

**Financial
System
Inquiry
Final
Report**

March 1997

© Commonwealth of Australia 1997

ISBN 0 642 26102 4

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Australian Government Publishing Service. Requests and inquiries concerning reproduction rights should be directed to the Manager, Commonwealth Information Services, Australian Government Publishing Service, GPO Box 84, Canberra ACT 2601.

Editorial assistance was provided by WordsWorth Writing
Produced by the Australian Government Publishing Service



Internet: <http://www.treasury.gov.au/fsi>

Level 9
35 Spring Street
MELBOURNE VIC 3000

18 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.

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	Patricia Pascuzzo
Matt Bekier	Chris Gaskell	Sarah Phipps
Neil Brown	Kim Hansen	Delia Rickard
Brendan Byrne	Amanda Heyworth	Colleen Sykes
Lisa Considine	Phyllis Macdonald	Greg Tanzer
Lynne Curran	John Nagle	Shauna Tomkins

Table of Contents

	Page No.
Foreword	
BACKGROUND TO THE INQUIRY	VII
Terms of Reference	vii
Approach to the Task.....	viii
The Final Report	viii
Acknowledgements	x
Overview	
THE FINANCIAL SYSTEM: TOWARDS 2010	1
RECOMMENDATIONS	31
Part 1	
Forces for Change	75
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

Chapter 3:	Regulation as a driver of change	119
3.1	Introduction	121
3.2	Liberalisation of Trade and Capital Flows	122
3.3	Superannuation	127
	3.4 Government Exit from Ownership	131
3.5	Taxation	132
3.6	Conclusion	135
Chapter 4:	The Changing Financial Landscape	137
4.1	Introduction	139
4.2	Focus on Efficiency and Competition	141
4.3	The Further Globalisation of Markets	149
4.4	Conglomeration and Market Widening	154
4.5	Shift from Intermediaries to Markets	159
4.6	Conclusion	167
Part 2	Key Issues in Regulatory Reform	173
Chapter 5:	Philosophy of Financial Regulation	175
5.1	Introduction	177
5.2	The Financial System	179
5.3	Financial System Regulation	186
5.4	Principles of Regulation	195
Chapter 6:	Cost and Efficiency	199
6.1	Introduction	201
6.2	Financial System Cost Comparison	202
6.3	Payments System	223
6.4	Conclusion	233
Chapter 7:	Conduct and Disclosure	235
7.1	Introduction	237
7.2	The Regulatory Framework	239

7.3	Approach to Regulation.....	257
Chapter 8:	Financial Safety	297
8.1	Introduction.....	299
8.2	The Extent of Regulatory Assurances.....	300
8.3	Framework for Prudential Regulation.....	301
8.4	Approach to Prudential Regulation.....	319
Chapter 9:	Stability and Payments	361
9.1	Introduction.....	363
9.2	Stability of the Financial System.....	364
9.3	Efficiency and Access to the Payments System.....	382
Chapter 10:	Mergers and Acquisitions.....	415
10.1	Introduction.....	417
10.2	Merger Laws.....	417
10.3	The 'Six Pillars' Policy.....	425
10.4	The Competition Effects of Mergers	428
10.5	Foreign Investment and Acquisitions.....	473
Chapter 11:	Promoting Increased Efficiency	477
11.1	Introduction.....	479
11.2	Funds Management.....	480
11.3	Selected Taxation Impediments.....	492
11.4	Coordination of Advice on Technology	500
11.5	Cross-Subsidies	507
11.6	Improving Market Information	509
11.7	Neutrality in Mortgage Markets.....	524
Chapter 12:	Coordination and Accountability	527
12.1	Introduction.....	529
12.2	Regulatory Performance	530
12.3	Funding.....	532

12.4	Governance.....	535
12.5	Accountability	538
12.6	Coordination of Regulatory Agencies	542
12.7	Further Inquiries into the Financial System.....	546
Chapter 13:	Managing Change	547
13.1	Introduction.....	549
13.2	Key Issues	549
13.3	Summary.....	558
Part 3:	Stocktake of Financial Deregulation	561
Chapter 14:	Stocktake: Historical Perspective	567
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.....	597
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

Chapter 16:	Stocktake: Financial Regulation	641
16.1	Introduction.....	643
16.2	Prudential Regulation	644
16.3	Increased Consumer Protection.....	648
16.4	Harmonisation with Global Regulation	654
16.5	Responses to Anti-Competitive Structures	657
16.6	Cost of Regulation	658
Chapter 17:	stocktake: The Economy	665
17.1	Introduction.....	667
17.2	Allocative Efficiency	668
17.3	Method of External Adjustment	678
17.4	Financial Deregulation and Monetary Policy	687
17.5	Financial Deregulation and Saving	694
17.6	Growth and Employment.....	701
17.7	Other Changes Attributed to Deregulation	703
17.8	Concluding Comments	704
Appendix A:	Documents of the inquiry	707
A.1	Terms of Reference	707
A.2	Documents Issued by the Inquiry	710
Appendix B:	Submissions, Speeches and Meetings	711
B.1	Submissions	711
B.2	Speeches by Committee Members	716
B.3	Public Consultations	717
B.4	Meetings.....	719
Appendix C:	Consultancies	723
Appendix D:	Legislation Review	725
Acronyms and Abbreviations		747

References	751
-------------------------	------------