Submission to Parliamentary Joint Committee on Corporations and Financial Services

Members Equity Bank

Members Equity Bank Pty Ltd (ME) is a licensed bank in Australia, and is wholly owned by 40 participating industry superannuation funds (ISFs). As a bank, the Australian Prudential Regulation Authority (APRA) regulates ME. ME also holds an Australian Financial Services Licence, and is regulated by the Australian Securities and Investment Commission (ASIC). The industry super funds that are shareholders of ME have an estimated 6.5 million customers, with A$100 billion in superannuation assets under management.

The bank has its origins in an innovative home loan programme established in 1994 as a collaboration between National Mutual Life Association and the Australian Council of Trade Unions. The evolution and growth of the home loan programme lead the company to apply for a banking licence in Australia. The licence was granted in July 2001.

ME is currently in the process of merging with Industry Funds Services Pty Ltd (IFS). IFS is a retail and wholesale funds management business focussed on servicing the industry superannuation funds. The merger will diversify ME's financial services business into wholesale, retail funds management and financial planning.

Aims

Members Equity Bank aims to provide Australians with innovative and low cost banking services. ME achieves this through the use of advanced distribution technologies and transparent banking products.

Technology is ME's key in providing low cost financial products. Rather than incurring the overheads of a retail branch network, customers can use the phone, Internet, ATMs, EFTPOS and Bank@Post as connections with ME.

ME, through its close relationship with ISFs and the trade union movement, is able to market its products and services in a low cost and direct manner. The savings generated by this approach are passed on to customers through more competitive interest rates, increased functionality, better service and lower charges.

Overview

ME is aware that a number of industry superannuation funds and the Australian Institute of Trustees (AIST) have provided extensive submissions relating to the Enquiry's terms of reference. ME will limit its submission to those terms of reference on which it feels it has the expertise to offer an opinion. We generally endorse, however, the submission by the AIST as being a comprehensive overview from an industry superannuation fund perspective.

Term of reference 1:

Whether uniform capital requirements should apply to trustees

ME believes that current capital requirements are adequate, and that there would be no benefit to members by the imposition of changed or more onerous capital adequacy requirements

Currently trustees of non-public offer funds do need to meet any capital or net tangible asset (NTA) requirements. Public offer funds need to hold $5m in NTA or an approved guarantee.

Capital adequacy is designed to meet a number of needs, and in all cases the ISF model has other effective mechanisms to meet these needs.

Risk protection

Capital adequacy can provide some insulation against risk. The typical ISF business model, however, is well structured to manage business risk by the adoption of the following practices:

- Outsourcing of administration, asset consulting, custodianship, insurance and investments, provides economies of scale, access to expertise at lower cost, and protection afforded by external party insurance and indemnity. Fund error is protected by trustee liability insurance;

- Compliance with the recently tightened regulatory and licensing regime has required ISFs to address risk and business continuity issues in extensive detail, and has directly caused the rationalisation of the number of funds into a reduced number of larger, better-resourced entities.

Trustees are acutely aware of their fiduciary responsibilities. Trustees are often drawn from Unions and Employer Associations, and are conscious that a high level of governance is critical to the maintenance of their professional reputation. Sponsoring organisations are aware of the long-term nature of superannuation, and the commitment necessary to always act in the member's interests.

Consequential Issues

The imposition of uniform capital requirements would have a range of adverse consequences:

- There would be a disproportionate impact upon ISFs, necessitating a shift in emphasis to ensuring a commercial return be paid on capital, at the expense of re-investment in members' services and benefits. Increased capital adequacy may also force further rationalisation of funds reducing choice and competition.

It is not desirable to provide capital against investment loss. Superannuation is a long-term investment - and diversification, member education and diligent trustee supervision are the most appropriate mechanisms to protect against adverse market movements. Trustees also have the option of holding reserves to smooth returns.

Summary

There is no evidence of the need for changed capital requirements for Trustees, and, in our view:

- ISFs have business practices that properly mitigate against risk;

- The regulatory environment is comprehensive in the obligations imposed upon trustees;

The impact would derogate from the ISFs' sole purpose of acting in members' best interests.

