Mutuals Industry Review 2017

Navigating the new normal: setting course for a sustainable future

November 2017

KPMG.com/au/mutualsreview

Foreword

This report examines the performance and trends of Australia's mutual banks, building societies and credit unions (together the 'mutuals sector') as regulated by the Australian Prudential Regulation Authority (APRA).

It includes the financial results of 52 mutuals for the year ended 30 June 2017, which represents over 90 percent of the mutuals sector by total assets and profit before tax.

The financial information, analysis and observations has been compiled from publicly available financial reports, APRA statistics and also includes information from prior year. In certain instances, data has also been obtained directly from survey participants.

This report also includes the results received through our qualitative survey, which asked mutuals to share their views on the risks, challenges and opportunities they see facing the industry. The survey response rate was 75 percent.

For the purposes of preparing our charts and analysis, KPMG has disclosed the results of the top 10 mutuals by total assets ('the top 10') together with the results of the remaining mutuals ('mutuals excluding the top 10').

We have also made reference to the financial results of the Australian major banks (the majors).

We would like to thank the survey respondents, interview participants and Moody's for their time and contribution to this report.

Please visit our website for access to the following materials that accompany this report:

– **Podcasts** which highlight the headline findings from this report and contains interviews with Steven Laidlaw (CEO of People's Choice Credit Union), John Tancevski (CEO of Community First Credit Union) and Damien Walsh (Managing Director of Bank Australia).

– **Mutuals Insights dashboard** which contains interactive charts and graphs of the financial data collected and can be filtered based on your preferences.

– **Financial datasheet** which details the financial information collected.

Contents

The *KPMG Mutuals Insights Dashboard* which accompanies this report contains interactive charts and graphs that are underpinned by the financial data collected from mutuals surveyed. This interactive dashboard enables you to filter the data based on your own preferences and view the financial metrics for a particular year or segment of the mutuals industry. You can also view metrics for an individual mutual in comparison to a peer group.

The dashboard can be accessed via our website at KPMG.com/au/mutualsreview

Year in review - 2017 highlights

Operating profit before tax decreased by **4.3% to $605.7m**

Net interest margin dropped **11 bps to 2.03%**

Residential lending increased by **9.8% to $83.4b**

Based on our survey results, **better pricing of products** was a main contributor of financial and market share growth this year for **67%** of mutuals

Average capital adequacy ratio decreased by **30 bps to 17.2%**

Impairment provisions remained steady at **0.07%** of average gross receivables.

Technology spend rose by **12.4% to $168.2m**

Non-interest income increased by **1.2%** to **$567.9m**

Deposits grew by **10.5% to $87.3b**

We asked survey participants what their top priority in the next three years is:

59% said
"Maintaining profitable and sustainable growth through lending, managing costs and capital"

10% said
"Digitisation of our business (technology transformation)"

8% said
"Keeping up with environmental changes such as NPP, regulation and fintech"

Did you know?

When combined, the assets of the top 10 make them the **5th largest ADI** (Authorised Deposit-taking Institution) in Australia.

6 of the top 10 currently partner with **Apple Pay, Android Pay and Samsung Pay**. Only 1 of the majors hold this complete suite.

The top 10 reported a **10.2% growth** in gross loans and advances, which outperformed system growth of 4.8%.

The average capital adequacy ratio for the top 10 was **15.7% versus the average of 17.2%** for the mutuals sector.

Introduction

2017 saw mutuals perform strongly with balance sheet (net assets) growth of 6.8 percent (2016: 6.1 percent) to $8.4 billion (2016: $7.9 billion). Overall profit before tax, however, fell 4.3 percent (2016: grew 3.1 percent) to $605.7 million (2016: 633.0 million) as net interest margin continued to tighten.

Impacting these results is a business environment characterised by low interest rates, increased competition, fluctuating property prices, threats from technology and heightened regulatory and compliance demands.

When we look at the past 5-10 years, this isn't anything new. This environment has become the 'new normal', albeit at even more competitive levels today.

What we are seeing is that, like customer preferences, the banking world is moving fast. Long gone are the days where lunch breaks were spent queuing at a bank. Even what was considered 'cool' or 'nice to have' a few years ago, is now an expectation. It seems that almost anything can be done digitally today, and a different type of customer service has evolved. In today's world, digital is king and often it is a combination of these aspects that can drive customers to pick or switch between financial institutions.

Regulation and compliance have also had a heavy hand in influencing the shape of the 'new normal'. The pace of change has created uncertainty in the environment and led regulators to impose additional requirements across the banking industry. The challenge for mutuals is working out how to grow organically and sustainably while meeting these new compliance and reporting requirements.

The latest movement by the Turnbull Government comes at a pivotal time when mutuals have actively been on the pursuit for growth. On 8 November 2017, the Government announced their support for all 11 recommendations commended by Greg Hammond OAM in his independent review over 'Reforms for Cooperatives, Mutuals and Member-owned Firms'. These recommendations looked to 'improve access to capital, remove uncertainties currently faced by the sector, reduce barriers and enable cooperatives and mutuals to invest, innovate, grow and compete' through proposed regulatory and legislative changes. The support of these recommendations is positive for the sector. They will help mutuals fund growth, explore new opportunities, invest in new technologies and better position themselves as a stronger competitive choice in the Australian market.

There have been some common talking points amongst mutuals this year, with our survey highlighting eight current and emerging topics on their radars:

1. **Capital** – finding the equilibrium between generating sufficient profit to support growth and maintaining adequate buffers to minimise the effect of financial shocks. In addition, mutuals need to start thinking about how to prepare for the impacts of the Hammond Review when legislated.
2. **Gen Y** – understanding this demographic's priorities, spending habits, and product and service expectations to offer relevant and competitive choice.
3. **Mobile banking** – investing in new forms of mobile banking and payments as we move more and more towards a cashless society.
4. **New Payments Platform** – embracing product innovation and enhancing the customer experience through avenues such as real-time payments.
5. **Fintech** – using organisational size and nimbleness as an advantage to provide both enabling and disruptive technology solutions.
6. **Digital labour** – streamlining business processes and reducing operating costs by automating and augmenting work performed by humans.
7. **Regulatory and accounting changes** – preparing for the impacts of the Banking Executive Accountability Regime (BEAR), AASB 9 *Financial Instruments* and tax matters on the horizon.
8. **Risk management** – understanding the interconnectedness of risk, and ensuring it is managed in a way so that the brand, reputation and purpose of mutuals are preserved.

These forces are imminent and ignoring them would open the opportunity for others to take the lead in the fight for growth, customers and returns.

In this 'new normal' environment, mutuals must be at the forefront of change, and evolve with the industry and their customers to stay relevant. Their success lies in their ability to move with the times and respond proactively to the challenges ahead, whilst preserving alignment with member interest and values.

We hope that you enjoy the publication and we look forward to having further discussions with the sector in the coming year.

Tim Aman
National Sector Leader, Mutuals
KPMG Australia

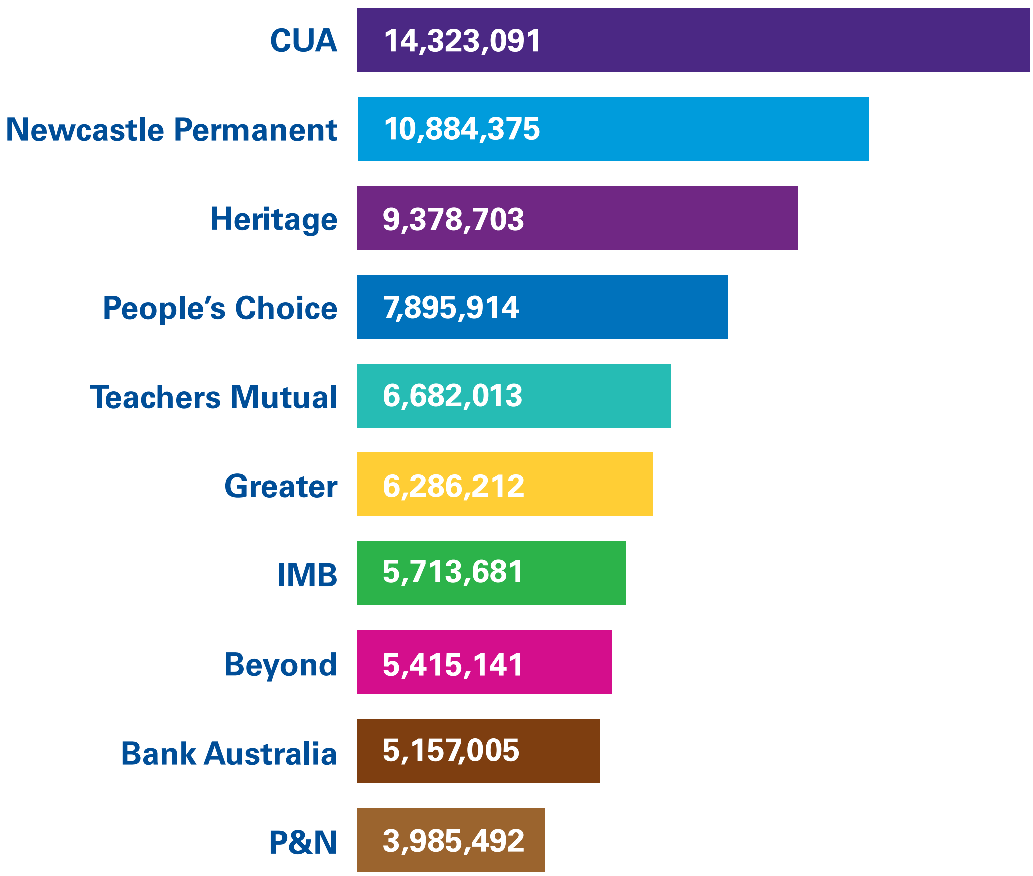
2017 financial results

Mutuals continued to show growth in a challenging operating environment in 2017.

Assets

The 10 largest mutuals by assets in 2016, as identified in last year's report, maintained their 'top 10' status and ranking this year.

Top 10 by total assets ($'000) – 2017



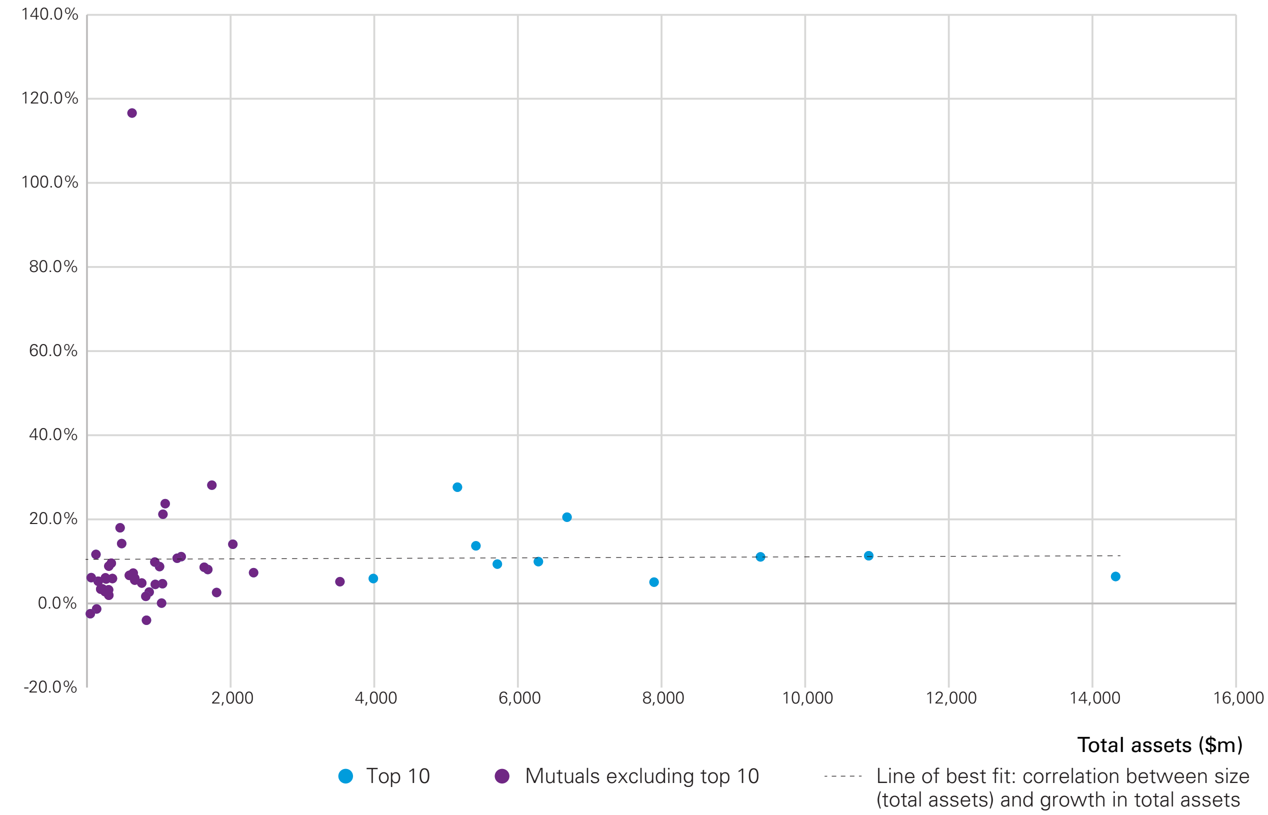
Total assets for mutuals increased by 9.8 percent (2016: 8.2 percent) to $110.9 billion in 2017 (2016: $101.0 billion) despite the pressures of a low interest rate environment, declining mortgage affordability and a strong, competitive market.

Despite comprising 2.4 percent (2016: 2.2 percent) of total assets across all ADIs in Australia at 30 June 2017, mutuals continue to be seen as an increasingly attractive proposition for consumers.

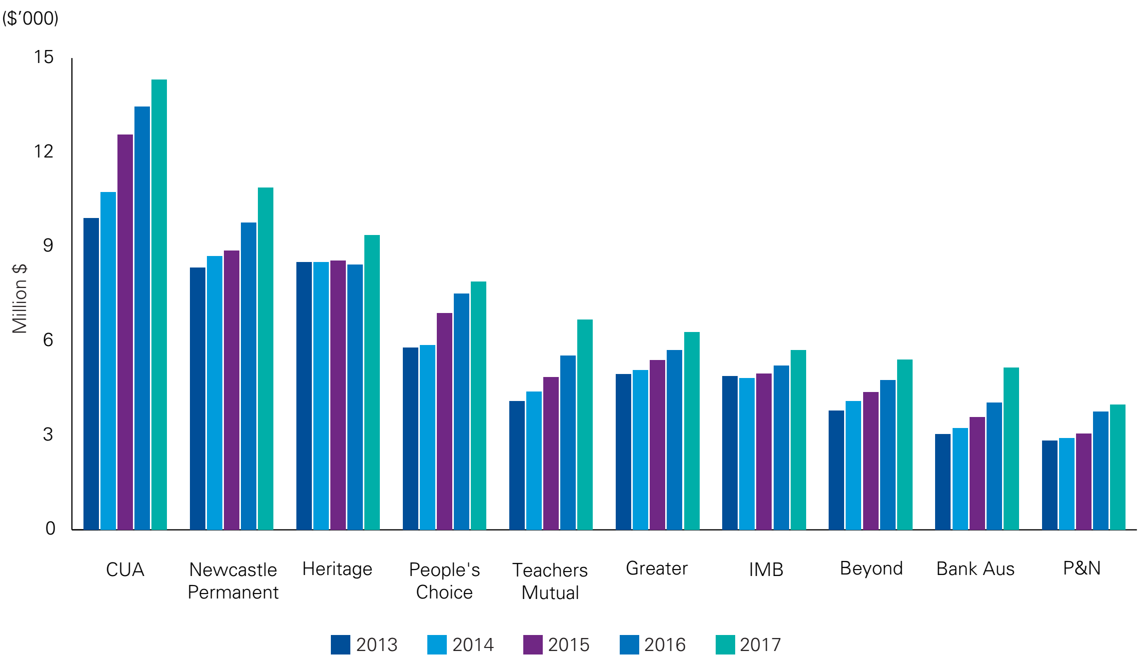
The top 10 performed strongly and grew their combined assets by 11.0 percent (2016: 8.0 percent). This outperformed the majors who showed an increase of 1.45 percent.

