



Abacus
Australian Mutuals

Association of Building Societies and Credit Unions

16 January 2009

Mr Matthew Brine
Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600
Per email: prebudgetsubs@treasury.gov.au

Dear Mr Brine

ABACUS PRE-BUDGET SUBMISSION 2009

Thank you for the opportunity to provide input into the budget process on behalf of our constituency, member owned financial institutions.

Abacus – Australian Mutuals is the industry body for credit unions, mutual building societies and friendly societies. Collectively, the 163 Abacus member institutions have more than \$70 billion in assets and serve more than 6 million members. Mutual financial institutions in Australia play a critical role in delivering competition and choice in the market. Australia has a strong mutual financial services sector, including one of the largest credit union sectors in the world.

In light of continuing market instability and domestic and global economic challenges, mutual financial institutions have a strong interest in Government initiatives to promote stability, ensure sound financial regulation, and promote confidence in the community.

As APRA-regulated and responsible market players, Abacus institutions have a strong interest in the efficient and fair operation of financial markets and regulation. As mutuals, Abacus members are committed to member-benefit and support pro-competitive outcomes in public policy.

Credit unions and mutual building societies are Authorised Deposit-taking Institutions (ADIs) regulated by APRA under the *Banking Act 1959*, offering retail financial services. Friendly societies provide investment and insurance services to members to assist in planning for life events. Most societies are registered under the *Life Insurance Act 1995* and regulated by APRA.

This submission highlights measures to enhance and support competition by mutuals and to promote stability and a savings culture in the Australian financial services market, for review.

Please contact me on (02) 8299 9034 or lpetschler@abacus.org.au, or Luke Lawler on (02) 6232 6666 or llawler@abacus.org.au, with any questions or for further information.

Yours sincerely

LOUISE PETSCHLER
Chief Executive Officer

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1. EXECUTIVE SUMMARY

Abacus is the industry association representing Australian mutual financial services providers – credit unions, mutual building societies and friendly societies. Abacus member institutions recommend budgetary measures that support financial stability, enhance wholesale debt and liquidity options, promote a greater understanding of the Australian regulatory framework, and support competition in financial services.

Promoting Competition & Enhancing Market Stability

Abacus ADI members (credit unions and mutual building societies) represent a large and competitive part of the broader ADI sector, with over 4.5 million members and the third largest share of household deposits in the nation. With increased concentration in the big four banks and the decline of non-ADI lenders, policy initiatives to enhance competition have never been more important.

Abacus welcomed the decisive Government action to enhance confidence and stability in the banking sector through the ADI deposit guarantee, but queries the basis for differential pricing for high value deposit guarantees. Abacus also endorses Government initiatives to enhance funding and wholesale liquidity in markets, but notes measures to date have not been accessible for Australia's mutual ADI sector.

Abacus recommends:

- that the general retail deposit guarantee under the FCS continue to operate, supported by measures to enhance consumer understanding of the Australian prudential framework and security of ADI funds;
- removal of differential pricing for optional guarantees for deposits over \$1 million;
- refinement of interventions designed to enhance ADI access to wholesale funding, to be more accessible and attractive to mutual ADIs; and
- a public awareness campaign to promote the prudential regulatory framework for deposit-taking and the concept of ADIs. The public benefit of this campaign will be a more competitive retail banking market than otherwise and the avoidance of shocks as a result of the review of the guarantee of deposits in 2011.

First Home Saver Accounts

Abacus and its member institutions support the policy of encouraging and assisting Australians to save for a home deposit. To improve FHSA take-up, Abacus recommends:

- removal or reduction of the period of time during which savings in FHSAs cannot be withdrawn, given antagonism by young savers to the lock-in period and the effective incentives created by the Government co-contributions for the product;
- a modest increase in the Government co-contribution from 17% to 20% and a maximum cap of \$1000, particularly if a lock-in period is retained; and
- reduced complexity for FHSA particularly in relation to electronic reporting requirements. Software development costs to comply with reporting obligations have been estimated in the hundreds of thousands, acting as a deterrent to widespread take up and promotion of FHSAs by members.

Measures to Promote Long Term Savings

Abacus has made a submission to the Australia's Future Tax System (AFTS) review, outlining the need to engage taxation policy measures to promote an increase in Australia's household savings. Abacus recommends that consideration be given to taxation reform for ADI deposits and life insurance products. These measures would support the attractiveness of domestic ADI deposit raising – critical as a secure funding base for ADIs – and also enhance the capacity of Australians to plan and make provision for challenging life events.

