APPENDIX 2.2: SUBMISSIONS TO THE STUDY

A number of interested parties supplied input to the Study. In total, eight formal submissions were received from the following individuals and organisations:[1]

Credit Union Services Corporation (Australia) Limited (CUSCAL)
Insurance Australia Group (IAG)
Insurance Council of Australia (ICA)
International Banks and Securities Association of Australia (IBSA)
Max Kummerow, Senior Lecturer, Curtin University
Motor Accident Insurance Commission Queensland (MAIC)
National Credit Union Association Inc (NCUA)
National Insurance Brokers Association of Australia (NIBA)

Professor Davis also met with a number of key stakeholders to discuss their views and draw on their technical expertise. Details of individuals and organisations met is provided at the end of this summary.

Following is a summary of some of the key views raised in the submissions. This summary is not meant to replace the submissions themselves.

General views

The vast majority of formal submissions did not support the introduction of an explicit guarantee to the Australian financial system on the grounds that a case for change is yet to be made. Many of the submissions cited the rejection of a guarantee by the Financial System Inquiry in 1997. It was argued that throughout Australia's history failures have been rare and that the existence of depositor preference (in the case of the banking sector) provided adequate consumer protection against the adverse effects of failure. The submissions

1 Copies of the submissions are available on the Study's website at: http://fsgstudy.treasury.gov.au/content/Input_received.asp?NavID=4.

noted that if a guarantee were to be introduced, the design features would be an important factor in its success.

The ICA and NCUA support the concept of a guarantee and see merit in enhancing consumer protection through such a system. The ICA, however, would only support a guarantee in conjunction with other general insurance reforms including changes to State and Territory regulation and taxation.

> *'A policyholder protection scheme will provide an additional level of protection for the policyholders who need it most and who are least able to avoid or mitigate the risk of an insurer collapse. These are the relatively unsophisticated purchasers of insurance, such as individuals and small business policyholders who are not in a position to assess the financial strength and solvency of an insurer and its ability to meet the financial promises made.'*

ICA submission, December 2003

Economic rationale

Most submissions noted the existence of strong community attitudes towards government intervention *to protect consumers* in the event of failure.

> *'…it would appear that in this day and age, community expectations of the safety of their savings is extremely high and it is at its own peril that the Government does not adequately address this matter.'*

NCUA submission, November 2003

> *'The ad hoc measures put in place by Commonwealth, State and Territory Governments after the failure of HIH have responded in various ways to the particular needs of policyholders. Ad hoc responses provide greater flexibility to governments in responding to a collapse as it arises. However ICA considers that the uncertainty created by this situation is unsatisfactory particularly as these ad hoc measures are likely to have led to an expectation in the minds of policyholders that the government will provide a form of guarantee or support if another insurer fails.'*

ICA submission, December 2003

There was a consistent theme that *institutions* should be allowed to fail and that Australia's existing prudential and regulatory arrangements provides appropriate frameworks for markets to operate competitively.

> *'The new supervisory framework provides APRA a greater flexibility to intervene early in response to warning signals in the industry and a wider range of powers for such intervention. … Competitive markets experience failures. Regulation of providers of financial services should provide for failures to be infrequent and provide for warnings, rather than guarantee that there will be no failures.'*

IAG submission, December 2003

> *' …the ultimate risk for the failure of a financial institution should lie with those that deal with the institution.'*

NIBA submission, November 2003

A number of submissions also noted the moral hazard implications associated with guarantees.

> *'The moral hazard risk of deposit insurance, which involves a weakening of market discipline, is well understood and experience has shown that this can cause significant economic loss (for example, the US Savings and Loan crisis) and increase the Government's exposure in the event of a failure.'*

IBSA submission, December 2003

> *'The Financial System Inquiry opposed guarantees because they introduce moral hazards and distort market signals. They inevitably involve some form of cross subsidization with the prudent often having to bear an unrealistic burden.'*

NIBA submission, November 2003

Design coverage

The majority of submissions agreed that a well-designed system would be important. While most submissions did not detail specific design features, the unique nature of the Australian financial system was noted as an important factor in the design of a scheme.

