Mr Greg Smith
The Secretary
Financial System Inquiry
Treasury Building
Parkes Place
Parkes ACT 2600
Telephone: (06) 263 2893
Fax: (06) 263 2898

Dear Mr Smith,

Enclosed is the National Credit Union Association's submission to the Inquiry. On behalf of the members of the Association I would like to thank you for the opportunity to participate in this inquiry.

Yours Faithfully,

Philip Elliott
Chief Executive Officer

SUBMISSION
TO

THE FINANCIAL SYSTEM INQUIRY

SEPTEMBER 1996

By National Credit Union Association Inc.
(NCUA Inc)

INDEX TO CONTENTS

ABBREVIATIONS

ACCC	Australian Competition and Consumer Commission
AFIC	Australian Financial Institutions Commission
ASC	Australian Securities Commission
ATM's	Automated Teller Machines
BAD	Bank Accounts Debits Tax
CFS	Council of Financial Supervisors
DTI's	Deposit Taking Institutions
EFTPOS	Electronic Funds Transfer at Point of Sale
F.I. CODE	Financial Institutions Code
FID	Financial Institutions Duty
ISC	Insurance and Superannuation Commission
OECD	Organisation for Economic Co-operation & Development
RBA	Reserve Bank of Australia
SSA	State Supervisory Authority
SSP's	Special Service Providers

EXECUTIVE SUMMARY

Australia's 284 credit unions have significant representation in the marketplace, and contribute to the breadth of choice available to consumers when selecting financial services.

Over 3.3 million Australian consumers (in excess of 25% of the adult population) have selected credit unions for all or some of their financial service requirements. The significance of credit unions to the personal household sector is therefore far greater than their 3% market share would suggest.

FINANCIAL SYSTEM POST CAMPBELL

The broad outcome of the Campbell Inquiry was the deregulation of the banking sector, whilst credit unions were regulated.

A number of recommendations from the Campbell Inquiry in relation to credit unions were not implemented, which resulted in the operating environment of credit unions becoming more onerous. The latest policy change was the application of company taxation, which significantly impacts on the only capital accumulation capacity of credit unions, of post tax retained earnings.

CREDIT UNIONS AND AUSTRALIA'S FINANCIAL SYSTEM

Credit unions, as mutual financial co-operatives, provide a unique option for consumers in the provision of financial services.

With aggregate assets of over $15.5 billion and over 3.3 million members, credit unions deserve to be recognised as an important segment of the finance market.

Although the majority of credit unions are relatively small financial institutions, they compete very effectively in the provision of quality and competitive financial services, primarily to the household sector.

With reserves of almost $1.5 billion, (most of which is retained earnings) producing a risk weighted capital ratio of 14.6%, they are one of the prudentially strongest arms of the finance sector.

On an aggregate asset basis, credit unions rank eighth behind the larger banks and ahead of building societies, on the domestic asset scale.

RISK SPECTRUM

In order to provide the community with a diverse risk/return spectrum, a number of different institutions needs to be provided for. Credit unions play an important part in contributing to the range of institutions available.

REGULATION AND SUPERVISION OF FINANCIAL INSTITUTIONS

The current regulation and supervision systems have evolved in response to the emergence and development of institutions and events, at both State and National levels. Not surprisingly, they are not cohesive and overlap.

Public policy issues and objectives in relation to the regulation and supervision of financial institutions are not publicised adequately to the community at large. An important part of the Inquiry process should be to detail them and promote them widely, so that the broader community is aware of them.

The RBA, AFIC (together with its SSA's) the ISC and the ASC are the primary corporate supervisors in Australia, to which can be added the ACCC, which spans the financial and non-financial corporate sectors.

The unique relationship between the RBA and the banks in relation to supervision appears to be outdated, given the broader range of institutions holding significant portions of financial system assets.

The CFS, introduced as a result of the 1991 Parliamentary Inquiry into Banking and Deregulation is simply a co-ordinating forum, without any authority or power. In its current form it cannot perform any significant functions in relation to effective supervision.

