**Australian Friendly Societies Association**

8 November 2005

The FSAC Secretariat
C/- Financial System Division
Department of the Treasury
Langton Crescent
Parkes ACT 2600

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Dear Sir/Madam,

**AFSA Submission: Efficiency of Financial Sector Regulation**

The Australian Friendly Societies Association ("AFSA") is the peak industry body representing friendly societies across Australia. On behalf of AFSA, I would like to express our appreciation for the opportunity to comment in respect of the Financial Sector Advisory Council's (FSAC) review of the efficiency of the regulatory framework in the financial sector.

We address ourselves to each of the matters raised in Attachment B of Mr Maurice Newman's letter to the AFSA President, Mr Chris Wright dated 23 September 2005.

***1. What particular aspects of the existing financial sector regulation present the greatest challenges for your industry grouping or business (please note where challenges are transitional)? What impact does this have on the efficiency of your business and the financial sector as a whole?***

Over the last decade, regulatory change has been a constant within the friendly society sector, with apparently unceasing reform of the multiple regulatory regimes impacting on friendly society business. This extended period of change includes –

- repeal of the State based *Friendly Societies Acts* and transfer to the national scheme of the *Friendly Societies Code* in 1996, regulated by AFIC and then APRA;
- introduction of and ongoing changes to APRA's Prudential Standards and Prudential Rules;
- transfer to the *Life Insurance Act 1995* and to the *Corporations Act 2001* regimes under the *Financial Sector Reform (Amendments and Transitional Provisions) Act 1999*;
- introduction of and ongoing changes to disclosure and licensing requirements under the *Financial Services Reform Act 2001* ("FSRA");
- introduction of the *Privacy Act 1988 (Cth)* and the National Privacy Principles; and
- multiple and complex changes of a taxation nature - we understand that taxation is beyond the scope of this inquiry and therefore, will not comment specifically in this respect.

AFSA does not disagree that some regulatory and legislative change has been necessary, but is most concerned about the **constancy and magnitude** of change. We feel strongly that the last decade of change has significantly contributed to a degree of stagnation within our industry, which is reflected in the lack of growth and new entrants to the industry. AFSA's primary concern is that Regulators and Government reconsider, where possible, the real necessity for

ever increasing regulation, particularly where it is questionable whether the benefits will outweigh the costs.

The common experience of friendly societies is that significant challenges have resulted from this period of constant reform, including the following:

1.1 **No "breathing space"**: Friendly societies have for over a decade suffered from the resource-consuming burden of managing regulatory change, implementing new policies, procedures and practices and introducing compliance related projects. There has been very little, if any, period of time for friendly societies to consolidate the implementation of necessary changes to the stage that they are operating at optimal efficiency, before they are confronted with more regulatory changes. In continually facing changes to their regulatory obligations, friendly societies are suffering "reform fatigue" and, as a result, have little time or energy available to concentrate on developing their businesses.

1.2 "**One size fits all" approach:** A growing challenge for the industry is tighter blanket regulation sometimes brought about by high-profile events such as HIH, Enron, NRMA and Worldcom. While many regulatory changes make good sense, regulations that are knee-jerk reactions are often implemented too quickly with a "one size fits all" approach and without giving adequate time to consider implications for -

(a) those who may already be regulated adequately, therefore leading to over-regulation; and

(b) smaller players within the industry, where tighter blanket regulation can actually lead to their withdrawal, therefore reducing diversity and competition.

Whilst it is acknowledged that such developments may be politically-driven and under strong and emotive community pressure at the time, we would be supportive of an approach, perhaps facilitated by FSAC, involving the calling of "time out", in recognition that much proposed regulation is viewed to be moving too fast and has the potential of creating unbalanced outcomes.

1.3 **Product and service innovation** has clearly been stifled due to the redirection of resources to compliance functions, thereby meaning the consumer misses out on relevant innovations in product and service design. Management's attention has for too long been diverted from focussing on core business activities, which would ultimately lead to increasing business opportunities, new product development and optimising benefits for friendly society members.

