Queensland Office of Financial Supervision

Submission to

Financial System Inquiry

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NOTES

The views expressed in this submission are those of QOFS. They have been formed on the basis of the experience of prudential supervision in Queensland since 1992.

The statistics quoted and the views expressed relate solely to Queensland and should not be extrapolated or inferred to apply in other States and Territories without due consideration.

In April 1996 QOFS commissioned an independent survey of Queensland BS and CU which covered a wide range of relationship and operational issues. The report of this Survey is referred to in the body of this submission.

Refer to Glossary in Annexure B for meaning of abbreviations used.

EXECUTIVE SUMMARY

KEY ISSUES

- *All Deposit Taking Institutions (DTIs) should be subject to the same supervisory regime.*
- *The supervision of compliance with prudential requirements should be tailored to the institution.*
- *Supervision should be on an entity basis as opposed to on a product basis.*
- *Properly resourced lender of last resort facilities should be available to all supervised DTIs.*
- *Supervisors must be well resourced to properly discharge their functions.*

SUMMARY

(Submission numbering reflects Terms of Reference numbering)

1.1 Choice, quality and cost of financial services

QOFS Submission is:

- *Deregulation has only been partly responsible for the choice, quality and cost of financial services available.*
- *Deregulation has generally been beneficial in the choice and quality of financial services available to consumers and other users.*
- *While general deposit rates have risen - to the advantage of savers - the increased cost of funds has made borrowing more expensive. These effects will be felt by individuals depending on their net financial status.*
- *Financial service providers have become more sophisticated in pricing their products with less cross subsidisation.*

1.2 Efficiency of the financial system, including international and domestic competitiveness

QOFS Submission is:

- *The financial system is more efficient since deregulation.*
- *Domestic competitiveness is far greater in all areas since deregulation.*
- *The impact of international competitiveness has not been noticeable in the industries reviewed.*

1.3 Economic effects of deregulation on growth, employment and savings

QOFS Submission is:

- *No submission.*

1.4 Evolution of financial institutions and their products, and impact on the regulatory structure.

QOFS Submission is:

- *The identities and core businesses of the institutions are unchanged.*
- *Products and services offered continue to become more varied and complex.*
- *The internal operations of institutions are becoming more varied and complex.*
- *Supervisors need to be funded and staffed to keep pace with institutional and product development.*
- *There must be a capacity to readily develop and amend supervisory standards.*
- *The present FI Scheme supervisory structure is working well, and there is generally a high degree of satisfaction with the structure.*

2.1 Technology and marketing advances

QOFS Submission is:

- *The focus of supervision should be on the entity providing the loan or holding the deposit.*
- *The technology or marketing used to provide the product or operating system must be understood by the supervisor to identify risks.*
- *The supervisor must be adequately resourced to identify and assess risks.*
- *There is a need for international liaison amongst supervisors to effect common prudential standards.*

2.2 International competition and integration of financial markets

QOFS Submission is:

- *International competition is unlikely to drive direct change in the industries.*
- *Indirect change may be driven by international competition.*
- *There is no perceived requirement to protect societies from international competition.*
- *International competitors should be subject to equivalent prudential and regulatory requirements as apply to domestic participants.*

- *Australian supervisors should provide supervision of recognised international standard to assist Australian societies' operations to be accepted overseas.*

2.3 Domestic competition in all forms

QOFS Submission is:

- *Any impediment to free interstate trading should be removed.*
- *Dismantle State and Federal discriminatory legislation between Banks and supervised Non Bank Financial Institutions (NBFIs) - particularly in deposit taking.*
- *Access to the payments system should be open to entities subject to similar prudential requirements and supervision.*
- *Supervisors must be resourced to identify and react to destabilising competitive institutional behaviour.*

2.4 Consumer needs and demand

QOFS Submission is:

- *All DTIs should be subject to prudential supervision.*
- *Prudential requirements for DTIs should be uniform.*
- *The supervision of compliance with prudential standards should be tailored to the institution.*
- *Product regulation should not be mixed with prudential supervision.*

3.1 Promote the most efficient and cost effective service for users, consistent with financial market stability, prudence, integrity and fairness.

QOFS Submission is:

- *DTIs should be differentiated in prudential supervision to other financial institutions.*
- *A viable "lender of last resort" facility should cover all DTIs.*
- *All DTIs should have similar preferences to depositors on liquidation.*
- *Self reporting and off-site monitoring must be augmented by on-site inspection by locally based supervisors.*
- *Prudential standards should be promulgated after defined industry consultative processes.*

- *Legislation supporting supervision should be capable of amendment without undue delay.*

- *Public reporting, disclosure, and auditing requirements should be uniform across DTIs and between financial institutions.*

3.2 Ensure that financial providers are well placed to develop technology, services and markets and that the regulatory regime is adaptable to innovation.

QOFS Submission is:

- *Prudential standards for supervision must be capable of being readily changed in response to market changes.*

- *The supervisor must be resourced adequately to identify, assess, and supervise developments in institutional operations and products.*

- *Prudential supervision of the financial institution, rather than the product, is preferred.*

3.3 Provide the best means of funding direct costs of regulation

QOFS Submission is:

- *The current direct costs of supervision are reasonable, and are outweighed by the reduction in funding costs achieved by societies.*

- *Most societies themselves do not view existing supervision costs as being excessive.*

- *Smaller institutions may be more demanding of supervisory resource than larger institutions.*

- *Direct payment of supervisory costs by industry is a transparent and preferred approach.*

3.4 Establish a consistent regulatory framework for similar financial functions, products or services that are offered by differing types of institutions.

QOFS Submission is:

- *DTIs should be subject to separate prudential supervision to other financial institutions.*

- *Product or service regulation may occur across industries, but should not replace entity prudential supervision.*

- *Institutions prefer to be supervised as entities as opposed to by product.*

- *There should be no barriers to the voluntary exchange of information between regulators/supervisors.*

4.1 Objectives or procedures of the RBA in its conduct of monetary policy

QOFS Submission is:

- *That DTI societies should not be distinguished from banks in the conduct of monetary policy by the RBA.*

4.2 Retirement incomes policies

QOFS Submission is:

- *BS, CU and FS could be allowed to offer retirement income products.*

4.3 Regulation of the general operation of companies through corporations law.

QOFS Submission is:

- *That incorporation, registration, and regulation of the general operation of societies be on an equal footing to that of banks subject to the Corporations Law.*

4.4 Policies for taxation of financial arrangements, products or institutions.

QOFS Submission is:

- *From a supervisory view it is preferable that there not be any taxation benefits granted, nor restrictions imposed, on societies as a result of their incorporation that are not available to companies generally.*

- *Uniform taxation of financial institutions and financial products throughout Australia may improve competitiveness and reduce "jurisdiction shopping".*

- *Taxation should neither confer nor take away competitive advantage of institutions.*

SUBMISSION

1.0 RESULTS OF POST-1981 DEREGULATION

1.1 *Choice, quality and cost of financial services*

1.1.1 Each industry is addressed below focussing on recent deregulation issues. It is useful to note that many of the factors that have affected the choice, quality and cost of services available during the past 15 years are not due to deregulation, but to technological advance (such as telecommunications, and computing power and access); and social change (such as consumer advocacy, marketing, and customer relations trends).

1.1.2 Building Societies

Since 1981 the number of societies has reduced marginally (including the conversion of Metropolitan Permanent Building Society to Metway Bank in 1988), but generally resulted in larger regionally based societies that provide a wider range of products, at a lesser price, and with more inherent stability than prior to deregulation. Representation through ATMs and other means has also improved customer access since deregulation.

Queensland societies experienced a change of governing legislation in 1985, which in the main remained prescriptive, and again in 1992 (the Financial Institutions Legislation), which altered the previous prescriptive legislation to considerable effect. Amongst the results of the 1992 legislation are the capacity to trade interstate, offer retail and business products other than residential mortgage loans, and offer cheque accounts. A major change was societies being enabled to issue permanent capital - allowing much stronger capital structure.

