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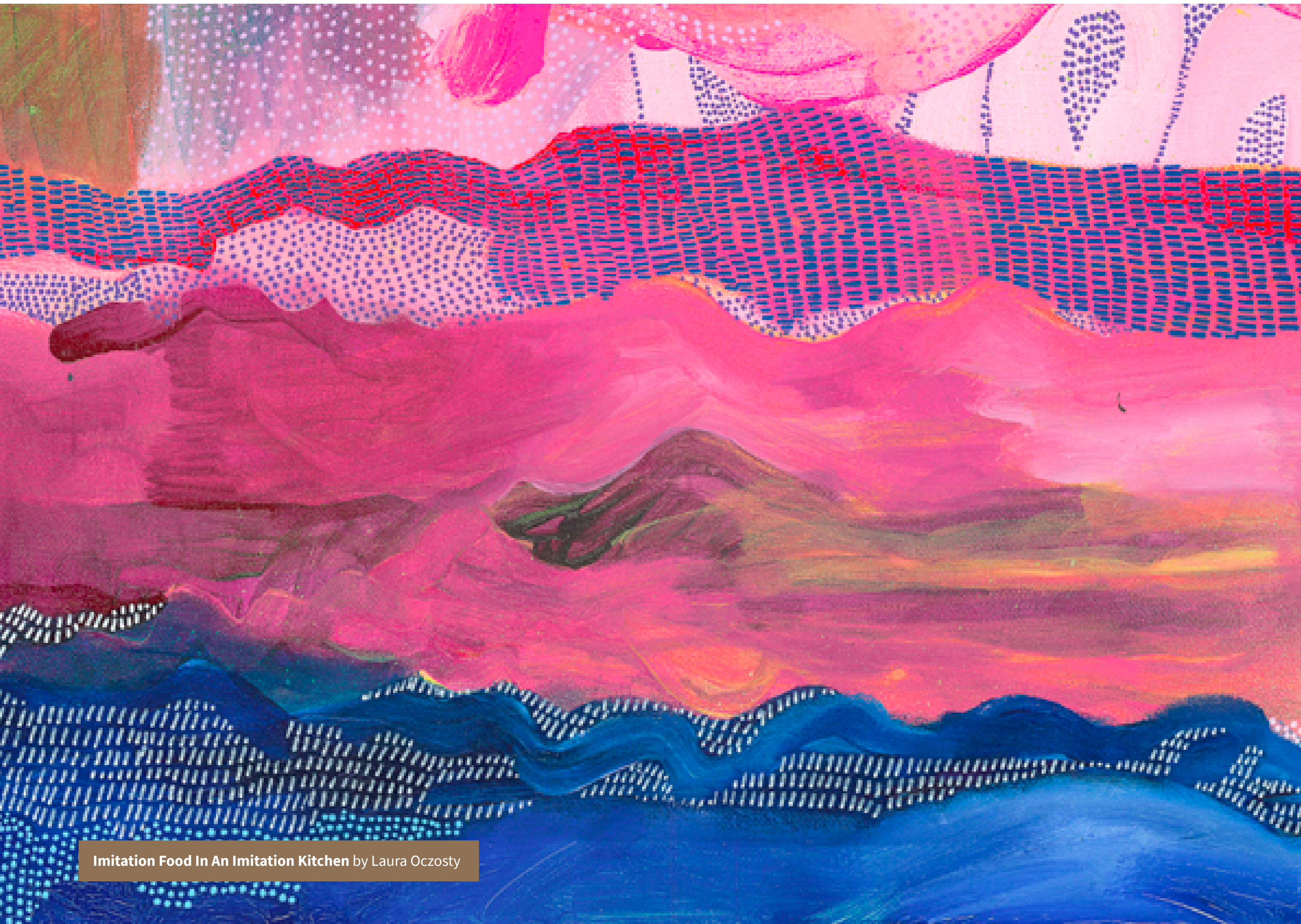


Imitation Food In An Imitation Kitchen by Laura Oczosty

THE GREAT AUSTRALIAN BANKING SHAKE-UP

WHY CONSOLIDATION OF MUTUAL BANKS IS THE NAME OF THE GAME.

As Australia's banking sector evolves amidst fierce competition, stringent regulations, and the need for (and high costs of) technological investment, a wave of consolidation is sweeping through the sector - and it shows no signs of slowing down. Recent high-profile mergers and acquisitions, such as Qudos Bank teaming up with Bank Australia, Australian Settlements Limited's sale to Banking Circle S.A., and the Auswide Bank-MyState Limited merger, are just the tip of the iceberg. The landscape has been further transformed by significant transactions like Suncorp Bank's acquisition by ANZ and a flurry of previous mergers among mutual banks, including Heritage Bank and People's Choice, as well as Greater Bank and Newcastle Permanent Building Society.

