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Part 3. IBSA Recommendations

The recommendations set out here have been determined by reference to the evolution of the financial system since deregulation, as outlined in Part 1, having regard to likely future changes, as outlined in Part 2. They concentrate on strategic issues that face the financial, sector and are not intended to cover all the secondary concerns that arise from this, or indeed other minor problems that need to be solved. However, a framework is suggested to handle the future development of the financial sector in a manner that will efficiently and effectively resolve all of these issues. IBSA views establishment of this framework as a vital outcome of the Inquiry, if it is to be a success.

The recommendations are considered under four main headings; regulation, competition and taxation, international competition in financial services and other issues. The priority recommendations are in bold type.

1. Regulation

The primary objective of financial regulation is the preservation of a stable financial system. Other central objectives are maintenance of market integrity and consumer protection. There are four interrelated strands to financial regulation policy in practice; supervision of financial institutions, oversight of financial markets, consumer protection and competition. This section considers the policy objectives and principles of financial sector regulation and recommends a framework that efficiently satisfies these into the future.

Systemic risk is the potential failure of one (or more) financial institutions that could set in place a train of events that results in the failure of otherwise healthy institutions and interferes with economic activity. This 'contagion' risk can emanate from within financial institutions, through failure in the operation of a financial market that impacts on financial institutions. Banks are regarded as especially vulnerable to systemic risk, due to their central place in the payments system and the importance of credit intermediation in the economy. Systemic failure of the financial sector can have a severe disruptive effect on the economy and, thus, is the main justification for regulating the financial sector. However, there is not universal acceptance of the need for regulation from this perspective.[1]

The primary defence against systemic risk from bank runs is an explicit or implicit government guarantee on deposits. For example, deposit insurance is provided in the USA, but depositors in Australia rely on the Reserve Bank's legislative requirement to protect bank deposits (seen by many as a form of implicit guarantee, despite the Reserve Bank's protestations). Prudential supervision that helps ensure solvency of financial institutions and regulation that prevents disturbances from financial markets underpin the short and long term financial security of banks. The two forms of regulation are closely related in practice, as financial institutions account for the bulk of transactions on the financial markets. Market risk from banks' off-balance sheet activities is quite different from credit risk associated with their traditional balance sheet business, because losses can occur much more quickly in the case of the former. Accepting the need for some level of regulation to alleviate the problem of systemic risk, the

[1] See Richard Dale, *Regulating the New Financial Markets*, Reserve Bank of Australia, Conference on the Future of the Financial System, July 1996.

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difficult task is to design an optimal form of regulation that achieves this in a manner that least impinges on the efficient operation of the financial system.[2]

The need for consumer protection arises from information asymmetries between retail consumers, that are not financially sophisticated, and financial institutions, that are sophisticated professional traders. Financial instruments involve promises to pay and are generally regarded as being more risky for retail consumers than standard consumer goods. The regulatory response is to require a minimum level of information disclosure and explicit legislative protection.

There is a need to retain balance in regulation designed to protect consumers. Firstly, it must be recognised that sophisticated financial entities require little direct protection and are able to self regulate. Secondly, financial investments are not the only risky investments, or the only investment based on a promise of service. For example, it does not make sense that an individual can invest $150,000 or more, in a house with little in the way of formal requirements for suitability tests and the like, but must receive detailed advice on the purchase of a $500 parcel of shares. Thirdly, it should be recognised that the average retail consumer's financial skills have improved considerably since deregulation, and individuals have a responsibility to themselves too - financial institutions and corporates were not the only entities to learn and benefit from the financial liberalisation process. Nonetheless, the central proposition that retail consumers need solid formal regulatory protection is absolutely correct. The analysis here just illustrates the need maintain proper balance in regulation. Consumer confidence in the financial system is vital and different levels of protection are required for different types of product.

Regulation itself entails risks, the most prominent of which is called 'moral hazard'. Institutions that are subject to prudential supervision may relax their internal control mechanisms, using regulatory oversight as a substitute, or there may be a perception amongst some that a bank is simply 'too big to fail'. Meanwhile, investors may overestimate the regulatory protection and confuse regulation of deposit taking institutions by the authorities with a guarantee that their capital will be returned. This can lead to a relaxation of consumers' commitment to risk assessment of deposits and other investments; in effect, ceding this responsibility to the regulators.

◊ *Prudential Supervision*

The primary objective of prudential supervision of banks is maintenance of financial sector stability. This greatly depends on the ongoing solvency of its constituent institutions so, by definition, this is institution based.[3] Banks' main vulnerability from a systemic risk perspective is their asset/liability maturity transformation role; that is why they are tightly regulated and are the exclusive providers of the payments system. The Reserve Bank requires banks to observe a set of defined behavioural rules with respect to:

- Capital adequacy - maintenance of minimum requirements, as a buffer against losses;
- Liquidity - maintain the PAR ratio, as a buffer against unforeseen cashflow fluctuations;

[2] An implicit assumption is that market forces are more efficient at resource allocation than are controlled market systems. There is ample international evidence that excessive control by the authorities is extremely damaging to the efficient operation of the financial system and the economy.

[3] The regulators will not prevent bank failure, though it is considered to be highly undesirable. When institutions fail, the regulators aim to achieve an orderly exit with least disruption to the financial system as a whole.

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- Risk management - Reserve Bank review of banks' risk management systems to reduce the probability of serious problems;
- Disclosure - reporting to the Reserve Bank and external auditor oversight arrangements, as a means of early detection of problems.

In addition to this, the Reserve Bank has issued prudential statements covering other aspects of bank business, like shareholding and large credit exposures. The Australian Financial Institutions Commission (AFIC) co-ordinates prudential supervision of building societies and credit unions, through minimum operating standards similar to those for banks.

Foreign bank subsidiaries must observe all the Reserve Bank's prudential guidelines, however, branches of foreign banks have an exemption (at the Reserve Bank's discretion) from reporting on capital adequacy and large exposures. This is because these entities are subject to intense solvency supervision by their parent banks' home regulators, though the Reserve Bank has responsibility for supervising the local entity's liquidity. Foreign banks can maintain both subsidiary and branch operations, but must operate in a way that makes clear its separate legal status and banking authorisation (for example, separate books of account and separate internal risk control mechanisms must be maintained). Foreign banks can also maintain a non-bank (merchant bank) subsidiary along side its branch, but the branch must conduct the bulk of the bank's intermediation business. However, there is a concession that recognises that the branches only access to Section 128F interest withholding tax free funds, which the other banks have free access to, is through a subsidiary.

The Insurance and Superannuation Commission (ISC) supervises the insurance and superannuation industries to protect the interests of policy holders and fund members and ensure compliance with Commonwealth legislation. The ISC sets standards for the solvency of insurance life and general companies and the management of superannuation funds. It monitors the application of these on an ongoing basis and requires these entities to maintain adequate risk management systems and internal controls. Like the Reserve Bank, it places emphasis on the responsibility of the entities to prudently manage their business and does not guarantee the preservation of consumers' interests.

Prudential supervision is not appropriate to unit trusts and other market linked investments, as the investor bears the full risk of the underlying investment (there is no *prima facie* commitment to return capital, as in the case of bank deposits). Instead, there is a strong need for consumers to be able to make informed investment decisions, with proper knowledge of product characteristics (especially risk). Consumer protection is most important and there is a heavy emphasis on disclosure and advice, which is regulated by the ASC.

◊ *Consumer Protection*

Regulation of deposit taking institutions to protect consumers is predicated on the grounds that depositors cannot satisfactorily assess the riskiness of the institutions that they place their money with. The depositor protection role of the Reserve Bank, through its prudential supervision, is vital in this respect (though the Reserve Bank emphasises that deposits are not guaranteed by it).

Foreign bank branches are not permitted to take retail deposits due to Reserve Bank concerns about its ability to provide the same degree of protection to their depositors, as it does for

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depositors of locally incorporated banks.[4] Unlike subsidiaries, bank branches do not have locally dedicated capital to protect depositors, so depositor protection partly depends on the actions of foreign supervisors. Thus, foreign banks must maintain a local subsidiary to participate in the retail deposit market. Despite these restrictions, bank branches must still inform depositors that the depositor protection provisions of the Banking Act do not apply.

AFIC supervises building societies and credit unions and consumer risk is reduced by maintaining their solvency. Uniform credit legislation (which involves State consumer affairs) is due to come into operation in November to regulate the provision of credit to retail borrowers. In addition, most financial institutions adhere to industry codes of practice that set minimum standards of behaviour in their retail business.

A similar philosophy underpins the regulation of financial markets, which is product based. Consumer protection in this mode revolves around disclosure and conflict resolution and deals with issues of fair treatment of investors and borrowers. This is managed by the Australian Securities Commission (ASC) in respect of the securities and futures markets. The ISC promotes fair and open dealing between the insurance and superannuation industries and their customers. This includes proper disclosure of fees and charges. As mentioned, the ASC has responsibility for collective investments.

The Australian Competition and Consumer Commission (ACCC) has a broad consumer protection role within the economy, through legislative provisions that prohibit misleading and deceptive conduct. The provisions of the Trade Practices Act apply to all transactions in trade and commerce.

◊ *Oversight of Securities and Futures Markets*

The ASC administers the Corporations Law and regulates the securities markets, with a view to maintaining market integrity. This covers regulation of the funds raising (including unit trusts) and futures markets, amongst other things. Its objectives include efficient operation of the market and maintenance of investor confidence through protection. It primarily operates through public disclosure of information to assist decision making by creditors and investors, market surveillance and law enforcement.

It is important to note that the securities and futures markets do not operate independently of prudential requirements. The bulk of dealings in financial markets are by entities that are subject to prudential supervision by the other financial regulators. This greatly eases concerns about market integrity and systemic risk that arise in relation to these markets.

