Good morning.

Chairman [redacted] and distinguished members of the committee.

Thank you for the opportunity to appear before the committee in connection with this inquiry into Cooperative, mutual and member-owned firms.

The Committee has been asked to consider the role, importance, and overall performance of cooperative, mutual and member-owned firms.

The distinctive feature at the core of these organisations is that the enterprise is run to benefit its members. This objective is reflected in the governance arrangement of firms, which in many instances involve representative governance.

This is distinct from the other forms of business organisation, where the enterprise is run either to maximise shareholder value, or in some cases to "share value" between parties with different interests.

A key tension at the heart of a business is, if there are profits or surplus income, who benefits from the surplus income: in a mutual, those profits distributed equitably to members, either through rebates, lower prices, or reinvestment in the business. In a for-profit firm, it is handled differently.

There is nothing wrong with a profit motive, or the payment of a fair return to capital. That is a prominent feature of our economy.

But the profit motive is not the only reason why people organise themselves and provides goods and services to each other.

There are a range of instances where the common interest of individuals is best served through a cooperative endeavour among them.

Financial services is an area of commerce where there is a long history of cooperative or mutual approaches.

Classic examples include insurance, securities exchange, and clearance and settlement, the latter of which perhaps still tends to be mutualised in many markets in the United States, though not here in Australia.

Then, of course, there is superannuation.

Superannuation is not entirely, and perhaps not even primarily, a financial product, but there is a strong financial component.

Within superannuation, Industry funds have been and continue to be a clear example of the success of the run-only-to-benefit members approach.

Industry funds have combined a loyalty to members that is typical for mutuals, with high quality execution and service levels to deliver excellent outcomes.

In 1987, Industry funds had assets of around $2.5 million. Nowadays, it has grown to around $376 billion.

In 1987, Industry funds had just over 200,000 members. Today, it is nearly 5 million.

As some people have put it, industry funds look after the retirement savings of half the country's working population.

Those assets of course are held for the benefit of members only.

And the evidence shows that the employer organisations and employee organisations -- who had the idea of coming together as core stakeholders in an occupational pension system – and elected to cooperate in this way, did the right thing.

The idea of providing occupational pensions through a member-benefit framework, with representative governance, has been critical to success.

The proof of the pudding is in the tasting, and as far back as statistics are available, funds that have been organised to run only to benefit members with representative governance, have consistently outperformed super funds organised for other purposes and with different governance arrangements.

And focusing on delivering the best outcomes you can for members also has inspired a lot of innovation.

When I first learned about industry super funds, I was struck most by what they call collective vehicles. In the United States, there are multiemployer occupation pension funds with representative governance and that are run to benefit their members.

But here in Australia, industry funds – rather than buy services from a third party for-profit provider, have collectively pooled their resources to deliver better services for less.

In effect, when an industry fund transacts with a collective vehicle, it is an instance where the buy side owns the sell side, and retains the profits of the transaction for the benefit of members.

Perhaps the best known of these collaborative ventures was the creation of what is today called IFM investors, a funds manager wholly owned by not-for-profit funds, which has developed specialist investment expertise in unlisted infrastructure, among other things. This was a real innovation, and is a model that has been borrowed by funds in other jurisdictions, most notably Canada.

The use of these collective vehicles was reviewed not too long ago by the prudential regulator, who found that these were "entities unique to the Australian scene: collaborative ventures formed by multiple industry funds, with the objective of attaining economies of scale without paying third-party profits." APRA continued on to note that "our analysis … indicates a consistency in approach by trustees of not-for-profit funds, to minimise the cost of delivering superannuation to the fund's members."

Industry super funds are today a recognised category in this country, and enjoy extraordinary levels of trust from the community.

But what about the future, and what are the key challenges?

First, is political risk. The government has proposed to legislate changes to the governance of industry super fund, prescribing board composition. This is an intrusion into the private affairs of corporations that are performing well. And it shows a willingness to use the power of the state, without regard to the public interest and without regard to the fact base. It is also quintessentially illiberal.