1.4 **Consumer benefit?** We raise the question of whether there is any evidence available to demonstrate that consumers, who are intended to be the beneficiaries of much of this regulatory change, may actually be realising the intended benefits. We would note our industry's experience of consumer frustration at the complexity, in particular, of product disclosure statements and the disclaimers and legalistic procedures that now govern all aspects of industry relationships with their customers. Consumers appear to be more confused about the range of products available and perplexed that comparison of products, without seeking expert financial advice, is virtually beyond the average consumer. Friendly societies are now spending the time they might have applied to business and product development in seeking to simplify the complexity of the new regime for their customers. We would query also whether this actually has had the effect of diverting consumers into direct equity and real estate investments, which are relatively unregulated compared to the complex disclosure regime applying to even the very simple products under the financial services reform agenda.

1.5 **Compliance costs:** It is without doubt that the associated escalating compliance costs of increasing regulation are eventually passed on to consumers, meaning that the consumer ultimately bears the cost of the supposed enhancements. Industry faces the ongoing challenge of digesting and understanding large volumes of legislation, regulations, standards and the like, commenting on proposals for amendments or reform and then

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working out their new responsibilities and what is required to implement and achieve compliance, whilst still attending to running their business. This may involve employing in-house legal staff or contracting the services of external lawyers, at potentially significant cost. We note as an example that the costs associated with preparation and legal review of product disclosure statements have increased ten-fold with financial services reform. We question whether sufficient attention is paid by the legislators to the likely costs of reform which will ultimately be borne by consumers and whether the extent of the reforms is actually warranted on a cost /benefit analysis.

In more specific terms, two particular aspects of the existing financial sector regulation that present the greatest challenges for industry are the key issues of **International Financial Reporting Standards ("IFRS")** and the ***Financial Services Reform Act 2001*** **("FSRA"):**

1.6 Whilst industry is now in an IFRS transitional period, the challenge with IFRS has been to both meet existing APRA Prudential Standards as well as the reporting requirements under IFRS. This has meant that financials have had to be restated, particularly at financial year end, in order to meet IFRS requirements. Additionally, the issues surrounding life insurance contract classification and how it impacts on accounting methodology has caused some concern at year end. This will not be resolved until the finalisation of the proposed APRA Prudential Standard entitled *"Contract Classification for the purpose of regulatory reporting to APRA"* (draft issued by APRA for comment on 26 September 2005) and is a good example of reform being introduced on a date based imperative and without adequate lead time to address the many interpretative issues.

1.7 A by-product of IFRS and the introduction of due diligence processes required in terms of Auditor sign-offs is the impact of additional costs to friendly societies' operations, ultimately borne from members' funds (ie. members potentially receive a lesser return on investment-style products, or decreased services). One example of inefficiency is the case where a friendly society's Auditor appointed its own Actuary to review all aspects of the work undertaken by the friendly society's Actuary, in order to satisfy themselves that all IFRS related matters had been taken into consideration and actioned.

1.8 Another future challenge is the need to make changes to core systems in order to meet the changed reporting requirements.

1.9 In April 2002, the then Chairman of ASIC, David Knott, stated in a presentation to the Australian Association of Permanent Building Societies (AAPBS) that the FSRA "*is the largest single logistical exercise that we have been called upon to implement*" and that it "*may well represent the single most important piece of law reform for the financial services sector over the past 50 years.*". This statement foreshadowed industry's subsequent experience of the significant degree to which resources have had to be diverted and dedicated to implementation, documentation and system changes, employee and consumer education and ongoing compliance.

1.10 FSRA reform has significantly changed the way that friendly societies do business, in particular, in necessitating changes to processes, policies, tools and frameworks that had operated successfully for many decades. The most significant impact is meeting the requirements of the Australian Financial Services Licence ("AFSL") regime. Furthermore, constant change caused by the need to resolve ambiguities in the disclosure requirements, particularly regarding fee guides, has resulted in Financial Services Guides and Product Disclosure Statements having to be continually reviewed and modified in order to meet the shifting ASIC interpretations, which is costly, time-consuming, confusing and counter-productive for consumers.

