

## **Evaluate the ML/TF risk in your industry and business environment and any changes that may affect those risks. How will these changes “necessitate” change?**

Money Laundering and Terrorism Financing (ML/TF) is one of the most significant threats to the integrity of Australia's financial system. Criminal actors are using a range of new and emerging technologies to facilitate financial crime and legislators, regulators, investigators and financial institutions are racing to catch up. Financial institutions cop the brunt of these efforts, facing waves and waves of legislative and regulatory change. In the last twelve months alone there have been changes to liquidity and capital standards, consultations for governance reform and a new Operational Risk Standard and AML/CTF legislative reform. This is on top of the rules and regulations yet to come following the introduction of the Scams Prevention Framework. While there is no doubt that the extent of regulatory and legislative change is necessary to mitigate these risks, it is also responsible for the quickening of the trend of consolidation among the Australian mutual banking sector. This article examines how the consolidation of Australia's mutual banking industry will reshape ML/TF risk in the sector.

Australia's ML/TF regime is a cooperative regime based on international standards developed by the Financial Action Task Force (FATF). It brings together law enforcement, regulators, policy makers, industry and the community. The regime is designed to protect the integrity of Australia's financial system by deterring, detecting, and disrupting money laundering and counter-terrorism financing. Australia's ML/TF regime has been heavily scrutinised by FATF for failing to implement any of the preventive measures required by FATF since 2003.<sup>1</sup> A grey listing would significantly harm Australia's financial reputation and increase transaction costs across the sector. In response to this scrutiny and the upcoming mutual evaluation by FATF in 2026, Australia's ML/TF regime is in the process of being modernised. The changes to the regime include an expansion of the regime to additional entities including Real Estate Agents, Lawyers and retailers of precious metals as well as the adoption of a risk-based approach to ML/TF risks by all designated entities. Smaller mutuals may struggle with analytical capabilities required for a risk-based approach. The intended outcome of these changes is to strengthen Australia's ML/TF regime and to avoid a grey listing by FATF.

The mutual banking sector is considered to have a lower ML/TF risk than the major banks. In its National Risk Assessment, AUSTRAC determined that major Australian banks and other domestic banks overall have a high ML/TF risk.<sup>2</sup> Conversely, AUSTRAC determined that mutual banks have a medium ML/TF risk.<sup>3</sup> However, the risk profile is evolving as structural and technological shifts alter traditional low-risk characteristics. One of the main reasons for the difference in the assessment was the size of the organisation. Major banks have large customer bases from diverse geographical areas including high-risk customers such as politically exposed persons (PEPs) and

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<sup>1</sup> FATF (2024) 'Horizontal Review of Gatekeepers' Technical Compliance Related to Corruption,' Page 21.

<sup>2</sup> AUSTRAC (2021) 'Australia's Major Banks: Money Laundering and Terrorism Financing Risk Assessment,' Page 4. AUSTRAC (2021) 'Australia's Other Domestic Banks: Money Laundering and Terrorism Financing Risk Assessment,' Page 20.

<sup>3</sup> AUSTRAC (2019) 'Australia's Mutual Banking Sector: Money Laundering and Terrorism Financing Risk Assessment,' Page 5.

criminals.<sup>4</sup> Mutual banks on the other hand have smaller customer bases, often from a specific geographical area (although this is being watered down with the removal of bonded areas) that are well known by their staff. Both types of institutions face a variety of typologies including the misuse of digital channels, structuring of cash deposits, high cash exposure in transaction accounts, and the use of money mules.<sup>5</sup> The rise of digital banking and corresponding decline in face-to-face service delivery has also increased the anonymity and speed of transactions, creating challenges for traditional monitoring systems.<sup>6</sup> These changes blur distinctions between mutuals and larger banks. While major banks have the resources to invest heavily in analytics and financial crime teams, mutuals have struggled with the cost and complexity of maintaining comparable programs, operating with smaller compliance teams, legacy systems, and limited automation. This imbalance could inadvertently increase ML/TF activity in smaller institutions. Despite this disparity in resources regulators remain concerned about systemic deficiencies in the major banks' governance and compliance programs which is reflected in their ML/TF risk assessment.

