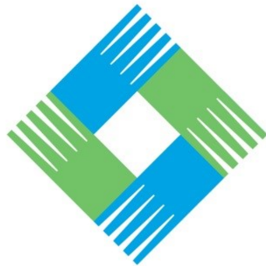

Friendly Societies of Australia

Exposure draft legislation for the removal of the funeral expenses exemption – Submission of the Friendly Societies of Australia

18 October 2019

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Friendly Societies of Australia

About the Friendly Societies of Australia (FSA)

The Friendly Societies of Australia (FSA) is the industry association representing Australia's friendly societies regulated by the Australian Prudential Regulation Authority (APRA). FSA members provide investment products, financial services, healthcare, retirement living, aged and home care services to some 800,000 members. Collectively, our sector manages around $7.5 billion in funds in a highly regulated environment and in 2018, paid out more than $800 million in benefits, with both funds under management and benefits paid increasing over the past few years.

FSA member friendly societies currently provide funeral bonds to more than 264,000 consumers, with $2.05 billion in funds under management.

The FSA appreciates the opportunity to comment on exposure draft legislation (and associated documentation) which, if it passes Parliament, would remove current exemptions for funeral expenses policies.

Friendly societies operate in a highly regulated funds management environment

Friendly societies operate under a unique "benefit fund" structure. Under this structure, funds invested by consumers are quarantined such that no money invested in an approved friendly society benefit fund can be used for anything else other than paying benefits to consumers who have contributed to the fund (other than regulated fees and expenses). This clearly differentiates friendly societies from other financial services providers and non-regulated funds, such as private trusts. In addition, the vast majority of FSA members are mutuals. Mutuals are member-based businesses owned and controlled by their customers. The purpose of mutuals is different from other businesses as they exist to serve their members, rather than to reward capital investors. Whether funds are put back into the business or are used to benefit local communities, all profits are reinvested for members' benefit.

These consumer protections are one of the major reasons why there is a legislative requirement in Victoria and Tasmania for consumer funds spent on pre-paid funerals with funeral directors to be held separately from funeral directors in regulated funds, such as friendly societies. No other state or territory has this legislated safety net in place.

FSA position on exposure drafts

The FSA supports the intent of the exposure draft of proposed changes to the *Corporations Act 2001* (Corporations Act) and the *Australian Securities and Investments Commission Act 2001*.

The intent of the proposed legislation is to overcome issues which were raised during the Financial Services Royal Commission about the way that funeral insurance policies were sold (or mis-sold) and design flaws in funeral insurance expense policies, with the Commissioner stating some funeral insurance products provided little real value to the insured. It is important to note that funeral bonds do not have the same issues neither were they discussed by the Royal Commission.

Funeral bonds and funeral insurance are distinctly different – funeral bonds are a sole-purpose friendly society product where contributions and any declared bonuses are guaranteed, while ongoing payments to funeral insurance are required for a consumer to receive a funeral insurance pay-out.

Therefore, on behalf of the industry, the FSA is supportive of:

- classification of funeral expenses policies as a financial product,
- requirement of providers of such funeral expenses policies be an Australian financial services licence (AFSL) holder,
- applicability of the general conduct obligations and anti-hawking provisions contained in the Corporations Act,
- exemption for funeral directors from needing to hold an AFSL when dealing in a friendly society funeral product.

As entities already regulated by APRA and ASIC, these changes are consistent with the existing obligations, requirements and practices of FSA members.

However, we have strong concerns that the proposed changes will, in fact, create an environment where there is an incentive for consumer funds, placed by consumers under a pre-paid funeral contract or a pre-arranged funeral plan, to be held outside of the regulated financial services sector that ASIC and APRA regulate, and as such, this would materially diminishing the current consumer protections.

Consumer protection concerns

While the FSA supports the intent of the proposed exposure drafts, our strong concerns centre on scenarios where funeral director businesses keep consumer funds placed by consumers under a pre-paid funeral contract or a pre-arranged funeral plan outside of the regulated financial services sector, rather than in a manner that protects consumers.

The exploitation of this opportunity is becoming evident with an emerging trend of large shareholder funeral businesses and funeral director associations establishing their own trusts and prioritising rapid expansions and shareholder returns without proper consumer protections for the funds that are being managed that this exposure draft is trying to implement. The prioritisation and focus on immediate financial returns will see these funds potentially target high risk investments, which in turn can endanger consumers who will, despite ultimately receiving no financial value from these investments, be fully exposed to the risks involved.

This is a form of vertical integration, which also came under some criticism in the Royal Commission. Vertical integration can be a favourable outcome for consumers as it can provide better access to a range of desirable products and scale benefits which can be passed on to consumers through better pricing and returns. However, it only works to the consumer's advantage in a sophisticated and robust, highly-regulated environment, such as that found in ASIC and APRA-regulated entities. Outside of that context, consumers will bear all the risks of vertical integration such as conflicts of interest, lack of transparency and minimal governance and risk management requirements, and receive none of the benefits.

The simple fact that consumer funds are managed outside the financial services sectors without the scrutiny of ASIC and APRA is clearly inconsistent with the Royal Commission's recommendations of materially strengthening consumer protection in the funeral expense policies industry.

The real risk of not placing funeral funds into an approved benefit fund of a friendly society or a life company is that funds could be mismanaged or misappropriated and, where specific state-based legislation is applicable (and often inconsistent), not be afforded the same level of scrutiny that is undertaken by APRA and ASIC.

Friendly Societies of Australia

While the funeral director industry is regulated at state/territory level, regulation of funds management is the responsibility of the Federal Government.

The failure of just one of these fund arrangements will not only have impacts for the consumers involved but also devastating reputational implications for the industry that is already highly scrutinised.

Friendly societies which offer products are licensed financial institutions that are prudentially regulated by APRA under life insurance laws. Products offered by our members are also subject to regulation by ASIC with respect to disclosure and financial servicing licensing obligations under the Corporations Act. All current FSA members have internal complaints resolution processes in place and are members of the Australian Financial Complaints Authority, providing robust consumer protections.

To ensure that the consumers are given maximum protection, the FSA recommends that consideration is given to new Commonwealth laws being introduced which would make it compulsory for all money invested by consumers under a pre-paid funeral contract or a pre-arranged funeral plan with funeral directors be placed into:

- an APRA-regulated benefit fund of a friendly society; or
- investment funds offered by companies registered under the Life Insurance Act 1995.

The primary reason for this FSA recommendation is that friendly societies operate under a unique "benefit fund" structure, as mentioned above. Consistency across all states/territories would ensure consumers receive the same protections regardless of where they live.

The protections offered by friendly societies' benefit funds have been recognised by ASIC. ASIC document titled "Paying for funerals" (dated July 2017) states:

"In some states, funeral directors must put your payments into a registered funeral fund, which protects your money if their business goes broke. If you buy a pre-paid funeral in Western Australia, the ACT or the Northern Territory, there are fewer consumer protections. In those states, think about using a bond to pre-pay a funeral."

Transition Period

The exposure draft proposes an implementation date of 1 April 2020. The FSA, giving consideration to the additional disclosure requirements and obligations associated with the removal of the existing exemption, have determined that this timeframe is insufficient. For an orderly transition to these new arrangements consideration of an implementation date after 31 December 2020 is requested.

Conclusion

Thank you for the opportunity to provide input and should Treasury require further information or clarification about the policy position of the FSA, please make fresh contact with us.

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