In conclusion, the ongoing challenge is that the continuing cycle of regulatory change for financial institutions does not seem to yet be abating. Whilst the FSRA and the IFSR are

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ongoing in their implementation, friendly societies will in the very near future face further change with –

(a) the release of the proposed Anti-Money Laundering legislation;
(b) the proposed APRA Prudential Standards LPS 510 - *Governance* and LPS 520 - *Fit and Proper Requirements* (submissions on the second drafts of these Standards were due 12 August 2005 and 24 August 2005 respectively);
(c) the proposed APRA Prudential Standards *Contract Classification for the purpose of regulatory reporting to APRA* (submissions on draft due 31 October 2005); and
(d) legislation implementing FSRA refinements.

***2. What proportion of your firm's administrative processes and resources are devoted to compliance activities that it would not undertake if the regulation did not exist? Please distinguish from procedures and activities (eg. accurate record keeping) that would likely occur without regulatory stipulation.***

Greater regulation of the financial services industry has been accompanied by increased employment of in-house or out-sourced compliance personnel. Clearly, the associated costs of such have favored larger players in the industry and have likely had an influence on industry rationalisation, as smaller players seek shelter via amalgamations and mergers. There may also sometimes be a lack of sufficiently trained compliance resources available for employment. AFSA queries whether the regulatory development process adequately appreciates these potential implications.

Some examples of the employment of additional compliance personnel include -

2.1 With the constant regulatory changes, including APRA Prudential Standards, the introduction of IFRS, FSRA and AFSL, one society reports that it –

2.1.1 has employed a full-time National Training and Compliance Manager, the key aim of this appointment being to provide greater focus and strengthen the society's marketing area to ensure that marketing controls are tightened with more emphasis placed on accreditation, quality control and compliance;

2.1.2 has introduced a compliance program which extends compliance responsibilities to all staff in order to meet the various legislative/regulatory requirements;

2.1.3 is recruiting a Financial Accountant who will be responsible specifically for Finance Department compliance activities, to ensure that that compliance is achieved and demonstrated in respect of all finance related activities. The Finance Department also had to hire a contractor in order to meet the increasing workload as a result of IFRS and all other compliance requirements.

2.1.4 has employed a Compliance Officer and a Business Improvements Manager. Some of the key functions performed by these resources include:

- to develop and undertake better business practices by ensuring compliance with relevant legislation and best practice standards;
- continuously monitoring and evaluating the efficiency and effectiveness of processes to ensure compliance with laws, regulations, Board and Management policy;
- continuously monitoring regulators' websites and other channels to ensure ongoing compliance;
- coordination of the compliance function across the society;
- developing and coordinating, in association with the Executive, educational and training programs regarding appropriate elements of regulatory requirements;

- coordinating the introduction of necessary actions to achieve compliance with FSRA and the auditor/ASIC compliance review;
- ensuring that the society has a functional Disaster Recovery Plan;
- liaising with FICS and other appropriate bodies as and when required on behalf of the society;
- ensuring the appropriate dissemination and communication on all regulatory, policy changes to affected personnel;
- coordinating the preparation of Product Disclosure Statements and Financial Services Guides including preparation of counsellor schedules as and when required.

2.1.5 as part of AFSL requirements, ongoing identification and education of "Responsible Officers" under ASIC Policy Statement 164 *Licensing: Organisational Capacities* (PS 164), particularly section E relating to "Organisational Competency". This has required the identification of personnel who are depended upon for organisational competency and who are directly responsible for significant day-to-day business decisions about the ongoing provision of financial services by the licensee.

2.2 Another society reports that –

2.2.1 a full time compliance resource has been necessary to assist the business with its regulatory requirements;

2.2.2 considerable management time and attention is required for implementing and embedding compliant processes into individual business units;

2.2.3 considerable additional time is also spent on monitoring upcoming regulatory change as well as ongoing interpretative and administrative issues relating to current legislation;

2.2.4 additional management time is allocated to ensure that adequate training in relation to regulatory requirements is given to employees;

2.2.5 it has also employed in-house legal counsel to assist this process and to contain external legal expense.

2.3 Other societies have reported the appointment of Compliance Officers, some combining this with risk management responsibilities because of APRA's focus on the risk management framework approach.

2.4 Many friendly societies have noted that compliance has become the responsibility of all staff, adding to each individual's existing tasks and the overall cost of compliance.

