NOTES ON THE
FINANCE AND EXPENDITURE SELECT COMMITTEE

Wednesday, 6th December 2017

Friendly Societies and Credit Unions (Regulatory Improvements) Amendment Bill

Members Present:

Kiritapu Allan (Labour)
Andrew Bayly (National)
David Carter (National)
Tamati Coffey (Labour)
Steven Joyce (National)
Willow-Jean Prime (Labour)
Deborah Russell (Labour)
David Seymour (ACT)
Stuart Smith (National)
Fletcher Tabuteau (NZ First)
Duncan Webb (Labour)
Michael Wood (Labour, Chairperson)
Jian Yang (National)
Lawrence Yule (National)

Evidence Presented by:

Westforce Credit Union
Victor Martick, General Manager

Police and Families Credit Union
Helen Hatchard, Chief Executive
Richard Middleton, Chair of the Board

First Credit Union
Malcolm Blair, Director

Manchester Unity Friendly Society
Sanjiv Jetly, Chief Executive

New Zealand Firefighters Credit Union
Craig Gold, Chair of the Board of Directors

The Finance and Expenditure Select Committee met to hear evidence in its examination of the Friendly Societies and Credit Unions (Regulatory Improvements) Amendment Bill, a member's Bill in the name of Stuart Smith. The Bill would amend the Friendly Societies and Credit Unions Act to simplify the statutory objects of an association of credit unions, provide for the incorporation of credit unions, and enable credit unions and associations of credit unions to have the powers of a natural person. It would also permit credit unions to provide financing to small and medium-sized enterprises owned by or closely associated with a member of the credit union and reduce from seven to two the minimum number of credit union members needed for an association of credit unions to be validly constituted.

Victor Martick, general manager at Westforce Credit Union, submitted that he was one of 160,000 New Zealanders who were members of credit unions. Their becoming corporatised and losing their mutuality was like tearing out a healthy heart and replacing it with a mechanical one that could make more money. The Bill appeared to be change for its own sake, and was based on a lack of understanding about what a not-for-profit mutual was and how they benefited communities. He suspected those wanting change did not understand the purpose of the Act. Mutuals are the members, and members help members, he said. Credit unions did not chase profits, they helped the people in the community. Mutuals were not just like cooperatives. He said the proposed changes lacked compassion for people and had an element of corporate greed. They would incorporate credit unions, forcing directors to act in the best interest of the credit union, even if it was not in the best interests of its members. The current Act requires directors to act in the best interests of its members. That was unique, he said. It should not be changed; members did not want that changed and had not even been asked. Four credit unions representing more than 51 percent of members and more than 50 percent of total equity had submitted to the Committee rejecting any concept of incorporation.

Martick noted the claim that the Bill's changes would remove unnecessary operating and compliance costs, but said that the changes would potentially cost the credit-union movement hundreds of thousands of dollars, which cost would be passed on to members. The Bill sought to change processes that had been working fine for decades, for example, by removing the need for trustees. In 1909 and in 1982 Parliament had provided for trustees because they had a fiduciary obligation to members. That was the best structure for a mutual. It followed a couple of centuries of English law. This Parliament should not ditch that philosophy without justification. Credit-union trustees had held assets in their name on behalf of members for decades. They were members who had been voted onto the board. They helped members with borrowing money and managing credit-union assets and cared about members.

Martick also noted the Bill's claim of greater efficiency, innovation and accountability, but said credit unions were already efficient, innovative and accountable. No credit union world-wide had fallen over during the Global Financial Crisis. They commonly became strong in difficult times. Credit unions had all the technology banks had and were ahead in some areas. He asked why credit unions want to be like all other financial service providers, which were greedy. Credit unions protected many in the community from payday-loan companies and loan sharks. They did not want to become profit-driven. They showed their members how to borrow money safely and how to save money. No other financial provider did that, Martick said.

To the claim the changes would retain an element of mutuality and the requirement of a common bond between members, Martick submitted that members being the credit union was what mutuality was. Deleting the mutuality and retaining an element would not benefit the members. If some did not like being a mutual, they could find another Act that did what they needed. Westforce Credit Union filled a gap by opening accounts for those whom banks did not want: released prisoners, those with bad credit ratings, the mentally ill, and homeless and transient people. If the Act was changed to make credit unions profit-driven, the would have to reconsider that because it would cost them money. The service credit unions provided was not profitable, but the Act permitted mutuals to help people. If mutuality were removed, directors would be forced to think of profit first, as the Companies Act did. Directors would be required to think of the credit union first, not the members first.

