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Association of Building Societies and Credit Unions

9 January 2012

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
Canberra ACT 2600
corporations.joint@aph.gov.au

Dear Committee Secretary

Inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.

Thank you for the opportunity to contribute to the Committee's inquiry.

Abacus – Australian Mutuals is the industry body for the customer-owned financial services sector, representing credit unions, mutual building societies, mutual banks and friendly societies.

Our initial submission to the inquiry lodged on 25 November 2011 focuses on the first Bill. This submission focuses on the second Bill. We strongly support well targeted reforms to deliver the objectives set out in the Bill's Explanatory Memorandum:

- To improve the quality of financial advice while building trust and confidence in the financial planning industry; and
- To facilitate access to financial advice, through the provision of simple or limited advice.

However, the legislation as currently drafted is too widely framed and will reduce rather than facilitate advice about simple, low risk financial products such as basic banking products.

Abacus recommends changes to the Bill to facilitate access to advice about basic banking products and to promote innovation and diversity in the provision of consumer banking services. The recommended changes do not compromise the Bill's primary objective of raising standards in the financial planning industry.

Specifically, we seek:

- A clear, unambiguous carve-out from the best interests duty for ADI employees advising on basic banking products;
- Clarification that the carve-out from the ban on conflicted remuneration for ADI employees advising on basic banking products will not inadvertently prevent these employees advising on other simple products such as general insurance; and

- Redrafting of the 'basic deposit product' (BDP) definition in the *Corporations Act 2001* to clarify that simple term deposits of up to two years are BDPs, including those where withdrawal within the term is at the discretion of the ADI.

About Abacus: Mutuals and customer-owned banking

Australia's 96 credit unions, 7 mutual building societies and 3 mutual banks have total assets of $85 billion and 4.6 million customers. All mutual banking institutions are Authorised Deposit-taking Institutions (ADIs) regulated by APRA under the *Banking Act 1959.*

Collectively, mutuals have more branches than any of the major banks, one of the largest national ATM networks, 7.4 per cent of the new home loan market and 11.5 per cent of the household deposits market. The mutual sector ranks fifth just behind the four major banks in household deposits.[1]

Mutual banking institutions provide important competition, choice and diversity in retail banking. This role received increased recognition by policy makers in the Government's December 2010 banking reform statement, including a commitment to "*take action to help build a new pillar in our banking system from the combined competitive power of our mutual credit unions and building societies.*"[2]

Credit unions and building societies consistently and strongly outperform the major banks in independent surveys of customer satisfaction. This demonstrates the success of the customer-owned business model where the focus is on excellent service and highly competitive pricing for customers, not on returns for external shareholders.

We seek a regulatory framework that allows all banking business models the opportunity to meet customer needs and provide the best possible customer experience, including the capacity to provide advice without undue regulatory complexity and compliance costs.

Customer-owned banking institutions want to engage with their customers and do not want to put up a 'no advice' sign in the window.

Financial product advice

As noted in the Bill's Explanatory Memorandum, there is no legislative definition of the term financial planner. The Explanatory Memorandum also notes that:

> "There are some differences between the common usage of the term 'financial planner' and legal concept of 'provider for financial product advice'. A broad range of people may provide 'financial product advice'."

The Minister's Second Reading Speech makes it clear the proposed new best interests duty is aimed at "boosting professionalism in the financial advice industry."

> "Financial planners and those who work in the financial services industry implicitly understand that the brand of financial advice needs renewal following a string of collapses including Storm, Trio and Westpoint. I believe that the vast majority of financial planners do see their role as making their dealings with customers such that,

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[1] See attached Fact Sheet for more detail.

[2] *Competitive and Sustainable Banking System,* Dec 2010, http://www.treasury.gov.au/banking/content/default.asp

> after having dealt with the planner, the customer is better off than if the customer had never sought financial advice to begin with."[3]

The FOFA legislation is aimed at the "financial advice industry" but affects a much wider group, including ADI employees who provide advice only about simple, low-risk products. ASIC has categorised[4] the following products as "Tier 2" or "generally simpler and better understood" than other financial products: basic deposit products, non-cash payment products, general insurance, consumer credit insurance and First Home Saver deposit accounts. Advisers on these products are subject to lighter training standards.

