# AUSTRALIAN UNITY FRIENDLY SOCIETY

A.R.B.N. 061 837 698

# SUBMISSION TO THE

# FINANCIAL SYSTEM INQUIRY

9 September 1996

Australian Unity Friendly Society. 114 Albert Road, South Melbourne 3205.

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Australian Unity

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**CHIEF EXECUTIVE'S OFFICE**

9 September 1996

Mr SDM Wallis, AO
Chairman
Financial System Inquiry
Treasury Building
Parkes Place
CANBERRA ACT 2600

Dear Mr Wallis

Attached is Australian Unity Friendly Society's submission to the Financial System Inquiry.

In preparing this submission have focused only those matters which critically affect our operations and our members. We may submit a further submission dealing with additional matters in response to the Discussion Paper which the Inquiry intends to release later this year. We would also be pleased to provide the Inquiry with any additional information which may be of assistance (for example, we have specific knowledge about recent developments in friendly society regulation in the UK).

Enquiries can be directed to the people listed below:

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We wish the Inquiry well in its deliberations and look forward to the Discussion Paper.

Yours sincerely

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M W Sibree
(Managing Director)

## EXECUTIVE SUMMARY

### Introduction

Australian Unity Friendly Society welcomes the opportunity provided by this Inquiry to review the present system by which our operations are regulated, and to outline proposals which would increase the efficiency of the financial system and improve consumer benefits.

Like all friendly societies, Australian Unity has a benefit fund structure which ensures exacting standards of internal prudential management, and a close and fraternal (rather than strictly commercial) relationship with its members. These special characteristics make friendly societies unique among financial service providers - a matter which regulators have occasionally found difficult to appreciate and comprehend.

In common with other mutual organisations, friendly societies are non-profit member-owned organisations established by individuals to provide for their common needs and welfare. This relationship is very different from that in profit-driven commercial bodies. Although we are non-profit, Australian Unity aims to create ongoing surpluses for reinvestment in improved benefits and services to our members.

Australian Unity was formed in 1993 as the result of the merger of two of the largest Victorian friendly societies - Manchester Unity, established in 1840, and the Australian Natives' Association (ANA) established in 1871. This merger reflected both organisations' belief that there would be significant benefit to their members by capturing increased operational efficiency and combining resources.

The Australian Unity Friendly Society Group is a medium sized financial conglomerate with over 200,000 members and $1.0 billion in Group assets. The benefits and services provided to members cover a diverse range of financial services markets, either directly or through subsidiary incorporated companies.

These include life insurance, general insurance, superannuation products such as ADFs, health insurance, building society products including home loans, funds management, investment bonds, unit trusts and other savings vehicles, funeral bonds and benefits, sickness and disability benefits. We provide pharmacy and dental services to members, and also own and manage retirement villages which include nursing home and hostel beds.

Staff numbers (just over 500) and administrative overheads are low relative to assets and services provided, and we make extensive use of technology to achieve operational efficiencies. In addition to head office we operate through 78 retail sales centres and shop front agencies in metropolitan and country Victoria, have interstate offices in South Australia, Queensland and New South Wales.

### Present regulation

Friendly societies are the only significant sector of financial services providers still operating under State jurisdictions (as of the date of this submission).

It is now expected that friendly societies will join building societies and credit unions in the Financial Institutions (FI) Scheme from 1 January 1997, but this depends on State and Territory Parliaments passing the necessary legislation (not yet finalised) this year.

In many key areas of our operations Australian Unity needs to deal with both the Victorian Financial Institutions Commission (VicFIC) and the relevant Federal regulator - usually either the Insurance and Superannuation Commission or the Australian Securities Commission. Health insurance involves VicFIC, the Commonwealth Department of Health and Family Services, and the Private Health Insurance Administration Council. Other areas of our business involve different Federal agencies in addition to VicFIC.

These dual jurisdictions generally apply for both prudential and product regulation.

**Assessment of present regulation**

While moving to the FI Scheme will be a less restrictive and prescriptive approach for friendly societies, this will still be a less than perfect regulatory environment.

The FI Scheme is fundamentally flawed. It is responsible to no single political authority and the important decisions of the AFIC Board (which have the force of law) are not generally reviewable. It is an expensive, inflexible and inconsistent system of regulation. Its approach is heavily prescriptive and interventionist, in a manner which is inappropriate for friendly societies given the exacting prudential controls which derive from our fundamental organisational structure.

In an increasingly global financial system there is no rationale for locking certain financial institutions in State jurisdictions, thus limiting their capacity to operate efficiently on an interstate and national basis.

Differential regulation also means that similar functions attract different standards of regulation and varying costs; like products offered by different institutions will vary in cost due to regulatory "expenses" built into the pricing structure; different institutions will have greater or less freedom to pursue the same commercial ambitions; and customers lose through higher costs, restricted choice and less innovative products.

**Options for the future**

*Australian Unity believes that the establishment of a single, national regulatory system by the Australian Parliament, and the secure location of friendly societies within this national system, is the most necessary reform in the financial system.*

We are less concerned about the actual shape of this national system - but believe the most effective system will be that with fewest regulators.

The principal objective of prudential regulation should be to ensure competitively neutral outcomes for *consumers*, not necessarily for institutions. We believe there is a case for some trade-off between the degree of prudential supervision and the complexity of disclosure requirements.

Prudential standards should be related to functional risk, and weighted taking into account the totality of internal controls and external supervision which underpin the security of individual products and functions. This is relatively easy in the case of friendly societies as each benefit fund is separately recorded in our accounts.

*Australian Unity does not see a compelling need for a distinct 'consumer' regulator which would monitor products and mediate consumer issues (including disclosure, fees and complaints).*

There are effective controls and remedies already available through a plethora of bodies including the ACCC, ISC, the Private Health Insurance Complaints Commissioner and the ASC. Australian Unity's disclosure practices are superior to those required and we experience no significant level of customer dissatisfaction.

We would prefer to see consumer issues dealt with under industry codes of practice and relevant legislation. If there is to be a consumer regulator, we would refer the Inquiry to the UK model of practitioner-based self-regulating organisations (SROs).

Competition issues, in our view, should be left to the Australian Competition and Consumer Commission - with an appropriate provision for the Treasurer to "call in" any matter with national significance.

All regulators should be required to produce an annual Regulatory Plan, and a Regulatory Impact Statement should accompany any new proposed regulation.

## Commercial impacts

The present regulatory structure is a substantial impediment to our commercial ambitions and imposes unnecessary costs and restrictions. *However, by far the greatest impact on our business over the last decade has come from government policies in health, retirement incomes and taxation.*

In particular, health insurance has suffered a dramatic fall in membership and higher costs; compulsory superannuation has seen a fall in non-superannuation retirement savings; and changes to the tax and social security treatment, for example the extended deeming rules, have undermined the competitiveness of key investment products and fuelled a climate of personal investment uncertainty.

## SUMMARY OF RECOMMENDATIONS

1. A single national framework for the regulation of the financial services industry should be established by the Australian Parliament. Friendly societies should be brought under this national framework at the earliest opportunity, in place of the present cooperative approach through the Financial Institutions (FI) Scheme. There is a number of different proposals for the specific structure of regulators within this national framework which would satisfy this objective.

2. There should be a fair and competitively neutral means of financing the regulatory and supervisory framework.

3. There should continue to be substantial government funding for regulation of the financial services industry, given the fact that all taxpayers have an intimate interest in the security and stability of the financial system.

4. To the extent that government considers that financial system regulation needs to be financed by contributions from the industry, then:

   - industry contributions should be remitted to one agency, which would have responsibility for allocating this global contribution to fund the various regulators, division or bodies established for different purposes;
   - individual institutions should contribute to the cost of supervision in proportion to their assets (special attention will need to be given to the appropriate treatment for this purpose of off balance sheet assets such as managed funds);
   - the level of contribution required by individual institutions should be reviewed at least annually to reflect changes in the proportional spread of assets within the financial system.

