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Financial Reform in Australia*

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Abstract

This paper reviews the development of financial reform in Australia, focusing primarily on the past twenty years. In this period the regulatory approach, regulatory institutions, and the financial system itself have undergone massive change. It is argued that the financial deregulation of the 1970s and 1980s, was founded on an inadequate vision of the workings of the financial system and financial institutions - one which paid inadequate attention to sources of market failure and agency problems involving financial institutions. Subsequent reform has focused on the need to ensure that there are appropriate incentives and accountability for market participants, together with adequate disclosure and transparency, and on the search for a suitable design for the regulatory infrastructure. While the practice of financial regulation in Australia generally correlates quite closely with "best practice / core principles" articulated by international bodies, there remain some key areas of difference and some characteristics of the Australian regulatory approach make it significantly different from other national approaches.

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1. Introduction

The process of reform of financial regulation in Australia provides a valuable case study of the interaction between the development of economic ideas, political constraints, and commercial realities. Australia was one of the first countries to embrace financial deregulation in the late 1970s and by the mid 1980s had largely liberalised its financial markets. However, that approach was premised on a belief that capital and product market forces would generate an efficient and stable financial system, without examining whether the necessary preconditions for such an outcome were in existence. Official regulation was not replaced by adequate market monitoring and capital market discipline, and management systems and governance practices within financial institutions were not adequate for the new competitive environment. Excessive credit expansion led to an asset price bubble, excessive corporate borrowing, and a minor financial crisis in the late 1980s. Subsequent developments have focused upon strengthening the regulatory infrastructure and ensuring that information, incentives, and accountability are adequate to ensure that market mechanisms operate effectively.

This chapter reviews the financial reform process in Australia, focusing primarily on the past twenty years. In section 2, a brief historical overview of financial reform is presented, and this is followed in section 3 by an outline of the current regulatory structure. Section 4 addresses the types of reform which have occurred and compares the current state of financial regulation in Australia with international practice. Section 5 considers some of the effects which financial reform has had on the Australian financial sector, and section 6 provides a brief assessment of the current regulatory approach and concluding comments.

2. Financial Reform: A Brief Historical Overview[1]

For some thirty years following the Second World War, the Australian financial system, and regulation thereof, changed relatively little – certainly when judged by the experiences of the subsequent thirty years. Until the latter part of the 1970s, the regulatory structure was one reliant on direct controls (of interest rates, allowable activities, portfolio structure, entry, etc.) imposed by the Central Bank upon the (small number of) banks, which dominated the financial sector. That approach, which evolved out of the war-time experience and ad hoc responses to subsequent market developments, had a strong institutional focus. It was oriented primarily towards monetary control considerations rather than prudential objectives – the latter being handled indirectly through restrictions on entry into banking and controls limiting the risk-taking activities of banks. Information flowing to the public, from both the authorities and the banks, was relatively scarce, with (for example) accounting and reporting requirements enabling banks to maintain substantial secret reserves. Outside of the banking sector, the 1901 Constitution had created a division of responsibilities between the Federal and State governments which led to a fragmented approach by individual states to regulation (or lack thereof – as in the case of general insurance) of non-bank financial intermediaries and securities markets.

The 1970s

By the 1970s, the inherent weaknesses in the regulatory structure were becoming clearly apparent. Non-bank financial institutions, operating outside the Reserve Bank's sphere of control, had grown rapidly since the 1950s. While some of those institutions (money market corporations, building societies etc) were

[1] Detailed analyses of the development of the Australian financial system and its regulation can be found in Lewis and Wallace (1995) and previous books in that series. See also, Grenville, (1991), the Wallis Inquiry (1997), Edey and Gray (1996), Battellino (2000), Gizycki and Lowe (2000).

competitors with the banks, others, such as bank owned finance company subsidiaries, provided a means for the banking groups to evade controls. Financial innovation, such as the development of the bank accepted commercial bill market, provided another way for banks to evade lending controls and the implicit taxes which direct controls imposed on deposit based financing. The Reserve Bank's stated preference for reliance on "market oriented" monetary policy measures rather than direct controls was thwarted by the absence of an active bond market, and monetary policy was further stressed by the development of large government fiscal deficits. The emergence of high inflation highlighted the distortions and costs of direct controls, and the breakdown of the Bretton Woods system of fixed exchange rates saw the emergence of a managed exchange rate system and associated problems of such a system for macroeconomic management[2].

For a time, and reflecting the ideological position of the Whitlam Labor government of 1972 – 1975, the possibility of an extension of controls to non-bank financial institutions looked possible[3]. The Financial Corporations Act, passed in 1974, provided for such a possibility, but the relevant section was never put into effect. Instead, the Fraser Liberal government (elected in late 1975) took small *ad hoc* steps along the deregulatory path for several years until the announcement in 1979 of the first full scale review of the Australian financial system (the Campbell Inquiry) since the Royal Commission of some 40 years earlier[4].

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[2] Davis and Lewis (1990) provide an overview of monetary policy and developments in the financial system over this period.
[3] Regulation of the previously unregulated general insurance company sector, in which 16 institutions collapsed between 1970 and 1973, occurred with the passage of the Insurance Act in 1973.
[4] Lewis (1997) provides a useful historical overview of inquiries into the Australian financial system.

The 1980s

The Campbell Committee did not report until November, l98l, but the government did not wait for its Committee's report to begin deregulating the financial system. A capital shortage of one smaller bank (due to losses incurred by its finance company subsidiary, highlighting weaknesses in extant prudential arrangements) saw a takeover by a larger bank arranged. Subsequently, other bank mergers were permitted and approval of a new entrant signalled a relaxation of the previous official entry barrier. Initial steps towards reform of the bond market were taken with new primary market issue techniques introduced and “captive market” asset holding requirements on banks, which limited secondary market activity, watered down.

The removal of most interest rate ceilings on bank deposits in December l980 marked the start of a massive process of deregulation, subsequently endorsed by the Campbell Report. Surprisingly (since the party platform had, until a few years earlier, contained a call for bank nationalisation) the process was accelerated by the Hawke Labour government which was elected in March l983. Over the first half of the 1980s, direct controls over banks were largely abolished (except for some asset portfolio restrictions retained for prudential reasons), foreign bank entry permitted, and the exchange rate floated. The stockbroking industry was reformed in 1984 and fixed brokerage rates abolished, stockbrokers being allowed to advertise and permitted to operate as incorporated companies rather than as partnerships. Banks were permitted to take an equity interest in stockbrokers.

Although the possibility of increased competition from new banks was created, the existing banks were largely freed of the shackles which had encumbered them, and permitted to engage, via subsidiaries, in securities market and wholesale money market activities as well as more traditional deposit markets. But banks

remained different to other institutions through their control of the domestic payments mechanism and through public perceptions of an implicit government guarantee of deposits.