This year, we have seen some mutuals outside the top 10 almost double their assets through consolidation.

Growth in Total Assets (%)



Top 10 Total Assets (2013-2017)



Loan portfolio

Total loans at 30 June 2017 was $90.1 billion (2016: $81.9 billion), which is a 10.1 percent increase from 2016. The residential loan book grew 9.8 percent (2016: 9.8 percent) to $83.4 billion (2016: $76.0 billion). This outperformed system growth of 4.8 percent across all ADIs.

The rate of growth in home loans has been challenged with spikes in property prices creating fierce competition amongst Australian ADIs. According to the Australian Bureau of Statistics, property prices increased by 10.2 percent in 2017 vis-à-vis 4.1 percent in 2016. This has continued to drive down mortgage affordability.

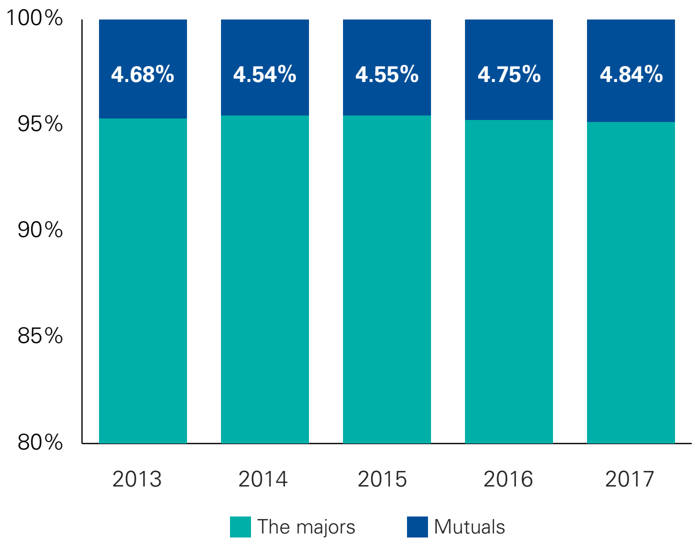
Since 2006 the median house price in Australian capital cities (where 67 percent of the population live) has more than doubled from $286,000 to almost $700,000. A similar story is true for units and apartments where median prices across capital cities has grown by 40 percent in the last ten years. Australian wages, on the other hand, have grown at a much more modest compound annual rate of 3 percent over the same period.

However, in spite of this climate, the great Australian dream of home ownership persists. In KPMG's mortgage market survey[1] conducted earlier this year, it was identified that residential property is still a sought-after investment, with 63 percent of professionals surveyed and currently without a home loan planning to apply and buy within the next two years.

Other key findings surfacing from the results of the survey were:

- **Don't close branches just yet:** 45 percent of respondents still want to apply for a home loan at a branch.
- **Digital reigns supreme for research and servicing home loans:** 87 percent of respondents indicated that digital channels are their preferred choice for researching and servicing their home loan.

Residential loans



[1] https://assets.kpmg.com/content/dam/kpmg/au/pdf/2017/australian-home-loan-market-survey-analysis-may-2017.pdf

Did you know?

In 2017, the top 3 places for Money Magazine's Home Lender of the Year Award were won by mutuals:

1. Bank Australia

2. Qudos Bank

3. Newcastle Permanent Building Society

These mutuals were merited for offering loan products that were rich in features and competitively priced – showing that "great-value home loans can be found outside the big banks".

- **The increasingly important role of brokers in origination:** 44 percent of mass affluents (working professionals earning between $70,000 and $250,000 per annum) prefer to use a broker when applying for a home loan.
- **Price isn't everything for some customers:** Only 9 percent of respondents who took out a loan with their existing bank did so because they believed they were getting 'the best deal'.
- **Loyalty to a single bank is rare:** 66 percent of respondents preferred to bank with more than one financial institution.

The mutuals' loan book remained concentrated on residential lending with 92.6 percent (2016: 92.8 percent) of their books secured in home loans at 30 June 2017.

Looking at the banking industry as a whole however, the majors continue to dominate the mortgage lending market, holding over 95 percent of the industry's portfolio. This is an area where size does matter and the impacts of APRA's 10 percent investor lending cap on growth and 30 percent cap on interest-only loans on new residential mortgage lending have challenged growth in the mutuals' loan book and altered the competitive landscape in favour of the majors.

In the face of stiff competition, mutuals have aimed to retain market share by heavily discounting their new loans. **67 percent of our survey participants indicated that better pricing was the one of the main contributors to their financial and market share growth in 2017.**

In addition to pricing tactics, mutuals have also increasingly tried to differentiate their value propositions by improving the home loan experience of customers through better service and product choice offerings.

Asset quality

2017 saw mutuals increase their loan provisions by 13.0* percent to $63.3 million (2016: $56.0 million). This was in response to heightened risk in the operating environment as interest rates remain low and housing affordability continues to decline. These sentiments have been shared across the industry with Standard & Poor's (S&P) recently downgrading the credit ratings of 23 ADIs, 13 of which were mutuals, due to concerns over a rise in significant credit losses arising from the risk of sharp corrections in property prices.

Total loan write-offs of $29.2 million (2016: $29.0 million) remained largely the same as last year, up 0.7 percent from 2016.

Looking ahead, we expect to see larger and more volatile provisions for loan impairment on balance sheets, as mutuals implement an expected credit loss model with AASB 9 *Financial Instruments* coming into effect on 1 January 2018. Refer to page 23 for further details.

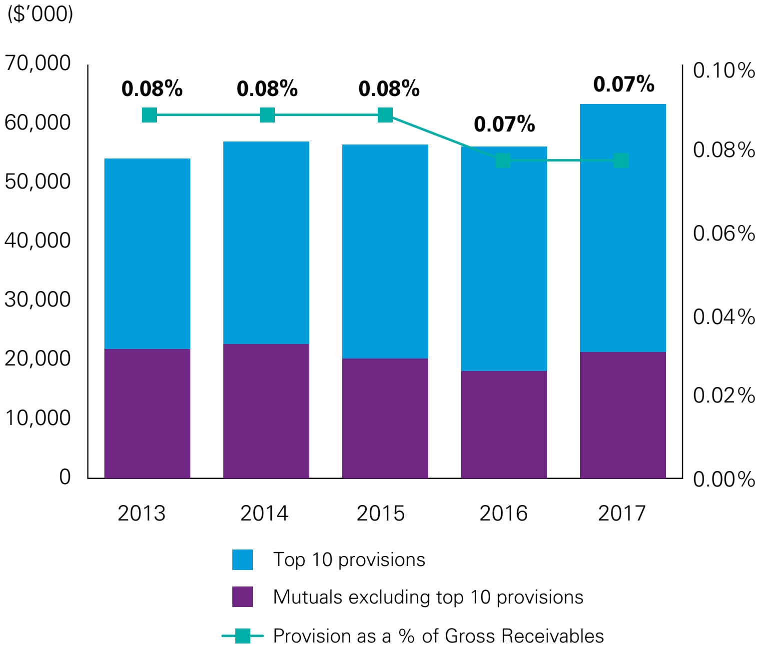
* Impairment provisions exclude the impacts of early adoption of AASB 9 *Financial Instruments.*

An analysis conducted by Moody's expects asset quality to remain strong in the next year, although there is likely to be an increasing divergence in asset quality across the mutuals sector. Given their small size, mutuals tend to have franchises that are concentrated by geography or by employment group. Mutuals based in resource-sensitive regions, such as Western Australia, could see rising asset quality strain given the decline in economic activity in that state.

Conversely, as mutuals seek to diversify their loan books, they also take on transition risks. There are additional challenges in managing origination quality as they source increased levels of mortgages via the broker channel and further diversify their loan exposures beyond their traditional regions or employment groups.

While strong capital buffers remain a key strength for mutuals, a weaker profit outlook coupled with strong asset growth will impact the capitalisation of mutuals. As a result, some mutuals will face rising pressures to curtail asset growth or will suffer erosion in their capital buffers. While the issuance of Mutual Equity Instruments (MEIs) could provide some support to capital, investor appetite for such securities has not been tested.

Impairment provisions

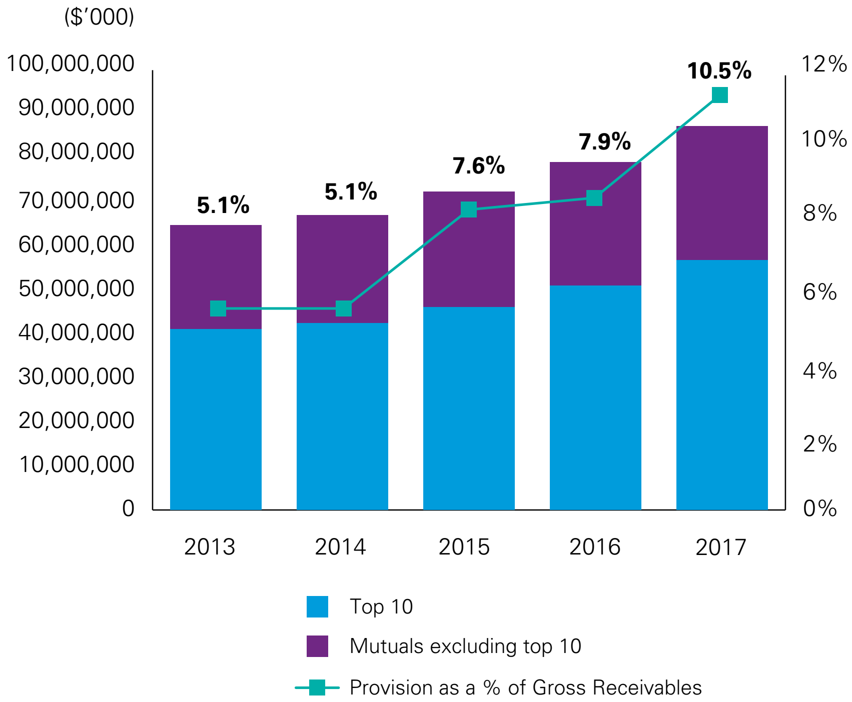


Deposits

Given their limited access to wholesale funding sources, retail deposits remain an important funding source for mutuals – almost the sole source.

2017 saw mutuals grow their deposit base by 10.5 percent (2016: 7.9 percent) to $87.3 billion (2016: $79.1 billion). This was above system growth of 6.0 percent and above the majors' growth of 5.4 percent. This result reflects the continued focus by mutuals towards membership acquisition, achieved through competitive product and service offerings to raise funds from household deposits. This has been made possible by investing in technology and delivering enhanced customer experiences.

Total deposits and growth in total deposits

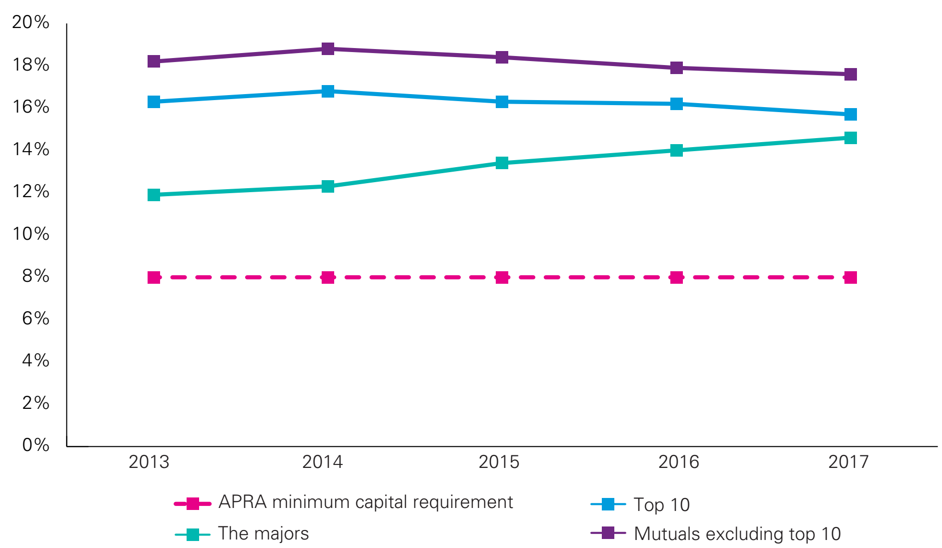


Capital

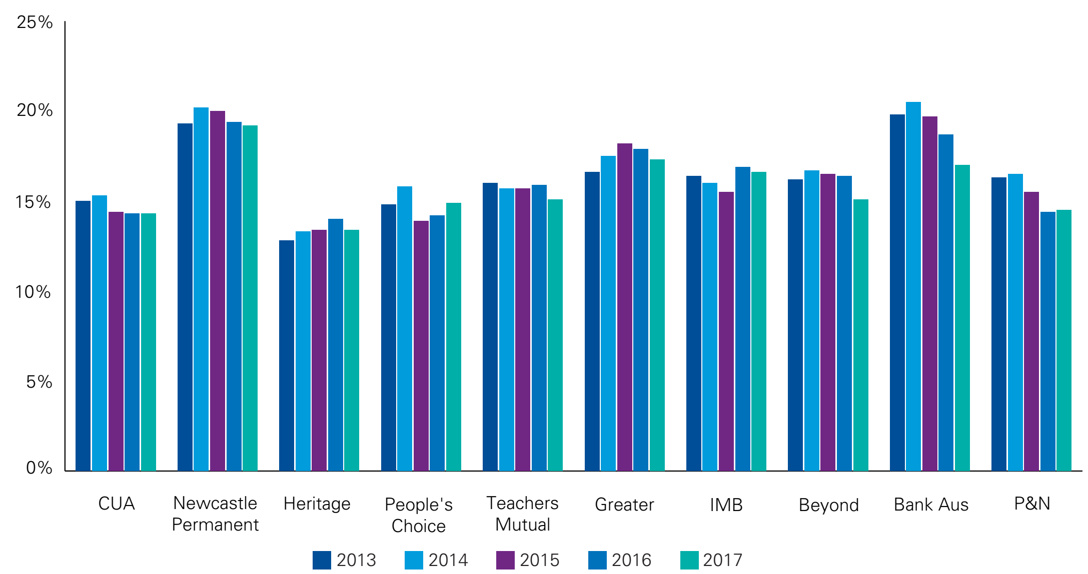
The average capital adequacy ratio dropped 30 basis points (2016: 40 basis points) to 17.2 percent (2016: 17.5 percent) in 2017, representing a decline in capital levels for the fourth consecutive year. This reflects the increasing prioritisation of effective capital use by mutuals. As limited equity funding is inherent within the mutuals' current business model and capital growth through new profits have been constrained this year, mutuals have looked to existing capital bases to fund balance sheet growth.

Despite greater capital utilisation, mutuals have continued to maintain capital levels significantly in excess of APRA's minimum requirements of 8 percent. Earlier this year, APRA announced requirements for 'unquestionably strong' capital adequacy ratios which will see ADIs using the internal ratings-based (IRB) approach raise minimum capital requirements by approximately 150 bps from current levels, by 2020. ADIs using the standardised approach to capital adequacy are expected to raise minimum capital requirements by approximately 50 bps over the same period. While this action improves resilience in the banking industry on a macro level, it also brings the majors and mutuals closer on the playing field. There is an opportunity for mutuals to take the market share lost by the majors, should the majors increase interest rates in response to APRA's new capital settings during the transition period.

