The Royal Automobile Club of Queensland Limited ABN 72 009 660 575
Agent for the RACQ Group
2649 Logan Road, Eight Mile Plains, Qld 4113 | PO Box 4, Springwood, Qld 4127
T (07) 3361 2444 W racq.com

Motoring Insurance Travel Finance

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Attention: Mr Greg Hammond AOM
coopsandmutualreview@treasury.gov.au

Submission: Response to Terms of Reference – Senate Economic References Committee report on Cooperative, Mutual and Member owned Firms.

Prepared by RACQ

The Royal Automobile Club of Queensland (RACQ) is a company limited by guarantee, established in May 1905, by a group of 12 of Brisbane's pioneer drivers to form a group to champion the rights of motorists. Today the RACQ has evolved to a membership of 1.67 million members, offering roadside assistance, general insurance, travel and banking (through a merger with QT mutual bank in November 2016), whilst continuing its heritage by providing advocacy for its membership base and the broader Queensland community.

Introduction

RACQ supports the legislative and regulatory changes proposed by the Business Council of Co-operatives and Mutuals (BCCM) and the Customer Owned Banking Association (COBA) that respond to recommendation 16 and 17 of the Senate Economic References Committee inquiry, which will enable mutual enterprises to access a broader range of capital raising.

The playing field is not level, and legislative and regulatory action is required to facilitate mutual firms' ability to provide the highest levels of service at the best possible price to our members and customers. This will also support greater competition, and therefore better consumer outcomes in the financial services sector.

The 'common bond' nature of mutual enterprise deserves further attention. Mutual enterprises operate in the very same communities their member-owners reside, this strong connection between community ownership and community operations, means mutual enterprise has one of the strongest bonds to the popular statement 'think global, act local'. A healthy mutual enterprise sector, supported by the recommendations outlined herein, will ensure 'common bond' enterprises can genuinely compete on an even playing field, irrespective of ownership structure.

Barriers to raising capital

Under RACQ's current corporate structure the raising of capital through traditional financial markets is limited and not seen as a viable option. Capital required for growth and / or investment in the business is currently sourced through retained earnings (current year and /or accumulated reserves). The accumulated reserves are limited and include a minimum level to protect against downside risks, thus there is a limit on the level of reserves we can deploy for investment.

This places a limit, relative to our competitors who are non-mutual and have access to capital both through their retained earnings together with external raisings through capital markets.

A key principle in how RACQ prices its products and thus generates retained earnings, is to ensure we can deliver our products and services at high levels, whilst only generating sufficient profit (and thus retained earnings) to meet our needs. These are typically defined as ensuring we continue to invest in our systems and processes to keep pace with our competitors whilst ensuring our reserves have a prudent level to cover reasonable expected downside risks.

As a consequence, our ability to increase working capital in the short term, to respond to investment needs is difficult, through re-pricing of products and/or reduction in expenses. Listed competitors have much quicker access to capital through traditional markets, which means that the lack of options available to mutuals is a serious challenge to our ability to maintain competitiveness and choice in the markets in which we operate.

Requirements for capital
Example of capital needs: 1. Diversification of the group

RACQ has merged with a mutual bank, Queensland Teachers Mutual Bank (QTMB) in late 2016. This merger was a key part of the RACQ group's strategy to diversify its product offering outside of Roadside and Insurance, and offer greater value to our members. This strategy will see QTMB rebranded as RACQ Bank towards the end of calendar year 2017, and then pursue growth within the existing RACQ member base.

These plans are ambitious and will require capital to support loan growth (QTMB's current loan base is planned to grow above systems growth). To support this growth, a material level of capital is required, to ensure we meet APRA requirements and satisfy our risk appetite. This capital requirement is well in excess of the profit to be generated over that period and thus a call on accumulated reserves will be required.

