19 May 2017

Mr Greg Hammond OAM
Coops and Mutual Review
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Dear Mr Hammond,

CUA welcomes the Turnbull Government's demonstration of support for the cooperative and mutual sector through your appointment to assist in preparing its response to the Senate Economic References Committee's 2016 review into cooperatives, mutuals and member-owned firms. We note in particular the Terms of Reference of your review, and the specific focus on regulatory and legislative barriers to accessing capital, as well as whether the *Corporations Act 2001* should include a definition of 'mutual enterprise'.

About CUA

CUA is Australia's largest credit union, with around $13 billion in assets and a branch footprint spanning five states and territories (Queensland, New South Wales, the ACT, Victoria and Western Australia). CUA provides financial, health and general insurance solutions to almost 500,000 Australians through our member-owned CUA banking business and our wholly-owned health insurance subsidiary CUA Health. Mutuality matters to us - CUA's members are our owners, with each member having an equal share in the organisation. This means that each CUA member has the equal ability to influence the direction of our business and the way in which it is operated.

CUA has been formed through the amalgamation of 171 credit unions and mutuals over the past 70 years – our roots extend back to Australia's very first credit union, the Catholic Thrift and Loan Cooperative founded in 1946.

CUA exists both for our members and the community. The way in which we conduct our operations is in line with the seven principles of co-operatives as adopted by the International Cooperative Alliance.

CUA is 12 months into a five-year corporate strategy of digital transformation towards a future where we are available to our members 'Anytime, Anywhere'. This approach is critical to sustain our relevance and provide greater reach beyond our physical footprint, offering more consumers an alternative. At the heart of everything we do is our Purpose – *members working together through life's changes for mutual good.* Connecting with, and supporting our communities, is part of our DNA, reflecting the values by which we operate the business. Our privileged opportunity to positively impact society drives our team and decision-making every day.

How regulatory and legislative barriers to accessing capital are impeding CUA

CUA's mutual business model is constrained in the ability to grow, and expand our social impact, by a lack of access to external capital. As a mutual, CUA's limited ability to raise capital means that we are reliant on retained earnings as our only source of capital.

a) Our mutual structure

The structure of a mutual is fundamentally different to other company structures like listed companies. A mutual or co-operative is important because it is a 'community' - in an environment where there is a degree of consumer distrust of publicly listed banks and corporations, mutuals and co-operatives bring together like-minded community members who want to work together to help each other achieve a common goal or objective.

Yet under the current legislative and regulatory framework, these groups of like-minded people who form a mutual or co-op are fundamentally disadvantaged, as they can only raise capital to grow their business from within their own membership (ie. through the profits they can generate by lending money or trading with the other members of their mutual organisation).

In other business models, parties external to the business can invest their money if they see value in a good idea or a good business model. Our economy is awash with capital and funds to invest. Even small start-ups can access such capital through crowd-funding. Mutuals need a vehicle that allows people outside of the member-base to provide capital by investing in the business, without devaluing the concept of mutuality – essentially a class of investors who do not hold voting rights. In the case of mutual ADIs like CUA, we need this investment of capital to also be recognised as the highest grade of capital available (Tier One), to help satisfy our regulatory capital responsibilities.

b) Complexity of existing options to raise capital

In April 2014, the regulator introduced changes to enable mutuals to issue capital instruments that are convertible to MEIs (or Mutual Equity Instruments) – in effect, a new, alternative way to raise capital. But the complexity of this instrument is a significant barrier to being able to access capital in this way.

While CUA has been actively exploring this opportunity for more than a year, this mechanism has proven to be very complicated both from a regulatory perspective, but more importantly, from a consumer and member perspective. It is a difficult concept for mutual members to understand, in order for them to make a fully informed decision as to whether or not to approve the issuance of such an instrument. Without an instrument that our members can understand, we have little likelihood of securing their support for a Constitutional Amendment, or to issue the instrument. We face a similar challenge in attracting investors to purchase such a complex capital instrument.