Many stakeholders assume that "personal financial product advice" is only provided by financial planners. In fact, an ADI employee talking to a customer about basic banking products will be providing "personal advice" if they make a recommendation about a product after considering one or more of a person's objectives, financial situation and needs. So, if a customer wants to save to buy Christmas presents and an ADI employee recommends a Christmas Club account, the employee could be providing "personal advice."

The provision of "personal financial product advice" is already a highly regulated activity, although there are some existing differences in the disclosure, conduct and competency obligations for advisers on basic deposit products.

Even with these existing 'lighter touch' concessions for advice about simple products, many ADIs choose to avoid regulatory compliance costs and complexities by adopting a 'no advice' business model.

Abacus has consistently supported changes to the existing regulatory regime to facilitate the provision of advice about basic banking products and foster positive interaction with customers. The introduction of the FOFA reforms is an opportunity to deliver this outcome rather than to move in the opposite direction and promote a further shift to the 'no advice' model.

Best interests duty & basic banking products

The Bill introduces a new 'best interests duty' for providers of personal advice.

The Bill says:

> The provider must act in the best interests of the client in relation to the advice.

According to the Explanatory Memorandum, this is a "general obligation" on providers. ASIC will release guidance, after the Bill is passed, on its expectations for meeting the best interests duty. The Bill lists a number of steps, (a) to (g), that the provider can take, and if the provider proves they have taken these steps, the provider has satisfied the duty.

The Government's April 2011 FOFA policy statement[5] said there would be a "limited carve-out" from the best interests duty for basic banking products where employees of an ADI are advising on and selling their employer ADI's basic banking products.

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[3] Second Reading Speech, Hansard, 24 Nov 2011
[4] ASIC Regulatory Guide 146
[5] Future of Financial Advice 2011, Information Pack 28 April 2011

> "As part of the consultation process, the Government was not made aware of any evidence of severe consumer detriment as a result of inappropriate selling of products of this nature and these products are less complex in nature relative to managed investments or life insurance.
>
> "As these basic banking products are often sold by frontline staff, the carve-out is largely intended to address the more routine activities of frontline staff, such as tellers and specialists. While these employees may provide either general or limited personal advice in relation to these basic banking products, these products are generally easier for consumers to understand, and consumers more readily understand that the frontline employee of an ADI is in the business of selling the employer's product."

As currently drafted, however, the Bill does not deliver an effective carve-out for basic banking products.

For providers of personal advice about "basic banking products", the "general obligation" applies, although the relevant steps to prove the duty is satisfied are limited to (a) to (c), noted below.

In addition to the "general obligation", these steps are new and complex obligations for ADIs compared to the existing regime which requires personal advice to be "reasonable" and "appropriate".

Advisers about basic banking products will be subject to a new 'best interests duty' that is aimed at financial planners. According to the Explanatory Memorandum, this obligation is "modified" for advisers on basic banking products and they are "deemed" to have complied with the best interest duty if the provider "proves" each of the following steps has been taken:

> (a) identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;
> (b) identified:
>> (i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and
>> (ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the ***client's relevant circumstances***);
>
> (c) where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information.

These new obligations are a significant departure from the current obligations that apply to providers of personal advice about basic banking products. Currently, there is no requirement for a Statement of Advice (SOA) in relation to basic deposit products. Under the proposed new regime a provider might need such documentary evidence to "prove" that the prescribed steps have been taken.

As noted above, the existing obligations already discourage the provision of advice about basic banking products. Increasing regulatory cost and complexity for advisers on basic banking products will counteract the objective of facilitating the provision of limited or simple advice.

Abacus recommends a clear and unambiguous carve-out from the best interests duty for advisers on basic banking products.

The FOFA objective of facilitating the provision of advice about basic banking products is much more likely to be delivered by preserving and clarifying the existing requirement for advice to be “reasonable” and “appropriate”.