◊ *Competition*

The ACCC also regulates competition in the financial sector by placing a control on unfair trade practices. In the course of its operations, it examines monopolies, exclusive dealings, mergers and the like. The Reserve Bank and ASC have a broader interest in this, as

[4] The depositor protection provisions in Division 2 of the Banking Act do not apply to a foreign bank that operates in Australia through a branch. A branch is permitted to take deposits in any amount from incorporated entities, non-residents and employees of the bank but is not permitted to accept initial deposits (and other funds) from other persons for amounts of less than $250,000.

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competitive markets are more likely to be efficient in an economic sense and a less concentrated financial sector provides a more secure base against systemic risk.

1.1 Principles to be Observed in Regulation

It is evident from the foregoing that financial regulation is an extremely complex matter. Therefore, it is important to delineate some principles to assist in the review of regulation and assist in the formulation of proposals to change regulation. The following list provides guidance in this respect.

- There is a need to maintain proper balance between the benefits from regulation, like consumer protection, and its costs, like reducing allocational efficiency by impinging on the free operation of market.

- The minimum degree of intervention necessary should be used.

- Regulation should not penalise financial institutions, or markets, either domestically or internationally, from a competitive perspective. Australia is a 'price taker' in the global regulatory market.

- Regulators must be properly attuned to financial institutions and markets, especially the commercial considerations and arrangements that underpin them.

- Proposed changes to regulation must be specifically justified in terms of the underlying policy objectives.

- A cost-benefit analysis of proposed regulatory changes should be undertaken and it should take full account of adjustment costs to new regulations.

- The regulatory framework must be sufficiently flexible to accommodate change, given the uncertainty facing the financial sector due to technological and other developments.

- Regulations should be the subject of periodic review, taking account of policy objectives and developments in the financial sector.

There is a need for both the policy objectives of regulatory reform to be made clear and for policy to be implemented in an efficient manner, that properly reflects the commercial nature of financial markets, especially with regard to competition. It must be emphasised that the method of delivering regulatory reform can matter as much as the content of the reform. The benefit of identification of the best regulatory solution can be offset, if the confidence of financial institutions in the regulators is compromised along the way. For example, the CASAC discussion paper *Regulation of the OTC Derivatives Market* (August 1995) damaged the perception of Australia as a place to locate regional operations in the minds of some, notwithstanding the fact that a suitable regulatory regime may be endorsed at the end of the day. Adherence to these principles will help achieve a better outcome in terms of meeting regulatory objectives in the least intrusive manner.

- *IBSA recommends that all initiatives for reform of financial regulation be justified by reference to the underlying public policy objectives and that strict principles to govern*

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the implementation of financial regulation, so that it is efficient and least intrusive on commercial activity, be adopted. Further, all regulation should be the subject of periodic critical review.

1.2 Functional versus Institutional Regulation

One of the first issues that arises in the design of a financial regulatory regime is whether regulation should be undertaken on an institutional basis or functional basis. An advantage to the functional approach is that the nature of the financial contract determines the type of regulation to apply and similar products are treated the same way in regulation. It has been the case in the past that institutional regulation has introduced a competitive bias that has disadvantaged some institutions (for example, the trading banks lost business to non-bank financial institutions in the 1970s and 1980s because of this). Still, similar debt instruments are regulated differently (by intensity) and attract different tax liabilities in some cases.

On the other hand, prudential supervision is to do with system stability and thus that of its constituent institutions. The problem of contagion complicates matters and supports the case for institutional regulation. In view of this, there is a compelling case for institutional supervision. In reality, it is not desirable or practical to adopt either a pure institutional or a pure functional approach to regulation. The best compromise is to adopt a co-ordinated institutional approach, with an overlay of product regulation. The problem of competitive bias can be alleviated through co-ordination of regulators and through education of consumers so that they can properly differentiate between products.

- *IBSA recommends the institutional approach to financial sector regulation is retained, with enhanced co-operation between institutional and product regulators.*

There is a danger with institutional regulation that it may become outmoded and inefficient, as the financial sector develops. However, it is wrong to assume that the regulators will not respond to this. Indeed, the Reserve Bank has adapted well in the past. Further, change in the financial sector can lead to greater institutional risk, while product risks are unchanged; for example, banks' better credits may be lost to direct market intermediation, so its business becomes inherently riskier. The effectiveness of the regulatory model will hinge to a great extent on the effectiveness of the policy dialogue between the regulators.

1.3 Co-ordination of Regulation by Different Regulators

It is evident that regulation of the financial sector in its various forms cannot be neatly compartmentalised by type of institution, or by regulator. All of the regulators have interests of varying degree in each of the identified strands. Each type of financial institution deals with several of the regulators, either directly in respect of prudential supervision, consumer protection and competition, or indirectly though their participation in the securities and futures markets.

The interrelationships are tight; for example, consumer protection spans both institutions and markets, while the level of competition in the sector helps determine consumers' market power and ability to protect their economic interests. Consequently, there is a compelling case for the activities of these regulators to be co-ordinated to ensure consistency between regulators, minimisation of regulatory overlap and the efficient operation of the regimes, so that the costs imposed on financial institutions are minimised.

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At present, the Council of Financial Supervisors (COFS) co-ordinates the activities of the industry's regulators. It was formed in 1992 following a recommendation by the 'Martin Inquiry' into banking and deregulation in 1991, prompted primarily by concerns about regulation of conglomerates. The Council's members are the Reserve Bank, ASC, ISC and AFIC (but not the ACCC). It is not a statutory authority, nor a regulator in its own right and reports to the Federal Treasurer and other ministers. It aims to enhance the quality of financial supervision and regulation by facilitating exchanges of information between regulators, increasing awareness about system wide developments, identifying important trends in the sector and improving regulatory coverage (including eliminating overlaps). The Council provides a useful framework to improve regulation in the financial system. Precisely what form its operations will take in the coming years is yet to be determined, but its current structure leaves sufficient flexibility to adjust to uncertain future events.

- **IBSA recommends that the Council of Financial Supervisors be retained as the co-ordinating body for regulators of the financial sector**

The need for co-ordination of this type is accentuated by the emergence of financial conglomerates, as discussed in Part 2. For example, it is common for investment banks, subject to prudential supervision by the Reserve Bank, to have to have stockbroking, funds management subsidiaries and the like, that are supervised in various forms by the other regulators. In addition, technological developments may change the nature of financial institutions to be regulated. These trends are likely to increasingly test the efficiency of the regulatory regime.

There are a number of alternative models to manage financial regulation from this perspective into the future. The most prominent are a mega-regulator with full authority or a co-ordinating body combined with some arrangement, like a lead regulator, for the efficient regulation of conglomerates. The former would be a radical departure from the current system, while the latter would build upon it. As with most choices, there are positives and negatives attached to each.

A mega-regulator would have several advantages including elimination of regulatory overlap and any regulatory arbitrage that may exist, a single regulator for financial conglomerates and a useful framework for managing change in the financial sector. In effect, it would internalise the activities of a more active Council of Financial Supervisors. However, it has disadvantages too. Potential problems include adjustment costs, greater contagion across entities in a financial conglomerate, a widening of the 'moral hazard' problem within the financial sector, loss of policy transparency (especially if competition is included in the mega-regulator's brief) and logistical difficulties in the management of a regulator on this scale.[5] The operations of a single regulator could become quite cumbersome, insensitive to the interests of the smaller participants in the financial system and inflexible.

The repeal of existing legislation and establishment of a mega-regulator would involve complex legislation, that could take up to a year to gain parliamentary consent. This could entail uncertainty and create a legislative vacuum, at a time when the push for mergers and conglomerates is gaining pace. This outcome should be avoided.

[5] Regulators have a concern with financial conglomerates in that they face operational risk as their management is stretched across a diverse range of activities; this principle must apply to regulators too.

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A mega-regulator would also entail the separation of monetary policy from bank supervision. This is not desirable from two points view; firstly, the Reserve Bank is well placed to provide stabilising liquidity support to individual financial institutions, or the broader system, and secondly, it would eliminate vital synergies in the implementation of monetary and prudential supervision policies. These synergies include sharing of market intelligence from both sources within the Bank and development of a keen appreciation of the commercial factors driving the business reflected in monetary and credit aggregates and the like. The first problem may be countered to a reasonable extent by a mechanism for effective dialogue between the relevant authorities but the second cannot be replicated. It is also quite likely that the compliance costs that banks face in reporting to the authorities are reduced by the joining of the two policy streams. On balance, it is not desirable to split the responsibility for monetary policy from bank supervision to two separate bodies.

- **IBSA recommends that the Reserve Bank retain responsibility for both monetary policy and prudential supervision of banks.**

In summary, the disadvantages to a mega-regulator outweigh the benefits. Nevertheless, the regulatory regime must be better placed to handle the emergence of financial conglomerates. An alternative is to use a lead regulator model, in which one regulator takes responsibility for each financial conglomerate, and the other regulators supervise the subsidiaries that operate in their area of specialist responsibility. The choice of lead regulator is determined by the substantive nature of the conglomerate's business. The lead regulator would collect information required to give an insight into group risk, assess the overall capital adequacy of the group and keep subsidiary regulators appraised of the group's position. This model provides a consistent approach to the supervision of each individual conglomerate, removes ambiguity about the scope of each regulator's reach and defines clear lines of communication between regulators.

There was general agreement in the international Tripartite Group[6] about the appropriateness of a lead regulator model. The Council of Financial Supervisors is moving in this direction too, which seems the appropriate course of action, all things considered. The Council's informal approach has assisted in its formative stages, but it is necessary to provide greater structure to its activities if it is to develop this role.