Average total capital adequacy ratio



Top 10 capital adequacy ratio (2013 - 2017)



Net interest income

Mutuals reported total net interest income of $2,150.3 million in 2017 (2016: $2,080.0 million). Of this, 64.5 percent was earned by the top 10 (2016: 63.9 percent).

The net interest margin (NIM) continued to tighten and decreased to 2.03 percent (2016: 2.14 percent). The increasing pressures on net interest margin is a result of historically low interest rates and increasing competition in the marketplace. As such, mutuals have sacrificed margins to maintain and grow the membership base.

The NIM for the top 10 fell by 9 bps (2016: 3 bps) to 1.93 percent (2016: 2.02 percent), whereas the NIM for the majors has remained relatively stable at 2.01 percent in 2017.

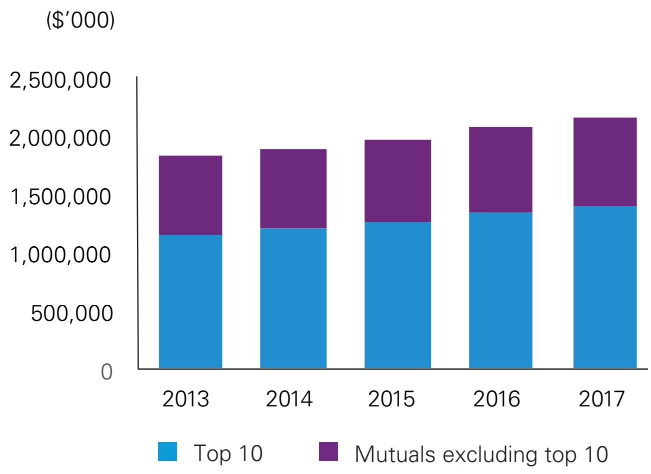
Non-interest income

Non-interest income grew 1.2 percent (2016: fell 5.0 percent) to $567.9 million (2016: $561.2 million) this year.

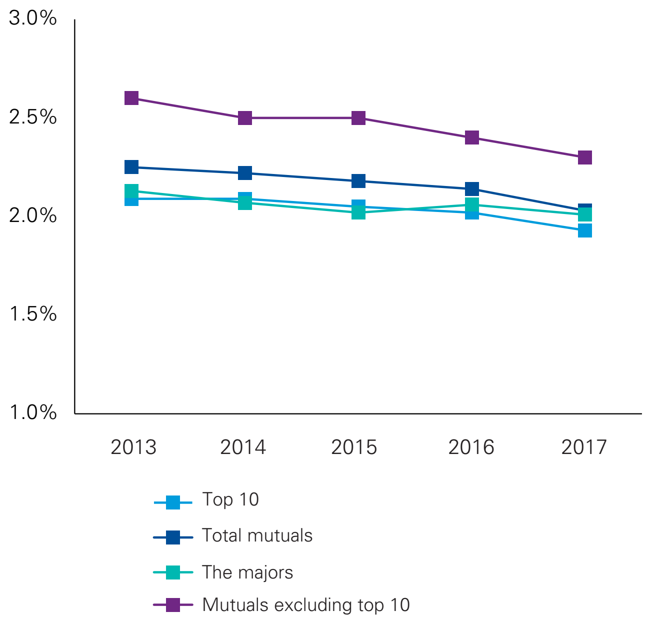
The top 10 recorded slight growth of 0.6 percent (2016: fell 13.7 percent) to $280.8 million (2016: $279.2 million). The diversification of income sources was the predominant driver of this result, with insurance and wealth offerings generating additional fees and commissions.

Mutuals excluding the top 10 performed above the industry, increasing alternate income by 1.8 percent (2016: 5.5 percent) to $287.1 million (2016: $282.1 million). This is a reinforcement of the sector's focus on returning benefits to its members through lower transaction and withdrawal fees. By delivering valuable offerings, mutuals can retain existing members and attract new members, as well as grow non-interest income sources.

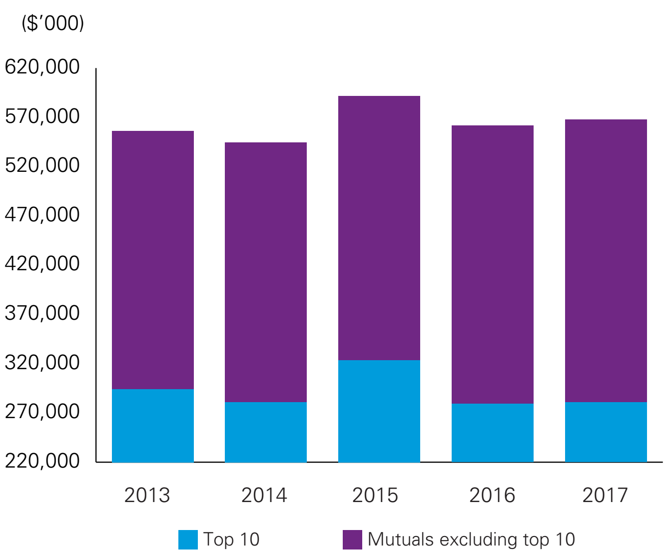
Net interest income



Net interest margin

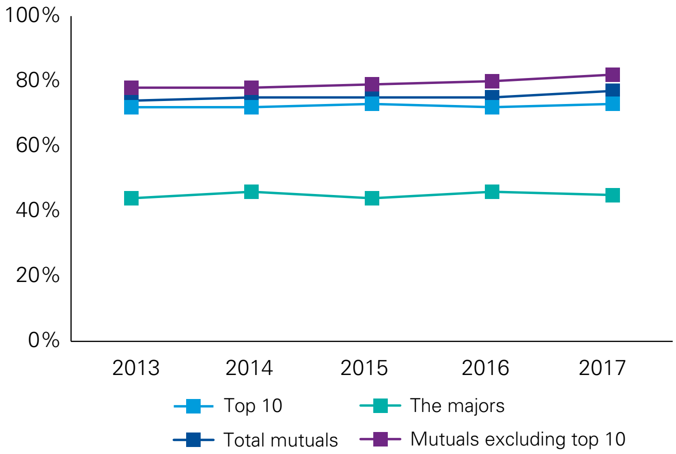


Non-interest income

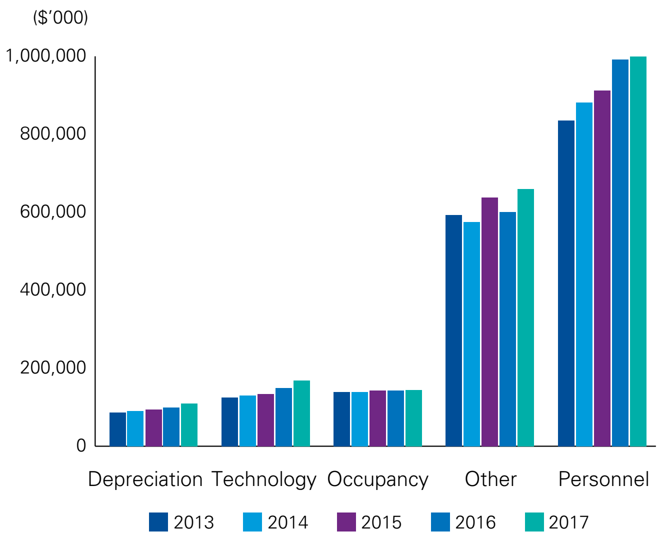


> **A high cost base constrains the ability of mutual ADIs to generate returns that are sufficient to fund balance sheet growth at above system levels – a precondition for growing market share. Tackling costs is therefore critical to being a stronger force in the Australian banking system."**
>
> — **Wayne Byres**
> Chairman, APRA
> Keynote address at the COBA 2017 – Customer Owned Banking Convention

Cost to income ratio



Growth in costs (2013 – 2017)



Costs

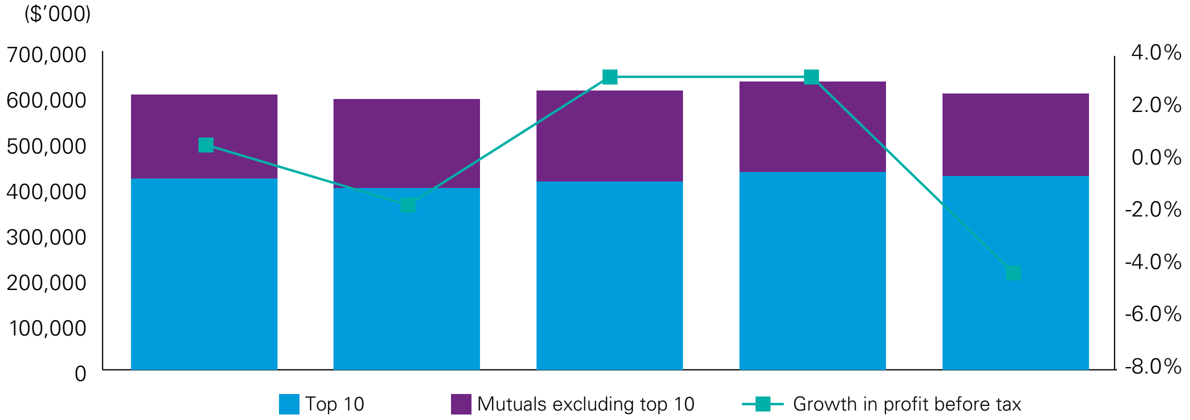
2017 saw total operating costs increase 5.0 percent (2016: 3.3 percent) to $2,080.7 million ($1,982.4 million). This was unmatched by income margins, with the average cost-to-income ratio rising to 76.6 percent in 2017, versus 75.1 percent in 2016.

Relative to assets, the higher level of costs have been a long-term challenge for mutuals, reflecting continued difficulty in finding appropriate economies of scale. With 87 percent of survey participants putting profitable and sustainable growth as one of their top 3 organisational priorities, reducing costs remains a key focus area.

The composition of costs has shifted slightly, with technology expenses starting to consume more of the mutuals' total operating spend. Recognising the need to be increasingly digital, mutuals have taken steps to invest in innovations such as digital wallets, mobile apps and the NPP. This is often a significant investment for mutuals. The top 10 were aggressive in pursuing their digital strategies and increased their technology expenditure by 14.9 percent in 2017 (2016: 13.9 percent), compared with 9.6 percent (2016: 9.4 percent) for all other mutuals.

Occupancy expenses showed marginal growth of 1.4 percent in 2017 (2016: 0.1 percent) to $144.5 million (2016: $142.5 million); however, as a proportion of total operating expenses, fell to 6.9 percent (2016: 7.2 percent). This reflects the continued reduction in bricks-and-mortar branches arising from mergers and conversions to greater digital banking, and rather, more smaller kiosk-style operations. This, coupled with the increasing popularity of online banking, has also led to a shrinkage of the proportion of employment expenses to 48.0 percent (2016: 50.0 percent).

Profit before tax

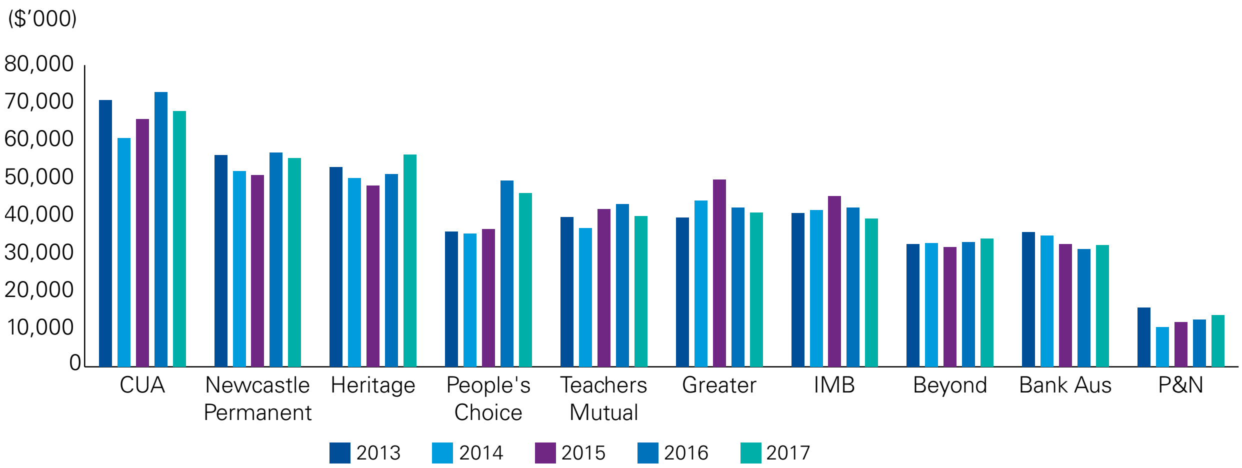


Profits

Profits before tax (PBT) declined by 4.3 percent (2016: grew 3.1 percent) to $605.7 million (2016: $633.0 million). This compares to the major banks which saw profits grow by 7.6 percent.

The top 10 had a combined profit before tax of $425.5 million, down from $434.5 million in 2016. This represents 70.2 percent (2016: 68.6 percent) of PBT earned by mutuals. The mutuals sector is continually challenged to maintain profitability in the highly competitive banking environment. The record low interest rates coupled with higher operating costs have negatively impacted the sector's profit levels. If the current benign economic conditions persist, mutuals will benefit through alliances and collaboration to leverage scale and reduce costs. Maintaining profitability is especially vital for mutuals as it is the building block for their capital base which underlies the pursuit of new growth opportunities.

Top 10 total profit before tax (2013 - 2017)



30 for 30 - Back to the future

Over the past 30 years, KPMG has tracked the performance of mutuals and watched the sector transform in response to changes in regulation, emerging technologies and dynamic customer preferences. Based on our survey results this year, these continue to be focus areas for mutuals today.

In this year's report, we look back at key milestones in the mutuals' history and invited senior executives and Board Directors to share their insights over the major challenges and successes they have seen over the past three decades.

Alan Beanland
Retiring Chair, Credit Union Australia

Alan has witnessed the sector's transformation through the decades. He joined the CUA Board as Chair in 2009 and spearheaded its growth in the past 8 years.

Alan reflected on some of his proudest achievements while Chair of CUA. He is most proud of the people, the collaboration achieved globally, and the journey of CUA. He commented that the nimbleness of mutuals remains today as it did 30 years ago. The size of mutuals is a positive trait from an agility perspective. His view is to merge based on strengths, and envisages a future of possible super mutuals and collaborations increasing around operational matters to generate future efficiencies and scale.

Prior to 1987, the mutuals and overall Australian financial system experienced a number of significant events :

- **First ATM** in Australia installed by Queensland Teachers Credit Union;
- **Campbell Inquiry** – deregulation of banks in the financial sector; and
- **Floating of the Australian dollar** and the removal of most restrictions on the movement of foreign capital.

1987
488 mutuals

U2's 'With or Without You' becomes the band's first No. 1 hit in the US. The band goes on "The Joshua Tree Tour"

Wall Street financial market crash aka **'Black Monday'**

1988

Australia 200 Years

Basel I introduced
Australian corporate finance collapse – $1.6M loss due to misappropriated Bank Bills

1990

Pyramid Building Society Group collapsed
>$2 billion debts

1992
380 mutuals

First building society demutualisation via listing on the ASX – The Rock Building Society

1994

Petrol price was 65c per litre

1996

Wallis Inquiry – reconfiguration of regulation and regulatory institutions

1997
299 mutuals

Asian financial crisis begin

1998

The Australian Stock Exchange (ASX) was demutualised and floated as a public company – world's first stock exchange to be listed on an exchange.

1999

Credit Unions and Building Societies registered as ADIs – licensed by APRA under the Banking Act 1959 to undertake the business of banking.