The F.I. Code contains the inherent problems of a State based national scheme, together with paternalistic regulation.

SUPERVISION OPTIONS

Products should be subject to the same regulation, irrespective of the type of institution providing them.

A variety of interests have to be met when addressing the elements of regulation and supervision.

The recommendations of the Inquiry must, at least:

- Cater for all existing financial institutions.
- Cater for evolving and future institutions which provide “financial” products.
- Propose a supervision regime, or regimes, that will apply a consistent regulatory framework for similar financial functions, products or services.
- Ensure there is a competitive and efficient environment for a variety of financial institutions which can provide choice for consumers, with quality and competitive services.

Functional and institutional supervision concepts both have attractions and deficiencies. On balance, a combination of both appears necessary, being driven by function and resulting in institution supervision.

The major existing supervision agencies contain the necessary elements for comprehensive supervision. Necessary efficiencies could be achieved by their reshaping.

The agencies involved in this regard are the RBA, AFIC (and the SSA’s), ISC, ASC and the ACCC.

By either reshaping the existing agencies or establishing new ones, the following supervision structure is proposed.

- A prudential supervisor for all DTI’s.

- A prudential supervisor for institutions providing investment-linked products.

- A competition regulator.
- A consumer and disclosure regulator.

OTHER ISSUES

The taxation of interest on savings is at the extreme, compared to rates applied to returns on various other forms of savings and investment.

Equitable taxation rates on investment returns should apply which should lower the rate applicable to savings interest.

FID and BAD taxes are applied at different rates across Australia and are erratic in their application to essentially similar transactions.

They are an impediment to the transfer of funds and can therefore reduce the benefits of competition.

New products and technology are developing at an increasing rate and will challenge existing systems of control and regulation. Regulators will need to be capable of addressing the emerging products and systems, particularly in order to ensure established institutions are not disadvantaged by regulation.

Consumer protection measures are expanding, at cost to institutions and ultimately consumers. The impact of such measures needs to be carefully considered in order to strike the correct balance.

SSP's to credit unions need to be catered for with dynamic capabilities, in order to respond to the service needs of credit unions.

Under the F.I. Code, these service providers are rigidly regulated and controlled, particularly in regard to the functions they can perform. Flexible incorporation and operations capacity should exist for these organisations.

R E C O M M E N D A T I O N S

1. That the responsibility for supervision of credit unions be transferred to the Federal level.

2. That special provision be made for small credit unions (e.g. < $10M in total assets), exempting them from onerous regulations, while requiring compliance with only basic prudential standards.

3. Specific provision be made for the incorporation of credit unions as Mutual “One Member - One Vote” member owned and controlled organisations.

4 Access to the payments system be available to all institutions which meet the necessary prudential criteria.

5. That an equitable and transparent “user pays” supervision fee be applied to all institutions, under efficient supervision systems.

6. That equitable taxation rates be applied to all forms of investment/saving earnings, in order to produce a lower rate of taxation on interest earnings.

7. That FID and BAD imposts be removed entirely.

8. That no specific depositor protection systems be maintained/implemented other than ensuring adequate minimum prudential requirements are met at all times.

9. That the following supervision structure be adopted:

- A prudential supervisor for DTI's
- A prudential supervisor for institutions providing investment-linked products.
- A competition regulator
- A consumer and disclosure regulator

10. That a "lead supervisor" system be implemented for allocation of institutions to one supervisor.

SUBMISSION
TO THE FINANCIAL SYSTEM INQUIRY

1. *Introduction*

Although some commentators have described the terms of reference as fairly narrow, from a credit union perspective they embrace a broad range of significant issues primarily since the credit union movement is only now settling into its new regime of prudential supervision under the F.I. Code introduced in 1992.

In the terms of reference of the Inquiry, item 1(a) refers to choice, quality and cost of financial services available to consumers and other users. In this regard, credit unions represent an important choice for consumers in selecting financial services, while also offering ownership and local service.