5. The principal purpose of prudential supervision should be to ensure competitively neutral outcomes for consumers. This does not necessarily mean that prudential requirements should be competitively neutral between institutions, but that there should be some trade-off between prudential supervision and the level and complexity of disclosure requirements.

6. There is no need for a new and distinct consumer regulator. Consumer issues should continue to be dealt with under industry codes of practice, relevant legislation and existing powers presently vested with the ACCC, ISC, ASC and other bodies (such as the Private Health Insurance Complaints Commissioner). If the Inquiry decides, on balance, that a consumer regulator is required, then the UK model of self-regulating organisations should be considered.

7. Competition policy should be left to the Australian Competition and Consumer Commission (ACCC).

8. There should be open competition in product markets subject to any new entrant:

(a) satisfying the same prudential standards as existing market competitors;
(b) establishing, where required, appropriate corporate structures for new activities, for example, incorporated subsidiaries;
(c) maintaining adequate additional cover under any depositor or investor protection requirements; and
(d) observing the rules set down for marketing, consumer protection [including disclosure] and professional standards.

9. FSI mergers should be subject to the same principles as apply to other sections of the economy under the Trade Practices Act, with the Treasurer retaining a power to "call in" any issue carried national implications. Within this policy framework:

- the "dominance" test should replace the present "substantial lessening of competition" test, which has proven unduly restrictive;
- the correct market for assessing dominance should be the national FSI, but the ACCC should also be required to take into account any effect that a merger would have in establishing undue dominance in any State or regional market or within a particular family of products or institutions;
- there should not be a mandatory requirement for institutions to change their name once they are taken over by another institution, although this is an area where the ACCC could exercise a discretionary power.

10. The financial services industry regulator(s) should be required to produce a regulatory plan on an annual basis as a means of ensuring accountability to consumers, the industry and to Parliament.

11. A detailed Regulatory Impact Statement should be required to accompany every proposal for new or modified legislation or regulation. This should consider the financial impact and administrative implications of the proposal, together with an assessment of the costs and benefits for consumers and the efficiency of the industry.

12. There should be genuine uniformity in State transaction taxes. To this extent a central agency should be responsible for the administration and collection of FID, debit tax and Stamp Duty levied on financial services institutions, returning the proceeds (net of any costs) to the relevant State or Territory government.

13. Consumer Credit legislation should be nationally-based, uniformly administrated and consistently applied. If necessary, there should be a voluntary transfer of powers to the Commonwealth by the States and Territories.

14. Privacy and data collection law should be created, controlled and administered by the Commonwealth as it affects financial institutions. If necessary, there should be a voluntary transfer of power to the Commonwealth by the States and Territories.

15. The Government should establish a separate Inquiry into retirement incomes policy and other issues affecting personal financial planning, in order to address the continuing decline in voluntary saving. This Inquiry should consider these

issues from the viewpoint of the independent-minded citizen, and examine the effect that current and proposed policies have in practice, rather than merely in theory or according to economic "models".

16. A Cabinet-level Minister for Retirement Incomes should be appointed.

**CONTENTS**

# 1. FRIENDLY SOCIETIES : MEETING CUSTOMERS' NEEDS

Due to their unique structure and governance, friendly societies are closer to the customer than virtually any other financial institution. Friendly societies are formed "of their members, by their members, and for their members". They are the original retail financial services corporation.

Until recently, government inquiries and some in the regulatory world overlooked the role and significance of friendly societies in the contemporary financial system. Indeed, some believed that the traditional mutual structure of friendly societies could not adapt to the more competitive marketplace of the 1980s and 1990s, and that they were 'minnows' to be 'swallowed up' by larger conglomerates.

Friendly societies have instead survived and prospered by offering improved products and services to their members and customers, and by maximising the commercial advantage derived from our not-for-profit, collective membership structure.

Current policy and regulatory debate overseas is sanctioning a broadening of the powers of friendly societies, and re-examining their potential in the context of social security changes which encourage greater self-provision and enhanced private responsibility.

## 1.1 Friendly societies: looking after their members' mutual welfare

Friendly societies are an old but not old-fashioned form of not-for-profit member-owned collective organisation, voluntarily established by groups of individuals sharing a common bond, need or outlook in order to provide for their mutual welfare. The oldest friendly societies in England are believed to pre-date the Norman Invasion; the friendly society "movement" received legislative attention as early as 1793. The first friendly society was established in New South Wales in 1830 [the Shipwrights' United Friends Benefit Society].

The two friendly societies which merged to form Australian Unity in 1993 are among Australia's oldest. Manchester Unity was established in 1840, and the Australian Natives' Association (ANA) was founded in 1871.

The early friendly societies, both in Britain and in "the colonies", concerned themselves with providing temporary relief and assistance to members in times of distress (sickness, unemployment, disability); financial assistance in old age; care during infirmity; and funeral expenses upon death. Education, medical care and other services were added to friendly societies' menu of member benefits from the second half of the Nineteenth Century. Many of the early societies also had religious or 'good character' purposes.

Friendly societies enjoyed enormous popularity in the times before government accepted broad social responsibilities.

Many friendly societies were formed by trade unions and other professional groups of workers, to ensure support for their families in times of trouble - not unlike today's social welfare "safety net".

Friendly societies also held a prominent place in the community life of early Australia, organising a range of social activities for their members and engaging in the key political debates of the time.

The Australian Natives' Association was a chief advocate for Federation, and many of its more prominent members played an active role in the Conventions. The ANA membership provided much of the on-the-ground campaign resources during the referendum campaign in 1898. Edmund Barton, Isaac Isaacs and Alfred Deakin were ANA activists, as were many prominent 'nation-building' politicians in State and Federal Parliaments through to the middle of the Twentieth Century.

According to an academic study of the role of friendly societies in Australia, before the First World War more than half of the population in Victoria, South Australia and Tasmania, 40 per cent of New South Wales' population, and between a quarter and a third of the population in Queensland and Western Australia were directly benefitting from friendly society services.

The expansion of the "welfare state" since the Second World War has removed a large part of the original compelling motivation for membership of a friendly society. In assuming responsibility for 'social insurance' including pensions and benefits for unemployment and sickness, government has required friendly societies to find new lines of business - while retaining their traditional commitment to mutual aid and the special relationship with their members.

The larger friendly societies have become broad financial services companies, offering their members a wide range of insurance and investment products in addition to traditional endowments and "supplementary" social insurance for health, sickness, disability and funeral expenses.

The recent retreat of governments from universal, comprehensive welfare entitlement, towards shared responsibility and the encouragement of self-provision, has the potential to create new opportunities for friendly societies. These opportunities have been extensively explored in the UK, where they are seen as 'a new lease of life' for both a troubled and financial stretched welfare State and for the friendly society movement.

### 1.2 The contemporary objectives of friendly societies

Friendly societies are very straightforward entities, with internal structures based on simple precepts which have proven to be very resilient and prudentially sound in the face of variations in commercial fashions and many turns of the economic wheel.

These internal structures today support successful commercial activities as varied as funds management and retail pharmacy. This variety of businesses has occasionally led to the conclusion that friendly societies are structurally complex, but the reverse in the case, as is appropriate for commercial entities with a community focus.

The contemporary objectives of a friendly society are to:

- provide health and welfare benefits, services and facilities for members or their dependants including but not limited to hospital, medical, dental, pharmaceutical, optical and physiotherapy benefits;

- provide benefits, services and facilities for the relief and maintenance of members or their dependants in the case of death, sickness, disability, accident, retirement, old age and unemployment;

- provide services and benefits for the education of members or their dependants;

- provide annuities and superannuation benefits for members or their dependants;

- sell or supply medical requisites and dispense or sell medicines to members of the public generally;

- provide any other benefit, service or facility to look after the personal and financial welfare of its members.

