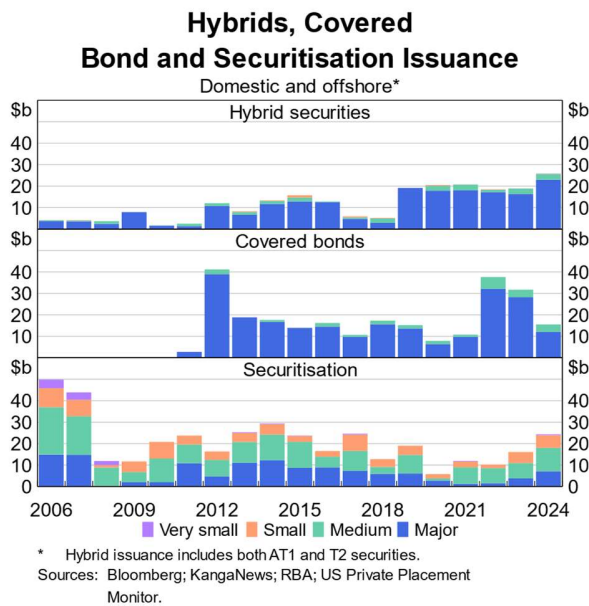
In recent years, the domestic funding market has become deeper and more mature, allowing the major banks to source a larger share of their long-term funding domestically.<sup>36</sup> Issuers have been able to issue larger deals at more attractive prices and for longer terms in the domestic market (Graph 4.15).

Outside of Macquarie Bank, the non-major banks are infrequent issuers in the offshore market. Some other medium-sized banks have issued in offshore markets to take advantage of attractive pricing and diversify their investor base.<sup>37</sup> Except for Rabobank Australia (and HSBC Australia before 2011), small and very-small banks typically do not issue offshore. The smaller banks have lower total demand for wholesale debt funding and thus have less of a structural need to tap the more-expensive offshore markets.

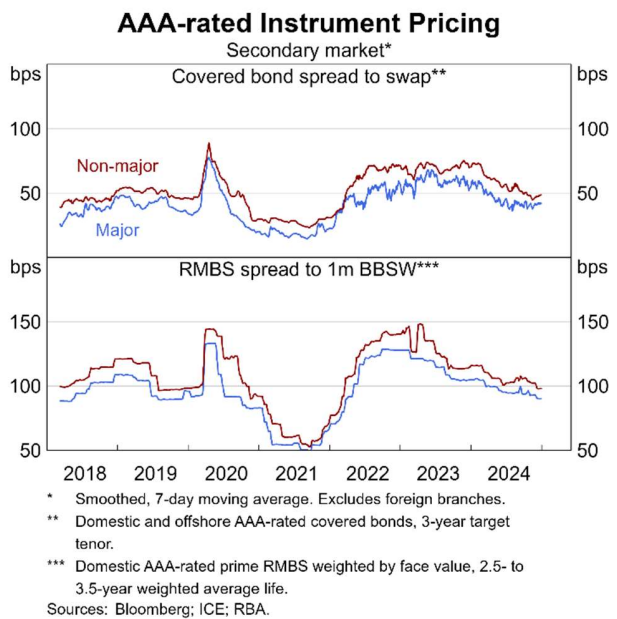
<sup>36</sup> Cole D, De Zoysa V and Schwartz C (2025), *Bank Funding in 2024*, RBA, accessed 24 June 2025.

<sup>37</sup> For example, *Bendigo and Adelaide Bank - annual report 2024* and *BOQ Group - annual report 2024*, accessed 24 June 2025.

Graph 4.14



Graph 4.15



The more limited access to – and higher cost of – wholesale funding, impacts the competitiveness of small and medium-sized banks. It does this by increasing their costs and limiting their opportunities to profitably expand their lending.

The CFR has sought to identify opportunities to improve medium-sized banks' access to funding in Chapter 7. Some opportunities explored relate to all banks, however, would be expected to comparatively benefit small and medium-sized banks more, given the cheaper access by major banks to senior unsecured debt markets.

## 5. Proportionality in regulation

As highlighted by stakeholder submissions in response to the Issues Paper, bigger banks can spread fixed costs associated with their operations against a larger customer base, lowering their unit costs and enhancing their competitiveness. Although many of these costs are driven by market trends (for example, investment in new technology to manage changing customer preferences and emerging risks), banks also bear substantial regulatory compliance costs.

While regulation is necessary and appropriate for the protection of consumers and broader financial stability, stakeholders have pointed to areas where the regulation of small and medium-sized banks could be streamlined to reduce costs, without undermining these objectives.

This chapter explores where the regulation of small and medium-sized banks could be made more proportionate to the risks they pose to financial safety and stability to improve competitive outcomes. Proportionality in regulation requires consideration of not just options for reform, but also of options for implementing those reforms.

### 5.1 A three-tier approach to prudential framework

Industry submissions indicated broad support for APRA's existing approach to proportionality, but also expressed desire for more nuance where possible. APRA is a risk-based regulator and as part of this has embedded important elements of proportionality into its prudential policy and supervisory frameworks:

- **APRA currently sets different requirements for banks according to their classification as a significant financial institution (SFI) or non-SFI.** SFIs are banks with assets greater than \$20 billion or determined as such by APRA, considering complexity and group structures. APRA formally introduced the concepts of SFI and non-SFI in 2022. Since then, all major policy consultations have explored opportunities to subject non-SFIs to simpler requirements or to provide non-SFIs with additional time to implement new requirements. As a result, non-SFIs are now subject to simpler requirements for standards on capital adequacy, remuneration, recovery, exit and resolution planning, and governance.<sup>38</sup> Overall, non-SFIs are subject to around three-quarters of the number of prudential standards that apply to SFIs. See Figure 5.1 for detail.
- **The largest banks must also meet heightened requirements for financial resilience.** APRA has designated the 4 major banks as Domestic Systemically Important Banks (D-SIBs). This requires them to hold materially higher capital than otherwise, including an additional Common Equity Tier 1 (CET1) capital buffer of 1 percent of risk weighted assets (RWAs). D-SIBs must also maintain additional loss absorbing capital (LAC). See Graph 5.1 for detail.
- **Proportionality is supported by flexibility in the prudential framework.** Many of APRA's prudential standards are principles-based. This supports each bank in meeting requirements in a

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<sup>38</sup> Currently subject to consultation: APRA (2025), [APRA proposes changes to strengthen and streamline governance and fit and proper requirements](#), APRA, accessed 24 June 2025.

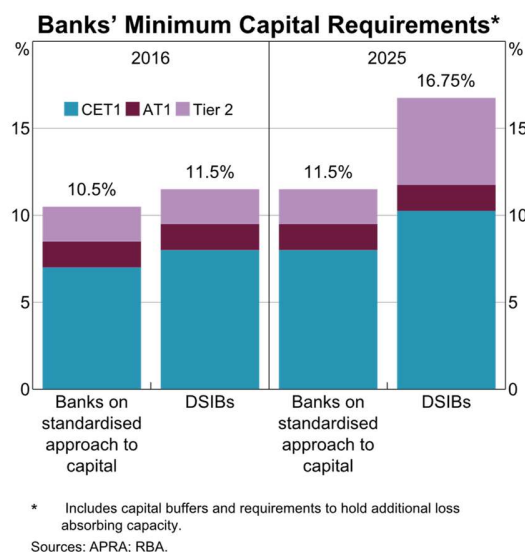


way that is fit for its size, complexity and risk profile – allowing for simpler implementation for small and less complex banks.

**Figure 5.1: Examples of APRA’s differentiated requirements for non-SFIs**

<b>Capital</b>	
Credit risk	Simplified
Operational risk	Simplified
Counterparty credit risk	Exempted
Interest rate risk in the banking book (IRRBB)	Exempted
Market risk	Exempted
Leverage ratio	Exempted
Securitisation	No difference
<b>Liquidity</b>	
Liquidity coverage ratio (LCR)	Simplified: minimum liquidity holdings (MLH)
Net stable funding ratio (NSFR)	Exempted
<b>Governance and risk management</b>	
Remuneration	Simplified
Public disclosure	Exempted
Governance	Principles-based: allows tailoring of requirements based on entities’ size, complexity and risk profile
Risk management	
Credit risk management	
Operational risk	
Audit	
<b>Recovery and resolution planning</b>	
Recovery and exit planning	Simplified
Resolution planning	Exempted

**Graph 5.1: Comparison of capital requirements**



Industry submissions were broadly supportive of APRA's approach to proportionality, noting the increased emphasis in APRA's recent policy consultations. However, submissions also suggested that APRA consider possible further differentiations across bank cohorts. While there are already elements of differentiation for large, medium and small banks, industry suggested APRA formalise a three-tiered approach to proportionality.

The CFR sees merit in a more granulated approach to proportionate regulation, and APRA will seek to further embed proportionality in its prudential framework. This can be done by APRA:

- **Formalising a three-tier approach to setting prudential requirements ('large', 'medium' and 'small' banks).** This would allow APRA to calibrate requirements more finely to risk profile.
- **Considering how to define the three cohorts, and where to 'draw the lines'.** APRA expects that the large bank cohort would at least include the D-SIBs. Other SFI banks could be classified as 'medium', and non-SFIs as 'small'.
- **Committing to a proportionality mindset.** APRA will continue to explore opportunities to further differentiate its requirements of banks between 'large', 'medium' and 'small'. This will occur progressively as standards are developed or revised over time. APRA will also continue giving smaller banks more time for policy implementation, where it is appropriate for the risks at hand.

The CFR also notes submissions from stakeholders regarding 'substituted compliance' of foreign banks' regulatory requirements. Substituted compliance involves deferring to overseas regulatory regimes. APRA has permitted substituted compliance for certain risks, including margining requirements. A detailed consideration of this issue was not possible within the constraints of the Review, given complexities such as the feasibility of negotiating mutual recognition arrangements with other jurisdictions, establishing effective international cooperation between regulators, and gaining sufficient understanding of the nature and impacts of foreign regulatory structures. Further consideration of options may be warranted.

**Action 1: APRA will formalise a three-tiered approach to proportionality in its prudential framework for banks (and consider a fourth tier if appropriate safeguards are put in place – see Chapter 8).**

## 5.2 Bank capital requirements

APRA – like its international peers – sets a minimum level of capital for banks to promote financial safety and stability. These minimum requirements aim to ensure that banks have sufficient financial resources to absorb unexpected losses that they may experience, without creating losses for bank depositors or financial instability. Capital acts as a cushion or shock absorber in times of stress.

APRA's minimum capital requirements are guided by international banking standards, as set by the Basel Committee on Banking Supervision (BCBS). APRA's approach to implementing Basel standards involves tailoring requirements so that they are appropriate for risks to the Australian banking system. This includes setting simpler requirements of smaller banks.

Consistent with the recommendation from the FSI, APRA requires banks to meet an unquestionably strong capital standard. This provides important benefits to the economy. For example, Australian banks played a role in helping Australian households and businesses absorb the disruption from COVID-19. The financial strength of Australian banks meant they could continue to offer credit over the period and relief to impacted borrowers.

There are also important benefits for individual banks from having a robust capital position. Credit ratings for Australian banks are underpinned by the strength of APRA's capital framework which ultimately lowers the cost of debt funding. Maintaining investor confidence is critical to banks' loan growth, including offshore investors for the larger Australian banks. Capital reforms finalised in 2023 sought to introduce greater proportionality in the capital framework. However, respondents suggested several areas where this could be refined. There were 3 main areas of focus, discussed in greater detail in this chapter:

- Differences in minimum capital requirements between IRB and standardised approaches;
- APRA's approach to permitting banks to use IRB models; and
- APRA's approach to applying supervisory (also known as Pillar 2) capital adjustments.

### 5.2.1 Credit-risk weights under different regulatory approaches

Varied submissions were received by CFR on the difference between IRB and standardised capital requirements. Some submissions considered the difference to be minimal, while others argued the material difference impacts the ability of standardised banks to compete. Where the difference was considered material, changes to the IRB accreditation process and/or a reduction in standardised risk weights were proposed. No submission supported an increase in IRB risk weights.