Approximately 3.3 million Australian consumers (slightly in excess of 25% of the adult population) have chosen credit unions for the provision of some, or all of their financial service requirements. This fact is significant in respect to the competitive and choice principles of the terms of reference as it is in contrast with the market share of the Australian financial system held by credit unions, of around 3%.

Items 2(c) and 2(d) of the Inquiry's terms of reference address factors likely to drive further change in domestic competition in all its forms, and consumer needs and demand.

The level of the Australian population which has chosen to join credit unions demonstrates that credit unions have succeeded as being effective competitors in meeting consumer needs and demands in a marketplace which is dominated by major banks.

The mission statement under the terms of reference states *“the Inquiry is charged with providing a stock take of the results arising from the financial deregulation of the Australian financial system since the early 1980’s……….”*

Credit unions maintain that they have not been deregulated under the F.I. Code, implemented in 1992. The nature of that regulatory regime, being a national State based system, has inherent difficulties and problems of a kind that other financial institutions have not had to contend with.

For credit unions to be efficient, responsive and competitive in a flexible financial system will require a new regime of regulation and supervision, which would not compromise their financial stability, prudential standing or integrity.

The existing F.I. Code under which credit unions are regulated sits in conflict with Item 3(d) or the objective thereof, which refers to achievement of a consistent regulatory framework for similar financial functions, products or services.

Credit unions, as mutual member owned and controlled organisations, predominately deal with the personal household sector in the provision of personal, housing and business loans, savings, transaction accounts and payments facilities.

They wish to remain essentially in this sector, with a greater ability to service the small business area. They also require direct participation in the payments system.

2. *Financial System Post Campbell*

The Campbell Inquiry recommended to Government that the banks be deregulated. This occurred and as a result:

* The number of major banks shrank from six to four.

* Banks increased their market share whilst competitors lost market share.

* New foreign banks failed to generate significant retail competition which has been provided primarily by domestic State and regional banks.

* Government sponsored financial institutions (State banks and housing co-operatives) have exited or are exiting the financial system; and

* Building societies have declined in importance. Those which converted to regional banks and still remain are likely take-over targets.

Deregulation has led to greater market control by banks and less alternatives available to the retail banking public.

* The Campbell Inquiry concluded that the most efficient way to

conduct activity is via the market system with minimum government regulation and intervention.

* The Campbell Inquiry recommended regulation of the credit union industry via a new national system of supervision and the imposition of company taxation. Credit unions have a State based scheme and company taxation. None of the benefits recommend by Campbell on the other hand have been provided, namely:

* Prudential supervision was meant to be less rigorous than that of banks. Actually, it is greater.

* Restrictions on assets, geographic trading and investments were not favoured, but remain.

* The RBA was to provide lender of last resort facilities. It has not done so.

3. *Credit Unions and Australia's Financial System*

3.1 *Credit Unions - A unique option for consumers.*

Credit unions are mutual financial co-operatives, owned and controlled by their members. They are "local" organisations, registered under the national State/Territory F.I. Code.

Credit unions offer the Australian public more choice as to where they can undertake financial business. They represent a genuine and viable alternative to banks, building societies and finance companies.

They represent competition in a financial system which is dominated by banks.

3.2 Why *Mutuality Matters*

A credit union is a "mutual" enterprise, meaning it is owned, serves and controlled by its members. Ownership is limited to members who hold limited participation shares and they have equal control rights with "one member - one vote". No permanent share structure exists, which means that control cannot be acquired by one or more individuals.

Members participate in decisions affecting the credit union, without regard to their level of savings, investments or volume of other business.

Credit unions are directed by member representatives. The prerequisite qualification of a director is simply to be a member.

Any surplus arising out of operations is allocated to reserves, to form the mandatory capital.

Services available are directed to improving the economic and social well-being of members, and their behaviour also reflects a genuine concern for the interests of members and the broader community within which its members reside.

As mutual organisations, credit unions represent an alternate corporate structure, with a unique service ethic of member service.