- **IBSA recommends that the Council of Financial Supervisors adopt a lead supervisor model for supervision of conglomerates.**

In the event that a conglomerate's business is widespread, with no dominant element, the Chairman of the Council of Financial Supervisors could appoint the lead regulator. At present, this is not an issue in Australia, but the principle should be established, before it becomes a matter of any contention.

At present, competition in the financial sector is regulated independently of the Council of Financial Supervisors by the ACCC. At a minimum, a formal mechanism for dialogue between the ACCC and the other regulators should be put in place. A much better option, given the

[6] Its report "The Supervision of Financial Conglomerates" was released under the auspices of the Basle Committee, the International Organisation of Securities Commission (IOSCO) and the International Association of Insurance Supervisors (IAIS) in 1995.

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Council's position at the heart of financial regulation, the interaction between all of the strands of regulation, the nature of competition in the financial sector and the likely impact of technology, is that the Council itself takes up responsibility for the oversight of competition in the financial sector. The Council would be better attuned to financial market practices, conditions and trends (at home and overseas). Its superior information base and specialist financial expertise would leave it best placed to make judgements about the effective level of competition in the financial sector generally and in specific financial markets.

Demands on the Council of Financial Supervisors are likely to increase in the future, given current trends in the financial sector, including movement towards conglomerates and redrawing of the product borders. In view of this, there is considerable merit, if not a necessity, in giving statutory recognition to the Council, with the Treasurer as the responsible Minister. A set of firm objectives for the Council should be formulated; these should include all of its current stated aims, in addition to new objectives designed to give it better direction. Its prime objective should be an optimal regulatory regime for financial regulation, that satisfies concerns about systemic risk, market integrity, competition and consumer protection with least intrusion on the free operation of the market. Subsidiary objectives should include;

- Co-ordination and consistency of financial regulation;
- Adherence to a set of minimum standards of operation;
- Elimination of overlap and duplication and closure of regulatory gaps;
- Efficient use of information gathered by regulators;
- Preservation of individual regulator's independence;
- Identification of key financial sector trends;
- An internationally competitive financial regulatory regime.

This would give the Council greater strength, which it will require in the future. It is emphasised that the Council itself would not become a regulator. Indeed, to avoid confusion on this front, an objective of the Council would be preservation of individual regulator's independence, within the broad policy direction set by the Government. Responsibility for liaison with international regulatory bodies would remain with the relevant individual regulatory authorities, as to do otherwise would compromise their operational independence.

The Council would formulate the strategic direction of financial regulation, as determined by public policy considerations. This includes determination of key issues and priorities within the given policy framework. In this regard, the Council would keep the Treasurer informed on all regulatory matters, including a regular review of the operations of the regulatory authorities. The Council would advise the Treasurer on all related matters, including policy direction, design and implementation. This would leave the authorities better placed to respond to new developments affecting the financial sector; for example, emerging issues affecting the international competitiveness of the financial sector could be managed efficiently within this framework.

To undertake these tasks, the Council would require an independent Chairman and a small secretariat. The Deputy Chairman of the Council should be the Governor of the Reserve Bank, in recognition of the Bank's critical role in the control of systemic risk. Allowing for efficiency gains from better co-ordination of regulators' efforts, it should not require a net increase in public sector employment.

♦ **IBSA recommends that:**

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- **The Council be given statutory recognition, but as a co-ordinating body only;**
- **The Council be comprised of representatives of the financial regulators, with the Governor of the Reserve Bank as Deputy Chairman and an independent Chairman, appointed by the Treasurer;**
- **The Council report directly to the Treasurer;**
- **The Council be made responsible for competition in the financial sector;**
- **The Reserve Bank's present role as bank regulator is not compromised.**

In recommending these changes, IBSA emphasises that the Reserve Bank functions well as the bank regulator and notes that the current regulatory regime has preserved the integrity of the financial sector. IBSA's principal concern is focused on the management and type of financial sector regulation that will best serve the financial sector and the economic community in the future. This is forward looking and necessarily involves uncertainty. The required framework must have flexibility, quality and speed of response to regulatory problems as they emerge at its core.

While it is not appropriate to change the role of the Reserve Bank, an alteration to current arrangements that might be considered is to make the Bank responsible for the prudential supervision of the financial institutions currently subject to supervision by AFIC. This would rationalise the system of financial regulation and better satisfy the principles of regulation, including simplicity, efficiency and elimination of competition biases.

1.4 Consumer Protection

Consumer protection is a pervasive issue in financial regulation and a matter of some complexity that involves the State bureaucracies, as well as financial regulators. There is a sound case for forming a single entity to regulate the provision of financial products and services, so that consumers' interests are protected. This would focus on disclosure and complaints resolution issues. Such a body should become a member of the Council of Financial Supervisors.

The intensity of consumer protection must be pitched at the right level as, otherwise, it will hinder the efficient operation of the market. The emphasis should be placed on disclosure, so that consumers can make an informed decision and then take responsibility for it. Regulation should not aim at preventing consumers from making losses on financial transactions, as profit and loss are an integral part of financial investment. Rather, it should aim at making the market for financial services a fair place for consumers to trade.

It is important that consumer protection regulation is properly targeted towards those it is intended to protect and is not indiscriminate. Financial institutions make a natural commercial distinction between retail consumers and wholesale (sophisticated) users of financial products in their normal business, through the application of screening criteria like counterpart risk and transaction scale. Sophisticated entities undertake their own due diligence and do not need the same level of formal regulatory protection as do retail consumers.

Regulation that fails to recognise this will impose an excessive level of control on financial transactions and inhibit the efficient operation of the market, possibly driving it offshore. For example, the application of Section 52 of the Trade Practices Act to certain financial transactions is inappropriate, especially where they only involve sophisticated entities. Similarly, in view of the fact that foreign bank branches are effectively barred from the retail

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deposits market, they should no longer be required to inform depositors that the depositor protection provisions of the Banking Act do not apply to them. Sophisticated entities, like banks, do not need or rely on formal protection of this nature. In summary, it is essential that the principles outlined in section 1.1 are adhered to in the design and implementation of consumer protection policy.

- *IBSA supports the Corporations Law Simplification Program proposal to regulate dealings in securities under the Corporation Law, rather than under Section 52 of the Trade Practices Act, and further recommends that, as a matter of principle, the distinction between wholesale and retail consumers of financial services is properly reflected in all consumer protection regulation.*

- *IBSA recommends that, having regard to the effective exclusion of retail depositors from their business, foreign bank branches should no longer be required to inform depositors that the depositor protection provisions of the Banking Act do not apply to them, as a practical matter that balances competition in the wholesale funds market.*

1.5 Periodic Review

As a matter of course, the effectiveness of financial regulation in meeting public policy objectives should be subject to periodic review, that takes account of industry developments. For example, the trend towards securitisation is likely to leave banks with more liquid balance sheets. Therefore, the difference in value between their assets on an ongoing basis and on a liquidation basis is reduced and the possibility of an orderly winding down of operations is possible. This suggests that less intensive prudential supervision of banks may be required in the future. The review process would automatically take account of such developments.

1.6 The Prime Asset Requirement (PAR) Ratio

Liquidity risk is the potential that a bank's counterparty will not meet its commitment to the bank, or the bank's other funding mechanisms might be disrupted, causing it difficulty in meeting its own payments. The Reserve Bank's PAR ratio (Prudential Statement D1) requires banks to maintain a minimum proportion of its domestic balance sheet in specified prime assets (mainly cash and government securities) at all times. It is intended to ensure that banks have adequate liquid balances to meet all of their day-to-day obligations as they fall due, including unanticipated flows. This supplements banks' own internal liquidity management arrangements, that are also reviewed by the Reserve Bank.

Development of a real time gross settlements system (RTGS) for high value domestic payments to reduce interbank settlements risk is progressing well and likely to be operational at the end of 1997. Counterparty credit exposure will be reduced as high value payments are settled through ESA accounts throughout the day, rather than at the end of the day. This helps to rapidly identify liquidity problems and organise remedial action. Currently, a deferred net settlements system is in use. In addition, the imposition of costs for intraday liquidity should reduce demand for daylight overdrafts. This will not eliminate liquidity risk, but it will significantly reduce it and contain the impact of an institution's failure on the financial system. This should be recognised by a reduction in the PAR ratio. This would also represent a welcome move away from a prescriptive approach to prudential supervision.

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- *IBSA recommends that PAR should be significantly reduced with the implementation of the real time gross settlements system for high value domestic payments.*

Having regard to the wholesale character of the core of foreign banks' business, the range of their eligible PAR assets should be reviewed. Trading banks have substantial retail business and carry considerable balances of some PAR assets, like notes and coin, as a matter of course, whereas foreign banks have less need to do so. An expansion of eligible assets may become necessary, in any event, if the Federal government returns its budget to surplus.

1.7 Non-callable Deposit Requirement

Banks are required to keep non-callable deposits (NCDs) with the Reserve Bank equivalent to 1% of their liabilities (excluding capital) in Australia. The interest rate paid on these deposits is *five* percentage points below the commercial rate. Based on bank NCDs at May 1996, this represents an annual levy of $195 million on banks. This was viewed as a charge for the benefits that accrue from supervision,[7] but it bears no relation to the actual cost of supervision, which is only a fraction of this. Therefore, NCDs operate as an effective tax on banks and should be abolished.

At a minimum, the NCD requirement for foreign bank branches should be eliminated, or greatly reduced. Firstly, foreign bank branches do not benefit from the deposit protection provisions of the Banking Act. Secondly, they have much lower supervision costs, as they are the subject of much less intensive Reserve Bank supervision because the prime responsibility for supervision of their operations rests with the parent bank's home supervisor. The parent bank pays an implicit charge for this supervision, so the current NCD regime represents a double charge and imposes a competitive disadvantage on foreign bank branches.