It is possible that the costs of funds rose following deregulation of interest rates and deposit terms with an impact on borrowing costs to the public. This is particularly evident in the shrinkage in " interest free" funds held by banks and others. In addition, the structure of funding has changed as less reliance could be placed on stable retail deposits, and these have been partially supplanted by more stable, but possibly more expensive, wholesale borrowings.

The impact of higher funding costs is passed through to higher lending costs. On the assumption that individuals are either net borrowers or net lenders, the effects of deregulation on individuals are different - the net borrower is probably paying more for financial services; the net lender (saver) is probably achieving higher returns.

1.1.3 Credit Unions

While the number of CU has diminished, principally through the exiting of smaller societies, the remaining societies have increased the range of services available - principally through co-operative effort. Many industry based societies have merged or exited due to changes in the host company's status.

The advent of deregulation and the FI scheme delivered similar effects to CU as were ascribed to BS in 1.1.2 above.

1.1.4 Friendly Societies

The two main events in the past 15 years in the FS industry were the explosive growth in the mid 1980s from the introduction of insurance bonds (based on a tax effective term investment); and the continuing displacement of the societies' traditional social welfare products by government provided benefits.

The introduction of insurance bonds turned relatively small societies into multi-million dollar investment houses. This often provided revenue to support the traditional products and activities of the societies. The downsizing of the industry as these tax effective investments mature is providing challenges, and in some cases difficulties, as societies readjust their financial profile to reflect diminishing income streams. In this regard deregulation probably allowed the growth and its accompanying member benefits to occur, as well as allowing the shrinkage and its consequent disadvantages to occur.

1.1.5 Cooperative Housing Societies

The legislation under which these societies operate has not changed in substance since 1958. As a result there has been no direct benefit of deregulation. Indirect benefits may extend to a widening of funding sources from banks and others, with there being many negative features of deregulation as competitors are allowed to operate more freely than the constrained societies.

1.1.6 General

The general observation is made that since deregulation there has been a growing trend for financial institutions to price products more directly to cost and rely less on cross subsidisation. In addition, older style of products (such as passbook accounts) are more expensive to operate and less flexible in operation than newer products (such as credit/debit cards) that are based on current technology.

1.1.7 *QOFS Submission is:*

- Deregulation has only been partly responsible for the choice, quality and cost of financial services available.
- Deregulation has generally been beneficial in the choice and quality of financial services available to consumers and other users.
- While general deposit rates have risen - to the advantage of savers - the increased cost of funds has made borrowing more expensive. These effects will be felt by individuals depending on their net financial status.
- Financial service providers have become more sophisticated in pricing their products with less cross subsidisation.

1.2 *Efficiency of the financial system, including international and domestic competitiveness*

1.2.1 There is no doubt that deregulation has achieved the economic effect of allowing free market forces to direct resources in the financial sector. The effects of this are noted in section 1.1 above. Some artificial impediments to efficiency remain; such as restricted access to the payments system, and legislative discrimination between types of institutions. In the past 15 years there have been examples of the adverse effects of this market efficiency as the economy has experienced several economic cycles.

A judgement on the social or political effects of the results of the economic efficiency will influence an opinion of the efficiency of the financial system - and the desirability of deregulation.

Domestic competitiveness of the industries under review has dramatically increased in the competition for deposit funds; the competition between loan providers; and the growing demands for wider ranges of products and services.

International competitiveness is not particularly relevant to the industries under review, and is covered in section 2.2 below.

1.2.2 *QOFS Submission is:*

- The financial system is more efficient since deregulation.
- Domestic competitiveness is far greater in all areas since deregulation.
- The impact of international competitiveness has not been noticeable in the industries reviewed.

1.3 *Economic effects of deregulation on growth, employment and savings*

1.3.1 QOFS is not well placed to analyse these economic factors in depth.

1.3.2 ***QOFS Submission is:***

- No submission.

1.4 *Evolution of financial institutions and their products, and impact on the regulatory structure.*

1.4.1 The identities of types of institutions have not changed since deregulation. BS, CU, FS and CH exist now as they did in 1960 (and before) and their core businesses are unchanged.

As noted elsewhere, since deregulation there has been a major shift in the range and sophistication of products and services offered by institutions. While the fundamentals of financial intermediation remain unchanged, these products and services have become more complex. Complexity has been achieved (or facilitated) by a range of factors, including:

- Greater "financial literacy" of the community
- Deregulation of artificial constraints - such as interest rate controls
- Increasing national wealth
- Communications and computing advances

The latter underpins almost all changes - generally in facilitating the change. As a very basic example, prior to the advent of desktop computing capacity, it would have been almost impossible for a housing lender to offer "personalised" repayment and redrawing options to borrowers; and, as importantly, impossible to create and manage the treasury products to support the loan product. This highlights the growing complexity of the internal operations of institutions, necessary to provide the complex products and services to customers.

The institutions have become more complex - partly from the need to manage more complex products; partly from the ability to offer a wider range of products and services; and partly through the growing complexity of generally conducting business - including subjection to supervision.

1.4.2 The impact on the regulatory structure has been to require the supervisor to be resourced to analyse and act on the changes to products and institutions. The key components of this are adequate funding and staffing of the supervisor (with staff mobility between institutions and supervisor a feature); and supervisory standards that may be readily developed and amended to cater for market changes. In addition the supervisor has been most effective where it is locally based to identify changes and more readily interact with the institutions.

It is possible to meet the challenge of the impact of evolution on the supervisor. There have been no society failures in Queensland since the introduction of the FI Scheme. The QOFS Survey highlighted a high degree of satisfaction in the existing supervisory structure from institutions.

The FI Scheme appears to work and replacement of it should be contemplated only to provide a superior system of supervision.

From Annexure H we note in particular:

- The supervisory function is performed very well (table 8)
- The ideal supervisor's role is similar to the present role (table 12)
- Few changes required to supervision or inspection function (tables 20 and 23)
- Satisfaction with the supervisors impact on the organisation (table 40)

1.4.3 ***QOFS Submission is:***

- The identities and core businesses of the institutions are unchanged.
- Products and services offered continue to become more varied and complex.
- The internal operations of institutions are becoming more varied and complex.
- Supervisors need to be funded and staffed to keep pace with institutional and product development.
- There must be a capacity to readily develop and amend supervisory standards.
- The present FI Scheme supervisory structure is working well, and there is generally a high degree of satisfaction with the structure.

2.0 FACTORS LIKELY TO DRIVE CHANGE

2.1 *Technology and marketing advances*

2.1.1 The core products provided by financial institutions - a loan, and a deposit - remain basically unchanged. Technology and marketing advances in the financial system have impacted on the methods by which products are delivered to users. The impact on the regulatory structure is to identify and appropriately supervise the entity that grants the loan and holds the deposit.

The implication for the supervisor in the use of technology to deliver and package loan or deposit products is for the supervisor to be resourced sufficiently to identify and understand the product (and thus the risks). This technology includes “smart” cards, stored value cards, direct electronic account access, international access, and methods of personal identification.

The implication for the supervisor in marketing advances is the same. These advances include operational and strategic alliances, telephone/electronic, and international marketing.

The introduction of international marketing elements highlights the requirement for close international liaison amongst supervisors toward common prudential standards.

Technology also impacts on the operations of institutions in such areas as automated treasury trading, and financial modelling. Again, the appropriate supervisory response is to be resourced to understand and assess the systems and the risks.

2.1.2 ***QOFS Submission is:***

- The focus of supervision should be on the entity providing the loan or holding the deposit.
- The technology or marketing used to provide the product or operating system must be understood by the supervisor to identify risks.
- The supervisor must be adequately resourced to identify and assess risks.
- There is a need for international liaison amongst supervisors to effect common prudential standards.