New millennium

2000

Introduction of GST

Olympic Games held in Sydney, Australia

2001

Enactment of the **Corporations Act 2001**

2002
213 mutuals

2004

Facebook was launched

Kenneth Pickering
Chair of Board Audit and Board Risk Committees, Community First Credit Union

Ken has been a Director of Community First Credit Union since the early 1970s and held numerous executive roles in the sector over 21 years. During this time, he has closely observed the periods of change experienced by mutuals:

1980s: An 'era of co-operation' where mutual groups were early innovators (first ATM, first EFTPOS transaction, first FX transaction via ATM, and early issuers of Visa Debit Cards which enabled credit unions to enter the mainstream of banking services)

1990s: The 'regulatory period of adolescence' following implementation of the uniform state supervisory system in response to 'moral hazard' concerns after the financial system deregulation in the previous decade. This decade witnessed a shift from personal lending to mortgage lending.

2000s: The big margins in mortgage secured lending quickly evaporated. ADIs could no longer subsidise the cost of transactions due to the unrelenting pressure on margins. This heralded the 'era of the transaction fee' as it necessitated a focus on other non-interest income sources.

2010s: The marketplace focused on recovering from the GFC and all its challenges. The major banks enjoyed a perfect storm of competitive advantage through the temporary collapse of the securitised business model and the rollout of the Basel II & III Capital and Liquidity standards. Today, mutuals continue to grow no matter what challenges are thrown at them and continually find new ways to compete and innovate for the benefit of their members.

2006

Coldplay's 'Speed of Sound' was iTunes' billionth song downloaded

2007

152 mutuals

2007 – 2009: GFC
Australia largely escaped the impacts compared to banks in other countries due to the close supervision of the Australian banking sector.

GFC hit

2008

Basel II implemented
Eased monetary policy led to the significant decrease of the cash rate from 7.25% (August 2008) to 4.25% (December 2008).

2011

Australia's first customer owned mutual to convert to "bank" status – MECU (currently Bank Australia)

2012

103 mutuals

2013

Transition arrangement for full implementation of Basel III.

2014

Murray Inquiry – more robust capital standards and the promotion of innovation.

2015

Mobile banking apps on the rise

2016

- **Customer owned banking sector reached $100bn in total assets.**
- Lowest cash rate at 1.50% in the past 30 years.
- APRA imposed a 10% lending cap on investment lending.
- Introduction of Apple Pay and Android Pay in Australia.

2017

76 mutuals

- **First automobile club in the world to launch a bank** – RACQ.
- Regional Australia Bank, first mutual to launch smartwatch app for mobile banking.
- APRA's 30% restriction of total residential mortgage lending for new interest-only advances.
- Banking Executive Accountability Regime (BEAR) draft legislation.

U2 launches 'The Joshua Tree Tour 2017' to mark the 30th anniversary of their 1987 album

Graham Olrich
Chairman, Regional Australia Bank

Graham has over 38 years of experience in the banking industry. During that time he completed 8 mergers which combined, brought together over 150 credit unions. He believes that a successful merger is one with like-minded organisations, early mutual agreement on difficult operational decisions, and knowing what the members want.

The 'big issues' that Graham has seen in the past 30 years were:

- 1990s imposition of tax – credit unions were generally "lazy managing expenses" and were forced down the efficiency path to cater for the impact of tax. This also led to increased merger activity.
- Late 1990s / early 2000s – the Wallace Inquiry and subsequent establishment of APRA with a stated aim of levelling the playing field for banking. Graham's considers this has "never really occurred".
- Cooperation – great in the 1990s, but has diminished over the past 15 to 20 years. Graham sees this partly as a result of more Big bank executives joining the sector who lack an understanding of mutuality and has also increased competition amongst sector participants.

Looking forward, the key issues ahead are access to affordable forms of capital, ability to invest in "digital" whilst reducing the branch footprint, and differentiation in a "crowded" banking market and doing so in a sustainable way. He also questioned the sustainability of mutual sector participants – largely because outside of their heartlands, they are not known, and will always find it difficult to compete with the Big 4 banks.

Kevin Dupe
CEO, Regional Australia Bank

Kevin started in the mutuals sector 30 years ago and commented that the key challenge back then was 'seeking legitimacy'. He recalled that credit unions were initially not allowed into the payments system, with the majority settled through NAB. Mergers were also happening all the time and at its peak, included over 800 credit unions. He commented that the sector has always serviced the parts of society who are unattractive to the majors e.g. single / divorced women in the 1980-90s and small businesses in the 2000s to date. When asked where opportunities lie in the future for mutuals, he responded that it will be niche and in relationship banking. Kevin believes that the key for mutuals is 'to succeed by collaboration'.

Robert Keogh
CEO, Beyond Bank

Robert has extensive experience in executive roles in the co-operative industry. In his 38 years spent in the sector, he has seen mutuals collaborate effectively throughout this time – e.g. CUSCAL. Robert believes that through collaboration, mutuals have gained access to the broader market. Mutuals offer a strong alternative to the major banks. He considers that focus on how to create a stronger differentiated position in the market and how to scale through collaboration will be critical in the future. The effective use of data to drive growth and profitability and improve balance sheet strength is key for all of us. A mindset of 'control your destiny' is essential in today's environment. The communities of the future will want a sense of belonging and Robert believes the values of mutuals will resonate with future members.

John Tancevski
CEO, Community First Credit Union

John has been in his role for the past 12 years and has witnessed the challenges faced by mutuals over the last decade.

John is of the belief that mutuals must continue to provide unique alternatives in the marketplace in order to compete with the major banks. By providing an element of trust and a higher standard of service, customers will continue to see the value of maintaining their relationships with smaller institutions.

He also believes that digital wallets such as Samsung Pay are not a point of difference for mutuals, but rather an enabler that will continue to allow people of all demographics to experience greater convenience.

For the full interview, you can listen to the podcast at KPMG.com/au/mutualsreview

Damien Walsh
Managing Director, Bank Australia

Damien has over 25 years of experience in the customer owned banking sphere. He considers consolidation as the standout change over the past 30 years, specifically in relation to Bank Australia who have had 72 mergers since 1957. Other significant changes include reforms to regulation and competition legislation, as well as technology and the role that digitisation has had on banking.

He believes that the biggest challenge for mutuals over the next 5 years will be "growing on purpose", being not just to gain market share, but to have a real impact on the communities in which they operate, and the ways in which technology can assist them achieve their purpose and values.

For the full interview, you can listen to the podcast at KPMG.com/au/mutualsreview

Jan Edwards
CEO, BDCU Alliance Bank

Jan has been involved in community-based banking for the past two decades and during this time, has seen mutuals 'compete in an increasingly international and regulated banking sector'. Jan considers that these are now the backdrop for change in the mutuals industry, with technology set to create dramatic changes. The challenges and opportunities of digital money, in particular, and related changes in the payments system and foundations of the banking business will challenge the banking model.

Jan notes that the perceptions of a 'mutual' remain as problematic today as they did 20 years ago – where understanding who mutuals are and what they stand for being often limited to the community groups that they serve. She considers that whilst rebranding to a 'bank' has created some breathing space for mutuals to catch up, if they don't rise to the sophistication and access methodologies of today's world, this breathing space will close. Jan believes that 'there's a way forward, but it requires some courage'.

Steve Laidlaw
CEO, People's Choice Credit Union

Steve is the CEO of People's Choice Credit Union, Australia's 4th largest mutual ADI.

Steve states that mutuals tend to be "fast followers", which allows them to adapt to environmental change quicker, with fewer resources and at lower costs.

Steve predicts that the mutual ADI sector will continue to grow and outperform the broader market. He believes that the next 10 years will see fewer mutual ADIs in the market due to the challenges of regulatory change; a reduced amount of branches; significant investment in digital capability; and considerable pressure on costs.

Steve views the concept of partnering across the sector to be key, so that mutuals can achieve greater economies of scale and are therefore able to compete with new entrants and existing players in the marketplace. For the full interview, you can listen to the podcast at KPMG.com/au/mutualsreview

Grant Strawbridge
CEO, Credit Union SA

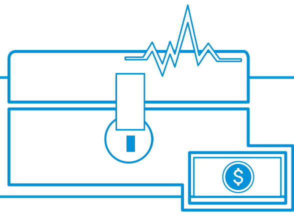
Grant has been involved in the mutuals sector for the last 26 years operating in various executive roles. He considers the ability to maintain relevance in the marketplace and balance member value as one of the key challenges in the future. It is essential to have a financial proposition that seamlessly meets the financial needs of the members. Mutuals also need to have a long term play and have a shared value proposition with their members and identified communities.

Grant views digital innovation as a tool to combat digital disruption in the marketplace. Mobile access will be a key enabler in the digital technologies used by mutuals to advance their business strategy. As member demographics shift from baby boomers to Gen-Y, there is a challenge to maintain engagement with both groups, while maintaining digital strategy. Even in a digital world, mutual values of building loyalty should be delivered by the personal touch of how mutuals interact with members.

8 points on the radar

Based on our 2017 Mutuals Industry Review survey results, we saw eight emerging themes that are calling for mutuals to respond to. If given the right attention, mutuals can turn these challenges into opportunities and achieve their stated strategies.

01 Capital



The capital base of a financial institution is a source of strength and mutuals have historically maintained higher levels of capital in comparison to industry players. Maintaining the right level of capital remains a balancing act and requires a choice between holding high levels of capital with its consequent opportunity cost, or a 'lean' capital level that puts the banking industry closer to a capital adequacy breach should significant headwinds emerge unexpectedly in the industry.

Mutuals have generally remained well capitalised and held substantial buffers of capital above the prudential requirement. A critical strategy for the mutuals is determining how to generate sufficient profit to support loan growth, while maintaining sufficient capital levels.

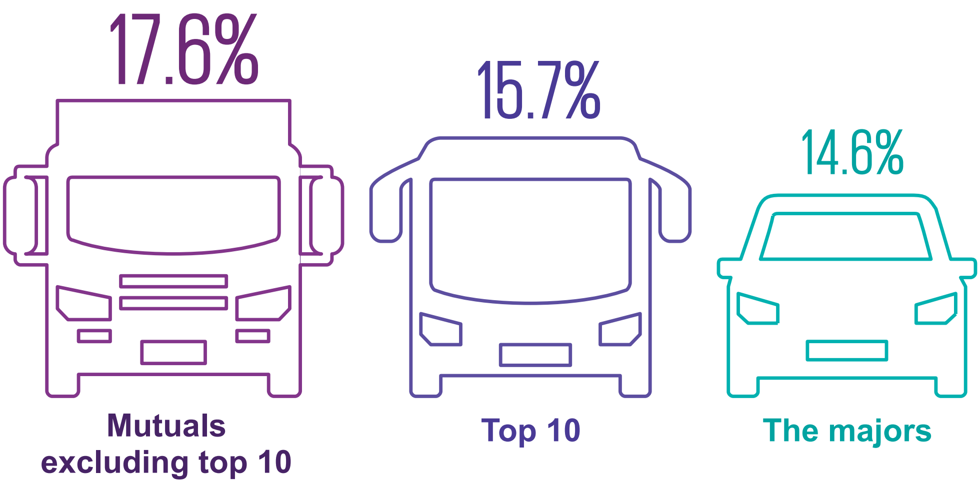
As at 30 June 2017, the average capital adequacy ratio of the industry was 17.2 percent (2016: 17.5 percent). We have seen a shift, with mutuals moving away from holding excessive levels of capital.

The decline in capital is more pronounced amongst the top 10 than the rest of the mutuals. The key issue is what level of loan growth can be achieved given a mutual's profitability. The need to find the optimum capital to manage this objective is important.

The current low interest rate environment and the downward pressure on net interest margins is a challenge for mutuals whose primary source of capital is retained earnings. Mutuals need to continuously maintain levels of loan growth and simultaneously maintain an adequate capital level. The enforcement of regulatory constraints on certain loan types (e.g. 10% cap on investment lending) by APRA are well-intentioned and have stemmed from concerns over credit losses in the event of a housing shock, which would impact interest-only loans and investment lending to a greater extent. However, at the same time, they have restricted growth and profitability in the mutuals sector.

To increase profits to support growth of the capital base, mutuals may need to address their cost-to-income ratios between the majors and the mutuals. Mutuals have historically had a higher cost-to-income ratio than the majors due to their relatively smaller size and hence reduced ability to achieve economies of scale. The concept of mutuality ensures that profits are reinvested in the business in the form of increased benefits to members and giving back to the community. To address the cost imbalance, some mutuals have merged for synergistic purposes to improve operational efficiency. Increased collaboration amongst mutuals this year has also seen significant cost savings be achieved. One example is the joint venture between People's Choice Credit Union and Credit Union Australia called the Mutual Marketplace. Here, a new procurement and accounts payable platform was established with the aim of delivering scale benefits, improved procurement outcomes and streamlined operations.

Average total capital ratios as at 30 June 2017



Managing risk

Risk is inherent in every financial activity including determining the optimum level of capital to hold. The risks faced by the banking industry span a myriad of types. Stress testing can be a powerful tool to assist in determining the optimum capital level, particularly in the current environment where growth is constrained in certain credit concentrations and the industry is heavily regulated. Stress testing allows mutuals to estimate the impact of unfavourable events on the balance sheet and profitability and consequently on capital. Appropriate levels of capital need to be maintained to sustain against the impact of negative financial headwinds.

Regulatory response

In recognition of the constraints on mutuals to raise capital, APRA's recent announcement to allow ADIs to issue Mutual Equity Instruments (MEI) as an additional source of capital beyond retained earnings has been well received by the mutuals sector. News of the Government's endorsement of the 11 recommendations proposed by the Hammond Review has also been met with positive response. Here, the Government has showed support for the issuance of capital instruments by mutuals and has encouraged a review of the capital framework to facilitate this.

The MEI will pay a return that reflects the risk of the equity instrument and this would be different for each mutual organisation. According to APRA, each ADI will need to carefully consider the risk and reward of the MEI because if the rate paid by an ADI on the MEI is higher than the ADI's rate of return, then issuing MEIs will risk diluting profitability and affect long term growth capacity[32]. Nevertheless the MEI will pave the way for mutuals to access sources of funds that were previously out of reach.

Finding the 'right' balance

The level of capital held by an ADI is constantly scrutinised by the regulator and finding the optimal capital level will continue to be a balancing act considering prevailing economic conditions and risk mitigation measures.

Reducing the historically higher cost-to-income ratio will require out of the box thinking to grow profitability and manage capital. Issuance of the MEI will increase the capacity of mutuals to access new sources of capital and ensure that they remain competitive by supporting loan growth and technology investments.

Hot off the press

One of the key recommendations in Mr Hammond's review of 'Reforms for Cooperatives, Mutuals and Member-owned Firms' was to allow the issue of a new class of co-operative shares and enable their classification within Tier 1 capital.

Recently backed by the Government, we see this to be a real opportunity for mutuals to grow their business through greater flexibility in funding.

02 Gen Y

According to our survey, 91 percent of our survey participants have been actively targeting the younger generation; however only 49 percent have been successful in gaining market share with this demographic.

Gen Y professionals will be significant drivers of retail banking revenue in the not-too-distant future. It is expected that they will form 50 percent of the workforce by 2022.

As more Gen Y professionals enter the workforce, we are starting to see important longer-term patterns as well as emerging trends in their expectations.

Below is a snapshot of eight trends that show how mutuals must urgently consider their high expectations, particularly around digital aptitude, and step up their level of delivery to attract them.