The bill ignores the fundamental conflicts of interest of for-profit superannuation funds, such as those owned by the major banks, and instead seek to disrupt their not-for-profit competitors.

The bill that mandates legislative change to industry fund boards is before the senate and considered in another committee, so this hearing is not the time to ventilate substantive objections to the bill.

But it signals a hostility to member-focused approaches that is truly regrettable.

Second, regulation that is tailored to a mutual ~~capital~~ structure.

For-profit firms are characterised by third party capital providers who demand a return on capital.

Sometimes financial institution regulation, particularly prudential regulation, seeks to build in buffers around safety and soundness that assume a third party capital provider.

A number of years ago, there was even a suggestion that not-for-profit super funds should have a capital buffer.

Fortunately, once it was made clear that there cannot be third party capital without destroying the mutual approach, these requirements were set aside, and other forms of regulation considered that take into account the features of mutual structures.

In recent times, there is consideration being given to how superannuation funds might provide retirement income streams to members. The government has recently embraced a recommendation from the Murray Inquiry that trustees be enabled to offer what is called a "comprehensive income product in retirement."

This is a welcome development.

The nature and requirements of a "comprehensive income product in retirement" remain to be scoped out, but it will be important to recognise the different ways in which retirement income can be delivered.

One way is through an annuity, which requires a third-party capital provider, and has generally been associated with on average lower levels of retirement income because of the return to capital, and the interest by the annuity provider in minimising its own risk, and maximising its own profit.

There are member-focused alternatives, such as collective defined contribution plans and group self annuitisation plans. As this concept of a "comprehensive retirement income product" evolves, the open mind shown to date for member-focused approaches ideally will continue.

Third, funding.

In general, mutuals can fund capital expenditures and other operating expenses only via retained earnings, debt, or raising funds ratably from the members, such as higher fees or a pledge drive or donations. This can limit their capacity to invest, grow and compete with other corporate forms.

The United Kingdom recently enacted legislation to address this, known as the Mutuals Deferred Shares Bill

The Mutuals Deferred Shares Bill passed in March will permit the creation of member investment shares for the first time in insurance mutuals. They will qualify as restricted tier one capital for regulatory purposes and provide mutual insurers with the opportunity to raise additional working capital by issuing a new form of mutual deferred share.

It may be worthwhile monitoring the effects of this bill in the UK, and considering something like it in the Australian context.

Third, there is a need for coordinated policy:

Currently, most government industry policy, and business development support, is geared toward how to establish and manage investor-owned models.

There is a relatively low allocation of resources to education and departmental programs, including at public universities -- programs focused on the distinctive business of co-ops and mutuals. This is true within business schools and across disciplines such as law and accountancy.

Information about co-operatives and mutuals can be difficult to find, and advisors on business development can lack relevant knowledge/experience.

Hence, high quality professional support for these business models can be difficult to find.

In the finance sector, and economics, the professional training and tertiary programs are sometimes observed to have a different culture than say, nursing, teaching, or even law. A bit more Gordon Gekko than Florence Nightingale, so to speak.

This can make recruiting more challenging for member-benefit firms in the finance industry. Industry funds have had success recuiting and developing culture, but it has required extra effort. Within ISA there is a relatively high concentration of former public servants for example, because that is an area where there is both technical excellence and a civic mindedness.

Training and culture aside, and I suppose the last observation around the potential benefits of a national strategy, is that official data on co-ops and mutuals is often collected on an ad hoc basis. For example, ASIC does not collect data that distinguishes between mutuals and other kinds of companies.

Other parties before the Inquiry have suggested a national strategy to support cooperative, mutual and member owned businesses. This seems like a recommendation worthy of careful consideration, as it would enable organised responses to these challenges.

Thank you again for the opportunity to appear here today.