CUA understands that to date, no other mutual Authorised Deposit-Taking Institution (ADI) has successfully raised this type of capital. Regulatory or legislative change could give mutuals access to a simpler capital instrument that our members and investors will understand.

c) <u>Constraints on spending on initiatives that benefit members</u>

CUA's profits are reinvested into the business to deliver improved products and services for our members, including ongoing significant investment in technology to keep pace with new possibilities that improve member experience. But CUA's reliance on profits – or retained earnings – as our sole source of capital means that we must constantly make a choice between making healthy profits that allow us to grow our business by lending to more members, or investing more in projects and initiatives that will deliver long-term benefits to our current and future members.

If we take the example of technology, CUA's balance sheet at 30 June 2016 reflected $66 million in information technology investments, which under the capital adequacy rules is a capital deduction. The bulk of this reflects CUA's new core banking system, which was launched in late 2013 after an investment of around $60 million in the new system - the equivalent of more than one years' profit. This was a critical investment for CUA in order to remain relevant, as our legacy systems would not have allowed us to offer the products and services that members would want in the future.

With no ability to issue Tier One capital, CUA can only generate this capital organically through earnings – an investment of this magnitude severely hinders growth and strategic initiatives until the capital can be organically replaced. Looking at this another way, in lending terms, CUA's annual net profit (circa $50 million at that time) would have provided the capital to fund approximately $860 million of secured housing lending. This highlights how the overall growth of the CUA business was constrained by the lack of alternative sources of capital, and the need to choose between growth or investment in the long-term viability of our systems.

The need to maximise profits/ retained earnings to organically generate capital also potentially places other areas of spending at risk of cut-backs. CUA invests in the wider community to create shared value, using our capabilities to make a positive impact on communities and in helping to solve social issues. But this investment requires us to divert funds from pre-tax profits, reducing the flow of surplus funds into retained earnings.

CUA benchmarks our performance through a measure of *Net Profit before Tax and Community (NPBTC),* and we have publicly affirmed our aim to lift our investment in the community and social change initiatives to 3 per cent of NPBTC in the next few years. This is above and beyond the reported average investment of around 1.1% of pre-tax profits internationally (Source: London Benchmarking Group).

If mutuals like CUA were forced to reduce community spending to boost profits/ build capital, this would be to the detriment of communities.

CUA is on track to spend a total of $2.7 million on community initiatives during FY17. This program of community initiatives – including our Mutual Good community grants which have this month returned $70,000 to important local projects delivering social change, our $150,000 investment in domestic violence support initiatives in Queensland, or our ongoing financial support of Red Nose and their work to prevent unexpected infant and child deaths – are typical of the initiatives that could be at risk if retained earnings remain our only option in the long-term for increasing our capital reserves.

d) Future opportunities

CUA has an obligation to our members – both current and future - to be 'unquestionably strong' as part of a strong Australian banking sector. Access to capital would give us the potential to increase our scale and strengthen CUA through a number of mechanisms such as:

1) Investing for organic scale. This may include investments in technology, increasing our geographical reach and improving productivity; allowing CUA to remain relevant and sustainable, so we can continue to be a viable and strong alternative for our members and communities.

2) Growing the breadth of our services for members and extending our ability to support the business and consumer segments. CUA is primarily a residential mortgage lender, but we could build deeper relationships with our members who operate small businesses if we offered small business banking. The higher risk involved in this type of banking would require CUA to have greater scale, and hold additional capital, in order to be able to lend to small business in a prudent manner.

3) Acting on inorganic opportunities to build scale or to explore different models of collaborating with other mutuals, start-ups or fintechs. For instance, greater access to capital would open up options to acquire other like-minded financial institutions, establishing economies of scale and allowing the mutual sector to compete more effectively with the for-profit banking sector, while enacting positive social change.

The need for regulatory and legislative changes

We support the position put forward by the Business Council of Cooperatives and Mutuals (BCCM) and the Customer Owned Banking Association (COBA) on the need to remove barriers impeding the ability of mutuals to access capital. We support all 17 recommendations made by the Senate Economic References Committee, including recommendations 16 and 17, which relate to access to capital.