The outcome of this process was a rapid increase in credit creation by banks and other financial intermediaries, contributing to significant asset price inflation. While reintermediation (particularly towards banks) and thus rapid, but largely benign, growth in credit aggregates had been expected to occur as a result of deregulation, the reality was somewhat different. Increased competition, coupled with inadequate internal control mechanisms and a lack of stockmarket (and regulatory) discipline, saw a relaxation of credit standards by banks and other financial institutions, which (assisted by the stock market crash of October 1987) culminated in a minor financial crisis at the end of the 1980s. Several state-government owned banks experienced horrendous losses (and were, ultimately, taken over by other banks), several non-bank financial institutions collapsed, and several of the major banks posted losses which made them, for a time, vulnerable to takeover.

During the second half of the 1980s, other financial and economic reform measures, which were to have major effects on the financial system – in particular, facilitating the subsequent growth of securities markets relative to intermediation - proceeded apace. Tax reform, particularly the introduction of a dividend imputation tax system, increased the attractiveness of equity finance relative to debt finance for Australian companies. Government policy promoting the growth of superannuation (pension) schemes contributed to the expansion of the managed funds industry and demand for marketable securities. Reform of Federal-State government fiscal relationships and state government borrowing techniques saw the emergence of an active "semi-government" (state government) bond market alongside the market for

Federal debt. The earlier deregulation of the stockmarket (1984) and creation of a unified national stock exchange (1987) facilitated growth of the securities markets, although the domestic corporate bond market remained in its infancy, with corporate borrowers reliant on bank lending or, for major companies, international bond markets.

The 1990s and the new millenium

The 1990s financial reform experience can be viewed as having three overlapping phases. First, there was a "mopping up" exercise following the problems which had emerged in the latter part of the 1980s, leading to an increased emphasis on prudential regulation and regulatory arrangements. The Reserve Bank had introduced risk weighted capital requirements for banks in 1988 (too late to constrain the excesses permitted by deregulation), and this was followed by the introduction of on-site inspections in the early 1990s. The Insurance and Superannuation Commission (ISC) had been established in 1987, and its supervisory powers (over life and general insurance and superannuation funds) were enhanced in legislation of 1993 and 1995. The Australian Financial Institutions Commission (AFIC) was created as a national coordinator of state supervisors of building societies and credit unions in 1992, following agreement amongst the state governments to adopt common regulation[5]. The Australian Securities Commission (ASC) was created in 1991 as a national regulator of companies and securities markets, succeeding the National Companies and Securities Commission which had attempted to coordinate state government based regulation and enforcement. The Council of Financial Supervisors was formed in 1992 to facilitate coordination amongst these regulators. A new accounting standard (AAS32) was introduced in 1996 setting out required standards for

disclosure by financial institutions of information relating to liquidity, solvency, and degrees of risk associated with various activities.

The second phase of the 1990s experience involved general economic reform[6] aimed at facilitating competition, marked by the adoption in 1996 of the National Competition Policy. The reforms included: strengthening trade practice laws; a requirement for competitive neutrality between government and private sector competitors; a review of laws which restrict competition; introduction of a national access regime to ensure fair terms for access to important national infrastructure; and specific reform (leading to privatisation) of industries such as gas, electricity, water and transport. The Australian Competition and Consumer Commission (ACCC), responsible for consumer protection and oversight of mergers and anti-competitive practices, was created by merging the previously separate Prices Justification Tribunal and the Trade Practices Commission. More emphasis was given by regulators to ensuring increased information flows and more attention given to consumer protection. Industry codes of practice were developed and the Uniform Consumer Credit Code introduced.

Major institutional restructuring of the financial sector occurred over this period, with governments generally exiting from the provision of financial services (as part of a wider privatisation agenda), numerous cases of demutualisation, and mergers and takeovers aplenty. Bancassurance emerged and universal banking, through the integration of commercial banking and securities market activities, became the norm. Securitisation, mortgage originators, managed investments and corporate bond issues all increased in significance as the role of securities markets

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[5] Its responsibilities were extended to include friendly societies in 1997.
[6] Tax reform was also a major issue, culminating in the introduction of a 10% Goods and Services Tax in July 2000.

relative to intermediation expanded. Notably however, other than through equity holdings via trustee (nominee company) arrrangements, funds management arms, or work-outs of distressed borrowers, a degree of separation of banking and commerce still existed – as much due to habits of banking practice as to regulation.

The final phase of the 1990s experience, merging into the new millenium, is the completion of a government agenda of putting in place a regulatory infrastructure consistent with efficient financial and capital markets, in which regulation hinges not upon enforcement of rigid rules, but upon disclosure, supervision and private sector monitoring. Beginning in the mid 1990s, attention was given to a reform of Corporate Law, initially focussing on simplification, but later broadened to the Corporate Law Economic Reform Program (CLERP). Improvements in accounting and disclosure, clearer articulation of directors' duties and expected standards of corporate governance, and improvements in regulation of fundraising, takeovers, and financial advisers form the basis of this program. In 1996, the Wallis Inquiry into the financial system was announced and its report in 1997 led to the restructuring of regulatory agencies as they exist today.

3. Australian Regulatory Institutions and Responsibilities

The current structure of financial regulation in Australia was introduced in 1998, following the recommendations of the Wallis Inquiry, through a restructuring and reallocation of regulatory responsibilities. The Wallis Inquiry placed great emphasis on the need for a functional approach to regulation. The restructuring (based upon the Wallis recommendations) can be interpreted as an attempt to divide

regulatory responsibilities along functional lines[7], although it retains significant features of an institutional approach. Table 1 summarises the current regulatory structure and responsibilities.

The Reserve Bank of Australia no longer has responsibility for prudential regulation, but a specific responsibility for systemic stability (reflecting the possibility of market failure arising from spillovers and externalities), monetary policy and efficiency and stability of the payments system. (A separate Payments System Board has been established within the Reserve Bank). The Australian Prudential Regulation Authority (APRA) was formed by combining the prudential regulation activities previously undertaken by the Reserve Bank, AFIC, and the ISC. It has responsibility for supervision of financial institutions which issue liabilities with a high "intensity of promise" (a concept underpinning the Wallis approach) and for which market failure arising from imperfect information might be significant. The Australian Securities and Investment Commission (ASIC) took over consumer protection responsibilities for insurance and superannuation from the ISC and for the financial sector generally from the ACCC. Allied with its responsibilities for ensuring market integrity and the operation of company law, inherited from its predecessor (ASC), its responsibilities can be viewed as reflecting the possibility of market failure from misconduct by market participants. The ACCC's involvement with the financial sector arises from its role in preventing market failure through anti-competitive behaviour, reflected in its responsibilities for oversight of mergers and pricing behaviour.