- **IBSA recommends that non-callable deposits be abolished for all banks. At a minimum, they should be eliminated, or greatly reduced, for foreign bank branches.**

1.8 Bank Licensing Requirements

Foreign bank applicants for a local banking licence are required to demonstrate that they can satisfy all of the Reserve Bank's standard prudential requirements, like appropriate management expertise and adequate risk management systems. This is entirely sensible and the only comment that we would make is that the application process could be streamlined.

Applicants must also indicate the economic contribution that they will make to Australia. Part 1 of the submission outlines many of the significant benefits from foreign bank entry to the banking market. Appropriate foreign banks that seek entry can readily demonstrate that they will make an economic contribution, though the need for them to actually demonstrate this is questionable. In practice, this is not a material issue.

However, there is a vital need for the Reserve Bank to adopt a more flexible approach in its licensing requirements for foreign bank branches in other areas. In particular, the Bank must be better able to accommodate commercial structures determined by market conditions. For example, it is unreasonable that major global financial conglomerates that operate as banks elsewhere in the world are unable to obtain a banking licence here solely because of the

[7] See Reserve Bank Press Release Number 95-08.

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commercial structure of their operations. The strict requirement for the holding company that has ultimate ownership of a foreign bank branch to be a bank, and for a conglomerate to be supervised by a bank regulator should be replaced with criteria that place greater cognisance on the commercial character of international banking.

This strict requirement would make more sense if there was at least an agreed common definition of a bank amongst international bank regulators; this is not the case. Indeed, the very concept of banking is undergoing review, as technology impacts on delivery systems for financial services. Further, given cross country variation in effective supervision, the comfort provided by the licensing of a parent bank will differ in accordance with its country of origin. Clearly, the value of assurance provided by the parent entity ownership is a matter of judgement and should not be subject to a hard and fast rule. In this context, it is noted that conglomerate holding companies may have higher credit ratings than the banks themselves.

The prohibition on foreign banks from accepting retail deposits restricts the most sensitive part of their banking business to the wholesale market. Thus, branches can only deal with professional investors that make independent credit assessments and do not rely near as much on the security provided by a bank licence. Therefore, protection of retail consumers is not an issue here. The systemic risk associated with a bank branch of a foreign financial conglomerate exists independently of the bank licence, as the entities affected can operate in Australia as merchant banks (and some do). Indeed, it can reasonably be argued that systemic risk is reduced by bringing the merchant bank within the more onerous licensed bank reporting regime. Consequently, from a public policy perspective, it is difficult to justify the current restrictive approach of the Reserve Bank.

The current requirements undermine the competitive position of Australia as an international financial centre and diverts business to its competitors in the region. If foreign banks that seek to place their regional headquarters in Australia cannot adopt their preferred commercial framework for operation (within reasonable limits), they will look towards countries that facilitate this structure, like Singapore. This will occur even though, in all other respects, the Australian entity may be the most efficient unit within a bank's global or regional operations. The outcome is a loss of employment and foreign earnings to the economy. Further, systemic risk is increased, as the Reserve Bank will see less of the market transactions that impact on the exchange rate and interest rates.

The global trend towards the formation of financial conglomerates reflects the development of new more competitive operating structures, so the degree of difficulty imposed by the current arrangements is likely to increase rather than decrease. It also raises a question about the status of a bank branch, if in the future, their parent bank merges with a non-bank entity and is a minority within a the new group.

- **IBSA recommends that the Reserve Bank adopt greater flexibility in setting its criteria for the ownership of foreign bank branches by concentrating on the substance of parent ownership risks, without compromising the integrity of the licensing system.**

Restrictions on the commercial structure of financial conglomerates may affect domestic banks too. It is a mistake to constrain the operations of Australian financial conglomerates in this manner, especially having regard to the ongoing restructuring of the financial system stimulated largely by technological developments. Increased flexibility by the Reserve Bank need not

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compromise the integrity of the licensing procedure, especially if the preferred conglomerate structure increases its profitability. Rather than proscribing certain commercial structures, the Reserve Bank should explore alternative mechanisms for achieving its desired level of prudential security.

1.9 Stored Value Cards

Stored value cards (SVCs) are a means of payment that in character are closer to cash than to cheques. Several different types of SVCs are being tested in a number of centres and their use is likely to increase substantially over coming years. A number of issues need to be resolved including the maintenance of card integrity, protection of consumer funds and the control of illegal activities, especially money laundering. In addition, the loss of seignoirage tax revenue to the government must be met by either increasing existing taxes, or introducing a new tax (perhaps on the balances of funds that underpin the cards).

The authorities have yet to formalise policy measures to address these issues. However, in doing so, a number of principles should be followed. In particular, competition in the market for SVCs should be encouraged. For example, the foreign banks have proved their mettle as catalysts for innovation and competition in banking, so they should be encouraged to enter the SVC market, as long as they hold a banking license from the Reserve Bank. It is likely that the investment of consumers' unredeemed funds will be subject to tight control, that will effectively protect retail depositors, independently of the current set of prudential regulations. Therefore, the status of a foreign bank, as a subsidiary or branch, should not affect its right to issue cards once the specified conditions are met. It will be necessary to maintain the integrity of the payments system, so as a general rule only issuers of good standing should be permitted to enter the market. Regulatory intrusion into the market should only be the minimum required to preserve consumer confidence in the cards and the overall integrity of the market.

- *IBSA recommends that the authorities should promote competition in the market for stored value cards, and other payments media, and encourage licensed foreign banks (subsidiary and branches) to participate in the market.*

1.10 International Regulation

Foreign banks are subject to two supervisory regimes; the Reserve Bank's and that of their parent bank's supervisor. Locally incorporated entities are subject to the same capital prudential requirements as the domestic banks. They are also subject to examination by their home base through consolidated supervision in accordance with the Basle Concordat principles. In contrast, the prime responsibility for supervision of foreign bank branches rests with their home supervisor - and the bank's internal management. The experience of IBSA members is that both are rigorous.

The Reserve Bank, and the other financial regulators, should continue to liaise with their counterparts in the main international financial centres, seek ways to enhance cross border co-operation and observe international benchmarks. This will preserve the international competitiveness of the financial sector and minimise regulatory compliance costs for foreign banks operating here.

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2. Competition and Taxation

It is impossible to analyse competition in the financial sector, especially with regard to foreign banks, without taking into consideration taxation issues. Few financial transactions are undertaken independently of some form of either explicit or implicit tax assessment. The outcome influences the type of financial business undertaken, who undertakes the business and where the business is undertaken. Taxation arrangements impact on competition in the financial sector at three levels:

1. Domestic competitiveness and efficiency of the sector;
2. Competitiveness within the sector;
3. International competitiveness of the sector.

In the first case, it can be argued that the tax system biases household behaviour in a manner that inhibits saving and then directs savings that are made towards real estate, rather than financial assets. In the second case, the tax system can bias the form of financial investment undertaken, or the financial institution with which financial business is conducted. In the third case, the tax regime may penalise financial local activity relative to that undertaken overseas. These are each relevant to this submission, but the analysis here concentrates on the latter two, where international banks have a particular interest.

The following sections concentrate on the impact of interest withholding tax and financial institutions duty (FID), both of which undermine the competitiveness of international banks but in different ways. The detail of broader tax issues, like the need for reform of the tax system to make it simpler, more certain and more efficient, are important to the financial sector but are left for discussion in another forum. Here, we just state that there is a definite and strong need for tax reform of the overall tax system.

2.1 Interest Withholding Tax

The interest withholding tax treatment of foreign bank branches differs from that of domestic banks and foreign bank subsidiaries in a manner that places them at a distinct competitive disadvantage; see table 1 This is an important consideration for merchant banks in their assessment of the value of obtaining a bank licence and for bank subsidiaries that are considering a change in their status to that of a branch. Unless interest withholding tax on intrabank funding is abolished, the competitive implications of a change in status will present a significant barrier for these entities, that may otherwise convert to branch status.

Table 1 Interest Withholding Tax Liabilities - Offshore Funding

	Foreign bank branch	**Foreign bank subsidiary**	**Domestic bank**
Unrelated party -sec 128F	10%	nil	nil
Related party	4.8%	10%/nil if sec 128F(6)	10%/nil if sec 128F(6)

The arrangements for the taxation of foreign banks are contained in Part III B of the Income Tax Assessment Act and came into operation with effect from 1 July 1994. These impose interest withholding tax on foreign bank branches for all offshore funding from non-related parties at the full rate of 10%. In general, a bank and head office constitute a single entity and intrabank transactions are not recognised but there are three exceptions; interest, foreign

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exchange and derivatives. Interest payments on intrabank funding attract interest withholding tax at half the normal rate (this works out at 4.8% after allowance for deemed notional equity). The application of interest withholding tax on intrabank funding is at odds with the practice of virtually every other major trading country (see table 2). The inability of most foreign banks to claim tax credits in respect of the tax undermines the viability of the branch banking option.

In contrast, domestic banks and foreign bank subsidiaries have access to offshore funds free of interest withholding tax through section 128F of the Act, subject to certain conditions being met. For issuers to avail of the 128F exemption, the debentures issued must have 'wide distribution', which prevents direct parent lending, and the funds must be intended for use in Australian industry. Interest withholding tax free funding is available through wholly owned special purpose subsidiaries (section 128F(6)), effectively on terms such that the subsidiary will not make a profit. The interest withholding tax exemption under section 128F requires the company making the issue to be a resident of Australia and a branch does not *prima facie* meet this requirement. Thus, foreign bank branches are prohibited from using this facility.

In June this year, the Treasurer confirmed changes announced in December 1995 that will eliminate the 'end use' requirement and that a public offer test, that reflects market practices, will replace the 'wide distribution' test. The new arrangements presently operate along side the old arrangements.[8] The substance of these changes is welcome but there are a number of important issues that arise from the draft legislation that require clarification. IBSA is currently pursuing these matters with the Australian Tax Office. However, it is certain that the prospective changes will not fundamentally alter the tax position of foreign bank branches.

