

Executive Summary

Introduction

1. National Mutual welcomes this opportunity to make a submission to the Inquiry into the Australian financial system.
2. 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 are to be analysed, in particular technological developments. Recommendations will then 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.
3. National Mutual believes this Inquiry, which provides an opportunity to build on the industry's current position of strength, is timely in view of the major and rapidly accelerating change in the Australian financial system and indeed globally since the Campbell Inquiry some 15 years ago.
4. We trust our submission will assist the Inquiry in its analysis of the results of financial deregulation flowing from the Australian financial system Inquiry in 1981, the "Campbell Inquiry", and particularly the factors likely to drive further change. Our recommendations are made with the objective of improving the international competitiveness of the Australian financial system by preparing it for the rapid and significant future changes which it will undoubtedly face. This will benefit consumers and ultimately help create a world leading financial system.
5. We are happy to discuss with the Inquiry any aspect of our submission and/or provide supplementary material as required. Moreover we would be pleased to conduct further research along lines we have already considered in the context of our submission at the Inquiry's request.

The Australian Financial System

1. It is important in conducting this review and making recommendations on the nature of regulatory arrangements for the future that there is a clear understanding of the scope of the Australian financial system. In preparing this submission, National Mutual has used a consumer perspective in defining this scope.
2. Consumers consider the industry to include all mechanisms by which they satisfy their financial needs. These can be summarised into five categories: information and advice; risk management; savings and investment; borrowing and transactions. Consumers include both wholesale and retail consumers and range from large corporate and government bodies to individuals and their families. The financial services industry therefore comprises all individuals, partnerships and corporates, etc. providing services to satisfy these needs. This is a broad view of the industry and one which incorporates both current and potential future participants.
3. In line with the terms of reference of the Inquiry (see Appendix 1.1) we have focussed our attention in this submission on the regulatory arrangements, the overriding purpose of which is to ensure that consumers are given appropriate protection and choice in a healthy, globally competitive financial services market. The types of regulation include: consumer protection regulation; prudential regulation; competition policy; and the integrity of the capital markets.

Consumer protection regulation deals with standards, guidelines and rules for the provision to customers of comprehensive and accurate information about terms and conditions attaching to financial products and services and of objective advice about meeting (often complex) financial needs. It also provides for procedures for complaints handling and redress.

Prudential regulation has the primary objective of promoting soundness and the stability of participants in the financial services industry and the broader financial system including the payments system.

Competition policy recognises the need to encourage sufficient competitiveness in the Australian financial system on both a domestic and global basis to ensure that consumers receive the best possible choice and price offering for all financial products and services.

Capital market integrity essentially relates to Corporations Law interpretation, supervision and enforcement. This falls largely within the scope of those items specifically excluded from the terms of reference to this Inquiry other than in relation to securities and futures dealers and collective investment products.

4. These broad definitions of the scope of the Australian financial system incorporate a large number of regulators and quasi regulatory bodies currently active in the system. The most important of these are the Reserve Bank of Australia (RBA), the Insurance and Superannuation Commission (ISC), the Australian Securities Commission (ASC), the Australian Competition and Consumer Commission (ACCC) and the Australian Financial Institutions Commission together with the State Supervisory Authorities (AFIC/SSAs).

An Assessment of the Current Regulatory Structure

1. The regulatory structure of the Australian financial system has evolved during a period of massive change in the 15 years since the Campbell Inquiry. It is reassuring that during this period Australia has established a high standard of regulation. Indeed, whilst the Australian financial system has faced some difficult times and some financial institutions have failed, financial incidents such as those which have been experienced in the Japanese, Nordic and US banking systems have not been mirrored here.
2. The evolution of the regulatory structure of the Australian financial system has led to the development of an enormous bank of expertise and skill in relation to financial regulation. It is important that any proposals to change the current structure build upon this valuable resource.
3. It is also important to recognise however, that regulation in Australia, as in many other financial markets across the world, has developed in line with two major themes.

First, the regulatory structure has predominantly been developed on an institutional basis. Regulators are structured according to the institutions they regulate rather than the nature of the financial products and services those institutions provide. As convergence within the industry increasingly blurs the boundaries between financial institutions, this framework becomes less relevant and more likely to lead to inconsistencies, gaps and overlaps in regulation.

Second, regulatory developments have generally been in reaction to particular incidents. For example the Barings collapse, consumers concerns over the practices of life insurance agents and the circumstances surrounding Occidental and Regal. Whilst this is inevitable, the reactive approach has meant that there has been less focus on producing a coherent regulatory structure designed to adapt to consumers', the industry's and the nation's evolving needs.