This institutional structure of the regulatory sector attempts to provide a clear delineation of each regulator's responsibilities and achieve minimal overlap or

[7] Goldsworthy, Lewis and Sheutrim (2000) interpret the new regulatory structure in this way, although their definition of "functional", which relates to causes of market failure (as used in the paragraph below), differs from the more common usage of that term as popularised by Merton (1995)

duplication and comprehensive coverage of areas requiring regulation. Where there are areas of common interest, such as between the Reserve Bank and the ACCC regarding the payments system, memoranda of understanding have been signed. The RBA, APRA and ASIC comprise the Council of Financial Regulators (which supplanted the Council of Financial Supervisors) and there is some cross representation on governing boards.

This Australian approach to the structure of regulatory arrangements has been asserted by Australian government ministers as being “a benchmark for countries around the world” (Hockey, 2001). While the structure appears to be working well, there are several features of it which warrant note. First, it does not achieve a clear functional division of responsibilities. An institutional distinction is used to determine which institutions are supervised by APRA and those supervised by ASIC. Second, by removing prudential regulation from the Central Bank, it is hoped that public expectations of automatic government support for failing institutions will be prevented, and private sector monitoring enhanced. The explicit eschewing of any deposit insurance or government guarantee scheme (or similar scheme for claimants on other regulated institutions), means that Australian financial regulators face a difficult task in managing public expectations when financial institutions face difficulties and in facilitating orderly exit of such institutions[8].

The Reserve Bank of Australia (RBA)

The Reserve Bank in 2001 is a much different institution from that of 20 (or more) years ago. One difference is that its direct involvement with the banking sector

[8] This difficulty is apparent in public reaction to the failure of a general insurance company (HIH) and expectations of the regulator’s responsibilities. See APRA (2001).

has declined markedly. Historically, the use of direct controls over the banking sector (until the mid 1980s) and development of techniques of prudential regulation since the 1980s, together with the provision of clearing and settlement services, meant that the Central Bank and commercial banks had a close, if not always, comfortable relationship. Now, that involvement is largely limited to the payments clearing and settlements systems.

A second relationship which has changed is that with the government. While the Bank was established in 1959[9] with its own Board, its degree of independence was questionable. Policy was nominally determined by the Board, and any decision by the Treasurer to overrule the Board had to be reported to Parliament. None ever were, and to outsiders the fact that the Secretary of the Treasury sat on the Board suggested that independence was in name only. That changed in August 1996 when the appointment of the current Governor was marked by release of a statement from the government giving explicit recognition of the "independence" of the Bank, and an explicit statement of the responsibility and procedures for policy formulation and resolution of disagreement.

The Bank has also changed markedly in terms of its degree of transparency and accountability. Information flows to the public have improved markedly.

This change in transparency is also reflected in the conduct of monetary policy. After a period of experimentation with monetary targets from 1976 to 1985, followed by a "checklist" approach, the Bank in 1990 commenced its current practice of making explicit announcements of a short term (cash) interest rate target as the basis for the operation of monetary policy. Subsequently, in the August 1996

[9] Prior to that time, Central Banking functions had been undertaken by the government owned Commonwealth Bank of Australia which also conducted trading and savings banking activities in competition with the rest of the banking sector.

"Statement on the Conduct of Monetary Policy", an inflation target for monetary policy of 2-3 per cent on average over the business cycle was agreed by the government and Bank, although an implicit inflation target had been in operation since 1993. Concurrent with that, regular six monthly presentations by the Reserve Bank Governor to a Parliamentary committee on the conduct of monetary policy began. Reflecting the continuing decline in Commonwealth Government securities outstanding (due to fiscal surpluses), the Bank commenced using repurchase agreements involving semi-government debt in 1997 and more recently has increased its use of foreign exchange swaps for monetary management purposes.

The change in the Bank's functions has also affected its structure and size. With the passing of direct control techniques, loss of the prudential regulation function, loss of banking business previously conducted for State governments, and labour saving technological change impacting on both account keeping/ clearing / settlement and note issue functions, the size of the bank's workforce has shrunk considerably.

The objectives for the Bank have also been updated. While the statutory objectives of the Bank, as given in the 1959 Reserve Bank Act, remain (a) the stability of the currency of Australia; (b) the maintenance of full employment in Australia; and (c) the economic prosperity and welfare of the people of Australia, the Bank's mandate is now focused explicitly upon monetary policy, overall financial system stability, and regulation of the payments system.

Australian Prudential Regulation Authority (APRA)

Australia's new regulatory structure specifically locates responsibility for prudential regulation of a specific set of financial institutions with a government

statutory authority (APRA), governed by a board appointed by the government for fixed terms (and with provision for a majority of private sector members). APRA is accountable to parliament and funded by levies on the financial institutions supervised. Its mission statement is "… to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions we supervise are met within a stable, efficient and competitive system."[10]

Several features of this mission and role are worthy of note. First, institutions supervised are banks, other approved deposit institutions (ADIs) such as building societies and credit unions, friendly societies, life and general insurers, and large superannuation funds[11] – ie those judged, on some basis, to be institutions for which the "intensity of promise" is high. The approach adopted in Australia of an "integrated" prudential supervisor (rather than a number of prudential supervisors for different types of institutions) is one which has increased in popularity internationally in recent years. Notably, however, finance companies which raise money by debenture, money market corporations (investment banks), and fund managers are outside this net. When such institutions are owned by a bank or an insurance company, their activities are included in APRA's consolidated supervision of the group, but they are not supervised as such. APRA supervisory responsibilities thus range from large diversified conglomerates to small specialised institutions and across both banking and insurance. Second, APRA has quite strong powers enabling it to intervene in the case of troubled institutions, and a good deal of regulatory discretion about when and how to do so. Third, APRA has no resources of its own available, nor

[10] APRA's Objectives and Funding http://www.apra.gov.au/CorporateInfo/APRAobjectivesfunding.pdf

[11] The Australian Tax Office is responsible for regulating small, self managed, superannuation funds.

is there a deposit insurance scheme in existence to ensure that claimants at failed financial institutions do not suffer loss. Fourth, supervision of “consumer issues”, such as information provision, advice, and quality of service of APRA supervised institutions, is not a responsibility of APRA, but of ASIC.