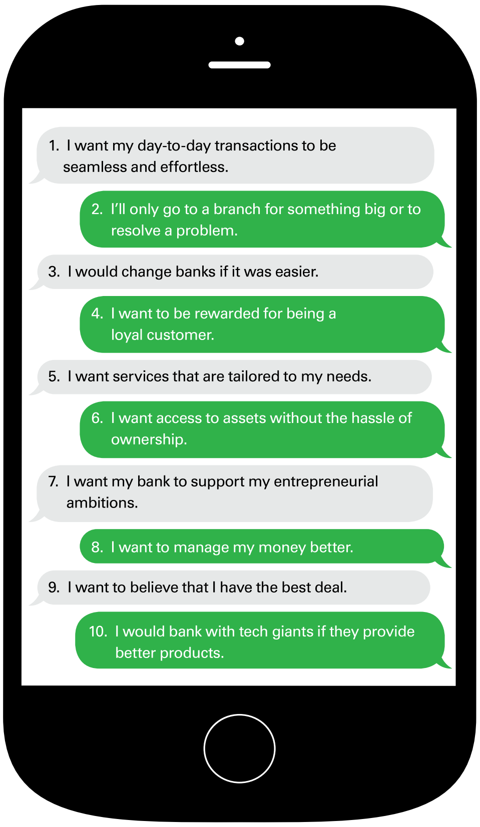
1. Banking in the Background: "Invisible Payments" resonate with this group, they want the convenience of making a payment without having to take out their wallet.
2. The relevance of Wealth: The noble savings account remains the primary investment tool. Liquidity is critical.
3. Spending Habits: #YOLO (You only live once!): Increased spending on luxury items, experiences and travel are delaying big commitments such as home ownership, indicating a broader shift towards paying for access rather than ownership of assets.
4. Cherry picking on the rise: As the digital barriers to multi-banking are relatively low, Gen Y are simply choosing products that tick all the right boxes for them.
5. Digital remains king: The digital experience has remained the most highly coveted banking attribute, holding the #1 position with mobile experience en-route to overtake this in the immediate short-term.
6. A bank that travels: Options to support the ease of travel through tailored product features, benefits and reward products to maximise the experience of both going on holidays and purchasing overseas.
7. Worker by day entrepreneur by night: Driven by their desire for independence, many of this group perceive entrepreneurship as the new way to get ahead. According to the Banking on the Future survey, over 50% of survey participants indicated that they are planning or already own their own business.
8. Banking with tech giants: The Banking on the Future survey also indicated that over 80% of survey participants would consider moving to a tech giant if the offer was lucrative enough, preferring Google and Apple to social media platforms such as Facebook or Twitter.

91 percent

of survey respondents have been actively targeting Gen Y.

The 10 Commandments of Gen Y

For mutuals, these perspectives will be important to consider as they shape their products, services and business models to meet their needs.



Actionable steps to meet Gen Y professionals' banking expectations

Customer Insight

- **Real-time insight.** Leverage your internal Gen Y employee network or customer base to continuously understand their changing saving and spending habits to ensure your product suite is tailored to address and meet their needs.
- **Experience matters.** Gen Y professionals definition of value has extended beyond price. Mutuals should utilise and manage customer data to deliver contextual experiences (i.e. personalised, timely, location based, proactive etc.).

Product

- **Changing habits.** Consider how to re-design products to help change their financial habits and 'force' them to save. This might be through incentives or automatic rounding of up transactions.

- **Global opportunities.** Explore how your banking products can enable their global endeavours and support their fast paced lifestyle. This could involve exploring on demand insurance or group holiday funds.
- **Entrepreneurial customers.** Look for opportunities to partner with young professionals on their entrepreneurial journeys. Understand the types of ventures your target customers are exploring, and tailor product benefits to support.

Digital

- **Innovative digital services are a given rather than nice to have.** This generation will only wait four seconds for a website to load before leaving. The mutuals need to continuously innovate and improve their digital service offerings to retain the loyalty of this cohort.
- **Open ecosystem.** A central pillar to enabling the bank of the future is having an open technology stack. Investing in Middleware/API layers to enable plug-and-play of new capabilities is critical for the mutuals.

Innovation

- **Sandpit thinking.** Foster a safe-to-fail environment where mutuals and customers can collaborate on the future of banking, honing in on opportunities to prototype innovative solutions that address Gen Y professionals evolving habits and needs. This should also include a mechanism for determining the best implementation path (build, buy, rent, outsource or invest).
- **Innovative partnerships.** Explore the opportunity to partner with fintechs to offer a better suite of products and services in response to the uprising threat of tech giants in the financial services industry.

Marketing

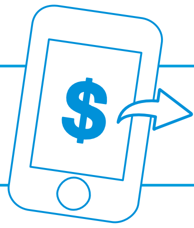
- **Educate and engage with them early.** Launch campaigns to inform them of the financial coaching and wealth management services on offer, but tailor these campaigns specifically to Gen Y professionals.
- **Relevant micro-campaigns.** Mutuals are offering products that Gen Y professionals are likely to value, but the group do not know are being offered. Our survey indicates that social media is the second most important advertising channel for products for mutuals. The Go-to-Market strategy for new products can be tailored to capitalise on Gen Y psychological realities of #FOMO (fear of missing out) and #YOLO.
- **Brand positioning.** Mutuals can run targeted campaigns to build a brand that embodies key attributes Gen Y professionals value (such as socially responsible banking).

Banking on the future

KPMG's third Banking on the future report reveals important longer-term patterns as well as emerging trends concerning Gen Y professionals' expectations and experiences of banking and broader financial services.

Click here or visit kpmg.com/au/bankingonthefuture for a copy of the report.

03 Mobile banking



'Anytime, anywhere' banking was hot on the agenda this year with it being the top strategy for mutuals to improve the customer experience. In a world where customers are demanding faster and more convenient ways of banking, it comes as no surprise that they are a key driver behind developments in the technology space.

2017 has seen mutuals continue to expand their omni-channel capabilities through new mobile functionalities, refreshed web designs, and improved digital workflows that have allowed customers to execute transactions digitally with limited manual or paper-based processing. Increased investment in technology and the introduction of digital banking capabilities were considered by our survey participants to be the next main contributor of growth after better pricing on products, and we do not see this momentum slowing anytime soon.

In the next year, the top spends on technology for capital investment show a focus towards enabling mobile commerce and doing more with data to gauge a closer insight into the profile and spending patterns of customers.

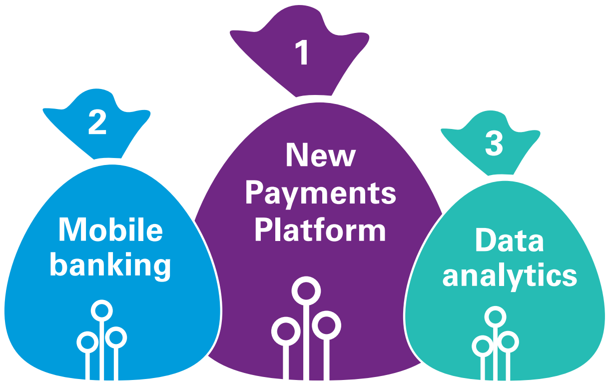
We see a strong desire by mutuals to be at the forefront of technological change with 68.3 percent of our survey participants viewing technological disruption as more of an opportunity than a threat. However, 63.4 percent are not backing themselves in action and do not currently consider themselves to be active disruptors in the industry.

According to the results of our survey, on average, 79.5 percent of IT budgets are planned to be used for continual business as usual activities, with the remaining 20.5 percent set aside for technology enhancement and innovation.

For the third consecutive year, innovation has remained the number one technological challenge with limitations in current IT systems, lack of funding and critical skills internally being viewed as the biggest impediments to digitisation.

With these challenges in mind, we see collaboration amongst mutuals to be a big opportunity to share ideas and pool resources to execute their digital strategies.

Greatest technology spends for capital investment in the next year



Payments of the future

The latest Consumer Payments Survey conducted by the Reserve Bank of Australia in November 2016 showed that, for the first time, credit and debit cards surpassed cash as the most frequently used method of payment by Australian consumers. Greater adoption of contactless 'tap and go' functionalities by merchants in recent years has been a primary driver of this.

Mobile commerce ('m-commerce') has taken contactless payments to the next level. M-commerce involves paying for goods and services through handheld devices, and has been made popular through mobile apps like ApplePay, AndroidPay and SamsungPay. These apps link a consumer's smartphone to their credit or debit cards and enable them to make purchases by simply waving their mobile over a merchant's point-of-sale terminal.

The number of mutuals that have partnered with the following digital wallets is:

Pay 36

pay 38

SAMSUNG pay 29

Over the past year, we have seen many examples of how the smartphone is quickly becoming a 'digital wallet' for Australians. Outside the financial services space, Manly Ferries passengers can use it to pay for travel fares, Woolworths shoppers can use it to track their loyalty points and rewards, and the Australian government have enabled digital copies of people's health and concession cards to be stored on a mobile.

Underlying this movement is the reminder that the customer is king. As customers become more technology savvy and comfortable with the online storage of personal and payment information, the ability to make 'invisible payments' will soon become an expectation, rather than a 'nice to have' functionality.

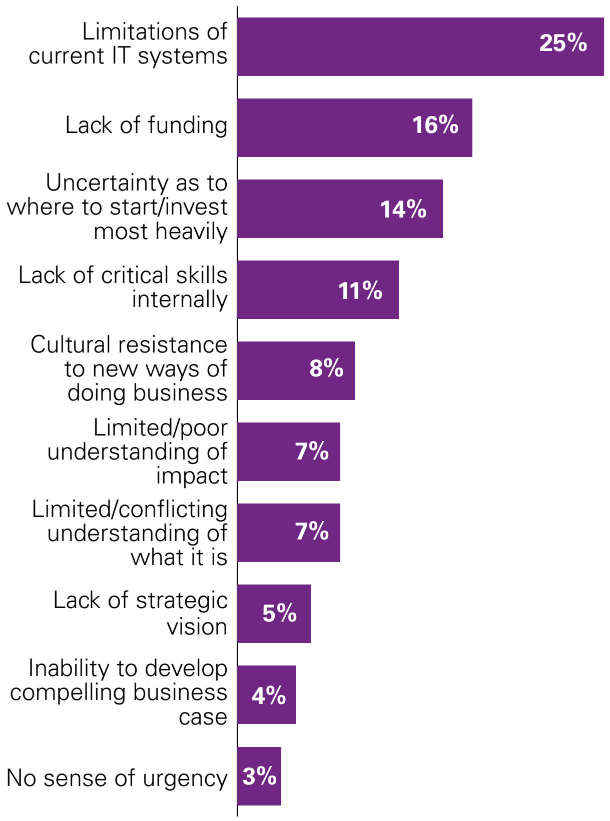
Some mutuals have been quick to detect and act on this trend. Heritage Bank, for example, launched HOVA in 2017 – a wristband with an embedded chip that allows users to leave their wallet or phone at home and make purchases by hovering the wristband over a contactless payment terminal. Heritage also took the idea of wearable technology to the next level by working with tailor MJ Bale to create a 'Payweave' power suit that allows wearers to make purchases by swiping their sleeve.

As cash payments continue to decline and digital payments emerge, will we eventually become a cashless society?

Looking abroad, we have seen early signs of what a world with limited banknotes and plastic would be like. In China, the mobile application WeChat has been a significant phenomenon and become a daily contact point for everything in the lives of its 700 million users. WeChat started as an instant-messaging mobile application in 2011 with text messaging, voice and video conferencing, photo and video sharing, as well as other integrated social networking services. In 2013, it introduced a digital wallet service, WeChat Pay, which allowed users to transfer money between WeChat contacts (peer-to-peer) via text and also make payments online. Known as the 'app for everything' in China today, WeChat can now also be used to order food, pay utility bills, split dinner tabs, make hospital appointments, book and pay for taxi, train, and plane travel, and more…with just a few taps on the app. WeChat has been a long-time driver of innovation and e-services in China by understanding what consumers of today want – getting the job done with minimal time, cost and energy expended. WeChat's success is down to the fact that it has integrated so many services for life's daily routines in one centralised hub.

While WeChat is a less commonly used chat application in Australia, we are starting to see other apps such as Whatsapp and Facebook messenger looking to join this bandwagon. In this digitally connected world, everyone is working to deliver convenient, accessible and relevant services to people's lives. It is important for the mutuals to keep abreast of these fast-approaching trends and to continue to create valuable experiences for its customers.

We asked survey participants…what do you consider to be the biggest impediments to digitisation?



Digital challenges

While the vision of a technologically-enabled business with the latest customer gadgets and new whiz tools is highly sought after, it is not one without challenges.

For most mutuals, the biggest impediment to digitisation is the limitation of current IT systems. It is undeniable that an overhaul of legacy mainframe technologies will require substantial investment by the business in terms of time, cost and resources. This, coupled with a lack of funding and specialised internal skills, make it a mean value proposition where the solutions are often outweighed by the effort involved to implement these technologies solo.

As a result, mutuals have looked to achieve technological progression and back-office efficiencies through other avenues. Partnership with fintech companies, niche lenders and agile players have brought the tools and capabilities for business digitisation in a cost and time efficient manner. These providers offer the expertise and dedicated personnel to deliver digital and advanced data solutions that mutuals have struggled to achieve alone. Collaboration across the mutuals sector has also enabled the pooling of funds necessary to cover the significant investment spending of technological advancement. These efforts have not only enabled greater returns to be generated, but also improved the customer experience and kept the mutuals on pace with other players in the banking industry. We see collaborative movement within the sector to be a big opportunity for mutuals to execute their operational and digital strategies, and use technology as a competitive differentiator.

04 New Payments Platform (NPP)

The New Payments Platform will become part of Australia's digital landscape in 2018.

The digital economy is now driving an on-demand economy which forces payments to move to the moment of customer need. Real-time commerce has been a catalyst for revolutionising Australia's 40 year old retail payment infrastructure with a modernised platform – the New Payments Platform (NPP).

What is the NPP?

The NPP will be a new open access infrastructure that will provide Australian businesses and consumers with a fast, versatile, data-rich payments system for making everyday payments in 2018. The platform is designed to be a world leading solution for real time payments and is being implemented through a cross-industry collaborative effort with 13 founding organisations. Mutuals are able to participate in this platform indirectly through collaboration with those who have direct connections with the NPP.

The NPP is the banking industry's response to a strategic review conducted by the Reserve Bank of Australia on innovation in the payments system, which outlined the following key strategic objectives for the platform:

- To develop a capability for businesses and consumers to make payments in real-time, with close to immediate fund availability to the recipient;
- To develop a capability that will allow consumers to make and receive low-value payments outside normal banking hours;
- To develop a capability to send more complete remittance information with payments; and
- To develop a capability that will enable easy addressing of retail payments to any recipient.

Based on a decentralised model, the platform includes core elements of Switching, Networking, Addressing and Settlement, all of which provide the rails for the new transactions to travel on. Additional customer offerings can be developed on top of the rails, and are referred to as Overlay Services.

Once implemented, the platform will provide the following benefits:

- The ability to pay quickly with real time acknowledgement, with payments not delaying purchases regardless of the time of day or day of the week;
- Improved cash flow as funds can be transferred quickly and easily; making reliance on cash less important;
- Greater ease of use and enhanced functionality. This is because BSB numbers and account numbers no longer dictate – a customer can nominate something like a mobile phone number which is more meaningful when they transact – a number they can remember;
- Leverage the global ISO20022 message standard enabling the use of additional data; and
- 24/7 availability.