Many friendly societies today offer certain wholesale investment services (including superannuation), act as a trustee for deceased estates of members and of matured policy proceeds, and conduct retirement village operations. Some conduct life insurance business.

In addition to the provision of benefits, friendly societies may provide services to members through the management fund or a subsidiary incorporated under the Corporations Law. The services may be of a non-profit or fraternal nature.

### 1.3 How a friendly society differs from other financial institutions.

*The defining characteristic of a friendly society is the establishment and administration of separate benefit funds for each class of benefit offered to its members.*

The assets of each benefit fund are kept distinct and separate from the friendly society's other assets, and cannot generally be used to meet the liabilities or expenses of the friendly society, other than those directly referable to the particular class of benefit or policy supported by the assets of that benefit fund.

Members' rights arise in contract law, rather than trust law (as is the case with superannuation funds).

The members' contractual interest (and the friendly society's liability) is effectively "secured" by the assets of a particular benefit fund -- and directors assume special "trustee-type" duties to ensure the quarantining of the assets of benefit funds.

The friendly society's rules, as approved from time to time by vote of the members or directors, have effect as a contract between members and between members and the friendly society.

Whilst the activities undertaken by friendly societies are diverse, the central administration and infrastructure of a friendly society is undertaken by its management fund. The management fund is financed by a management fee levied on benefit funds, and by earnings derived from other commercial activities undertaken by the management fund. Surpluses in benefit funds are returned to the members as bonuses.

In contrast to life companies, in almost all cases the benefit funds of friendly societies contain monies from only one class of business and clearly separate management monies from those of members (consumers). Management funds are recorded separately.

The measures undertaken by friendly societies to ensure separation of assets is extensive. Benefit fund assets are separated in the bookkeeping of the society - including accounts, systems and records (including banking records) and, most importantly, notations on the indicia of title to fund investments. This ensures that the determination of each fund's financial status at any particular time is a simple matter of accounting.

The annual accounts of a friendly society thus clearly disclose to members the performance of individual products and the reserves of the whole entity in its management fund.

This is in sharp contrast to the confusion of the annual accounts of a life company. Few value judgments by actuaries are required to determine the ongoing profitability of a friendly society; regular monthly profitability is thus simply determined without the need for such expert assistance. Life companies are not well placed to do this - notwithstanding the introduction of 'margin on service' accounting, which appears to be less precise.

Although friendly societies offer products which are similar to unit trusts offered by fund managers registered under the Corporations Law, friendly societies meet demanding prudential standards, are subject to extensive supervision, and also meet disclosure standards equivalent to the ASC regime. This contrasts with most Corporations Law unit trusts which are simply required to meet disclosure rules.

While friendly societies have in recent years adopted more 'corporate' practices in governance and management, Directors and senior management continue to face regular election by the members based on "one member one vote".

# 2. BARRIERS TO IMPROVED BENEFITS FOR CUSTOMERS

## 2.1 Introduction

Following the floating of the dollar and the removal of exchange rate controls in December 1983, the entry of foreign banks and lifting of most of the remaining restrictions on interest rates in 1985, it was possible for the then Governor of the Reserve Bank to claim that Australia had "a virtually fully-deregulated financial system".

It is doubtful whether home owners or home loan applicants then still facing the additional costs of 'cocktail loans' or rationing of finance resulting from the 13.5% interest rate ceiling on housing loans would have agreed with this assessment. (This restriction was finally lifted by Treasurer Keating in 1986 under intense political pressure from the Government's backbench.)

Similarly, financial institutions who were not invited to the deregulation party - in some cases, despite recommendations from Campbell - have experienced a decade of mixed benefit. While in most cases they indirectly benefited from the gains in efficiency and competitiveness driven by the changes in the banking system, they generally also came under tighter supervision and had to live with more complex and costly regulation.

Some of this regulation was necessary and essential to ensure proper prudential management in the financial system. Some of it could be regarded as an over-reaction to the excesses of the mid-to-late 1980s by some institutions. Some of it was a genuine attempt to close gates in regulatory fences, usually after the horse had bolted. Reforms to consumer protection laws attempted to "even up" the balance of rights and obligations, especially in the provision of information, but may have tipped the scales further than what consumers reasonably expect. [Certainly in the UK regulators are now actively adopting steps to simplify the regulatory framework and lift the burden of compliance on smaller players.]

It would be fair to say that Australia's financial system in 1996 is trying to satisfy a number of masters, none perfectly. The major banks want to "grow globally and dominate locally"; indeed, they want freedom to expand into superannuation, to purchase attractive regional banks, and to fight off new competition in the home loan market. The major life offices want to be banks in all but name, ownership and structure. The major super funds want to offer a broader product mix, beginning with home loan securitisation via mortgage originators. The regional banks want to be bigger banks. The large building societies that haven't already become banks want to be treated like banks. New entrants, surfing the wave of technology, are emerging as "virtual banks".

There is mounting evidence that the existing division of responsibilities, based on institutional form, is no longer producing the best outcome for consumers or for the efficiency of the financial system.

Almost a century after Federation, key sections of the financial system remain regulated by States rather than as a national market increasingly subject to global competition. Present regulatory structures reflect the historical development of different institutional forms, constitutional powers and political tastes. It is a ramshackle structure neither suitable nor sustainable into the future.

The present financial system structure inhibits consumer choice by restricting the diversity of products that can be offered by different institutions; and imposes unnecessary costs on institutions which, ultimately, are passed onto customers by way of higher charges or lower returns.

## 2.2 Australians and the competition ethic

Australians appear to have warmly embraced the ethic of competition in many vital industries, especially in the services sector where telecommunications, package and courier delivery and financial services are subject to intense and aggressive battles between rival suppliers and have delivered tangible benefits to consumers.

The community appears less welcoming of competition where it is seen to result in (a) the loss of significant local employment (b) the loss of or reduction in access to vital community services, (c) the wholesale displacement of manufacturing 'sectors' by imported goods, (d) declining quality of service due to the withdrawal of community service obligations, cross-subsidies or other "uneconomic" activities, and/or (e) the achievement of "obscenely large" profit results accompanied by steep rises in senior executive remuneration and other signs of corporate largesse.

In this respect, the competition ethic has two important implications for public policy and for the level of community acceptance of future reform.

First, there is considerable reason to believe that wide sections of the community are still reserving judgment about the overall effect of deregulation and competition in the financial industry.

The positive benefits in terms of wider access to electronic banking and new products such as low-start home loans are not widely understood as effects of deregulation. The technology for remote banking was available and would probably have been introduced in any event. While more flexible options in home and other loans are correctly seen as a response to competition (but not necessarily deregulation), they are seen by many as adding to the overall confusion and clutter in the marketplace; the prevailing air of cynicism also leads some to conclude that such loans cost more in the long term.

On the other hand there are many less positive developments which have attracted wide and usually negative publicity.

Secondly, there remain a number of substantive regulatory barriers which have prevented the full benefits of open competition flowing to the economy and the community. The most important priority is to encourage and facilitate more open competition between financial industry sectors.

At the moment there is a degree of "ring fencing" between different institutional types, sometimes based on organisational structure, but usually based on dominant (or prime) business.

The overall effect is that there is effective competition within each "vertical" industry type - for example, superannuation - but less effective (and sometimes little) competition between industry sectors.

### 2.3 Lack of a national regulatory framework

Although they manage $9.7 billion of assets and provide services and products to 1,200,000 Australians, friendly societies have in recent times been treated as the "Cinderella" of the financial services industry.

Friendly societies rated one 'throw-away' mention in the 1981 Campbell Report [para 5.138] and were not considered at all by the Martin Committee in 1991.