2.5 Finally, since the move of friendly societies to regulation by ASIC in 1999, a greater level of responsibility and resultant more stringent controls has been imposed on Directors of friendly societies by virtue of regulatory and legislative obligations under the *Corporations Act 2001*. The responsibilities of Directors will continue to grow with the introduction of the proposed APRA Prudential Standards LPS 510 - *Governance* and LPS 520 - *Fit and Proper Requirements* (submissions on the second drafts of these Standards were due 12 August 2005 and 24 August 2005 respectively) and leading to further administrative costs to achieve compliance.

***3. Have you identified any of the following features which may impact on the efficiency of financial sector regulation?***

***(a) Overlaps between regulatory requirements, both in terms of meeting legal and administrative requirements (eg. between two or more of the following: APRA, ASIC, ACCC, RBA, ASX, ABS, etc)***

Current requirements involve the duplication of information required to be provided by friendly societies to various regulatory bodies. AFSA would propose that all relevant regulatory bodies should be required to participate in a process of coordinating

requirements for provision of information and reporting by financial institutions, with the aim that a standard format and style of reporting be established in a central repository accessible by all relevant regulatory authorities.

Furthermore, we would question the need for the separate regulatory systems headed by APRA & ASIC. We understand that a suggestion of the Wallis Inquiry in the mid 1990s favoured a single regulator for the financial sector. The merger of these regulatory bodies and their overlapping roles could potentially reduce costs substantially for all concerned.

Areas where particular overlaps are evidenced include:

3.a.1 The need to lodge annual reports with both ASIC and APRA using different forms and methods. For example, friendly societies must lodge annual reports with both regulators using different forms and methods. This includes lodging annual reports with ASIC under section 388 of the *Corporations Law,* as well as in order to meet the requirements of forms FS70 and FS71 as required under the *Financial Services Reform Act*, plus the same annual report must also be lodged with APRA twice under Prudential Standards and IFRS: four lodgements in total. With the proposed APRA Prudential Standards LPS 510 - *Governance* and LPS 520 - *Fit and Proper Requirements,* further duplication in reporting is likely to occur.

3.a.2 Reporting of compensation arrangements for insurance cover. APRA Prudential Standard 6.1 requires changes to compensation arrangements to be reviewed quarterly and notified accordingly. ASIC requires notification of changes to be submitted via form FS 20 within 10 days of the change.

3.a.3 The identification and maintenance of service contracts under APRA and outsourcing requirements under AFSL requirements administered by ASIC:

(i) APRA Prudential Standard 6.4.4 defines a service contract as "*other arrangements entered by a society to obtain services and products without the abrogation of management contro*l". APRA requires that a friendly society is to demonstrate systems for selection, regular review and renewal of service agreements that ensure arm's length dealings. The society has to ensure that adequate systems and controls are in place to review the decisions made and ensure they are in accordance with board approved policies and procedures.

(ii) ASIC requires AFSL licensees to put in place compliance measures different to those it would need if it provided the outsourced functions itself. Expectations from ASIC's perspective require the licensee to demonstrate that it: has measures, processes and procedures in place to ensure that due skill and care has been taken in choosing suitable providers; can and will monitor ongoing performance; and will deal effectively with any breaches of the service agreement or actions that lead, or might lead, to a breach of the licensee obligations, including reporting where appropriate.

The result is that a society must maintain two separate registers and policies in order to meet the specific requirements of both regulators.

3.a.4 As mentioned in section 1.6, with the introduction of IFRS it has been necessary for friendly societies to restate financials in order to comply with the IFSR as well as existing reporting requirements.

3.a.5 The inefficiencies and unnecessary costs of a system involving both State and Federal Revenue Authorities is an ongoing issue.

3.a.6 The duplication of regulation by various State Governments, including significant variations in requirements from State to State. One example is recent and varied changes to the diverse legislation applicable to pre-paid funerals in Queensland and NSW, which affect friendly societies which market funeral policies nationally. The Victorian and South Australian Governments are also reviewing relevant legislation. Many of these State-based legislative reviews appear to be motivated by the federal government's competition requirements for funding.