4. The consequence of this evolution of the Australian regulatory structure is that there now exists a large number of regulators and quasi regulatory bodies within the financial system who ostensibly share the same objective of protecting consumers but who approach the task from different philosophies, different organisational cultures, and have adopted different methods and practices. The result is a degree of inconsistency, overlap and uncertainty, particularly in the areas of consumer protection regulation and prudential regulation.

Consumer protection - the current regulatory structure has not produced an optimal outcome in relation to consumer protection regulation. In particular, from the consumer's perspective there is uncertainty as to:

- who is responsible for the regulation of financial products and services, especially where products from different institutions have similar features;
- why extensive disclosure is necessary for one product but not for another that has substantially the same features; and
- which of a variety of complaints resolution processes they should utilise.

Moreover there is duplication of regulation and financial product providers are usually subject to at least two consumer protection regimes.

Prudential regulation similarly is not optimal within the current regulatory structure. In particular, the effectiveness, competitive neutrality, flexibility and efficiency of the financial system are less than ideal:

- convergence and the trend to financial conglomerates is ensuring that the institutional division of the financial system is becoming increasingly inappropriate with regulators being required to monitor institutions outside their usual brief to ensure effective prudential regulation;
 - the different regulatory approaches where they affect capital, solvency and other prudential requirements raise issues of competitive equality. Indeed it is arguable that regulatory differences have kept the financial system more fragmented than it would naturally be, thereby restricting competitive forces and reducing efficiency;
 - with rigid division of regulatory boundaries, flexibility for product innovation is reduced especially where more comprehensive products covering a number of consumer needs are desired; and
 - the broader range and greater complexity of financial products being offered by an increasing number of different institution types is challenging the concept that systemic risk and its potential threat to financial stability is restricted to banks. An approach to systemic risk which does not consider the broader view of the system is therefore inappropriate.
5. In addition to the uncertainty and confusion which arises from the current regulatory structure, preliminary analysis indicates that the cost of regulation in Australia is high, both in absolute terms and relative to international competition. Clearly any analysis of the cost of regulation is highly subjective and one also needs to consider the consequent benefits from regulation. However, it is important that in the future, with the breaking down of national boundaries and the opportunity to “regulation shop” on an international scale, we more clearly understand the cost and benefits of regulation in Australia and strive to make it more competitive.
6. It is encouraging that significant effort is being applied within the existing regulatory structure to address these issues of concern, in particular:
- the Council of Financial Supervisors’ “Financial Supervision Boundaries and Approaches” project to identify proposals to “remove or remedy unintended gaps, overlaps and inconsistencies in the regimes regulating sales and advice practices for functionally similar retail savings and risk products”, as well as their work both in Australia and Internationally with the Basle Committee, the International Organisation for Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) in relation to the emerging issue of the supervision of financial conglomerates; and
 - the ASC and ISC in relation to their “Harmonisation” project designed to eliminate overlap and conflict between unit trust and life insurance/superannuation products and advisory practices

However, whilst these moves are to be applauded, we believe that the cultural and philosophical differences between the regulators will impede and slow down attempts to impose consistency and transparency within the existing framework.

7. In summary, the scorecard shows that the Australian financial regulatory structure has performed well when compared internationally. However, its development has not matched that of the industry and we believe that a different regulatory structure and approach is now warranted.