They continue to be regulated under State legislation and are subject to the nuances of different emphases and priorities in different States, despite the best intentions of the Special Premiers' Conference in May 1991 which decided to implement a uniform Financial Institutions (FI) Code. [The *Financial Corporations Act 1974* had provided for direct Commonwealth regulation of NBFIs, but this power was never proclaimed and the effect of the Act was limited to the collection of statistics].

The establishment of the Australian Financial Institutions Commission (AFIC) in 1992 raised some hope that a genuine and national cooperative system would replace the existing State-based means of regulating building societies, credit unions and friendly societies - and that the FI Scheme would be suitable for the longer term. Experience has proven this optimism misfounded.

There have, of course, been improvements for the State-based financial institutions arising from the AFIC cooperative approach for building societies and credit unions. We understand that, despite these improvements, both the Australian Association of Permanent Building Societies (AAPBS) and the Australian Federation of Credit Unions Limited (AFCUL) have expressed substantial disappointment with AFIC and seek to migrate to a national regulatory scheme.

Four years after the establishment of AFIC, friendly societies have still not been brought within the overall FI scheme framework.

Proposed legislation establishing the cooperative basis for supervising friendly societies has not yet been finalised, nor have all of the appropriate uniform standards been drafted for the industry and legislators to consider. The Implementation Task Force

(ITF) was provided with the industry's recommendations for Proposed Legislation in August 1994, but the legislation has not yet appeared as at September 1996.

The latest schedule indicates that the enabling legislation for friendly societies to be brought within the FI Scheme will be introduced into and possibly passed by the State and Territory Parliaments this year, so that we might operate under the FI Code from 1 January 1997.

As at the date of this submission, friendly societies continue to operate under the relevant State legislation which, in all cases, pre-dates the establishment of the cooperative approach. Australian Unity Friendly Society is currently regulated by the Victorian *Friendly Societies Act 1986*.

This State-based approach creates substantial difficulties for friendly societies:

- It is an historical abstraction which inhibits interstate trade, reduces efficiency and complicates life for those friendly societies which have national ambitions. In particular it prevents interstate expansion through the establishment of new branches or by merger. It is not impossible to operate interstate - Australian Unity is registered as a "foreign" friendly society in NSW and operations in other States are not required to be registered - but it reduces efficiency by duplicating reporting requirements and limiting competitive market access. [It is useful to recall that many friendly societies used to operate branches in different States and their members would meet as a "national organisation", especially the ANA].

- It unnecessarily inhibits competition between friendly societies, let alone competition between friendly societies and other financial institutions on a national basis. This is completely out of step with every other sector of the financial services industry.

- There is considerable variation in the regulatory environment affecting friendly societies in each State including the degree of consultation with government, the extent of supervisory "intrusion" into commercial decisions, and the complexity of requirements affecting investment decisions, corporate governance, accounting standards and audit.

- The limitations of State markets inhibit the development of more innovative products which, although viable in a national market, would not be sustainable on the smaller population of State boundaries.

- Each State has its own policy, legal and information processing resources - frequently with different formats and systems.

Even when the legislation is passed to finally bring friendly societies within the AFIC framework, the cooperative nature of the scheme and some unique characteristics of the FI Scheme make this a 'less than perfect' arrangement.

- Many of the difficulties encountered with the separate State regimes will not be resolved simply by adding a further "policy" layer (the AFIC Board) while leaving interpretation and enforcement to the States.

- The industry will still be contributing funds to support eight State and Territory bodies as well as the central Commission, thus incurring a substantially higher cost than financial institutions supervised by other regulators.

- There will still be the overwhelming difficulty of achieving legislative change where the agreement of all of the States and Territories is required.

- There will still be different action times and response times between the various State regulators.

- 80 percent of total friendly society assets are held in Victorian friendly societies. Yet AFIC is located in Queensland, where only 3 percent of friendly society assets are based.

- The FI Scheme approach is generally more prescriptive and onerous than those adopted by other financial system regulators, which undermines the principle of competitive neutrality. For example, building societies are still subject to the prime purpose clauses which requires a minimum 50 percent of loans to be directed to housing finance; by comparison, the RBA imposes no restrictions on banks' core business or primary objects, or on shares which they can issue.

- There is inadequate systemic protection for customers. As noted by the AAPBS, there is no provision under the FI Scheme that depositors rank ahead of creditors if a society is wound up. The industry-based Emergency Liquidity Support Scheme is a less than satisfactory alternative to the role of the Reserve Bank as a de facto lender of last resort to the banking industry (although in the case of friendly societies it could be argued that the risk of failure is substantially lower due to the structural principle of the benefit fund).

- Perhaps the most serious deficiency of the FI Scheme is that it lacks political and public accountability.

  AFIC has an appointed Board which is responsible to nobody for its supervisory activities. It is not responsible to the Ministerial Council which appoints it. Although it is charged with the development and implementation of significant public policy issues, the Board is not responsible to any single political authority. As such it is not subject to the normal disciplines of Ministerial responsibility. This means that a State Minister could potentially be held accountable for the collapse of a financial institution technically under his or her portfolio responsibility without a means of intervening effectively to prevent such an event.
  It has also meant that no single Minister accepts a responsibility to act on representations from industry to 'drive' the decision-making process for necessary amendments to the legislation. This has caused unending delays in implementing amending legislation since the inception of the FI Scheme.

With limited exceptions, the Board's decisions are also non-reviewable - even by the Appeals Tribunal established under the FI Scheme.

This has the bizarre consequence that the AFIC Board will draft the initial standards for friendly societies, which will apply from the date that friendly societies operate under the FI Scheme (expected to be 1 January 1997).

At present there is no practical review mechanism for these standards apart from a period of public exposure. Indeed, the AFIC Code provides that a standard can be validly made even if it fails to comply with the required exposure period.

Friendly societies have consistently argued that AFIC needs to be accountable to the political process and that Board decisions should be reviewable as a general right.

Finally, while there are perceived commercial advantages from national regulation, it is logical to expect a continued flight from the State-based system wherever possible (eg., by converting from a building society to a bank). This will place an ever-heavier financing burden on those institutions which remain subject to the State regulator.

The current arrangements, and the FI Code, are excessively onerous and restrict Australian Unity's capacity to grow and to offer new, more innovative products.

With the higher end of the financial market increasingly global in scale and operations, there is no justification for locking smaller and more 'community-minded' institutions in the historical time-warp of State borders.

### 2.4 Discriminatory Costs

Almost alone among the financial system regulators, the FI Scheme is expected to recover its costs from industry levies. Each institution is required to contribute a sum based on the size of its assets.

In practice this imposes a discriminatory revenue model and cost disadvantage on the State-regulated institutions. Costs are higher than could otherwise be the case due to duplication of effort and resources between the States and Territories.

Significant variations in the financing requirement for the FI Scheme between States seem to bear little relation to population or the total asset base of regulated institutions in each jurisdiction.

A few comparative figures may illustrate these points:

- It has been estimated that the total cost of the FI Scheme, supervising institutions with an asset base of about $35 billion, is almost two-thirds the total cost of Reserve Bank supervision of banks, with an asset base of close to $450 billion.

- Supervision by the Reserve Bank has traditionally been at zero cost for the banks, although there is now an implied "bank levy" retained by the RBA due to the payment of an interest rate on NCDs of 5 percentage points below the 13 week Treasury Note yield. However, this is not intended as a measure to recover, nor related to, any proportion of direct supervisory costs.

- The Insurance and Superannuation Commission funds its supervisory activities by a charge on subject institutions which is substantially less than the contributions required by the FI Scheme. Life offices and general insurers are charged a flat rate of $70,000 and $16,300 per institution, irrespective of size [1995-96 figures]. Superannuation funds pay a levy of $200 per $500m of assets, to a cap of $14,000 per fund.