The Bill proposes to repeal the relevant section of the Corporations Act 2001, section 945A, as it is replaced by the new best interests duty.

As we have previously proposed to Treasury in a joint submission[6] with the Australian Bankers’ Association, Abacus recommends the retention of 945A for basic banking products and other products prescribed by regulations. These other products could include Tier 2 products such as general insurance and consumer credit insurance. This would mean the new best interests duty would apply to all other financial products.

Further, to promote the availability of advice, section 945A(1) should be amended as follows:

> (1) <u>For the subject matter of the advice</u>, a providing entity must only provide the advice if: [and then proceed with the current wording].

The amendment should be explained with the following:

> “The amendment is made to clarify that the subject matter of personal advice can be a single issue such as a particular objective or need, an aspect of a single financial product or a single topic. The scope of personal advice can be agreed between a customer and a providing entity or can be offered on a limited basis. Inquiries, under section 945A, can be tailored to the scope of the advice to be provided.”

We also recommend that section 945A as set out above should be accompanied by an additional provision to subsection 945A(2):

> “Where it is clear in the provision of the advice that only certain types of products or identified objectives are to be considered, the provider need only obtain personal and other information that is relevant to the subject matter of the advice under consideration.”

Ban on conflicted remuneration

We welcome the carve-out from the ban on conflicted remuneration for advisers on basic banking products. This reflects recognition in the Government’s April 2011 policy statement of concerns about the impact on employee remuneration and workplace arrangements.

However, the drafting of the carve-out creates the risk of an unintended outcome.

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[6] ABA/Abacus letter to Treasury, 11 October 2011

Under section 963D(c), the carve-out is conditional on the adviser not, in the course of recommending a basic banking product, giving other financial product advice that does not relate to a basic banking product.

The Explanatory Memorandum says that "if the [ADI] employee provides financial product advice on financial products other than basic banking products, either in combination with or in addition to advice provided on basic banking products, the receipt of the benefit will be considered conflicted remuneration. This will encourage customer service specialists, who wish to continue receiving volume or sales bonuses, to focus on providing advice on basic banking products only."

As noted above, ADI employees who are not "financial planners" may also provide advice about "Tier 2" products, including general insurance and consumer credit insurance.

General insurance is not subject to the ban on conflicted remuneration. However, it would appear that an ADI employee providing advice about general insurance would become ineligible for the basic banking carve-out.

Abacus is not aware of any stakeholder making a case for such an outcome. It reduces consumer choice and diversity in retail financial services distribution and it has a direct impact on the potential earnings of frontline ADI staff. These ADI employees are not highly paid "financial planners". Customers will not wish to be referred to separate staff if they wish to talk about other simple products, such as general insurance, in addition to basic banking products.

We recommend that the carve-out from the ban on conflicted remuneration for ADI employees advising on basic banking products should be amended to make it clear that such employees can also advise on products categorised as Tier 2 in ASIC Regulatory Guide 146.

Basic deposit product definition

The Bill defines 'basic banking product' in the following way:

> (a) a basic deposit product;
> (b) a facility for making non-cash payments (see section 763D) that is related to basic deposit product;
> (c) an FHSA product of a kind mentioned in subparagraph (c)(i) of the meaning of ***FHSA*** in section 8 of the *First Home Saver Accounts Act 2008* (first home saver accounts);
> (d) a facility for providing traveller's cheques;
> (e) any other product prescribed by regulations for the purposes of this paragraph.

The most important category is 'basic deposit product'.

Basic deposit product is defined under section 761A of the Corporations Act 2001. This long-settled definition has very recently become subject to new uncertainty due to ASIC reviewing the definition in the context of the Basel III international banking reforms.

The issue is whether certain term deposits can qualify as 'basic deposit products'. Any effective narrowing in the category of deposits that qualify as basic deposit products has significant implications for ADIs and consumers.

ASIC issued a consultation paper[7] in November 2011 with proposals for relief to enable ADIs to issue term deposits of up to two years that can only be broken on 31 days' notice while being subject to the same regulatory requirements as 'basic deposit products.'