2. ABACUS MEMBER INSTITUTIONS – SCALE & COMPETITIVE CONTRIBUTION

Australia has a strong mutual financial services sector. Between them, Abacus member institutions provide a range of retail financial services to more than six million Australians, and share a collective asset base of over \$70 billion.

Credit unions and mutual building societies are Authorised Deposit-taking Institutions (ADIs) regulated by the Australian Prudential Regulation Authority (APRA) under the *Banking Act 1959*. They offer retail banking and other financial services to their members.

A common misconception, evident in some poorly informed commentary by financial “experts” and others over recent months, is that credit unions and mutual building societies are less secure, offer limited products, or have little impact on competition.

In fact, the mutual ADI sector is the third largest holder of Australia’s household deposits behind the Commonwealth Bank and Westpac post the merger with St George, exceeding ANZ and NAB and all other second tier banking players (see Figure A). Until the recent, large St George/Westpac merger, the mutual ADI sector was the second largest holder of household deposits, exceeding all major banks except CBA.

Abacus analysis shows that between 2001 and 2008, credit unions have doubled the combined balance of loans and deposits that the average member holds. As fees have been rising and service levels falling at banks, more Australians have found that mutuals offer a better alternative.

CUBS have average capital holdings in excess of 15%, high liquidity levels, a sound funding base drawn approximately 90% from domestic retail deposits, the lowest arrears in the market and continued annualised growth of 10% on assets and liabilities over many years. Credit unions and mutual building societies continue to enjoy sound deposit growth (see Figure B), reflecting the sticky connections with members and communities and their position as a trusted safe haven. Deposits are critical for credit unions and building societies as the primary source of their funding.

Abacus believes that the ADI retail deposit guarantee has been of critical importance supporting depositor confidence. However, this submission raises concerns about the anti-competitive impacts of the differential pricing for the high value ADI deposit guarantee and its impact on the competitive position of mutuals in relation to the major banks.

Figure A: Share of household deposits

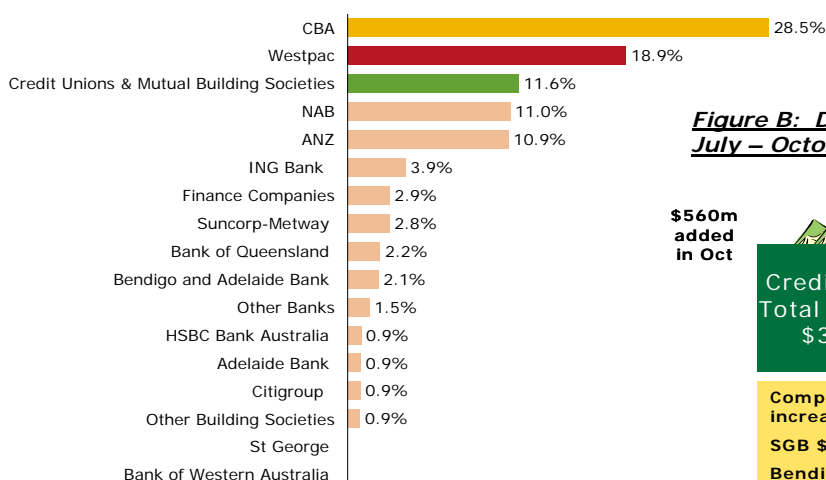
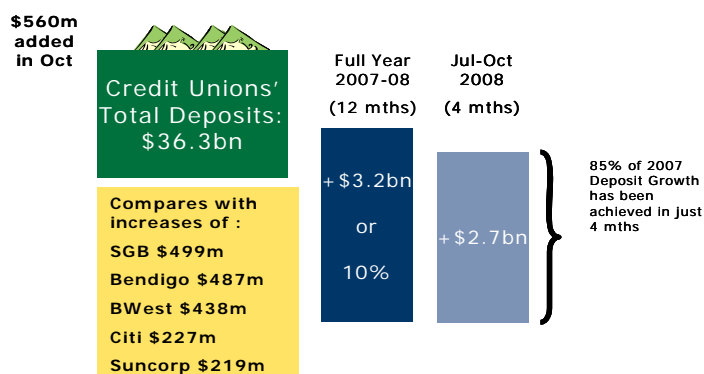


Figure B: Deposit Growth for Credit Unions July – October 2008



Mutuals are still very much open for business and are lending.