  *By contrast, Australian Unity Friendly Society's levies to VicFIC in 1996/97 are $253,000 on assets of slightly more than $1,000 million. Our building society subsidiary separately contributes to VicFIC at the rate of $60,000 p.a. and a further $13,000 p.a. to AFIC.*

  *Total Group payments to AFIC and VicFIC are thus in excess of $300,000 p.a. Total compliance costs in dealing with these regulators are also of a similar order.*

  Further operating costs are expected to be charged to friendly societies when they are brought under the AFIC regime.

  These will be in addition to AFIC establishment costs of at least an additional $400,000, incurred since 1992, will we understand are also to be recovered from friendly societies.

  It is doubtful whether the public perceives the Australian Unity group as any more secure as a consequence of these payments.

Differential modes of levying industry contributions and vast differences in the cost of supervision between the regulators are a severe impediment to institutions in the FI Scheme.

Ultimately, of course, the cost of regulation is borne by customers - either in higher fees and charges or lower rates of return.

*The above supervisory levies are clearly outrageous in comparison with other regimes.* They are the product of State governments failing to recognise their on-going responsibility for NBFIs.

Irrespective of the final conclusions the Inquiry might draw about the shape of the national regulatory framework, it seems clear that a fairer and more competitively neutral means of financing the supervisory network needs to be developed.

## 2.5 Structural impediments and governance

The defining characteristic of friendly societies is their unique structure, which is a competitive strength and represents security and stability for customers. Yet in other ways our competitiveness is restricted by current regulations which are outdated, unduly intrusive and reflect a lack of appreciation of the professionalism of friendly society governance and management.

The fundamental structure of friendly societies - based on separate benefit funds for each class of benefit - imposes an unavoidable and necessary obligation on friendly societies to quarantine each fund's assets and liabilities. By law, monies once placed into these "steel-walled containers" cannot be used to subsidise the activities of other parts of the friendly society.

Australian Unity sees the benefit fund structure as a major source of competitive advantage among customers who place a premium on security, stability and accountability. This fund separation allows a line-item report annually on the state of each benefit fund, printed in our Annual Report for all to see.

This is a highly transparent and simple way for our customers to monitor performance of each individual benefit or product. People know that their investment in a friendly society fund is secure from the ups and downs in other funds, or in other commercial areas of the organisation.

This imposes a conservative discipline on investment undertaken on behalf of our funds. We believe that is appropriate for a financial institution which seeks to promote security for our customers and provides a number of capital guaranteed products.

On the other hand, there are a number of 'structural' limitations imposed by the present State regulation which are unnecessary and restrictive. While many of these will be relaxed when friendly societies finally are brought within the FI Scheme, they remain in force as at the date of this submission:

- Existing legislation exhaustively lists the ways that friendly societies can invest their funds. Friendly societies can only undertake investments from the legislatively prescribed list to the extent that they are authorised by registered rules.

- Restricted equity investments and share ownership for subsidiary holdings purposes were introduced in the late 1980s, together with discretionary investment approvals. In practice, however, these did not result in significant expansion of the "authorised trustee" and "fixed interest" type portfolios of friendly societies.

- Under the existing VicFIC guidelines, a friendly society can only invest up to 50 percent of a benefit fund portfolio in listed shares of companies with a proven and consistent dividend history.

- There are also certain restrictions on the investment of shares for the purposes of a friendly society owning or controlling a subsidiary company.

- The appointed actuary to each friendly society has a somewhat larger role than is appropriate and we understand this role is likely to be increased under the FI Scheme.

  In Australian Unity's view, actuarial involvement is required only for the assessment of risk where this cannot be simply determined by ordinary accounting means.

  Continued reliance on actuarial services where unnecessary is a product of regulatory authorities adopting a "belt and braces" approach where the actuary becomes another arm of the regulator at further expense to the "client" institution and its customers.

There are also restrictive requirements which impact on appointment of directors and other critical issues of corporate governance.

- For example, alone among the States the Victorian legislation requires friendly society directors to be licensed.

  The criteria which applicants must satisfy include "good fame, character and experience" tests, which have been well entrenched for licensing in security and credit industry legislation for many years.

  We understand that the licensing requirement will be dispensed with in the FI Scheme regulations for friendly societies.

- In addition, present regulations allow the appointment of only one Executive Director to the Board of the friendly society.

  For a period following the merger of Manchester Unity and ANA, Australian Unity needed special dispensation from VicFIC to permit both chief executives of the merged societies to sit on the Board of the new entity.

Australian Unity believes that the rules relating to corporate governance of friendly societies need to be more attuned to the commercial realities facing financial conglomerates in highly competitive, cost-sensitive markets.

## 2.6 Prudential high-jumps

In many ways Australian Unity is a medium scale financial conglomerate. While somewhat smaller than those which normally gain the critical attention of policy-makers and regulators, we have substantial operations across varied financial services markets including:

- life insurance
- general insurance

- superannuation
- health insurance
- building society activities including deposit-taking and housing finance
- investment bonds, unit trusts and other vehicles
- funds management.

Australian Unity is subject to prudential supervision by a multitude of regulators. We consequently have first-hand experience of the difficulties caused by duplication of functions and variations in prudential standards based on institutional classification.

*Australian Unity Group Indicators*

| | |
|---|---|
| Friendly Society Investment Products | $800m |
| Unit Trust Products | $ 40m |
| Health Insurance Fund Turnover | $150m p.a. |
| Building Society Assets | $140m |
| General Insurance Premiums | $ 10m p.a. |
| Retirement Village Residents | 500 |
| Pharmacies | 9 shops |

At present Australian Unity's key commercial activities are regulated by:

- Insurance and Superannuation Commission (ISC)
- Australian Securities Commission (ASC)
- Australian Financial Institutions Commission (AFIC) [Building society]
- Victorian Financial Institutions Commission (VicFIC)
- Commonwealth Department of Health & Family Services (CHFS)
- Private Health Insurance Administration Council (PHIAC)

Other areas of our business (eg., retirement villages, pharmacies) involve other regulatory bodies at the State and Federal level.

It might be noted that in most cases we are required to undertake detailed negotiation with both Victorian and Federal regulatory agencies in the course of our normal commercial operations.

Recent examples have included:

- Registration of premium adjustments to our health insurance tables, which involves liaison with VicFIC, the Commonwealth Department of Health and Family Services and, on occasions, the Private Health Insurance Administration Council;

- Disclosure documentation for the Eureka Bonus Bond, a new product developed to meet the needs of investors affected by Extended Deeming, was required to be lodged with VicFIC and registered as a prospectus with the ASC. Each body had specific requirements and nuances to be satisfied through detailed negotiation.

Rather than comment individually on each regulator (noting that CHFS and PHIAC have responsibilities affecting only the health insurance business), we would like to offer the following observations from a broad policy perspective.

1. First, setting different prudential "high jumps" for banks, superannuation funds, life offices and other financial institutions is no longer appropriate. The blurring of activities across traditional boundaries makes it harder to define appropriate standards for each sector.

   The spectrum of risk in financial services is not a function of the type of institution conducting the business. There is no scientific rule which suggests that every bank is more secure than the best-managed investment trust. Indeed, the late 1980s would indicate that some of the largest problems arose in the banking sector due to imprudent lending practices, inadequate internal supervision and controls, and an unhealthy obsession with market share at the expense of asset management.

   In recent media commentary a frequent remark has been that "products don't fail, institutions do". That attitude perhaps conveniently ignores the experience of unlisted property trusts (a clearly flawed product which was saved only by a government-imposed freeze) in the early 1990s, but more importantly forgets that institutional risk is a reflection of the assets and liabilities attached to *products*, and consequent exposure to a sudden reversal of fortune in these product *markets*.

   A more suitable basis for supervision would be to set prudential standards for each institution based on the weighted risk of its overall mix of its business. This would treat financial institutions with a similar mix of business consistently, no matter what the nature of their institutional 'parentage'.

2. Secondly, it is potentially misleading to consumers for prudential supervision to be based on institutional types.
   This is especially the case with banks, where there is still a common belief that bank deposits are "guaranteed" by the government (through the Reserve Bank), but is equally true for any section of the financial services industry.