ASIC's consultation paper says Basel III liquidity reforms require strict conditions on certain term deposits to qualify for new liquidity standards. Term deposits that require a minimum notice period of 31 days before being able to be withdrawn by the depositor will achieve recognition under the new liquidity standards.

ASIC has taken the view that such deposits may not be 'basic deposit products' and that there is "significant regulatory uncertainty" without some form of relief provided by ASIC.

> "Without relief, term deposits that are only breakable on 31 days' notice could fall outside the definition of basic deposit product and therefore be Tier 1 products for the purpose of training requirements in accordance with RG 146. This would mean that persons advising on term deposits would be required to meet a higher knowledge and skill requirement at the Tier 1 diploma education level.
>
> "This could have significant implications for ADIs, because frontline staff would be unable to sell term deposits unless they meet the higher Tier 1 training standards. It could lead to higher compliance costs for ADIs if they had to meet higher training requirements for all bank staff dealing with term deposits, as well as ongoing monitoring and competency requirements.
>
> "In addition, without relief, in a recommendation, issue or sale situation, ADIs may be required to give clients a PDS for term deposits that are only breakable on 31 days' notice. ADIs may also be required to give a client an SOA when providing personal advice on such term deposits.
>
> "We think that potentially significant regulatory uncertainty would be removed if we provided relief to clarify the classification of term deposits of up to two years that are only breakable on 31 days' notice."

The uncertainty arises because the current definition of basic deposit product does not specify the period of notice that an ADI may require a depositor to give for an early withdrawal from a term deposit of up to two years.

Abacus takes the view that the notice of withdrawal period for a term deposit of up two years is the term, unless otherwise stated in the terms and conditions. In our view, ASIC relief should not be required for ADIs to choose to offer term deposits of up to two years with a 31-day 'notice of withdrawal' period.[8]

The implication in ASIC's consultation paper is that ASIC considers that term deposits must be effectively at-call, whether or not the ADI imposes an interest penalty for early withdrawal, to qualify as basic deposit products.

[7] ASIC Consultation Paper 169

[8] Term deposits of up to five years must be breakable at the depositor's discretion to be basic deposit products, and ASIC's proposed relief is necessary for these term deposits.

We do not agree with this view and we are concerned that there will be negative consequences for consumers and ADIs from a shift in the common perception of a term deposit from being a product where funds are “locked up” for a fixed term, to a product where funds are at call, with a higher return if the at-call right is not exercised. For ADIs, deposit funding may be less stable. For depositors, returns may decline.

Abacus recommends an amendment to the basic deposit product definition to remove any doubt that term deposits of up to two years, where early withdrawal is <u>at the discretion of the **ADI**</u>, are basic deposit products.

This will provide certainty to ADIs and consumers and ASIC, and will avoid disrupting the competitive and diverse term deposits market. It is important to note that the uncertainty identified by ASIC has arisen due to the Basel III reforms and is not the result of complaints by consumers or problems in the term deposits market.

We also recommend that the amended definition should accommodate the new Basel III liquidity standards by including term deposits of up to five years, where early withdrawal is <u>at the discretion of the **depositor**</u>, with a notice of withdrawal period of up to 31 days.

Regulatory creep

The number one item on the list of five features of regulations identified by the Regulation Taskforce[9] as contributing to compliance burdens on business that are not justified by the intent of the regulation was ‘excessive coverage, including regulatory creep’.

Imposing elaborate new ‘financial planner’ regulations on people who advise on basic banking products is a clear case of excessive coverage.

The Productivity Commission’s December 2011 report[10] on regulation reforms says excessive coverage can impose undue compliance burdens on business and have unintended consequences, such as distorted incentives for investment and innovation.

ADIs are the most intensely regulated entities in the financial sector and deposits are the safest and simplest financial products. Imposing new regulatory obligations on ADI employees in relation to basic banking products is not only unnecessary, but is likely to reduce the availability of advice to consumers.