APRA has estimated that the mortgage loan pricing differential due to the difference between IRB and standardised capital requirements is approximately 5 basis points.<sup>39</sup> Most submissions acknowledged APRA's analysis, but noted that:

- while APRA uses the minimum requirement, all banks have higher capital targets than the minimum; and
- the analysis assumes that the cost of debt funding is fixed but smaller banks have higher funding costs.<sup>40</sup>

Two submissions also included independent estimates of the mortgage loan pricing differential. One of the 2 submissions estimated a significantly higher pricing differential than suggested by APRA's analysis. A driver of the higher pricing differential was the assumption made for individual bank capital targets under the IRB and standardised approaches. The other submission had an estimate comparable to APRA.

Consistent with APRA's analysis of the mortgage loan pricing differential, the CFR is of the view that using actual capital targets and varying cost of debt assumptions would not produce a like-for-like comparison of IRB and standardised capital requirements. This is because they reflect bank-specific risks and circumstances, such as differences in Pillar 2 adjustments, management buffers and access to debt funding. These factors are unrelated to the IRB and standardised approaches.

Some submissions also noted that APRA's analysis assumes that any pricing impact from higher standardised capital requirements can be passed onto consumers. The submissions argued that IRB banks set prices, and standardised banks are price takers, meaning standardised banks earn lower ROEs due to higher capital requirements.

The CFR notes that the capital requirement is only one of several factors impacting IRB bank pricing strategies. Therefore, any impact on ROE cannot be solely attributed to the difference between IRB and standardised capital requirements. This includes the additional costs of achieving and maintaining IRB accreditation, which can be substantial and are not reflected in APRA's estimate of the pricing differential.

The CFR also notes that the difference between IRB and standardised capital requirements will vary over the cycle because IRB risk weights are more responsive to economic conditions than standardised risk weights. APRA's recent stress test of IRB banks suggests that IRB capital requirements for mortgage loans are likely to exceed standardised requirements during periods of stress.

The difference between IRB and standardised capital requirements has narrowed considerably over time. This reflects actions taken by APRA to increase IRB risk weights (in response to a recommendation from

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<sup>39</sup> Coleman A and Thavabalan N (2024), [Demystifying credit risk capital requirements for housing loans](#), APRA, accessed 24 June 2025.

<sup>40</sup> Some submissions also disagreed with APRA's assumption for the expected loss adjustment, noting that this is negligible based on recent reported data by IRB banks. The expected loss adjustment is intended to reflect any increase in the capital requirement arising from the deductions from CET1 capital of shortfalls in provisions compared to regulatory expected losses. The CFR Review acknowledges this point but notes that the expected loss adjustment has a relatively small impact on the overall pricing differential (~1 bps).

the FSI) and reduce standardised risk weights (as part of the 2023 capital framework revisions).<sup>41</sup> APRA has also strengthened mechanisms, such as capital floors, to ensure that any capital benefit to IRB banks is not excessive and does not unfairly disadvantage standardised banks.

The CFR considers that some difference between IRB and standardised capital requirements is appropriate as it incentivises banks to:

- invest in advanced modelling capability and improve risk and capital management practices; and
- more accurately allocate capital for risk.

These incentives may not be maintained if there is a narrower difference between IRB and standardised capital requirements. In addition, the magnitude of the difference in Australia is much smaller than observed in peer jurisdictions. As a consequence, there is not a compelling reason for adjusting capital settings to narrow the difference further. The CFR also notes that reducing standardised risk weights may compromise the ‘unquestionably strong’ calibration of the capital framework, thereby weakening the financial resilience of standardised banks and undermining broader confidence in the financial system.<sup>42</sup>

### 5.2.2 IRB accreditation

To be accredited to use the IRB approach, banks must demonstrate to APRA that they have good historical data, sophisticated risk measurement frameworks and advanced internal modelling capabilities. Accreditation is designed to ensure that IRB banks have the capabilities to fully realise the benefits of the IRB approach in terms more accurate measurement of, and alignment of capital to, risk.

Some submissions to the CFR have suggested that the IRB accreditation process be made cheaper, faster and more transparent by providing greater flexibility for banks to adopt a phased implementation approach and simplifying accreditation requirements.

An efficient and effective accreditation process has a positive impact on banks’ incentives to develop IRB modelling capability and improve risk and capital management practices across material risks. The CFR also notes that APRA has previously modified its IRB accreditation process with a view to making accreditation more accessible and less resource intensive. These changes occurred largely in response to the 2014 Financial System Inquiry<sup>43</sup> and focused on defining an acceptable staged accreditation

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<sup>41</sup> The 2014 FSI recommended that APRA raise the average IRB mortgage risk weight to narrow the difference between average mortgage risk weights for banks using IRB models and banks using standardised risk weights. See FSI (2014), [Final report](#), Treasury, p.60, accessed 24 June 2025.

<sup>42</sup> The 2014 FSI recommended that APRA set capital standards such that Australian bank capital ratios are unquestionably strong. The Inquiry noted that this standard should apply to all banks rather than only the largest banks because ‘the failure of an ADI would have adverse consequences for its customers and the economy, and has the potential to undermine confidence and trust in the system... In addition, holding different parts of the banking system to substantially different standards would introduce an unwelcome distortion to the competitive neutrality of regulatory settings’. See FSI (2014), [Final report](#), Treasury, p.59, accessed 24 June 2025.

<sup>43</sup> The 2014 FSI suggested that APRA ‘consider how to make the accreditation process less resource intensive without compromising the (necessarily) very high standards that must be met’. See FSI (2014), [Final report](#), Treasury, p.66, accessed 24 June 2025.

approach and decoupling operational risk modelling from IRB accreditation.<sup>44</sup> ING Australia has been accredited to use the IRB approach under this modified process.

However, given the feedback from some industry participants that IRB accreditation is still too costly, protracted and uncertain, APRA will revisit the accreditation process in a holistic review. This should aim to ensure that IRB accreditation remains accessible to banks that are able to model their risks to an acceptable standard and that the process is fit-for-purpose for the future. APRA has committed to review the IRB accreditation process and is considering options to make the process simpler and clearer, while maintaining adequate controls against any increase in risk.

Any changes stemming from the CFR recommendations should not undermine the high standards required of IRB banks to use internal models for regulatory capital. These standards, together with APRA's rigorous supervision approach, play an important role in the strength of Australia's capital framework and the safety and stability of the financial system.

**Action 2: APRA will review its IRB accreditation process, making its expectations of applicants more transparent and introducing further flexibility, where appropriate. APRA will consider adjusting its processes to:**

- a. Streamline the accreditation process.**
- b. Further simplify staged accreditation expectations.**
- c. Provide additional guidance to applicant banks, including on engagement models.**

### 5.2.3 Supervisory capital adjustments

Two pillars under APRA's prudential framework determine a bank's minimum prudential capital requirements.<sup>45</sup> The first pillar – the policy pillar – is set out in APRA's prudential standards and establishes a minimum capital amount that all banks must meet, calibrated against the composition of their balance sheets. Pillar 1 minimum capital requirements for credit risk are a function of whether a 'standardised approach' or internal models are used.

The second pillar – the supervisory pillar – captures risks not fully addressed under Pillar 1. Pillar 1 may inadequately capitalise risks where there are weaknesses in a bank's systems, governance or business models. Pillar 2 provides APRA with a tool for adjusting a bank's minimum capital requirement to adequately reflect these risks. This is a common feature of prudential regulation internationally.

Pillar 2 capital adjustments are not typically made public, unlike Pillar 1. Unless otherwise advised by APRA, banks must not disclose their Pillar 2 capital adjustment, because disclosure by one bank may

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<sup>44</sup> A staged accreditation approach provides the capacity for banks to use IRB models for regulatory capital for some credit portfolios ahead of other portfolios and demonstrate maturity in aspects of their IRB systems over a longer timeframe.

<sup>45</sup> There is also a third pillar, market discipline, which relates to disclosure requirements. This pillar does not impact minimum capital requirements.

create pressure for disclosure by others. This is intended to manage the risk of unintended or incorrect signalling, leading to financial instability at one or more banks.

Some submissions focused on APRA's approach to Pillar 2 capital adjustments given they can be drivers of differences in capital requirements across individual banks. Submissions typically suggested that APRA be more transparent about the reasons for Pillar 2 capital adjustments and what banks would need to do for adjustments to be removed or reduced. Some submissions suggested APRA could make public an anonymised distribution of Pillar 2 capital adjustments across the industry.

A lack of understanding about the reasons for Pillar 2 capital adjustments can make it difficult for banks to address APRA's concerns. Greater clarity on the outcomes needed for capital adjustments to be removed or lowered would create stronger incentives for banks to improve their practices, creating a safer system overall.

APRA has committed to improve the way it communicates Pillar 2 capital adjustments with individual banks. These changes will include clearer explanations for how the key components of the adjustment relate to a particular risk or supervisory concern. Where appropriate, banks would also be made aware of the outcomes APRA would expect to see to remove or reduce their Pillar 2 capital adjustment.

Improving communication on Pillar 2 decisions is important for reinforcing accountability, for industry and regulators. Banks can expect APRA will more clearly justify the basis for Pillar 2 capital adjustments. They should also expect that APRA would remove or lower certain adjustments, where specific risks or supervisory concerns have been addressed.<sup>46</sup>

**Action 3: APRA will improve its communications to banks on its decisions on minimum capital requirements, clearly explaining the basis for the decision, and what risks need to be addressed for certain capital adjustments to be removed or lowered.**

## 5.3 Regulatory reporting

Submissions highlighted that reporting requirements can have a disproportionate cost for smaller banks. Some submissions nominated particular areas for simplification. The CFR has considered this feedback and recommends changes to some collections alongside improved governance practices for data collections to ensure that they remain appropriate.

### 5.3.1 Reportable situations reporting requirements

Under the reportable situations regime, Australian Financial Services (AFS) licensees and Australian credit licensees are required to submit notifications to ASIC about reportable situations, including breaches that are *deemed* significant breaches of *core obligations*, as specified in subsection 912D(4) of the *Corporations Act 2001* (Corporations Act) and subsection 50A(4) of the *National Consumer Credit*

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<sup>46</sup> APRA may also increase adjustments where new risks or concerns emerge.

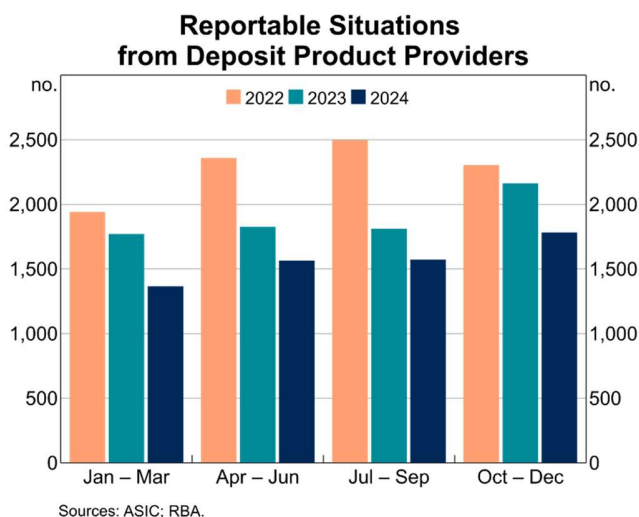
*Protection Act 2009* (National Credit Act). There are other reportable situations under section 912D and section 50A, including breaches that satisfy the ‘significant test’ at subsections 912D(5) and 50A(5).

Some submissions argued that the reporting requirements under the reportable situations regime are overly burdensome and not proportionate to regulatory benefits. One respondent suggested there should be a comprehensive review of the reportable situations regime, including exploring ways to reduce reporting of insignificant breaches and setting a materiality threshold for determining if a breach is significant. Others suggested that breach reporting should be more targeted and proposed easing reporting obligations for smaller banks.

In October 2023, ASIC provided relief of one year from the requirement to report misleading and deceptive conduct breaches in circumstances where only one consumer is affected, there is no financial loss, and the breach does not give rise to other reportable situations. ASIC recently extended this relief for a further 5 years.<sup>47</sup> Additionally, in February 2025, ASIC invited feedback on a proposal to give further relief from reporting certain misleading and deceptive conduct and civil penalty provision breaches.

Under the reportable situation obligations, ASIC receives a very large number of reports. In 2023–24, ASIC received 12,298 reports from AFS and credit licensees. Licensees also lodged 7,762 updates, bringing the total number of lodgements received to 18,934. The overall volume of reports decreased by 27 percent from the previous reporting period.<sup>48</sup> The number of reports lodged by deposit product providers also decreased between 2022 and 2024 (see Graph 5.2).