   On the one hand there may be an implied advantage to banks and other institutional types which are seen as more secure because there is a perceived "premium" attached to scrutiny by a particular prudential supervisor. Conversely there may be an implied disadvantage to institutions which are subject to prudential supervision by a lower profile body such as AFIC, which may be perceived publicly to be less diligent in its monitoring of standards and performance (although, in reality, AFIC's prudential standards are the most onerous of any similar regulator).

3. The adoption of a weighted risk approach to prudential supervision would strengthen the system's early-warning capability. This would allow regulators to

then adopt a more active "watching brief" during the period of difficulty - or to directly intervene in order to take appropriate action.

4. The existence of differential prudential standards undermines competitive neutrality. Those institutions which are subject to more prescriptive rules, more frequent reporting requirements and 'spot' on-site inspections naturally face higher costs than institutions subject to a more permissive regime. It is noted, in this context, that the Reserve Bank does not generally send teams to inspect banks but relies on regular statistical returns verified by external auditors as the basis for checking that banks are adhering to prudential standards.

5. Risk-related prudential supervision could also reward those institutions which have a lower risk. They would be able to borrow funds at a rate which reflects their relatively low risk, in contrast to the present system where banks have privileged access by dint of their institutional classification (qualified, as appropriate, by Moody's or S&P ratings). Institutions which are low-risk could also be exempt from some of the more time-consuming procedural requirements in the prudential guidelines.

   This would be particularly relevant for friendly societies.

   The structural principle of the benefit fund, acting as a "steel-walled container" shielding each benefit fund from risks in other funds or commercial businesses of the friendly society, is one of the most exacting prudential safeguards possible. It mitigates contagion by confining the risk to the fund or business directly responsible for the financial mismanagement, and preventing the spread of 'disease' to otherwise healthy benefit funds.

   This does not prevent the problems of one fund leading to the collapse of the friendly society, but the 'healthy' benefit funds generally survive and can be absorbed by another friendly society.

6. The present system of prudential regulation seems perverse in that there is an inverse relationship between the degree of prescriptive control and the size of the institution in the overall financial system. Regulation is most permissive and "gentlemanly" for the banking sector (with assets of some $450 billion) and most prescriptive for smaller institutions like friendly societies (with total assets of about $9 billion).

7. It might be recognised that for most consumers the actual prudential standards that an institution meets is of questionable value. As noted earlier, many consumers still harbour perceptions that banks are rock solid institutions due to 'the fallacy of the government guarantee'. Similarly, institutions which are performing strongly in times of solid economic growth can rapidly encounter serious difficulties when a downturn creates acute problems in their loan book.

   Friendly societies have long argued that disclosure documents should include a clear statement of the investment strategy and policy underpinning the forecast earnings. In most cases this might cover the entire institution, in some cases only a division or pooled fund, and in the case of friendly societies it might (and should) be the investment policy for the benefit fund being offered.

The point is that it is really the investment policy which is the key to the consistency with the represented character and claims made in respect of security, performance and accessibility.

8. Finally, a consistent prudential regime across the financial services industry will remove any temptation which might exist for the regulators to "trial" a particular requirement in one pocket of the industry as a prelude to a system-wide extension if it proves valuable to the regulator.

   The possibility of regulatory leap-frog would then be replaced by a more transparent process where new powers have to be argued, justified, evaluated and applied consistently across all institutions.

Australian Unity believes that the principal purpose of prudential regulation should be to ensure competitively neutral outcomes for *consumers*.

This does not necessarily mean that prudential requirements should be competitively neutral between institutions, but that there should be some trade-off between prudential supervision and the level and complexity of disclosure requirements.

For example, an institution which is subject to regular inspections, frequent auditing and demanding compliance obligations should be able to offer its products more competitively than an institution which is less heavily supervised. This could be achieved by simplifying the disclosure requirements taking into account the fact that these institutions have already satisfied exacting prudential requirements.

## 2.7 Product quarantines

Friendly societies have been able to enter several non-traditional markets through the creation of subsidiary businesses. For example, Australian Unity subsidiaries include a building society and a funds management business, incorporated under the FI Code and the Corporations Law respectively.

It is generally also expected that there may be broader scope for new activities when friendly societies operate under the FI Code, expected from 1 January 1997.

However, there are still significant barriers to effective participation in important sections of the financial services industry imposed by legislation and regulation.

Friendly societies face cumbersome and complex obstacles in attempting to directly offer employment based superannuation products, despite the fact that we offer Approved Deposit Funds (ADFs) and a range of non-superannuation retirement savings vehicles. Current legislation denies friendly societies a more active role in the competitive market for savings generated through the Superannuation Guarantee scheme.

Some of the more technical restrictions on commercial operations include:

- benefit limit provisions;
- limitations on the capacity to underwrite particular business;
- authorised investment limits;
- contribution limits.

The fact is that friendly societies' permissable activities are restricted by legislation to those functions which could be regarded as their "traditional" benefits and others which fit within the same broad "genus" or product family.

The overall approach is prescriptive and restrictive.

It might also be noted that friendly societies will not be able to offer Retirement Savings Accounts (RSAs) until we are finally brought within the FI Scheme. While this is presently expected to apply from 1 January 1997, the starting date has been delayed three times over the last few years and there is no guarantee of commencement on the scheduled date.

The generally restrictive approach in Australia contrasts significantly with the practice in the UK, where the Friendly Societies Commission has been moving towards a more permissive regime since it was established in 1992.

The more important of these reforms allow UK friendly societies to operate, through subsidiaries, almost the full menu of financial services in direct competition to banks and other institutions. These include:

- deposit-taking accounts and loan facilities to individuals, including TESSAs (Tax Exempt Special Savings Accounts)
- Personal Equity Plans (tax-exempt savings vehicle)
- unit trust schemes
- credit facilities
- fund management services for trustees of pension funds.

The UK Friendly Societies Commission is currently considering a further extension of commercial powers to include the ability to offer investment trust schemes; property management and computer bureaux services; open ended investment companies; and allowing friendly societies to enter agency agreements with third parties, thus extending the range of benefits offered.

The historical practice in Australia has been to erect artificial barriers which prevent friendly societies from competing directly in other product markets.

*Australian Unity believes that as a general principle there is no public benefit in ring fencing certain product markets or institutions from open competition. Given effective prudential supervision and effective director and trustee duties, there is no reason why there should not be free competition in product markets.*

*Accordingly, the regulatory environment should be permissive rather than prescriptive in relation to products and services. Where product quarantines are maintained or introduced, it is suggested that these should be supported by explicit and transparent government policy.*

# 3. FUTURE MODELS FOR THE FINANCIAL SYSTEM

It is not our intention to set out a comprehensive blueprint for the future regulatory structure. It would be presumptuous of us to comment on the strengths and weaknesses of the existing national regulators when, as of this date, the Australian Unity Group's parent friendly society is still not even part of the flawed Financial Institutions Scheme - due to delays in State Parliament passage of the enabling legislation.

In common with other friendly societies, *the "make or break" outcome we seek from this Inquiry's deliberations is a single, national regulatory system* for the financial services industry, created by the Australian Parliament.

## 3.1 Goals for the regulatory framework

Starting from the perspective of "good public policy" we would like to advocate the following principles as the test of "best regulatory practice" for consideration by the Inquiry. In our view the best regulatory framework should seek to:

- avoid gaps in the regulatory fence
- anticipate changes in market structure and be flexible to cope with these
- avoid duplication in reporting
- minimise costs to market participants
- gear compliance towards simplicity and consistency
- promote centres of excellence in knowledge and information
- achieve transparency in decision-making and enforcement of rules
- maximise market efficiency
- practice "decision division" and focus on key indicators
- establish a partnership with market participants
- provide effective safeguards from abuse of market power, both for consumers and for market participants
- readily accommodate changes in technology.