> *'In CUSCAL's view, it is important that any guarantee be limited to a maximum amount per depositor and should exclude non-private and interbank deposits. Limiting the amount of funds guaranteed and extending protection to only a per depositor basis helps to ensure that the scheme is only applicable to small depositors who would normally be unable to adequately monitor a bank's performance (and therefore make sound investment decisions).'*

CUSCAL submission, December 2003

> *'A deposit insurance scheme would have to be designed to ameliorate the worst effects of the problems … like moral hazard, and minimise the direct and indirect costs of the scheme.'*

IBSA submission, December 2003

Cost, funding and pricing

Those not in favour of a scheme argued that it would impose an additional cost on consumers as well as 'honest' industry participants.

> *'We are concerned that the introduction of a deposit insurance scheme would impose unnecessary cost on banks and their customers without generating additional public benefit.'*

IBSA submission, December 2003

> *'We believe that the introduction of financial system guarantees to cover the costs of the failure of a general insurer would in effect impose a tax on viable insurance businesses to cover the failures of their competitors. This is inconsistent with a market competing for the delivery of a product to consumers.'*

IAG submission, December 2003

A post-funded system, particularly in light of Australia's limited experience with financial institution failure, was strongly favoured. Issues of adverse effects of cross-subsidisation were also raised.

> *'Post event funding … will also ensure that no funds are actually required unless and until there is another insurer failure.'*
>
> ICA submission, December 2003

> *'Pre-event funding provides some certainty of cost for members of the scheme and allows the smoothing of premiums over the course of a business cycle. It also ensures that financial institutions that subsequently fail have contributed to the cost of their failure …'*
>
> CUSCAL submission, December 2003

> *'If the Government forces all other companies to subsidise the loss of a high-risk company then the stakeholders of other companies are all penalised for being risk averse. This creates a perverse result, as it is in the interest of the community to reward prudence and penalise excesses.'*
>
> IAG submission, December 2003

Governance and accountability

There were no strong views on the governance arrangements of a scheme. As the majority of submissions were presented from an industry perspective, a clear theme emerged that industry specific schemes would be preferable. The ICA provided a comprehensive account of how a guarantee scheme for general insurance could be administered.

Schedule of consultations and advice

Monday 13 October 2003 (Canberra)
Australian Consumers' Association (ACA)
Thursday 23 October 2003 (Sydney)
Australian Bankers' Association (ABA) and member institutions
Investment and Financial Services Association (IFSA) and AMP
Credit Union Services Corporation of Australia Limited (CUSCAL)
Friday 24 October 2003 (Sydney)
Insurance Council of Australia (ICA)
Association of Superannuation Funds of Australia (ASFA)
Thursday 30 October 2003 (Brisbane)
National Credit Union Association (NCUA) & Australian Finance Conference (AFC)
Queensland Motor Accidents Insurance Commission (MAIC) and Queensland Treasury
Suncorp-Metway
Tuesday 18 November 2003 (Sydney)
Australian Securities and Investments Commission (ASIC)
Insurance Council of Australia (ICA)
Mr Bob Glading
Wednesday 19 November 2003 (Sydney)
NSW Motor Accidents Authority (MAA) and NSW Treasury
Insurance Australia Group (IAG)
Monday 8 December 2003 (Melbourne)
Standard and Poors
PwC Acturial
Australian Friendly Societies Association (AFSA)
Friday 12 December 2003 (Sydney)
Australian Association of Permanent Building Societies (AAPBS)
Monday 2 February 2004 (Sydney)
Reserve Bank of Australia (RBA)
Tuesday 3 February 2004 (Sydney)
Australian Securities and Investments Commission (ASIC)
Insurance Council of Australia (ICA)
Australian Prudential Regulation Authority (APRA)
Mr Tony McGrath, KPMG