Martick submitted that the New Zealand Association of Credit Unions (Co-op Money NZ) was not representing the members of the credit unions, but he was. A 2017 omnibus Bill that had proposed changes had failed because it was not unanimous, and these changes were not unanimous either, he said. 160,000 members would be affected.

David Seymour (ACT) asked whether a credit union that incorporated could maintain mutuality by setting its own rule not to deal with anyone who was not a member. Martick replied that it could, but legislation would always override rules. If the services it provided were unprofitable, the directors would be pulled up, because they were operating under the Companies Act. Seymour suggested the companies did many things that were not profitable in themselves, but were in the long-term interest of the company. Martick responded that those companies made great profits and credit unions did not.

Stuart Smith (National) suggested that the concept of mutuality was not changed by the Bill. The objects of credit unions remained: the common bond, the requirement for one-member-one-vote and the restrictions on share transfers. Martick responded that that was opinion and not fact; the directors made decisions that were not profitable, and if they had to make profitable decisions, people would be affected.

Richard Middleton, chair of the board of the Police and Families Credit Union, said it considered itself to be the original peer-to-peer lenders. It had only ever borrowed from members and loaned to members, never sourcing funding from outside. It did not see any good reason to change the legislation and feared unintended consequences. No investors had lost money through the Global Financial Crisis. The Bill would not remove unnecessary compliance costs, Middleton submitted. There were six levels of compliance, from internal controls to the Reserve Bank of New Zealand. The Bill did not take them away. If a credit union wanted to be a body corporate, it could do so under existing law.

Middleton said that the Police and Families Credit Union's members knew they could come to it for help often where banks would not. It had built $23 million in equity, which allowed it to undertake initiatives, such as spending $1 million over three years on financial-literacy courses. It could finance potential police recruits, thanks to the current legislation, because it put members at the centre of what the Credit Union did. That would change if the directors had a fiduciary duty to a body corporate. The Credit Union wanted to be different to financial institutions like banks. He responded to the suggestion that removing internal trustees would reduce compliance costs by saying that the cost was only 0.5 percent of its overall expenses. He submitted that in the age of the sharing economy, the Act was more relevant than it had been for many years.

Kiritapu Allan (Labour) asked about the union's legal advice that a legal challenge to the mutuality of credit unions was likely. Middleton replied that the advice was that the change meant the directors' fiduciary duty would be to the structure, not to the members. If they acted in the best interests of the body corporate and not the members, however, the members could dispute that. Helen Hatchard, chief executive of the Police and Families Credit Union, added that it was a governance issue: directors now had a different lens than a normal board would have. Initiatives like the financial-literacy courses were about doing the right thing and not always about making money. Middleton went on to say that the Credit Union did not sell any product in relation to the courses, which were run by the Commission for Financial Capability.

Allan asked for clarification that the legal advice suggested such an investment would be at risk under the Bill. Hatchard replied that it did. Michael Wood (Labour, Chairperson) asked the submitters to share the advice with the Committee. Hatchard said she was willing to do that.

Smith commented that New Zealand was unique in not allowing credit unions to be corporatised. Middleton replied that Australia had similar legislation to the Bill, and the police credit unions were taken over by the taxi drivers credit unions for a long time. There were only three credit unions left there; the rest were banks, which took away their ethos from members. Smith said the Australian legislation differed markedly from what was proposed here, as it had allowed registration under the Companies Act. Middleton responded that it still changed a director's fiduciary duty to the body corporate and not to members.

Wood asked whether there were different views in the credit-union movement about the Bill and how they could be reconciled. Middleton replied that the New Zealand Association of Credit Unions was pushing the Bill, but it was not a credit union. Some credit unions were lumped in with it, but they were mainly very small and had nowhere else to go. He commented that the Police and Families Credit Union had had to join with other credit unions to get a card supplier. Hatchard added that others supported the Bill mainly so that the Association could do business with third parties. That was important so its credit-union members could generate other income. The High Court had ruled in relation to the registrar's decision that they could not provide to third parties that they could do that now. Smaller credit unions were supportive of the Bill because they needed to make sure the Association stayed solvent by getting third-party business.

Seymour asked how the Bill could be amended to enable change without compelling it for those who did not want it. Middleton replied that it could allow the optional change of the corporate structure to a body corporate. She wondered if those credit unions could use a different Act to do what they wanted.