In a sector already known for its regulatory complexities, navigating these deals is no small feat. Yet, the mutual banking sector is particularly intriguing, as many discussions around potential mergers often fizzle out, stuck in the limbo in the non-binding 'MoU' stage. In part, this is driven by the fact that, by and large, mutuals live and breathe in a unique organisational culture which is acutely member-centric and steeped in localised history. In a dealmaking context, there is invariably a range of philosophical views around the boardroom table, generally more emotion in the negotiation, and often a reluctance (from the 'smaller' player) to be perceived as being 'taken over'.

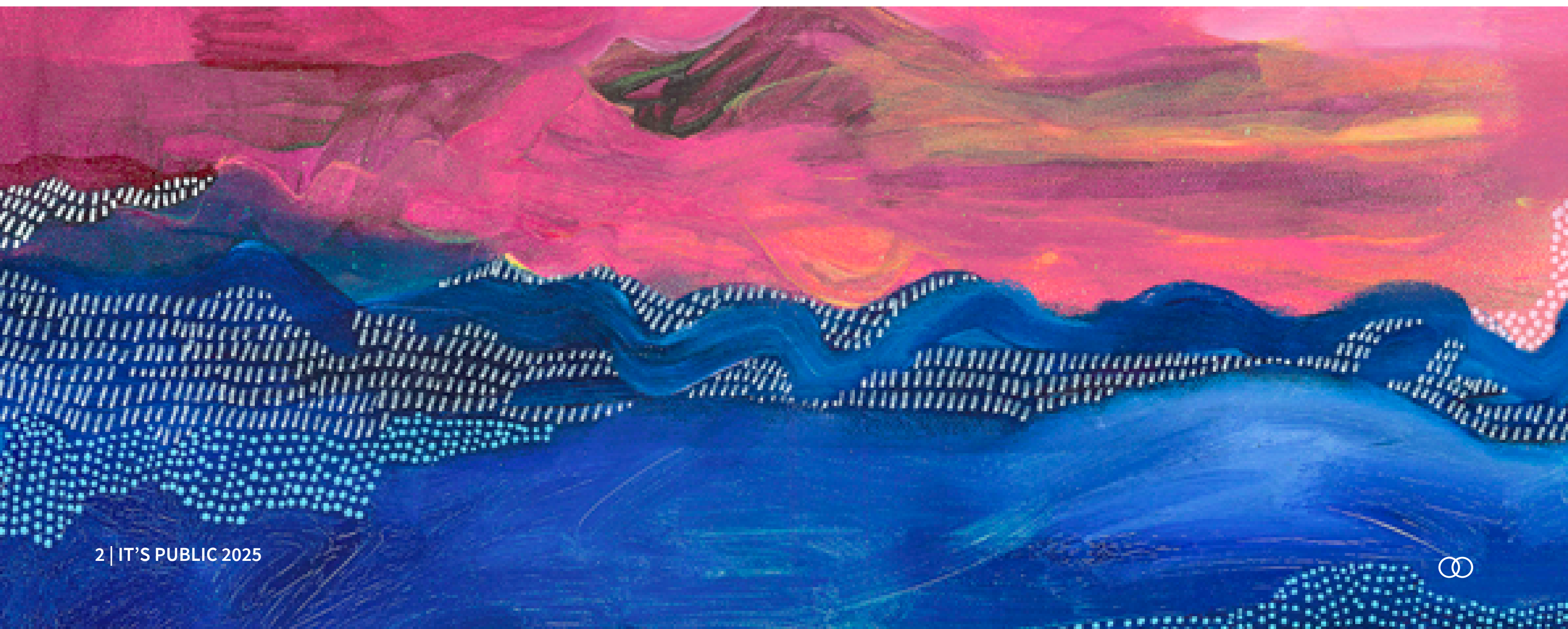
In this article, we delve into the compelling dynamics of mutual bank mergers, exploring the threshold considerations that make dealmaking in this sector not just challenging, but utterly fascinating. Buckle up as we navigate the complexities of Australia's banking consolidation journey!

