Financial System Inquiry Final Report

March 1997
The Hon Peter Costello MP  
Treasurer  
Parliament House  
CANBERRA ACT 2600  

Dear Treasurer,  

We are pleased to present the Final Report of the Financial System Inquiry.  

The Committee acknowledges the valuable input received from many individuals and organisations directly and indirectly involved with the financial system.  

In particular, we wish to record our appreciation for the help and support provided by the Inquiry Secretariat ably led by Greg Smith which enabled the Inquiry to meet the requirements of its Terms of Reference and timetable.  

Yours sincerely,  

Stan Wallis (Chairman)  

Bill Beerworth       Jeff Carmichael  

Ian Harper       Linda Nicholls
Members of the Inquiry

Mr Stan Wallis, Inquiry Chairman

Mr Wallis was Managing Director of Amcor Ltd between 1977 and 1996 and is now Deputy Chairman of that company. He is President of the Business Council of Australia and holds a number of other company directorships.

Mr Bill Beerworth

Mr Beerworth is a solicitor and merchant banker and is Principal Partner of the corporate and financial advisory firm, Beerworth & Partners Limited.

Professor Jeffrey Carmichael

Professor Carmichael was formerly Professor of Finance at Bond University, Chairman of the Australian Financial Institutions Commission and Chief Manager of the Markets Group of the Reserve Bank.

Professor Ian Harper

Professor Harper directs the Ian Potter Centre for International Finance at the Melbourne Business School within the University of Melbourne. He has held positions with the Australian National University and Reserve Bank.

Mrs Linda Nicholls

Mrs Nicholls is a company director and adviser to Coopers & Lybrand. She has held senior positions in banking and funds management in Australia, New Zealand and the United States.
Foreword

Background to the Inquiry

Much of the regulatory framework for the Australian financial system has been established over the 16 years since the Australian Financial System Inquiry (the Campbell Committee) reported in 1981. The financial system has been transformed over this period and continues to undergo sweeping change. Against this background, the Government decided in 1996 to establish a new Inquiry to review these developments, to consider the factors likely to drive further change, and to make recommendations for possible further improvements to the regulatory arrangements.

Terms of Reference

The Treasurer, the Hon Peter Costello MP, established the Financial System Inquiry in June 1996 with the following mission:

The Inquiry is charged with providing a stocktake of the results arising from the financial deregulation of the Australian financial system since the early 1980s. The forces driving further change will be analysed, in particular, technological development. Recommendations will be made on the nature of the regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness.

The Inquiry was asked to report by 31 March 1997.

The Inquiry’s full Terms of Reference are reproduced in Appendix A.
Approach to the Task

To provide substantial opportunity for public participation and to gain information and views from those involved in the finance industry, the Inquiry approached its task by:

- inviting submissions from the public in June 1996;
- publishing a Discussion Paper in November 1996, which set out the issues to be addressed and invited supplementary submissions;
- holding public consultations in all mainland capital cities during December 1996;
- meeting with experts, finance industry participants, regulatory agencies and consumers, both in Australia and overseas;
- making information about the Inquiry publicly available on its Internet home page http://www.treasury.gov.au/fsi; and
- stimulating public debate through participation in a range of conferences and seminars.

The Final Report

Scope

In accordance with its Terms of Reference, the Inquiry has confined its attention to the main fields of financial regulation, including those which aim to improve market conduct, disclosure, safety, stability, competition and competitiveness.

The Inquiry has not made specific recommendations on the conduct of monetary policy, retirement incomes policies, taxation policies, or the regulation of the general operation of companies through corporations law. However, these issues have been taken into account in formulating recommendations on other financial regulatory arrangements and some potential links or conflicts have been noted for possible future study.
For reasons of efficiency, the Final Report does not repeat most of the material provided in the Discussion Paper released in November 1996. In particular, reference should be made to the Discussion Paper for:

- a more complete description of the existing regulatory arrangements for the Australian financial system;
- summaries of the views put to the Inquiry in the first round of submissions; and
- a more complete description of the alternative options for changes to current regulatory arrangements.