Therefore, the competitive disadvantage suffered by foreign bank branches relative to other banks operating in Australia because their access to funds free of interest withholding tax is blocked, will persist into the future. As noted in Part 1, some foreign banks conduct their operations through both a branch and a non-bank subsidiary, with corporate lending conducted through a subsidiary that can access funds free of interest withholding tax. This is an artificial and unnecessarily expensive structure.[9]

At the time the arrangements for taxation of foreign bank branches were announced, the government acknowledged that the interest withholding tax regime would penalise foreign bank branches by reducing their competitiveness and hinder their development. It justified this by reference to its medium term budgetary objectives. This is unsatisfactory on two counts. Firstly, it is incorrect to discriminate against foreign banks and force them to carry an excessive part of the budgetary adjustment. Indeed, if that was the prime concern, a firm commitment should have been given to rectify the problem once the budget was in order. Secondly, the Government must properly articulate its concerns about the cost of a full exemption, as it has grossly overstated the revenue cost to it of full relief. The amount of interest withholding tax collected from foreign banks is small in relation to the total amount collected through interest withholding tax. Concerns about the indirect loss of a large amount of revenue are largely misplaced, given the nature of the underlying business that attracts interest withholding tax, the capital and operating cost structure of banks and the tax pick-up on local bank profits.

[8] At least for those who feel confident that they meet the new, yet to be finalised, conditions for exemption.

[9] Even if the proposed section 128F changes are passed and the subsidiary can lend the interest withholding tax free funds to the branch, the branch/subsidiary structure must be retained to undertake that borrowing.

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Interest withholding tax on intrabank funding should be abolished in order to place foreign bank branches on the same effective footing for offshore funding as the other banks. This would help balance competition in the financial sector, in this area at least. It must be remembered that foreign bank branches are excluded from the market for cheap retail deposits by regulation and other barriers. Therefore, the competitive disadvantage imposed by the current interest withholding tax arrangements is exacerbated by necessary heavy reliance of foreign banks on offshore funding.

As demonstrated in Part 1, foreign banks have proven their ability to markedly heighten competition in the financial sector and generate significant economic benefits. The bank branch option is a means for foreign banks to access funding more easily and more cheaply. If the interest withholding tax impediments are removed, competition will ensure that Australian industry and consumers will be the ultimate beneficiaries. It is argued that the revenue costs of this would be low and be more than offset by the economic returns.

- **IBSA recommends that, with a view to balancing competition in the financial sector, interest withholding tax on intrabank funding by foreign bank branches be abolished forthwith.**

Interest withholding tax has inhibited development of a domestic corporate bond market, because local issues are not exempt for non-resident investors, which effectively precludes them from participation in the market.[10] It is not the only causal factor behind the failure of a deep local corporate bond market to develop, but the substantial issue of fixed interest securities offshore by the corporate sector has not helped. Companies will not issue bonds locally if cheaper funds are available offshore.

There is a need to develop the market so it can serve as an additional investment outlet for superannuation savings. The reduction in Commonwealth government bonds issued in the late 1980s prompted concern about a shortage of high quality fixed interest investments. If the government budget strategy is successful, this problem will emerge again. Industry is a natural borrower, in order to finance its investment projects. A better developed corporate bond market would provide a stable long term investment outlet and bring on-shore financial activity currently conducted in other countries. This would have a significant revenue cost, but the net benefit in terms of market efficiency, lower finance costs and development of a local bond market would offset this.

IBSA recommends that interest withholding tax be abolished over the medium term, with a view to promoting further development of the domestic non-government fixed interest market.

[10] In this context, it is worth noting that the Campbell Committee stated "withholding tax is an undesirable levy insofar as the workings of the financial system are concerned. Indeed, if this were the only consideration it (the Committee) would recommend its removal" - Section 16.75, Australian Financial System, Final Report of the Committee of Inquiry, AGPS, 1981.

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2.2 Financial Institutions Duty

Financial institutions duty (FID) is a State based tax on selected receipts of financial institutions (and other entities). In most States, the primary rate of FID is 0.06%, subject to a cap of $1,200.[11] Registered person dealings for amounts of $50,000, or more, that are under 185 days maturity are exempt from primary rate FID and a special rate (usually called the 'concessional rate', which is a misnomer) of 0.005% is applied to the average amount outstanding of these 'short term dealings'. Thus, the former is a turnover based tax and the latter is a stock based tax. The short term dealing rate was introduced in recognition of the fact that the multiplier effect of the tax would close the domestic money market.

◊ *Problems with FID*

Financial institutions duty (FID) is a major problem for banks and the financial sector in general. It is unnecessarily complex, uncertain, tainted by State rivalry and inhibits the efficient operation of the financial sector. FID compliance costs for banks are high and it undermines the international competitiveness of the financial sector, at a time when competition in finance at this level has intensified. The failings of FID are not a matter, or consequence, of intricate detail and subtlety; FID offends the basic principles of an efficient tax regime.[12]

The starting point in the design of any tax is a clear understanding of the policy objective that it is intended to implement. In particular, it should be clear which activities are meant to be taxed, who is to meant to bear the tax and at what level the tax should be paid. The first problem with FID is that a significant ambiguity has developed over the years about its principal policy intent. It is no longer clear upon which financial transactions the tax is intended to fall. With this uncertainty, the FID liability of new product innovations are difficult to gauge. For example, the likely treatment of stored value cards is uncertain.

FID is widely accepted as a financial transactions tax. However, the problem with defining FID as a financial transactions tax is that 'financial transactions' are not uniform or homogeneous. There is a world of difference between a bank retail customer having her weekly earnings deposited into a cheque account and a funds manager transferring the proceeds of an equity portfolio transaction to its bank account, or a bank taking an interbank deposit as part of its liquidity management operations. This non-uniformity of financial transactions reflects the varied nature of financial activity and gets straight to the heart of the problem with FID; it is based on a false premise of uniformity.

Turning to the basics as outlined in Part 1, the financial sector produces four types of services; payments, liquidity management, intermediation and risk management. These services each have unique characteristics, though some products contain elements of more than one of them. For example, a bank deposit can be used to:

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[11] The main exceptions are South Australia (0.065%) and the ACT (0.1%). Queensland does not levy FID. There are a myriad of differences between different State regimes. For brevity and simplicity, analysis here focuses on the substantive similarities in the tax regimes. This does not at all compromise the analysis.

[12] It is interesting to note that the Campbell Report (paragraph 16.33) recommended replacement of the existing financial transactions tax regime because it was inequitable, regressive, non-uniform across States and between instruments and inhibiting securities transactions. There has been no real progress since then; this is a good description of FID as it operates today. Indeed, the Campbell Report went on to note that "total abolition of specific duties in the financial area has much to commend it" (paragraph 16.34).

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- facilitate payments, if it has cheque or similar facilities attached; and/or
- meet variations in short term liquidity needs, depending on its term; and/or
- serve as an savings/investment outlet, with reduced counterparty risk; and/or
- fund bank's lending activities; and/or
- hedge currency risk, depending on its currency of denomination.

It does not make sense to tax each of these activities in a similar manner as their commercial characteristics are quite different, competition in each area differs and their individual sensitivity to tax varies greatly. FID operates as a tax on payments and as a tax on liquidity management (qualified by the short-term dealing arrangements). Whether intended or not, it is a tax on saving. The intention with regard to risk management is uncertain.

The policy intent of the tax is not clear in an economic or commercially meaningful sense. FID drives off the concepts like receipt, account and money; none of which are defined with certainty in the legislation nor can be defined in a manner to properly discriminate across the different types of financial activity. This has resulted in a somewhat capricious set of policy directives and regulations.[13] Banks are left with an absence of certainty about their FID liabilities and a concern that as yet unidentified liabilities, or 'sleepers', may give rise to their being penalised for unwittingly transgressing FID regulations at some time in the future.

Banks must accommodate seven different FID regimes and keep abreast of changes in each of them individually. There is an established lack of uniformity and consistency in the design and implementation of FID across the States and Territories that impose it. A disturbing review of differences across States is given the November 1995 issue of *The Australian Corporate Treasurer;* there are important differences across States in key definitions like that of a receipt, a financial institution, exempt accounts and short-term dealings. Add to this differences in interpretations, revenue rulings and penalties and it is clear that banks operating in more than one State or Territory face some difficulty in coming to grips with all of their FID liabilities in each location.[14] Difficulties that arise for banks include greater complexity than is really necessary and heightened uncertainty. These are an important causal factor of the high compliance costs of FID. The idiosyncrasies in the States' and Territories' FID legislation may reflect subtle differences in policy intent, but the country can no longer afford the luxury of these distinguishing features. Because of problems like this, banks that collect a small amount of FID end up paying high compliance costs in ascertaining their FID liability.

Some, if not all, State revenue authorities wish to collect FID in proportion to, or accordance with, economic activity in their State. Given the character of financial transactions, this is not a reasonable objective. Firstly, the financial sector is a national market not a State based market (as assumed in FID), so there is no theoretical reason why there should be a perfect

[13] Frustrating revenue rulings continue to be issued. For example, a recent ruling by the Victorian State Revenue Office has the effect of making deposits from a charitable entity that holds a FID exemption liable to FID at the concessional rate on short-term dealings, where the deposits could qualify as a short term dealing. The intent of the primary rate exemption is that the charitable entity is not liable to FID. To impose FID at the short term dealing rate is unreasonable and contrary to the intent of the exemption. A sensible application of FID would apply the primary rate exemption automatically to the short-term dealings. It is extraordinary that what purports to be a concession should in fact operate as a penalty.