2.2 *International competition and integration of financial markets*

2.2.1 In terms of the markets of the four industries supervised, the effect of international competition is not directly felt. Indirectly there are effects, ranging from the introduction of banking technology and techniques from overseas to the effect on general market rates of interest from overseas influences.

Three factors mitigate against direct international competition.

- Firstly, the markets serviced by all supervised institutions are predominantly personal financial - there is negligible overseas trade or commerce.

- Secondly, the industries are small in terms of total assets and are unlikely to attract the attention of significant international competitors.

- Thirdly, the nature of the personal products and services offered are retail in nature and often expensive to deliver in the personal manner that appears to be demanded by the members. Larger international institutions, with the possible exception of some card providers, appear unlikely to stray from their more traditional wholesale markets.

There is the potential for smaller retail institutions to benefit from international competition in other markets. A recent example is an alliance formed between a large rural CU and a specialist overseas owned financier to primary industry operating in Australia. The local CU sought to provide personal deposit, lending and local branch services to rural clients, and the overseas entity was only interested in lending in volumes larger than the CU could provide - its funding sources being principally wholesale. The institutions provide complementary products, and engage in security sharing.

There is currently little potential for NBFIs to offer services overseas. There is a possibility, however, to offer services through the co-operative movements working in lesser developed countries. These services could be advisory or expand to fully fledged financial operations. While the potential exists for these services to be provided electronically, the strength of the institutions' operations is probably in more traditional delivery methods. Given the continuation of a strong prudential framework in Australia, there is no apparent reason why operations of this nature should not occur - as it does with banks. The national economic benefits would be positive.

2.2.2 *QOFS Submission is:*

- International competition is unlikely to directly drive change in the industries.

- Indirect change may be driven by international competition.

- There is no perceived requirement to protect societies from international competition.

- International competitors should be subject to equivalent prudential and regulatory requirements as apply to domestic participants.

- Australian supervisors should provide supervision of recognised international standard to assist Australian societies' operations to be accepted overseas.

2.3 *Domestic competition in all forms*

2.3.1 The supervised industries are susceptible to domestic competition.

The key areas of competition are in:

- The products offered,

- The method of delivering the products, and

- The differing cost and operating structures imposed on competing industries by differing regulation and supervision.

The product and delivery competition has supervisory impact that is discussed in 1.4 and 2.1 above. Competition occurs on both sides of the balance sheet. Both assets and liabilities are primarily retail - with the exception of CH liability funding. Competition occurs in varying degrees from supervised industries (such as banks) and unsupervised industries (such as mortgage originators).

While most societies do not want to trade outside Queensland, legislation should not impede this possibility. At present there are barriers to such trading - for example the requirement to register as foreign societies under the FI Scheme; prohibition on interstate mergers for FS; and "location of lending" restrictions for CH.

There are numerous examples of statutory discrimination between banks and NBFIs - particularly in the area of deposit taking. In view of the similar prudential standards now applying to both banks and NBFIs these legislative constraints can be seen as an interference in legitimate domestic competition. While considerable progress has been made by State governments in removing this discrimination, completion of this process at State and Federal level will enhance domestic competition.

Access to the payments system by entities subjected to the rigour of similar prudential requirements should be equal. The capacity for NBFIs to participate without using banks as agents is an important part of equalising domestic competition. Protection of the payments system is an important factor in opening access to it - which is why the "price" paid for entry must include equivalent prudential requirements and supervision.

The need for institutions to freely trade nationally is based on prudential grounds as well as commercial grounds. The ability for assets and liabilities to be sourced from any economic zone in the nation enables institutions to reduce concentration risks and thus be less susceptible to failure through enforced linkage to the economy of one geographic area.

The impact of domestic competition on the regulatory system is to focus on the difference between Deposit Taking Institutions (DTI) and other providers of financial services. As discussed elsewhere - there is a clear distinction between the two. The biggest challenge posed to the regulatory system by domestic competition is in the identification of, and reaction to, any destabilising behaviour by institutions in reaction to competition.

2.3.2 *QOFS Submission is:*

- Any impediment to free interstate trading should be removed.
- Dismantle State and Federal discriminatory legislation between Banks and supervised NBFIs - particularly in deposit taking.
- Access to the payments system should be open to entities subject to similar prudential requirements and supervision.
- Supervisors must be resourced to identify and react to destabilising competitive institutional behaviour.

2.4 *Consumer needs and demand*

2.4.1 Historically there has been a very strong demand for institutions into which individuals may make deposits with a high degree of certainty of repayment of the principal and at a set rate of interest. DTIs have been vital to the social and economic fabric of our society - not only for providing safety for deposits (particularly of the small depositor), but in personal and business financial intermediation, and in effecting payments.

It is difficult to envisage that demand for this requirement will not continue to exist at substantial levels in the foreseeable future. To meet this demand it will be necessary to provide the framework for DTIs to continue to exist and to continue to perform their intermediation and payments roles.

This requirement will continue to be met by a wide range of institutions - from multinational banks to small community CU. The principles of their prudential operation are the same, the application of the principles may require differing treatment. Uniformity in the principles, and appropriate approach to supervision are fundamental requirements. An example of the differing approaches sought by different sectors is shown in Annexure H, tables 10 and 12.

In addition to consumer demands for depositor protection, there is widespread demand for consumer protection “against” products and their delivery. This is quite distinct to depositor protection and may apply in areas where there is no prudential management issues. For example, the full disclosure of loan terms and conditions appears to be an issue of consumer protection - whatever the source of the loan. Consumer loans may be provided by a BS - which requires prudential supervision due to its deposit taking activities; or a mortgage originator - which requires no prudential supervision as it is funded from wholesale markets.

The impact on regulatory structure is evident - there is a requirement for prudential supervision of deposit taking institutions; consumer protection may apply to products but not to institutions.

2.4.2 ***QOFS Submission is:***

- All DTIs should be subject to prudential supervision.
- Prudential requirements for DTIs should be uniform.
- The supervision of compliance with prudential standards should be tailored to the institution.
- Product regulation should not be mixed with prudential supervision.

3.0 REGULATORY ARRANGEMENTS

3.1 *Promote the most efficient and cost effective service for users, consistent with financial market stability, prudence, integrity and fairness*.

3.1.1 We are firmly of the view that the goal of prudential supervision is to protect the interests of retail depositors and systemic confidence. It is not to protect product buyers or other consumers. This is the key difference between DTIs - banks, BS and CU with demand or term deposits - and other forms of “investment”. The key issues are those of depositor confidence - the certainty of withdrawal and rate of return.

A key feature of DTIs is the structure of the balance sheet with generally short dated liabilities (call deposits) and long dated assets (housing and other loans). They are very sensitive to liquidity problems and the institutional and systemic problems of a "run" are well documented and understood. The implied "lender of last resort" role of the RBA has been critical to the confidence of the public in banks. The FI Scheme attempted to emulate this with the Emergency Liquidity Support Schemes for BS and for CU. A form of viable and publicly visible lender of last resort facility provided by the Reserve or Central Bank should be retained, and made common across all supervised DTIs to preserve public confidence in the system.

The supervision of financial institutions requires distinct skills and approaches from that of trading companies. These are quite different to those required for the regulation of products, for example. The distinction between supervision and regulation is clear. In addition the supervision of a financial institution should be based on the institution, and not on the products it offers. This is to ensure an holistic approach to the supervision and to reduce the possibility of unsupervised activities in an institution threatening the survival of the institution. There is also a clear distinction between DTIs and other financial institutions which are highlighted elsewhere.

We note that there are presently differences between banks and other DTIs where bank depositors have statutory preference to funds, and banks are prohibited from pledging their assets. BS depositors rank with unsecured creditors; CU members rank behind secured creditors (SSPs) and equally with unsecured creditors.

Financial institution supervision is best conducted by a combination of on-site inspection and off-site analysis. This provides both an ongoing monitoring function, and a confirmation that the institution's reports to the supervisor reflect the reality of the institution.