3.a.7 APRA's draft Prudential Standard LPS 520 - *Fit and Proper Requirements* seems to indicate potentially more duplication with the ASIC regime in relation to provision of information relating to responsible persons, such as directors, and auditors.

3.a.8 Review of the *Life Insurance Act 1995* has been on the agenda for some years now but has been deferred due to more pressing issues. It might appear that the anomalies between friendly societies and life companies evident in this legislation have been of little concern to the legislators.

3.a.9 The inconsistent requirements in relation to the issue of "badging" a product. "Badging" involves a society entering into arrangements with third parties in an effort to generate alternative revenue streams. This may mean entering into an agreement with an external party in order to provide additional benefits to friendly societies members such as discounted superannuation, health benefits or insurance, which provides added products and services for the friendly society's members. By entering into such arrangements, the society can offer its members a "badged" product (provided by the third party product issuer) at discounted rates, and the society benefits from this association in that it receives a commission from such arrangements.

(i) In terms of these initiatives, APRA provides the following guidelines in relation to marketing products of third party institutions under APRA Prudential Standard 6, section 6.7.5:

*"Where a society or its subsidiary allows its name, logo or trademark to be used in marketing products of third party institutions, additional risks may arise. Under these circumstances:*

- *the "name" or "badge" of the party providing the product must also feature prominently in all advertising material, marketing documents and any documents inviting investment or participation in a product;*
- *the respective roles of the parties must be explained clearly and prominently in any document inviting investment or participation in the product – including to the extent to which each party is responsible for the safety and performance of the product;*
- *the disclosure provisions of this Prudential Standard must be satisfied fully.*

*If these conditions are not met, the SSA [APRA] may direct the association with the relevant product to be discontinued.".*

(ii) in terms of ASIC requirements under the *Corporations Act 2001* and AFSL, if a society is not licensed to deal in, for example, a superannuation product, any involvement in a badged superannuation product would be limited to referrals only. Referrals are exempt from licensing requirements with the following conditions:

At the time the referral is made, the friendly society must only:

- Advise who is the issuer of the particular product; and
- Provide the contact details of the issuer; and
- Advise of the commission that the society will receive for its referral.

These conflicting "badging" requirements would apply to all types of communications (ie. internet promotional text, brochures, letters, emails, general mailouts) and the society must ensure that all such communications do not imply any financial product advice. Additionally, where Financial Service Guides and Product Disclosure Statements are involved, a "badged" version may need to be developed prior to offering that product to members.

***(b) Inconsistencies between regulatory requirements***

Please refer to comments in paragraph (a) of this section above.

***(c) Regulation that is out of date due to industry trends***

3.c.1 Electronic commerce is clearly one such area and this as been addressed in detail in our earlier submission to FSAC dated 7 October 2005 relating to the inquiry into the regulation and the use of technologies in the financial sector.

3.c.2 A further example is the various State and Territory based *Credit Acts* and *Credit Administration Acts*, in particular, the issue of licensing requirements when offering credit products. Such legislation in some States and Territories has clearly not been updated to address changes in Federal legislation, such as the repeal of the *Life Insurance Act 1945* and introduction of the *Life Insurance Act 1995,* resulting in confusion about a friendly society's obligation to maintain a credit provider's licence (in WA and the ACT). State and Territory legislation must be kept up to date.

3.c.3 Finally, the various States and Territories have in place *Fair Trading* legislation, which overlaps with ASIC responsibilities under Division 2 of the *ASIC Act 2001,* as well as those of the ACCC under the *Trade Practices Act 1974*. It would be useful if there were some linkages between these varying requirements of State, Territory and Commonwealth legislation.

***(d) Regulation that is hindering the introduction of new products, working against industry developments or creating inappropriate barriers to entry***

3.d.1 One matter already discussed is the issue of "badging" of products provided by third parties and offered to a society's members (see at paragraph 3.a.7 above). A friendly society recently faced a situation where a "badging" deal fell through, due to the third party perceiving that the barriers of entering into such an arrangement were too prohibitive. Guidance statements from regulators would be beneficial in order to limit the complexity and regulatory inconsistencies involved in entering into such agreements.