**Structure**

The Report’s *Overview (The Financial System: Towards 2010)* summarises the Inquiry’s vision for the future, the Inquiry’s regulatory philosophy and a blueprint for proposed regulatory reform. This blueprint is followed by a full list of the Inquiry’s recommendations.

The remainder of the Final Report is structured in three parts.

- **Part One: Forces for Change** canvasses the major factors driving change in the financial system, including changing customer needs, new skills and technologies, and regulatory change. Part One also describes consequent changes in the conduct and structure of financial markets and businesses.

- **Part Two: Key Issues in Regulatory Reform** sets out the philosophy of financial regulation adopted by the Committee and examines the costs of financial activity in Australia. Part Two describes a broad range of reforms aimed at improving financial system efficiency. It presents the Inquiry’s recommendations for financial regulation, including arrangements for market integrity, consumer protection, safety, stability and competition.

- **Part Three: Stocktake of Financial Deregulation** provides a history of the changes in financial regulation in Australia and reports on the results of the deregulation flowing from the Campbell Committee. It examines the impact of financial deregulation on competition, efficiency, international competitiveness, and product choice and quality in the Australian financial system.
Appendix D contains the Inquiry’s review of financial system legislation required under the Competition Principles Agreement.

**Acknowledgements**

The Committee wishes to thank the large number of financial system participants and observers who made submissions, participated in public consultations and meetings with the Inquiry, or assisted with research. Submissions to the Inquiry and the Committee’s meetings with financial system participants and observers both in Australia and overseas are listed at Appendix B.

Research conducted for the Inquiry by the Secretariat would not have been possible without the generous assistance of many organisations which gave freely of their time, resources and skills. The Committee would particularly like to thank the Reserve Bank of Australia, the Insurance and Superannuation Commission, Professor Neil Quigley (of The Victoria University of Wellington) and Mr Charles Taylor (former Executive Director of the Group of Thirty) who provided both data and additional information. Research work was also informed by the commissioned material provided by Roy Morgan Research and others listed in Appendix C.

The Inquiry is grateful for administrative support from many areas of the Department of the Treasury and particularly wishes to thank Anne Fornasiero and her publications team, the Treasury Travel section and the staff of the Treasury & Finance Library.

Finally, the Committee wishes to acknowledge the outstanding support provided by all members of the Secretariat drawn from both the private and public sectors:

- Greg Smith (Secretary)  
- John Eyers
- Matt Bekier  
- Chris Gaskell
- Neil Brown  
- Kim Hansen
- Brendan Byrne  
- Amanda Heyworth
- Lisa Considine  
- Phyllis Macdonald
- Lynne Curran  
- John Nagle
-  
- Patricia Pascuzzo
- Sarah Phipps
- Delia Rickard
- Colleen Sykes
- Greg Tanzer
- Shauna Tomkins
# Table of Contents

**Table of Contents**

<table>
<thead>
<tr>
<th>Foreword</th>
<th>BACKGROUND TO THE INQUIRY ....................................................... VII</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Terms of Reference........................................................................ vii</td>
</tr>
<tr>
<td></td>
<td>Approach to the Task...................................................................... viii</td>
</tr>
<tr>
<td></td>
<td>The Final Report........................................................................... viii</td>
</tr>
<tr>
<td></td>
<td>Acknowledgements ......................................................................... x</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Overview</th>
<th>THE FINANCIAL SYSTEM: TOWARDS 2010............................................ 1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>RECOMMENDATIONS ........................................................................... 31</td>
</tr>
</tbody>
</table>

| Part 1         | Forces for Change ........................................................................ 75 |

## Part 1 Forces for Change

### Chapter 1: Changing Customer Needs ..................................................... 77

1.1 Introduction............................................................................................. 79
1.2 Developments Influencing Customer Needs............................................. 79
1.3 Implications for Distribution Channel, Product and Supplier Choice ........ 89
1.4 Conclusion............................................................................................... 91

