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Credit Union
Industry Association

23 December 2005

Mr Gary Banks
Chairman
Regulation Taskforce
PO Box 282,
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Dear Sir

Submission on Reducing the Regulatory Burden on Business
Credit Union Industry Association (CUIA)

Thank you for the opportunity to make a submission to the Taskforce and for the opportunity to meet with Taskforce members, Mr Dick Humphrey and Mr Rod Halstead to discuss the Taskforce's role.

The CUIA (formerly CUSCAL Industry Association) is the representative body for the majority of Australia's credit unions. Credit unions are an important part of the financial services sector providing competition and choice in financial services, particularly in regional and rural Australia.

Credit unions are regulated in the same way as banks and of course appreciate the importance of effective regulation of the banking sector, given its critical role in the broader Australian economy. However, credit unions are also acutely aware of the uneven impact of excessive or ineffective legislation on smaller institutions that simply do not have the resources or scale of their larger counterparts.

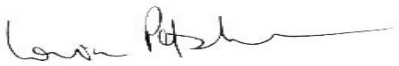
It is clear that a number of the major pieces of legislation for our sector – for example, FSR, anti-money laundering and the treatment of mutuals under the Corporations Act – all have areas that could be improved and further detail of these improvements are contained in our submission.

Credit unions are also of the view that the tendency to rely on regulation through disclosure and a 'regulate first' response to market failures hurts smaller institutions, particularly those smaller institutions like credit unions that already fall under "mainstream" regulatory frameworks.

We support the Government's efforts to look at ways to reduce red tape. In our view, these efforts should be focused not just the practical first steps in addressing obvious inconsistencies or errors, but also in looking at the way in which regulations are made. Better coordination between agencies and regulators, more effort in understanding how business operates and significant improvement in ASIC blinkered approach to the mutual sector should all be priorities in this regard.

Thank you again for the opportunity to comment. Please do not hesitate to contact me if you have any further questions on (02) 8299 9046 or at lpetschler@cuscal.com.au, or Mark Degotardi, Senior Adviser Policy & Public Affairs, on (02) 8299 9053 or mdegotardi@cuscal.com.au .

Yours sincerely



LOUISE PETSCHLER
Head of Public Affairs

SUBMISSION

Credit Union Industry Association

Taskforce on Reducing the Regulatory Burdens on Business

21 December 2005

2. About the Credit Union Industry Association

The Credit Union Industry Association (CUIA) (formerly known as the CUSCAL Industry Association) represents the vast majority of Australia's credit unions. The CUIA provides a range of services to 135 of Australia's 157 credit unions, including representation, compliance, research and fraud prevention advice and assistance.

Credit unions have assets in excess of $31 billion and more than 3.5 million Australians are members of a credit union. Further information on the sector's performance, portfolio and diversity can be provided on request if this is relevant to the Taskforce's consideration.

The CUIA is part of Cuscal, which is an aggregated service provider to credit unions and other financial institutions (and an Authorised Deposit-taking Institution under the Banking Act 1959 in its own right). Cuscal provides competitive retail products and services and wholesale funding solutions to its customers. These include direct entry, member chequing, ATM services, Treasury functions and wholesale lending products. Cuscal is owned by its member credit unions, and has a AA- rating from Standard & Poors reflecting its size and operations.

3. Overview

As requested in our meeting with members of the Taskforce, we have provided specific examples of regulatory "red tape" in this submission. These examples are not exhaustive and need to be considered in the context of some of the comments on the regulatory framework provided below. We would be pleased to provide further examples or detail if this would benefit the review.

3.1 The Uneven Impact of Regulation on Smaller Institutions

Whilst regulation of course impacts on all regulated institutions, the impact is far greater on smaller institutions such as credit unions. The credit union sector does not oppose regulation, and seeks to work constructively with regulators and legislators on sensible, member and consumer-focused outcomes in each of the various regulatory frameworks affecting our industry. However, the considerable cost, overlap and impact of regulation (particularly an undue focus on disclosure, requiring considerable systems changes and printing costs with little consumer benefit) has a major and substantive impact on our sector.