In combination with on-site inspection, a supervisor must have an intimate knowledge of the local conditions in which the institution operates. The economic and social context of its operations can be as important to its survival and the safety of the depositors as its financial management. To this end the requirement for regional or locally based supervisors is evident.

The FI Scheme has followed a model where the standards are promulgated by one body (AFIC), and supervision provided by another (the SSA). The arguments for this form of supervision include the transparency of separation of function. This differs from the RBA supervision of banks where the standards and the supervision are conducted by the same body. One aspect of the separation is that it may facilitate consultative processes prior to the introduction of standards. Provided that these processes have finite time limits, and there is no doubt as to the supervisor having the final decision, this consultative approach can have significant advantages over a more directive one.

The legislation supporting a supervisory system should be capable of amendment without undue delay. The present FI Scheme structure where agreement and legislation by all participating states and territories has proved deficient in this regard.

Public reporting and disclosure should be as consistent as possible, but recognising inherent differences between insurance, banking, and general purpose company accounts. Audit requirements should be standardised with separate additional areas for different industries.

3.1.2 ***QOFS Submission is:***

- DTIs should be differentiated in prudential supervision to other financial institutions.

- A viable "lender of last resort" facility should cover all DTIs.

- All DTIs should have similar preferences to depositors on liquidation.

- Self reporting and off-site monitoring must be augmented by on-site inspection by locally based supervisors.

- Prudential standards should be promulgated after defined industry consultative processes.

- Legislation supporting supervision should be capable of amendment without undue delay.

- Public reporting, disclosure, and auditing requirements should be uniform across DTIs and between financial institutions.

3.2 ***Ensure that financial providers are well placed to develop technology, services and markets and that the regulatory regime is adaptable to innovation.***

3.2.1 The principle driver for service and market development is the provider and not the regulator or supervisor. To facilitate development, any limitations on activities of the provider should be contained in prudential standards and not in legislation. The capacity to amend and fine tune prudential standards to take account of developments in a timely manner is superior to the capacity for legislative amendment.

To adequately provide effective supervision and to adapt to innovation, a high level of diverse and relevant skill is required in the staffing of the supervisor. This is combined with the use of technology to perform routine administrative, data processing, and elementary analytical tasks. As an indication of skills required in staff, a summary of QOFS staff skills is at Annexure I.

The requirements for an effective supervisor include the skill levels noted above, and the following three key factors:

- Extensive experience in the supervision and operation of financial institutions.

- A knowledge of the local issues faced by institutions and the economies in which they operate.

- A wide acceptance by the individual institutions of both the need for and benefits of the supervision.

The Survey demonstrates that the present NBFI supervisory structure has achieved these in Queensland - refer to Annex H, tables 13,14, 31.

3.2.2 ***QOFS Submission is:***

- Prudential standards for supervision must be capable of being readily changed in response to market changes.

- The supervisor must be resourced adequately to identify, assess, and supervise developments in institutional operations and products.

- Prudential supervision of the financial institution, rather than the product, is preferred.

3.3 *Provide the best means of funding direct costs of regulation*

3.3.1 The entire operating costs of QOFS are met by direct levy on the supervised industries. There were some initial grants from the Queensland Government to fund the establishment costs.

The costs are recovered in two manners - directly from the societies in the case of FS and CH, and by deduction from industry based funds under the control of QOFS for BS and CU.

In addition to levies, societies pay registry charges on certain transactions with the supervisor. However these are a minor part of total revenue - 0.7% in 1995/96. QOFS has proposed in the past that no registry fees be payable by an institution paying levies - however national uniformity could not be achieved on this matter due to differing revenue regulations applying to individual SSAs.

The allocation of levy cost to individual industries is made on a broadly based combination of direct expenditure identifiable with an industry activity, and a time based allocation of other direct and indirect costs. Thus a general relativity is maintained between cost to industry and the degree of supervision effected.

The allocation of levy to each institution is made on a formula based on total asset size. Generally a minimum and maximum payment is also specified. This is recognised as being inexact as there is no direct correlation between size of institution and degree of supervision. However QOFS and industry have accepted the practice as being equitable and without the cost and administrative burden of accounting for costs and time on an individual society basis.

A summary of levy costs is at Annexure J. These show that in 1996/97, levies will be 0.01% of total assets for BS, 0.03% for CU, and 0.07% for FS and CH. This cost reflects in part the greater resource allocated to the smaller institutions to provide equivalent levels of supervision.

The FI Code provides for a CU Contingency Fund (CUCF) to be established by each SSA. The CUCF administered by QOFS has approximately $21 million in assets - of which $15 million is reflected as a deferred asset in the accounts of CUs and $6 million is in retained earnings. This fund and its earnings may be accessed to pay QOFS Supervision Levy and AFIC Administration Levy. An argument could be mounted that the retention of the CUCF is an opportunity cost of supervision to CUs. On the assumption that the CUCF was returned to industry in full and free of taxation, and using an industry average net margin of 5%, this would equate to $1.05 million being added to the gross profit of the industry in 1995/96 - less the $788,235 that would have been paid directly as QOFS Supervision and AFIC Administration levies.

The Queensland Government established the BS Fund (BSF) in 1993 to provide for QOFS Supervision Levy and AFIC Administration Levy for BS in Queensland. The BSF has approximately $29 million in total assets. In a similar manner to the CUCF, there may be an opportunity cost attached to the industry of the supervisor retaining these funds. On the same assumptions as used for the CUCF and a net interest margin of 3.5%, the gross income effect on industry would have been $1.02 million - less $441,148 for QOFS and AFIC levies.

The employment in these industries of an RBA style “Non Callable Deposit” at the current rate of 1% of Total Liabilities could equate to supervision levies. Assuming an opportunity cost to the societies at the average cost of funds (BS -5%, CU - 6%) - the levy would be approximately $3 million for BS and $1.1 million for CU.

The Survey elicited the following responses in regard to the cost of supervision:-

***Question**:* In your opinion, what, if any, impact has QOFS had on the way your society/CU performs?

***Relevant Response**:* Increased our costs - 6% of respondents.

***Question**:* What, if anything, would you like to see QOFS do to increase their value to you and your industry?

***Relevant Response*:** Review associated costs - 6% of respondents.

Question: How satisfied/dissatisfied are you with QOFS and its impact on your organisation?

Relevant Response: Neither satisfied nor dissatisfied, Cost - 4% of respondents.

In summary it would appear that the cost of supervision is not a major issue among CU and BS.

There is no necessary correlation between the size of an entity and the supervisory requirements - and thus its supervisory cost.

Any discussion on costs needs to include a comparison of the benefits derived. This is a wide topic and the benefits (like some of the costs) are not always readily quantified. One measure of benefit is the degree to which the introduction of a supervision regime may have reduced the cost of funds in societies. Annexure G demonstrates the changes in 90 day term deposits for BS and CU against regional banks since the introduction of prudential supervision in July 1992. It is clearly demonstrated that CU funding costs have significantly decreased; and BS have marginally decreased.

3.3.2 ***QOFS Submission is:***

- The current direct costs of supervision are reasonable, and are outweighed by the reduction in funding costs achieved by societies.

- Most societies themselves do not view existing supervision costs as being excessive.

- Smaller institutions may be more demanding than larger institutions of supervisory resource.

- Direct payment of supervisory costs by industry is a transparent and preferred approach.

3.4 *Establish a consistent regulatory framework for similar financial functions, products or services that are offered by differing types of institutions.*

3.4.1 As argued above, the grouping of supervision should be on a functional basis (DTIs, insurance,) and not on a product or service basis. Products or services may be subject to regulation across offering entities - but for the purposes of consumer protection.

Any company operating in Australia will transact with a number of regulatory bodies - the range will be dependent on its activities. Some will be common to all - such as the ASC for registration purposes, the Australian Tax Office. Various other regulatory bodies regulate issues as diverse as accounting and audit standards, competition and fair trading, State taxes, export licensing, customs and import duties, workplace health and safety, equal opportunity and discrimination. It would not appear logical to assume that all regulation, or even groups of activities, could necessarily be combined into one regulatory entity.