56 percent

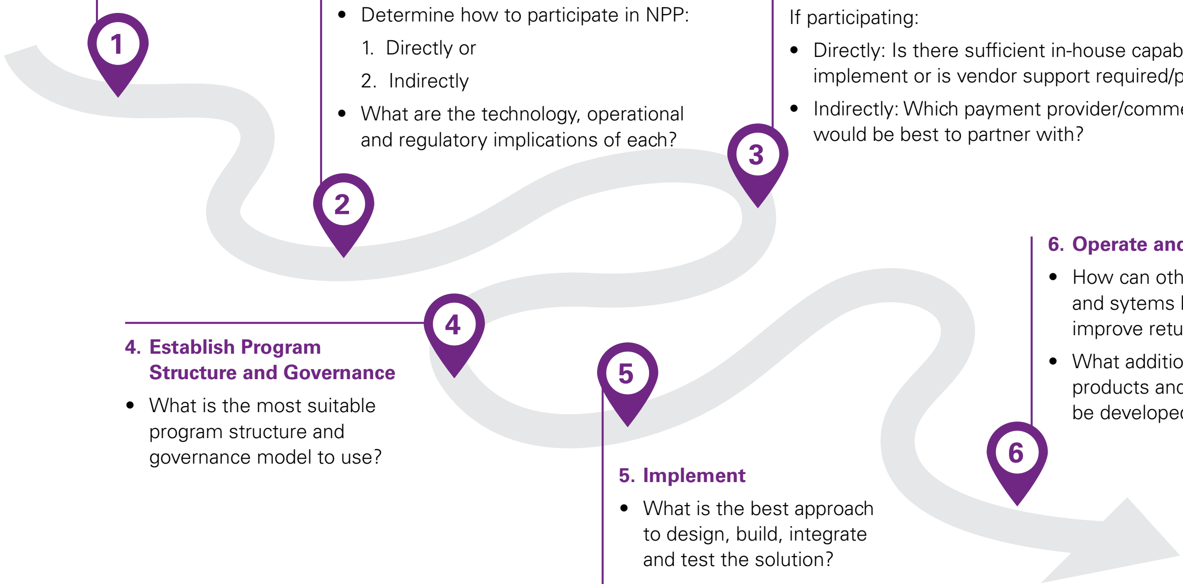
of survey respondents said NPP is their top technology spend for capital investment next year.

Strategic thinking

To remain competitive in the market place, mutuals should consider an enterprise-wide real time payments strategy that enables both consumers and corporates to utilise real-time payments in 2018. Learnings from other jurisdictions have shown that ADIs who approach this initiative as an opportunity for product innovation and to improve their customer experiences, as opposed to compliance projects, have experienced both revenue opportunities and customer growth.

Real time payments provide a platform for traditional institutions to offer innovative products that focus on improving customer experience and solving existing pain points. The early movers will have the benefits of customer growth and revenue opportunities, while over time, real time payments will become commoditised.

What would your NPP journey look like?



1. NPP Strategy

- Is it valuable for your organisation to participate in NPP?
- What is the customer service offering?
- What are your competitors offering?

2. Type of Participation

- Determine how to participate in NPP:
  1. Directly or
  2. Indirectly
- What are the technology, operational and regulatory implications of each?

3. Source Partners and Secure Funding

- What is the scope of development – internal systems (e.g. back office, fraud, etc.), integration with the NPP and/or a payment provider?

If participating:

- Directly: Is there sufficient in-house capability to implement or is vendor support required/preferred?
- Indirectly: Which payment provider/commercial bank would be best to partner with?

4. Establish Program Structure and Governance

- What is the most suitable program structure and governance model to use?

5. Implement

- What is the best approach to design, build, integrate and test the solution?
- How do we ensure a successful delivery?

6. Operate and Enhance

- How can other processes and sytems be streamlined to improve return on investment?
- What additional customer products and services can be developed?

05 Fintech

The banking industry is undergoing a paradigm shift. Emerging technologies like artificial intelligence (AI), machine learning, the Internet of Things (IoT) and blockchain, combined with ever-changing customer expectations and preferences, are redefining how the banking industry deliver services.

Newly established financial technology businesses (fintech) are disrupting the value chains of incumbent financial service providers. These emerging technology vendors have encroached on incumbents providing both enabling and disruptive technology solutions but importantly have provided opportunities to deliver new products and services, drive back office efficiencies and enable customer centricity.

Surprisingly, our survey results indicate that 62 percent of respondents do not plan to invest in fintech next year and only 19 percent will commit the same amount as this year. Only 17 percent indicated that they will increase their fintech expenditure. The type of fintech that the respondents are most interested in investing in is lending.

Mutuals that can best discover, engage and collaborate with fintech and regtech (regulatory focused technologies) will be better placed to keep up with the pace of change in the environment around them.

Our experience is that there is no single solution for incumbents in terms of a fintech strategy. An effective strategy will be made up of different avenues with an element of trial and error. Successful mutuals need to reflect change both internally and also how they engage with the external market. Important features of a good fintech strategy are:

- Solid knowledge of current business operations;
- Awareness and early identification of signals of change;
- Readiness for change and understanding of cultural barriers;
- Alignment between business objectives and fintech approach; and
- Broad array of innovation activity that includes both incremental improvements and transformative change.

Fintech Landscape

View, download and print a one-page snapshot that showcases the breadth of fintech companies operating in Australia.

Mutuals are well positioned to leverage their size and agility to engage with fintech. Unlike the majors they can move at speed and, with the right governance and organisational framework in place, can drive outcomes. Importantly mutuals should remain flexible and adopt different approaches based on their specific circumstances. Mutuals should be doing the following:

Build – Internal capabilities including fostering an innovation culture, a 'safe to fail' environment and ensuring there are the right capabilities within the mutuals (agile methodologies, design thinking etc.).

Procure / Source – Ensuring access to the external ecosystem and development of a process for scanning the market and procurement processes that ensure that the business is startup ready.

Partner / Collaborate – Sourcing new products and business model opportunities through collaboration with the ecosystem.

White labelling – Finding opportunities to sell to or through fintech companies.

Investment and Acquisition – Taking equity stakes in a high-growth business and consider acquisitions.

Forging the future: Embracing fintech to evolve and grow

Our global survey and report explores how global financial institutions are designing strategies and adopting fintech innovation, as well as best practices for forging the path ahead.

Click here or visit KPMG.com.au for a copy of the report.

06 Digital labour

Recently, it seems that hardly a day goes by without apocalyptic warnings that robots in the workplace will create a dystopian destiny. The convergence of artificial intelligence, robotic process automation (RPA), machine learning, and cognitive platforms is potentially so disruptive that Klaus Schwab, founder of the World Economic Forum calls it the "Fourth Industrial Revolution."[1]

As businesses and governments seek to streamline processes and reduce operating costs, cognitive technologies are rapidly creating a new class of digital labour. Many jobs will be reconfigured and redesigned, causing job dislocations and requiring employees to learn new skills.

How then, can mutuals begin to act now, sensibly and pre-emptively, to benefit from the opportunities digital labour presents to continue their historically strong performance?

A series of potentially positive outcomes exist for mutuals. Cognitive technologies can spur a growth in jobs overall and enhance human skills and expertise. Ultimately they can make every employee an innovator and transform the enterprise into an engine of unconstrained innovation.

Of particular interest to mutuals in the shorter term is learning from the lessons of early movers at larger financial institutions who are already deploying Intelligent Automation (IA), especially around RPA. RPA is the use of technology and 'bots' to automate work traditionally done by humans. RPA describes the continuum of technologies used to automate business processes and operations.

Immediate examples of successful applications of RPA by larger financial services organisations (as assisted by KPMG) include

- Pension Funds: 20 percent of policy administration effort has been saved so far through RPA, and there are targets for a further 50 percent through AI.
- European Bank: Running 200 bots, with a target for 500 by the end of the year and targeting automation of 35 percent of roles across the bank. Achieved ROI of 4:1 FTE savings from their automation efforts so far. They are not implementing point solutions, instead they are cognisant of the end to end process and how automation best supports the whole value chain.
- Small International Bank: Applied automation across their card servicing processes, achieving 99 percent cost saving and 60 percent improvement in process time.

Coupled with these early success stories is the reality that some organisations do not achieve the full value of digital labour because:

- They have looked for opportunities to apply robotics rather than considering how customer experience and profitability could be achieved through various methods of process automation;
- Point solutions have been implemented rather than redesigning entire processes;
- The automation program is owned by IT not by the business responsible for delivery to the customer;
- Robots are not plugged into IT release schedules (so when inputs change, robots are not changed and things break-down);
- They are only able to harvest 'fingers and toes' benefits (rather than re-thinking whole groups of activities or processes using a blend of process design techniques); and
- There is a lack of active performance management for automation solutions, so intended benefits are never realised.

The experience in working with those clients adopting IA showed that it is often the tasks, as opposed to the whole job, that are being automated. The overall effect, therefore, which we believe will continue for a few years yet, is that jobs, work teams, processes and functions will need to be redesigned as a result of task automation and decision enablement. In time we will see jobs being automated, such as will happen with driver-less cars, and this will herald an acceleration in transformation, but we have not yet reached that point for most businesses.

Mutuals must consider that any move to IA needs to be connected to business strategy and sources of competitive advantage. As less resources are available to mutuals compared to the rest of the banking industry, it must be stressed that it is not all about cost. Robotics and other forms of digital transformation represent an opportunity to rethink the business and operating models, reduce costs and enhance customer service.

A recent example of how mutuals are beginning to digitally transform their business models is the development of a chat bot by RACQ Bank, who have ramped up their digital transformation strategy following their merger with QT Mutual Bank. This chat bot is backed by an artificial intelligence engine and will replace RACQ Bank's 'click-to-chat' capabilities that are currently being used to pick up issues in their back-office functions. The chat bot will have the ability to sort them out to continue with the automation process. RACQ Bank are also looking to introduce chat bots to their member-facing processes.

Moving to IA offers the potential to achieve operational excellence, improve customer intimacy and experience, and accelerate product innovation. However it should be noted that this can be fraught with peril, and that the implementation of automation for these purposes will involve a lot of trial and error, some failures and learning along the way. One thing remains constant in what we have seen, heard and researched: without a connection to strategy, deployment of robotics and IA is likely to be sub-optimal.

In addition, just because you can replace humans with bots does not mean you must – or should. As more cognitive solutions are deployed, greater coordination and governance is required in order for mutuals to scale up from pilots and realise widespread benefits.

Mutuals also need to think about their reputation, community, morality, ethics and brand when considering a move to robotics, particularly for customer-facing activities.

Dealing with the transition – and change management associated with the automation revolution – will evolve, as core values and corporate social responsibility focuses may need to be updated.[2]

Engaging with IA should only be done holistically, not using a 'toe-in-the-water' approach and must consider alignment of business strategy.

Mutuals may lack scale alone, especially compared to the individual investment and resource capacities of a larger financial institution. Whilst this is seemingly a barrier to entry into exploiting the benefits of digital labour, an opportunity exists for mutuals to collectively fund the development of digital labour capabilities as an industry-wide effort. Learning from the pitfalls of early investors and benefiting from hindsight also means that any large portions of outsourced business or shared services by mutuals could similarly share the gains to be made from digital labour as a collective body.

Almost 56 percent

of survey respondents plan to invest in robotics next year for process efficiency

07 Regulatory and accounting changes

Regulators continue to play an active role in the banking landscape. A number of key changes are on the way, and mutuals must be thinking about how they need to prepare for them now.

1. The Banking Executive Accountability Regime (BEAR)

Announced in the 2017 Federal Budget, the BEAR is intended to encourage a more accountable banking industry. The BEAR will apply to all ADIs, which includes mutuals. If it is passed in Parliament unchanged, it will apply from 1 July 2018.

The intent of the BEAR is to make those with significant influence over conduct and behaviour in ADIs more accountable for the actions and outcomes of their organisation to ensure that they cannot avoid responsibility for issues that occur under their management.

Specific obligations that the ADI must meet include:

- Meeting key personnel obligations (through its 'accountable persons');
- Complying with its accountability obligations, specifically in how it conducts itself and engages with APRA;
- Providing accountability maps and accountability statements; and
- Implementing specific remuneration policies.

There will be a maximum civil penalty of $200 million for larger ADIs and $50 million for smaller ADIs.

In the feedback received from our survey, the BEAR has been viewed as a looming regulatory burden for mutuals, with many considering it to be (once again) unfair that they have been bluntly lumped in the same category as the majors by the government.

This has continued to be one of the biggest frustrations expressed by mutuals – that they struggle to keep up with the sheer volume, diversity and constant change in the regulatory space when often the impact of certain regulation is not fit for scale and not commensurate with the risk profile of the mutual sector. We have heard similar views before when APRA introduced the 10 percent limit on investor lending and 30 percent interest only funding cap over the past two years.

It is expected that the BEAR will be a significantly onerous task for mutuals and will create heavy pressures on time, cost and resources. The Customer Owned Banking Association (COBA) have suggested to the Government that the BEAR should only apply to the majors; however the Government have remained firm on their decision for it to apply to all ADIs.

It is expected that mutuals will request a staged implementation timetable over two years to ensure that they have enough time to prepare for the BEAR.

> **"There's going to be far greater granularity and transparency of people's responsibilities, and that goes from the Board of Directors and Non-Executive Directors through to the C-Suite, as well as legal and human resource professionals. It's quite a lot of work for the industry to set up and meet these requirements."**
>
> — **Michael Cunningham**
> Partner, Audit,
> Assurance and Risk Consulting
> KPMG

2. AASB 9 *Financial Instruments*

In response to the credit crisis that emerged during the Global Financial Crisis (GFC), financial institutions were constrained by the accounting standard for loan impairment, AASB 139 *Financial Instruments*, to write off impaired loans. This was because they did not meet the criteria of 'incurred loss' until the occurrence of the event and this contributed to the reactionary response to the GFC by financial institutions. The new and yet to be effective AASB 9 *Financial Instruments* applies an 'expected credit loss' model which means that a loss event will no longer need to occur before an impairment allowance is recognised and forward looking information can be incorporated into loss allowances.

AASB 9 aims to address concerns about 'too little', 'too late' provisioning for loan losses.

AASB 9 simplifies the requirements of impairment recognition and aligns more closely with the way credit risk is managed by financial institutions. Under AASB 9 significant increases in credit risk will primarily drive the timing of the recognition of losses and expected loss calculation will drive the amount of impairment loss that should be recorded. Expected Credit Loss (ECL) models can be complex and require estimates concerning future, uncertain events. In accordance with the AASB 9 impairment model, expected credit losses will be measured as either 12-month expected credit losses or lifetime expected credit losses.

AASB 9 readiness

The implementation of AASB 9 comes with key considerations for mutuals, for example the reliance on data from core banking systems to support impairment models is significantly higher and mutuals must consider the readiness of information systems and address all data gaps prior to the implementation of AASB 9 and data collection processes must be in place to support any AASB 9 impairment model. Furthermore upgrades to existing core banking systems or new IT systems need to embed AASB 9 data requirements as appropriate and minimise manual workarounds.

Consequently it is important to set realistic timescales and accountabilities in the project team and not underestimate time and costs involved to implement AASB 9. Access to the appropriate relevant data that is complete and accurate is a key starting point and the effort required must not be underestimated.

The key considerations for the mutuals when implementing AASB 9 are outlined below:

- Data availability: significant implementation effort will be required for access to the appropriate data;
- IT-system capacity: systems must have the capacity to enable the retrieving and modelling input data for the impairment model; and
- Processes and overarching issues: controls and methodology must be in place to support the impairment process.

AASB 9 fundamentally shifts the approach the mutuals must take when assessing loans for impairment. It is expected that AASB 9 will improve loan loss visibility and give mutuals the flexibility to bring forward losses that were 'forbidden' under the 'incurred loss' approach for loan provisioning under the predecessor accounting standard AASB 139. There are also disclosure requirements even where loan losses are not expected to occur.

Lastly, under AASB 9 we anticipate a departure from reliance on the APRA standardised provisioning approach for accounting reporting purposes and in effect a two pronged provision approach – one for financial reporting purposes under IFRS and another for APRA reporting purposes. This process must be managed appropriately on day 1 of AASB 9 implementation.