3.3 *Recognition of Credit Unions' Due*

Credit unions have achieved a level of success in acceptance by Australians, far in excess of their share of financial institutions assets. Although only accounting for around 3% of the finance sector market with assets of over $15.5 billion, with over 3 million members (over 25% of Australia's adult population) they represent a major force in the household sector.

As at June 1996, there were 284 credit unions in Australia, which operate a total of about 2,150 branches and agencies, and employ over 6,000 full-time staff as well as many part-timers. Credit unions are an important component of Australia's financial and economic system.

Whilst there is a mixture of large credit unions (about $500M in assets) and small ones (under $10M), the majority are smaller. About three quarters of credit unions are less than $50M in size. The average size is in fact $53.7M.

Credit unions are traditionally "grass roots" organisations which interface closely with their members in their own environments (e.g. in the local community, workplace, church, and within ethnic groupings).

They are widely distributed around Australia, in all States and Territories. They play a major role in servicing country Australia. However, the majority do not trade nationally.

3.4 *Prudential Strength*

Credit unions present very low risk to their members, the general public, government and the financial system. History supports this statement. The industry has a tradition of stability and attending its problems.

They recognised well before the implementation of the F.I. Code in July 1992 that high prudential standards would be required of them if they were to continue to compete successfully in the finance sector.

With very few exceptions, they met the capital and other prudential requirements prior to July 1992 and have continued to strengthen their prudential status since, as the following table illustrates:

CREDIT UNIONS As At 30th June 1996	
Total Assets	$15.560 billion
Reserves	$1.446 billion
Total Capital	$1.495 billion
Total Capital to Risk Weighted Assets	14.60%
Total Liquidity Ratio	21.19%
* Source - AFIC	

Under their legislation, credit unions are required to maintain capital of a minimum 8% of risk weighted assets. As can be seen from the above table, they exceed that level by almost double.

The capital adequacy of credit unions compares more than favourably with both banks and building societies at 30th June 1996, as the following table illustrates.

Item	All Credit Unions	All Building Soc.	All Banks
Risk Weighted Capital	14.60%	13.0%	11.2%
Tier 1 Component	13.82%	12.0%	8.3%
Source: RBA, AFIC			

Liquidity is also maintained at comparatively very high levels, presently at around 21% of total deposits. Credit unions are required to maintain at least 13% in "liquidity" under the legislation, of which only 4% can be "off balance sheet" in standby facilities.

In addition to those requirements, there is an emergency liquidity support scheme controlled by AFIC and contingency funds controlled by the SSA's under the F.I. Code. These systems are designed to provide industry wide support for liquidity and solvency respectively, if necessary, to support individual credit unions.

3.5 *Financial System Market Share*

Analysis of market share (domestic assets) of the Australian financial system confirms it is dominated by the banks, and in particular the four majors, while life and general insurance companies rank second.

However, from the perspective of credit unions in aggregate, they are a major force in the finance sector. In comparison with individual banks, credit unions (in aggregate assets) rank eighth (8^{th}), and ahead of building societies, as follows:

National Australia Bank	$90.722 billion
Commonwealth Bank	$84.496 billion

Westpac Banking Corp.	$78.162 billion
ANZ Banking Group	$68.897 billion
St George Bank	$21.424 billion
Advance Bank	$21.245 billion
State Bank of NSW	$16.910 billion
CREDIT UNIONS	$15.560 billion
BUILDING SOCIETIES	$13.108 billion

N.B. Assets are domestic only.

Source: RBA, AFIC

Perhaps a more important perspective on credit unions, particularly in view of the terms of reference of the Inquiry, is that with 3,300,000 members they represent a far more significant participant in the financial system, from the consumer perspective.

By their own choice, credit unions continue to primarily service the personal household sector.

4. *Risk Spectrum*

It is essential that the Australian financial services sector provide a variety of risk/return options for the community. This is best achieved by facilitating different organisations operating at various positions on the risk/return spectrum.

The issues involved that give rise to different levels of risk are related to the nature of the organisations, their operations and their balance sheet structure (i.e. their risk profile), rather than the positioning of their supervisor.