Different forms of financial institutions require different accounting and capital treatments. Liability driven entities such as insurance companies calculate reserves on actuarial bases and require capital for different purposes than DTIs. DTIs are asset driven and generate and hold reserves to absorb losses. Liquidity requirements are quite different. To attempt to amalgamate entities for accounting and disclosure would be of little value; as would any attempt to supervise in the same manner.

The provision of a wide range of financial products from one institution (including the “bancassurance” concept) poses a concentration risk for the customer. Where previously an individual’s savings and investments would have been spread between several institutions, they may now be concentrated in one. This concentration of risk provides a strong argument for sound supervision of the entity rather than the product.

The Survey (see Annex H, tables 10,12) highlighted different perceptions from industry as to the ideal role of the supervisor. In broad terms the smaller institutions (principally CU) placed a greater emphasis on the supervisor acting in an advisory and “hand holding” role; in distinction to larger institutions which were more self-reliant. Reflection on this result confirms its validity, in the potential for smaller institutions to need to externally augment their professional resources. The observation also highlights the differences between all types of financial institutions and the need to guard against generalisations in treatment.

In any system where there may be a number of regulators/supervisors interacting with an institution, it is imperative that there be no legislative barriers to the free exchange of information among the regulators/supervisors. The absence of barriers helps to ensure that at the operational level the potential for supervisory matters to “fall between the cracks” is reduced and that better intelligence is available to the supervisor.

3.4.2 *QOFS Submission is:*

- DTIs should be subject to separate prudential supervision to other financial institutions.

- Product or service regulation may occur across industries, but should not replace entity prudential supervision.

- Institutions prefer to be supervised as entities as opposed to by product.

- There should be no barriers to the voluntary exchange of information between regulators/supervisors.

4. OTHER ISSUES

4.1 *Objectives or procedures of the RBA in its conduct of monetary policy*

4.1.1 As relatively minor participants in the markets in which they operate, it is unlikely that the operations of the DTI societies would have any significant effect on monetary policy. The corollary to this is that it would not appear to be reasonable that these industries should be distinguished by the RBA in its conduct of monetary policy.

4.1.2 ***QOFS Submission is:***

- That DTI societies should not be distinguished from banks in the conduct of monetary policy by the RBA.

4.2 *Retirement incomes policies*

4.2.1 With the prudential supervision afforded BS and CU under the FI Scheme, there would appear to be no reason why these institutions could not publicly offer suitably structured Retirement Savings Accounts. There is no apparent reason why such accounts should be different to those offered by banks.

Under existing legislation and supervisory arrangements, FS may offer retirement and superannuation products. There would appear to be no reason why this practice could not continue.

4.2.2 ***QOFS Submission is:***

- BS, CU and FS could be allowed to offer retirement income products.

4.3 *Regulation of the general operation of companies through corporations law.*

4.3.1 The existing legal structure for the supervision of NBFIs is that legislation particular to the supervision of those industries is layered over the general provisions of Corporations Law. That is where the specific Acts are silent, the Corporations Law prevails. Examples of this include winding-up provisions.

At present this structure is tainted by the specific Acts also providing for the registration and incorporation of societies. This is due to the historical nature of the industries and the State based statutes under which the FI scheme operates. There would appear to be no impediment from a supervisory view to all incorporation, registry and general operational functions being regulated under Corporations Law with the prudential supervisory function subject to separate legislation - as is the model provided by the RBA and the banks.

Amendments may be required to the Corporations Law to provide for the incorporation of cooperative organisations.

4.3.2 *QOFS Submission is:*

- That incorporation, registration, and regulation of the general operation of societies be on an equal footing to that of banks subject to the Corporations Law.

4.4 *Policies for taxation of financial arrangements, products or institutions.*

4.4.1 Building Societies

BS are subject to the full provisions of the taxation legislation. The State Government owned Suncorp Building Society Limited accounts as a taxpaying entity, with payments being made to the Queensland Government in lieu of the Federal Government.

4.4.2 Credit Unions

CU are in a transitionary phase from being exempt from general taxation under section 26 of the Income Tax Assessment Act 1936 during the period 1972 to 1994. The new regime will result in all but "small" CU (based on an asset test) subject to full taxation.

From a supervisory view, there are dangers in differing taxation regimes applying to societies on the basis of size. These include the potential for the exemptions to be removed and the society being unable to manage the transition, to decisions on strategy and business being tax driven. We do not dispute any arguments that may be put forward on social policy grounds for differing taxation treatments.

4.4.3 Friendly Societies

FS are taxed on their non-mutual income (investments, sales to non members) but otherwise generally exempt under the mutuality concept.

There is a prudential risk where a society bases a large proportion of its business on a unique taxation advantage. The risk occurs where the advantage is withdrawn and the business also withdraws. If the institution cannot replace the business it faces shrinkage and potential stability problems. This is the situation experienced by FS in recent years as specific taxation benefits on investment products expired. As a matter of principle, a significant business should not be built on a taxation advantage that could be withdrawn or altered at any time.

4.4.4 Cooperative Housing Societies

CH are cooperatives and as such generally exempt from taxation other than for investment income. They are not operated for profit and, as profits cannot be distributed to members as cash, are unlikely to have significant taxation issues.

4.4.5 State and Federal taxes on financial institutions and their products and activities are not always uniform in either the form of tax and the rates applied. Examples are the uneven application of stamp duties on financial transactions, and the application of financial institutions duty. Such non-uniformity does not necessarily promote a competitive national system, and may encourage jurisdiction shopping for benefits. However, social and political requirements of governments may provide grounds for differing positions.

4.4.6 ***QOFS Submission is:***

- From a supervisory view it is preferable that there not be any taxation benefits granted, nor restrictions imposed, on societies as a result of their incorporation that are not available to companies generally.

- Uniform taxation of financial institutions and financial products throughout Australia may improve competitiveness and reduce "jurisdiction shopping".

- Taxation should neither confer nor take away competitive advantage of institutions.

ANNEXURES

"A" BACKGROUND TO QOFS AND SUPERVISED INDUSTRIES

Background to QOFS

The Queensland Office of Financial Supervision (QOFS) was established in July 1992 by the Queensland Government. At the same time a similar organisation (called State Supervisory Authority or SSA) was established by every other State and Territory government; and the Australian Financial Institutions Commission (AFIC) was established. All these organisations were charged with the supervision of BS and CU under the Financial Institutions (FI) Scheme - AFIC to establish the prudential supervision framework, the SSAs to effect the supervision.

For the first time there was uniform legislation throughout Australia for these financial institutions, and modern concepts of prudential banking supervision were applied. These follow the principles applied by the RBA to the supervision of banks.

Since that time the Queensland Government has assigned the supervision of FS and CH under State laws to the Queensland Office of Financial Supervision.

Except as prescribed in the various Acts, QOFS is independent of Government and not subject to direction by the Minister. It is governed by a board of five directors, including the Under Treasurer. None of the directors can hold an office with a supervised institution. QOFS is funded by statutory levies on the industries supervised.

Background to Supervised Industries

(Refer to Annexure F for industry statistics)

Queensland Building Societies

BS are supervised under the FI scheme.

At 30 June 1996 there were 9 BS in Queensland with total assets of $6,641 million. The societies are headquartered in Brisbane and in major provincial centres throughout the State. A strong local franchise in their home city is a characteristic of the societies. Many conduct operations throughout the State through branch and agency networks. There is generally not a large degree of inter-society competition.

Prior to the introduction of the FI Scheme, Queensland BS operated under restrictive legislation that only allowed lending against insured first residential property mortgages. Since the introduction of the FI scheme the societies have gradually expanded into personal and business lending activities.