The Future

1. The key market trends which will drive the industry over the next decade include technological and marketing developments, consumer needs and demands, globalisation of financial markets and increasing convergence and prominence of conglomerates. Whilst the existing regulatory structure has been effective to date, these trends suggest it will become increasingly difficult to maintain this track record without some change. In particular:
 - as the degree of integration and convergence in the market increases so will the potential for gaps in regulation, overlap and inconsistency;
 - financial conglomerates will become an increasingly important area for regulatory attention, which will require a working understanding by the responsible regulator of all aspects of the conglomerate;
 - technological advances will increasingly have implications across the financial system requiring a common and consistent approach from a regulatory perspective;
 - the entry of new players into the financial system that do not fit into historical institutional categories will require new regulatory definitions under the existing structure;
 - as the boundaries between financial product and services providers reduce, the concept that systemic risk relates mostly to banks will become less accurate, requiring a new approach to non bank financial institutions; and
 - the emergence of large international companies without a local base will present major challenges for national regulators.
2. With the internationalisation of financial markets an inefficient regulatory structure will become a major impediment to our ability to compete globally. If the regulatory structure in Australia is not internationally competitive consumers will shop outside of the national market through the Internet and other technology driven mediums. Therefore a harmonised, progressive and world class regulatory structure will provide Australia with a significant competitive advantage both regionally within the Asia Pacific and globally.
3. The major trends driving further change in the financial system are illustrated in the strategic response the AXA/National Mutual Group has adopted. AXA has developed a strategy built on the belief that to be competitive and profitable in the coming global market for financial services the Group has to be both large and international. In the implementation of this strategy AXA "thinks global and acts local". This allows for centralised strategic development with local implementation. Key strategic developments in technology and marketing focus the Group's international approach in these areas regardless of national boundaries. Global marketing strategies are increasingly looking for opportunities to cross-market 'local' products across geographic boundaries. Local implementation is driven by market and cultural differences as well as regulatory constraints. However, as regulatory constraints come down (such as in the European community with their harmonisation process) and as technological developments become more important (such as the Internet), national boundaries will become increasingly irrelevant to truly global players such as AXA.
4. The future regulatory structure of the Australian financial system must recognise these key trends which are driving further change. The existing regulatory structure will become increasingly inappropriate as they develop. Australia has a tremendous opportunity to build a world class regulatory structure and exploit its existing competitive advantages, such as the high level of technology acceptance and its regional position, to create a world leading financial system.

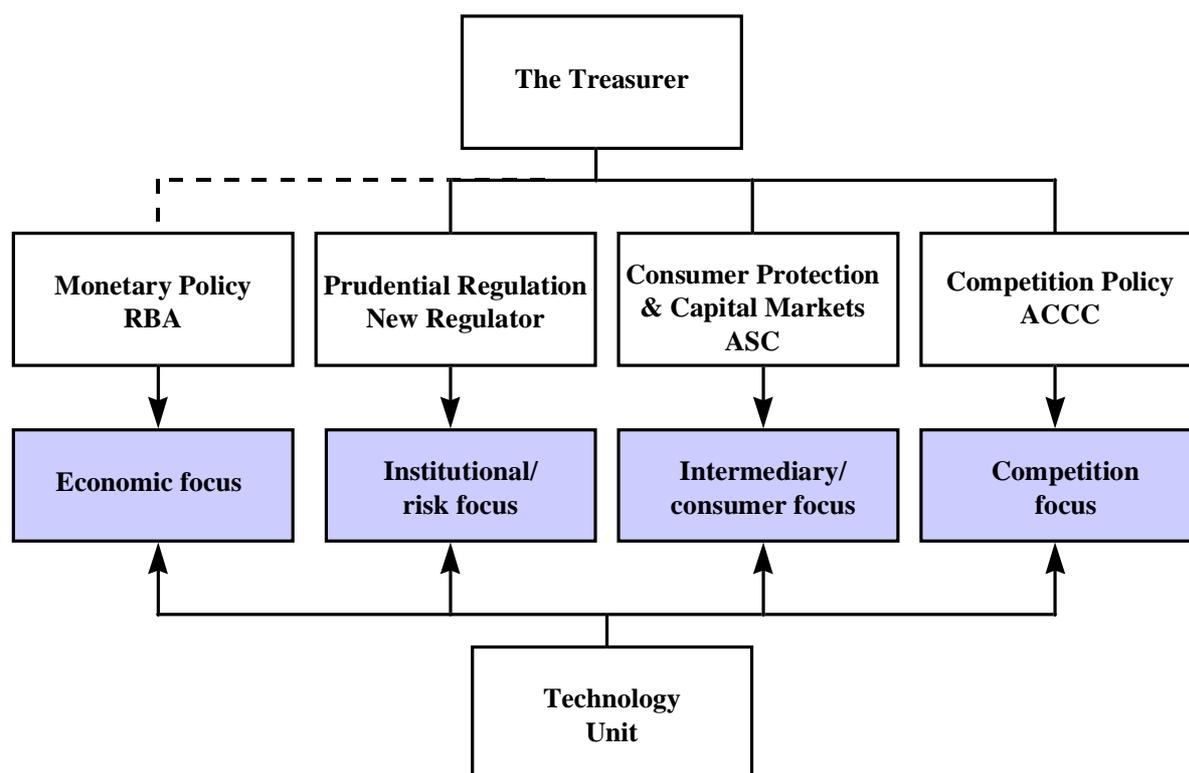
Recommendations For A New Regulatory Structure

1. In light of the emerging inefficiencies in the current regulatory structure and more importantly the trends driving further change, National Mutual recommends a new regulatory structure for the Australian financial system. The proposed regulatory changes are both revolutionary and evolutionary:

- **revolutionary** because they recommend a new regulatory structure which more closely meets the emerging nature of the financial system and which is sufficiently flexible to adapt to future change; and
- **evolutionary** because they build upon the significant value in the existing structure and recognise the importance of maintaining financial system stability by moving quickly but carefully to the new model.