**Graph 5.2: Reportable situations from deposit product providers**



Note: The number of updates per quarter have been excluded from this diagram

<sup>47</sup> ASIC (2024), [ASIC extends reportable situations relief and personal advice record keeping requirements](#), ASIC, accessed 24 June 2025.

<sup>48</sup> ASIC (2024), [Insights from the reportable situations regime: July 2023 to June 2024](#), ASIC, p.8, accessed 24 June 2025.



The data suggests that ASIC's changes to the reporting requirements have already helped reduce the reporting burden, leading to fewer overall reports. However, further changes should be considered to ease the reporting burden on small banks, while ensuring ASIC still receives breach reports that have high regulatory value. Specifically, reforms could exempt small banks (which could be aligned to APRA's Tier 3 entities and smaller) from the obligation to report breaches that are *deemed* significant, instead requiring them to report only those breaches they assess to be significant, having regard to the factors set out in subsection 912D(5) of the *Corporations Act 2001* and subsection 50A(5) of the National Credit Act.

Consideration should be given to requiring small banks to instead maintain internal breach registers for these excluded breaches so that they properly identify and rectify breaches. These registers should be made available to ASIC upon request.

The CFR acknowledges that there would be an administrative burden for ASIC to administer different requirements for bank and non-bank licensees, which could also cause confusion to licensees as to their compliance requirements. If such a reform be adopted the Government may wish to consider whether similar adjustments should be extended to the reporting obligations of licensees in different sectors. However, this question lies outside the Review's Terms of Reference. Extending this change to other licensees would require significant modelling and industry consultation given the diversity of firms and products of AFS and credit licensees subject to reportable situations reporting requirements.

**Recommendation 1: The Government should remove small banks from the requirement to automatically report certain breaches to ASIC, unless they are assessed as being significant, as per the relevant act.**

**Extending this proposal to other Australian financial services licensees and credit licensees that are subject to the regime is outside of the Review's Terms of Reference. However, the Government may wish to consider whether this should occur. It may also wish to consider whether broader changes to simplify reportable situations reporting are warranted.**

### 5.3.2 Annual compliance certificate

Under the National Credit Act all credit licensees are obliged to lodge an annual compliance certificate on the anniversary of the day their licence was issued (annual compliance date). The CFR considered whether this obligation should be removed. However, as the annual compliance certificate currently informs ASIC of changes in credit licensees' responsible managers (among other things), the CFR considers that credit licensees be required to advise ASIC of responsible manager changes through a new form. Changes to the key person condition for credit licensees should continue to be reported through existing processes.

Previous arguments to maintain the annual compliance certificate requirement included that it:

- enabled credit licensees to update the details of their fit and proper persons;
- assisted ASIC in assessing the annual fee; and
- ensured a focus at the credit licensee's senior level on ensuring the adequacy of their processes and systems for complying with the law going forward.<sup>49</sup>

However, data collected from the annual compliance certificate is not required to generate ASIC's industry funding levies for credit licensees. The obligation to lodge the annual compliance certificate was not specifically raised in submissions, but the CFR considers this recommendation will assist to reduce the reporting burden for banks which was an issue raised more broadly by respondents. As mentioned in section 5.3.1, having different requirements for bank and non-bank licensees would create an administrative burden for ASIC and may cause confusion for licensees. As such, the Government may wish to consider applying the same requirements for bank and non-bank credit licensees, noting this is outside the Terms of Reference for the Review.

**Recommendation 2: The Government should replace the requirement for banks to lodge the annual compliance certificate with ASIC with a simplified responsible manager form.**

**The CFR notes that extending this proposal to other credit licensees is outside of the Review's Terms of Reference. However, the Government may wish to consider similar changes for non-bank credit licensees who are subject to annual compliance certificate requirements.**

### 5.3.3 Internal dispute resolution (IDR) reporting

The CFR proposes that no changes be made to data collected through IDR reporting as the data set was developed following extensive industry consultation and the regime is in its infancy. All AFS licensees who provide financial services to retail clients and all credit licensees must report IDR complaints data to ASIC every 6 months, consistent with the IDR data reporting handbook. ASIC mandated this requirement in 2022 in the *ASIC Corporations (Internal Dispute Resolution Data Reporting) Instrument 2022/205*. However, the CFR considers that the burden on smaller banks (applying the same tiering process as noted above for reportable situations) should be alleviated by decreasing reporting frequency.

The purpose of the IDR data reporting framework is to record, improve and standardise the quality of dispute resolution data. Collecting, and ultimately publishing internal dispute resolution data will give greater public visibility of where consumers may be having difficulties. The phased implementation of the IDR reporting requirements provided more time for many smaller firms to prepare for the start of their reporting obligations.

While none of the submissions received in the CFR raised IDR reporting requirements as a concern, this proposal seeks to alleviate the resources small banks need to expend to comply with this framework.

<sup>49</sup>ASIC (2017), [Self-reporting of contraventions by financial services and credit licensees](#), Treasury, p.29, accessed 24 June 2025.

As mentioned in the previous sections, due to the administrative burden and potential compliance complications caused by having different requirements for small bank and non-bank licensees, the Government may wish to consider applying the same frequency change to other smaller licensees that are subject to the IDR reporting requirements. It is outside the scope of the Terms of Reference of this Review to make recommendations in relation to non-banks. Extending this change to other licensees would require significant modelling and industry consultation.

**Action 4: ASIC will reduce the reporting frequency of internal dispute resolution reporting requirements for small banks from 6 months to 12 months.**

**The CFR notes that extending this proposal to other small Australian financial service licensees and credit licensees is outside of the Review's Terms of Reference. However, the Government may wish to consider similar changes for other smaller licensees that are subject to the IDR reporting regime.**

#### 5.3.4 RBA and ABS reporting requirements

APRA collects economic and financial statistics data on behalf of the RBA and the ABS, as well as other data used by the RBA for its analysis. In reviewing these submissions, the CFR proposes that:

- the reporting threshold for the International Banking Statistics forms be reviewed to consider whether submissions are required from smaller banks that would have an immaterial impact on the aggregate data; and
- forms introduced during the disruption associated with COVID-19 are reviewed to remove any duplicate data or reporting forms that are no longer necessary.

The RBA and the ABS should consider other opportunities to scale back requirements for smaller banks where this could be done without significant impact to agencies' visibility of the banking system, beyond the existing system of tiered reporting requirements.

#### 5.3.5 APRA reporting requirements

APRA has reduced its data collections over the past 2 years, particularly for smaller banks. For example, APRA recently stopped collecting the reporting form ARF 923.0, which was highlighted by industry as a potential area for review. In other instances, the forms raised by industry contain important information for informing APRA and other government agency decision making.

#### 5.3.6 General regulatory approach to reporting requirements

In addition to these targeted recommendations, CFR agencies and the ACCC should regularly review their existing data collections, within the scope of this Review, to ensure they remain appropriate.<sup>50</sup> For the

ACCC, this refers to any ad hoc data requests arising from any inquiries. In doing so, CFR agencies and the ACCC should be mindful of the impact, particularly for smaller banks, and take this into account when designing standard or ad hoc requests.

**Action 5: APRA, ASIC, the Reserve Bank of Australia (RBA) and the ACCC will adopt ongoing processes to review regulatory reporting requirements within the scope of this review to ensure that they remain fit for purpose.**

## 5.4 Implementation timelines

Stakeholders suggested that the approaches adopted for the implementation of regulatory reforms, including timings and staging, has a material impact on smaller banks – separate to the impacts of the actual reforms.

Smaller banks can face disproportionate challenges in implementing new policy reforms, in part due to a lack of internal resources, and competition with other firms for external expertise. This not only results in higher costs to smaller firms, but also increases implementation risks for firms and affect the effectiveness of reforms.

Phasing of implementation deadlines can provide opportunities for smaller banks to develop expertise, learn from prior experiences, develop implementation resources and tools, and to collaborate on developing common solutions. It can also give policy makers and regulators more time to adjust and improve the regulation and supporting guidance for smaller banks.

Some respondents suggested expanding the role of the Regulatory Initiatives Grid (RIG) in driving greater coordination between the Government and regulators. However, the RIG is outside of the Terms of Reference of this Review.

The Australian Government Guide to Policy Impact Analysis already requires policymakers to consider the different impacts policy reforms could have on affected cohorts.<sup>51</sup> Therefore, policymakers should already be taking small and medium-sized banks into account when considering reforms. For example, APRA is providing non-SFIs an extra year to comply with the full requirements of the new operational risk management standard (*Prudential Standard (CPS) 230 Operational Risk Management*).

The CFR further considered but did not support a default position of granting smaller banks more time than larger banks to implement reforms. This would not be appropriate given the need to consider other factors when setting implementation timetables – such as the urgency to address risks to banks and their customers, or the broader financial system.

**Recommendation 3: The Government and regulators should seek to give due consideration to how future policy changes will affect smaller banks relative to their larger peers, including the impacts of different implementation approaches. This should include consideration of different options for staging commencements, having regard to organisational size and capabilities.**

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<sup>51</sup> [www.oia.pmc.gov.au/resources/guidance-impact-analysis/australian-government-guide-policy-impact-analysis](http://www.oia.pmc.gov.au/resources/guidance-impact-analysis/australian-government-guide-policy-impact-analysis)

## 6. Entry, exit and scale

This chapter explores issues relating to the ability of small and medium-sized banks to enter the Australian market and grow their businesses. New entrants can be a source of competitive pressure in any market, including through introducing new technologies and business models, and by targeting specific customer cohorts. Barriers to entry or growth can reduce competitive pressures.

Like some industries, scale presents a significant challenge in Australia's banking market. Banks typically face high fixed costs and lack of scale can present challenges to ongoing profitability and sustainability, particularly given the costs associated with investing in systems and technologies. Larger banks can typically spread these costs across a higher revenue base.

This chapter set out recommendations aimed at assisting new entrants and existing small and medium-sized banks in gaining greater scale.

### 6.1 New bank entry and exit

In recent years, new banking entrants have generally been large international banks establishing branches, or small digitally focused start-up banks. Foreign bank branches are a heterogeneous group, primarily offering services to institutional clients, and are likely to be operating in Australia as part of a global product offering, or servicing clients from their home jurisdiction – they do not typically provide services to retail customers. Start-ups, by their nature, can sometimes struggle to apply substantive competitive pressure, unless they successfully gain significant growth or introduce significantly disruptive business models or technologies.

#### Start-up banks – licensing

Bank licensing requirements must be of a high standard to ensure new banks are financially sound and to give depositors confidence their money is safe. APRA must strike an appropriate balance in licensing new entities, so that prudential requirements and processes are robust to ensure financial safety but are not unduly burdensome or delay timely entry.

Australia's banking market has seen an increase in new entrants over recent years. Since 2018, when APRA introduced a new licensing framework aimed at encouraging new entrants, 17 new banks have entered the Australian banking market, 8 of which were domestic and 9 foreign banks. For domestic banks, this represents a significant increase compared to the decade prior where there was only one new domestic bank; the numbers of new applications by foreign banks have been less changed.

As expected with start-ups in any industry, newly licensed banks have experienced mixed success. Some continue to apply pressure to incumbents. This includes Judo Bank, which has emerged as a key lender to small and medium-sized businesses, growing to a \$17 billion balance sheet within a few years of being licensed. Some new entrants have been acquired by larger players and others have voluntarily exited. A common challenge has been raising sufficient capital from investors to support new banks' growth plans.

Notwithstanding APRA's 2018 changes to support new entrants, APRA's approach to licensing was an area of focus in some submissions. Several stakeholders suggested that assessment timeframes could be shorter and that greater clarity on entry requirements and timeframes should be provided at the outset.

Last year, APRA announced that it would review its licensing framework.<sup>52</sup> Submissions to this Review have provided an important input to APRA's work.

The CFR is supportive of APRA's planned changes to its licensing framework, which would be subject to further consultation with industry. In simple terms, these changes aim to introduce greater efficiency in the licensing process. This would involve providing applicants with greater clarity on what is required to gain a licence via the introduction of new formal licensing criteria. The changes may introduce a set timeframe for assessing applications.