Since the Wallis reforms, credit unions and other ADIs have been subject to an increasing range of regulatory interventions. This has included implementation of the FSR regime, adoption of the international accounting standards, preparation for the implementation of Basel II, a number of changes to prudential standards including Business Continuity Management and the upcoming Corporate Governance standards as well as a significant number of consumer credit issues (such as mandatory comparison rates).

The combined effect of these reforms is significant for smaller institutions, particularly mutual institutions that have a member focus. Whilst these reforms may individually be well intentioned, the incremental effect of each reform is devastating for smaller institutions that do not have the scale to absorb the IT and compliance costs associated with the reforms.

The impact on smaller institutions like credit unions has been marked, with significant consolidation occurring in the sector as a direct result of compliance costs. The cost to competition and choice in the financial services market together

with the community cost of losing credit unions that often service rural and regional areas is seldom considered in the policy process.

3 Multiple regulators

The Taskforce will be aware of the large number of regulators with responsibility affecting the banking and financial services sector. Unsurprisingly each of these regulators is focused on delivering on its mandate. APRA, for example, is uncompromising in its focus on protecting depositors. ASIC is focused on market operation, protection of shareholders and consumers. The RBA is concerned only with efficient markets in terms of payments systems. Seldom, and then only randomly, do individual regulators concern themselves with questions about how their regulation intersects or overlaps with the regulations of other institutions.

In the implementation of these mandates, each of these regulators continually develops and reforms developing mandatory disclosure based obligations and a plethora of best practice guidance. It is of little surprise that the Productivity Commission counted some 2,380 regulations being introduced during the last financial year.

The problem is not isolated to areas of regulatory overlap. For small institutions, the timing of the introduction of regulation that might otherwise be acceptable can be critical. Credit unions like other ADIs have seen the introduction of the substantial FSR regime in 2003 and 2004, the introduction of international accounting standards from 2005, significant corporate governance, other prudential reforms, significant payments system reforms and a revised FSR regime in 2006, significant anti-money laundering reforms and deposit insurance moted for 2007 and Basel II from 2008.

At the same time, credit unions are subject to changes to employment laws, act as tax collection agents for the Government, comply with self-regulatory Codes of Practice, provide prudential and statistical reports to APRA on a quarterly basis, comply with licensing requirements as Australian Financial Services licensees as well as complying with a vast range of consumer protection and fair trading laws.

As each regulator attempts to eliminate risk from their particular patch, in our view too little regard is paid to the cost of the regulations that are introduced, a cost

that is borne by industry. Clearly, many regulations have had no or inadequate regulatory impact assessments prepared. The impact of this inadequate cost/benefit assessment and the sheer volume of regulatory reform in recent years is crippling to smaller institutions like credit unions.

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As risk-averse regulators seek to eliminate even the most minimal risks, there has been an increasing incidence for regulatory overlap. Whilst this may be understandable, it is not desirable and has a significant impact on small institutions.

Corporate Governance – Who's in Charge?

The recent APRA proposals in terms of Governance and Fit and Proper standards are a useful example. In essence, while the Banking Act 1959 may provide APRA with authority to regulate ADIs "at the firmer end of the governance spectrum that companies incorporated in Australia are expected to meet," this creates compliance issues in relation to existing and well-established corporate law and fiduciary obligations.

For example, APRA's draft governance standard asserted that "the Board must have regard for the interests of depositors at all times" when setting policies and making decisions. But at general law and under the Corporations Act 2001 directors' duties are owed to the company and not to individual shareholders. Additionally, APRA's standard asserted "the Board cannot delegate its responsibility", although it can delegate authority to management to act on its behalf. But, under s.190(2) of the Corporations Act 2001 a director of the Board is not responsible for the actions of a delegate when:

- the delegating director believes on reasonable grounds the delegate would exercise the power in accordance with the director's duties set out in the Corporations Act 201 and the company's constitution; and
- the delegating director believed on reasonable grounds and in good faith the delegate was reliable and competent in relation to the power delegated.

Provided these criteria are satisfied, the delegating director will be considered, under the Corporations Act 2001, to have fulfilled their duty as a director.

Each regulator in its attempts to ensure the effectiveness of their oversight implements high standards for directors, standards that however result in duplication of compliance requirements such as breach reporting, and subjecting directors (and some employees) to different propriety and competence tests. Credit unions are also concerned to ensure that regulation is pragmatic and realistic, for example recognizing the circumstances of well regulated and run smaller country-based institutions on issues such as board renewal, expert independent directors and rotations.