Abacus seeks the Parliamentary Joint Committee’s support for our recommendations to:

- Provide an effective carve-out for basic banking products from the best interests duty;
- Preserve and clarify the existing requirement for advice on basic banking products to be “reasonable” and “appropriate”;
- Ensure the carve-out from the ban on conflicted remuneration for basic banking products does not prevent ADI staff from advising about other “Tier 2” products; and
- Amend the Corporations Act definition of ‘basic deposit product’ to provide certainty about its coverage of term deposits.

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[9] http://www.regulationtaskforce.gov.au/

[10] Identifying & Evaluating Regulation Reforms, PC Research Report, Dec 2011

If the Committee is unable to support our recommendations and the legislation is passed without amendment, our member institutions will need an adequate transition period to assess the new regime, including ASIC's guidance, and to adjust business models as required. Abacus recommends a commencement date no earlier than 12 months from the finalisation of the ASIC guidance and any relevant regulations.

I can be contacted on 02 6232 6666 to discuss any aspect of this submission.

Yours sincerely

LUKE LAWLER
Acting Head of Public Affairs

Abacus
Australian Mutuals

December 2011

Australian Mutuals

Credit Unions, Building Societies & Mutual Banks

Key Fact Sheet

Size

> **96 credit unions**
> **3 mutual banks**
> **7 mutual building societies**

Assets and Growth

> Collectively, our sector has $85 billion in assets.
> Credit unions' on-balance sheet assets* reached $58.0bn in September 2011, growing by 14.0% annually while mutual building societies' on-balance sheet assets† grew by 10.7% and amounted to $27.3bn in the same period.

Market Share

> Hold 7.4% of the new home loan market and 11.5% of household deposits as at October 2011.
> Collectively, credit unions, mutual banks and building societies are the fifth largest holder of household deposits in Australia.

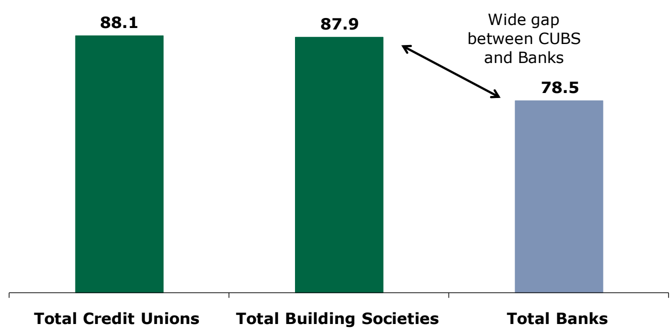
Population Penetration

> Australian mutuals serve over 4.6 million members - over 1 in 5 of the total population.
> Population penetration (members as a proportion of the total population) highest in SA (30%) and NSW (28%).

Strength

"Mutuals consistently outperform banks in customer satisfaction."

Customer Satisfaction - October 2011



Source: Roy Morgan Research Customer Satisfaction Survey, 6 months to October 2011, aged 14 and over

Size & Strength

> $85 billion in assets
> Serving over 4.6 million members
> Fifth largest retail deposit holders collectively
> High customer satisfaction
> No conflict of interest between customers and shareholders
> Strong community focus
> Same prudential regulation as banks

Strong Regulation

> All credit unions, mutual banks and building societies are Authorised Deposit-Taking Institutions (ADIs), regulated under the Banking Act. We meet the same high standards of prudential regulation as banks with full regulatory oversight.
> The Government has guaranteed deposits at Australian mutuals and banks.

Competitive Advantage

> The mutual structure means no tension between servicing members and external shareholders—members are the owners of their ADI.
> Mutuals are better placed than most to satisfy key needs of consumers, that is:
– Member focus
– Sense of community / belonging
– Honesty and integrity
– Guidance
– Simplicity
– Competitive pricing
> Strong regional & rural focus

† includes securitised assets of $600m over Dec 10 & Mar'11
* includes securitised assets of $2.6bn over Dec 10 & Mar'11