There is a sliding scale of public policy benefit in the various proposals which have been canvassed in the literature and during the progress of the Inquiry, and no single possible "constellation" seems to leap out as the obvious one. Rather there appears to be a wide range of outcomes which will satisfy some of these objectives better than others, but which also carry disadvantages from a broader perspective.

## 3.2 A single national regulatory framework

Australian Unity would be happy with an outcome which:

- transfers responsibility for friendly societies to a national regulatory framework in place of the present cooperative approach through the FI Scheme; and

- achieves a more equitable distribution of costs of regulation between different sectors of the financial services market.

In any future structure, we envisage that the infrastructure of the FI Scheme which is to supervise friendly societies would be moved to be part of such a national scheme.

A broad range of alternatives would satisfy those objectives.

One possible approach for prudential regulation is discussed in detail in the submission to the Inquiry by the Australian Friendly Societies' Association (AFSA).

*The establishment by the Australian Parliament of a single national regulatory framework is the most important reform from Australian Unity's point of view.*

*Within this single national framework, we could live in a world of "two peaks", "three peaks" or more as easily as we could in a world of one - provided that there was substantial and improved coordination between the regulators.*

The only caveat is that the more "peaks" there are on the regulatory landscape, the more "valleys" there are in which new forms of hybrid institution or function can roam unsupervised and where important issues can be lost from sight.

### 3.3 Consumer and competition issues

Australian Unity does not see a compelling need for a new and distinct 'consumer' regulator which would monitor products and mediate consumer issues (including disclosure, fees and complaints).

The existing requirements and responsibilities - vested largely in the Australian Competition and Consumer Commission (ACCC), industry Codes of Conduct and practice, the Consumer Credit Code and various disclosure obligations - are more than adequate for all but the most exceptional circumstances.

From Australian Unity's viewpoint, our own established disclosure practices are superior to those required under any legislation. These exceptional levels of disclosure are mandated in our rules (which exist as a contract between the society and its members). In addition, the benefit fund structure unique to friendly societies permits us to annually disclose to members the performance of individual products and the reserves of the whole entity in its management fund. Few other financial institutions, not even the life companies, can match this level of disclosure.

As a result of this exacting standard, and the fact that as a friendly society we exist for our members and are accountable to them collectively and individually, Australian Unity experiences no significant level of customer dissatisfaction. Generally speaking, we would have no more than one genuine customer complaint each year, from a total membership of over 200,000 people.

We would prefer to see consumer issues dealt with under industry codes of practice and relevant legislation, rather than create another expensive regulator.

The need for such a body has not been argued, let alone established.

If there *is* to be a consumer regulator, then we would favourably refer the Inquiry to the UK model of practitioner-based self-regulating organisations (SROs).

- Self-regulating organisations in the UK include provider companies, officials nominated by the regulators and consumer representatives, and are commonly chaired by a retired industry leader. In most cases the regulator nominees do not hold current office with a financial industry regulator. SROs are serviced by a small, highly skilled secretariat. We would submit that the UK experience strongly suggests that this secretariat need not be entirely staffed by public servants.

- The general responsibilities of SROs include: "generic" product viability, commercial practice including disclosure and marketing, fees and charges, registration and licensing of providers and intermediaries (including financial advisers), and alternative dispute resolution and grievance processes.

- Under the present UK structure products are regulated by five bodies including three SROs - the Personal Investment Authority (PIA), the Investment Management Regulatory Organisation (IMRO) and the Securities and Futures Authority (SFA) - which report to Treasury and the Parliament through the Securities and Investments Board (SIB).

- In addition the Bank of England (BoE) supervises deposits, mortgages and non-investment loans, and the Department of Trade & Industry (DTI) regulates general insurance products.

- UK friendly societies' "traditional" product lines are regulated by the Personal Investment Authority (PIA), which covers all retail financial products offered to individuals with the exception of personal and housing loans (regulated by BoE).

Australian Unity has no particular enthusiasm for a PIA-style apparatus. We believe that the considerable powers vested in the ACCC should more than adequately satisfy most consumer concerns.

The UK model of SROs has possibly played a useful role in the absence of a body like the ACCC, but they are less than perfect incarnations and have proven to be overly prescriptive, bureaucratic and expensive.

If, on balance, the Inquiry believes that it is necessary to recommend the establishment of a distinct "consumer" regulator, then Australian Unity would support the establishment of self-regulating organisations as an alternative to an all-powerful public service Commission.

Depending on the Inquiry's initial approach in the Discussion Paper, Australian Unity may address this matter in more detail in a subsequent submission.

Apart from consumer issues, the other important area is competition policy.

Competition issues, in our view, should be left to the Australian Competition and Consumer Commission - with an appropriate provision for the Treasurer to "call in" any matter with national significance.

- This presumes, of course, that the artificial boundaries between institutions which, for example, presently restrict certain institutions from participating in defined markets, are dissolved as a result of the Inquiry's recommendations.

Broadly speaking, Australian Unity believes that there should open competition in product markets subject to any new entrant:

(a) satisfying the same prudential standards as existing market competitors,

(b) establishing, where required, appropriate corporate structures for new activities (eg., incorporated subsidiaries),

(c) maintaining adequate additional cover under any depositor or investor protection requirements, and

(d) observing the rules set down for marketing, consumer protection [including disclosure] and professional standards.

The other major issue in competition policy appears to be mergers - specifically, mergers between banks, and between banks and other institutions such as life offices.

As a general principle, we believe that a good public policy outcome would be to subject FSI mergers to the same principles as apply to other sectors of the economy under the Trade Practices Act, with the Treasurer retaining a power to "call in" any issue which carried national implications. This is broadly similar to the direction which seems to be the most likely future arrangements for media ownership, another industry which has a "special" relationship with the community.

Three implications flow subsequent to this position:

- We support the "dominance" test being reinstated to replace the present "lessening of competition" test, which has proven to be unduly restrictive;

- We believe that the correct market for judging dominance should be the national FSI <u>but</u> that the ACCC should also be required to take into account any effect that a merger would have in establishing undue dominance in any State or regional market or within a particular family of products or institutions;

- We do not support the suggestion that institutions must change their name once they are taken over by another institution, although this could be a matter where the ACCC could have a discretionary power to make such a direction. Broadly speaking, trading names should be a commercial decision reflecting best business judgment; there is substantial marketing advantage and goodwill attached to a trading name.

## 3.4 Standardising financial services industry law and taxes

Australian Unity supports the views, widely held in the industry, that:

- There should be genuine uniformity in State transaction taxes. To this extent a central agency should be responsible for the administration and collection of FID, debit tax and Stamp Duty levied on financial services institutions, returning the proceeds (net of any costs) to the relevant State or Territory government.

- Consumer Credit legislation should be nationally-based, uniformly administrated and consistently applied. If necessary, there should be a voluntary transfer of powers to the Commonwealth by the States and Territories.

- Privacy and data collection law should be created, controlled and administered by the Commonwealth as it affects financial institutions. If necessary, there should be a voluntary transfer of power to the Commonwealth by the States and Territories.

## 3.5 Funding mechanism

As outlined earlier in this submission there are substantially different levels of government contribution to each regulator, with AFIC the most heavily dependent on industry financial contribution [section 2.4]

Australian Unity believes that that the national significance of the sector warrants substantial public funding of the regulatory function. All taxpayers have an intimate and personal interest in the security and stability of the financial system.

To the extent that Government considers that financial system regulation needs to be financed by contributions from the industry, the funds should be remitted centrally to one agency, which would have responsibility for allocating this global contribution to fund the various regulators, divisions or bodies established for different purposes.

Individual institutions would contribute to the cost of supervision in proportion to their assets. (Special attention will need to be given to the appropriate treatment for this purpose of off balance sheet assets such as managed funds.)