[14] There are inconsistencies in the treatment of products within individual States, as well as for individual products across States. For example, in NSW and Victoria equity based treasury products are subject to FID but interest rate products of a similar economic character are not. This does not make sense and stems from the lack of policy definition outlined above.

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correlation between economic activity and banking activity in a particular State and there are many commercial (non-tax related) reasons why it should not be. Secondly, the increased globalisation of financial markets means that for wholesale or professional products, the market crosses national as well as State borders. There has already been a trend towards account centralisation within the country and technological developments may further increase the distance between 'banking' activity and 'economic' activity. In particular, there may be a capacity to provide traditional retail banking facilities through international computer networks in the not too distant future. Thirdly, the trend towards centralisation make it inappropriate for the smaller States and Territories to use their locally based banking institutions as tax collecting agents.

◊ *FID and International Competitiveness*

FID is not a tax on financial institutions *per se*, but rather is a tax on consumers of certain financial services provided by them. Financial institutions are simply a convenient revenue collection agency. The right of banks to pass on the revenue cost to their customers has been recognised by the authorities. However, care must still be taken in this regard, as competitive pressures do not always enable financial institutions to pass on the revenue impost to its customers, especially if they can alternatively deal in a FID free area, onshore or offshore. Indeed, the application of FID to some particularly sensitive instruments, like derivatives, (or even uncertainty about its application) could quickly drive these markets offshore.

This emphasises the need to maintain the international competitiveness of Australia's financial markets. The application of FID is contradictory to State and Federal government policy to establish Australia as an international financial centre and as a location for international headquarters. Disadvantages to the Australian financial sector are both direct (through the levy of the tax) and indirect (through compliance and other costs). Important FID concessions have been given by most (but not all) State governments for OBU and RHQ business, but because the tax is not understood internationally, it very existence is a barrier to the full competitiveness of the Australian financial sector.

The fact that Australia is about the only country to levy a FID type tax exacerbates the problem of entry to the market for foreign banks. Giving his impressions of Australia in a talk to CEDA in 1994, Bob Joss described FID and BAD as two of the strangest taxes he ever came across in his international banking experience. A lack of understanding of FID by foreign bankers, together with uncertainty about its incidence and the associated contingency that this implies, is of concern to foreign bankers looking at Australia as a business location.

◊ *The Future of FID*

Regardless of the initial suitability of FID, dramatic change in the character of the financial sector since the early 1980s has made it a thoroughly inefficient tax. The impact on the financial sector of deregulation, globalisation and technology are most important in this regard. The first has largely run its course but certainly not the other two. Technology had a major impact on banking over the last decade and is likely to continue to be one of the main factors determining the industry's direction into the next century. Risk management is probably the area most affected to date. Critically from a FID perspective, the payments system is likely to be a key point for change in the future.

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As it stands, new electronic payments media, like EFTPOS and EFT, sit uneasily within the FID regime. Some electronic payments systems provide new facilities to aggregate receipts and thus, more readily avail of the $1,200 cap on primary rate deposit receipts. Other systems militate against aggregation of receipts, so certain types of activity are biased away from them. Increased account centralisation, cross-border transactions and netting are likely to increase for solid commercial reasons. This provides uncertainty in the short term FID revenue of the States and will lead to a decline in revenue over time. Another problem is that FID inhibits financial sector efficiency in this environment by biasing payments towards the media that attract lower tax liability.

The emergence of stored value cards (SVCs) and computer banking will exacerbate these problems. To the extent that they facilitate the transfer of funds between card holders, without the need to pass through a banking facility, they could reduce FID revenue. In addition, reduced reliance on traditional payments methods like cheques and credit cards could (but will not necessarily) cause a reduction in revenue.

Computer banking, for example through the *Internet*, is a different matter. State and national boundaries have little meaning in the computer world. In addition, it can be impossible to trace transactions and attribute them to the relevant parties. Indeed, the very concept of what a bank is could change in the face of technological development. This is a problem because the concepts of financial institutions, transaction traceability and association of each transaction to a geographical entity are key elements in the design and implementation of FID.

If FID cannot be collected equitably and efficiently from the broad cross-spectrum of society, its integrity will be irreparably compromised. This outcome is inevitable so FID will become non-collectable in this sense in the future. As the application of technology in banking expands further, the movement could be quite rapid. There are uncertainties with regard to timing, but the long term trends are clear. Industry surveys point to a shift in consumer behaviour towards a greater use of technology in their financial transactions. Banks have already committed substantial resources to adapting technology to their business and some already offer their facilities through the Internet.

- **IBSA recommends that the State and Federal governments announce their intention to abolish Financial Institutions Duty forthwith and immediately begin to plan for this.**

In January 1996 a Forum was established by the State revenue authorities, with industry participation, to examine options for the reform of FID. The Forum is precluded from recommending the abolition of FID by its terms of reference. This limits its value given the long term trends outlined above. However, given its revenue importance ($1 billion in 1994/95) FID will continue to be levied until a replacement tax is found and agreed to by all States. Industry has taken the view that any measures that reduce the cost of FID in the interim are worthwhile and should be pursued. Thus, it is actively participating in the reform process but emphasises that this does not compromise its efforts to have FID abolished.

It is recognised that the revenue authorities have made considerable input to the reform process. However, it will not preserve FID as a viable tax; it has a quite limited remaining life-span. Economic distortion, the inefficiency that it generates and its impost on the international competitiveness of the financial system will become too heavy to bear.

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3. International Competitiveness of the Financial Sector

In the earlier parts of the submission, it is shown that the financial sector operates in a global industry. There is an opportunity for the sector and the economy to earn significant external income by selling Australian financial services to foreign entities, either directly through cross border transactions or by enticing them to locate their regional operations here. On the other hand, Australian companies are offered similar services by financial institutions located in Singapore, Hong Kong, London, New York and elsewhere in competition with the local banks. For the domestic financial sector to hold its current status in the long run, not to mind capturing new foreign business, measures must taken to enhance its competitiveness.

IBSA is of the view that this can achieved by better organising governments' efforts in this regard and removing many of the obstacles that inhibit efficient domestic banking and other financial transactions. These are addressed in the other recommendations contained in this part of the submission. The Federal government offers tax concessions for offshore banking units and has commenced a program to attract regional headquarters, in addition to other generally available incentives, like research and development tax concessions. Many State governments, like that of New South Wales, provide measures to alleviate the effects of State taxes and actively promote the concept of an international financial centre within their State. Further significant financial incentives targeted directly at international banking are not needed, though policy makers need always be mindful of developments overseas.

Australia has the essential infrastructure required to be a successful international financial centre and location for regional headquarters (RHQs). For example, Australia enjoys a reputation for a stable business and political environment, which is an essential factor for businesses making long term investments in the region. The remaining problems must be resolved and the advantages of Australia aggressively sold. There is a widespread belief that more could be done to streamline the current approach by governments'. IBSA's members are keen to assist in this process and are committed to the concept of Australia as an international financial centre. They operate in financial centres throughout the world and confirm the special advantages that Australia has in this respect and also identify some of the problems that need to be addressed.

3.1 Australia's Advantages

Many studies have been conducted into Australia's advantages over other regional centres and how to market this. Amongst the identified advantages that Australia has are;

- Highly skilled and flexible workforce and competitive wage rates;
- Timezone location that spans New York and Tokyo;
- Strong legal system;
- Good communications and information systems, at low cost;
- Political and economic stability;
- Superior range of financial products;
- Strong domestic commodities sector;
- Leading international futures exchange and stock exchange;
- The most deregulated financial sector in Asia, perhaps, apart from Hong Kong;
- More sophisticated domestic banking system than anywhere else in the region;

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- Competitive costs, including accommodation and general living expenses, and high quality of social infrastructure.

Australia's workforce is highly skilled and relatively low cost, as shown on table 3, and stable. Meanwhile, its ethnic diversity means that the workforce is well suited for providing RHQ and international financial services. Australia has world class tertiary education facilities, especially in finance. The universities attract a great number of overseas students and a number of universities export their courses in finance to the region. The world's largest postgraduate programme in applied finance was developed in Sydney and is now taught in Hong Kong, Singapore and Tokyo, as well as in the major cities in Australia.[15]

Table 3 Australia's Advantage in Salary Costs (US dollars)

	Hong Kong	Tokyo	Singapore	**Australia**
Total Cash Compensation				
Executive Secretaries	35,590	-	28,840	**26,504**
Middle Managers	71,917	112,359	73,989	**52,358**
Senior Managers	91,228	147,011	96,508	**61,679**
Top Managers	157,818	205,815	173,714	**86,731**
1993 Salary Increase	11%	not available	6.75%	**3.1%**
Total Cash Compensation				
Senior Managers				
Finance & Administration	79,908	not available	91,429	**70,140**
Sales & Marketing	73,615	"	84,656	**71,872**
Manufacturing & Eng.	60,281	"	71,111	**57,018**
Personnel	65,889	"	84,656	**67,955**
Electronic Data Processing	84,113	"	94,815	**64,700**
Purchasing & Logistics	56,776	"	67,725	**63,549**
Cost of Living				
(Sydney as base of 100)	152.0	330.3	151.0	**100.0**
GOL Inflation Rate	6.1%	1.7%	0.8%	**1.8%**
Government Inflation Rate	9.21%	1.32%	2.39%	**2.23%**

Source: Employment Conditions Abroad (ECA), Consultant to Department of Industry, Science & Technology, 1994. Department of Industry, Science and Technology, June 1994, *Australia Your Business Location in Asia*, 2nd ed.