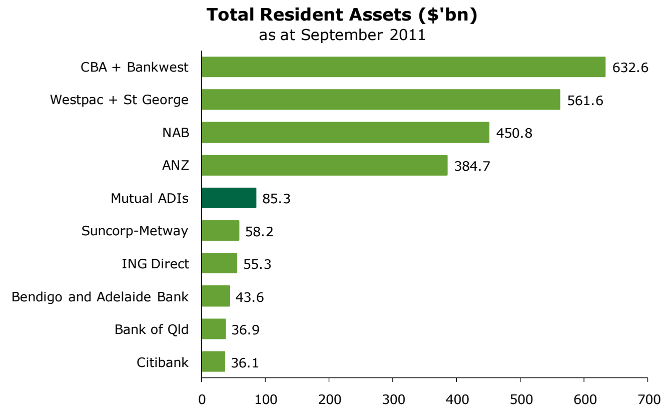
Mutual ADIs

Credit unions, mutual banks and building societies are customer-owned – entities, operating under the mutual principles of one member one vote, an equal share in the say of the organisation, and with the purpose of member and community benefit at the forefront of their operations.

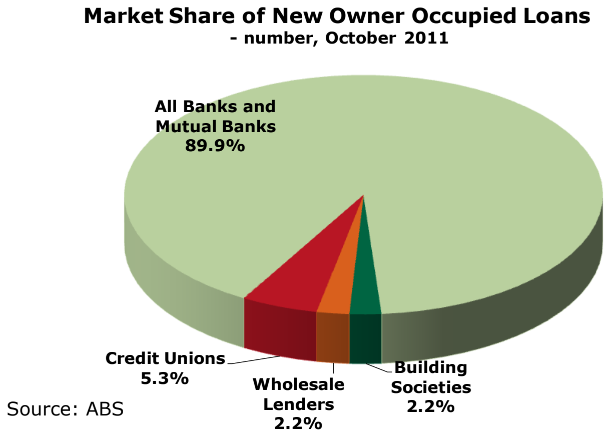
Mutuals have strong community and customer focus.

Market Share

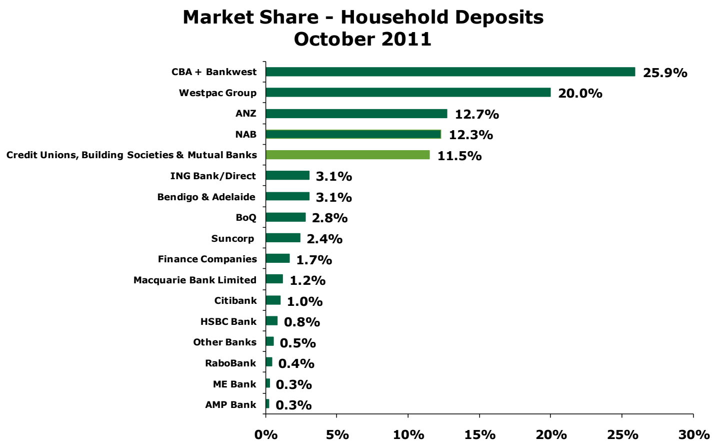
Collectively, credit unions, mutual banks and building societies sit behind the four major banks in terms of total on-balance sheet assets. Mutual ADIs hold 7.5% of the new home loan market.



Source: APRA & RBA



Source: ABS



Source: APRA, RBA and Abacus

As a group, credit unions, mutual banks and building societies are the fifth largest deposit gathering force after CBA, Westpac ANZ and NAB reaching 11.5% market share.

Products & Services

The majority of credit unions, mutual banks and building societies offer a full range of personal banking services. Mutuals typically charge less than the major banks in loan interest , while also offering attractive deposit rates on saving investment accounts and 90-day term deposits.

The latest Canstar Cannex comparative rates are shown in the tables at right.