3.d.2 Amalgamations and mergers are often the only means by which the smaller players might survive and thereby continue to protect affected member interests. It should be noted that capital gains tax rules do not assist in the case of mergers, as asset rollover relief is unavailable to mutuals that merge. The regulations may indicate no disposal event has occurred, yet the tax rules may be applied as if assets have been disposed of.

3.d.3 Normal commercial transactions and restructures may often be conducted within a wholly-owned group to achieve greater efficiency and competitiveness. The abolition of the relative simple income tax group rules (on 1 July 2003) and their replacement with the significantly more complex consolidation regime (from 1 July 2002) has added to compliance demands. Contrast this with the much simpler and flexible GST grouping regime (introduced on 1 July 2000). Assuming these tax

developments are irreversible, future regime substitutions should be subject to greater accountability of expected compliance impact.

3.d.4 Given the complexity of legislation and regularity of change in some areas, there is a barrier to organisations providing certain products. Superannuation is one example.

3.d.5 A further complication which creates unnecessary barriers by diverting attention from business development is the ASIC Enforceable Undertaking (EU). We are concerned that where an EU is in place, this means that all aspects of an entity's operations are scrutinised by ASIC (not simply those relevant to the EU) and stringent compliance tasks are imposed. This will have significant cost implications, in addition to the requirement for an independent annual review to be undertaken by an independent consultant to assess compliance with the EU. Our concern is whether the significant burden of scrutiny of the whole entity's operations under an EU is warranted, when weighing the cost implications against the overall benefits, particularly as the relevant entity must still meet all its other obligations under the *Corporations Act.*

***4. Can you suggest ways of improving the ongoing operation of particular aspects of the regulation in practice? What role can the regulator (s) play in this?***

4.1 In addition to the various improvements suggested in response to questions 1, 2 & 3 above, the key from AFSA's perspective is for regulation and Regulators, primarily ASIC and APRA, to strike a balance between compliance with required regulations, whilst not stifling the growth of the business. It also appears at times that these key Regulators do not talk to each other.

4.2 This is evidenced with the proposed APRA Prudential Standards LPS 510 – *Governance* (submissions on the second draft closed 12 August 2005). The draft was silent on how amendments to a friendly society's constitution could be made in order to comply with LPS 510 requirements. Any amendments to a society's Constitution currently falls under the jurisdiction of the *Corporations Act 2001*. Specifically, section 136(2) states that a company may modify or repeal its constitution, or a provision of its constitution, by special resolution. As many constitutions may require amendment in order to comply with LPS 510, it was AFSA's submission that relief should be granted from the application of section 136(2) of the Act in order to allow a society to adopt any constitutional amendments for the purposes of compliance with LPS 510 by a resolution of a society's Board. Awareness by APRA of how its proposals impact in relation to other regulators and regulatory regimes would mean issues like this would be addressed in the drafting of the proposals.

4.3 Where possible, it is suggested that the reporting system needs to be simplified in relation to information requirements. Is it feasible that regulators could work together to determine a standard format of reporting that is provided only to one centralized agency? If a regulator considers that the necessary information is not thereby available (eg. by virtue of the application of the relevant the accounting standards), we would suggest that they seek appropriate change to the primary reporting format, so that one overall solution suits the purpose of all regulators. This would then remove the requirement for societies to carry out additional work to recast information to suit the needs of only one regulator. For example where ASIC requires information that is based around accounting standards, APRA will require it to be presented differently in order to address capital and solvency requirements.

4.4 A further improvement would be that incremental change be undertaken where enhancements are beneficial to all. This will ensure that changes have the opportunity to be bedded down and operating at optimal efficiency prior to moving onto the next suite of changes. Once again, AFSA is of the view that the Regulators and Government should communicate with each other more frequently in order to implement a coordinated timetable

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of reforms and thereby limit the drain on friendly societies' resources in constantly trying to keep up with reform implementation.

4.5 It would appear that the policy direction of ASIC in some areas may be at odds with the interests of consumers. By way of example, the recent ASIC Consultation paper *Proposed relief and guidance for online calculators* IR 05-46 includes interpretations relating to the "advice" position of such calculators. This may ultimately result in fewer organisations providing these useful education tools, or they may become far too cumbersome to be of any practical benefit to potential investors.