There appears to be insufficient effort from Government agencies in adopting broad Government policy development that takes into account the risks of delivering those policies through multiple regulators and quasi-regulatory bodies.

Misleading and Deceptive Conduct

Instances of misleading and deceptive conduct are a prime example of Commonwealth/State overlaps especially in respect of regulated financial institutions like credit unions.

Misleading and deceptive conduct for financial services falls under section 12D of the ASIC Act 2001, however misleading and deceptive conduct for general corporate transactions falls under section 51 of the Trade Practices Act 1974. However, the conduct relates to a consumer credit contract then the Uniform Consumer Credit Code applies. For a regulated institution like a credit union, then there are potentially three different regulatory frameworks with different legislative test that it needs to comply with in relation to its activities.

Further, fair trading is a State responsibility and some States have introduced, and others are considering introducing, unfair contracts legislation. Not only is non-uniform legislation a problem in itself for corporations operating across State borders, but the unfair contracts legislation proposed is yet another layer of legislation primarily aimed at protecting consumers from the behaviour of a small number of entities, but proposed to apply to all corporations whether they operate in an industry where problems have been identified or not.

Other inconsistencies between the ASIC and APRA regimes include:

- in relation to Nominated Responsible Officers (NROs), ASIC requires a "statement of personal information" but APRA requires the same people in some circumstances to meet their proposed "Fit and Proper" tests;
- in relation to breach reporting, ASIC requires notification of breaches of the Banking Act 1959 whilst such breaches are already required to be reported to APRA;
- in relation to both the Governance and Fit and Proper standards proposed by APRA, the associated reporting obligations initially sought reporting times that were inconsistent with related reporting already required to ASIC;

- in relation to auditor sign-off, APRA's Governance proposals seek an additional obligation on top of the existing FSR obligations where auditor sign off is already required by ASIC; and
- in relation to requests from ASIC inspectors for policies and procedures on risk management systems, which clearly falls within APRA's jurisdiction.

Because of their critical and overlapping role in the regulation of credit unions, coordination between APRA and ASIC is seen by our industry as a high priority. Outside of the governance requirements, the overlap and often inconsistent messages (exacerbated by a lack of understanding of the mutual sector within ASIC) from the regulators can increase costs and delay transactions unnecessarily. Examples include:

- failure by ASIC to ensure consistency in reporting obligations for ADIs where the same information is reported to ASIC and APRA;
- lack of clarity in ASIC's role on the transfer of business process, whereby APRA oversees mergers between credit unions. APRA and ASIC re-wrote the transfer rules in early 2005 with very little consultation with industry, a disappointing outcome given examples of overlap and mixed messages (ranging from definition of 'member share' through to extent of disclosure requirements where mergers involve very small credit unions being transferred to much larger institutions) from ASIC delaying transfers;Dual inspections (under prudential requirements and FSR) of the risk policies and operations of credit unions by both APRA and ASIC.

ASIC and APRA have an agreement on the approach the regulators will take to sharing information and regulatory responsibilities. This agreement should be reviewed with genuine industry input, to assist in reducing the confusing and expensive overlap that ASIC's FSR role has exacerbated for ADIs.

More effort needs to be invested in developing a policy approach that ensures that regulatory purposes and activities are aligned and that co-operative schemes like the UCCC are supported to ensure national consistency and co-operation.

The Basel II Capital Accord is another example where regulators have adopted international banking regulations without adequate consideration about how they should apply. Basel II was designed to make the approach of internationally active banks consistent and more sophisticated than the simpler risk approaches laid out in the first Basel Accord. These are of course admirable aims, however the implementation of the Accord in Australia has been anything other than consistent with overseas jurisdictions.

Basel II – One in, All in

Unlike most other countries, Basel II will be implemented by all ADIs in Australia as at 1 January 2008. This means that Australian credit unions will be amongst the only credit unions in the world implementing the Basel II framework, a framework designed for internationally active banks.