DRIVERS OF CONSOLIDATION

So, what's fuelling this trend? A mix of factors is driving mutual banks to merge, reshape, and redefine their futures:

- Scale matters: The need to achieve scale through a larger loan and deposit books and a broader capital base to maintain liquidity, fund growth and remain competitive.
- Diversification is key: Banks are on the hunt for greater customer and product diversification. By broadening their offerings, they aim to unlock new growth opportunities, mitigate risks, and enhance customer satisfaction.
- Digital transformation imperative: The imperative to significantly invest in digital infrastructure and technology to deliver modern banking services.
- Competing with giants: The ongoing challenge of competing with larger commercial banks in the context of Australia's prudential framework and more limited capital options (the hope of mutual capital instruments (MCIs) as an accessible form of Common Equity Tier 1 capital for mutuals following the Hammond Report has, unfortunately, not yet been realised).
- Robust risk management: As threats like fraud and cybercrime become increasingly sophisticated, banks must elevate their risk management practices. Protecting members and institutions from emerging risks is paramount.
- APRA's regulatory influence: APRA's focus on recovery and exit and resolution planning – which has forced a number of organisations to be 'merger-ready'.

Each deal is different, and so the relevant drivers ultimately dictate the universe of potential merger parties.



THRESHOLD CONSIDERATIONS IN CONTEMPLATING A MERGER

Mutual mergers can be structured in a number of ways, having regard to:

- **The relative size of each entity and its assets and liabilities.**
- **Company type, capital structure and historical constitutional idiosyncrasies.**
- **Integration considerations (principally the relative maturity of technology infrastructure and banking platforms).**
- **Size and geographical spread of asset portfolio and members.**
- **Other legal, tax and accounting considerations.**

In thinking about any merger, some of the key threshold considerations are as follows:

KEY CONSIDERATIONS INCLUDE

Transaction structuring

- Whether the deal will need to be positioned as a 'merger-of-equals' - thereby preserving each party's mutual foundations. The 'social' issues (such as head office, board and senior management appointments, branding, community initiatives and member benefits) will be key, in additional to business-critical issues, including the ongoing use of each party's brands, processes and business and operating infrastructure.
- Company type, capital structure and historical constitutional idiosyncrasies (and the associated tax implications) typically drive transaction structuring. Novel issues can arise where the merger parties have member shares (or other forms of capital) on issue.
- A threshold issue can arise as to whether the Corporations Act takeovers regime needs to be navigated (most often by undertaking a transaction as a scheme of arrangement) or 'sidestepped' via the magic of the Financial Sector (Transfer and Restructure) Act 1999 (Cth) (FSTRA) regime.
- Novel structures involving the effective 'redemption' of member interests in exchange for scrip in a newly created NOHC or other BidCo which preserves member value can also be explored.

Member approvals and engagement

- Where mergers proceed as a voluntary transfer in accordance with the FSTRA, the expectation will be that the merger will need to be approved by 75% of the votes cast by members (whether in person or by proxy) of both merger parties. Board only approval may be sufficient if APRA can be satisfied that this method of adoption adequately takes into account the interests of members because 'special circumstances' are present.
- In either case, the member proposition will need to be well articulated to secure the vote (and support the recommendation of the respective boards).
- Often there are challenging quorum, 'demutualisation' or 'turnout' requirements which need to be met, necessitating a thoughtful and proactive member engagement and solicitation campaign.
- Given the typically long lead times in doing these deals, aligning timeframes and any required approvals with the AGM can be practically important, particularly from a board succession planning perspective or if any constitutional changes need to be 'front-run' (noting the risks of having a de facto referendum on a deal).

Regulatory approvals and engagement

- Early and proactive engagement with APRA, ACCC, ASIC, ATO and relevant State and Territory revenue offices (as applicable) is key.
- Relief from certain provisions of the Corporations Act as a result of the transfer of assets and liabilities between the merger parties may be required.
- Business transfers can be dutiable transactions and so any stamp duty leakage costs need to be assessed. Class rulings from the ATO may be required depending on the structure.
- Given the upcoming merger reforms, mandatory notification to the ACCC will most likely be required for most deals going forward – see our analysis here. This also means appropriate 'deal hygiene' measures need to be put in place upfront to appropriately manage gun-jumping and other competition law risks.