2. The structure is illustrated below:

Recommended Regulatory Structure for the Australian Financial System



3. The key features of the new structure are:

- a single regulator for consumer protection supported by a due diligence regime for all financial products and services, thus placing more regulatory responsibility on providers. The single consumer protection regulator should be the ASC, consolidating the current consumer protection roles of the other regulators under the ASC regime;
- a new single regulator for prudential regulation of the industry initially through the existing structures of the RBA, ISC AFIC/SSAs and the minor prudential functions of the ASC in relation to securities dealers. The new prudential regulator will, in addition to managing a move to a single regulatory regime, be responsible for monitoring conglomerate risk;
- an approach to financial regulation based on the nature of products and risks undertaken rather than the institution providing them, thus removing existing regulatory inconsistencies in relation to products of a similar nature;
- in addition to absorbing consumer protection responsibilities for the industry, the ASC retains its capital market integrity responsibilities;
- the ACCC's responsibilities in relation to consumer protection and competition policy across the whole economy will remain unchanged although the Trade Practices Act (TPA) needs to

be amended to exclude financial product providers to ensure the Australian financial system is not subject to two consumer protection regulators implementing different regimes. This point is of such importance that if the appropriate changes to the TPA were not effected, it would be necessary for the ACCC to be directly and exclusively responsible for consumer protection of the financial services industry to ensure one regulator and one regime for the Australian financial system;

- in accordance with the terms of reference we make no recommendation in relation to the implementation of monetary policy which will remain the responsibility of the RBA; and
 - the establishment of a technology unit skilled in technologies such as electronic commerce, electronic payments systems and telecommunications, and charged with addressing regulatory issues arising from emerging technological developments in the financial system. The unit would address issues of relevance across the financial regulatory structure and would work closely with all regulatory bodies.
4. The new regulatory structure should work towards developing consistent policy, methodology and standards across the industry taking account of global trends in regulation and the increasing need for greater harmonisation internationally. In the area of consumer protection this should include moving to a consistent regime for disclosure and advice under the regulation of the Corporations Law and the establishment of a single Financial Industry Complaints Scheme in place of the existing multiplicity of schemes in the industry. In the area of prudential regulation special focus should be applied to: developing world-leading risk-based capital measures addressing all major areas of risk; removing existing inconsistencies in capital requirements; and thoroughly reviewing the extent and nature of systemic risk and the difficulties in assessing conglomerate risk, with recommendations for appropriate regulatory reforms. The need for and nature of any implicit "Government guarantees" on financial products should be assessed with clarification for consumers of the level of protection to be provided.
 5. In the proposed new regulatory structure each of the regulators will report to the Treasurer. This will facilitate the essential coordination at a policy level and consultation between the regulators in relation to approach and cross industry issues while enabling each body to develop the skills and resources necessary for its specific task in financial regulation. In particular, there would be a special relationship between the prudential regulator and the Reserve Bank in relation to the sharing of information, advice and response to market developments relevant to their respective roles of promoting financial system stability and monetary policy.

Australia's Competitiveness

1. Our recommendations for a new regulatory structure are made with the objective of improving the international competitiveness of the Australian financial system. This will be achieved through a more flexible, efficient and effective approach with consequent benefits for Australian financial institutions and consumers and making Australia more attractive to foreign investment.
2. As technological advances facilitate greater cross border selling opportunities it will become increasingly important that our regulatory structure is both compatible and competitive on an international scale. The regulatory approach and cost of regulation will by necessity, be reflected in product flexibility and price and if these factors are not competitive internationally consumers will increasingly purchase off-shore through the Internet and other mediums.
3. In addition to the changes to the regulatory structure and regulatory approach we recommend that international regulatory cooperation should assume greater importance. In this respect Australia has already been involved in actively promoting cooperation with overseas regulators. Greater international cooperation will mean significant cost savings and additional choice for consumers. Therefore Australia should pursue entering into treaties recognising offer documents which comply with laws in one country are exempt from the prospectus type laws in another, and the development of mutual recognition treaties with countries who have comparable prudential regulation regimes.