Australia has one of the most competitive telecommunications frameworks in the Asia Pacific region and arguably the world. With a reputation for reasonable priced leased circuits and a high level of security in the region Australia offers a service Singapore and Hong Kong are yet to match in this area. Domestic telecommunications companies offer comprehensive geographical coverage, price stability, operational integration and technical strength, and close to 100% service availability and reliability. Australia already has more fibre optic cable - well over a million kilometres - than any other country in the world, including the United States.[16]

A number of surveys have established the fact that Australia's unit costs in accounting, management and consulting are 25% less than Hong Kong's and equivalent to Singapore's. In addition the legal framework is based upon the British system, which is the dominant forum for international finance. The Australian Commercial Disputes Centre has an excellent reputation

[15] The programme was developed and is taught by the Centre for Studies in Money, Banking and Finance at Macquarie University.

[16] *Information Technology and Telecommunications in New South Wales*, Office of Economic Development, NSW Premiers Department, February 1995, p.14

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in helping countries, businesses and government authorities to resolve their commercial disputes without necessarily having to go to court or having to continue with court proceedings. Some believe that there is a good potential for Australia to develop as the key centre for disputes resolution in the region.

Modern building design ensures the vast amount of cabling required for access to the sort of technology required to do business in the global financial markets is readily available in Australia, adequate inter-floor gaps are provided in the vast majority of buildings in our financial centres. Sophisticated technology such as screen trading systems, data feeds, payments systems and settlement systems are all established and operational for institutions operating in Australia. Overall costs of both commercial and residential premises are also considered one of the region's lowest.

3.2 A Sophisticated Domestic Financial Sector

Australia's domestic financial markets are better developed than those elsewhere in the region, Japan included. A wider range of more sophisticated financial products are offered to consumers of financial services here than is offered to consumers elsewhere. The domestic financial markets in Singapore and, to a lesser extent Hong Kong, are more controlled and not as well developed as those in Australia. Domestic retail banking markets are not yet open to vibrant international competition, though this is likely to change soon.

Australia's financial sector is probably the most efficient and competitive in the region at the wholesale market level, where trade in international financial services takes place. For example, the money and fixed interest markets in Australia are better developed than those in any other country in the region, if measured by product sophistication and size of market. Table 4 provides a subjective outline of the OTC derivatives markets in the region.[17] The markets in Australia and Japan have the widest range of actively traded derivatives denominated in local currency. The Singapore dollar derivative markets are not nearly as well developed, partly due to caution on behalf the authorities.

Table 4 Foreign Exchange and Interest Rate OTC Derivatives Asia Pacific Markets in mid-1996

	Foreign exchange		Interest rate			
	Forward/Swaps	Options	FRA's	Swap	Option	Exotics
Developed Countries						
Australian Dollar	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
Hong Kong Dollar	✓✓✓	✓✓	✓✓	✓✓✓	✓✓	✓✓✓
Japanese Yen	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
New Zealand Dollar	✓✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
Singapore Dollar	✓	✓	✓	✓	✓	✓
Other Countries						
Indonesian Rupiah	✓✓	✓	✓	✓	×	×
Korean Won	✓	✓	✓	✓	×	×
Malaysian Ringgit	✓✓	✓	✓✓	✓✓	✓	×
Taiwanese (New) Dollar	✓✓	×	✓	✓	×	×
Thai Baht	✓✓	✓✓	✓✓	✓✓	✓	×

Key: ✓✓✓ Strong market ✓✓ Reasonably active market
✓ Small/emerging market × No market

[17] Tables 4 and 5 are prepared from material brought together for inclusion in a forthcoming book, *The New Derivatives Industry*, Allen and Unwin.

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Table 5

Main Financial Futures & Options Contracts Traded on Asia-Pacific Exchanges - 1996

Exchange		Turnover - 1995 ('000)	
		Futures	Options
Sydney Futures Exchange	Bank accepted bills	6,173	713
(trading commenced in 1979)	3 year Treasury bonds	8,821	434
	10 year Treasury bonds	5,741	604
	Share Price Index	2,476	653
	Individual shares	131	×
Australian Stock Exchange	Individual shares	×	9,146
Hong Kong Futures Exchange	Hang Seng Index	4,547	646
(trading commenced in 1985)	Rolling USD Forex DM	13	×
	Rolling USD Forex Yen	9	×
	Individual shares	n/a	n/a
Tokyo Stock Exchange	Government bond 10 year	14,010	2,017
(trading commenced in 1988)	Government bond 20 year	3	×
	TOPIX (equity index)	2,745	17
	US T-Bond	102	×
Osaka Stock Exchange	Nikkei 300	2,319	122
(trading commenced in 1988)	Nikkei 225	7,221	5,175
Tokyo International Futures Exchange	Euroyen 3 months	36,330	362
(trading commenced in 1989)	Euroyen 1 year	25	×
	USD/JPY	14	×
Korea Stock Exchange (trading commenced in 1996)	KOSPI 200 (equity index)	new market	×
Kuala Lumpur Futures & Options Exchange (trading commenced in December 1995)	KLCI (equity index)	new market	×
Malaysian Monetary Exchange (trading commenced in 1996)	KLIBOR	new market	×
Manila International Futures Exchange	USD/DM	96	×
(trading commenced in 1990)	USD/YEN	180	×
	GBP/USD	55	×
	USD/CHF	99	×
New Zealand Futures and Options	Bank bills	478	18
Exchange (trading commenced in 1986)	Government bond 3 year	27	0
	Government bond 10 year	8	0
	NZSE-40 (FIF)	4	0
	NZSE-10 (TOP)	3	0
	Share options	×	137
Singapore International Monetary	Euroyen 3 months	6,549	129
Exchange (trading commenced 1984)	Eurodollar	8,395	5
	Japanese govt bond 10 year	297	35
	Nikkei 300	174	3
	Nikkei 225	6,547	1,943
	Deferred spot USD/YEN	59	×
	Deferred spot USD/YEN	109	×

Note: '×' indicates that no contract is traded. The notional monetary value of contracts differ markedly by contract type. Source: Material provided by relevant exchanges.

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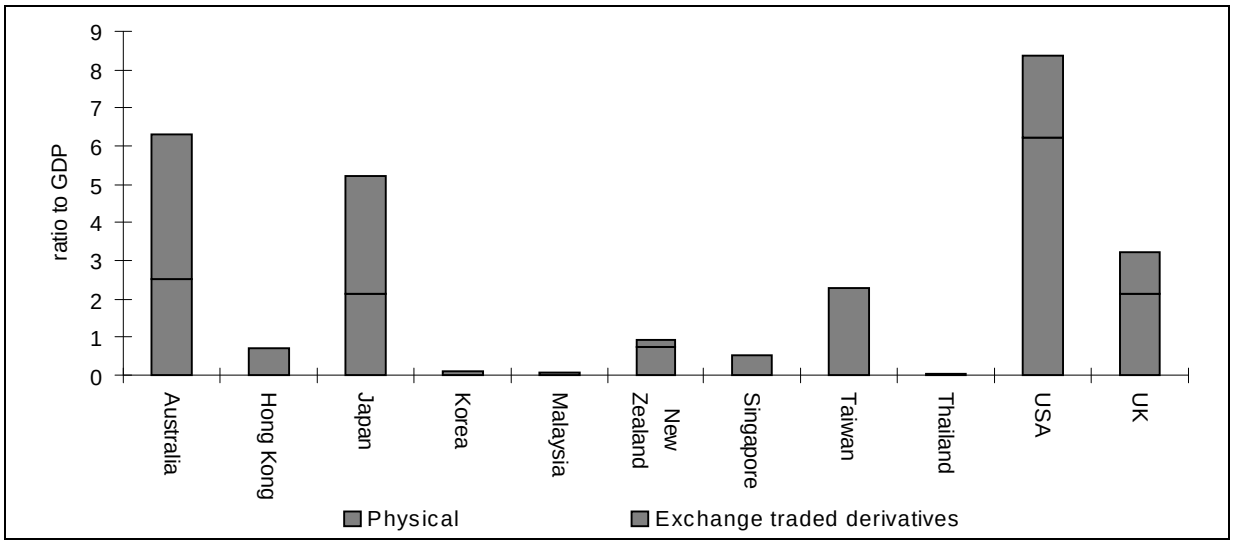
Both Australia and Japan have large futures exchanges that actively trade interest rate and equity futures based on local securities, as shown on table 5. Hong Kong's futures exchange is more modest and trades only equity derivatives. SIMEX in Singapore does not trade any local products but has a large market in Eurodollar, Euroyen and Nikkei 225 futures contracts.

Australian interest rate markets (both money market and fixed interest) are better developed than those elsewhere in the region. A range of money market instruments, including bank bills, Treasury notes, commercial paper and repos, are actively traded and provide the foundation for the derivatives markets. Figure 1 illustrates the level of turnover on government bond markets, in terms of GDP. The Australian market is relatively well developed compared to most markets, including the extremely liquid US T-Bond market. With the exception of Japan, pure corporate bond markets in the region (including Australia) are not well developed. Most countries in the regions have sizeable equity markets and there is growing competition between them for international company listings.

Figure 1. Turnover on Government Bond Markets



Note: Data sourced from central banks and industry organisations.

In summary, Australia has a number of significant strategic advantages as a location for basing regional financial operations. These include domestic wholesale financial markets that are superior to those elsewhere in the region. Together with domestic retail markets that are sophisticated in regional terms, this provides a useful base from which to build and market international financial services, including trading, funds management, back office functions, advisory services and banking.

3.3 Action Required

There are a number of obstacles that must be tackled for Australia to reach it full potential in international financial services. These are worth addressing because the potential returns are large and the potential losses from doing nothing are significant. Listed below is a range of measure that should be undertaken in the immediate future.[18]

[18] IBSA's submission to the Standing Committee on State Development of the NSW Parliament (1995) provides additional information on these issues.