Greater clarity in expectations and timeframes would assist new entrants in their planning, providing a smoother and more efficient licensing pathway. The new criteria could also provide supervisory efficiencies. Historically, there has been a tendency for some applicants to apply for a licence well before they are ready to do so. This can provide a material drain on APRA's resources, diverting APRA's focus from better prepared applicants that have invested more time and resources into their application. Formal timelines would create a stronger incentive for applicants to be appropriately resourced.

**Action 6: APRA will make changes to its licensing framework, with the aim of making its expectations more transparent and its processes more efficient. This includes introducing formally defined and explicit timeframes for licensing assessments.**

## Improving access to funding for new entrants

Start-up banks face significant commercial and regulatory hurdles. For many, success involves a race to profitability before using up initial investor capital. New banks experience difficulties in attracting initial investors and then diversifying ownership over time. For investors in these start-up banks, success could be the transition to profitability, but also potentially acquisition by a larger bank.

The *Treasury Laws Amendment (2019 Measures No. 3) Act 2020* implemented changes to the *Financial Sector (Shareholdings) Act 1998* (FSSA) to streamline approvals for larger ownership holdings in start-ups. This mainly involved changing the relevant test from a national interest test to a much simpler fit and proper person test of the proposed owner. The objective was to introduce a streamlined approval path for investors to hold more than 20 per cent in a new bank. It is unclear whether previous FSSA reforms have had a positive effect on start-up numbers.

There are major complex commercial challenges for start-ups to acquire sufficient capital. The CFR considers there are relatively fewer regulatory obstacles. However, the CFR understands there are some interconnections between the two. For example, obtaining regulatory approvals can contribute to investor confidence to provide further funding.

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<sup>52</sup> APRA (2024), [APRA Corporate Plan 2024–25](#), APRA, accessed 24 June 2025.

The CFR considers that regulatory frameworks should facilitate (or at least not unduly obstruct) banking start-ups being able to source capital to establish and support their operations to the point of profitability. This can be subject to other competing policy objectives such as promoting competition, protecting consumers, and ensuring system stability (although sometimes these objectives can be mutually reinforcing).

The CFR considered whether current thresholds for streamlined FSSA approvals for start-ups reflected:

- the expected time and scale for start-ups to be well onto the path to viability; and
- an appropriate proxy for lower risk circumstances that justifies a streamlined regime.

It also considered whether time limits, as well as asset limits, were necessary to appropriately limit the application of streamlined processes for start-ups.

**Recommendation 4: The Government should expand the eligibility to use the current streamlined test for *Financial Sector (Shareholdings) Act 1998* approvals for bank start-ups by extending the life of streamlined approvals from 2 years to 5 years in duration; and increasing the maximum total resident assets limit from \$200 million to \$500 million.**

## 6.2 Consolidation approvals and delegations

The Australian banking industry has seen significant consolidation in recent decades. This consolidation was driven by efforts mainly among smaller banks to achieve synergies, adapt to innovations and obtain scale.<sup>53</sup>

Consolidation among smaller banks is likely to continue, given ongoing trends benefiting scale (such as digitisation). Smaller banks face competitive pressures in their key product markets (notably, residential mortgages), and higher relative cost-to-assets and cost-to-income ratios compared to larger banks. They also report lower returns on equity and assets, compared to larger banks.<sup>54</sup>

Consolidation in industries can often be associated with less competitive outcomes. However, in sectors such as banking where there are a handful of large banks that dominate most product segments, mergers between small players may allow them to gain benefits of scale, develop into more vigorous competitors and, therefore, benefit consumers. Regulatory requirements for consolidation can be substantial for small banks. Recognising this, the CFR considers that the Government should facilitate streamlined regulatory approval processes for small banks to reduce cost and complexity, while maintaining safeguards on competition and financial security.

Regulatory approvals associated with banking industry consolidation include those under the:

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<sup>53</sup> For example: major banks' acquisitions of St.George, Bank West, Suncorp, 86400, and the retail arm of Citibank; Bank of Queensland's acquisition of ME Bank, the Bendigo/Adelaide Bank merger, the Heritage/People Choice merger, the Newcastle Permanent/Greater Bank merger.

<sup>54</sup> CFR (2024), [Review into small and medium-sized banks - an Issues Paper by the Council of Financial Regulators, in consultation with the Australian Competition and Consumer Commission](#), CFR, p.13-14, accessed 24 June 2025.



- FSSA
- *Financial Sector (Transfer and Restructure) Act 1999* (FSTRA)
- Section 63 of the *Banking Act 1959* (Banking Act)
- *Foreign Acquisitions and Takeovers Act 1975* (FATA)
- Merger assessments under the *Competition and Consumer Act 2010* (CCA).

Most recently, the *Treasury Laws Amendment (Mergers and Acquisitions Reform) Act 2024* has amended the CCA to create a mandatory and suspensory merger regime. The new regime only applies to mergers that meet certain thresholds and is designed so that where no competition concerns arise, mergers are approved quickly (as soon as 15 business days). Consideration of further changes to the CCA merger provisions are outside of the scope of the Review's Terms of Reference. However, the provisions in the FSSA, the FSTRA and the Banking Act are in scope.

There is some overlap in the tests being applied under the different approval requirements. Notably there are 'national interest' tests under FATA, Banking Act and the FSSA. There is consideration of competition impacts under CCA merger authorisations as well as under the various national interest tests.

The CFR considered how regulatory frameworks could facilitate (or at least not unduly obstruct) consolidation between small banks to enable them to better realise economies of scale, and to potentially provide stronger competitive pressure for banking services. Any changes would still need to meet the underlying objectives of the FSSA and other approval processes. They would need to ensure the structure of the banking sector serves the national interest, including by supporting competition and protecting consumers.

While yet to be tested, the CFR concluded recent competition merger reforms can provide a good model for streamlining approval processes. That said, the *de minimis* thresholds in that regime should not be replicated for other banking consolidation approval processes in the first instance. While the ability to introduce them at some future stage should be pursued, the effectiveness of streamlined processes for approval should be assessed first. This would provide an opportunity to gather information on the risks and benefits of a potential future carve out for consolidations between very small banks.

The CFR also observed that delegation thresholds to APRA under the FSSA, FSTRA and Banking Act could be raised to streamline approvals, while maintaining appropriate direct control by the Government over more systemically important entities.

Overlaps in the tests applied under different approvals could result in inconsistent decisions, or at least unnecessary costs and delays in coming to similar conclusions. The CFR believes that reforms could be taken to remove duplication, such as by allowing approvals to adopt conclusions already determined in other processes, without reconsideration.

A streamlined notification and clearance regime should apply for FSSA and related approvals.<sup>55</sup> This should not apply to banks of greater than \$10 billion in assets or banks that are subject to the streamlined start-up FSSA regime. The FSSA regime should be reformed to minimise reconsideration of elements of the approval tests that have been determined under other approval processes commonly required for bank mergers – most notably competition impacts, if already considered under merger clearances.

If FSSA reforms are progressed, the Government could take the opportunity to address various technical issues that add complexity and delay to FSSA processes. Existing delegations to APRA to grant FSSA, FSTRA and related approvals should be raised from currently applying to acquisitions with less than \$5 billion of assets.

Smaller bank consolidation approvals are more likely to be driven by practical regulatory considerations for which the front-line regulator is well placed to make judgements. The larger the transaction the more likely that consideration of the ‘national interest’ test may involve impacts on the larger economy and society, which are better assessed by Government rather than by APRA. The CFR considers that these factors weigh in favour of delegation being raised to a threshold in the order of \$10 billion.<sup>56</sup> A higher delegation could be supported with appropriate governance and accountability mechanisms.

**Recommendation 5: The Government should introduce a streamlined notification and clearance regime for *Financial Sector (Shareholdings) Act 1998* (FSSA) and related approvals. This should apply to banks with less than \$10 billion in assets.**

**Additionally, existing delegations to APRA to grant FSSA and related approvals should be raised from currently applying to acquisitions with less than \$5 billion of assets to at least a \$10 billion threshold.**

### 6.3 Modernising the Financial Claims Scheme

Depositor confidence is an enabler of small bank competition, providing them with access to stable and efficient deposit funding.

Deposit guarantees play an important role in promoting confidence by assuring depositors that their money is safe, protecting them from potential loss and enabling prompt access to their money. This supports confidence for bank customers to deposit their funds with smaller banks, including with start-ups. It also reduces depositors’ incentive to withdraw their deposits in times of market stress and cause a ‘run’ on the bank and can help prevent a loss of confidence in one bank from spreading to healthy banks. In doing so, deposit guarantees complement the assurances of safety provided by up-front prudential regulation.

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<sup>55</sup> Including approvals required under section 63 of the Banking Act, but not *Financial Sector (Transfer and Restructure) Act 1999* approvals.

<sup>56</sup> Assuming the delegation solely referenced the transferring entity (noting that some delegation refers to the combined entity), 83 of the 126 ADIs could be in scope with a delegation of \$5 billion, 100 with a delegation of \$10 billion

Australia launched its deposit guarantee scheme, the FCS, in December 2008 in response to the GFC. The scheme was reviewed in 2011, with depositor coverage being adjusted to \$250,000 per depositor per bank.

In the unlikely event of bank failure, the FCS forms part of the broader resolution toolkit by helping to minimise the impact. The FCS will pay out depositors following a bank's closure. In addition, FCS funds can also be used to support the transfer of depositors to another bank. The FCS is a particularly important resolution tool where a forced sale of the failing bank is not possible given the lack of a willing commercial acquirer. This is particularly the case for small banks, which may be less attractive to potential acquirers due to their small asset size relative to the absorption costs involved in an acquisition. Finding a willing acquirer can be even more challenging in an uncertain environment. In these circumstances, use of the FCS may be the most appropriate resolution option.

This section examines the effectiveness of the FCS, particularly in its role as a resolution tool for small banks.

### ***Maintaining depositor confidence***

The guaranteed protection of \$250,000 per depositor is the bedrock of the FCS's role as a confidence tool. While the growth of the financial system has seen coverage levels gradually decline, the FCS still insures most depositors in full (95.4 per cent of all depositors, as at December 2024) and a substantial proportion of deposits by value (45.3 per cent as at December 2024, down from 50 per cent in 2015). The \$250,000 limit is also generous by international standards.<sup>57</sup>

The CFR has formed the view that the deposit limit is adequate to achieve the purposes of the regime, and that Government should maintain the existing FCS customer account coverage limit of \$250,000 per depositor per bank. However, the CFR considers it appropriate for coverage levels to be re-examined periodically to ensure coverage levels remain sufficient to achieve the FCS's objectives.

### ***Providing a more continuous depositor experience***

While the deposit limit is adequate, fundamental shifts have taken place in the banking sector since the FCS was last reviewed that challenges its effectiveness. Specifically, the ubiquity of social media and the digitisation of banking means bank runs are likely to be faster and more severe than in the past. Additionally, customers now expect 24/7 or 'continuous' access to their at-call deposits, and may withdraw funds if this is under threat, even if they do not perceive the funds being at risk of loss.

Currently, a failing bank would close following FCS activation, with insured deposits being paid out within 7 days (via electronic funds transfer (EFT) or cheque) and uninsured depositors receiving any residual proceeds following liquidation. This would cause significant disruption and uncertainty for depositors, as depositors would not have access to their insured deposits until funds are paid out via

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<sup>57</sup> The FCS guarantees deposits up to \$250,000 per depositor. UK coverage limit is currently GBP85,000, with a proposal for an increase to GBP110,000 from 1 December 2025; European Union members coverage levels differs across the region, with most covering approximately EUR100,000; Canada at CAD100,000; Singapore at SGD75,000; Hong Kong at HKD800,000, which increased from HKD500,000 in Oct 2024; New Zealand at NZD100,000; and US at USD250,000. However, unlike some jurisdictions, Australia does not provide higher coverage for temporary high balances.

FCS. The mismatch in expectations of access to funds could potentially undermine the ability of the FCS to instil confidence.

In an increasingly cashless society, paying daily living expenses for many depositors would be difficult without access to their bank account. Businesses would be unable to pay employees and suppliers. If insured depositors anticipate such disruption and inconvenience, they may even participate in a bank run despite the fact their deposits are ultimately safe.