4.6 Finally, AFSA would respectfully suggest that not all friendly society Regulators have a well-developed understanding of how friendly societies are structured and how they operate. This is apparent from the "one size fits all" mentality in recent regulatory changes. For example, under FSRA, regulations are applied across all business types and industries without any consideration of the structure or operations of particular businesses. This ultimately leads to costs being incurred by the smaller players in the market such as friendly societies, which cause both an erosion of benefits for their members and a threat to the existence of diverse financial institutions on a long-term basis. ASFA therefore respectfully submits that Regulators be encouraged take the time to understand the business types and structures in the markets that they regulate, therefore eliminating practices that are not applicable and removing perceived restrictions for certain business types.

***5. Have you received any complaints or positive feedback from your stakeholders that relate specifically to your compliance with the particular sector regulation (eg. from clients, creditors, third party service providers, shareholders, etc)?***

Indications from some friendly society clients suggest that clients are being overloaded with information when considering friendly society products. It appears that there is now a trend of consumers moving away from heavily regulated products such as managed investments into investments on the fringe of regulation that are perceived as easier to enter. This move to markets which may not be well regulated is counterproductive to the intent of the FSRA.

***6. What have been your experiences dealing with the regulators and Treasury on the particular financial sector regulation?***

6.1 APRA supervises friendly society operations for the purposes of prudential regulation aimed at ensuring that the regulated institution is able to meet their obligations to members. From friendly societies' experiences, we have found that APRA are accessible, responsive and are fully aware of the issues facing friendly societies and the likely impacts of regulations that are to be introduced. They appear to listen to friendly societies' concerns and feedback in formulating policy. However, one area where improvement could be worthwhile is where the regulatory burden could be minimized if APRA were to adopt a pragmatic approach. The making of routine amendments to benefit fund rules is an example where the pragmatic approach would be to allow such amendments to be approved by Board resolution. One society recently issued notices of special resolution to members of five benefit funds in an attempt to hold member meetings in various locations across Australia. Only two meetings met the quorum, two were held a week later with two people present and the final special resolution was eventually passed by Board resolution.

6.2 ASIC supervises market integrity and investor protection. Comments AFSA has received suggest that ASIC is not as responsive as APRA to friendly society issues and does not fully understand the structure of friendly societies. Policies seem to be tailored and aimed at the major "blue chip" companies without any thought of the smaller diverse regulated organisations such as friendly societies. Essentially, AFSA is led to the view that friendly societies have been "pigeon-holed" and are often overlooked, because their structures are not well understood. This is particularly evident with respect to the FSRA.

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6.3 AFSA members have suggested that ASIC's responsiveness to issues has been less than satisfactory. As an example, one society submitted a query to ASIC in relation to APRA Prudential Standards LPS 510 – *Governance* and possible relief from the requirements for constitution amendments to be by special resolution of members (see further explanation at section 4.2 above). After more than 17 weeks and multiple follow ups, the society gave up chasing ASIC for a response. Note however that AFSA referred the same question to ASIC on 5 September 2005 and received a response, albeit negative (ie. ASIC is unable to assist), on 22 September 2005.

6.4 Another concern is that Regulators are adopting a rules based and prescriptive approach to regulation which will only result in additional paperwork and cost without achieving the desired result. Little consideration appears to be given to the size, type, structure or products of regulated organisations, with the result that regulators are simply adopting a "tick the box" process. We believe a different approach could be taken between large organisations compared to smaller organisations (as does the ATO) provided that it can be demonstrated that the smaller organisations are complying with the appropriate standards.

6.5 We are also concerned about the continued impact of disclosure. Whilst we support full and open disclosure, we are concerned about the amount of information being thrust upon consumers and the increasing cost of such. There appears currently to be a "stand off" between ASIC and the legal profession with the end result being that large, complicated Product Disclosure Statements (PDS) are being issued to consumers, who are in turn finding those PDS difficult to comprehend. We acknowledge that some recent work has been undertaken by ASIC to simplify this process; however we believe that there continues to be a need for ASIC to provide succinct guidance, so that the legal profession can be relieved from endeavoring to cover all issues and risks by adding large amounts of potentially superfluous information into the PDS. This is a distinct problem because the same disclosure principles apply to very simple as well as complex investment products.