### Chapter 2: Technology Driven Innovation ............................................... 93

2.1 Introduction............................................................................................. 95
2.2 New Technology Platforms...................................................................... 96
2.3 Retail Payments and Distribution Channels............................................ 99
2.4 Information and Risk Management......................................................... 110
2.5 Conduct of Markets and Exchanges......................................................... 114
2.6 The Future............................................................................................... 117
<table>
<thead>
<tr>
<th>Chapter 8:</th>
<th>Financial Safety</th>
<th>297</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.1 Introduction</td>
<td></td>
<td>299</td>
</tr>
<tr>
<td>8.2 The Extent of Regulatory Assurances</td>
<td>300</td>
<td></td>
</tr>
<tr>
<td>8.3 Framework for Prudential Regulation</td>
<td>301</td>
<td></td>
</tr>
<tr>
<td>8.4 Approach to Prudential Regulation</td>
<td>319</td>
<td></td>
</tr>
<tr>
<td>Chapter 9:</td>
<td>Stability and Payments</td>
<td>361</td>
</tr>
<tr>
<td>9.1 Introduction</td>
<td></td>
<td>363</td>
</tr>
<tr>
<td>9.2 Stability of the Financial System</td>
<td>364</td>
<td></td>
</tr>
<tr>
<td>9.3 Efficiency and Access to the Payments System</td>
<td>382</td>
<td></td>
</tr>
<tr>
<td>Chapter 10:</td>
<td>Mergers and Acquisitions</td>
<td>415</td>
</tr>
<tr>
<td>10.1 Introduction</td>
<td></td>
<td>417</td>
</tr>
<tr>
<td>10.2 Merger Laws</td>
<td></td>
<td>417</td>
</tr>
<tr>
<td>10.3 The ‘Six Pillars’ Policy</td>
<td>425</td>
<td></td>
</tr>
<tr>
<td>10.4 The Competition Effects of Mergers</td>
<td>428</td>
<td></td>
</tr>
<tr>
<td>10.5 Foreign Investment and Acquisitions</td>
<td>473</td>
<td></td>
</tr>
<tr>
<td>Chapter 11:</td>
<td>Promoting Increased Efficiency</td>
<td>477</td>
</tr>
<tr>
<td>11.1 Introduction</td>
<td></td>
<td>479</td>
</tr>
<tr>
<td>11.2 Funds Management</td>
<td></td>
<td>480</td>
</tr>
<tr>
<td>11.3 Selected Taxation Impediments</td>
<td>492</td>
<td></td>
</tr>
<tr>
<td>11.4 Coordination of Advice on Technology</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>11.5 Cross-Subsidies</td>
<td></td>
<td>507</td>
</tr>
<tr>
<td>11.6 Improving Market Information</td>
<td>509</td>
<td></td>
</tr>
<tr>
<td>11.7 Neutrality in Mortgage Markets</td>
<td>524</td>
<td></td>
</tr>
<tr>
<td>Chapter 12:</td>
<td>Coordination and Accountability</td>
<td>527</td>
</tr>
<tr>
<td>12.1 Introduction</td>
<td></td>
<td>529</td>
</tr>
<tr>
<td>12.2 Regulatory Performance</td>
<td>530</td>
<td></td>
</tr>
<tr>
<td>12.3 Funding</td>
<td></td>
<td>532</td>
</tr>
</tbody>
</table>
### Chapter 13: Managing Change

- **13.1 Introduction** ................................................................. 549
- **13.2 Key Issues** ................................................................ 549
- **13.3 Summary** ...................................................................... 558

### Part 3: Stocktake of Financial Deregulation

#### Chapter 14: Stocktake: Historical Perspective

- **14.1 Introduction** .................................................................. 569
- **14.2 Evolution of the Australian Financial System** ............. 575
- **14.3 Forces for Change in the 1970s** ................................. 580
- **14.4 The Campbell Committee** .......................................... 586
- **14.5 Other Policy Developments since the Campbell Report** .................................................................................. 591
- **14.6 The Financial System since Deregulation:**
  - A Broad Assessment ......................................................... 593
- **14.7 Conclusion** .................................................................. 596

#### Chapter 15: Stocktake: The Financial System

- **15.1 Introduction** ................................................................. 599
- **15.2 Competition in the Financial System** ........................ 600
- **15.3 Efficiency** .................................................................... 606
- **15.4 International Competitiveness** ................................... 617
- **15.5 Choice of Financial Products** ....................................... 622
- **15.6 Quality of Financial Products and Services** ............ 635
- **15.7 Conclusion** ................................................................. 639