

Submission to Independent Facilitator

Reforms for cooperatives, mutuals and member-owned firms

**Key Message**

Defence Bank supports amending the Corporations Act to establish a statutory definition of a mutual organisation in Australia to underpin the issue of a Mutual Capital Instrument. The ability to issue such an instrument would provide Defence Bank, and other Mutual Banks, a source of capital that can be deployed against new lending thereby allowing Mutual Banks to provide more effective competition to listed banks.

**About Defence Bank**

Defence Bank (formally known as Defence Force Credit Union), is a responsible and profitable member owned or Mutual bank that has been in operation since 1975. The organisation was established over 40 years ago to assist and supports the Defence community with financial services and money management. The organisation has established a significant presence in the Defence community with over 90,000 members and $2.0 billion in assets under management and is a participant in the Defence Home Ownership Assistance Scheme (DHOAS or the Scheme).

Membership is open to serving and former members of the Australian Defence Force (ADF), civilian employees of the Department of Defence (DOD), Defence Contractors, and their extended families and the Defence Community.

Defence Bank is owned by its members and exists to help members to achieve financial security in a profitable and sustainable way. Unlike listed financial institutions, Defence Bank does not exist to provide dividends to an external shareholder base. Our members are our shareholders and we strive to provide them with attractively priced products and financial solutions that meet their needs.

**About DHOAS**

DHOAS is scheme legislated by the Federal Government of Australia that assists serving and ex-serving ADF members and their families to achieve home ownership. DHOAS is a part of the ADF recruitment and retention benefits arrangements incentivising length of service whereby the longer a member serves in the ADF, the greater the entitlement they are entitled to under DHOAS and the longer they can receive assistance.

Defence Bank is one of three authorised providers of loans within the DHOAS scheme who compete with each other for the business of individual ADF members.

The Department of Veterans Affairs (who administer the DHOAS Scheme on behalf of the department of Defence) continually monitors the performance of the loan providers against a number of service criteria.

**The Impact of Capital Constraints on the Mutual Banking Industry**

Current regulatory settings, which preclude Mutual Banks such as Defence Bank from issuing capital, impose limits on the extent to which Mutual Banks are able to provide sustained and effective competition against listed or privately owned Banks.

This limitation arises as Mutual Banks that are reliant solely on retained earnings as a source of capital are limited to growing their loans portfolio at a rate that is broadly in line with their growth in retained earnings (ie. their Return on Equity)

Such a restriction traps Mutual Banks in a scenario where asset growth / revenue growth is only just sufficient to offset rising costs, including those imposed by ever increasing regulatory burdens.

 What is required to break free from this scenario is for Mutual Banks to be able to grow loans / revenues faster than the growth in operating costs which will in turn will provide economies of scale.

Trends in recent years have seen Mutual Banks growing at rates that are in excess of systems growth with commensurate increases in market share. This demonstrates the ability of Mutual Banks to provide an attractive and competitive alternative offer to that of the major banks; however, in many cases this growth has been made possible due to existing pools of surplus capital and as capital levels decline towards Prudential minimums this loans growth (and therefore the ability to achieve further economies of scale) once again become limited by a Mutual Bank’s profitability.

The ability for Mutual Banks to access alternative forms of capital, other than retained earnings, is therefore key to enabling them to continue to grow their business and provide competitive loan products on a sustainable basis.

**Impact of Capital Constraints on Defence Bank**

Whilst Defence Bank is subject to the macro issues discussed above it also has specific concerns in relation to its participation in the DHOAS scheme. Defence Bank, in its capacity as an authorised loan provider under the DHOAS scheme, finds itself in a situation where on one hand it is expected to provide the best possible loan products to one arm of government (the ADF) whereas at the same time it is hampered in its ability to do so by another arms of government (ASIC and APRA).

The optimal outcome for ADF members procuring loans under the DHOAS scheme would be one where each of the loan providers aggressively compete on product, service and price to obtain the best outcome for members of the ADF; however, the requirement to manage loans growth in line with the generation of retain earnings means that Defence Bank is limited in it competition. As such the outcome for ADF personnel is less optimal than it could otherwise be. Defence Bank wishes to increase our home lending under the DHOAS scheme to the benefit of ADF personnel and our Bank.

**Proposed Solution**

Defence Bank supports amending the corporations act to establish a statutory definition of a mutual organisation in Australia which would underpin the issue of a Mutual Capital Instrument. Such an instrument would necessarily have the following features:

* New securities are permanent
* They may confer membership on the holders
* They could be owned by individuals or institutions
* Yet no member would have more than one vote as a result of holding the shares
* Investing members that did not trade with the business would be excluded from any member votes related to mergers or dissolution

This will also help to maintain the integrity of mutual ownership by clearly stating the rights of purchasers of such instruments.

An approach that involves a formal recognition of mutual ownership structures and the securities such entities can issue would remove much of the uncertainty that currently exists under the current scenario where the potential of shifting regulatory views can affect investor appetite for any such instruments to the extent that they are not viable.

Defence Bank notes that there is international precedent for such an approach as demonstrated in Canada, the UK and the Netherlands.

A Mutual Capital Instrument constructed with safeguards to protect the Mutual status and purpose of Defence Bank would provide a means for Defence Bank the means to compete with the major banks on the basis of price, product and service rather than just product and service as is currently the case.