3. GST recovery rates

In September 2017, the Australian Taxation Office (ATO) published Practical Compliance Guideline 2017/15 (PCG) that allowed mutuals to use a 'safe harbor' rate of 18 percent to recover Goods and Services Tax (GST) on certain costs.

Whilst not mandatory for mutuals, our survey results indicate that 52 percent plan to rely on the 'safe harbor' rate.

Mutuals can consider the benefit of applying the 18 percent GST recovery rate in light of their particular circumstances taking note that they:

- May be entitled to recover GST at a rate higher than 18 percent because of the nature of their enterprise activities;
- Cannot use the safe harbor rate to calculate GST credits for costs incurred in tax periods prior to its use; and
- Will continue to be subject to ATO verification activities due to the contentious nature of determining whether costs are incurred solely or partly for the purpose of making input taxed supplies.

08 Risk management

As technology revolutionises the way organisations function and brings competition from all areas of the globe, the array of new risks to pre-empt and mitigate is vast. Understanding these risks – in real time – and being able to respond quickly, is a necessary organisational capability today.

In the current environment, we have seen that there is a need for mutuals to take calculated risks, perhaps in finding new markets or innovating new products, in order to remain competitive.

We see two key areas of risk in the mutuals' direct line of sight that can be costly to their brand and reputation, if not properly managed.

- **Cyber security and data privacy**
  Based on our survey results, one in ten mutuals feel that they are not prepared for a cyber-event. While mutuals have at times been slower to implement technological changes, cyber security is something that they cannot afford to fall behind on. Active management in keeping data gateways secure and customer details private are integral to maintaining customer confidence.

- **Culture and conduct**
  With mutuals priding themselves on quality customer service, developing the right skills, behaviours and experiences of their staff is essential. Even without malicious intent, a single misunderstanding, a temporary lack of attention, or a private or careless comment by an employee can lead to reputational damage and loss of brand value. Carefully remediating these situations and implementing safeguards through employee training is imperative for mutuals, as it has direct impacts on their image and customers' experience.

Brand and reputation

Underpinning these risks, is the mutual's corporate image. Often the loss of reputation, damage to a brand name or loss of customer confidence are considered to be some of the most crucial risks a business may face.

With 43.6 percent of survey participants considering word of mouth to be the most important advertising channel for their products, maintaining a positive and trustworthy image is essential. Social media channels came in second at 28.2 percent, which reinforces the 'power of the people' and the reliance that mutuals place on their customers for referrals and recommendations to friends, family and colleagues.

A strong reputation built through integrity and trust can attract business, help retain existing customers and make the entity an attractive place to work for and be associated with. If managed properly, it can be the divider that sets mutuals apart from their competitors and ensure future growth and sustainability.

Trust is an indicator that an entity will behave in a certain way – ideally with integrity, ethics and reliability – whether it be with handling private data, providing honest customer service, or demonstrating good corporate responsibility. In a world where we seem to trust less and feel overwhelmed with information, offers and opportunities, the sense of being able to rely on a provider or a product carries great weight.

For mutuals specifically, a core strength of their brand is their community and social purpose, which has resonated well with their customers and at times, this has been more important than generating profits.

The risk function of the future

Looking ahead, mutuals must develop a big picture vision and adopt a strategic outlook beyond the risk function. The mutuals' risk functions need to be involved in how their broader business operates, what the value drivers are, and take this information to align their risk thinking with the overall strategy of the organisation.

The first step is understanding how their mutual fits within the environment, which is full of interconnected risks. They must understand how these risks interact with, and are influenced by, each other and take actions to leverage them in the most strategic and well-balanced way.

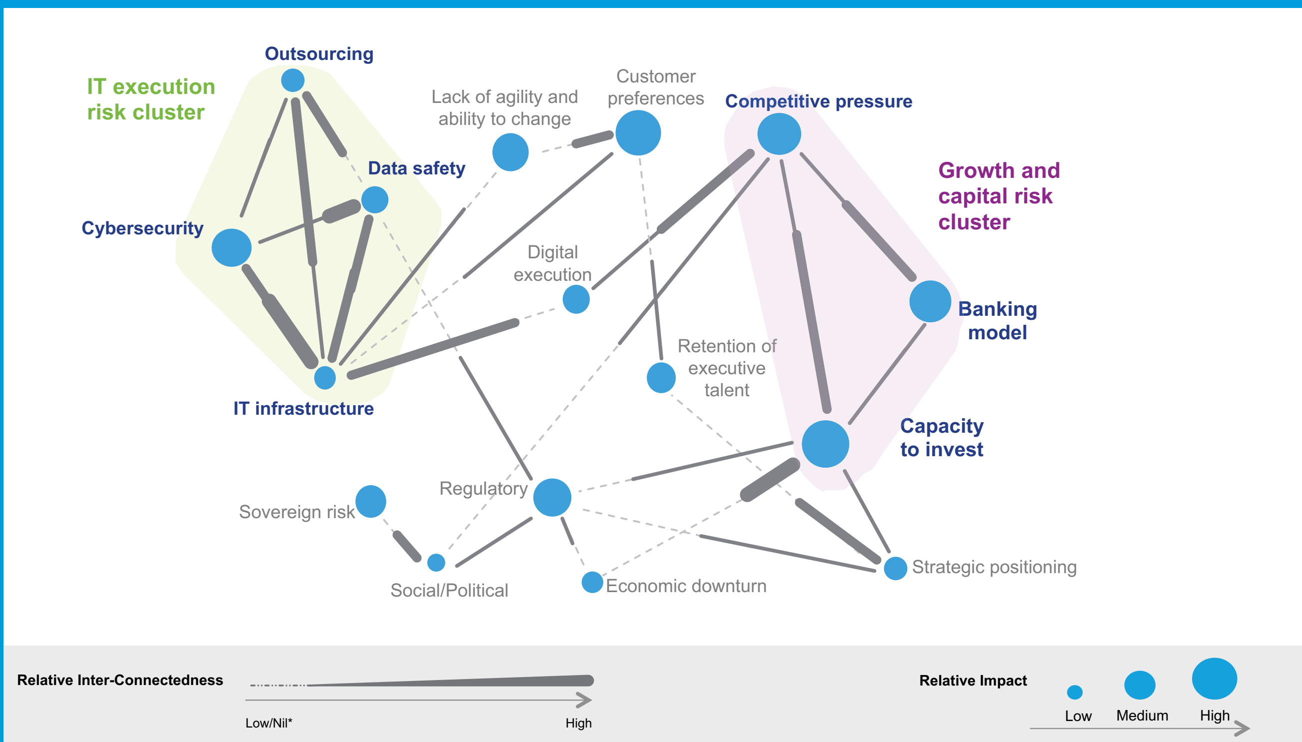
The three skills required to manage risks effectively are:

- **Agility** – learning to adapt quickly and being agile in how they assess risk and support their business partners;
- Adoption and development of **new processes** that deal with ambiguity and uncertainty – e.g. managing disruption from social media and cyber-attacks; and
- Having a **broader view of risk** – by considering the interlinking risks across an organisation and the dynamic nature of risk.

Dynamic Risk Assessment

Dynamic Risk Assessment (DRA) is KPMG's proprietary and ground breaking approach that integrates network analysis with macroeconomic, econometric, and microeconomic data that empowers us with unparalleled insight into our clients' risk environments. It was developed by a KPMG team of scientists, economists, actuaries, auditors and mathematicians and is now being deployed to clients with great effect.

In today's highly interconnected and volatile world, dominated by new technology and emerging business models, the past is no longer a guide to the future. Past data is a poor fit for the future because the things that shape our future have increasingly not manifested themselves before. Risks combine, they spill over into each other – they don't sit neatly in separate compartments – and we no longer have the luxury of dealing with single risks. Instead, we need to consider whether and how risks can potentially cluster together, as well as the potential cumulative impact of such clusters. We need to advance beyond historical risk analyses comprising of two-dimensional depictions through expected probability and severity. We are required to consider a third, and indeed a fourth dimension: velocity and contagion. This – together with the consideration of the global trends that are shaping our world – is what DRA does.



We are using DRA across the banking and mutuals sectors. If you would like to find out more information on how your organisation can use DRA, visit https://home.kpmg.com/au/en/home/services/audit/dynamic-risk-assessment.html

Community highlights

Social and community involvement remains a core focus for mutuals. Below is a snapshot of some community initiatives undertaken by mutuals during the year.

12
mutuals operate their own charities or foundations.

$18.6m
in donations and fundraising raised for 2017.

90%
of mutuals believe community involvement is a key differentiator to their business.

519
community organisations were supported.

271
community events were supported.

P&N launched their Donation Saver Account, where P&N Bank makes an annual donation to WA-based charities Hart Kids and WA Police Legacy based on 1.25% p.a. of the account's average annual balance.

Credit Union SA remain committed to education and healthcare causes, sponsoring the SA Excellence in Public Teaching Awards and World Teachers Day as well as St John's Youth Service, who have been their major charity partner since 2010 and recently committed $20,000 to their service.

Beyond Bank became Australia's first and only bank to achieve B-Corp certification, which recognises those organisations that have pledged greater commitment to social and environmental sustainability. Beyond Bank was also recognised as Australia's Best Financial Institution in Corporate Social Responsibility for 2017 by the Retail Banking Awards.

RACQ is the title sponsor of Queensland's major helicopter rescue service, the LifeFlight Rescue, which operates RACQ Air Ambulance, RACQ CQ Rescue and RACQ Capricorn Rescue. Together they have completed 49,000 critical rescue missions since their inception.

CUA sponsored the development of Australia's first financial empowerment app for victims of domestic violence – the Penda App. The app guides users through a series of tailored steps to meet their financial goals.

Heritage Bank supported the METRO Care Loads of Love Appeal by collecting 14,500 tonnes of non-perishable food and personal item donations such as meal bases and toiletries for over 1,000 families during the Christmas period in 2016.

Australian Military Bank provides an everyday transaction account where it uses "cents rounding" to gather the spare change less than $1.00 in the account at the end of each month and setting it aside to donate to a defence charity of the member's choice.

Select Encompass CU launched the Australia Mutuals Foundation (AMF) which supports Australian youth who have suffered abuse or are disadvantaged in terms of housing, medical care. or education.

Newcastle Permanent continues to commit $1.5million each year through the Newcastle Permanent Charitable Foundation to local football clubs and Surf Life Saving. Also, the Staff *CommunityAssist* Program has seen staff dedicate over 600 volunteer hours to assist local charities in need.

Community First CU have raised over $123,000 ($550,000 since inception) through its Pink Visa Credit Card and turned the NBCU surf life saving boat pink in support of the McGrath Foundation. Community First was also awarded the Palladium Balanced Scorecard Hall of Fame for Executing Strategy award that recognizes organisations that have well-designed strategies and sustained excellence leading to more satisfied stakeholders and employees.

IMB continues to contribute $500,000 through the IMB Community Foundation each year since 1999. IMB also launched the Shire Foundation this year to provide financial support to community groups in the Sutherland Shire region, committing $100,000 p.a..

People's Choice Credit Union continued to raise awareness of economic abuse and became the first Australian institution to be accredited as a White Ribbon Workplace in March 2017.

B&E remained committed to promoting positive health outcomes and encouraging 'happy, healthy communities' through active sponsorship of Tasmania's leading fun runs; the B&E Launceston Ten, the B&E Burnie Ten and the B&E Hobart Run the Bridge.

Bank Australia have partnered with the Brotherhood of St Laurence to help deliver its *Given the Chance* program, which aims to place people from an asylum seeker or refugee background into work placements with organisations. Bank Australia supports four interns for a 12-month internship.

Appendix

Financial Results: 2017 survey participants

The following table details key financial data[3] of the mutuals included in our report.

Mutual	Period[4,5]	Net Assets[6] $'000	Total Assets $'000	Total Deposits $'000	Operating Profit Before Tax[7] $'000	Capital Adequacy Ratio[8] %	Return on Equity[9] %	Cost to Income Ratio[10] %
Australian Military Bank Limited	**30-Jun-17**	**88,339**	**1,253,987**	**1,109,037**	**7,598**	**14.9%**	**5.9%**	**76.2%**
	30-Jun-16	83,339	1,131,797	986,187	6,519	14.7%	5.9%	78.3%
B&E Ltd[11]	**30-Jun-17**	**68,223**	**763,603**	**649,739**	**4,856**	**19.1%**	**5.2%**	**75.4%**
	30-Jun-16	63,613	727,867	609,852	4,590	18.7%	5.2%	75.1%
Bank Australia Limited[12]	**30-Jun-17**	**484,894**	**5,157,005**	**4,169,704**	**32,306**	**17.0%**	**5.1%**	**69.4%**
	30-Jun-16	435,951	4,038,759	3,402,568	31,188	18.7%	5.3%	67.0%
BankVic	**30-Jun-17**	**164,995**	**1,632,873**	**1,415,085**	**15,898**	**20.2%**	**6.9%**	**66.5%**
	30-Jun-16	153,936	1,502,852	1,312,602	14,574	20.5%	6.9%	67.5%
Beyond Bank Australia[13]	**30-Jun-17**	**431,184**	**5,415,141**	**4,268,837**	**33,977**	**15.1%**	**5.9%**	**74.3%**
	30-Jun-16	406,489	4,760,663	3,778,382	33,040	16.4%	6.3%	72.6%
Big Sky Building Society Limited	**30-Jun-17**	**59,779**	**827,351**	**761,476**	**2,380**	**16.4%**	**2.8%**	**82.6%**
	30-Jun-16	58,101	861,563	795,691	4,877	14.1%	6.2%	73.4%
Coastline Credit Union Limited	**30-Jun-17**	**35,061**	**461,319**	**420,980**	**3,407**	**13.7%**	**7.1%**	**72.0%**
	30-Jun-16	32,101	390,934	355,272	2,768	14.7%	6.3%	73.3%
Community Alliance Credit Union Limited[14]	**30-Jun-17**	**42,738**	**664,178**	**615,574**	**788**	**14.2%**	**1.2%**	**94.1%**
	30-Jun-16	41,293	626,340	580,833	1,844	14.3%	3.4%	89.3%
Community First Credit Union Limited	**30-Jun-17**	**81,169**	**950,435**	**859,091**	**3,252**	**15.3%**	**3.1%**	**87.1%**
	30-Jun-16	78,658	909,106	820,003	3,118	15.8%	3.3%	87.5%
Credit Union Australia Ltd	**30-Jun-17**	**907,257**	**14,323,091**	**8,760,229**	**67,871**	**14.3%**	**5.7%**	**71.5%**
	30-Jun-16	843,957	13,456,715	8,327,180	72,920	14.3%	6.5%	70.3%
Credit Union SA Ltd	**30-Jun-17**	**96,224**	**1,009,480**	**899,025**	**5,628**	**19.8%**	**4.5%**	**80.7%**
	30-Jun-16	91,806	927,793	827,873	5,025	20.1%	4.3%	82.40%
Defence Bank Limited	**30-Jun-17**	**159,624**	**2,031,528**	**1,741,142**	**13,176**	**15.4%**	**6.1%**	**73.0%**
	30-Jun-16	150,214	1,780,500	1,475,187	14,429	16.2%	6.9%	71.1%
Family First Credit Union Limited	**30-Jun-17**	**10,759**	**126,287**	**112,834**	**605**	**16.2%**	**4.2%**	**85.1%**
	30-Jun-16	10,320	113,054	100,313	586	17.5%	4.2%	86.7%