The latest mortgage approval data shows that while the demand for loans has softened, credit unions and building societies have written more than 16,000 new mortgages in the five months ended November 2008¹. This represents 55% of the 29,000 mortgages provided by lenders other than banks. Mutuals were writing only 45% of these loans in the same period in 2007. This underscores the importance of credit unions and mutual building societies in meeting Australia's housing finance needs as an alternative to banks and when others are exiting.

Mutual ADI mortgages are well secured "prime" loans and bad debt provision levels have remained around 0.1% of loans (compared with 0.6% for the major banks).

As mutual institutions, credit unions and building societies focus on returning value to their members through pricing and service advantages, as opposed to dividend returns to external shareholders. Canstar CANNEX product ratings demonstrate the competitiveness of our lending products. Mutuals also perform strongly in offering highly competitive deposit and other financial services to members.

Unsecured Personal Loans (no. of products)						
	5-Star	4-Star	3-Star	2-Star	1-Star	All Stars
Total Products	13	17	15	14	31	90
Credit Unions & Mutual Building Societies	13	13	11	9	18	64
Proportion of CUMBS within the Category	100.0%	76.5%	73.3%	64.3%	58.1%	71.1%

Variable Rate Home Loans (no. of products)						
	5-Star	4-Star	3-Star	2-Star	1-Star	All Stars
Total Products	30	23	76	52	91	272
Credit Unions & Mutual Building Societies	13	16	34	27	48	138
Proportion of CUMBS within the Category	43.3%	69.6%	44.7%	51.9%	52.7%	50.7%

Car Loans (no. of products)						
	5-Star	4-Star	3-Star	2-Star	1-Star	All Stars
Total Products	34	38	53	49	83	257
Credit Unions & Mutual Building Societies	34	36	46	39	63	218
Proportion of CUMBS within the Category	100.0%	94.7%	86.8%	79.6%	75.9%	84.8%

5-Star Superior Value
 4-Star Exceptional Value
 3-Star Strong Value
 2-Star Average Value
 1-Star Satisfactory Value

Credit unions and mutual building societies also have the highest levels of customer satisfaction, as reported in monthly Roy Morgan banking customer satisfaction surveys².

Mutuals are well placed to manage any credit deterioration as a consequence of changes in the operating environment and economic conditions. Mutual ADIs, despite these strong fundamentals, also face a number of competitive challenges in the current market, relating to access to wholesale funding, regulatory constraints on expanding lending activities, and the competitive impacts of the differential guarantee pricing regime for high value deposits.

The final group of Abacus member institutions, Australian friendly societies provide a range of investment and insurance services to enable their members and the community to make responsible provision for life events. Friendly societies provide investment, savings and other products that help people become financially independent.

¹ Source : ABS Cat 5609

² In its November 2008 Banking Customer Satisfaction Survey, Roy Morgan reported headline customer satisfaction results of 85.6% for credit unions and 84.6% for building societies, compared with 70.7% for the four major banks.

These include education savings plans, investment products and health insurance. Most friendly societies are registered under the *Life Insurance Act 1995* and are regulated by APRA. The values of friendly societies and mutual ADIs are closely aligned and centred around trust, helping people to gain financial independence and putting the needs of members first.

Friendly societies have operated in Australia for more than 160 years, mutual building societies for more than 100 years, and credit unions for more than 60 years.

At a time of significant consolidation in financial services, and with the increasing dominance of the major banks in the retail market, Australia's mutual financial institutions are a vital source of competition. It is critical that the role of credit unions, building societies and friendly societies is recognised in policy decisions relating to financial services regulation, market interventions, and market stability measures.

3. PROMOTING COMPETITION & ENHANCING MARKET STABILITY

Last year's inquiry into competition in the retail banking market by the House of Representatives Economics Committee recommended a review of the adequacy of the *Trade Practices Act 1974* to empower the ACCC to monitor competition in the banking market.

"While there is no doubt that the big four [banks] aggressively compete with the other players in the market, including foreign-owned banks, the credit unions, building societies and the non-banking sector, there is some uncertainty as to whether the big four are actively competing with each other," the Committee observed.

CBA's takeover of BankWest gives the merged entity 46 per cent of the market for deposits in Western Australia, as well as 38 per cent of the ATMs. According to the ACCC's December 2008 assessment, the merged entity's national market share of deposits is almost 31 per cent and for home loans it is almost 22 per cent.