Societies vary in total assets from $150 million to over $3 billion. The largest, SUNCORP, is prospectively to exit the industry under the Government's plan to amalgamate the SUNCORP group and QIDC with Metway Bank. Two smaller societies have also announced an intention to merge. The Queensland industry represents over 45% of the Australian BS industry assets. Of the nine societies, one (SUNCORP) is government owned; one (Heritage) remains a mutual, four have demutualised and are listed on the ASX; and three have demutualised on to exempt stock markets.

The societies have experienced strong growth in recent years and appear to be retaining market share of housing loans in recent depressed and competitive conditions.

Queensland Credit Unions

CU are supervised under the FI Scheme.

There were 27 CU registered at 30 June 1996 with total assets of $2,068 million. These ranged from $225,000 to $440 million in total assets. The industry is characterised by a relatively large number of smaller CU. In recent years there has been some reduction in society numbers; and this trend may continue, as economies of scale; capacity to comply with Prudential Standards; and competition affects smaller societies. All societies retain their mutual status.

CU operate throughout the State through branch and agency networks, although the majority are domiciled in the South East corner of the State. A distinction between societies is the bond of membership - 13 have a restricted bond based on an employer; 4 have a bond based on location or ethnic grounds; and 10 are open bonded or community CU.

CU have grown strongly over the past years and appear to be continuing that growth trend. The loan portfolio mix has shifted from the traditional personal lending emphasis to include business lending and a large increase in mortgage lending.

Societies are characterised by strong affiliation with industry bodies that provide services to member societies that would be unavailable to individual societies. There is not a large degree of inter-society competition.

Queensland Friendly Societies

This industry is distinguished by its participants not being homogenous in general activity. We have identified several distinct categories of FS - only some of which could be described as being financial institutions. Some engage in limited activities across categories - our categorisation is based on the principle activity of the entity. FS operate throughout the State.

The reason for the diversity is largely historical, in that the incorporation of a FS was the appropriate method of engaging in a number of these activities before, for example, the introduction of the Associations Incorporation Act 1981. QOFS has overseen the conversion of a large number of FS to Incorporated Associations.

At 30 June 1996 the Register of FS showed:

- 2 Retirement villages\Nursing homes
- 18 Dispensaries and other health providers (hospitals, health funds etc)
- 17 Single benefit societies
- 6 Social\Cultural\Sporting
- 13 Flexible benefit products

The retirement villages and dispensary categories are generally conventional businesses which do not have depositor or investor funds at risk. The requirement for prudential supervision is minimal, and the “product” supervision is conducted by other agencies (for example Health Departments, Pharmacy Boards) .

Single benefit societies provide a single benefit fund (sickness, unemployment, and the like) and are generally workplace based. There are no depositor funds at risk and the prudential supervisory requirements are negligible.

The social category remains an anomaly and these societies could readily become incorporated bodies or unincorporated associations. There are no investor or depositor funds at risk and the requirement for prudential supervision is minimal.

The flexible benefit category comprises those societies offering insurance and other products for which investor monies are publicly sought. There is considerable prudential risk and there are substantial supervisory demands.

Most of the Queensland societies offering flexible benefit funds are closely associated with major southern based FS. Under existing Queensland legislation, interstate merger is prohibited. It is anticipated that with the introduction of the uniform FS legislation currently being prepared, that mergers will occur.

As at 30 June 1996 the 13 flexible benefit societies conducted 27 funds with aggregate assets of $183.6 million. This total is declining at a rate of 8% in the 1995/96 financial year. The principal reason for this is the maturity of tax-based products and the lack of market competitive replacement products.

Our comments on FS in the rest of this report pertain only to those that are defined as Flexible benefit societies.

Queensland Cooperative Housing Societies

CH have been operating under current legislation since 1958. They are mutual organisations that borrow wholesale funds (often with a guarantee from the State Treasurer) and make loans for housing. On repayment of the last loan the society terminates. A Bill is before the Queensland Parliament to replace the 1958 Act and substantially revise the operation of these organisations. Amongst the changes will be perpetual succession.

The societies were widely used as an instrument of housing policy and were the conduit for federal and state housing funds in the 1960's and 70's. Societies were promoted by independent managers who formed large numbers of societies. The register in Queensland at 30 June 1996 contained 671 societies, and the majority of these are managed by some 10 managers. Total loans outstanding are of the order of $295 million. Societies are concentrated in the South East of the State.

These societies have, by their nature and the form of regulation under the 1958 Act, generally operated in the lower value end of the market. The new Act will allow rationalisation of societies, and we would expect the total number to reduce to approximately fifty by December 1997, and total asset size to remain relatively constant.

New societies continue to be registered and lending by societies is active.

"B" GLOSSARY

Abbreviations used in this submission:

AFIC	Australian Financial Institutions Commission
ASX	Australian Stock Exchange
BS	Building Society/ies
BSF	Building Societies Fund
CH	Cooperative Housing Society/ies
CU	Credit Union/s
CUCF	Credit Unions Contingency Fund
DTI	Deposit taking institution
FI Code	Financial Institutions (Queensland) Code
FI Scheme	Financial Institutions Scheme
FS	Friendly Society/ies
NBFI	Non Bank Financial Institution
QIDC	Queensland Industry Development Corporation
QOFS	Queensland Office of Financial Supervision
RBA	Reserve Bank of Australia
Society/ ies	Building Society, Credit Union, Friendly Society, Cooperative Housing Society.
SSA	State Supervisory Authority (including Territory Supervisory Authorities)
Survey	"Perceptions of QOFS", May 1996

"C" TERMS OF REFERENCE

Financial System Inquiry - Terms of Reference

- **Mission**

  The inquiry is charged with providing a stocktake of the results arising from the financial deregulation of the Australian financial system since the early 1980's. The forces driving further change will be analysed, in particular, technological development. Recommendations will be made on the nature of the regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness.

- **Specifics**

  1. The inquiry will report on the results arising from the financial deregulation flowing from the *Inquiry into the Australian Financial System* ("Campbell Report") published in 1981. This will involve examining and reporting the consequences for:

  (a) The choice, quality and cost of financial services available to consumers and other users:

  (b) The efficiency of the financial system, including its international and domestic competitiveness;

  (c) The economic benefits of deregulation on growth, employment and savings;

  (d) The evolution of financial institutions and products offered by them and the impact on the regulatory structure of the industry.

  2. The inquiry will identify the factors likely to drive further change including:

  (a) Technological and marketing advances;

  (b) International competition and integration of financial markets;

  (c) Domestic competition in all its forms;

  (d) Consumer needs and demand.

3. The Inquiry will make recommendations on the regulatory arrangements and other matters affecting the operation of the financial system (including prudential and other regulations made by the Reserve Bank and other bodies) as will:

(a) Best promote the most efficient and cost-effective service for users, consistent with financial market stability, prudence, integrity and fairness;

(b) Ensure that financial system providers are well placed to develop technology, services and markets and that the financial system regulatory regime is adaptable to such innovation;

(c) Provide the best means for funding the direct costs of regulation;

(d) Establish a consistent regulatory framework for similar financial functions, products or services that are offered by differing types of institutions.

4. The Inquiry in its consideration of financial system regulation may not make recommendations on, but will take account of:

(a) The objectives or procedures of the Reserve Bank in its conduct of monetary policy;

(b) Retirement incomes policies;

(c) The regulation of the general operation of companies through corporations law;

(d) Policies for the taxation of financial arrangements, products or institutions.

5. In carrying out its investigations, the inquiry may invite submissions and seek information from any persons or bodies.

6. A final report is to be provided to the Treasurer no later than 31 March 1997.

"D" QOFS 1996 ANNUAL REPORT

Copy will be provided to Inquiry upon the annual report being released in early September

"E" ACTS ADMINISTERED BY QOFS

- **Financial Institutions Scheme**

  Queensland Office of Financial Supervision Act 1992

  Financial Institutions (Queensland) Act 1992

  Regulations made under the above Acts and Codes

  Prudential Standards made pursuant to part 4 of the AFIC Code

- **State Legislation**

  Building Societies Fund Act 1993

  Friendly Societies Act 1991 (a)

  Cooperative Housing Societies Act 1958 (b)

  Building Societies Act 1985

  Regulations made under the above Acts

(a) This Act will be replaced by the proposed uniform national legislation for FS, to be incorporated in the FI Scheme.