- Recommendation 16

The committee recommends that APRA set a target date for the outcome of discussions with the co-operative and mutuals sector on issues of capital raising and bring those discussions to a timely conclusion.

CUA supports the position put forward by BCCM and COBA in their submissions to you that we need to maximise flexibility for mutual Authorised Deposit Taking Institutions (ADIs) to directly issue CET1 instruments to retail or wholesale investor markets in accordance with their own governance and strategic objectives. The current capital instruments available to mutuals – instruments convertible to MEIs – could be simplified with an amendment to the APRA prudential standards. This does not require legislative change and would be a valuable interim step, prior to any legislative change (recommendation 17). Further information is contained in the BCCM and COBA submissions.

- Recommendation 17
  The committee recommends that the Commonwealth Government examine proposals to amend the Corporations Act 2001 to provide co-operative and mutual enterprises with a mechanism to enable them access to a broader range of capital raising and investment opportunities.

As BCCM and COBA have stated in their submissions to you, the intention of this proposal is to permit **all** mutuals or co-operatives federally registered under the *Corporations Act*, to issue a capital instrument that may be used to raise additional capital for business development and growth.

In CUA's case, the barriers to raising capital have meant missed opportunities to realise greater economies of scale and provide a broader array of products and services to members. Removing the barriers would increase our ability to invest to bring awareness, consideration and genuine choice in the larger Sydney and Melbourne markets.

The ability to issue capital instruments will enhance CUA's ability to withstand economic shocks, increase our rate of growth and enable CUA to accelerate the progress of strategic initiatives that ultimately benefit our members.

Definition of a 'mutual enterprise'

CUA supports BCCM on their position with regards to defining "mutual enterprise" in the *Corporations Act 2001*. Including this definition in the Act would be a logical extension of legislating for a new capital instrument, as the legislation would need to identify and define the type of organisations eligible to issue the new capital instrument.

Further to this, clearly defining "mutual enterprise" in legislation would help validate the extensive work already being undertaken by our sector to enhance the understanding of the mutual and cooperatives model – with regulators, Government and the wider community.

CUA has found through our interactions with stakeholders in areas such as Government, the media, consumers and the community that there is an inconsistent understanding of the mutual model and the value it brings to mutual members, the community and the wider Australian economy. There is a lack of formal recognition of the mutual models' differences in policy and legislation. A greater understanding of the model – and enshrining this in legislation - will reinforce the Federal Government's recent policy settings aimed at promoting competition and growth in the financial services sector.

In the absence of a legislative definition of 'mutual enterprise', CUA has been actively working to raise awareness of our role in the financial system, what differentiates mutuals from other businesses and our commitment to community.

One way we are doing this is through relationships with Queensland Cricket and the Brisbane Heat BBL team, Red Nose, the First Nations Foundation, outreach and support services Micah Projects in Brisbane and the Queensland Women's Legal Service, and the School Fun Run program. These relationships are designed to provide tangible benefits to the community, raise awareness of CUA and create stronger links with key organisations such as sporting clubs, school communities, indigenous communities and charities.

At a sector-wide level, CUA is supporting education on mutuality, including actively supporting the University of Newcastle's Masters of Cooperatives Management and Organisation post-graduate degree – I am one of seven team members from CUA enrolled in the course. We are also sponsoring a project through Monash University to conduct a study into measuring mutual value.

Defining "mutual enterprises" in legislation would be further reinforcement and validation of the role of mutuals in a diverse and thriving economy.

Thank you again for the opportunity to contribute to your review into cooperatives and mutuals. We look forward to discussing our submission with you in detail in the coming weeks. I may be contacted through my Executive Assistant, Nicole Power, on (07) 3552 4190 or by emailing nicole.power@cua.com.au

Yours sincerely,

Rob Goudswaard
Chief Executive Officer
CUA