CBA has also taken a one-third stake in Aussie Home Loans and Aussie Home Loans and CBA have jointly acquired Wizard Home Loans from GE Money.

Westpac's takeover of St George, the earlier merger of Bendigo and Adelaide Bank, and suggestions that both Bank of Queensland and Suncorp-Metway are for sale has further heightened concerns about market concentration and reduced competition.

The role of mutual ADIs in providing competition and choice in the retail banking market is more important than ever.

Abacus recommends consideration of initiatives that will support this vital competition and choice, and careful review of impacts on mutuals in any regulatory responses to market instability.

Promotion of the "ADI" Concept

Abacus believes there is a strong case for Government spending on a public information campaign to promote the prudential regulatory framework for deposit-taking and the concept of Authorised Deposit-taking Institutions (ADIs).

The public benefit of this campaign will be a more competitive retail banking market than otherwise and the avoidance of major shocks as a result of the review of the Government guarantee of deposits in 2011.

The Global Financial Crisis has highlighted widespread community ignorance about the ADI concept and at the same time has precipitated a dramatic concentration in the retail banking market, gravely threatening competition and choice. The reduction in competition is particularly stark in the home lending market, due to the exit of non-ADI lenders.

Since 1999 credit unions and building societies have been subject to the same prudential regulatory regime as banks. As ADIs, credit unions and building societies hold the same licence as banks and are subject to the same strict, legally-enforceable prudential standards as banks.

However, in debating the impact of the Global Financial Crisis before and after the Government's announcement of the guarantee of ADI deposits many leading and presumably trusted commentators have demonstrated little understanding of the prudential regulatory framework for deposit-taking. There has been a failure of communication about Australia's prudential regulatory system and the only beneficiaries are the four major banks.

The following examples illustrate the problem.

- The deputy chairman of financial advisory firm Dixon Advisory, Max Walsh, in an "analysis" column in the *Canberra Times* on 20 September 2008 said "credit unions and building societies do not have the same deposit protection" as banks. Further, Mr Walsh advised *Canberra Times* readers that the "Goldman Sachs JB Were CMT" was safer than regional banks and credit unions and building societies.³
- The *Sydney Morning Herald* editorialised on 27 October 2008 that: "It is absurd that nondescript credit unions should enjoy government backing while well-run cash management trusts and mortgage trusts – bearing some of the most respected names in Australian finance – should not."⁴
- *Herald Sun* columnist Terry McCrann wrote on 12 November: "Institutions which shouldn't even be borrowing triple-C, like building societies and credit unions are borrowing triple-A."⁵
- *The Australian* editorialised on 7 January 2009 that "banks are subject to more rigorous requirements than other deposit takers."⁶

Given that "experts" don't understand the prudential status of ADIs, the general public's level of understanding is a matter of significant concern. "Just how close did Australia come to having a run on a bank in the past four weeks?" the Economics Editor of the *West Australian* Shane Wright asked in the paper's 3 November 2008 edition. "Very. Indeed, the phone calls I received from ordinary people wanting to be reassured about their savings was at such a level it worried me."⁷

In public debate about retail banking issues, politicians and other stakeholders tend to refer only to banks rather than "banks, building societies and credit unions." This perpetuates the false impression that banks have a prudential and regulatory standing that is superior to building societies and credit unions.

Even ASIC has taken this approach in its publications, despite objections from Abacus.

ASIC Regulatory Guide 156 *Debenture advertising* repeatedly refers to "bank deposits" but the terms "building society" and "credit union" each appear only once. More significantly, the guide says: "Advertisements for debentures should state that the debenture is not a bank deposit. They should *also* not suggest that: the debenture is, or compares favourably to, a bank deposit."

The outcome of this advice from ASIC is that advertising of debenture products will have the side-effect of advantaging listed ADIs over mutual ADIs.

ASIC advised Abacus that it chose the term 'bank deposits' because "we felt that it was the most easily understood and straightforward term to use in advertising."

³ Crisis emphasises importance of following fundamental investment rules, *Canberra Times* 20 Sep 2008, p4.

⁴ Extend the guarantees, *SMH* 27 Oct 2008, p12.

⁵ Defining the risk, *Herald Sun* 12 Nov 2008, p67.

⁶ Bank on trouble with deposit guarantees, *The Australian* 7 Jan 2009, p13.