Term of reference 4:

The role of advice in superannuation

ME believes there should be no commissions payable on Superannuation Guarantee Contributions (SGC)–legislative intervention is required to protect consumers from conflicts inherent in the advice from advisors in receipt of commissions and incentives to promote particular products

- SG contributions are a compulsory and legislated component of an employee's remuneration. There can be no justification for a financial advisor to benefit financially by way of commission for such a mandatory transaction;

- Commissions on SGC erode the member's end benefit, prejudicing their quality of retirement. A typical commission of 1% significantly reduces a member's end benefit, and is more odious - given the reality that 9% contribution is generally accepted as being inadequate to maintain a person's standard of living in retirement;

- Work by the Australian Securities and Investment Commission (ASIC) has revealed disturbing levels of conflicted interests and unacceptable conduct from the financial advice industry. ASIC's shadow shopping survey identified incidences of unreasonable advice, advice that lacked credible foundation which risked leaving the consumer worse off, and that unreasonable advice was substantially more common where the advisor was in receipt of commissions.

In the context of ASIC's findings, and the failure of the financial advice industry to adequately self regulate the deleterious effects of sales commissions and the concomitant conflict of interest, legislative protection for consumers' SGC is recommended.

Summary

There can be no justification for consumers' superannuation guarantee charges being reduced by the imposition of a sales commission as the contribution is mandatory, paid by the employer, and is part of an employee's remuneration. It is particularly an issue of concern in light of ASIC's investigation into the behaviour of advisors in receipt of sale commissions.

Term of reference 11:

Whether promotional advertising should be a cost to a fund, and therefore its members

ME considers that in the context of a choice of fund environment, promotion and advertising costs are a necessary and legitimate cost of running a superannuation fund

Advertising and promotion is a legitimate business cost and essential to informing and communicating with an audience. Funds have an obligation to retain and attract members, particularly in a choice of fund environment. Financial services is also a scale operation, and members will benefit from the productivity derived from a larger, more efficient superannuation fund.

It would be an unreasonable constraint on ISFs, and inimical to consumers' interests, if a situation was permitted whereby a particular segment of the superannuation industry was denied access to the market via advertising. Consumer sovereignty assumes an informed market and clearly advertising and promotion is an important dimension in raising awareness. It is also evident that with a complex financial services market and relatively low levels of financial literacy it is critical that ISFs be able to rely upon advertising to assist with overall communication.

APRA has previously determined (February 2001) that the 'sole purpose test', the governing principle that must be observed by all trustees, permits advertising. APRA inter alia suggested:

- The sole purpose test is broad enough to encompass the normal activities of a fund trustee;

- Trustees are entitled to levy reasonable charges to reimburse expenses incurred that are reasonable, incidental to the running of the fund;

Advertising and promotion is not in contravention of the sole purpose test (except where it has not been primarily to inform and educate existing members, or where it imposes a cost on existing members to attract new members).

Summary

As advertising and promotion costs are critical to informing members, and attracting and retaining new members, they are an essential business cost. APRA has articulated clear principles governing the sole purpose test and its application to advertising for the benefit of trustees. Accordingly ME sees no need for any amendment to existing regulatory constraints.

Term of reference 12:

The meaning of the concepts "not for profit" and "all profits to members"

ME submits that the terms "all profits to members" and "not for profit", are appropriate to describe Industry Superannuation Funds on the basis that earnings, net of taxes, fees, and costs are paid to members as a crediting rate on superannuation balances.

The terms 'not for profit' and 'all profit to members' are suitable to describe industry super funds. A defining feature of industry funds is that they do not pay dividends to shareholders, and thus all profits generated are returned to the fund members.

"All profits to members" funds, without the need to generate a return to shareholders, are able to build a business model dedicated to the sole interests of the fund members. This produces a very strong organisational culture where the members' interests are paramount, and determine the priorities and values of the fund.

This commitment to an "all profits to members" business model drives the commitment not to pay sales commissions to advisors and planners.

The twin principles of "all profits to members" and no sales commissions, associated with low fees and strong investment performance, are the key identifiers of the industry superannuation model.

Summary

Industry super funds can be properly described as "all profits to members" or "not for profit " and, in conjunction with a resolve not to pay sales commissions, have built a business model genuinely focussed on member needs as the highest priority, and without the conflicts associated with the "for profit" funds.