The CFR recommends modernising the FCS to address these issues with the aim of reducing disruption for affected depositors. This would be consistent with the approach of the USA's Federal Deposit Insurance Corporation (FDIC). Their ability to provide depositors with uninterrupted access to their accounts was fundamental to Silicon Valley Bank's resolution. Modernisation should also deal with the end of cheques, which are being phased out. In designing a modernised FCS, it will be important to balance the benefits of greater continuity for depositors with the potential implementation costs for industry.

#### ***Enabling timely intervention***

Timely declaration of the FCS will be essential to facilitate a more continuous experience for depositors. Contagion risk may be more likely if declarations occurs after material disruption has already begun.

Current FCS triggers were designed to support the payment of depositors within 7 days. Therefore, facilitating timely intervention will require revisiting triggers. Designing appropriate triggers to enable APRA and the Government to gain the requisite legal certainty to act in a highly uncertain and fast-moving environment will be key, particularly as bank runs are likely to be faster and more severe than in the past. FCS triggers should be designed to permit activation on a forward-looking basis, that is, when a bank is likely to fail. This can be accomplished by the Treasurer having the power to intervene with the declaration of the FCS at the point the Treasurer deems intervention appropriate. Further, APRA's resolution powers should also have similar flexibility.

#### ***Enabling more flexible use of FCS funds***

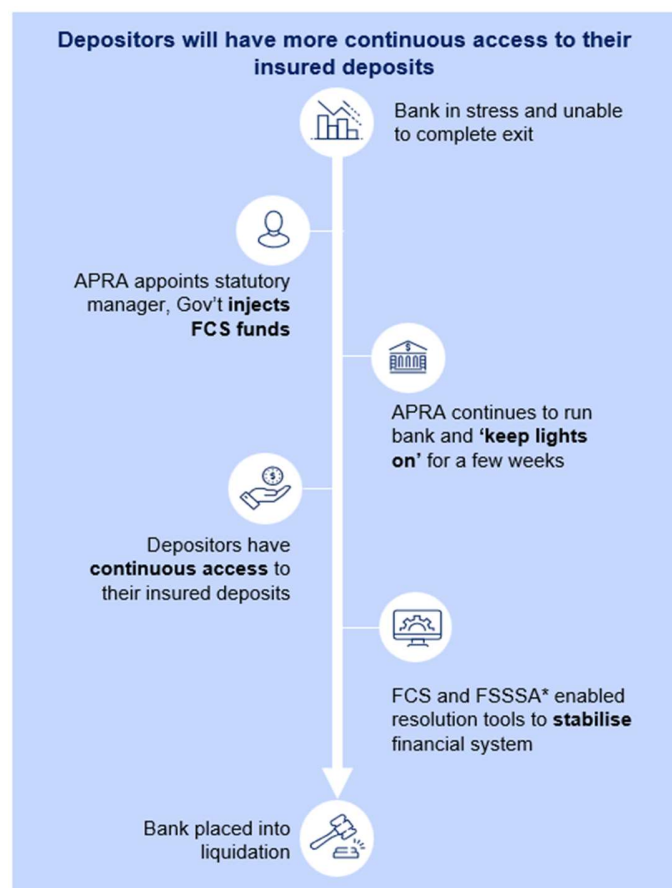
As an alternative to liquidating a bank and paying out insured depositors, APRA and the Government can already facilitate the compulsory transfer of a bank using FCS funds. However, FCS funds can only be used to support the transfer of assets and liabilities to an acquiring bank. FCS funds cannot support the transfer of shares from the failing bank to an acquiring bank through a sale of shares.

Recent overseas experience indicates that without the availability of responsive and appropriate resolution tools, bank runs can occur quickly in the digital era. The CFR recommends enabling FCS-backed transfers of shares, as it avoids the need to identify assets and liabilities for transfer. Share transfers also more closely resemble practice in commercial mergers and acquisitions. This power would be similar to the resolution tool recently announced in the UK, which incorporates lessons learnt from the resolution of Silicon Valley Bank in the UK.

#### ***Supporting operational arrangements***

There are supporting operational arrangements underpinning the FCS, including in relation to the management and sourcing of funds for making FCS payments. These arrangements must also adapt to the changing performance requirements of the FCS.

**Figure 6.1 – What a modernised FCS could look like**



\* FSSSA refers to Financial System Stability Special Account, as defined in s70E Banking Act

Overall, a modernised FCS proposed by the CFR should deliver a flexible and fit-for-purpose scheme that can be executed faster, better supporting depositor confidence and financial stability. Greater confidence in the safety of deposits should support small and medium-sized banks attracting deposit funding. It should also improve the reliability of deposit funding for these banks in times of market turmoil by disincentivising bank withdrawals, through lower-perceived risks of access to funds being disrupted.

Improvements to FCS effectiveness will also support competition by facilitating lower upfront regulatory requirements and costs, thereby lowering barriers to entry and a more proportionate approach to regulation.

**Recommendation 6: The Government should modernise the FCS by facilitating a more continuous depositor experience, enabling more timely FCS intervention, providing for more flexible use of FCS funds and ensuring supporting operational arrangements remain fit for purpose.**

## 6.4 Addressing gaps with unclaimed moneys and deposits in bank exits

Deposits may be unclaimed when a bank fails (or otherwise ceases to be a bank) and the rightful owner of the deposit cannot be located. Similarly, FCS payments can become unclaimed if APRA cannot locate the deposit holder entitled to the payment.

Complexities, delays and costs can arise from dealing with unclaimed deposits. This can disrupt the orderly winding-up of a bank and can result in additional costs, particularly for smaller banks, affecting their competitiveness.

This section sets out identified gaps with unclaimed moneys and deposits that can affect and prolong bank wind-up or delay payments to deposit holders, in turn affecting depositor confidence in the banking sector.

### ***Deposit tail accounts following a return of deposit process***

In the event of a voluntary bank exit, APRA oversees a return of deposits process where the bank is required to take all reasonable steps to return customers' deposits. There can be a small number of depositors who are uncontactable despite reasonable attempts, and dealing with the deposit tail can delay and add complexity to an orderly exit. Workarounds are currently used to address this gap, including transferring unclaimed deposits to another bank which has agreed to take them on. The absence of a clear process and the need to find a bank to accept deposits in each case can complicate and delay a bank's exit. There are also significant costs to do so – for the exiting bank, the bank taking on the deposits and APRA.

To address this issue, APRA now generally expects the exiting bank (including start-ups) to bear the cost burden associated with the operational challenges of dealing with unclaimed deposits. This creates additional barriers to entry and profitability for start-ups.

### ***Unclaimed moneys for inactive accounts***

The unclaimed moneys regime allows banks to transfer bank deposits that have been inactive for at least 7 years to Consolidated Revenue.<sup>58</sup> ASIC administers these accounts on behalf of the Government. The depositor can reclaim their unclaimed moneys later with the bank by verifying their identity with the bank, who processes the claim for approval. If the bank is satisfied the deposited amount is payable to the claimant, ASIC returns the unclaimed moneys to the bank who in turn pays the claimant.

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<sup>58</sup> Section 69 *Banking Act 1959*.

In rare circumstances, there can be a gap in this unclaimed moneys process where the entity ceases to be a bank or is no longer in operation, and its banking business has not been transferred to another bank. In those circumstances, there is no bank for ASIC to return the unclaimed money to, and the Banking Act does not prescribe what should occur. To ensure depositors receive their funds on these rare occasions, ASIC has implemented a workaround where ASIC verifies the identity of the claimant, in place of the bank. If ASIC is satisfied, it then applies to the Department of Finance to make an act of grace payment to the claimant, as ASIC does not have statutory authority to pay the money to the claimant directly. This workaround is resource intensive and slows down the return of funds to claimants.

More generally, the amount of unclaimed money lodged with ASIC and claims volumes have grown significantly. The processes for handling complex claims where ASIC assesses the identity of the claimants are largely manual.

### ***Unclaimed FCS payments***

There is currently no regime for dealing with unclaimed FCS payments. This has the potential to add complexities, costs and delays to any bank exits which involve the FCS. It also has the potential to reduce the assurances that the FCS provides; that customers' access to their deposits will be subject to minimal disruption.

### ***Using the unclaimed moneys regime to deal with unreturned deposits***

The CFR recommends reforms to address these 3 gaps to ensure funds can be returned efficiently, and complexities associated with bank exits are removed.

Easier and less costly bank exits would promote a more dynamic banking sector, supporting competition. It will also reduce up-front costs for new entrants, as APRA would not need new entrants to bear the disproportionate cost burden associated with dealing with unclaimed deposits. Consumers can also be confident that there is a clear process in place for their funds to be returned, which could help boost the competitiveness of small and medium-sized banks.

ASIC currently administers the unclaimed moneys regime under the Banking Act. ASIC is also responsible for unclaimed deposits under the *Life Insurance Act 1995* and various sections of the *Corporations Act 2001*. This includes situations when a company cannot contact a shareholder for more than 6 years, the money is the property of a deregistered company or there is unclaimed money after the liquidation of a company.

The CFR considers that as ASIC already administers unclaimed moneys arising from several different situations, the Government should consider extending ASIC's remit to also accept unreturned deposit tail accounts and unclaimed FCS payments. Because the bank has exited, ASIC would be required to assess any claim and, if valid, pay the money directly to the claimant. APRA would continue to be responsible for ensuring that the bank has taken all reasonable steps to contact customers before any money is transferred to ASIC, in accordance with its remit.

Accepting these deposits and verifying and paying claims would place an additional burden on the unclaimed money regime, which, as noted, has already seen a large increase in claims. Many unclaimed

deposits or FCS claims are also likely to have small balances, where the administrative cost of dealing with those accounts may be disproportionate to the amount eventually returned to customers. Dealing with these small claims is also an expansion of ASIC's existing role for unclaimed moneys received from banks, which requires the amount to be over \$500.

ASIC's current systems for management of unclaimed money are outdated, which present both cyber and scam risks. This is compounded by the phasing out of the use of cheques by government entities, which is currently the main method used to return deposits directly to a claimant following approval from the Department of Finance. ASIC would require resourcing to upgrade its existing systems for unclaimed moneys to deal effectively with these additional complex accounts. The Government should consider the need for additional resourcing for system improvements so that ASIC can efficiently and effectively administer the regime, including adequately addressing operational and emerging risks. Any additional resources provided to address risks in ASIC's current systems would also allow ASIC to take on any expanded remit.

Legislative amendments would be required so that ASIC has explicit powers to accept unclaimed deposits following a bank exit, assess and verify claims in place of the bank, and legal authority to pay these amounts to claimants. Similarly, amendments would be required to amend the Banking Act unclaimed money refund processes.

**Recommendation 7: The Government should address gaps with unclaimed moneys and unclaimed deposits associated with banking exits by:**

- a. Enabling ASIC to receive and deal with unclaimed deposits in relation to banking exits, including unclaimed FCS payments.
- b. Providing ASIC with the ability to repay unclaimed moneys from inactive accounts to a claimant in circumstances where the bank is no longer carrying on a banking business and has not sold or disposed of the business.

**If the Government adopts the recommendation above, this would support the removal of the expectation that future new entrants bear the cost of dealing with unclaimed deposits.**

## 6.5 Lowering barriers to collaboration

As noted in the Issues Paper and submissions, collaboration between small and medium-sized banks can provide a mechanism for increasing scale, reducing costs, better achieving compliance with the law, achieving efficiencies, and improving the quality of services provided and available to consumers. It can help overcome 'tragedy of the commons' or free-rider type issues in an industry. That includes situations where action would benefit all consumers but may impose higher costs on the first party or bank to act to make these changes. It also covers scenarios where individual banks do not have an incentive or ability to address an issue on their own. However, some collaborations can harm competition and be



detrimental to consumers and the economy. There are strong laws to protect consumers from such harm. When banks collaborate with each other, it is important to be aware of the elevated risk of breaching the prohibitions relating to cartel conduct and/or concerted practices. Concerted practices are communication or cooperation between 2 or more businesses. The communication or cooperation may not quite amount to a contract, arrangement or understanding, but it goes beyond businesses independently responding to market conditions. It involves sharing strategic commercial information, either publicly or privately.