⁷ Big banks grow fatter as minnows flounder, *West Australian* 3 Nov 2008, p21.

"We did not feel that RG 156 Debenture advertising was the appropriate vehicle for consumer education on Authorised Deposit-taking Institutions (ADIs). We felt that the use of advertising of the expanded term for ADI deposits and a discussion of the nature of ADIs generally might confuse a financially unsophisticated audience and potentially mislead the consumer from the main message," ASIC said.

"We agree that there needs to be a consumer education piece to promote community understanding of this sector and planning for that work is underway," ASIC advised Abacus.

Abacus is unaware of the status of this consumer education proposal.

In our view there has always been a strong case for Government to promote the ADI concept since it was legislated into the *Banking Act 1959* a decade ago.

Developments in the retail banking market and the need to optimise conditions ahead of the 2011 review of the Government guarantee of deposits mean that such a public information campaign is urgently needed in 2009-10.

All Australians benefit from a strong and diverse banking sector. Whether or not a consumer belongs to a credit union or mutual building society, that consumer benefits from the competitive difference offered by mutual ADIs – competition in transaction accounts and payment products, competition in home lending, competition in personal lending, and competition in deposit products. Only mutual ADIs compete with banks across all of these essential services and products.

Informing consumers about the ADI concept and the prudential regulatory system will empower consumers to make effective choices and increase the competitiveness of the retail banking market.

Given the enormous advantage major banks already have in terms of size and marketing power, and the impact of the Global Financial Crisis on competition, there is a pressing need to educate consumers to promote real choice.

Abacus recommends the allocation of \$10 million, shared between APRA and ASIC, for a public information campaign explaining the ADI concept and encouraging retail banking consumers to "shop around" with confidence in the ADI sector.

Please contact Luke Lawler on 02 6232 6666 or at llawler@abacus.org.au to discuss any aspect of this proposal.

Government Guarantee of ADI Liabilities and Deposits

Credit unions and building societies are very appreciative of the close consultation with our sector by the Government in its planning and implementation of the guarantee scheme.

The speed and understanding of the severity of the situation that was displayed by the Government regulators is also applauded. Treasury, the RBA and APRA have all contributed significantly to the smooth negotiation of this crisis by Australian ADIs.

a) Government Guarantee of Retail ADI Deposits

Abacus strongly supports the Government's decisive and timely move to introduce the general ADI deposit guarantee for deposits under \$1 million, under the Financial Claims Scheme. Abacus advocates the continuation of the deposit guarantee for its legislative term and supports engagement with industry, including mutual financial institutions, on transitional arrangements after the initial three year operation of the guarantee.

Abacus is aware of views advanced by some commentators, including the large banks, in favour of a winding back of the retail deposits guarantee to a lower threshold and a shorter

term. Such a position would only serve to advantage big banks, already benefiting from unprecedented deposit growth domestically and increased market dominance.

Our industry strongly opposes refinements to the scheme that would serve to diminish the competitive position of smaller ADIs. Significant uncertainty remains in the financial services market. Removing or reducing the scope of the guarantee scheme at this time would disrupt the stability that the scheme has provided.

Abacus also supports, in principle, the introduction of an optional "for fee" guarantee for high value deposits held in ADIs.

However, Abacus strongly objects to the differential pricing for optional guarantees over \$1 million. Whenever a differential fee applies to high value deposits, reinforcing a perception of differing levels of prudential standing between ADIs, credit unions and building societies will continue to see their market position eroded and big banks advantaged.

The differential fee arrangements applying to the Government guarantee for deposits of more than \$1 million make it impossible for mutual ADIs to compete effectively in the market for deposits from depositors who want the guarantee.

The use of ratings by credit ratings agencies to determine the fee payable by ADIs for access to the government guarantee for high value deposits increases the competitive advantage of major banks by effectively equating the ratings system with the prudential regulatory framework.

The implication, quite damaging to competition and choice, is that there are three tiers of ADIs.

The record of the ratings agencies does not justify giving them status as arbiter of the prudential standing of Australian deposit-takers. Unrated Australian mutual ADIs have proven themselves to be prudentially stronger than highly rated global banks.

The Prime Minister commented on the role of the agencies in his 15 October 2008 speech to the National Press Club about the Global Financial Crisis and the complex financial products that financed risky loans.

"And through it all, the ratings agencies blessed these products as safe investments – ratings agencies that have yet to face their own day of reckoning – and the products they sanctioned continued to proliferate," Mr Rudd said.