Any steps which assist in strengthening the array of the various players in the system must be in the interests of the community overall, and this aspect should be at the forefront of the committee in its deliberations with respect to its recommendations.

In summary, Australia is considered to be well served by a wide variety of financial institutions. The outcome of the Inquiry should be to ensure their continued ability to compete openly and effectively in the market place, thereby providing a diverse range of organisations facilitating choice, quality and pricing options in the financial services area for consumers.

5. *Regulation and Supervision of Financial Institutions*

5.1 *Financial Institution Supervision Objectives, and Public Policy*

The present systems of supervision have evolved in response to the emergence and development of institutions and events at both the State and National levels. The existing supervision format is disjointed when viewed from a national perspective, with each system tending its allocated territory and evolving in relation to its own experiences.

We understand that the primary public policy issues and objectives of supervision of financial institutions include:

1. Maintain the stability of financial institutions.
2. Protect deposits.
3. Promote stability of the financial system generally.
4. Ensure the integrity of the settlement and payments systems.
5. Encourage efficiency and competitive neutrality.

With the emergence of new players and new technologies in respect to payments systems and financial services, a new statement of objectives and public policy is needed.

The RBA Annual Report for 1996 states;

"Despite perceptions of the blurring of traditional functions and products encouraged by such developments, financial institutions continue to offer two conceptually distinct sets of liabilities:

* deposits (including transactions balances) some life insurance policies and annuities *where institutions undertake to repay a specified nominal sum at some future date. In the normal course, the institution, not the customer assumes the risks associated with earning a return on its assets; and*

* investment - linked products *such as Unit Trusts and Accumulation Superannuation Funds which are managed by financial institutions on a "best endeavours" basis. Customers bear the risks of declining investment value but reap the benefits of higher returns."*

By that analysis the RBA is clearly identifying two different institutional types within the financial services sector. The question which arises is whether all, or only some, financial institutions engaged in providing those two types of facilities to the public should be supervised by the same body and in a similar manner.

Consumers have an expectation that Governments through their supervisory instrumentalities will protect deposits and investments by whatever type called, insofar as Government can through regulation and supervision.

5.2 Current Supervisory Structure and Future Impacts

The RBA, AFIC (together with its SSA's), the ASC and the ISC are the primary corporate supervisors in Australia. To this group can be added the ACCC, which although non prudential in its activities has a very significant (potential) capacity to influence events.

The unique supervision system for banks within the RBA arose when banks were the predominant financial organisations in the system.

With the growth of non-banks share of financial system assets in Australia over recent years, a primary issue that the inquiry must address is the relevance of only bank supervision being conducted by the RBA.

If a major charter of Government is to ensure appropriate supervision of financial institutions and to encourage competition and choice, these and other fundamental objectives will not be achieved with differing supervision levels/systems.

The RBA, AFIC (and its attendant SSA's), the ASC and ISC produces a disjointed matrix of supervisors, institutions and products. Surely it is possible to not only rationalise, but appropriately compartmentalise these aspects of the financial system. The institutions supervised by those bodies are well documented and not repeated here.

Of perhaps greater significance is a view to the future whereby technology and other developments are spawning players in the financial services arena, which were hitherto un-thought of. Communications carriers, electronic systems and plastic card issuers all have the ability to become mainstream players in the area of financial services and payments systems.

The CFS is a very recent body, having been formed in 1992 following a recommendation by the 1991 Parliamentary Inquiry into Banking and Deregulation.

This Council is simply a co-ordinating body and brings together the heads of the main financial supervisory agencies, namely the RBA, ISC, ASC and AFIC.

The Council is not a statutory body nor is it a prudential supervisor or regulator. Its creation has not altered in any way the statutory responsilbilities and powers of its members.

In view of those severe restrictions, it is doubtful that there can be any heavy reliance placed upon the performance of the Council, as it lacks authority and accountability.

In the event of serious difficulties within one or a number of the finanical insitutions sectors, it is doubtful that the CFS will perform any other role than to observe and meet.