To ensure we can meet customer expectations, there is also a significant investment in systems and processes required to ensure the banking offering is contemporary. The larger banking institutions are able to invest significantly in development. For RACQ and our banking strategy we need to balance this level of investment, whilst we remain conscious that capital support will also be required. This system investment and the additional required capital all come from the one source, the group's retained earnings / accumulated reserves.

This requirement for capital to meet the diversification strategy limits flexibility for the broader group to respond to other investment opportunities and/or the level of growth we could obtain in the bank.

Example of capital needs: 2. Provide funding for investment in business

In addition to the banking investment, the market place in which RACQ operates (financial services together with roadside assistance) continues to evolve. Disruption and technological advancement are placing heightened (and increasing) pressure on the group's future viability. To ensure we keep pace with this change, significant capital investment is also being undertaken.

This investment is funded from the same source as the group's diversification strategy, that being accumulated reserves and / or current year profits. This places pressure on the level of investment the group can undertake.

Technology is a key input in supporting modern growth initiatives. Mutual enterprises are effectively constrained in their ability to deploy capital to new technology, given their funding sources and balance sheet profile can typically only support incremental enhancements on dated technology, rather than support complete replacement of technology systems. As new technologies and innovations emerge at an ever-increasing rate, they become fundamental to consumer propositions and this dynamic can be observed in the proportionally higher technology spend by firms that are not constrained in their ability to raise capital.

Example of capital needs: 3. The ability to respond to regulatory capital requirements

The regulatory landscape continues to evolve, with increased harmonisation of regulation on a global level. These developments are driving higher requirements for capital across the financial services industry. Where changes are implemented and additional capital is required, RACQ would access its accumulated reserves to provide this capital. For our competitors who are can access traditional capital markets, this need can be sourced externally, and not limit other expansion and / or investment opportunities. This creates an uneven playing field for RACQ as a mutual relative to our competitors.

What regulatory and legislative changes could improve the situation

As stated above, RACQ supports the two proposals advanced by the BCCM and COBA. Clearly, as a company limited by guarantee, RACQ is severely limited in its options to raise investment capital, as it has no ordinary shares. The options currently available to us: to continue only with access to accumulated reserves (retained earnings) or alternatively to abandon our mutual status and become a company limited by shares are sub-optimal and an artificial barrier to competition.

Greater flexibility from financial regulators on their interpretation and approval for the issuance of new capital instruments would be helpful to many mutuals and mutual ADIs.

Of value to the entire mutual sector would be new legislation, which would create a new mutual capital instrument, designed to allow the maintenance of mutual ownership and create new opportunities for investment in our firms by institutions and existing members.

We note that the legislative option has been followed in other jurisdictions and believe that Australian mutuals should have similar opportunities.

The case for inserting a definition of “mutual enterprise” into the Corporations Act

RACQ recognises that the creation of a new capital instrument for ‘mutuals’ will necessitate defining in law which firms would actually qualify to issue such securities. For us, the notion of an ‘Incorporated Mutual Company’ would perform the task of clarifying, for the first time, the nature of such a member owned business, and ensuring that the concept is not abused or misunderstood.

We believe that by creating the new mutual capital instrument in law and defining which incorporated bodies may issue it, this will provide greater confidence to what will be a new investment market.

One view that we have heard emerging from parts of the mutual ADI community is that a regulatory solution to capital is the best route for mutual ADIs and a legislative route is best for all other mutuals. This distinction would probably be problematic for RACQ.

Should there be regulatory and/or legislative changes

RACQ's view is that both regulatory and legislative changes should be pursued. This would ensure all mutuals, both those regulated by APRA (predominately the mutual ADI sector) and those that sit outside APRA's industries have access to capital reforms. Specifically, we would not like to see mutual ADIs unable to benefit from any potential new legislation because we believe that having a new mutual capital instrument established in law and available to all mutuals, will help to build confidence in what will be a new investment market.

We look to engaging further on these reforms and working together to ensure that mutuals can operate on a level playing field.

Yours faithfully

Michael Lonergan
Group Chief Financial Officer