(b) This Act is scheduled to be replaced by the Financial Intermediaries Act 1996 in October 1996.

“F” INDUSTRY STATISTICS

Building Societies

	06/96	*03/96*	*12/95*	*9/95*	*06/95*	*06/94*	*06/93*	*06/92*
No. of Societies	9	9	9	9	9	9	9	9
No. of Members (‘000)	1,460	1,393	1,378	1,347	1,312	1,230	1,148	
Total Assets ($M)	6,641	6,421	6,293	6,115	5,937	5,203	4,260	3,573
Total Deposits ($M)	5,599	5,557	5,507	5,354	5,109	4,607	3,831	3,059
Total Loans ($M)	5,505	5,316	5,144	5,013	4,930	4,225	3,395	2,860
Housing Loans ($M)	5,114	4,925	4,761	4,635	4,557	4,155	3,388	
Personal Loans ($M)	98	103	98	96	94	50	4	
Revolving Credit Loans ($M)	35	31	27	24	18	6	3	
Commercial Loans ($M)	259	257	258	258	262	13	0	
Capital Adequacy Ratio (%)	11.61	11.52	11.37	11.46	11.48	11.43	9.04	
Prime Liquid Assets Ratio (%)	13.90	14.54	14.72	14.86	14.00	16.04	17.92	
Total Liquidity Ratio (%)	18.79	19.55	20.34	20.53	19.58	22.19	23.21	
Provision for Bad & Doubtful Debts ($M)	2.31	2.75	2.34	2.01	2.11	2.08	1.81	2.03
Net Profit after Tax ($M)	10.4	9.2	11.7	9.5	43.1	37.7	24.6	26.6

Notes:

1. Data prior to September 1992 not collected by QOFS. Accuracy cannot be guaranteed. Some data is not available.
2. Capital Adequacy Ratio - the ratio of Total Qualifying Capital to Risk Weighted Assets. Prudential Standards specify a minimum of 8%.
3. Prime Liquid Assets Ratio - the ratio of readily negotiable liquid assets to Total Liabilities. Prudential Standards specify a minimum of 7%.
4. Total Liquidity Ratio - the ratio of total liquid assets to Total Liabilities. Prudential Standards specify a minimum of 13%.
5. 1995/96 data is subject to audit of societies.
6. Data is for societies only and does not include consolidated entities.

Credit Unions

	06/96	03/96	12/95	9/95	06/95	06/94	06/93	06/92
No. of Societies	27	27	29	29	29	31	35	37
No. of Members ('000)	446	445	455	452	446	427	422	440
Total Assets ($M)	2,068	2,061	2,039	1,984	1,881	1,690	1,506	1,336
Total Deposits ($M)	1,856	1,860	1,843	1,787	1,689	1,532	1,365	1,220
Total Loans ($M)	1,656	1,621	1,592	1,542	1,515	1,281	1,130	1,030
Personal Loans ($M)	666	704	695	682	682	602	589	
Revolving credit Loans ($M)	69	66	63	59	56	43	33	
Housing / Real Estate Loans ($M)	871	803	786	756	730	592	481	
Commercial Loans ($M)	49	47	48	45	47	44	26	
Capital Adequacy Ratio (%)	12.13	11.78	11.77	11.81	11.82	11.73	11.06	6.59
Prime Liquid Assets Ratio (%)	10.28	10.83	10.58	10.87	9.81	11.39	10.97	
Total Liquidity Ratio (%)	18.84	20.02	21.14	21.54	18.41	20.99	20.97	
Provision for Bad & Doubtful Debts ($M)	10.9	10.5	10.9	10.4	10.4	11.5	9.3	8.7
Net Profit After Tax ($M)	4.9	4.2	3.8	3.2	18.5	18.9	21.1	

Notes:

1. Data prior to September 1992 not collected by QOFS. Accuracy cannot be guaranteed. Some data is not available.
2. Capital Adequacy Ratio - the ratio of Total Qualifying Capital to Risk Weighted Assets. Prudential Standards specify a minimum of 8%.
3. Prime Liquid Assets Ratio - the ratio of readily negotiable liquid assets to Total Liabilities. Prudential Standards specify a minimum of 7%.
4. Total Liquidity Ratio - the ratio of total liquid assets to Total Liabilities. Prudential Standards specify a minimum of 13%.
5. 1995/96 data is subject to audit of societies.
6. Data is for societies only and does not include consolidated entities.

Friendly Societies

	06/96	*03/96*	*12/95*	*9/95*	*06/95*	*06/94*	*06/93*	*06/92*
Total No. of Societies	63	69	74	78	85	114	116	119
Total Assets ($M)	356	n/a	n/a	n/a	370	400	n/a	n/a
Flexible Insurance Funds								
Number of Societies	15	16	16	17	17	19	20	21
Number of Funds	27	31	31	32	32	32	33	34
Gross Assets ($M)	184	188	195	198	197	216	221	226
Liquidity Ratio (%)	70.00	74.33	67.63	76.57	65.00	n/a	n/a	n/a
Other Societies by Type								
Social / Cultural / Sporting	7	9	13	15	20	37	37	39
Dispensaries & Health Providers	18	19	19	19	19	19	19	19
Single Benefit	21	23	24	25	26	36	37	37
Retirement Villages & Nursing Homes	2	2	2	2	3	3	3	3

Notes:

1. Data prior to September 1994 not collected by QOFS. Accuracy cannot be guaranteed. Some data is not available.
2. Flexible Insurance Fund - a withdrawable Investment product not offering a defined benefit.
3. Liquidity Ratio - is the ratio of Liquid Funds to Total Assets.
4. 1995/96 data is subject to audit of societies.
5. Classification by type is by principle business activity of society

Cooperative Housing Societies

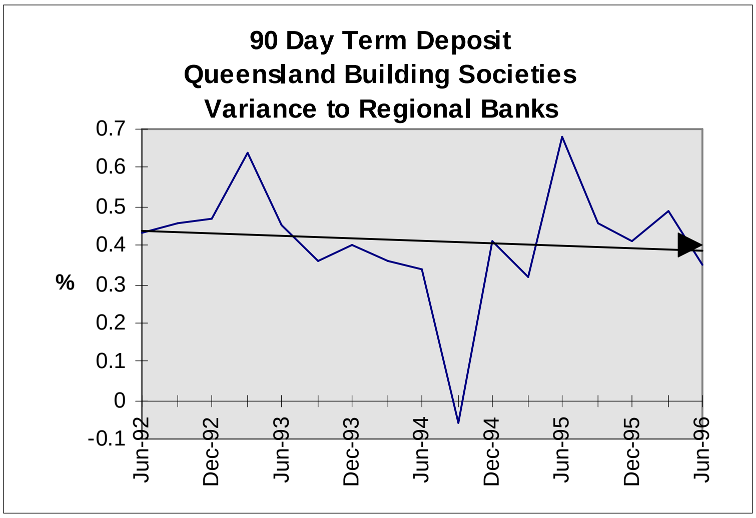
	06/96	*12/95*	*06/95*	*12/94*	*06/94*	*12/93*	*06/93*
No. of Societies	671	695	769	n/a	791	n/a	788
Loans Advanced in period ($M)	24.9	39.2	65.9	76.9	53.6	43.6	24.8
Loans Advanced in period (no.)	343	495	728	1009	753	548	379
Total Assets ($M)	n/a	328	n/a	n/a	n/a	169.7	n/a
Total Loans from Wholesale Funders ($M)	294	294	302	n/a	n/a	141	n/a
Loans guaranteed by the Treasurer ($M)	281	n/a	n/a	n/a	n/a	n/a	n/a
Loans guaranteed by the Treasurer (no.)	226	n/a	n/a	n/a	n/a	n/a	n/a

