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Briefing note

January 2016

Government rubber stamps Australian financial system reform proposals

The Australian Government has adopted many of the recommendations made by the Financial System Inquiry Committee, which will likely have wide-ranging effects on the banking, superannuation and payment sectors, other financial services participants and capital markets.

With some measures are already in effect and others in train, the Australian Government's turbo charged reform agenda will mean that the financial services regulatory landscape is set to change.

On 20 October 2015, the Australian Government released its response to the final report of the Financial System Inquiry (**FSI**) (released in November 2014), which provides the Government's tick of approval to most of the 44 recommendations made by the FSI in its final report.

As a result, the Australian financial services regulatory landscape is set to change with the aim of building on existing measures to ensure that the financial services industry is resilient, efficient, innovative and fair, and increasing regulator accountability.

Ensuring that Australia is resilient – reducing the impact of future financial crisis

The impact of the global financial crisis (which occurred over eight years ago) set the world economy on a path from which there was no return, and still has a resounding impact upon the financial services sector.

Strong capital ratios

In an effort to ensure that Australia is able to reduce the impact of future financial crisis and lower the risk of taxpayer bailout, emphasis has been placed on ensuring that the capital ratio of Australian banks is unquestionably strong. To date, these measures have included ensuring that larger banks have been required to increase their mortgage risk weights.[1]

In future, such measures will include:

- narrowing the gap between average mortgage risk weights;
- implementing a framework for minimum loss absorbing and recapitalisation capacity in line with international practice;
- introducing a leverage ratio that acts as a backstop to banks' risk-weighted capital positions, and
- requiring banks to report against the minimum Basel capital framework.

The question, however, arises as to how banks will fund its increased

Key issues

- A raft of reform is set to take place within the next year, with the aim of ensuring that the Australian financial services industry is resilient, efficient, innovative and fair and increasing regulator accountability;
- Banks will be required to have unquestionably strong capital ratios;
- Superannuation entities will be subject to far-reaching changes to ensure efficiency and drive consumer engagement, and
- Financial product issuers will be required to re-examine commission structures, product design and disclosure.

capital requirements and what the economic effects of doing so will be. Arguably, the increased capital requirements will, in part, be funded by consumers (whether directly or indirectly).

Other measures

In addition to the above, the Australian Government plans to:

- facilitate participation of Australian entities in international derivative markets, and
- provide the Australian Prudential Regulatory Authority with the power to intervene in the event of failure of a prudentially regulated entity fails or financial market infrastructure fails.

Improve efficiency in the superannuation industry and boost retirement income

As the superannuation system forms a large and important part of the Australian financial system it is important that it works efficiently, so as to ensure that retirement incomes are increased and lessen the impact of the ageing population on taxpayers.

The Australian Government hopes to invigorate the superannuation and retirement income system by enhancing consumer engagement. The Australian Government's plan to do so, includes:

- ensuring that efficiency is improved during the accumulation phase by introducing a competitive process to allocate new default members to MySuper products;
- reviewing the efficiency and competitiveness of the superannuation system and explore additional measures to improve the efficiency and competitiveness of the system (such as by reducing fees and improving after-fee returns to members);
- enabling trustees to pre-select a comprehensive income product for members' retirement;
- supporting the development of comprehensive retirement income products and removing impediments to such development (ie by extending concessional tax treatment to them), and
- introducing director penalties.

Ensuring that the regulatory landscape is readily able to respond to change and innovation, unlock new sources of finance and support competition

Whether the Australian financial services industry is competitive will depend on whether its infrastructure is readily able to respond to change and innovation. The Australian Government recognises this challenge and, in addition to passing legislation to extend the period before unclaimed monies in the banking and insurance sector are captured (from three to seven years), intends to:

- (*crowd sourced funding*) consult on legislation to facilitate crowd sourced equity and debt funding, which would have the effect of encouraging innovation as it is the type of funding typically used by early stage innovators;
- (*interchange fees and card surcharging*) work to improve, and reduce upward pressure on, interchange fees and introduce a ban on excessive card surcharges (ie surcharges in excess of merchant costs) and give the ACCC power to enforce card surcharging rules;
- (*access to, and use of, data*) review the costs and benefits of increasing access to and improving the use data, taking into account privacy concerns and Government processes, as a means of accessing efficiency improvements in the financial system;
- (*innovation collaboration committee*) establish an Innovation Collaboration committee, being the committee through which emerging firms and start-ups can engage with the Government. It is proposed that the committee will be linked with the Australian Securities and Investments Commission's (**ASIC**) Digital Finance Advisory Committee;
- (*Asian Region Funds Passport*) give effect to the Asian Region Funds Passport, which will, once implemented, provide an agreed framework to facilitate the cross border marketing of managed funds across participating economies in the Asia region (ie Australia, New Zealand, Singapore, Republic of Korea, Thailand and the Philippines);
- (*technology neutrality*) consult and amend priority areas of regulation to ensure that it is technology neutral and embed consideration of the principle of technology neutrality into the development processes for future regulation;
- (*simple corporate bonds*) modernise and simplify disclosure requirements for large corporations issuing 'simple'

corporate bonds to the retail market, and

- (*rationalisation*) introduce a mechanism to facilitate the rationalisation of legacy life insurance and managed investment scheme products.

Driving consumer outcome measures to instil consumer confidence

In order to ensure that consumers are confident that they will be treated fairly when participating in the financial system, the Australian Government proposes to:

- develop measures to address the misalignment of incentives in life insurance, stock broking and mortgage broking and therefore align the interests of financial firms and consumers;
- develop legislation which provides a professional standards framework for financial advisers and therefore raise the competency of advisers;
- introduce an ASIC product intervention power, which will enable AISC to modify or remove harmful products from the marketplace;
- create a targeted and principles-based financial product design and distribution obligation;
- introduce legislation to facilitate innovative disclosure so as to unlock the productivity benefits that technology has to offer;
- extend unfair contact term protections to small businesses, and
- improve the regulation of managed investment scheme regulation, including in respect of consumer detriment (including illiquid schemes and freezing of funds) and regulatory architecture impeding cross-border transactions and mutual recognition arrangements.

Making regulators more accountable for their performance and ensuring that they are capable and effective

As regulators are given more power to guide the operation of the financial system, the Australian Government highlighted the importance of ensuring that regulators are accountable and that they have appropriate powers to ensure that they are capable and effective. As such, the Australian Government proposes to:

- work with regulators to ensure that businesses are given appropriate time to implement regulatory changes and conduct post-implementation reviews of major regulatory changes more frequently;
- review the Statement of Expectations for regulators (ASIC, Australian Prudential Regulation Authority and the Payments System Board), including requiring them to provide a greater level of disclosure and focus on performance assessment;
- consult on the possible introduction of a three year funding model for ASIC and APRA;
- review ASIC's enforcement regime to ensure that it provides a credible deterrent for poor behaviour and breaches of financial services laws;
- consult on a model whereby ASIC's regulatory activities would be funded by industry, and
- introduce competition into ASIC's mandate and tasking the Productivity Commissioner to examine the state of competition in the financial sector in 2017.

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[1] As announced by the Australian Prudential Regulation Authority on 20 July 2015.

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