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# *Improving Australia's Financial System*





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# *First reactions to the Federal Government response to the Financial System Inquiry*

The Federal Government has released its response to the Financial System Inquiry report which was published in December 2014. The Government response overwhelmingly supported the report, and accepted 41 of the 44 recommendations. This response gives strong endorsement to the areas identified for focus, which includes resilience, superannuation, innovation, consumer outcomes and the regulatory system.

## *Our perspective*

In our view, the Government response to the Financial System Inquiry is positive. The financial services sector is closely linked to Australia's growth performance, so we are encouraged to see nearly all the recommendations from the Financial System Inquiry have been adopted. There is a substantial amount of work that needs to be completed in a relatively short period of time, with a number of actions set for completion by the end of 2016.

## *Resilience*

The Government has agreed with all 8 recommendations in respect of resilience, which aim to reduce the impact of potential future financial crises by ensuring the system is better able to weather them, and lessen their cost to the taxpayers and the economy.

## *Our perspective*

We are not surprised by the adoption of all resilience measures. The proposed resilience measures have been seen as the lynchpin of the Inquiry as the fear of failure was front of mind following the global financial crisis. The Government has adopted the steps that APRA foreshadowed, and the banks are already taking steps to respond to this. The adoption of these measures provide certainty to the banks and the broader market, and the debate can now move from whether they need to hold more capital to what is the deadline and who bears the cost.



## Superannuation

The Government has agreed with 6 of the 7 recommendations in respect of superannuation, which aim to improve the efficiency and operation of the superannuation system, and in doing so, boosting retirement incomes.

The Government did not agree with the recommendation to introduce a prohibition on limited recourse borrowing arrangements by superannuation funds (Inquiry Recommendation 8), but tasks the Council of Financial Regulators and the Australian Taxation Office to monitor leverage and risk in the superannuation system. These agencies will report back to the Government after 3 years.

### Our perspective

The broader actions to improve the competitiveness, efficiency and transparency are welcome, and recognise the significance of superannuation to Australia's economic and social future. However we are surprised the Government did not adopt the recommendation to prohibit borrowing by superannuation funds. The argument presented in the Financial System Inquiry report is that the household sector is already heavily leveraged, and in this context it makes sense not to add further leverage to this sector. We are supportive of this argument, and suspect that in time this recommendation will be revisited.

## Innovation

The Government has agreed with all 14 recommendations in respect of innovation measures, which aim to unlock new sources of finance for the wider economy and provide further support for competition.

### Our perspective

We are particularly encouraged by the endorsement of innovation measures, given the need to make Australia a competitive place to do business. The ability of the financial services industry to embrace disruption and fintech opportunities is probably the single most determining factor of the future success of the industry. The recommendations adopted are a good start in driving this, but success will only be realised once we can see and feel innovation being embraced by the sector. It is clear from the new leadership team in Government that this will be an area of significant focus.



## **Consumer outcomes**

The Government has agreed with all 10 recommendations in respect of consumer outcomes, which are designed to give consumers confidence to participate in the financial system, and the confidence that they will be treated fairly.

### **Our perspective**

It is encouraging to see the Government endorse the Inquiry's recommendations in legislating and giving regulators more power to put consumer outcomes first. This is likely to drive increased consumer confidence in the sector.

## **Regulatory system**

The Government has agreed with 3 of the 5 recommendations in respect of the regulatory system, which aim to make regulators more accountable for their performance, more capable and more effective in conducting their activities.

The Government agreed with the Inquiry's objective of strengthening the regulator accountability framework, but did not support the creation of a new Financial Regulator Assessment Board (Inquiry Recommendation 27), although changes will be made to the regulators' powers and KPIs.

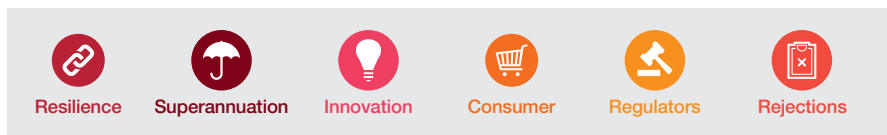
The Government also agreed to provide the industry appropriate time to implement regulatory change, but did not support the conduct of more frequent post implementation reviews (Inquiry Recommendation 31), as changes to strengthen the review regime have already been implemented.

### **Our perspective**

The focus on the regulatory system provides important impetus to continue the efforts in ensuring that Australia retains a world class regulatory system. We welcome moves to ensure regulators are increasingly agile, which we believe will help facilitate broader innovation within the sector.



# Financial System Inquiry – implementation roadmap to 2017 and beyond



- Legislate to improve governance and transparency in superannuation.
- Progress the Retirement Income Streams Review.
- Productivity Commission to develop criteria to assess the efficiency and competitiveness of superannuation system and alternative models for competition in allocating default fund members to products.
  - Capability review of ASIC. Consult on industry funding arrangements for ASIC.
  - Appoint new members and revise the Terms of Reference of the Financial Sector Advisory Council.



Consult on providing financial regulators the tools to manage any future financial crisis.



- Ban excessive card surcharges and better protect consumers using electronic payment systems.
- Reduce disclosure requirements for issuers of simple corporate bonds. Establish the Innovation Collaboration Committee.



- Develop legislation to give ASIC the power to ban individuals from managing financial firms.
- Consult on strengthening ASIC's enforcement tools in relation to the financial services and credit licensing regimes.
- ASIC to review remuneration arrangements in mortgage broking.



Introduce competition into ASIC's mandate.



APRA to ensure our banks have appropriate total loss-absorbing capacity and leverage ratios in place.



- Implement legislation to introduce director penalties.
- Consult on legislation to improve member engagement, consistent with the recommendations in the Inquiry. Monitor leverage and risk within the superannuation system.



Facilitate rationalisation of life insurance and managed investment scheme legacy products.



Legislate to facilitate participation of Australian entities in international derivative markets and better protect client monies.



- Consult on crowd-sourced equity funding.
- Consult on crowd-sourced debt financing.
- Productivity Commission to review data access and usage.



Address the misalignment from conflicted incentives in life insurance, stockbroking and mortgage broking.



- Update the Statement of Expectations for APRA, ASIC and the Payments System Board about the Government's expectations for their strategic direction and performance and improve regulator accountability.
- Consider ASIC capability review and legislate to enhance operational capabilities of regulators.



- Legislate a professional standards framework for financial advisers.
- Consult accountabilities for issuers and distributors of financial products and ASIC product intervention powers.



APRA to take additional steps to ensure our banks have unquestionably strong capital ratios.



Give legal effect to the Asian Region Funds Passport initiative. Consider technology neutrality in financial sector regulation.



- Legislate the objective of the superannuation system.
- Consult on legislation to facilitate trustees of superannuation funds providing pre-selected comprehensive income products for retirement.



- Consult on and develop legislation to enable innovative disclosure for financial products and to improve the regulation of managed investment schemes.
- ASIC to review stockbroking remuneration arrangements.



- Commence a review of ASIC's enforcement regime.
- Productivity Commission to review the state of competition in the financial system.

By End 2015  
By Mid-2016  
By End 2016  
Beyond 2016



- The recommendation to create a new Financial Regulator Assessment Board, although changes will be made to regulators' powers and KPIs
- Prohibition of limited recourse borrowing arrangements by superannuation funds – but the Council of Financial Regulators and the Australian Taxation Office will monitor leverage and risk in the superannuation system and report back to Government after three years.
- More frequent post implementation reviews, as changes to strengthen the review regime in 2014 have already been implemented.

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