ANZ chairman Charles Goode commented recently that the bank had relied "far too much" on ratings given to US debt products. "The ratings agencies have been found wanting and we have been found wanting for relying on them," Mr Goode said.⁸

Nobel Prize winning economist Joseph E Stiglitz singled out the agencies in commenting on multiple conflicts of interest in the finance industry. "The worst culprits have been the ratings agencies, which are paid by the companies whose financial products they were supposed to be evaluating and which make money by consulting with their clients on how to get AAA designation," Professor Stiglitz said.⁹ "These financial alchemists announced that the lead of sub-prime mortgages had been transformed into golden products safe enough to be held by pension funds."

With some exceptions, mutual ADIs do not have credit ratings because they have never needed a credit rating for their deposit-taking activities. A credit rating – being an opinion, purchased from an external agency, about a company's creditworthiness for debt instruments – has to date only been necessary for gaining access to capital and wholesale debt markets.

⁸ Rating agencies found wanting, *The Australian* 22 December 2008, p18.

⁹ Extreme makeover – Realign Wall Street's interests, *AFR Review* 7 Nov 2008, p6.

There is now a growing risk that an agency rating will become a requirement for ADIs competing in the high value deposits market. In our view this is a worrying development for competition in retail banking and will serve only to benefit the major banks.

As economic growth slows, mutual ADIs are working hard to provide much needed competition in a market that has seen the exit of a number of regional banks and non-ADI lenders. These efforts are handicapped by the competitive barriers put in place by differential pricing arrangements.

We seek refinements to the guarantee scheme to better balance stability and competition objectives. This could be achieved by imposing the same fee on all ADIs for high value deposit guarantees. A single fee would reflect the fact that ADI deposits are subject to the same level of prudential protection across the ADI sector and are distinct from non-deposit wholesale funding.

Imposing the same fee on all ADIs for high value deposits will also better facilitate the ultimate removal of all guarantees in due course by reinforcing and deepening public perceptions about the ADI concept and hence lowering the risk of disruption and instability.

If this proposal is not supported, Abacus requests that the Government consider reducing the fee and fee differential to reflect changed market and interest rate conditions.

b) Market Interventions to Support Wholesale Funding & Liquidity

Abacus is supportive, in principle, of Government initiatives to enhance wholesale liquidity and access by Australian ADIs to wholesale funding, in light of current market conditions.

However, to date these measures have had unintended consequences that have seen the capacity of mutual ADIs to fund growth severely curtailed. The halt on securitisation markets has further negated the competitive alternative that these mutuals offer to the big banks. We suggest refinements to existing measures be considered.

As an example, the RBA's decision to extend repo-eligibility to include internal securitisation transactions is extremely beneficial for those ADIs that are able to access the scheme. The reality is that most mutuals will need to tap into the knowledge base of an industry aggregator, such as Cuscal Limited (see www.cuscal.com.au), to participate. This also applies to the wholesale funding guarantee scheme and AOFM.

Abacus encourages Government engagement with mutual industry aggregators, Cuscal Limited, Indue and Australian Settlements Limited, the wholesale ADIs that support credit unions and mutual building societies, on options to enhance the capacity of mutual ADIs to access affordable sources of wholesale funds.

Abacus members have also suggested improvements to the AOFM RMBS program. Participation is not attractive for mutual ADIs in view of the current pricing and program design. Under the current arrangements those most likely to benefit from the program are non-ADIs or ADIs without significant deposit bases. Mutual ADIs have raised concerns about regulatory capital impacts for mutual ADIs under the current program arising from limited market appetite for sub-ordinated tranches and the application of Australian Prudential Standard APS120.

Most mutuals that have been involved in securitisation rely on the capital efficiency afforded under the 'capital relief' provisions specified within prudential standards. Without this treatment the cost effectiveness of this funding channel is severely undermined for mutuals. Abacus members have suggested that the Government consider AOFM direct purchase of program B notes and a direct private placement/direct investment model for high quality mutual ADI mortgages, noting the high asset quality of mutual ADIs compared to other market participants and the LMI coverage provided in mutual sponsored deals.

Abacus also encourages Government consideration of the Canadian Mortgage Bonds Program as a model for facilitating access to liquidity for a range of ADIs and market participants. Canadian credit unions access the CMB program through their central aggregator (the equivalent of Cuscal Limited in Australia) and have advised that the CMB has proven to be a very effective tool in easing liquidity concerns and supporting competition by credit unions in the concentrated Canadian banking market.