Disclosure and due diligence / verification processes

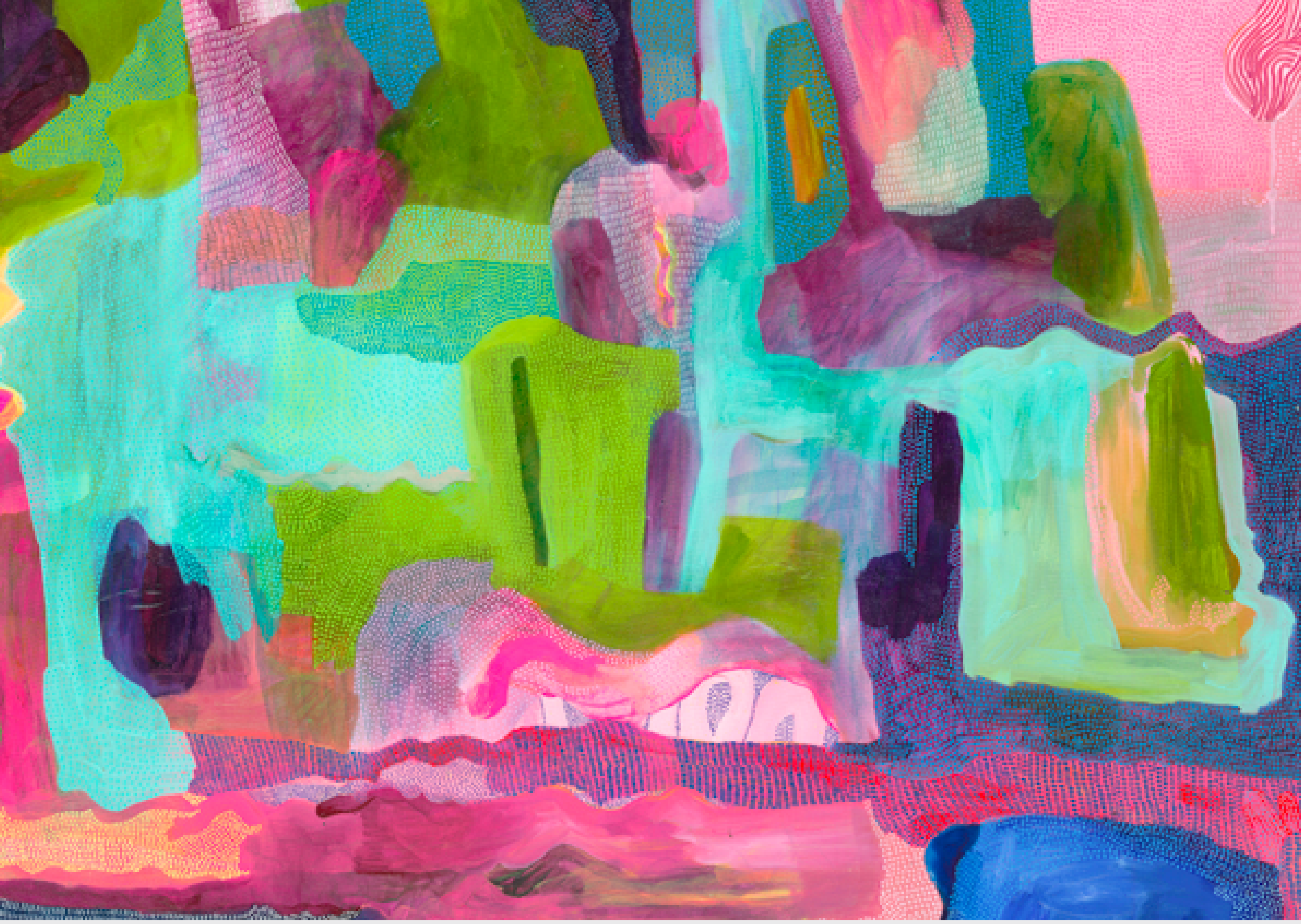
- For a FSTRA transfer, the merger parties will be required to prepare an 'Information Document' (or equivalent) for members. Similar documents are generally required if the transaction proceeds by way of scheme or if a member vote is in any event required.
- The 'Information Document' will be provided to APRA for review and, together with the relevant notice of meeting, must contain certain information prescribed by (amongst others) FSTRA, the Corporations Act, the parties' constitutions and related regulatory materials, including prescribed information relating to each entity and certain pro-forma financial disclosures.
- While not always required, boards sometimes want the comfort of an independent expert's report which opines on whether the transaction is in the best interests of members. The basis and methodology of any such expert evaluation (eg whether on a 'merger-of-equals' or 'controlling interest' basis) can be nuanced in the context of these transactions where often no consideration is flowing.
- A due diligence and verification process should be undertaken to ensure that the 'Information Document' and any other materials provided to members are not misleading or deceptive (including by omission), and to allow those involved in its preparation to avail themselves of any relevant defences to liability.

Employee considerations

- Early consideration will need to be given to the treatment and restructuring of each entities' employees, including any retention and bonus arrangements for KMP, and any relevant BEAR/FAR implications.
- Employee communications are paramount in transactions such as these, when anxieties tend to be heightened.

TAKEAWAY

An early focus on these key areas goes a long way to surfacing threshold key issues at the outset of any merger discussion. Given the drivers of consolidation are only amplifying, we expect the number of those discussions will continue to increase throughout 2025.



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