The level of contribution required by individual institutions would be reviewed at least annually to reflect changes in the proportional spread of assets within the financial system.

## 3.6 Production of regulatory plans

Australian Unity believes that each regulator (or the single regulator, depending on which model is adopted by the government) should be required to produce a regulatory plan each year as a means of ensuring accountability to customers, the industry and to Parliament.

These plans should clearly articulate the key objectives of regulation, review the past year and current year planned activities against these objectives, report on major work in progress, and explain the rationale and purpose for the approach taken by the regulator in fulfilment of its statutory duties.

Publication of these plans will improve the accountability and transparency of the regulatory process, and help to identify clearly for industry participants the priorities for regulatory attention on an annual basis. The need to annually evaluate the effectiveness of present activities, including industry reaction and viewpoints, will also aid in highlighting areas warranting reform as the market further evolves.

In addition, it should also be mandatory for a detailed Regulatory Impact Statement to accompany every proposal for new or modified legislation or regulation. This should consider the financial impact and administrative implications of any proposal, together with an assessment of the costs and benefits for consumers and the efficiency of the industry.

# 4. THE FINANCIAL SYSTEM AND NATIONAL SAVING

The Inquiry is not permitted to make recommendations on retirement incomes policy or the taxation of financial arrangements, products or institutions.

The Government's decision to restrict the Inquiry's focus to a stocktake of financial system developments since the Campbell Committee, and an examination of future regulatory arrangements, is understandable. This is the same approach taken in the UK with the Jack Committee, which had a similar responsibility.

**Australian Unity believes that the Inquiry would make a valuable and necessary contribution to the broader cause of higher national saving if it recommended that the Government establish a separate inquiry into retirement incomes policy and other critical issues affecting personal financial planning.**

Australia's deficiency in national saving has been much discussed and analysed over the past decade, most recently by the National Commission of Audit. The need to restore national saving from its current level of some 17-18 percent of GDP to around 22-23 percent of GDP (the Fitzgerald benchmark) is now well accepted as a necessary condition to reducing our structural current account imbalance.

The major cause of the fall in Australian private saving is the long term decline in savings by households - in layman's language, individuals and families. From 15 percent of GDP in the 1970s this has fallen to 6.3 percent in 1994-95.

After noting that the introduction of compulsory superannuation has led to some reduction in saving by companies and individuals (the so-called private saving offset, generally estimated to be between 50 and 75 percent), the National Commission of Audit stated:

> "Despite the superannuation reforms of the past decade, total household saving has continued to decline as a proportion of household disposable income. It now appears that the ratio has fallen below 2 per cent of household disposable income - a quarter of what it was a decade ago".

The real causes for this steep and continuing decline in saving by individuals and families deserve urgent attention. It has a major impact on Australia's overall economic health, and the size and shape of the financial system.

Most importantly, we may find that people reach retirement without sufficient resources to enjoy the quality of life they expect.

It is not appropriate to outlay before this Inquiry the full spectrum of opinion and evidence about the confusing, complex and often contradictory policies affecting personal saving.

Yet we would like to state here, for the record, some of the broad conclusions we have gathered over recent years from our own members' feedback:

- <u>There have been so many changes to tax and social security rules that investment in retirement savings is now a 'guessing-game'</u>.

  In its 1996 election policy the Coalition correctly noted that superannuation has been the subject of some 2,000 changes since 1983.

  In the August Budget the Coalition merely increased this tally to "2,000 plus" changes with negligible benefit to 'saving individuals' or to companies responsible for administering the law.

  Without itemising the benefit or otherwise of individual changes, some of which have substantial long-term merit, it is worth noting that for consumers the overall impression is a system in constant and continual change.

  This leads to one outcome: uncertainty.

  It is unacceptable for any government to retrospectively change the environment in which people have planned and invested their savings. This is, sadly, the effect of many of the key changes in the last decade. Governments have alternately granted, reduced and then withdrawn tax concessions and other incentives, in such a cavalier manner that investors now justifiably discount every single assurance - whatever their political colour.

  If government promises and decisions were subject to the same enforceable safeguards as company prospectuses, the Prime Minister of the day and the Treasurer would never be out of court.

- <u>Compulsory superannuation is "out of our hands". Personal superannuation is too complex to even think about</u>.

  Other commentators have correctly noted that "enforced" or compulsory saving is usually accompanied by a fall in "voluntary saving".

  Australian Unity's experience suggests that if people feel removed or distant from investment decisions *made on their behalf*, they feel remote from the savings function and lose all incentive to stay involved in the process.

  The Superannuation Guarantee has certainly widened access to some level of employer based superannuation. The extent to which this is welcomed or appreciated by individual workers (as an alternative to higher wages) is unclear.

  What *is* certain is that compulsory superannuation has not been accompanied by a wide variety of choice for individual employees. In most cases they have little or no say in which fund manages their assets, and incomplete or imperfect information about their end-benefits.

  Most of the tax incentives for voluntary personal contributions to superannuation - - whether as supplements to employer contributions or as self-employed contributions

- have either been withdrawn or made subject to such a complex set of rules that it is no longer worth the effort for many people.

- The 'tax hand' never knows what the 'welfare hand' is doing.

  It is hard to avoid the conclusion that a "whole of government" approach is needed to personal saving and retirement incomes (including compulsory and voluntary superannuation).

  At present, the Tax Office toys around to cut concessions and save money, the Department of Social Security cuts benefits and saves money through income and assets tests, and Department of the Prime Minister and Cabinet bureaucrats tear their hair out trying to meet the Government's election promises while still preserving some consistency and continuity in public policy. Meanwhile Treasury and Finance officials cry "spilt milk" over the loss of extra savings which could have been achieved by a tougher approach - whatever the consequences for individuals.

  Nobody at the national level seems to be in control of the total private savings and retirement incomes framework.

  What is required is determination at the political level to coordinate these matters.

  Australian Unity believes that cabinet-level Minister for Retirement Incomes should be appointed.

- There's nothing to worry about because we have 'compulsory super'.

  Potentially there is no more dangerous belief than the mistaken attitude that compulsory super is a satisfactory provider for all future needs.

  Very few people aged above 35 in 1996 are going to be able to retire with security on SG contributions and the aged pension without an adequate store of supplementary and voluntary savings.

  The political marketing effort of different governments has concentrated on the *nominal* benefits at retirement age to somebody on AWE. These predictions, by government or according to government edict, have not been fully honest because they have not told each individual what their personal SG "investment" will really be worth - as a sum or as an annuity - in future dollars taking all of the variables into account.

  To use a very live example: an annuity of $60,000 looks like a lot of money to a first-year employee on a $20,000 wage in 1996. at retirement age in, say, the year 2036, it may prove to be completely inadequate.

  Very few compulsory superannuation vehicles accurately tell people what the real value of their future entitlement is in today's dollar equivalent.

  This can only dash a lot of hopes and plans in the future.

The point is that many people falsely believe that the SG scheme has removed the need for them to independently save.

This is a dangerous and fallacious presumption.

We would hope that the present government has the determination and courage to overhaul the retirement incomes and savings policies in order to realign incentives.

Australian Unity endorses the conclusion of the National Commission of Audit that:

> "[T]he recent decline in household saving is cause for concern that either the superannuation reforms are failing in their main policy objectives of increasing saving for retirement as well as national saving, or that the objectives are more sensitive to other influences which the government should address."

**Australian Unity encourages the Financial System Inquiry to recommend that the Government establish a separate Inquiry into retirement incomes policy and other critical issues affecting personal financial planning, including a full review of tax and social security arrangements in terms of how they affect incentives to save.**

This Inquiry should consider these issues from the viewpoint of the independent-minded citizen, and examine the effect that current and proposed policies have in *practice*, rather than merely in *theory* or according to economic models.

# AUSTRALIAN UNITY GROUP STRUCTURE