Australian Securities and Investment Commission

ASIC is an independent government body headed by government-appointed commissioners and reporting to Parliament through the Treasurer. Its responsibilities can be summarised as involving first, the protection of investors and financial claimants (such as superannuants, depositors and insurance policy holders), and second, the regulation and enforcement of laws that promote honesty and fairness in financial markets, products and services and in Australian companies. In sum, these responsibilities with regard to the financial sector can be referred to as investor protection and market integrity. In pursuing these objectives, the approach followed is based upon ensuring that adequate information is available for consumers and investors to make informed decisions rather than a rule-based approach of setting standard for products and services.

ASIC has explicit responsibility for the regulation of a group of financial institutions – money market corporations, finance companies, public unit trusts – which are excluded from APRA’s ambit on the grounds that investors in securities issued by such institutions are expected to be aware of the market and credit risks involved. ASIC does not undertake prudential regulation of such institutions, but ensures that they comply with legal requirements regarding fund raising and securities licensing requirements.

Organised securities exchanges in Australia, most notably the Australian Stock

Exchange (ASX) and the Sydney Futures Exchange (SFE), are also subject to oversight by ASIC and in turn play a role in self regulation of financial markets through their listing requirements and rules for member organisations. For example, in 1994, the ASX introduced its continuous disclosure regime for listed companies.

Australian Competition and Consumer Commission

The ACCC is not generally regarded as a financial regulator, although its activities impinge on financial institutions and markets in (at least) two ways. First, given its role as a regulator of mergers and takeovers under competition objectives, it can have a significant influence on the structure of the financial system. Second, its role in determining the justifiability of prices in markets where there are concerns about the degree of competition, means that it has had important influence on the pricing of payments services and on other fees and charges of financial institutions.

4. Changes in Australian Regulatory Practice

This section examines in more detail the changes which have occurred in the conduct of financial regulation in Australia, and relates them to best practice as advocated by international bodies such as the Basle Committee. In doing so, a classification of reform areas into (a) financial price and quantity distortions (b) impediments to competition (c) financial infrastructure, and (d) strengthening of financial institutions as presented in Cull (2001) is adopted. Table 2 provides an overview of key dates.

Financial Price and Quantity Distortions

As the brief historical overview in section 2 indicates, most regulatory impediments to market-determined prices and quantities in Australian financial markets were removed by the mid 1980s. Foreign exchange market liberalisation

occurred in December 1983, with the floating of the exchange rate and removal of foreign exchange control regulations. Interest rate controls on banks were progressively abolished, with the interest rate on housing loans being the last rate deregulated in 1986. Restrictions on the composition of asset portfolios of financial intermediaries have also been largely abolished. "Captive market" restrictions on banks and life offices which required minimum holdings of government debt were removed in the 1980s, and quantitative lending directives issued to the banking sector by the Reserve Bank were discontinued in the early 1980s. The practice of paying below-market interest rates on required bank reserves persisted[12] (except for a short period) until minimum reserve ratios were replaced in 1998 by the requirement that an agreed, satisfactory, liquidity management policy be in place. Restrictions on bank involvement in property development and ownership have been replaced by prudential standards for the treatment of equity associations (which link such investments to capital requirements). "Blanket" portfolio restrictions on "specialist" institutions such as credit unions have been replaced by requirements that institutions have appropriate risk management policies and practices in place for the types of activities undertaken. Risk-weighted capital adequacy requirements, introduced for banks in 1988, have been argued by some to lead to distortions in pricing and credit allocation with a significant expansion in home mortgage lending by banks in the 1990s sometimes being attributed to the lower risk weight accorded to these assets.

In the tax arena, the introduction of the dividend imputation tax system in 1987 has largely removed the tax distortion favouring debt over equity finance – although complicating the tax analysis of international financing choices (and

[12] This practice was sometimes justified on the grounds that it was a substitute for bank licence fees and/or compensation for the cost of prudential supervision and resultant benefits to the banking sector.

business activities). Likewise, the introduction of explicit capital gains tax in 1996 (as a tax on inflation-adjusted gains, later changed in 1999 to a tax on 50 percent of nominal capital gains) has gone someway to removing tax distortions on both real and financial investment decisions. Some transactions taxes on financing activities have also been ameliorated, with significant reductions in stamp duty and planned abolition of the Financial Institutions Duty imposed by State Governments on deposit transactions in July 2001 and eventual removal (2005) of the bank accounts debit tax. Tax concessions to sectors believed to be not adequately financed by free markets or adversely affected by usual tax arrangements, such as small venture capital and large infrastructure projects, have also occurred.

Impediments to Competition

Until the start of the 1980s, new entry into banking in Australia was generally thought to be not possible. In 1981, the first new domestic entrant was permitted and a limited number of foreign entrants were permitted to establish local bank subsidiaries in 1985[13]. (Foreign banks could previously only operate as merchant banks). That quantitative limit has since been removed. Foreign banks wanting involvement in retail deposit markets must do so by establishment of a subsidiary, while those that limit activities to wholesale markets can operate as branches of the foreign parent.

Those changes have altered the face of the Australian banking sector which at the start of 1980s comprised four major banks, several smaller private banks, three long-standing foreign banks (with very small operations) and a number of government-owned banks. During the 1980s and 1990s, significant numbers of building societies demutualised and became banks – reflecting the fact that the

[13] Sixteen applicants were given approval (although only four or five licences had been expected to be granted) and fifteen of the successful applicants took up the licences.

deregulation of the early 1980s had, if anything, reversed the tilt in the playing field to now favouring banks. Significant numbers of foreign banks have established a presence. Now, entry is possible for any organisation which meets fairly standard criteria of minimum capital, expertise etc., although policy guidelines limit allowable structures for financial conglomerates[14].

The extent to which product market competition and efficiency are enhanced by pressures from the market for corporate control is somewhat less obvious. Privatisation of government banks (or their sale to private competitors) has meant that all banks operating in Australia are either listed on the local stock exchange or foreign-owned[15]. There are, however, restrictions on ownership shares and take-overs. First, there is a maximum limit (which can only be exceeded with permission of the Treasurer) of 15 per cent on the ownership stake which any one party can have in an Australian bank, except in the case of subsidiaries of foreign-owned banks. Second, the Australian government has in place a “four pillars” policy towards the market structure of the banking system which precludes mergers between the big four local banks, and creates uncertainties about their susceptibility to foreign take-over. While this can be seen as an attempt to ensure that an adequate number of competitors exist, it can also be interpreted as a measure which inhibits cost saving rationalisations in the banking industry.