The mutual banking sector is in the midst of a wave of consolidation. Whilst the major banks have adequate resources to adapt to legislative and regulatory change and to invest in new technologies, mutual banks, in particular small mutual banks, are at a disadvantage. Rising compliance costs, pressure to modernise technology, and competitive constraints have led many smaller institutions to merge. This trend has changed in recent times with an increase in merger activity amongst larger mutuals, for example the recent merger of Bank Australia and Qudos Bank. Since 2008 the number of mutual banks has decreased by 50%.<sup>7</sup> It is unclear where the wave of consolidation will end with some commentators suggesting that it could end with only 10 mutuals each boasting approximately \$20 billion in assets.<sup>8</sup> If this is the case, what will the effect of this consolidation be on the sector's ML/TF risk?

The consolidation of mutual banks will increase ML/TF risk in the short term but overall will decrease it in the long term. Mergers create larger, more complex institutions with broader customer bases, diverse product offerings, and expanded geographic footprints. These changes increase inherent ML/TF exposure. The merger also has the potential to disrupt ML/TF processes and controls while the two entities are focused on trying to align systems, policies and procedures. There may be gaps in the integration of the two systems during the transition period which could lead to an increase in ML/TF risk. During the period of transition mutuals must prioritise change management in ML/TF frameworks to ensure the integrity of the system is maintained. Nevertheless, consolidation also offers long-term benefits including a reduction in ML/TF risk. Larger

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<sup>4</sup> AUSTRAC (2021) 'Australia's Major Banks: Money Laundering and Terrorism Financing Risk Assessment,' Page 6.

<sup>5</sup> AUSTRAC (2021) 'Australia's Major Banks: Money Laundering and Terrorism Financing Risk Assessment,' Page 6. AUSTRAC (2019) 'Australia's Mutual Banking Sector: Money Laundering and Terrorism Financing Risk Assessment,' Page 5. AUSTRAC (2021) 'Australia's Other Domestic Banks: Money Laundering and Terrorism Financing Risk Assessment,' Page 7.

<sup>6</sup> AUSTRAC (2021) 'Australia's Major Banks: Money Laundering and Terrorism Financing Risk Assessment,' Page 6. AUSTRAC (2019) 'Australia's Mutual Banking Sector: Money Laundering and Terrorism Financing Risk Assessment,' Page 5. AUSTRAC (2021) 'Australia's Other Domestic Banks: Money Laundering and Terrorism Financing Risk Assessment,' Page 7.

<sup>7</sup> AUSTRAC (2019) 'Australia's Mutual Banking Sector: Money Laundering and Terrorism Financing Risk Assessment,' Page 3.

<sup>8</sup> Annie Kane (2024) 'Mutual Mania: The Great Wave of Mergers Continue,' The Advisor, October. Available at <https://www.theadvisor.com.au/supplements/the-advisor-digital-magazine/2024/mutual-mania/11-cover-mutual-mania>

mutuals can use their newfound economies of scale to invest in sophisticated transaction monitoring systems, skilled financial crime professionals, and stronger governance structures resulting in increased professionalism and maturity in their ML/TF program. These developments will necessitate countervailing changes at both institutional and regulatory levels. Mutuals must be careful not to let go of their values as they transition into larger entities to avoid the systemic issues of ML/TF non-compliance experienced by the major banks.

The consolidation of Australia's mutual banking sector is a reaction and strategic response to the escalating cost and complexity of regulation. As regulatory and legislative expectations increase, smaller mutuals are finding it increasingly difficult to maintain compliance without the efficiencies that come with scale. This restructuring of the mutual sector will inevitably reshape the ML/TF risk profile of the sector. In the short term, mergers create transitional vulnerabilities that can elevate exposure to ML/TF risk, particularly where systems and processes are being integrated. However, over time, consolidation can deliver stronger, more sophisticated ML/TF controls through better resourcing, professionalisation, and investment in technology. The challenge will be to ensure that growth in size and capability does not come at the cost of the mutuality and ethical governance that have historically underpinned the sector.

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