4. FIRST HOME SAVER ACCOUNTS

Abacus suggests improvements to the Government's First Home Saver Accounts (FHSAs) policy.

According to APRA, in January 2009 only 14 ADIs are offering FHSAs, including 10 mutual ADIs. So far no super funds or life insurers are offering FHSAs. Only two of the four major banks are offering the product. At this stage, the number of FHSAs opened by Abacus members who have chosen to enter the market varies from several hundred to nil.

Clearly, there has been a somewhat muted response to this policy initiative from providers and first home savers. It seems highly likely that the cost of Government contributions to FHSAs and tax concessions will fall well short of the \$1.2 billion over four years forecast in the 2008-09 Budget.

Our 7 March 2008 submission to Treasury on the *Outline of proposed arrangements* for FHSAs sought a regulatory framework "that maximises competition and choice for savers, particularly risk-averse savers, and minimises entry barriers to providers."

"Optimising the FHSA initiative will require FHSA products that are attractive to, and understood by, young people," our submission said. "Each additional layer of complexity in the regulatory framework will reduce returns to savers, dampen competition and choice, and slow the arrival of FHSA products to market."

It is now clear that complexity is proving to be a severe handicap for the FHSA initiative.

In this 2009 Budget submission, Abacus calls for changes to the FHSA model to remove disincentives for both savers and providers.

These changes will assist the Government to deliver on its commitment to provide a simple, tax effective way for Australians to save for the purchase of their first home through a combination of Government contributions and low taxes.

Based on feedback from Abacus member credit unions and building societies, we seek the following changes:

- remove or reduce the period of time during which savings in FHSAs can't be withdrawn;
- increase the 17% Government contribution to at least 20%; and
- reduce administrative complexity and regulatory compliance burden on FHSA providers.

A number of Abacus members have also suggested lowering the FHSA eligibility age from 18 to 16.

a) FHSA lock-in period

The most consistent issue that appears in feedback to Abacus from building societies and credit unions about FHSAs is that the four-year requirement is too long and is the single most important disincentive for savers.

"Our members do not want their money tied up for such a long period," was a typical response from an industrial credit union.

A community credit union said: "Our view has been that the FHSA is unlikely to be a profit generator since the restrictive conditions applied to the account will lead to minimal take-up of the product and to date this view has been confirmed."

As noted in our 2008 submission, the Government contribution is incentive enough to contribute to a FHSA over a number of years so a minimum period is not only unnecessary but penalises savers who have the opportunity to buy a house within that period.

Feedback from Abacus members indicates that young savers are highly averse to locking up funds for four years. These first home buyers want to be able to respond to housing market conditions.

b) Increase Government contribution

According to our feedback, the current maximum Government contribution of \$850 appears modest, particularly when tied to the four-year requirement.

Increasing the Government contribution from 17% to 20%, and hence a maximum of \$1,000, would encourage more saving for first homes and respond to first home buyer concerns that house price rises will outpace saving for a deposit.

c) Reduce complexity

FHSAs have complex rules and requirements for savers and also for providers. Providers have process, reporting and record-keeping obligations as well as obligations in relation to taxation and switching accounts.

The complexity and associated project and ongoing costs of offering FHSAs is deterring many potential providers.

Abacus provided the following advice to the ATO in October 2008:

"The cost of software for FHSA reporting and record-keeping is proving to be a major barrier stopping credit unions and building societies offering FHSAs. Even some of the Abacus members who have indicated to APRA they intend to offer FHSAs are baulking at the quotes they have received from software providers and are looking for alternative solutions. So, we have a situation where even some of those ADIs that have publicly advised they wish to offer FHSAs are getting cold feet. Many Abacus members believe that in the near term at least, numbers of FHSAs will be very low. There is a widespread view that it will be difficult to make a return on the product, due to high implementation costs - as illustrated by the requirements set out in the 53-page Electronic reporting specification document. Abacus members are asking for alternative ways of meeting FHSA reporting and record-keeping obligations to reduce cost. In the absence of simpler, manual and paper-based options for meeting FHSA reporting obligations, it is likely that the number of FHSA providers will remain small, therefore limiting competition and choice for savers."

In a welcome development, the ATO has recently advised Abacus that it will utilise the existing direct entry system to pay Government contributions, reducing some development costs for providers.