Despite a significant number of new entrants, there has also been a degree of consolidation in the financial sector. Some of the “regional banks”, which emerged in the 1980s from the demutualisation of building societies (as well as a “bankassurance” group formed through takeover of a state government bank by a

[14] A conglomerate group including an ADI must be either headed by an ADI or a non-operating holding company, or by an approved foreign entity, and can involve non-financial activities.
[15] Government insurance businesses have also been privatised.

demutualised life office), have been taken over by the larger banks. While permitted by the competition watchdog (the ACCC), and justified on the grounds of cost savings and greater efficiency arising from increased scale and scope, these events have certainly decreased the number of competitors operating in retail deposit markets. For while foreign banks have been active participants in the wholesale markets they have largely eschewed the retail market, and a marked reduction in the number of other non-bank ADIs has occurred through mergers. Numerous commentators have suggested, and popular opinion is of like mind – prompted by high bank profits and growth in explicit bank fees and charges – that the degree of competition in retail deposit and transactions services markets has been less than optimal[16]. In contrast, competition in wholesale markets and at the retail level in securities markets (evidenced by unit trust/mutual fund charges and brokerage charges for direct equity investments) appears more intense.

Strengthening of Financial Infrastructure

The restructuring of Australia's regulatory bodies, which has clearly delineated their responsibilities and powers, has been outlined in section 3. Central Bank independence (and that of other regulators) has been accepted, and specific attention paid to the importance and regulation of payments, clearing and settlement schemes. As part of those latter changes, significant changes have been made to arrangements for daily, system wide, liquidity management (including abolition of the "authorised short term money market dealers") – making such activities more transparent and efficient. Also relevant to the goal of assuring systemic stability has been the introduction of a Real Time Gross Settlements System (RTGS) in 1998 for

[16] A joint investigation by the RBA and ACCC into interchange fees and access arrangements for credit and debit cards concluded that competition and pricing practices were less than optimal. (RBA, 2000)

inter-bank settlements.

The reform of prudential regulation arrangements has also been outlined previously. Underpinning those arrangements is the view articulated by the Wallis Inquiry that financial claimants should have confidence that promises made by issuers of certain liabilities will be kept. However, and an important distinguishing feature of the Australian approach, the government has eschewed the introduction of any form of deposit insurance scheme. The argument underlying this approach, recommended by the Wallis Inquiry, is that explicit recognition of depositor priority in the event of liquidation coupled with adequate disclosure, monitoring and supervision, is sufficient to maintain depositor confidence. In this regard, several question marks hang over the Australian approach.

First, depositor preference over other creditors does not overcome the problem of potential for runs by depositors arising from the "first come first served" nature of bank deposits - which makes intra-depositor priority dependent on timing of withdrawal. Second, although the prudential regulator APRA has been explicitly structured to make it clear that it has no resources available to it to compensate claimants on a failed institution, it is far from clear that public expectations reflect the intention that *caveat emptor* applies for customers of regulated institutions. While improved disclosure, accountability and transparency of regulated institutions has occurred, the extent to which private sector monitoring will supplement supervisory activity is open to question. Third, the Australian system retains a distinction between "banks" and other ADIs. The logic of such a distinction, which suggests something special about one sub-group of institutions (when all are subject to similar regulation), can be questioned – although restrictions on use of the label of "bank" are consistent with the Basle core principles. Fourth, one of the potential merits of an explicit

deposit insurance scheme is that it can have benefits for competition, by offsetting possible advantages of perceived safety of large institutions arising from perceptions of "too big to fail". Fifth, prudential regulation reflects both the desire to control the risk characteristics of certain products or services such as deposits, long term savings schemes, insurance products, and payments services, as well as to ensure orderly exit of insolvent institutions from the market place. The dilemma is that the relevant products and functions are provided by institutions and, in practice, it is difficult to prevent the image of protection of products and services (justifiable only for a subset of activities) from also being attached to the institution involved and extending across its entire range of activities. The institutional approach to prudential regulation adopted in Australia has this weakness.

A further important component of financial infrastructure strengthening has been the government's commitment to reform of corporate law, which has found expression in the Corporate Law Economic Reform Program (CLERP) announced in 1997. Prior developments in the 1990s had focused upon simplification of company law, which had become unwieldy and complicated. CLERP was premised on the view that efficient financial markets require: market freedom (subject to appropriate regulation); access to appropriate information to ensure investor protection; a need for transparency through adequate disclosure; cost effective regulation; regulatory neutrality and flexibility; and a fostering of high standards of business practices and ethics[17]. Subsequent changes, including the CLERP Act (1999), have focused upon: corporate accounting and reporting standards; articulation of directors' duties and improvements in standards of corporate governance; improving efficiency of the regulatory approval process for fund raising documents while ensuring adequate

provision of information; and improvements in takeover mechanisms. (See Table 3 for a summary). The latest stage of the process involves the Financial Services Reform Bill, due to be passed in 2001, which seeks to implement a uniform regime across the whole financial sector for licensing arrangements for the sale of financial products and provision of financial advice.

The ACCC and other regulators have paid particular attention to the role of information provision in financial markets and this has led to the development of codes of banking practice, the consumer credit code, greater disclosure requirements etc. There is little doubt that a major change in recent decades has been in the extent of information provision to users of financial services and customers of financial institutions. In the case of banks, that can be seen from the growth of information contained in annual reports. Between 1987 and 1998, the average number of pages given to providing risk-related information in the Annual Reports of the four major banking groups increased from 5 to 110. (Thompson and Gray, 2000).

Strengthening Institutions

At the start of the 1990s, the Australian financial sector was characterised by a significant number of institutions in weak financial positions. Following the deregulation of the 1980s, the expansion of credit and asset price inflation, and subsequent collapse of asset prices and some large corporate borrowers, a significant portion of the banking sector needed recapitalisation. Several building societies collapsed, as did some merchant banks and life offices, while inadequacies in the structure of several unit trusts were shown up – leading to an imposed freezing of funds in unlisted (open ended) property trusts pending their eventual conversion to listed (closed end) form.

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[17] See Treasury (2001)

Gizycki and Lowe (2000, p 181) comment that Australia was "probably fortunate that it did not experience a more profound episode of financial instability" and resolution of banking sector problems proceeded relatively smoothly, with sell-offs of state government banks, and equity raisings by major banks which had posted large losses[18]. The Reserve Bank commenced on-site inspections of bank credit systems in 1992 (and of their market risk systems in 1994), improved reporting of impaired assets was required, and the role of auditors and directors regarding risk management was clarified. Building societies, credit unions and friendly societies were brought under a consistent national regulatory scheme and supervision increased in intensity. Risk-based capital standards were introduced for building societies and credit unions in 1992, official vetting of risk management policies was introduced, and amalgamations involving smaller and/or weaker institutions were encouraged. The ISC introduced risk-based capital requirements for Life Insurance Offices in 1995.

Consequently, there was a major increase in the capitalisation of financial firms in Australia, together with a significant degree of financial innovation in terms of developing alternative financial instruments to straight equity which meet capital adequacy requirements.