12-Dec-11

Standard Variable	Avg (%)	Min (%)
4 Major Banks	7.55	7.47
Credit Unions	7.06	6.55
Building Societies	7.00	6.74
Mutual Banks	7.04	6.48

12-Dec-11

TD 10K 3-Month	Avg (%)	Max (%)
4 Major Banks	5.48	5.50
4 Foreign Banks	4.89	5.80
Credit Unions	4.95	5.80
Building Societies	5.13	5.60
Mutual Banks	5.12	5.60

Source: Canstar Cannex

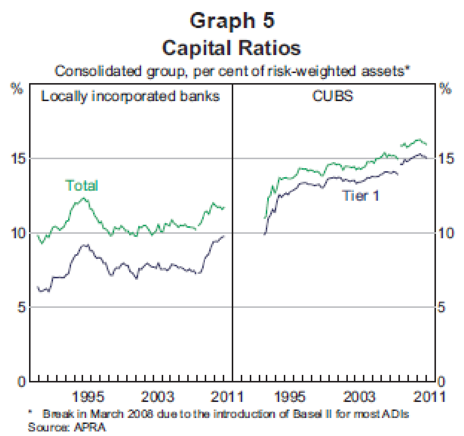
ATM Accessibility @ June 2011	Number of ATMs
CBA/BankWest	3,757
rediATM	3,400
Westpac/St George Bank	2,875
ANZ	2,714

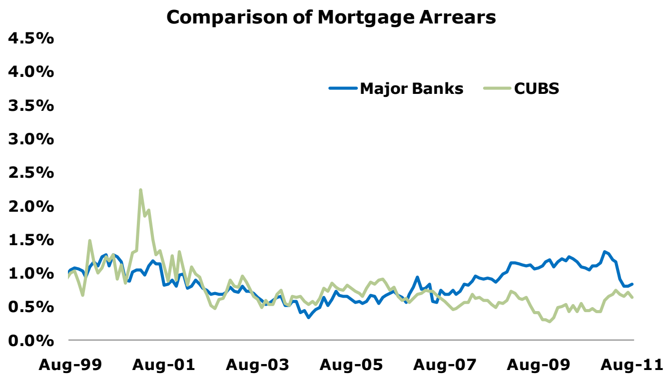
Source: APRA & Cuscal

The mutual sector has the second highest ATM accessibility across the country

The spread of ATM coverage is important to customers who want convenient service without incurring fees. The rediATM network used by many mutual organisations has the highest accessibility ahead of ANZ, Westpac and St George, widening the accessibility levels for our members.

Solid Fundamentals





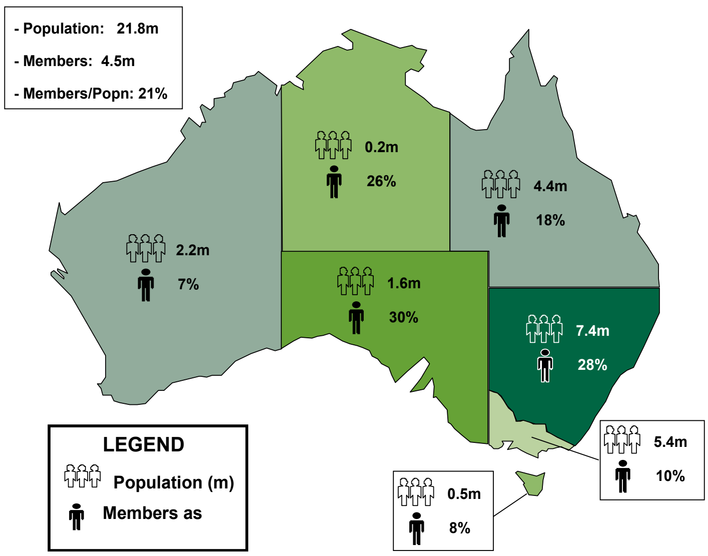
Source: Standard & Poor's

The credit union, mutual bank and building society sector is well capitalised, with aggregate total capital ratios of about 15%, as compared with around 12% for Australian banks, according to the RBA's June Qtr Bulletin.

The sector continues to demonstrate prudent lending practices with respect to mortgage arrears—currently lower than peers as shown in the Standard & Poor's Prime RMBS SPIN Index above.

The mutual sector is sound and secure

Strong Coverage Across Australia



There are approximately 4.6 million credit union, mutual bank and building society members in Australia as at August 2011.

This represents an overall population penetration of approximately 21%.

Population penetration (members as a proportion of the total population) highest in SA (30%) and NSW (28%).