AFIC and its attendant SSA's represent a unique structure in financial supervision, as is the case with their subordinate institutions, being State based.

The existence of such a divergent State based system, from that applying to mainstream finanical institutions, creates inequities and distortions that ought not exist.

5.3 *Credit Union Supervision*

The current legislative and supervisory system governing credit unions (and building societies), the F.I. Code was developed in response to the collapse of the Pyramid Group and others. It is a complex system, involving all States and Territories.

The development of that legislation and its attendant supervision system (in the post Pyramid environment) resulted in regulation, not deregulation.

Examples in this regard to be found in the F.I. Code include:

- Service contracts require Supervisor approval.
- Prime Objects - Loans to members MUST comprise > 60% of assets.
- Commercial lending "capped" at 10% of assets.
- Registration required to trade interstate.
- Subscription to contingency funds mandatory.
- Compulsory subscription to a liquidity support scheme.
- Capital requirements in excess of bank requirements.
- Liquidity requirements almost double pre F.I. Code levels.

Credit unions had no case to answer in the wake of the Pyramid collapse, yet they were swept into the same regulatory regime, indeed, the very same piece of legislation as building societies.

Ironically, the structure of the supervisory system of the F.I. Code carries the major elements of the systems that were in place in developed credit union States (e.g: NSW, VIC, SA), involving a board/commission, onsite inspections and minimum prudential requirements.

The issues of regulation and supervision are intermingled and the terms are interchanged. The processes of regulation are scattered between AFIC on one hand and all of the States/Territories on the other. AFIC controls the operating Standards pursuant to the legislation, while the States/Territories control the legislation itself.

Not surprisingly, this national system of regulation and supervision lacks uniformity, with the SSA's of each State/Territory, evolving in their own way.

Amendments to the legislation essentially require the agreement of all States and Territories and to date, amendments are taking at least two (2) years to be achieved.

The legislation itself is very prescriptive and the Standards extend this level of detail. In short, there are serious shortcomings within the existing scheme of supervision which is out of step with the national perspectives and developments and has the potential to assign credit unions to the past.

6. *Supervision Options*

6.1 *Outline*

It is difficult to argue that like products should not be subject to the same regulation and supervision regimes.

Having said that, the process then entails identification of like products, for categorisation, in order to apply supervision.

Also, the many issues and interests in relation to financial institutions need to be considered, e.g.:

- Prudential quality
- Consumers rights
- Competition issues

- Disclosure requirements
- Shareholders
- Government

Addressing those interests creates difficulties in assembling an orderly and efficient system of supervision.

It is extremely doubtful if not impossible, for different supervisors to provide *".....a consistent regulatory framework for similar financial functions, products and services which are offered by differing types of institutions".* (Inquiry Terms of Reference 3(d))

We believe the recommendations from the Inquiry must:

- Provide for all existing financial institutions.

- Provide for evolving and future institutions which provide "financial" products.

- Propose a supervision regime, or regimes, that will apply a consistent regulatory framework for similar financial functions, products or services.

- Ensure there is a competitive and efficient environment for a variety of financial institutions which can provide choice, quality and competitive services for consumers.

On the question of *functional* or *institutional* supervision, the logic of supervision by function immediately appeals, as it could be uniform and capable of application to different or new service providers.

However, it could fail to address public policy issues in not adequately providing prudential supervision of the whole organisation and could produce a complex array of supervisors.

Institutional supervision perhaps achieves public policy issues in one sense, but could fail in others, due to its very nature.

On balance, it would appear that a combination is required (i.e. supervision <u>based</u> on primary function, and applied to the prudential standing of the whole organisation).

6.2 *Ancillary Regulation*

A plethora of ancillary regulation and agencies applies to financial institutions, which include Privacy, Credit and Trade Practices, to name but a few. The ancillary legislation needs to be identified and assessed in respect to its suitability and the basis under which it is applied.

6.3 *National Supervisory Body*

The major existing supervision agencies could be reshaped to produce a suitable supervision system, as they currently provide for the major elements which need to be addressed.