The introduction of risk-based capital adequacy requirements has had a major influence upon the activities of financial institutions. In particular, in conjunction with deregulation, it has caused them to focus upon the appropriate pricing of various financial products to ensure an adequate expected return for the risk involved, and encouraged the development of risk-based performance measures and capital

[18] Several smaller banks experienced significant deposit outflows which were stemmed following Reserve Bank pronouncements about the financial strength of those institutions.

management policies.

Greater focus on corporate governance practices also occurred. It has already been noted that the problems following the deregulation of the early 1980s reflected the fact that regulatory constraints were removed from management of financial institutions and not immediately replaced by effective market based monitoring and control mechanisms. Improvements in disclosure and internal management systems, and better articulation of directors' duties and accountability, are among the changes which have occurred to supplement the existing legal framework which protects the rights of shareholders.

Australia and Comparative International, and Best Practice Financial Regulation

International organisations such as the Basel Committee, IOSCO, IAIS, OECD, IMF and the World Bank have been active in recent years in producing check lists and guidelines for good regulatory practice in financial markets. The Basel Committee, for example, has released documents setting out "core principles" (Basel, 1997), and articulated a "three pillars" policy (Basel, 1999) for financial regulation involving minimum capital requirements, the supervisory review process, and an enhanced disclosure framework.

The Basel Committee has set out its view on preconditions for effective regulation which can be summarized as: sound macroeconomic policies; well developed public infrastructure; effective market disciplines; and mechanisms which provide systemic protection. The comparison between Australia at the start of the 21st century and the deregulatory period of the 1980s could not be starker.

In the 1980s, macroeconomic policies were undermined by continued fiscal imbalance and inadequate monetary indicators, although labour market policies had contributed to the containment of inflation. Now, monetary policy has a clear inflation

objective and a *modus operandi* of market operations (including foreign exchange swaps) to achieve an announced target for the short term interest rate, conducted by an independent Reserve Bank. Fiscal stability is in place, with ongoing budgetary surpluses and clearly articulated arrangements for government-financing activities, including a Charter of Budget Honesty and introduction of accrual accounting. In these regards, Australian experience parallels international developments in Central Banking over the past 25 years, noted by the BIS (1997, p143) as involving "a greater emphasis on transparency, market incentives and the credibility of policies", with the last of these factors reflected in greater Central Bank autonomy and accountability, and specification of clearer goals for policy.

In the 1980s, the supervisory structure was inadequate, although accounting standards and the legal infrastructure were adequate (although capable of improvement). Now, the supervisory structure has been reformed, the CLERP reforms are in train (focused upon legal and accounting reform) and disclosure and reporting by financial institutions greatly improved. Market discipline has increased through activities of ratings agencies and because capital market assessment of performance is now applicable to a far greater proportion of the financial sector, due both to changes in organisational forms to listed companies and to greater use of debt market funding.

Kane (2001) provides comparative international information on relevant indicators of financial system integrity. On the "quality of economic information" criteria, based on accounting standards, levels of corruption and press restrictions, Australia scores relatively well amongst high income countries. (These figures relate primarily to the first half of the 1990s). Similarly, on indicators of counterparty protection, Australia again rates well.

Systemic stability responsibility is specifically allocated to the Reserve Bank which has lender of last resort powers and system liquidity management ability, although management of the exit of troubled institutions is the responsibility of APRA. Although these arrangements have not been put to the test, the ability of the Australian financial system to come through the Asian financial crisis of 1997-98 largely unscathed was a positive sign that the reforms of the 1990s had strengthened the financial system. In that respect, Australia was perhaps doubly fortunate, since absence of a deposit insurance scheme would have been viewed negatively by the IMF, which regards explicit deposit insurance as an necessary feature for a well functioning financial system (Garcia, 2000).

APRA has conducted a self-assessment exercise against the core principles for banking supervision articulated by the Basle Committee, and believes that Australia is non-compliant on only two of the twenty five principles. Those areas of non-compliance involve the absence of a "fit and proper" test for bank directors and managers (which is planned for introduction) and lack of supervisory oversight of foreign banks operating as merchant banks (who cannot take retail deposits without a prospectus) in Australia. In terms of regulatory standards and approach, APRA adheres quite closely to the Basle (and IAIS) standards of risk-weighted capital requirements, a two tier approach to risk measurement and management (relying on agreed use of acceptable internal models for risk management and specification of a required method otherwise), and emphasis on disclosure, accountability, and governance.

The Payments System Board (2000) also undertook a stocktake of Australia's high-value payments system against a separate set of "core principles" for systemically important payments systems (CPSS, 2000) and concluded that it scored

highly. Particularly important for meeting those principles was the introduction of the Real Time Gross Settlements System in July 1998 and associated legal changes under the *Payments System and Netting Act (1998)*. In the area of foreign exchange settlement arrangements, Australia is participating in the CIS initiative, which aims to further reduce settlements risk.

Barth, Caprio and Levin (2001) illustrate vividly that regulatory systems differ markedly around the world, and have constructed several indices characterising regulatory systems. It is noticeable that Australia ranks very high on their index of “private monitoring” reflecting partly the absence of a deposit insurance scheme, and the assumption that this provides incentives for such monitoring. Also noticeable are the relatively high rankings on “overall capital stringency” (reflecting the incorporation of some market valuation information into capital requirements), “overall official supervisory power”, and “restructuring power”. In contrast, the ranking is low on the index of “prompt corrective action” (since there is no legally imposed solvency trigger which requires action) and high on an index of “forbearance and discretion”. The overall impression is that, internationally, APRA has a relatively high degree of authority and freedom to exercise discretion in the use of that power.

On Barth, Caprio and Levin’s (2001) index of “overall bank activities and ownership restrictiveness” (based on 1999 data) Australia appears as a moderately restrictive regime by international standards. This reflects a combination of prudentially based restrictions on bank involvement in property development and direct equity interests in non-financial activities, some impediments to takeovers (the four pillars policy), maximum shareholding restrictions, preclusion of foreign banks from retail deposit markets unless a subsidiary is created, and restrictions on financial

conglomerate structures[19] and on conglomerates involving both finance and commerce. Since then, APRA has released guidelines on allowable organisational forms and activities for financial conglomerates and replaced restrictions on property and business activities with prudential standards for equity associations which permit such activities and link them into the risk-weighted capital requirements approach. The ranking on this index has thus probably already changed.