The CFR understands that not all collaborative arrangements require competition clearance. Some collaborations will be less likely to raise competition concerns. Where collaborations do raise competition concerns, they may result in an overall public benefit or benefit for banking consumers that outweighs the likely or possible competitive detriment.<sup>59</sup> Whether a particular collaboration will give rise to competition issues or concerns will depend on the particular facts of the proposed arrangement. Banks will need to consider whether a proposed collaboration could give rise to such concerns, and assess their risk under the CCA before proceeding, including seeking legal advice where necessary.

For those collaborative arrangements that do require competition clearance, there are 2 main exemption processes available to small and medium-sized banks; authorisations (non-merger) and notifications (see Box 6.1). Banks, or industry groups representing banks, have successfully used both processes for conduct of both customer-owned and major banks.<sup>60</sup> Banks have also successfully sought interim authorisations, including in recent applications.<sup>61</sup> Interim applications can be approved quickly, as demonstrated in authorisations during the COVID-19 pandemic (see Box 6.1).

One submission to the CFR argued for the implementation of 'safe harbour' rules. A class exemption is an alternative process for protection from the prohibitions in the CCA for eligible conduct, which allows a business to self-assess whether their planned activity is covered by the class exemption. There is one class exemption currently in place, for collective bargaining for smaller businesses. It applies to small businesses that form (or that are members of) a bargaining group – and that each had a turnover of less than \$10 million in the financial year before the bargaining group was formed.<sup>62</sup> The CFR considers it unlikely that any significant number of current banks would be below this turnover threshold and qualify under the existing class exemption.

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<sup>59</sup> ACCC (2024), [Sustainability collaborations and Australian competition law - a guide for business](#), ACCC, p.20, accessed 24 June 2025.

<sup>60</sup> Recent examples include the [ACCC allowing a notification from COBA](#) enabling a subset of its members to engage a procurement company to negotiate with potential providers of a loan serviceability calculator, and the [ACCC granting an authorisation for the major banks and Macquarie Bank](#) to collectively acquire assurance services in relation to mortgage assurance.

<sup>61</sup> Examples include the ACCC granting interim authorisations in relation to [basic accounts and default interest charges for farmers during drought or a natural disaster](#), [cash in transit and business continuity planning](#), [cash in transit sustainability measures](#), and [financial relief programs during the COVID-19 Pandemic](#).

<sup>62</sup> ACCC (2021), [Collective Bargaining Class Exemption Guidelines](#), ACCC, accessed 24 June 2025.

### **Box 6.1: The ACCC's authorisation (non-merger) and notification processes**

#### *Authorisation*

Authorisation is a formal decision process undertaken by the ACCC. It provides statutory protection from legal action for arrangements that might otherwise breach the *Competition and Consumer Act 2010* (CCA). The ACCC can specify conditions on an authorisation and will only authorise conduct if it will not likely substantially lessen competition or if it is likely to result in a net public benefit.

Parties can also seek interim authorisation, which enables parties to engage in the proposed conduct while the ACCC considers the substantive application. When urgent, the ACCC can consider interim applications quickly. This was the case during the COVID-19 pandemic, where some interim applications were considered and granted within days of application.

Further information on the ACCC's non-merger authorisation process, including interim authorisations, can be found in the ACCC's guidelines . The ACCC also has a guide for sustainability collaborations, which provides an overview of the usual steps for assessing authorisation applications. While this guide focuses on sustainability collaborations, the examples and information within this guide may also be useful for banks considering other collaborations. The guide includes a 5-step checklist for businesses considering collaboration on sustainability objectives that may also be useful for banks.

#### *Notification*

Notifications are usually simpler and faster than the authorisation process, but can only be used for specific proposed conduct. Notifications can only be used for exclusive dealing, resale price maintenance and some collective bargaining and collective boycotts. As with authorisations, the test the ACCC uses to assess a notification is dependent on the nature of the activity. However, collective bargaining and collective boycott notifications are assessed by the ACCC to determine whether the arrangement is likely to result in a net public benefit.

Further information on the ACCC's notification process, as it relates to some collaboration between small banks, can be found in the ACCC's guidelines on small business collective bargaining. There is also further information on notifications in the guide for sustainability collaborations.

The ACCC is receptive to considering new class exemptions, including those from and in relation to small banks, and is open to discussions. However, there needs to be a clear and compelling case, supported by evidence, for a well-defined category of collaboration that businesses are considering and to which a

class exemption could be applied. Any new class exemption would be subject to approval by parliament.<sup>63</sup>

While there are processes available for competition clearance of collaborative arrangements between small banks, the CFR acknowledges stakeholder concerns and uncertainty about banks' obligations under the CCA and the relevant regulatory process. The CFR supports the ACCC reducing any such uncertainty through its engagement with the sector in order to lower the barriers to collaboration between small banks, noting the potential for net public benefit and for improving banks' compliance with laws. However, the CFR recognises the ACCC cannot give legal advice to banks.

**Action 7: The ACCC will communicate its openness to considering proposals involving collaboration between small banks, including:**

- **being willing and open to having early discussions with small banks and/or relevant industry representatives about their proposals for collaboration, and to help them understand whether an exemption may be available; and**
- **having discussions and providing clear guidance about small banks' options and processes available under the *Competition and Consumer Act 2010*.**

## 6.6 Consumer switching

Households and businesses can obtain significant value from switching their providers. This might involve switching all or some of their banking needs to those who provide better prices or offer products more aligned to their requirements.

The threat of customers switching also provides an important form of market discipline on banks of all sizes. However, it is not necessary for customers to actually switch to improve customer outcomes. Any increase in the potential for switching and the threat of losing customers can incentivise banks to improve prices or the quality of their offerings. Similarly, any increase in the ease with which they may acquire their competitors' customers also incentivises improvements of their offerings.

In Chapter 4, the CFR observed developments in the market that could support more consumer switching, as well as a number of obstacles for consumers wanting to switch providers.

Outside of mortgages and retail deposits there is limited recent data on switching rates. The CFR considers older switching data to be unreliable as it is unlikely to reflect current industry practices or consumer attitudes towards switching. Older switching data will also not reflect changes in switching behaviour resulting from recent movements in interest rates. The ACCC's Retail Deposits Inquiry (2023)

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<sup>63</sup> For more detail see ACCC (n.d.), [Class exemptions](#), ACCC, accessed 24 June 2025.

found switching rates of 11 per cent over 3 years for transaction accounts, 16 per cent over 3 years for main savings accounts and 14 per cent at maturity for term deposits.<sup>64</sup>

**Box 6.2: Current work on understanding and addressing the barriers to switching**

In recent years, there have been 2 ACCC inquiries that looked at switching for banking products – the *Home Loan Price Inquiry* in 2020 and the *Retail Deposits Inquiry* in 2023.

In the context of mortgages and retail deposits, the ACCC found that:

- A lack of price transparency makes it difficult for consumers to compare home loan products on their own.
- Comparison websites and mortgage brokers cannot fully address unnecessarily high search costs caused by opaque mortgage pricing.
- Issues with the home loan discharge process create inefficiencies in the switching process. This included opaque and difficult steps for borrowers to complete, and delays in existing lenders processing discharge requests.
- There are significant impediments to switching retail deposit products, which occur at several points in the process. Examples include changing direct debits and other recurring payments, redirecting incoming payments and proving identity.
- Key information on retail deposit products is available through bank websites and comparison websites, but can be too complex, not always easy to locate, and is inconsistent between providers.
- It is difficult for consumers to obtain an objective view of the best products due to lack of consistency between banks and conflicted arrangements with comparison websites.

The ACCC made recommendations to reduce the observed friction in the switching process. These recommendations included prompts for consumers, clearer disclosure of information and bank account portability. On 15 June 2024, the Government publicly announced its responses to those inquiries and work is progressing on implementation. Part of this response includes working with the Government’s behavioural economics team in the Department of Prime Minister and Cabinet, on behavioural prompts to encourage consumers to switch home loans and retail banking products.

There are currently mechanisms in place to reduce barriers to switching. This includes the listing and switching provisions of the ePayments Code for switching direct debits (also known as ‘tick and flick’). There appears to be low awareness and little promotion of ‘tick and flick’.<sup>65</sup>

Competition in small business banking and personal lending (including credit cards) has not been subject to recent examination. As a result, the CFR had little insight into consumer switching behaviours for those products, what the barriers might be, and how to address them.

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<sup>64</sup> ACCC (2023), [Retail Deposits Inquiry - Final Report](#), ACCC, p.129, accessed 24 June 2025.

<sup>65</sup> ACCC (2023), [Retail-deposits-inquiry-final-report.pdf](#), ACCC, p.138, accessed 24 June 2025

The obstacles to, and potential facilitators of, increased consumer switching are complex and will differ for different products. The CFR acknowledges the fundamental role switching can play in the competitiveness of the banking sector and recognises that well-designed policies can help facilitate switching, including in relation to home loans and deposit products. Further work is, however, needed to assist in better understanding the actual drivers of switching behaviour in relation to small business banking and personal lending. There would also be benefit in obtaining better data on switching activity, and activity relevant to understanding switching, such as current rates of multi-banking.

It is also important that the Government places appropriate priority on progressing its responses to the 2 previous ACCC reviews, particularly in relation to home loans given their importance.

## 7. Funding

Banks fund their assets with a mix of deposits, wholesale debt, and equity. Their funding mix is influenced by a range of factors including cost, risk and regulations. The relative stability of funding sources and banks' ability to access them are also part of the risk considerations. A bank's cost of funding is one factor that can affect its ability to compete on price.

Overall, submissions from small and medium-sized banks highlighted their cost of funding as an area where policy reforms could help improve their competitiveness. Specific issues raised included their differential cost and access to wholesale funding markets, in part due to institutional size, credit ratings and perception of different levels of implicit government support between cohorts of banks. The CFR acknowledges these challenges, but notes the inherent risks that complex interventions and explicit support may create for government and taxpayers. The CFR investigated the prudential treatment of warehouse provision and found that it struck an appropriate balance between safety and competition. Stakeholder submissions on the differences in the amount of capital required are dealt with separately in Chapter 5.

This chapter explores the policy areas considered by the CFR and outlines any corresponding recommendations.

### 7.1 Covered bonds

The Australian covered bonds regime was introduced in 2011, after the GFC. The regime was introduced to support Australian banks in accessing a potentially cheaper, more stable, and longer duration source of wholesale funding.<sup>66</sup> Existing legislation requires that a bank commits no more than 8 per cent of their Australian assets to 'cover pools' (groups of assets that secure the covered bonds issued). This cap was designed to limit the risks posed by claims from covered bond holders to depositors' claims in the scenario where a bank fails.

Covered bonds typically receive the highest credit rating as the cover pool is generally over-collateralised with high-quality mortgages and covered bond holders rank above unsecured creditors in their recourse to the issuer. This makes them a relatively cheap form of long-term wholesale funding. Australian banks tend to issue covered bonds at levels significantly below the cap to maintain capacity to access a contingent source of funding in times of stress, as investor appetite for covered bonds is typically more robust.

Due at least in part to the complexity of maintaining programs, only 5 medium-sized banks and the major banks have issued covered bonds to date.<sup>67</sup> While any increase in the 8 per cent cap would be unlikely to benefit smaller banks that do not have the scale to make a covered bonds program viable, it may still have competitive benefits for the medium-sized banks while reducing funding competition between medium-sized and small banks.

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<sup>66</sup> Lonsdale J (2011), [\*Understanding the key elements of covered bonds legislation\*](#), Treasury, accessed 24 June 2025.

<sup>67</sup> Individual banks' financial reporting.

Covered bond issuance provides banks with the ability to access markets that are typically of longer duration and cheaper than other unsecured wholesale funding. A higher cap would have several advantages for medium-sized banks. It would provide banks that issue offshore funding to mitigate rollover risks, given the typically longer duration of covered bonds. Banks that already issue covered bonds would have the additional flexibility to reduce their reliance on other wholesale funding sources. Additionally, for mid-tier banks which have not established access to offshore senior unsecured markets, a higher cap could provide greater incentive to issue in the offshore covered bond markets, giving them access to an additional source of investor demand.