- <u>Expanded RBA Role</u>

  The RBA could expand its role and also supervise credit unions and building societies.

- <u>A DTI Supervisor</u>

  Bank supervision could be removed from the RBA and a new body established to supervise banks, credit unions and building societies ---- OR extend its role to take in the ISC functions as well.

- <u>ISC</u>

  Retain the ISC for the supervision of all other financial institutions, if banks, credit unions and building societies are supervised separately.

- <u>Incorporation under ASC</u>

  The ASC could provide for the incorporation of all financial institutions and disclosure requirements.

- <u>ACCC for Competition and Consumer Issues</u>

  The ACCC, as its name suggests, could maintain its competition review role and also administer all consumer/disclosure regulation.

Although the preceding scenarios package the major elements neatly, they could prove unwieldy and be ineffective/inefficient, given the breadth of issues, the number of and types of institutions involved.

On balance, a more precise separation may be necessary due to the preceding factors, which would produce in simplistic form, the following:

- A prudential supervisor for DTI's.

- A prudential supervisor for institutions providing investment-linked products.

- A competition regulator.

- A consumer and disclosure regulator.

With the issues involved in the question of an appropriate supervision model, the following matters should be considered:

- Few other countries in the OECD have a functionally based super watchdog. Such a system is academically neat, but most central bankers are wary of it.

- The Campbell Committee supported a functional approach to supervision.

- The concept of a super regulator was raised in the 1991 House of Representatives Inquiry (The Martin Inquiry). That report on banking and deregulation stated that the committee was not convinced that a mega-supervisor was necessary at that time but acknowledged there may be a need to re-examine the case at a later date, especially if the formation of conglomerates by merger or alliance continues. The Martin Inquiry further stated that the CFS (RBA, AFIC, ISC and ASC) could form the basis of a mega-supervisor.

- The ACCC is appropriately named to perform the competition and consumer protection roles. However, the conduct of such two diverse roles by the one body would be effectively difficult to perform.

7. *Other*

7.1 *Competitive Inequities*

The financial system in Australia is undergoing a revolution, with institutional boundaries eroding or blurring. New entrants are emerging, which do not fit the established institutional forms and therefore can compete unregulated or with limited regulation.

Examples in this regard include insurance companies providing mortgage loans, independent mortgage managers and plastic card/smart card companies/issuers.

Such organisations can, and are increasingly offering a full range of services, including transaction facilities, without similar prudential requirements which apply to other institutions.

Superannuation, because of both taxation advantages and compulsion is eroding the current and future available savings pool from which traditional deposits can be won. Fund Managers in various guises also compete in this area.

In short, the supervision processes in place today are being outpaced by market developments.

7.2 *Taxation Inequities*

<u>Income Taxation Treatment</u>

The varying degrees at which income tax is applied to earnings from various savings/investment instruments are the result of past social policy objectives influencing taxation policy. With the passage of time there can be limited arguments now in favour of the differing taxation rates applied to various forms of investment and savings.

The one exception in this regard is Superannuation, where an incentive is provided for people to contribute to their retirement phase. Concessional taxation treatment at the contribution phase is considered essential, whilst some measure of concession is also warranted at the point of redemption.

There appears to be an unduly harsh taxation regime applied to interest earnings on deposits. While Friendly Society Bonds and negative property gearing provide generous taxation concessions, the Coalition's pre-election commitment to a review (reduction) of the applicable tax rate on interest earnings is anticipated.

It is argued that there is a capacity, by re-aligning equitable taxation rates on all savings/investment options to in fact reduce the rate of taxation charged on interest earnings.

FID and BAD TAXES

Since the introduction of these two imposts, the rates at which they apply have only increased and at varying degrees, from State to State. Similar comments can be made regarding Stamp Duty imposed by the States on various financial transactions, such as loans.

Due to the erratic application of these taxes on essentially similar transactions, there are distortions occurring, allegedly due to the processing of funds outside of States with the higher rates and at an individual level, the imposition of a penalty when funds are moved from one account or institution to another.