Malcolm Blair, a director of First Credit Union, submitted that its members were mainly those on low wages or beneficiaries who found it difficult to get banking services through banks. It emphasised the provision of loans for members for debt consolidation, household items and motor vehicles, which were often unsecured. First Credit Union was not about being a corporate organisation or making huge profits, but about members helping each other where they could not otherwise get help. First Credit Union did not believe that the Bill would decrease its compliance costs. It would in fact increase them initially, because legal advice would be needed and amendments to the external trust deed made. It main compliance costs came from its product disclosure statement, the Reserve Bank, which was its regulators, and its external trust deed. The removal of the internal trustees would make no difference to its costs.

Blair submitted that it was not the role of the credit unions to provide lending to small to medium-sized enterprises. That was better provided by banks, finance companies or some other financial institutions. Even though First Credit Union was the largest in the country, it was not geared up to provide skilled business lending and did not have the expertise or experience. Credit unions were about people helping people, not about helping builders grow. Most of its members were on the minimum wage or were beneficiaries.

Blair noted that many submissions from credit unions were about the ability to provide third-party business, to maximise return on IT investment, but said that impediment had been removed by the courts. They had decided the Association was free to provide services to third parties, not just credit unions. Credit unions seem to be divided on that issue. In 2016 there was to have been an omnibus Bill with a number of amendments related to the Act for credit unions, but when it came forward, some objected, including First Credit Union. Officials and the Minister therefore decided that the omnibus Bill could not proceed with those amendments in it.

The Ministry of Business, Innovation and Employment had asked credit unions to come back with a consensus on changes, Blair said. That had not happened. There had not been an opportunity for credit unions to come together and see if there could be consensus, particularly on mutuality and lending to small and medium-sized enterprises. First Credit Union opposed the Bill, but would like the Committee to find a way to let credit unions try and reach consensus for future legislation.

Wood asked why the sector had not done that. Blair replied that the member's Bill had been put forward, a number of credit unions had supported it and said those that did not could oppose it. It had just been left with their having a difference of opinion. Smith asked whether the High Court had not merely set aside the registrar's decision, which allowed for another challenge, rather than making the law clear. Blair thought that it had made it reasonably clear that there would not be a further challenge. A credit union would probably have to challenge the Association's rules and the registrar's interpretation, and he was not aware of any credit union planning to to that.

Allan asked whether the Credit Union would support having the option to keep its current structure or to have a corporate structure. Blair replied that it would have to see how it looked, but if some credit unions wanted to be more corporate, there were ways to do that and he would not object. Duncan Webb (Labour) asked whether being corporate meant a union would have to be profit-focused, and whether specifying that it was a mutual entity that was member-focused would address some of Blair's concerns. Blair replied that it could. Under the current Bill the Credit Union would become a corporate, which meant cost. External trustees would want the trust deed changed, they would want lawyers and the Reserve Bank and Financial Markets Authority would get involved, so bills started stacking up. There was a large cost.

Webb asked about the concept of mutuality. Blair replied that it would be good if the concept of mutuality could be reflected in the legislation. The culture at the moment was that members' concerns and needs could be put to the directors and would be at the forefront when they made decisions.

Sanjiv Jetly, chief executive of the Manchester Unity Friendly Society, explained that it offers insurance products, mutual benefits, and fraternal services to its members. Jetly sought an amendment to the Bill to allow friendly societies to raise capital by allowing them to issue

securities, similar to the way credit unions could under the Act. Members of Manchester Unity Friendly Society pay a small amount of money over a long period of time so when they get ill, experience hardship or get old they could get the money back. Unregulated activities included providing subsidised medical subscriptions, paying benevolent payments to members in financial hardship, at-home companionship for members who needed it, transporting members to appointments and meetings, carrying out social events and helping projects. Regulated activities such as insurance provided the money for the unregulated ones.

Jetly submitted on the importance of capital, the need to match capital-raising powers of credit unions, and the need to modernise the legislation. He said that friendly societies, unlike companies, cannot raise capital except through their members. The Insurance (Prudential Supervision) Act 2010 placed a requirement on the Friendly Society to maintain a minimum level of capital. Its proposed amendment would identify new sources of capital for friendly societies, strengthen their balance sheets, create a level playing field when competing against overseas-based insurers. By expanding the capital they had access to, they would be able to offer innovative services for members.

Jetly said another benefit of his proposed amendments was that they would avoid demutualisation for those that could not raise capital. Demutualisation would take away consumers' options for low-cost low-risk insurance. The other reason was to match the capital-raising powers of credit unions. They could raise capital through credit union securities under the Act. The third reason was modernisation, Jetly said. To compete with other insurers, friendly societies needed to be able to raise capital. The Act was last reviewed in 1982 and insurers were regulated in 2010. He believed his suggested amendments were non-controversial and would be good for the friendly-society sector as they would continue their mutual business model and would be good for consumers.