On the other side of the ledger, higher covered bond issuance increases the risk of unsecured creditor losses in a resolution scenario, as covered bond holders' claims on the bank rank above unsecured claims, including those of depositors. Increased covered bond issuance may impact banks' credit ratings and the cost of senior unsecured debt funding, reflecting the lesser recourse to the banks' assets for unsecured creditors. Government could also be exposed to higher losses, given the Government's insurance of certain deposits under the FCS. Given that there are both potential benefits and risks associated with increasing the covered bonds cap, Government will need to weigh these carefully. In CFR's view, the Government could consider a moderate increase in the covered bond limit, to a 12 per cent cap.

**Recommendation 8: The Government should consider increasing the amount of Australian assets that can be committed to covered bond cover pools from 8 to 12 percent.**

The CFR further notes that some respondents argued for covered bonds to be included as eligible HQLA instruments under the Liquidity Coverage Ratio (LCR) regime. It was argued that this would help develop the domestic Australian covered bond market, which may result in better pricing of covered bonds for issuers.

Given the recommendation to increase the covered bond limit from 8 to 12 percent, there are several implications that the CFR agencies would need to subsequently consider:

1. **HQLA:** Increasing the issuance limit could improve the size and depth of the domestic covered bond market. Accordingly, APRA needs to assess whether to broaden the definition of HQLA to include covered bonds. APRA plans to look at this issue as part of a broader future review of *Prudential Standard APS 210: Liquidity*.
2. **Asset encumbrance:** A higher covered bond limit would increase asset encumbrance. This has implications for depositor protection, as well as wider financial stability since encumbered assets would not be available to obtain additional secured borrowing from other sources, such as RBA facilities. As a result, APRA will need to consider whether any controls are needed for a bank's overall level of asset encumbrance.

**Action 8: As part of a broader future review of its liquidity policy, APRA will consider whether:**

- a. covered bonds should qualify as High-Quality Liquid Assets under the Liquidity Coverage Ratio; and**
- b. total asset encumbrance limits should be introduced.**

## 7.2 Government support for funding markets

### Publicly backed residential mortgage-backed securities program

Residential Mortgage-Backed Securities (RMBS) are financial instruments issued by banks and non-bank lenders to transform illiquid assets, such as mortgages, into tradable securities backed by pools of residential home loans.

Lenders can use proceeds from selling RMBS to offer further lending. This provides lenders with flexibility and can enhance their ability to provide competitive mortgage products to customers. Investors of RMBS benefit from a steady income-generating asset, and the financial system may benefit from mortgage risk being distributed across a broader range of market participants. In Australia, the share of housing credit funded by securitisation has been broadly stable at 6 per cent over the past decade.

For some small and medium-sized banks, RMBS can be an attractive source of competitively priced funding compared to unsecured debt. This may reflect the fact that investors consider RMBS to be lower risk financial instruments secured against a structurally separated pool of assets.

However, insufficient scale can make RMBS a relatively costly source of funding because of the fixed costs involved with issuance, such as structuring, legal, and credit rating costs. Additionally, smaller banks may struggle to issue sufficient volumes to satisfy investor preferences. These factors mean that using RMBS as a source of funding is not commercially viable for many smaller banks. Further, a price differential still exists between RMBS issuances for major and smaller banks even where the latter holds more assets than is necessary to cover expected losses on the securitised pool of assets.<sup>68</sup>

Some stakeholder submissions argued that government intervention in the form of a publicly backed RMBS program is one way to facilitate smaller bank access to RMBS as a source of funding on comparable terms to larger banks. Examining the merits of similar schemes internationally aligns with previous government committee findings.<sup>69</sup>

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<sup>68</sup> There may be good reasons for this, such as mortgages of some smaller banks being less geographically diversified.

<sup>69</sup> House of Representatives Standing Committee on Economics (2024), [\*Better competition, better prices - Report on the inquiry into promoting economic dynamism, competition and business formation\*](#), Parliament of Australia, accessed 24 June 2025.



A publicly backed RMBS program is a government-supported initiative where a public entity directly intervenes in the RMBS market through the guarantee of RMBS issuance to private investors and/or mortgage insurance programs. They are subject to specific eligibility criteria and fees, which are designed to limit risks to the program and government.

#### **Box 7.1: Canada's publicly backed housing model**

Some stakeholders raised Canada's model as a potential solution to some of the funding cost challenges faced by small and medium-sized banks.

The Canada Mortgage and Housing Corporation, a government-owned entity, guarantees the timely payment of principal and interest to investors of National Housing Act Mortgage-Backed Securities. This guarantee, along with insurance on the underlying mortgages, protects investors from payment and mortgage credit risk. The Canada Housing Trust also purchases these securities from issuers as collateral for the issuance of Canada Mortgage Bonds.

For the guarantee, a one-off upfront fee as a percentage of the principal is charged to the Canada Housing Trust who issues the bond, which is then passed onto participating financial institutions. This fee changes according to the term of the bond.

The program appeals to a broader investor base because of its bond-like characteristics such as semi-annual coupon payments and principal payment at maturity (that is, a lower pre-payment risk). In this way, the program is intended to achieve funding at lower cost compared to non-guaranteed mortgage-backed securities.

The CFR considered the benefits and costs of implementing a publicly backed RMBS program in Australia modelled on the Canadian approach.

#### ***Arguments in support of a publicly backed RMBS program***

Several submissions supported the introduction of a government supported RMBS program, citing a number of arguments in favour of such a program:

- **Lower funding costs for banks and non-bank lenders:** By transferring payment and mortgage credit risks to the Government, lenders could benefit from lower funding costs. Government guarantees on mortgage-backed securities, like those provided by Fannie Mae and Freddie Mac in the US, have been shown to lower funding costs, as evidenced by lower option adjusted spreads.<sup>70</sup> In Canada, the insurance of underlying mortgages and the federal government's guarantees help attract investors and make funding available to lenders at rates close to those at which the federal government borrows.<sup>71</sup>

<sup>70</sup> Stroebe J and Taylor JB (2012), [Estimated Impact of the Federal Reserve's Mortgage-Backed Purchase Program](#), *International Journal of Central Banking*, 8(2), 1-42, accessed 24 June 2025.

<sup>71</sup> Bank of Canada (2024), [Canada's mortgage market—A question of balance](#), Bank of Canada, accessed 24 June 2025.

- **Benefits to consumers and the economy:** Lenders could pass through its lower funding costs to consumers in the form of lower lending rates on residential mortgages. These lower lending rates could improve housing affordability through increased access to credit for borrowers, promote housing related economic activity, and provide support to housing lending in weaker economic periods.
- **Generation of revenue for the Government:** By charging fees for insurance and guarantees, a publicly backed RMBS program could be a new revenue source for the Government. However, the revenue generated by the CMHC from charging insurance premiums and other fees are commensurate to the risk being transferred.<sup>72</sup>

### ***Arguments against a publicly backed RMBS program***

The Review has identified the following arguments against a publicly backed RMBS program:

- **Costs of transferring risks to the Government:** The transfer of risk from investors to the Government is not costless to investors. The Government will need to set lender guarantee fees that reflect the risk of the mortgages being guaranteed. Therefore, any reduction in funding costs will be post lender guarantee fees.
- **Indefinite Government exposure to credit and fiscal risks:** The Government and the Australian taxpayer would be indefinitely exposed to very large credit and fiscal risks related to the housing market, reflected as contingent liabilities for the Commonwealth. If the Government were to mirror Canada, where a quarter of the CAD\$2.4 trillion in outstanding mortgages are guaranteed by the Canadian Government.<sup>73</sup> This would translate to guaranteeing about \$600 billion dollars in mortgages in the Australian market.<sup>74</sup>
  - Accurately assessing risks and pricing accordingly would be challenging. Even if the program is designed to price and manage these risks appropriately, the Government may be pressured over time to change mortgage eligibility criteria or risk pricing. In this way, mispricing the risks being transferred from investors to the Government may ultimately lead to significant taxpayer bailouts in the event of a crisis. For example, during the GFC, the US Government had to bail-out two government-sponsored enterprises at a gross cost of nearly \$200 billion<sup>75</sup> to keep the housing market stable and functioning.<sup>76</sup> Further, financial risks related to the housing market are pro-cyclical, meaning that losses are more likely to occur and be more severe during economic downturns.

<sup>72</sup> CMHC (2023), [2023 Annual Report](#), CMHC, accessed 24 June 2025.

<sup>73</sup> Bank of Canada (2024), [Canada's mortgage market – A question of balance](#), accessed 24 June 2025.

<sup>74</sup> RBA (2025) [Financial Aggregates March 2025 | RBA](#). D2- Lending and Credit Aggregates, accessed 24 June 2025. One quarter of \$2.4 trillion is \$600 billion.

<sup>75</sup> House Committee on Financial Services (2013), [A Reminder of the Corruption That Helped Birth the Biggest Bailout in History](#), accessed 24 June 2025.

<sup>76</sup> Frame et al. (2015) 'The Rescue of Fannie Mae and Freddie Mac', *Journal of Economic Perspectives*, 29 (2) 25-52, accessed 24 June 2025.

- **Implementation and operational costs:** These costs would likely include the creation of a new agency, or expansion of an existing agency, which would be responsible for insuring mortgages, managing risk, issuing, and administering securities, and providing government guarantees for securities. For comparison, CMHC employs 2,379 full time equivalent employees,<sup>77</sup> which is similar in size to ASIC, at 2,188<sup>78</sup> and has a FY2024-25 cost to government of \$658 million.<sup>79</sup> Fees would be also expected to have to cover these operational costs.
- **Crowding out the private securitisation and lenders mortgage insurance (LMI) markets:** A publicly backed RMBS program could potentially crowd out private participation in the well-functioning private securitisation and LMI markets in Australia. In 2024, total issuance of asset-backed securities in Australia reached a post-GFC record of A\$80 billion.<sup>80</sup> Further, LMI is one of the most common forms of mortgage pool credit enhancements used in the Australian RMBS market.<sup>81</sup> Evidence from Canada supports these concerns, where private sector participation in the securitisation market fell from 50 per cent in 2000 to almost none by 2015.<sup>82</sup> In the Australian context, crowding out of private LMI could disrupt the critical role it already plays in supporting smaller lenders to compete with larger lenders (who can self-insure) by providing a means to mitigate risks associated with high loan-to-value (LVR) ratio lending.
- **Housing affordability and market distortion:** While a publicly backed RMBS program may improve access to lower-cost mortgage credit, it risks encouraging lending beyond prudent levels.<sup>83</sup> Enhanced access to credit is also likely to exacerbate housing affordability issues by inflating demand, without corresponding supply improvements. Ultimately, government intervention may weaken market-based risk pricing, which in turn undermines efficient capital allocation and reduces the effectiveness of market signals that guide investment to its most productive uses resulting in market distortions.

### ***Overall assessment of a publicly backed RMBS program***

A publicly backed RMBS program could deliver certain benefits, such as lowering funding costs for lenders and lowering borrowing costs for consumers through government guarantees. However, these potential advantages come with trade-offs, including market distortions, long-term fiscal commitments, and substantial contingent liabilities for the Government, that could ultimately be borne by Australian taxpayers.

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<sup>77</sup> CMHC (2023) [2024-28 Summary of the Corporate Plan](#), CMHC, accessed 24 June 2025.

<sup>78</sup> Treasury (2025) [Budget Paper No. 4](#), Budget, accessed 24 June 2025.

<sup>79</sup> Treasury (2025) [Budget Paper No. 4](#), Budget, accessed 24 June 2025.

<sup>80</sup> Australian Securitisation Forum (ASF) (2025), [ASF Response to CFR Review SME Banks](#), ASF, accessed 24 June 2025.

<sup>81</sup> RBA (2015), [Structural Features of Australian Residential Mortgage-backed Securities](#), RBA, accessed 24 June 2025.

<sup>82</sup> Bank of Canada (2015), [Residential mortgage Securitization in Canada: a Review](#), Bank of Canada, accessed 24 June 2025.

<sup>83</sup> Increasing reliance on serviceability and responsible lending requirements; and necessitating strict eligibility requirements for securitisation.

The Review has concluded on balance that the costs and risks associated with implementing such a program outweigh the potential benefits. As a result, it recommends that a publicly backed RMBS program should not be pursued in Australia.

### Publicly backed multi-seller securitisation

Multi-seller securitisation (MSS) is a financial mechanism that allows multiple banks to pool their assets to create a larger, more diversified portfolio. This pooled portfolio is then securitised, meaning it is transformed into marketable securities that can be sold to investors. By combining assets from various sellers, MSS aims to overcome the challenges that small and medium-sized banks face in accessing the securitisation market, such as limited size and diversification of the asset pool, increasing the perceived risk and lowering investor demand.