Where such fees apply in transferring accounts from one financial institution to another, it can only be seen as an impediment to the community reacting to the benefits of competition. This aspect must surely be seen as the most unacceptable social consequence of these taxes.

7.3 *Other Inequities*

More significantly however is the very differing treatment by the States/Territories in other jurisdictions, such as Trustee Status, other general legislation provisions which discriminate against credit unions, Stamp Duty applications, State Credit legislation and various interstate registration requirements.

These issues can be particularly disruptive to any financial institutions which operate in more than one State. There are instances where such problems have been the reason for credit unions deciding not to operate in certain States.

7.4 *Technology and Innovation*

Technology is revolutionising the banking and finance industry in Australia and more change is to come. The impact is occurring through new products and services, delivery mechanisms, and new providers.

- The range of products and services now includes ATM's, EFTPOS and interactive voice response. In future, we will have stored value cards and electronic purses refillable over the telephone or through an ATM. These will slowly replace cash and cheques.

- The information highway holds out the prospect of interactive television with electronic banking capability. Office banking from home, perhaps using the Internet, is likely to become significant within a decade or so.

- Technology is globalising financial markets. This could force Australian institutions to compete internationally, on terms and conditions set in alien environments. Obtaining a home loan via the Internet or similar communication networks, funded by a foreign financier, may soon be a reality. Such networks (which have lower costs, limited or ineffective supervision and greater flexibility) are placed at a competitive advantage. The will probably be able to offer cheaper funds than are generally available in Australia.

In summary, Australian financial institutions could be seriously disadvantaged in the domestic market if they are tightly regulated and supervised, while international competitors are not.

It is essential that the authorities address the issue of technology and its future application in the area of financial services. This is to ensure that domestic institutions are not prevented from competing on equal terms with organisations outside the scope of Australian regulators.

Technology has broader ramifications on the domestic front alone and provides the opportunity for innovative and improved services and competition. These developments must not be retarded due to outmoded regulation and supervision practices.

7.5 *Consumer Protection*

There is a widespread hierarchy of industry-funded, government-supervised consumer protection codes. The range of controls is growing rapidly. The proliferation of product regulation adds to costs, with questionable value added for consumers. A cost/benefit analysis needs to be undertaken of the impact of these codes.

The financial system is at the point where facilities are being or will be withdrawn from certain consumers, as a result of intrusive regulation.

There is a strong case for the rationalisation of product regulation in Australia and a containment of its progress along sensible lines in future. The Deputy Governor of the RBA recently stated:

> *"I suspect there is room for some rationalisation in arrangements for product regulation. A large number of laws and agencies impinge in financial institutions in this area..... and an inquiry will almost certainly be able to identify avoidable costs and inefficiencies." (RBA Bulletin, 1996).*

The inquiry needs to subject the present grid of supervision to intense scrutiny in order to consolidate its level of intrusion and contain or reduce the costs, which are borne initially by financial institutions and ultimately by the consumers.

7.6 *Service Providers To Credit Unions*

Because of their nature, operations and generally small size, credit unions have collectively addressed many business structural and policy issues in co-operation with each other, through various types of service providers.

Appropriately, provision was made in the F.I. Code for these unique organisations which conduct many essential functions on behalf of credit unions. They facilitate particular services by credit unions which might not otherwise be possible, due to costs, economies or technology.

Although it is readily acknowledged that SSP's ought to be free from excessive risk, such a prescriptive formula for their operation appears to be unnecessarily rigid and limiting in its application.

Only when such organisations control a significant level of credit union funds should they be subjected to tight prudential controls.

There are no substantive reasons for these service providers to be uniquely incorporated as they are presently. It is the regulation and supervision that should only be of concern to the supervisory regime.

The options in relation to the incorporation of SSP's range from the present restrictive structure through to normal company registration, with memorandum and articles as determined by the owner credit unions.

Irrespective of changes that may occur in the regulation and supervision of credit unions, provision for the operation of this type of organisation must be provided for.