4. There are further structural impediments to competition in the Australian financial system which exist either for historic, national interest, prudential or other reasons. These restrictions are anti-competitive in nature and should, over time, be removed including:
 - the removal of restrictions on shareholdings in Australian banks. The Campbell Committee recognised these as anti competitive. It has been argued these restrictions should be maintained for prudential reasons. However, as we believe that systemic risk beyond the usual confines of banks is increasing, it is becoming inappropriate to differentiate banks from other financial institutions. Similar restrictions in relation to insurance companies should be removed;
 - the lifting of restrictions on access to the payment system. The Campbell Committee, the Martin Inquiry and the ACCC all identified this as a notable barrier to entry into the financial services industry and therefore anti competitive. Access should be extended to all financial institutions which can satisfy the Australian Payment System Council (APSC) that the participant is appropriately prudentially regulated either under the new structure proposed in Australia or internationally through a mutual recognition agreement. Although immediate access to an alternative to the payment system is limited, technological advances are being made at such a rate that the regulatory framework must be put in place now to deal with emerging alternatives;
 - the removal of foreign investment restrictions. While these exist predominantly for national interest reasons, over time increasing cross border business will render the limitations less effective as foreign institutions will access the Australian market from off-shore if they are prevented from investing locally. In addition the business activities of domestic financial institutions which are majority foreign owned and which wish to invest Australian sourced capital in companies subject to foreign investment limits is restricted and this needs to be addressed as a matter of priority; and
 - the removal of state tax costs involved in switching between financial products and transferring accounts. Although we recognise the significant state revenue implications of this recommendation, the existence of taxes on financial transactions makes the cost of Australian financial products and services uncompetitive on an international basis, acts as a disincentive for international financial institutions to use Australia as a base and presents a barrier to effective domestic competition.
5. With the globalisation of financial markets and technological and marketing advances, these restrictions will become increasingly ineffective as institutions find ways around them and consumers will increasingly shop for financial products and services on a global scale. Therefore we recommend that the removal of the structural impediments listed above be made quickly but carefully ensuring the maintenance of financial stability and appropriate protection of consumers.
6. The major technological and other developments which are driving change in the Australian and global financial markets, a greater degree of international regulatory cooperation and the removal of structural impediments to competition identified will lead to a significantly more competitive Australian financial system. As a consequence we would expect to see a broadening of the current interpretation of the definition of the market for competition policy purposes in the future.
7. Finally, Australia has a tremendous opportunity to exploit its national advantages and leverage off growth in the surrounding region. In particular, the availability of skilled financial managers, the relative cost of conducting business in Australia compared to other centres in the region, the quality of telecommunications systems and a highly sophisticated financial system present Australia with significant competitive advantages over other major financial centres in the region. We recommend that the inquiry consider this opportunity in making its recommendations. In particular, proposals to boost promotion of Australia as a regional and/or processing centre for financial services companies should be adopted.

National Saving

1. Enormous progress has been made in the development of the Australian financial system since the Campbell Inquiry. Nonetheless national saving during this period has been disappointing. In

particular, household saving, the products and services for which are provided by the financial services industry, has deteriorated.

2. Whilst the direct impact of regulation on the level of saving is not large (outside the compulsion to contribute to superannuation and tax incentives) it has the ability to promote inertia in saving as a consequence of its complexity. Indeed we believe that the regulatory structure and approach recommended in this submission will facilitate a more positive attitude toward saving by providing straightforward and consistent regulation of financial products and services and thus removing confusion and uncertainty in the mind of consumers. This should, we recommend, be further supported by continued educational activities by the Government and industry of consumers about the importance of long term saving.
3. We recognise the limitations placed on the Inquiry in relation to making recommendations on retirement incomes policies and policies for the taxation of financial arrangements, products and institutions. Obviously these are major levers which the Government can use to influence saving patterns in Australia and therefore their omission reduces the role that this Inquiry can play in promoting national saving. However, because the issue of national saving is of such strategic importance to the Australian economy, we recommend that the Inquiry take every opportunity to ensure its final recommendations support the objective of promoting long term saving in Australia.

Conclusion

1. As a major participant in the Australian and global financial system, National Mutual has a significant interest in the work of this Inquiry. In the context of today's rapidly changing financial markets it is appropriate to review the Australian regulatory arrangements with a view to improving Australia's international competitiveness. We believe our recommendations will help achieve this objective with consequent benefits for consumers.