5. Assessing the Effects of Financial Reform in Australia

Financial reform is undertaken (presumably) because it is believed to be in the social interest – although it is hard to ignore the multiplicity of private self-interests which influence the reform process and direction. In that regard, the public examination of past experience and assessment of alternative future directions by major official inquiries (Campbell, Wallis, and several other less comprehensive reviews) is a positive characteristic of the reform process in Australia. However, in reviewing the outcome, costs and benefits of regulatory reform may be hard to identify precisely and harder still to quantify.

The *Financial Supervisory Authority* in the United Kingdom has placed great emphasis on undertaking cost-benefit analysis of regulatory reform. Alfon and Andrews (1999) suggest six main impacts of regulatory change which can generate costs and / or benefits. These are: direct costs; compliance costs; product quantity adjustments; product quality adjustments; product variety changes; changes in the efficiency of competition.

Where wholesale regulatory reform has been undertaken, such as in Australia,

[19] Historically, life insurance companies were allowed by the ISC to engage in other (non financial) activities, whereas the RBA put strict limits on banking groups doing so. The RBA also adopted an

the ability to utilise such techniques is limited. Cost – benefit analysis of a change to one piece of legislation is feasible, but when many regulations are being changed the interrelationships between them make calculations infeasible. Consequently, it is necessary to look to more general indicators of costs and benefits. Among such indicators might be such things as growth of the financial sector, improvements in operating efficiency of the financial sector, evidence of increased competition, evidence of increased innovation, and absence of systemic problems.

Unfortunately, interpretation of movement in such indicators of improved financial sector performance as evidence of the effects of financial reform is confounded by the effects of ongoing technological change, real sector developments etc. Nevertheless, it is worth perusing such indicators for evidence consistent with the hypothesis that financial reform has had beneficial effects.

Battellino (2000) examines four broad areas consistent with those mentioned above in which it would be expected that financial reform would affect the financial sector and bring social benefits[20]. First, growth and increasing financial sophistication of the financial sector could be expected as the repressive effects of regulation were removed and opportunities for profitable innovation (other than that to evade regulations) were increased. There are no simple indicators of "financial sophistication" or "innovativeness" available, but there are numerous examples of a more innovative and sophisticated system. These include an explosion in the range of retail financial products available, introduction of innovative corporate securities, growth of securitisation, funds management and mortgage origination, strong growth in futures and derivatives markets, and development of sophisticated risk management

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"umbrella" approach to bank holding company structure, requiring the bank itself to be the holding company.

[20] Davis (1997) also provides an overview.

techniques within financial institutions.

The second indicator which might be considered relevant is that of an increased size of the financial sector relative to the economy. Figure 1 and Table 4 provide such information. As shown in Figure 1, the total assets of financial institutions have increased relative to GDP quite markedly since the start of the 1980s, with the growth coinciding with the process of financial reform. Table 4 indicates that similar growth in activity has occurred in financial markets, with turnover increasing markedly relative to GDP. Amongst developed nations, Australia's ratio of financial institution assets to GDP is in the mid range, while financial market turnover ratios are consistent with the size of the economy[21]. Other relevant evidence includes the "financial deepening" evidenced in the growth in size of household sector portfolios in the 1990s (see Gizycki and Lowe, 2000).

A third indicator is growth of securities market financing techniques and funds management relative to intermediation, reflecting improvements in disclosure, investor protection, monitoring techniques, and consequent willingness of ultimate savers to bear market and credit risk. This can be seen in Figure 1 which shows the increased share of funds managers in total financial institution assets since the start of the 1980s. Again relative to other developed nations, the mix of securities markets versus intermediary financing is mid range. However, significant recent growth in corporate bond financing, mortgage origination and securitisation, together with increased emphasis on private provision for retirement saving, suggest that securities markets will grow further in relative importance.

Finally, financial reform could be expected to have lead to increased efficiency within the Australian financial sector, with competitive pressures reducing

costs and profit margins. The evidence on this score is mixed, and confounded by changes in risk-taking by financial institutions following deregulation and consequent changes in required rates of return (profit rates) to compensate for such risk-taking. To the extent that efficiency gains from financial reform in the banking sector have occurred, those benefits appear to relate primarily to the latter half of the 1990s. Gizycki and Lowe (2000, p 180) looking back at writings from 1991 comment that "At the time, there was a sense that liberalisation had promised much, but delivered relatively little, other than a speculative property boom and a lot of wasted assets". More recently, there is some evidence of declining margins in banking, although rates of return on equity remain high.

An alternative perspective on efficiency changes can be gained from an examination of Figure 2. Employment in the financial sector has declined, despite massive growth in financial sector assets. Such improved labour efficiency is consistent with financial reform increasing competitive pressures, but also reflects improvements in technology and communications which have dramatically affected the methods of delivery of financial services. Also shown is the contribution of the financial sector to GDP. This has increased much less than the increase in the asset size of the financial sector. Such an outcome could be interpreted as reflecting the effects of increased competition and technological improvements and declining costs and usage of labour in the sector, with efficiency gains being passed on to customers via improved prices, rather than showing up as increased profits and value added.

6. Conclusion

Financial reform in Australia has occurred on a grand scale since the start of

[21] Battellino (2000) provides information on turnover figures on a "world league table" basis.

the 1980s. Initially focused on (primarily bank) deregulation and in the absence of the necessary preconditions for reliance on market mechanisms, the experience of the 1980s was less than satisfactory. In the past decade, those inadequacies have been systematically rectified, enabling the development of a "contract based" rather than "rule based" approach[22] which increasingly underpins contemporary thinking on optimal regulatory approaches. By international standards, the Australian regulatory system appears to accord closely with world "best practices" espoused by international agencies. Nevertheless, there are a number of distinct features of the Australian approach which have been identified in this chapter, and which constitute potential weaknesses warranting continued scrutiny.

First, the Australian approach (like that of New Zealand[23]) is marked by the absence of explicit deposit insurance and explicit disavowal of government guarantees of bank deposits – despite the apparent acceptance that it is important that some "risk free haven" should exist for unsophisticated investors. Separation of the prudential regulator (APRA) from the Central Bank is partly premised on a view that such a structure will reduce public perceptions of government guarantees. It is not clear that explicit deposit insurance is the appropriate form of "safety net" in all circumstances (Kane, 2001), although this is the IMF view of best practice (Garcia, 2000). Its absence however can be argued to be a potential impediment to competition if market monitoring is weak or if perceptions of "too big to fail" persist despite government denials of ultimate support for failing institutions.