In the US, for example, Basel II is likely to be compulsory for only the largest 10 to 20 banks. By way of comparison, the top 10 US banks are all internationally active and range from around $2 00 bn in assets to over 2 ,000 billion in assets (in $A). No Australian credit unions are internationally active, the largest credit union is around $4 billion, and total sector assets are around $32 billion.

Whilst it must be acknowledged that APRA has been cognisant of the compliance costs risks of implementing Basel II for all ADIs, it is difficult to see how credit union members or other consumers benefit from this new regulatory framework.

Whilst it might be easier to have a single regime for all ADIs from the regulators perspective, the impact of such decisions on a diverse sector is often not sufficiently considered.

Perhaps the most significant regulatory regime emanating from international jurisdictions is the Government's proposed anti-money laundering legislation. It is too early to comment on the compliance costs arising from the proposals, however there are substantial risks that the regime will result in increases in the amount of information collected by financial institutions without necessarily providing the benefits sought by law enforcement agencies. The opportunity to learn from the impacts of similar regimes in other jurisdictions (eg the US Patriot Act experience

for smaller institutions) should be encouraged. Minister Ellison has overseen an extensive consultation process with further opportunities for input on the draft foreshadowed.

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CUSCAL is concerned that some regulation is created or modified in a vacuum, that is regulators and legislators do not always consult one another nor have a clear grasp of overlapping or complementary regulatory regimes. In these circumstances, it becomes incumbent on industry to respond to reform proposals with a full expose of concurrent inquiries or recommendations. There is a danger that under this approach, particularly where co-operative arrangements are in place as in the UCCC, any prospect of national consistency may be lost.

CSR – Putting in Your Two Cents Worth

The better the media, the more involved are the legislators.

The Corporations and Markets Advisory Committee (CAMAC) is looking to extend director obligations to include considering corporate social responsibility (CSR) in their decision-making.

At the same, however, the Parliamentary Joint Committee on Corporations and Financial Services is considering very similar matters in terms of corporate responsibility obligations under the Corporations Act 2001.

But wait, there's more. Interestingly, the Minister for Environment has also asked the ASX's Corporate Governance Council to consider CSR reporting as well. Here are three separate investigations of the fundamentally the same questions.

While the CSR work has not yet come in to conflict, CAMAC's other inquiry into extending personal liability from directors of the board to include some arms of senior management has. This is because while CAMAC is extending responsibility through different corporate arms, APRA is arguably looking to refocus governance and fit and proper standards on the board, with ultimate responsibility with directors.

Similarly, Consumer Affairs Victoria is currently reviewing Consumer Credit, which includes considering unfair contract terms, finance and mortgage brokers, property spruikers and fringe credit providers however:

- the Ministerial Council of Consumer Affairs (MCCA) is already considering reform to address unfair contract terms;
- the MCCA is also considering a national regulatory scheme for finance and mortgage brokers and whether property investment advice ought to be regulated; and
- the Uniform Consumer Credit Code Management Committee (UCCCMC) is already leading research into the regulation of fringe credit providers.

Additionally, the CAV Issues Paper also canvasses positive credit reporting even though it has been raised in other forums, including:

- the Office of the Privacy Commissioner's Review of the Private Sector Provisions of the Privacy Act 1988;
- the Senate Legal and Constitutional References and Legislation Committee's The Real Big Brother – Inquiry into the Privacy Act 1988; and
- the Senate Economics Committee Inquiry into possible links between household debt, demand for imported goods and Australia's current account deficit.

Book Up in the NT – Gaming and Racing's Guide on Using Other People's PINs

Whilst obviously an attempt to protect indigenous people in remote and regional communities, the NT's Licensing, Racing and Gaming Department issued a guide for merchants on taking cards and PIN for purchases for the common practice of book-up in indigenous communities.

The Minimum Record Keeping Guidelines were released to assist liquor licensees to comply with new requirements relating to the prohibition on liquor book-up. These Guidelines had the status of an official government document approved by the Minister for Racing, Gaming and Licensing and implied that cardholders can disclose their personal identification number (PIN) to a store licensee.

Disclosure of cardholder's PIN to another person is a breach of standard terms and conditions in the contract between the cardholder and card issuer. Further, under the Electronic Funds Transfer Code of Conduct, such disclosure exposes the cardholder to liability for unauthorised transactions.