Andrew Bayly (National) asked whether the Manchester Unity Friendly Society supported the Bill's demutualising of the structure of friendly societies. Jetly replied that it did not support that. He was looking at the capital-raising provisions. It was happy for mutuality to continue in New Zealand, because it gave consumers options. Bayly asked what kind of capital raising was sought by the amendment. Jetly replied that it could be ordinary capital or preference capital, which would be quasi-equity capital.

Bayly asked why the Friendly Society wanted to grow its insurance business. Jetly replied that the insurance activity essentially funded the mutual model. The Reserve Bank requirements for a minimum capital essentially applied it to an unproductive use; it could not fund those activities. His amendment would allow friendly societies to raise the funding to continue those mutual activities for members. Wood asked if any other friendly societies had views on the matter. Jetly replied that he had talked to the Hibernians and they were positive. It was pretty non-controversial.

Craig Gold, chair of the board of directors of the New Zealand Firefighters Credit Union, submitted that it supports the Bill. It had started 40 years ago with a notebook, a pencil and a biscuit tin to hold the cash, but that system and an Act almost as old did not serve modern members in a society of apps, instant banking and 24-hour, seven-day service. It was run by four employees and a voluntary board of directors, three of whom were internal trustees. It provided savings, loans and transactional banking, mobile and internet banking and a Mastercard debit card. That product suite was unheard-of outside the credit-union sector for an organisation of its size. That was a result of its collaboration through Co-op Money NZ. Gold submitted that the Bill would reduce the time and cost of compliance. There were more

people checking on the Credit Union than working for it. That created an unnecessary drag on its business. Co-op Money NZ was key to the Credit Union's survival. Having to get members who had small businesses to on-loan money to their business did not seem up-front. The advent of Fire and Emergency New Zealand meant there were 12,000 new volunteer members available, who were plumbers, electricians and builders, and the Credit Union wanted to be able to support them.

Gold was surprised that those credit unions who opposed the Bill did not offer a way forward, suggesting a 35-year-old Act was sufficient. He agreed with Seymour that additional oversight could be voluntary, and did not need to be legislated for. Firefighters Credit Union spent all their time on compliance and had no time for members.

Allan asked about the disparity of compliance time and costs between the Firefighters Credit Union and those of other submitters. Gold replied that the amount of compliance work did not change regardless of the number of staff or size of the credit union. The Firefighters Credit Union did not have the luxury of a dedicated compliance officer and did not make enough profit to pay those expenses. He conceded that the Police and Families Credit Union offered compliance support and credit unions worked together to share policies and procedures.

Smith asked how Gold reconciled his view about maintaining mutuality with the previous submission. Gold replied that he was a member of the Association, which had made a submission to change the Act. In the last few submission he had heard concern about operating in the best interests of the credit union and being profit-driven. The Association's suggested amendment about operating according to the credit union's objects would take that away. The Firefighters Credit Union looked for what was best for members, and what was best for it was generally what was best for its members. He recognised that some wanted to just be an organisation that people went to in a time of need, but if the Firefighters Credit Union did not provide a suite to millennial recruit fire-fighters, they would drop it like a stone for a foreign-owned bank who offered to put their jet ski on their mortgage.

Deborah Russell (Labour) asked if mutuality was served by its specific membership base or whether it could preserve it if it joined with a larger credit union. Gold replied that it would be retained if it joined with another. It had received assistance from other credit unions. It would not survive without voluntary support from board members, but could not expect that in future.

Bayly noted that the Credit Union had achieved much that the Bill envisaged already, and asked what the missing element was that would make it more viable. Gold did not know that there was a missing element, but replied that the Bill supported the current structure. Without mutuality and the cooperative it worked with, the Firefighters Credit Union would not have access to a tier-one banking system. By being part of that organisation it accessed lower-cost, more modern and better services. It would be beneficial to be able to lend to small and medium-sized enterprises, to enable it to grow. asked why it was important that the structure needed to be changed. Gold replied that he did not know that it was so important or that all the changes were integral to the Credit Union's survival, but some helped clarify the way it did business and helped keep things above board.

Tamati Coffey (Labour) asked whether the Bill would expose credit unions to the effects of something like the Global Financial Crisis. Gold replied that the Credit Union sometimes did not offer the best deal on mortgages and took higher risks to lend to new members, but people still borrowed from it. If the union could get members' financial security right and

make them comfortable at home, that could take worry away and they could be more effective in their job as fire-fighters. That was an important value of the Credit Union.

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