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First, and foremost, there is a need for a strong political commitment to the concept of Australia as an international financial centre, allied with effective marketing of this. The government must not simply endorse efforts to promote Australia as a financial centre, it must aggressively participate in them. This will guide policy formulation across a range of areas, like taxation, to improve Australia's competitive advantages and not impinge on efforts to develop an international financial centre here. There must be no doubt in the minds of potential entrants as RHQ's, or otherwise, about governments' commitment to the success of the financial sector and that problems, as yet unforeseen, will be competently dealt with. At the moment, Singapore has an advantage over Australia in this respect.

Secondly, all Federal and State government facilitation programmes should be placed in a unified framework. A national co-ordination of marketing could take place through a body similar to the Tourism Task force. Apart from co-ordinated marketing, IBSA strongly advocates a single desk approach to the process of negotiating business to expand or relocate to Australia. The current disorganised and inconsistent manner in which State government agencies approach large organisations is not effective. It is also inefficient and costly. Government marketing should be more tightly targeted at specified large financial institutions and multinational companies.

Thirdly, the definition of RHQ adopted should be as broad as possible, to encompass regional service centres (including centres of excellence), in addition to traditional interposed holding companies.[19] Regional service operations which operate as a specified department within an otherwise domestic business would operate in a similar manner to OBUs.

Fourthly, financial tax issues must be addressed. FID (and the bank debits tax, or BAD) are significant disincentives, as discussed above, and should be removed. They create a significant layer of uncertainty and unfamiliarity between potential entrants and the Australian market place. Further, a resolution to the interest withholding tax problem for foreign bank branches would encourage them to locate regional operations here. It is also desirable to remove stamp duty on share trading in the interests of retaining existing business in Australia and attracting new business.

Fifthly, the thin capitalisation requirements as they apply to off-shore banking units need to be reviewed. As they currently operate, they are an obstacle to the transfer of global proprietary trading books to Australian OBU operations. It would be consistent with the policy intent of establishing an OBU as an offshore operation for a more relaxed approach to be taken in this regard. There are limited revenue implications to this, as business sensitive to this does not take place here at the moment.

Sixthly, the RHQ and OBU regime should be unified for RHQ treasury operations; for example, non-bank RHQ's that carry out regional treasury operations should be exempt from interest withholding tax.

Seventhly, Australia has a comparative advantage in funds management that must be built upon. With this in mind, the OBU concessions that apply to licensed banks and foreign

[19] An RHQ is defined as a company that the Federal Treasurer has determined, under section 82CE of the Income Tax Assessment Act to be an RHQ company. It is an Australian company established to provide support services to its associates located in other countries in the region and acts as intermediary between them and the overseas parent company. Support services include management related services (including finance, treasury and marketing), data services and software services.

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exchange dealers only, should be extended to groups involved in offshore management of funds (that is, the management of funds for non-residents only), amongst other things.

These are not a complete list of measures that should be undertaken, but it does cover the main issues. A wide range of secondary issues must also be dealt with; for example, there is a need to fine tune OBU and RHQ stamp duty and FID exemptions, so that they are uniform across States. However, these can be managed in the normal course of business once the proper framework is put in place to manage the development of the financial sector's international business. IBSA believes that an important outcome from the Inquiry will be precisely this framework.

- **IBSA recommends that the Federal and State Governments significantly upgrade their efforts to establish Australia as an international financial centre and location for RHQs, co-ordinate and concentrate their efforts in this regard and unambiguously state their intention to preserve the international competitiveness of the financial sector in the future.**

The Inquiry represents a unique opportunity to market Australia as an international financial centre. It provides an opportunity for the government to provide a clear, totally unambiguous signal to the world about its commitment to Sydney as a financial centre. Australia has significant competitive advantages, but some of these have a 'use by' date. For example, domestic financial markets in the region are developing and their participants are becoming more sophisticated, and telecommunications facilities are being upgraded throughout the region. It is important that the Government act now. The Inquiry should recommend that to the Government that it should provide a down-payment on its commitment, for example, by making the necessary changes to attract offshore funds management and RHQ treasury operations business.

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4. Other Issues

4.1 Dialogue between Government and Industry

IBSA supports the concept of a Financial Markets Council recommended in the Allen Consulting Group's report *Australia's Capital Markets*, sponsored by the Australian Stock Exchange, the Sydney Futures Exchange and the Australian Investment Managers Association. The dialogue between industry and government must be improved, so that policy is more responsive and industry properly understands the Government's concerns. The correct policy decisions must not simply be made, it must be made quickly and in the appropriate manner. The Council would play a useful role in achieving this.

It is important that the economic contribution of the financial sector is appreciated by policy makers, so that its competitiveness can be preserved into the future. A high level channel of communication would facilitate a deepening of this understanding, as well as the sharing of information on emerging trends, the setting of broad priorities for the industry's development and serve as a means to quickly resolve misunderstandings. The Financial Markets Council would complement the Council of Financial Supervisors, in its role as suggested above.

- *IBSA supports the concept of a Financial Markets Council to improve the dialogue between industry and government, so that policy is more responsive and industry properly understands the Government's concerns.*

Establishment of a Financial Markets Council would create a valuable framework to promote development of the financial sector and Australia as an international financial centre. It is especially important in view of the uncertainty that faces the industry over the coming years. It is not possible to plan for all eventualities now, but the Council would help ensure that the authorities respond appropriately to problems and opportunities as they emerge.

4.2 APEC - Opportunities to be Taken

An aspect of international trade not discussed so far is the production and sale by Australian financial institutions of their services in foreign countries. Domestic financial institutions face a diverse range of opportunities for business expansion in the region. Australian banks have recently increased their presence in Asia Pacific Economic Co-Operation (APEC) countries, by opening new branches and subsidiaries and through joint ventures, that handle both retail and wholesale business.[20] For instance, this year the Commonwealth Bank of Australia set up a joint venture bank in Indonesia to service both retail and corporate clients and Macquarie Bank established a funds management joint venture in Malaysia. Non-bank entities are also exploiting opportunities in the region; for example, Lend Lease's business includes a life insurance joint venture in Indonesia.

Government policy and national regulations in the APEC countries impact on each of these activities to varying degrees. Many of the region's markets are difficult for foreign banks to enter. Obstacles take many forms from an outright bar on entry and operating restrictions to less direct impediments, like a lack of regulatory transparency, unfavourable 'administrative guidance from government and an inability to properly hedge foreign currency exposures.

[20] Australian banks are best represented in Japan, Singapore and Hong Kong, reflecting their status as international financial centres, and New Zealand, reflecting the traditional, close economic relationship.

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Technological developments will push the issue of foreign bank entry to the fore over coming years.

APEC has yet to directly address the role of foreign banks in financial sector development, or in more specific areas, like private infrastructure financing. This is likely to form part of the country action plans to be placed on the table in the current round of trade negotiations. The thrust of Australian government policy is to minimise their impediment to financial services trade in the region and improve the business climate for Australian financial institutions.[21] This is the correct approach. The Asia Pacific Economic Co-Operation (APEC) trade liberalisation process has the potential to open new opportunities in this regard but has yet to deliver. Therefore, appropriate pressure should be maintained.

- *IBSA supports government efforts to liberalise trade through APEC and recommends that pressure be maintained to achieve more open financial markets in the region.*

The evolving international integration of the region's financial markets provides a strong rationale for co-ordination between the region's central banks in their financial market and regulatory activities. APEC provides a useful framework to widen the extent of co-operation between the monetary authorities. There is support for this concept at a variety of levels within the region and the Finance Ministers have recognised the value of sharing country experiences and of the need for conformity of prudential supervision and regulation, in accordance with international standards. A regional institution would provide a forum for the exchange of information (for example, on market intelligence and regulatory developments) and provide a more influential voice in world financial affairs for Asian countries. In addition, stable financial markets and a consistent approach to regulation across countries have commercial benefits, especially for banks with significant cross-border operations.

- *IBSA recommends that the Government should promote the concept of a regional bank, similar in function to the Bank for International Settlements, to better co-ordinate activities by the Asia-Pacific central banks and promote Sydney as a location to base its secretariat.*

It now remains for a firm initiative to be undertaken to establish an institution to co-ordinate the activities of central banks in the region. The Government should press for the establishment an institution to facilitate regional central bank co-operation (similar in form to the Bank for International Settlements). Further, it should canvass for Australia to be the location for the new institutions secretariat. The Reserve Bank is a leader within the Asia-Pacific group of central banks and Australia meets the key locational criteria better than other centres, like Singapore, Hong Kong, Kuala Lumpur and Tokyo. The location of a regional institution of this type would have appreciable direct and indirect economic benefits for Australia.

[21] This approach has also been taken in the Government's submissions in the General Agreement on Trade in Services (GATS) negotiations.

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4.3 Review of Bills of Exchange Act

An immediate review of the Bills of Exchange Act should be undertaken, with a view to enabling security issuers to take full advantage of modern technology. At present, the legal rights attached to a bill centre on the issue of a physical paper security. To enhance the efficient operation of the securities market, similar legal status should be accorded to properly established rights recorded through electronic means. The commercial need for physical bills to be issued has become increasingly rare. In practical terms, appropriate amendment to the Act would eliminate the need to issue a physical bill, without affecting investor rights or otherwise impinging on the operation of the market.

4.4 International Accounting Standards

A key function of financial markets is the transfer of information between financial market participants. The public release of company accounts prepared on a standardised basis is an important conduit for the transfer of such information. A recurrent theme throughout this submission is the increasingly global nature of financial markets. This will increase pressure for greater adherence to international accounting standards.

Against this background IBSA endorses efforts to achieve greater harmonisation of international accounting standards. It is a means to lower compliance costs for banks and companies that operate in a range of countries and trade across borders. It is also a means to enhance the international competitiveness of the domestic security markets, and the financial sector more generally, by lowering the implicit costs of using the markets for both borrowers or investors.