The Department clearly failed to adequately consult with the financial services sector – if it had done so, it would have discovered that the "best practices" it was recommending potentially put the very consumers it was trying to protect at risk

Government and regulators need to pl an their reform propos als more co-operative ly and seek to actively engage one a nother whe n developing policy.

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CUIA i s concerned th at consul tat ion can often amount to a v ictory of form o ver subst ance, where it is undert aken t o sat isfy st at ut ory an d policy obligat ion s, bu t nei t her resourced, targ eted nor schedul ed in a way tha t woul d al low input to tr uly inform the r egulation development process.

As an ex ample, t he AML regim e has t he pot ential t o imp ose con side rable in dustry costs and c onsumer inconvenienc e. Althou gh many months of research and w ork were beh ind in it ial proposals t o brin g Au stralia in to line w ith FATF obligat ion s, a serious focus on industry co ncerns requir ed intervention via PM&C and Treasur y and th e Minist er, est ablish ing special in dustry rou ndt ables an d engagin g in clos e industry co nsultation.

An acute e xampl e of consul tati on wi thout s ubsta nti ve engagement i s currentl y facing credit unions a nd the mutual sect or. Because of the unusual nature o f mutual shar e registers – which are in fact the customer li st for mut ual in st it ut ions – the normal access requirements for sh are reg isters have been modified by Parliament for transfer red mutual enti ties such as credit union, m utual building societies and friendly s ocieties.

Under Corp orations Regulation 12.8.06, th ese mutuals can refuse access to their member registers in certain circumstances, with ASIC ha ving the power to approve access by third parties.

Since the regul ati on was estabi ished, t he credi t uni on i ndustry has so ug ht clar ificat ion f rom ASIC on it s proposed policy approach to acce ss to register requests, along with addition al pr otections (for example , the option of enforcing contact with members via a prof essional m ailing house, to prevent the contact det ails of members an d t he customer list it self bein g made av ailab le extern ally) in the regul ati ons.

Recent increased interest in launching hostile takeovers of mutuals (outside the hostile takeover processes outlined in Chapter 6 of the Corporations Act) have brought these issues to the forefront, and exposed both the regulator's lack of policy framework and a lack of willingness to engage productively with mutuals and the issues they have raised.

Currently the mutual sector is responding to policy proposals from both ASIC and Treasury, even though it is readily apparent that ASIC and Treasury are not consulting each other. Both organizations have failed to fundamentally grasp the differences between the mutual sector and other corporations. Their inability or unwillingness to consider the possibility that one size fits all regulation may not always be appropriate is currently putting the mutual sector at considerable risk and providing less consumer protection for the members of mutuals than for shareholders and consumers of other financial institutions.

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The failure to meet regulatory timeframes makes it difficult and costly to track developments and additionally difficult to plan and manage new obligations. This problem is particularly difficult for smaller institutions like credit unions and is intensified where the reform involves broad changes such as in relation to FSR or the proposed AML regime. CUIA submission to the Financial Sector Advisory Council's review of FSR is attached for your information.

Examples of these delays include:

- AML – initial consultation on the proposed legislation commenced in 2003 with a view to having legislation finalized before the FATF review in late 2005. Whilst happy with some of the changes to the proposed legislation, a draft Bill was finally released in December 2005;
- Mandatory Comparison Rates (MCR) - this in effective legislation (see earlier comments) has a sunset clause that takes effect in early 2006. At this time, industry understands that a review of the impact of the regime is being undertaken by an external consultant. With less than three months to go before the legislation's sunset clause takes effect, industry still has no information as to what changes if any will come into effect, despite this legislation affecting publication of interest rates on printed and other material provided to consumers.

- electronic statements – this issue has been under consideration since 2002 by the Ministerial Council, with a draft Bill issued in 2004. Industry and Government agreed on a Bill in early 2005 which has been stalled with the Queensland Government since that time despite apparently being considered a priority. The timetable for this non-controversial legislation that has clear consumer benefits (not to mention environmental ones) is still unknown nearly four years after it was first proposed.

Regulators need to make reasonable estimates of timeframes involved and should strive to meet them. Whilst understanding that all contingencies cannot be planned for, regulators should at least ensure that regular updates are provided to industry regarding the progress of the reform and what the contingency arrangements might be.

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