To help address the problem of access to diverse funding sources for smaller banks, some submissions argued for government intervention, as current market participants are deterred by the complexities and costs associated with setting up such a program. A publicly backed MSS scheme would involve government support to enhance the attractiveness of the securitised assets to both lenders and investors, including through reducing perceived risk. This support could take the form of guarantees (or other involvement in 'risk transformation') or other financial incentives. By facilitating access to the securitisation market, a publicly backed MSS may provide small and medium-sized banks with a more diversified and resilient funding base, thereby improving their ability to support economic growth and withstand financial shocks.

The CFR notes the complexity of MSS arrangements, particularly in relation to sharing credit risks. This complexity, combined with the historically limited market uptake or interest in MSS, operational costs and investor uncertainty, has made it challenging for small banks to implement or see the viability of such structures. Other market participants have previously made attempts at developing MSS structures, but have been unsuccessful in building long-term programs. Additionally, the Australian market is relatively conservative and small compared to other markets such as the US where the asset backed commercial paper market is more concentrated among multi-seller programs.<sup>84</sup>

Furthermore, the absence of a thriving Australian MSS market in the absence of public sector support may suggest that in the Australian context, the benefits are outweighed by the costs. If the private sector is unwilling to accept the current cost to benefits trade-off it is not evident why the Government should take on the cost and risk to do so. More broadly, MSS subsidies appear to be an inefficient way to support competition.

Given the efficiency of Australia's existing securitisation market, the lack of major regulatory and legal barriers to MSS, and uncertainty of consumer benefit, the CFR concludes that an MSS regime that is dependent upon ongoing government subsidy is not an appropriate approach to support banking sector competition in Australia. The CFR remains open to considering an effective industry-sponsored MSS model that provides resilient sources of finance, including in times of crisis.

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<sup>84</sup> Mayer|Brown (2024), [ABCP: Market and Regulatory Developments](#), Mayer|Brown, accessed 24 June 2025.

### 7.3 Exchange Settlement Accounts

Industry submissions highlighted that cost and operational complexity can affect the ability of smaller banks to access Exchange Settlement Accounts (ESAs) at the RBA as part of their liquidity arrangements. The RBA has recently updated its ESA Policy to streamline the application process for smaller banks applying to hold an ESA to deposit funds (not to settle payment obligations), including by reducing application information requirements. Additionally, the RBA is reviewing the operational requirements for maintaining this type of ESA. The RBA has communicated the policy changes to industry and will implement any changes to operational requirements by the end of July 2025.

## 8. Going further

This chapter explores more ambitious options for reform, namely a more material reduction in prudential regulatory settings for very small banks (a 'Tier 4' regime). While these changes would support increased dynamism in the sector, they would also increase the riskiness of very small banks.

The appropriate balance between competition, safety and stability is ultimately a decision for the Government. Given this, the CFR has set out the potential implications of establishing a Tier 4 regime, rather than making a direct recommendation to the Government. If the Government is supportive of a Tier 4 regime, CFR considers that additional safeguards will be required beyond the changes to the FCS set out in Chapter 6.

### 8.1 Competition and safety

Under APRA's existing approach to prudential regulation, the failure of a very small bank is unlikely. APRA's prudential framework is intentionally designed to ensure the Australian banking system is among the strongest in the world. This has important benefits: for large banks, it supports them in accessing international funding markets; for smaller banks, it can assist with maintaining depositor confidence, particularly in times of stress.

However, this emphasis on safety can also weigh on innovation and dynamism, reducing longer-term outcomes for customers. For small banks and startups, regulatory costs can represent a material share of income. Government, and consequentially regulators, need to be conscious of the desired target levels of risk which optimise overall outcomes for stakeholders in the longer term. This Review is an opportunity to consider the balance of settings for smaller banks.

A Tier 4 prudential regime would involve a lighter set of prudential requirements for very small banks. This would reduce the focus on preventing the failure of a very small bank, allowing these banks to take on more risk. The lowering of the costs of additional regulatory compliance would help to free up more capital for these banks to improve the competitiveness of their offerings, and to expand and grow. The adoption of a fourth tier of banking regulation may result in a higher rate of orderly bank failure in Australia, particularly compared to the last few decades.

To mitigate the potential risks to depositors and financial stability when failure occurs, the CFR considers that additional safeguards would need to be introduced, in particular additional changes to the FCS. Even with these additional safeguards, this would represent a material change in how the community experiences Australian banks and risk appetite settings for the Government. A higher rate of orderly bank failure could increase risks to the Government's budget from greater use of the FCS, as well as potentially exposing uninsured depositors and other creditors to greater losses.

The balance between risk prevention and harm mitigation is an important trade-off for the Government to consider. Set out below is the key design features of a potential Tier 4 regime, and CFR's view of the additional safeguards the Government would need to implement to protect depositors and financial stability.

## 8.2 Further enhancing proportionate prudential regulation

Subject to a strengthening of ex-post safeguards to mitigate the harms from disorderly failure, the CFR considered whether APRA could develop a 'light' prudential regime for very small banks. This could be implemented through introducing fourth tier to the prudential framework, which would reduce prudential requirements for banks with total assets below a certain threshold.

The creation of a fourth tier of regulation would provide an opportunity to reset government and regulator risk appetites (and the balance between risk mitigation and harm mitigation measures) for the smallest non-systemically important banks. The reduction in regulatory burden would free up capital for innovation and competition.

Reduction in burden may also help with the low profitability of very small banks although, as stated previously, this is driven largely by commercial factors. A lighter-touch fourth tier of banking regulation would also provide a more graduated regulatory pathway for new entrants, with potentially additional competition benefits to the system. The changes could also refocus regulatory effort towards more systemically important banks, although the creation of an additional tier of regulation would be expected to place significant demands on APRA in the short term.

Conditional on enhancements to FCS as discussed in section 8.3, the CFR considers a \$2 billion asset threshold may be appropriate for a fourth tier of banking regulation. This level would capture a significant population of very small banks with simple business models and risk profiles (55 out of 134 APRA licensed banks representing 0.58 per cent of total system assets). The CFR considers that a higher threshold would not be appropriate, given the greater risks to financial safety and stability.

The design of a possible fourth tier would need to be subject to consultation. At a high level, APRA expects that the main area where requirements could be reduced would be non-financial requirements, such as expectations for governance, remuneration and risk management. This approach would reduce compliance burdens and costs for small banks, reflecting their simple business models and risk profiles. There may also be some reduction in Pillar 2 capital requirements, reflecting that APRA could permit a higher likelihood of failure given the greater ex-post safeguards in place, which would support orderly resolution of failing banks.

Expectations on fourth tier banks for exit planning and FCS operational readiness would be expected to be heightened. This would ensure any exits or failures (which would be more likely given lower 'resilience' settings) are orderly.

## 8.3 Ex-post safeguards – the Financial Claims Scheme

There are further steps that could be taken to improve the FCS' effectiveness through ensuring reliable and timely triggering of the FCS. These steps would be necessary for ensuring that risks can be mitigated, if prudential requirements of Tier 4 banks were reduced.

The Banking Act (section 16AD) provides the Treasurer the power to activate the FCS should a distressed bank meet at least one of the two requirements. Both requirements imply that the bank is either likely to become insolvent, or is already insolvent, given APRA's appointment of a statutory manager or an

application for wind up. APRA, as both the prudential regulator and resolution authority, would be working closely with all CFR agencies, including the Treasury, in the lead up to the activation of the FCS.

The FCS has not yet been used in the resolution of a bank in Australia, with APRA in practice having encouraged alternative approaches such as mergers with other banks, voluntary return of deposits, and return of licence. However, a willing buyer is not always available for a merger to materialise, and a voluntary return of license may unnecessarily prolong the life of a weak bank, inhibiting business opportunities for stronger banks.

As discussed in Chapter 6, the CFR recommends the FCS be modernised to improve confidence in its use as a resolution tool for small banks. Additional enhancements to the FCS are needed if Australia was to move to a lighter touch prudential regime for Tier 4 banks. This includes improving the efficacy of the FCS trigger framework via a delegation to APRA for banks below a specified threshold (Tier 4). The improvements are not directed at enhancing the level of being protection for customer deposits; as previously stated, the CFR is confident that the regime currently sets appropriate limits. Instead, the improvements would provide greater confidence that the FCS can be quickly used as a practical means to resolve the failure of very small banks in an orderly way. This would include exits of new entrants, supporting APRA in designing licensing requirements that appropriately balance competition and safety.

This approach of delegating the triggering of the FCS for very small banks to the independent resolution authority (in this case, APRA) would better align with international best practice. For example, the triggering of deposit insurance, at least for small banks, in the UK, Canada and US is determined by the decisions of independent regulators and deposit insurance agencies. The CFR considers delegation of triggers would be an important prerequisite for any decision to implement greater proportionality through a fourth tier of prudential regulation.

**Table 8.1: Deposit insurance trigger body in UK, Canada and US**

Country	Who activates deposit insurance?	Role for government
UK	✓ FSCS Board	<ul style="list-style-type: none"> <li>Effective approval for larger banks (e.g. beyond prefund size)</li> </ul>
Canada	✓ CDIC	<ul style="list-style-type: none"> <li>Effective approval role for larger banks (e.g. beyond prefund size &amp; statutory borrowing limit)</li> <li>Veto power and directions power</li> </ul>
US	✓ FDIC	<ul style="list-style-type: none"> <li>N/A</li> </ul>

The CFR considered the potential merits of pre-funding the FCS through ex-ante industry levies, as is the case in many foreign jurisdictions. The CFR notes that any decision on pre-funding would have implications for competition, the Government's fiscal position (at least in the short-term following activation of the FCS), as well the operation of the FCS.



**Recommendation 9: The Government should consider its openness to APRA taking a lighter-touch approach to the regulation of very small banks, to support their improved dynamism and competitiveness.**

**In CFR's view, a lighter-touch prudential regime for very small banks would only be appropriate if corresponding adjustments were implemented by Government to protect depositors and financial stability – this includes delegation of FCS triggers to APRA for this cohort.**

## 8.4 Ex-post safeguards – liquidity support

In addition to FCS improvements, the strength of liquidity support would be a key consideration in establishing a Tier 4 regime for very small banks. A range of submissions advocated for various forms of additional RBA facilities for smaller banks, reflecting the fewer funding options available to them in times of stress, which are in turn reflected in the calibration of APRA's existing liquidity requirements for smaller banks. Smaller banks may have fewer options for liquidity in times of stress because their smaller size means their normal funding sources are less diversified and they have less collateral to obtain secured funding.

All banks can obtain liquidity from the RBA if they meet the RBA's eligibility criteria and become an eligible counterparty. While banks are responsible for managing their own liquidity, including in periods of stress, it is possible for eligible counterparties that are solvent but facing acute liquidity stress to seek exceptional liquidity assistance (ELA) from the RBA. ELA is provided at the absolute discretion of the RBA's Monetary Policy Board and would be considered in circumstances where the Monetary Policy Board judges that the bank is solvent and providing ELA would be in the public interest.<sup>85</sup> The RBA also has discretion over the range of collateral it would be prepared to accept in ELA operations, which could extend to self-securitisations that do not feature in its regular open market operations.

An existing private financial support mechanism available to some smaller banks is the Credit Union Financial Support System (CUFSS). CUFSS was established by the Australian mutual bank industry and provides certain mechanisms for members to help facilitate liquidity support to each other should a member require liquidity support under a stress scenario.<sup>86</sup> Smaller banks also have the option to pre-position collateral with larger institutions (via bilateral or trilateral repo arrangements) to manage the risk of liquidity stress.

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<sup>85</sup> RBA (2025), [Liquidity facilities](#), RBA, accessed 24 June 2025.

<sup>86</sup> CUFSS included 34 member banks as at September 2024. For further details, see CUFSS Limited (n.d.), [About CUFSS](#), CUFSS, accessed 24 June 2025.

**Action 9: CFR agencies will work with the industry to assess whether refinements could be made to improve operational arrangements for small banks' access to private and public liquidity support. Any improvements to liquidity safeguards should be considered by APRA when setting requirements of small banks.**