However, substantial complexity remains, as indicated in the following feedback to Abacus by members:

- "Why offer a product that is expensive to develop and administer when it is not a great product?" – Regional building society.
- "It is just too complex for what should have been a really simple product. Our software cost alone is likely to be in the order of \$100,000 so how could we ever make a profit from it?" – Community credit union.

- "I just think the ATO need to put themselves in the position of an ADI who opens only 10 FHSAs a year and work out what is the minimum information they need that can go on an Excel spreadsheet. Until they do this, they are just wasting time. We put our neck out to support this government initiative and offer the FHSA to members, trusting that the administration would be reasonable. It would be a shame if we came to think of this as folly, and to withdraw our product citing the ATO's over the top requirements as the cause."
– Industrial credit union.

Please contact Luke Lawler on 02 6232 6666 to discuss matters relating to mutual ADIs and FHSAs.

5. MEASURES TO SUPPORT LONGER TERM SAVINGS

Abacus has made a submission to the Australia's Future Tax System (AFTS) review, outlining the need to engage taxation policy measures to promote an increase in Australia's household savings. With the full impact of the Global Financial Crisis likely to buffet the Australian economy in the 2009-10 financial year, Abacus recommends that measures to further improve household savings are implemented rapidly by the Australian Government, before the release of the final report from the AFTS review.

As has been outlined elsewhere¹⁰ Australia has a low rate of national savings (especially household savings) by international comparison. This low rate of savings is inadequate to meet the future needs of Australians, and without additional government incentives to increase discretionary savings there will be significant economic distress and potential social disruption before the full impact of the superannuation guarantee system is felt across the financial system in 2037, in addition to insufficient domestic funds for business investment.

Abacus encourages measures to improve the attractiveness of household savings to achieve several policy objectives:

- improve ADI stability through increased deposits;
- fund business and personal investment to increase national economic capacity; and
- provide for medium and long-term financial reserves to meet 'life event' objectives.

Government intervention to improve the attraction of savings is not a new concept, but a traditional solution with perhaps an even greater relevance in the current economic environment. As the capacity of governments to withstand economic downturns are stretched, measures to increase individual financial reserves are a prudent investment.

Abacus proposes a reduction in tax rates on ADI deposits and life insurance savings to strengthen reserves, increase deposit funding, and boost the capacity of individuals to overcome major 'life event' financial commitments outside of retirement. The capacity to fund important pre-retirement objectives such as children's education, home ownership and healthcare are important savings goals that deserve a policy response to drive improvement.

The Government has an existing mechanism to achieve an increased household savings culture through the reduction of the income tax rate applicable to life insurance savings. Abacus believes that an income tax rate on this income below the key marginal tax rate of 30% and above the 15% on superannuation will deliver on government superannuation policy objectives while still increasing the attractiveness of savings relative to other income. Abacus believes an incentive rate of 20% will achieve this goal. This measure is strongly endorsed by Australian friendly societies.

Abacus also advocates early action to address the inequitable and excessive taxation of Australian ADI deposits. Research commissioned by Abacus in October 2008, and provided to the Henry Tax Review, showed that the taxation of deposits disproportionately impacts savers

¹⁰ *The Economic Impact of Increased National Saving*, Econotech Pty Ltd, July 2008; *Australia's National Saving Revisited: Where do we stand now?* The Allen Consulting Group, August 2007

with relatively lower levels of wealth and income. Abacus recommends reforms to give interest earnings on ADI deposits equivalent treatment to capital gains on assets held for longer than 12 months. For further detail, please see the report at the link below:

http://www.abacus.org.au/media_centre/submissions/docs/2008/20081015_report_interest_earnings_adi_deposits.pdf

The Government should not postpone action to address the household savings task until the report from the AFTS review is received. Data from 2002-03 suggests that Australia's net household savings ratio has been negative, indicating that households have been borrowing to fund purchases beyond their economic means¹¹.

Measures to improve the attractiveness of domestic savings will not only provide needed stability to Australian financial markets, but will help put Australian households in a position to fund life events into the future.

Please contact Luke Lawler on 02 6232 6666 or Matt Gijselman on 02 8299 9048 to discuss measures to promote long term savings.

FURTHER INFORMATION:

For further information on the mutual financial services sector, or the issues raised in this submission, please contact Abacus staff as below:

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¹¹ *Australia's National Saving Revisited: Where do we stand now?*, The Allen Consulting Group, August 2007