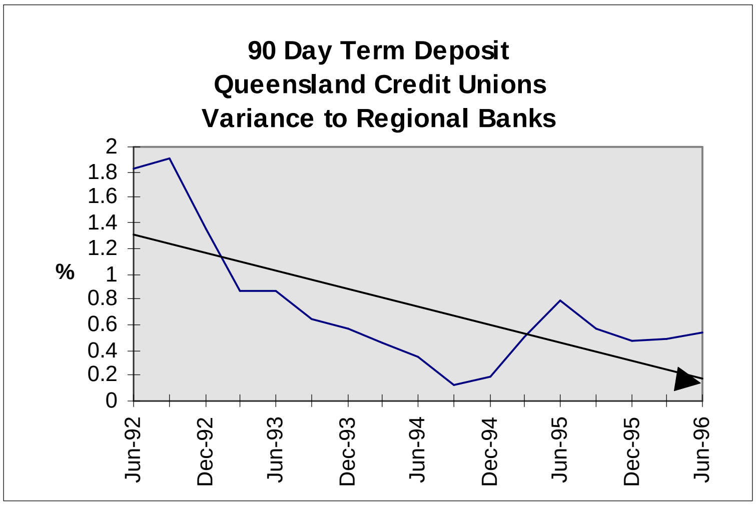
Notes:

1. Data prior to December 1995 not collected by QOFS. Accuracy cannot be guaranteed. Some data is not available.

2. Society balance dates are on or before 31 December each year.

"G" COST OF FUNDS





"H" EXTRACTS FROM CUSTOMER SURVEY

Table 8 How well QOFS performs most important function.

Question: How well does QOFS perform its most important function ?

Response:

	Total	BS	CU
Very well	**46%**	42%	48%
Well	**48%**	50%	48%
Neither well nor poorly	**6%**	8%	5%
(single response)			

Table 10 Other functions of QOFS

Question: Other than its most important function, what other functions does QOFS perform ?

Response:

	Total	BS	CU
Adviser	**43%**	25%	48%
Providing statistics	**19%**	15%	17%
Education\training	**13%**	17%	12%
Nothing else	**13%**	8%	14%
Monitor compliance	**11%**	25%	7%
Supervision	**11%**	25%	7%
Others	**28%**	25%	29%
(multiple responses)			

Table 12 Ideal role of QOFS

Question: What would you regard as the ideal role for QOFS in your industry ?

Response:

	Total	BS	CU
Exactly as now	**37%**	33%	38%
Supervision	**24%**	25%	24%
Monitor compliance	**19%**	17%	19%
Adviser	**15%**	-	19%
rationalise AFIC\QOFS	**8%**	8%	7%
Others	**30%**	42%	26%
(multiple responses)			

Table 13 **Benefits to societies**

Question: What impact has QOFS had on the way that your society performs ?

Response:

	Total	BS	CU
need to comply	**22%**	17%	24%
more professional	**20%**	25%	19%
improved policies	**15%**	17%	14%
other positive	**35%**	25%	36%
None	**17%**	17%	17%
neutral	**7%**	33%	-
negative	**17%**	-	22%
(multiple responses)			

Table 14 **Improvements to societies**

Question: In what way has QOFS contributed to stability, credibility, business activity of your society ?

Response:

	Total	BS	CU
Increased investor confidence	**19%**	18%	20%
Increased professionalism	**15%**	18%	15%
monitor compliance	**13%**	-	17%
heighten awareness	**10%**	9%	10%
Nothing in particular	**27%**	27%	27%
others	**16%**	27%	12%
(single response)			

Table 20 **Changes to inspection function**

Question: How can the inspection function be improved upon ?

Response:

	Total	BS	CU
Nothing in particular	**52%**	67%	48%
alter some process	**13%**	25%	10%
better liaison	**7%**	8%	7%
others	**29%**	-	37%
(single response)			

Table 23 Changes to supervision function

Question: How can the supervision function be improved upon ?

Response:

	Total	BS	CU
Nothing in particular	**52%**	33%	57%
better liaison	**7%**	25%	2%
individual treatment	**7%**	8%	7%
more feedback	**6%**	8%	5%
others	**32%**	33%	32%
(single response)			

Table 31 etc Benefits of functions

Question: Perceived be benefit of inspection and supervision functions.

Response:

	Inspection	Supervision
Beneficial	69%	55%
Neutral	22%	33%
Not beneficial	10%	11%
(single response)		

Table 40 Satisfaction with QOFS

Question: How satisfied are you with QOFS and its impact on your organisation ?

Response:

	Total	BS	CU
Very satisfied	**37%**	50%	33%
Satisfied	**46%**	33%	50%
Neither satisfied nor dissatisfied	**13%**	17%	12%
Dissatisfied	**4%**	-	5%

“I” QOFS SKILLS BASE

QOFS staff consists of 10 professional and 3 support staff full time, and one part time support staff member. All have been recruited from the private sector with appropriate professional qualifications and relevant work experience in finance and related industries.

Status	Core Skill	Secondary Skills
Accountant	Management	Credit, Treasury
Chartered Accountant	Audit	Treasury
Chartered Accountant	Audit	External reporting
Chartered Accountant	Audit	Treasury, Superannuation
Chartered Accountant	Audit	EDP Audit
Chartered Accountant	Banking	Credit, Liquidation
Accountant	Financial Accounting	Management Accounting
Accountant	Financial Accounting	
Barrister	Commercial Law	Advocacy, Finance
Solicitor	Commercial Law	Securities, Finance

Three of the support staff are undertaking undergraduate studies - in accounting, in records management, and in finance.

"I" SUPERVISION LEVIES

	Supervision Levies Collected				
	Building Societies	Credit Unions	Friendly Societies	Co-op Housing Societies	TOTAL
1992/93					
Total Levy $ (half year only)	286,542	158,739	-	-	445,281
% of QOFS Total Revenue	21.85%	12.10%	-	-	33.95%
Industry Assets (Avg) $M	4,000	1,471	-	-	
Levy/Assets	0.01%	0.01%	-	-	
Government Grant $.850M					
1993/94					
Total Levy $	835,688	448,957	-	-	1,284,645
% of QOFS Total Revenue	54.91%	29.50%	-	-	84.41%
Industry Assets (Avg) $M	4,832	1,636	-	-	
Levy/Assets	0.02%	0.03%	-	-	
Government Grant $.216M					
1994/95					
Total Levy $	655,270	541,325	46,794	-	1,243,389
% of QOFS Total Revenue	46.13%	38.11%	3.29%	-	87.53%
Industry Assets (Avg) $M	5,697	1,796	382	-	
Levy/Assets	0.01%	0.03%	0.01%	-	
Government Grant $.106M					
1995/96 (Estimate)					
Total Levy $	580,540	636,015	150,550	150,246	1,517,351
% of QOFS Total Revenue	37.79%	41.40%	9.80%	9.78%	98.77%
Industry Assets (Avg) $M	6,266	2,028	360	290	
Levy/Assets	0.01%	0.03%	0.04%	0.05%	
Government Grant $.02M					
1996/97(Estimate)					
Total Levy $	461,640	646,020	230,910	200,230	1,538,800
% of QOFS Total Revenue	28.00%	39.18%	14.01%	12.14%	93.33%
Industry Assets (Avg) $M	6,600	2,300	340	300	
Levy/Assets	0.01%	0.03%	0.07%	0.07%	
Government Grant $ NIL					

<u>1996/97 Levy Structure</u>			**Minimum pa.**	**Maximum pa.**
• BS & CU	Up to $25m $25m < $100m	.0530% of total assets .0522% of total assets	$1,000	$51,300
• FS	$700 per society per year + $700 if total assets >$1m + .088% flexible benefit fund balance		$700	n/a
• CH	.0674% of loans from wholesale lenders pa.		$10	n/a