***7. Please provide any additional comments that you may wish to make relating to the particular financial sector regulation.***

7.1 By imposing increasingly greater requirements on already prudently managed financial institutions, we query whether Government, Regulators and society in general are accepting this imposition of additional responsibilities and costs for little perceived additional benefit to their beneficiaries and stakeholders, costs ultimately borne by those beneficiaries or stakeholders. In fact, APRA has recently drawn attention to the fact that certain proposed measures will reduce, but not eliminate, the risk of failure arising from incompetent or dishonest management[1]. AFSA thereby questions whether the move towards greater prudential regulation is being properly directed at the "many" already acting prudently, rather than developing innovative ways to seek out the dishonest and fraudulent "few"?

7.2 AFSA is also concerned with the pace at which much regulatory change is introduced. We have seen numerous instances where reform is announced with a strict timetable for its introduction, but as the detail of the regulatory requirements are developed and issues arise, there is little time to address the issues fully before the changes are rushed into force to meet the initial (usually impracticable) timetable. There is insufficient opportunity for those involved, including Regulators, to gain a deeper understanding of, and address, the complex issues. This has the potential to require additional resources after the event to ensure that the requirements are properly clarified and understood. Clearly, there is need for a more measured approach, which allows adequate lead times and avoids rushing of regulatory changes, and then subsequent amendment as inconsistencies and poor drafting

[1] APRA Discussion Paper, *Fit and proper requirements*, 29 June 2005, at p. 5, Chapter 1.

are clarified. Sufficient lead times would also enable Regulators to be mindful of impacts on business and, in particular, the busy times in the business cycle such as year end.

7.3 In this respect, there are examples where, with implementation imminent, further information or clarification is required from regulators, but is not available. In relation to IFRS implementation for instance, APRA have been concerned about how friendly societies will classify their products, that is, as insurance contracts or investment contracts. However, APRA have only recently released a draft Prudential Standard (on 30 September 2005) to provide guidance on the matter, which is yet to be finalised, despite the fact that the IFRS regime has applied for a period of 4 months. This is certainly a less than desirable situation. It would be preferable that early consideration and clarification of such issues were possible in anticipation of the application of such changes, or in the alternative, that extension of the implementation timetable be granted to affected entities so that the issues may be fully considered and resolved in an orderly fashion.

7.4 An issue that is looming as of potential significant threat to friendly society mutuals is the recent proposed ASIC policy issued in May 2005 as a Consultation Paper entitled "*Approving a purpose for access to the register of members of a mutual entity*". This paper has raised considerable concern in the mutual sector, including amongst Credit Unions and Building Societies, as it represents a significant change in approach by ASIC. In brief, in 1999, when mutuals were transferred into the Corporations Law regime, it was generally agreed that mutuals were in some significant aspects clearly different from public companies. To this extent, Parliament acknowledged certain specific differences in the treatment of mutual entities under the legislative amendments that gave effect to the transfer of mutuals into the Corporations Law. It is worth noting that members of a mutual are not equivalent to shareholders: members are customers of the mutual; the mutual entity exists to serve its members and to manage the entity for the collective benefit of the members (and without the conflict between customer interests and shareholder interests); members are each entitled only to one vote despite the extent of their investments in products offered by the mutual; membership rights are not tradeable and no member can gain a controlling interest over a mutual. ASIC's recent Consultation Paper reflects a diminution of Parliament's earlier recognition of difference and is indicative of a policy change that would seek to treat mutuals as akin to a public company. We are extremely concerned about this apparent challenge to those entities that have successfully functioned with a mutual structure for much of Australia's history, and the nearly 6.5 million Australians who have chosen to be customers and members of mutuals in the financial sector.

On behalf of members of AFSA, we note our appreciation for the opportunity to participate in this consultation process. AFSA would be grateful for your consideration of the matters raised herein. We would also welcome the opportunity to discuss this submission further with you or to provide any additional information. Please do not hesitate to contact me on 03 9685 7543 or by email jane.southwell@afsa.com.au.

Yours sincerely

Jane Southwell
Executive Director