Mutual	Period[4,5]	Net Assets[6] $'000	Total Assets $'000	Total Deposits $'000	Operating Profit Before Tax[7] $'000	Capital Adequacy Ratio[8] %	Return on Equity[9] %	Cost to Income Ratio[10] %
Fire Service Credit Union Ltd	**30-Jun-17**	**4,774**	**58,553**	**53,257**	**113**	**18.1%**	**1.8%**	**92.6%**
	30-Jun-16	4,687	55,134	50,086	98	20.7%	1.5%	93.4%
Ford Co-operative Credit Society Limited	**30-Jun-17**	**9,469**	**133,232**	**120,867**	**690**	**15.3%**	**4.9%**	**95.9%**
	30-Jun-16	9,097	134,940	122,644	797	14.1%	5.8%	79.0%
G&C Mutual Bank Limited[15]	**30-Jun-17**	**99,974**	**1,088,114**	**959,864**	**5,117**	**18.1%**	**4.0%**	**78.8%**
	30-Jun-16	80,915	879,148	764,376	3,292	18.7%	2.9%	83.9%
Gateway Credit Union Ltd	**30-Jun-17**	**101,004**	**1,038,882**	**704,893**	**3,224**	**19.8%**	**2.3%**	**81.5%**
	30-Jun-16	98,007	1,037,536	657,639	3,807	19.8%	2.8%	80.3%
Greater Bank Limited	**30-Jun-17**	**481,233**	**6,286,212**	**5,375,917**	**40,845**	**17.3%**	**6.1%**	**73.9%**
	30-Jun-16	452,786	5,715,315	4,911,888	42,211	17.9%	6.7%	72.1%
Heritage Bank Limited	**30-Jun-17**	**487,461**	**9,378,703**	**7,124,224**	**56,310**	**13.4%**	**8.5%**	**71.3%**
	30-Jun-16	442,105	8,440,727	6,107,419	51,111	14.0%	8.5%	71.1%
Holiday Coast Credit Union Ltd	**30-Jun-17**	**41,948**	**589,083**	**539,854**	**2,206**	**14.1%**	**3.8%**	**87.0%**
	30-Jun-16	40,218	552,091	502,941	2,643	14.5%	4.7%	84.6%
Horizon Credit Union Ltd	**30-Jun-17**	**22,415**	**337,427**	**312,161**	**1,648**	**14.6**	**5.4%**	**85.2%**
	30-Jun-16	21,240	307,824	282,926	1,531	15.0%	5.3%	85.5%
Hume Bank Limited	**30-Jun-17**	**71,741**	**1,051,850**	**966,078**	**5,729**	**14.7%**	**5.7%**	**79.9%**
	30-Jun-16	67,310	1,004,578	923,336	5,324	14.7%	5.7%	80.5%
Hunter United Employees Credit Union Limited	**30-Jun-17**	**24,071**	**302,950**	**276,995**	**422**	**16.9%**	**1.3%**	**94.8%**
	30-Jun-16	23,273	278,158	253,355	391	17.5%	0.7%	97.0%
IMB Bank[16, 17]	**30-Jun-17**	**330,248**	**5,713,681**	**4,795,283**	**39,252**	**16.6%**	**8.6%**	**67.9%**
	30-Jun-16	308,579	5,224,118	4,268,430	42,222	16.9%	9.9%	64.0%
MCU Ltd	**30-Jun-17**	**4,125**	**46,319**	**42,016**	**78**	**15.5%**	**1.5%**	**96.9%**
	30-Jun-16	4,062	47,450	43,226	7	15.4%	0.3%	100.4%
My Credit Union Limited	**30-Jun-17**	**31,357**	**215,269**	**181,714**	**404**	**27.6%**	**0.9%**	**92.7%**
	30-Jun-16	31,089	208,050	174,625	811	27.3%	2.0%	87.2%
Newcastle Permanent Building Society Ltd	**30-Jun-17**	**909,071**	**10,884,375**	**8,164,204**	**55,346**	**19.2%**	**4.3%**	**70.5%**
	30-Jun-16	877,401	9,773,168	7,297,864	56,774	19.4%	4.6%	70.9%
Nexus Mutual[18]	**30-Jun-17**	**17,260**	**304,630**	**280,320**	**2,309**	**14.4%**	**9.6%**	**67.3%**
	30-Jun-16	15,948	298,595	275,752	1,462	14.1%	6.7%	76.2%

Mutual	Period[4,5]	Net Assets[6] $'000	Total Assets $'000	Total Deposits $'000	Operating Profit Before Tax[7] $'000	Capital Adequacy Ratio[8] %	Return on Equity[9] %	Cost to Income Ratio[10] %
Northern Inland Credit Union Limited	**30-Jun-17**	**35,102**	**265,919**	**226,502**	**1,720**	**21.8%**	**3.5%**	**84.2%**
	30-Jun-16	33,898	251,151	213,379	1,070	21.1%	2.3%	89.5%
Orange Credit Union Limited	**30-Jun-17**	**25,318**	**190,795**	**164,028**	**985**	**24.2%**	**2.8%**	**85.3%**
	30-Jun-16	24,616	184,424	157,936	1,165	24.1%	3.4%	82.8%
P&N Bank[19]	**30-Jun-17**	**273,493**	**3,985,492**	**2,837,251**	**13,667**	**14.5%**	**4.1%**	**80.3%**
	30-Jun-16	260,540	3,761,092	2,701,103	12,567	14.4%	3.3%	84.2%
People's Choice Credit Union[20]	**30-Jun-17**	**570,754**	**7,895,914**	**5,802,013**	**46,018**	**14.9%**	**6.0%**	**78.9%**
	30-Jun-16	533,291	7,514,308	5,501,037	49,400	14.2%	7.0%	77.4%
Police Bank Ltd	**30-Jun-17**	**183,699**	**1,681,290**	**1,368,936**	**12,122**	**18.7%**	**4.6%**	**75.9%**
	30-Jun-16	175,272	1,555,132	1,254,379	12,502	18.9%	5.2%	74.4%
Police Credit Union Ltd	**30-Jun-17**	**73,156**	**943,636**	**856,091**	**7,097**	**14.9%**	**7.2%**	**79.1%**
	30-Jun-16	68,479	858,831	781,496	5,788	15.3%	6.2%	77.3%
QBANK[21]	**30-Jun-17**	**74,043**	**819,596**	**728,528**	**3,439**	**19.2%**	**3.3%**	**82.7%**
	30-Jun-16	74,491	805,702	710,744	3,509	18.6%	3.4%	83.2%
Qudos Bank[22]	**30-Jun-17**	**254,786**	**3,522,266**	**3,087,283**	**15,682**	**14.7%**	**4.5%**	**77.2%**
	30-Jun-16	238,349	3,347,074	2,929,622	20,276	13.8%	6.1%	70.7%
Queensland Country Credit Union Limited[23]	**30-Jun-17**	**199,573**	**1,740,359**	**1,482,771**	**5,218**	**14.3%**	**1.0%**	**95.3%**
	30-Jun-16	179,162	1,358,074	1,125,545	8,317	14.0%	5.0%	93.1%
Queenslanders Credit Union Limited	**30-Jun-17**	**43,865**	**353,281**	**306,703**	**1,013**	**22.1%**	**1.7%**	**92.4%**
	30-Jun-16	43,121	333,369	286,976	1,036	23.0%	1.8%	90.3%
RACQ Bank[24]	**30-Jun-17**	**153,515**	**1,803,972**	**1,357,514**	**1,636**	**19.9%**	**1.0%**	**95.4%**
	30-Jun-16	145,925	1,757,478	1,257,269	6,725	21.0%	3.7%	84.5%
Regional Australia Bank[25]	**30-Jun-17**	**107,182**	**1,311,010**	**1,176,723**	**11,755**	**15.8%**	**7.9%**	**71.0%**
	30-Jun-16	99,037	1,179,112	1,053,280	10,588	15.5%	7.1%	73.3%
Select Encompass Credit Union Ltd[26]	**30-Jun-17**	**80,518**	**627,480**	**533,167**	**1,902**	**25.1%**	**2.4%**	**89.9%**
	30-Jun-16	39,136	289,629	243,165	118	25.3%	0.3%	98.8%
South West Slopes Credit Union Ltd	**30-Jun-17**	**20,645**	**157,170**	**135,387**	**905**	**27.0%**	**3.1%**	**84.6%**
	30-Jun-16	20,006	149,236	127,493	1,139	27.7%	4.1%	80.8%
Southern Cross Credit Union Limited	**30-Jun-17**	**49,689**	**482,090**	**427,006**	**4,217**	**19.6%**	**6.2%**	**69.9%**
	30-Jun-16	46,581	421,922	369,426	4,201	20.4%	6.6%	71.2%

Mutual	Period[4,5]	Net Assets[6] $'000	Total Assets $'000	Total Deposits $'000	Operating Profit Before Tax[7] $'000	Capital Adequacy Ratio[8] %	Return on Equity[9] %	Cost to Income Ratio[10] %
Summerland Credit Union Limited	**30-Jun-17**	**55,962**	**666,069**	**577,932**	**3,048**	**16.5%**	**3.9%**	**84.4%**
	30-Jun-16	53,714	630,904	554,793	4,733	16.7%	6.4%	77.0%
Sydney Credit Union Ltd	**30-Jun-17**	**76,783**	**867,043**	**777,372**	**2,912**	**17.1%**	**2.8%**	**86.4%**
	30-Jun-16	76,399	844,095	753,627	3,039	17.5%	3.1%	87.1%
Teachers Mutual bank Limited[27]	**30-Jun-17**	**492,226**	**6,682,013**	**5,479,874**	**39,943**	**15.1%**	**6.0%**	**72.7%**
	30-Jun-16	437,099	5,542,509	4,636,734	43115	15.9%	7.3%	68.7%
The Capricornian Ltd	**30-Jun-17**	**22,600**	**301,335**	**275,406**	**1,871**	**14.0%**	**6.0%**	**77.6%**
	30-Jun-16	21,406	291,808	267,696	1,888	14.3%	6.3%	78.6%
The Mac[28]	**30-Jun-17**	**24,449**	**249,279**	**233,033**	**723**	**19.3%**	**2.3%**	**91.7%**
	30-Jun-16	23,895	242,356	216,385	863	19.5%	2.60%	89.4%
The Mutual[29]	**30-Jun-17**	**42,034**	**641,600**	**573,384**	**3,399**	**15.2%**	**5.8%**	**71.6%**
	30-Jun-16	39,652	598,334	510,577	4,150	15.2%	7.6%	66.8%
Unity Bank Limited[30]	**30-Jun-17**	**96,920**	**1,057,749**	**932,210**	**3,162**	**17.5%**	**2.5%**	**87.7%**
	30-Jun-16	75,291	872,546	762,814	4414	17.4%	4.3%	82.7%
Victoria Teachers Mutual Bank[31]	**30-Jun-17**	**193,511**	**2,320,374**	**2,104,696**	**17,262**	**15.7%**	**6.4%**	**75.1%**
	30-Jun-16	181,813	2,161,212	1,957,289	21,483	15.5%	8.7%	68.0%
Warwick Credit Union Limited	**30-Jun-17**	**17,230**	**255,476**	**220,919**	**643**	**12.8%**	**2.6%**	**91.0%**
	30-Jun-16	16,784	240,777	208,547	1,592	12.50	6.8%	79.1%

For the complete datasheet compiled by KPMG, please visit **website**.

Footnotes

1. Klaus Schwab, The Fourth Industrial Revolution, World Economic Forum, 2016.
2. For a deeper discussion see "An ethical compass in the automation age: Decisions require deep dive into company core values," by Todd Lohr, KPMG, 2017.
3. Information has been extracted from published annual reports (at a consolidated level where applicable). Parent numbers have been used in limited cases where they are a better reflection of results. In limited cases, KPMG has adjusted a number of balances to reflect significant one-off events.
4. All figures for the current and prior year are reported under AIFRS and in Australian dollars.
5. All of the results reported in the report were for a 12-month period.
6. Net assets include other equity interests.
7. Operating profit before tax is before outside equity interests.
8. Capital adequacy ratio has been calculated under the APRA's risk based measures.
9. Return on equity has been calculated as profit after tax as a percentage of average net assets.
10. Cost-to-income ratio has been calculated as operating expenses as a percentage of operating income.
11. From November 2017, trading as Bank of us.
12. In January 2017, Intech Credit Union Limited merged with Bank Australia Limited.
13. Registered as Community CPS Australia Limited.
14. Trading as Illawarra Credit Union.
15. In September 2016, Quay Credit Union Ltd merged with G&C Mutual Bank Limited.
16. Registered as IMB Ltd.
17. In July 2016, Sutherland Credit Union Ltd merged with IMB Ltd.
18. Registered as EECU Limited.
19. Registered as Police & Nurses Limited.
20. Registered as Australian Central Credit Union Limited.
21. Registered as QPCU Limited.
22. Registered as Qudos Mutual Limited.
23. In April 2017, ECU Australia Ltd merged with Queensland Country Credit Union Limited.
24. In November 2016, QT Mutual Bank merged with The Royal Automobile Club of Queensland Limited (RACQ), to become RACQ Bank.
25. Registered as Community Mutual Limited.
26. In July 2016, Select Credit Union Limited merged with Encompass Credit Union, to become Select Encompass Credit Union.
27. In November 2016, Firefighters Mutual Bank merged with Teachers Mutual Bank Limited.
28. Registered as Macarthur Credit Union Ltd.
29. Registered as Maitland Mutual Building Society Limited.
30. In June 2017, Bankstown City Unity Bank and Reliance bank merged with Maritime Mining and Power Credit Union Ltd, to become Unity Bank Limited.
31. Registered as Victoria Teachers Limited.
32. COBA Conference 2017 opening speech by Wayne Byres.

Report contributions

The following subject matter specialists have made a significant contribution to this report.

Regulatory and accounting changes – Tax
Natalie Raju
Partner
T: +61 2 9335 7929
E: nraju1@kpmg.com.au

Digital labour
Jordan Robinson
Associate Director
T: +61 2 9455 9955
E: jrobinson6@kpmg.com.au

Fintech
Mandeep Sandhu
Director
T: +61 2 9335 7997
E: msandhu@kpmg.com.au

The New Payments Platform (NPP)
Kamal Kandasamy
Associate Director
T: +61 3 9838 4609
E: kkandasamy@kpmg.com.au

Regulatory and accounting changes – the BEAR
Steve Clark
Director
T: +61 2 9455 9403
E: sjclark@kpmg.com.au

Risk management
Christian Kramer
Associate Director
T: +61 3 9288 5748
E: ckramer1@kpmg.com.au

The KPMG Mutuals Industry Review 2017 team:

Back row: Zachary Veksler, Andrew Trang, Victor Owusu, Tim Aman

Front row: Charlene Tan, Elizabeth Man, Vaishnavi Sothirajah, Suzanna Pang

Absent: Dimi Kumarasinghe

Contact us

Tim Aman
National Mutuals Leader
Partner
T: +61 2 9455 9103
E: taman@kpmg.com.au

Ian Pollari
National Banking Leader
Partner
T: +61 2 9335 8408
E: ipollari@kpmg.com.au

Jillian Richards
QLD Mutuals Leader
Partner
T: +61 7 3233 3108
E: jrichards@kpmg.com.au

Michael O Connell
NSW Mutuals Leader
Partner
T: +61 2 9455 9498
E: moconnell1@kpmg.com.au

Darren Ball
VIC and SA Mutuals Leader
Partner
T: +61 8 8236 3197
E: darrensball@kpmg.com.au

Kevin Smout
WA Mutuals Leader
Partner
T: +61 8 9263 7105
E: ksmout@kpmg.com.au

John Evans
SA Mutuals Leader
Partner
T: +61 8 8236 3344
E: jhevans@kpmg.com.au

Daniel Knoll
Management Consulting
Partner
T: +61 2 9455 9148
E: danielknoll@kpmg.com.au

Michael Cunningham
Audit, Assurance & Risk Consulting
Partner
T: +61 2 9335 8949
E: mcunningham@kpmg.com.au

#mutuals2017

KPMG.com/au/mutualsreview

November 2017. N16088LOB.