[22] "At the risk of gross over-simplification, there are two general and alternative approaches to regulation. At one end of the spectrum the regulator lays down fairly precise regulatory requirements that are applied to all regulated firms. While there may be limited differentiations within the rules, the presumption is for a high degree of uniformity. At the other end of the spectrum is … Contract Regulation. Under this regime, the regulator sets down a clear set of objectives and general principles. It is then for each regulated firm to demonstrate to the regulator how these objectives and principles are to be satisfied by its own chosen procedures." (Llewellyn, 1999)

In that regard, the continuing distinction between banks and other ADIs even though both are subject to the same regulation raises concerns about the implications for competition. Use of the label "bank" is restricted to larger institutions (Tier 1 capital in excess of $A 50 mill is required). Accepting that such a label is valuable (ie that it signifies something special to the general public) thus creates a distinction between larger and smaller depository institutions which could be inimical to the entry and activities of smaller institutions and thus have adverse competitive effects.

Second, there is an interesting juxtaposition in the approach to prudential regulation of substantial regulator discretion (regarding when and how to take action over troubled institutions) and absence of regulatory fiscal responsibility for losses incurred from regulatory forbearance. The implications of such arrangements for regulatory incentives towards forbearance warrant further study.

Third, arrangements for dealing with cases of systemic stability create potentially interesting problems. Institutions viewed as solvent by APRA, but facing systemic liquidity crises, would presumably get access to discount window facilities and lender of last resort loans at the RBA. This suggests the possibility of some interesting regulatory interrelationships if the market value of assets of the institution receiving support turned out to be less than initially thought. Lender of last resort loans would presumably be secured against particular assets of the troubled institution, but would also presumably rank behind depositor claims. In that regard, lender of last resort loans could turn out, *ex post*, to be little different to the put option over a bank's assets which depositors hold under a system of government guarantees. The critical difference, of course, is that access to that put option would be conditional upon APRA (and the RBA) misjudging the underlying worth of the bank's assets and

[23] See Davis (1999) for a comparison of Australian and New Zealand financial reform.

liabilities.

Fourth, the Australian approach involves a mix of both functional and institutional approaches to regulation. Prudential regulation is premised on the view that certain economic functions or financial products are worthy of protection, but the regulatory focus is upon the health of the institutions which provide those products. The extension of benefits and costs of official supervision to the whole of the institutions activities, rather than just those activities warranting attention, would seem to be unnecessary when other alternatives (such as "narrow banking" proposals) could be considered.

Fifth, the Australian approach is marked by a somewhat cautious approach to the likelihood of a competitive environment emerging from an unrestricted entry and ownership policy in financial markets. Whether such restrictions as currently exist are socially benign, since interested parties can typically undertake the desired activities through some alternative institutional arrangements, or whether they inhibit competitive forces and the ability of institutions to exploit economies of scale or scope, is an open question.

Finally, the Australian system appears somewhat atypical internationally in that the prudential regulator (APRA) is financed by levies upon the institutions it regulates[24]. The merits of such an approach to regulatory financing, in particular the implications for whether the level of funding provided for supervision is optimal (or socially preferable to those which would arise from other funding mechanisms), have yet to be fully explored.

[24] The Reserve Bank, on the other hand, is financed by seigniorage from the note issue, trading profits, and fees from provision of banking services, and is required to remit a dividend to the Government.

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Table 1
Australian Financial Regulation at the Start of the 21st Century

	Regulatory Institutions			
	Reserve Bank	**APRA**	**ASIC**	**ACCC**
Responsibilities	• Systemic Stability • Monetary Policy • Payments System	• Prudential Regulation	• Integrity of (primary and secondary) securities markets • Investor / financial claimant protection	• Consumer Protection (excluding financial sector) • Competition Policy
Financial Institutions supervised		• Banks • Other ADIs • Insurance • Large Superannuation Funds	• Fund Managers • Securities Firms • Investment Advisers	
Techniques	• Market Operations (in bonds, repos and forex swaps) to achieve announced cash interest rate target • Lender of Last Resort and Discount Window operations for system stability purposes • Determining rules for access to, and setting efficiency and safety standards for, designated payments systems	• On and Off site inspections • Formulation of Policy • Risk-Weighted Capital Requirements	• Enforcement of Company Law • Ensuring adequate disclosure • Dealing with consumer issues • Promotion of industry codes of conduct and self regulation	• Enforcement of Trade Practices and Prices Surveillance Acts • Conduct of Inquiries and Monitoring of market behaviour • Provision of information

Table 2
Financial Reform in Australia: Some Major Events

Year	Event
l980 (Dec)	Interest rate ceilings on many bank deposits removed, new bank entry permitted
1981	Campbell Inquiry Report released
l982	Maturity controls on bank deposits relaxed, lending restrictions abolished, some asset portfolio restrictions relaxed, Bond tender system introduced
l983 (Dec)	Australian dollar floated and exchange control regulations largely abolished
l984	40 new foreign exchange dealers authorised, interest rate prohibition on cheque accounts removed, deregulation of stockbroking, portfolio deregulation of life offices
l985	16 Foreign Banks given banking licences, interest rate ceiling on "small" bank loans (other than housing loans) removed, LGS convention abolished
l986	Interest rate ceiling on bank home mortgage loans removed, NBFI's permitted to participate in payments system
1987	ISC established, dividend imputation tax system commenced,
1988	Risk-weighted capital requirements introduced for banks
1989	Banking Industry Ombudsman scheme introduced
1990	"Six pillars" policy on bank mergers introduced
1991	Part privatisation of Commonwealth Bank, ASC established, life and general insurance complaints schemes introduced
1992	Foreign bank entry as a branch permitted, AFIC established, risk-weighted capital requirements applied to building societies and credit unions. Council of Financial Supervisors formed, bank on-site inspections commenced
1993	Banking code of practice released
1994	General insurance code of practice released, continuous disclosure regime introduced by ASX for listed companies, first "bancassurance" group created
1995	Life Insurance Act passed and life insurance code of practice released, risk-weighted capital requirements applied to life companies, ACCC created
1996	Wallis Inquiry announced, Uniform Consumer Credit Code introduced, Central Bank independence affirmed, National Competition Policy adopted, Accounting Standard AAS32 addressing disclosure standards for financial institutions released
1997	Wallis Inquiry reports, "four pillars" policy towards bank mergers adopted, CLERP announced
1998	Bank capital requirements for market risk introduced, APRA created, ASIC created, Payments System Board established within Reserve Bank, Council of Financial Regulators replaces Council of Financial Supervisors, Financial Sector Reform Act passed, Financial Sector (Shareholdings) Act passed, Payments System (Regulation) Act passed, RTGS introduced
1999	CLERP Act passed, replacement of minimum liquidity requirements for banks with "agreed liquidity policy" based approach, access to exchange settlements account facilities at RBA widened
2000	Uniform prudential standards for ADIs announced by APRA
2001	Financial Services Reform Bill scheduled for introduction

Table 3

CLERP ACT 1999 – An Overview of Changes	
Fundraising	• Four types of disclosure document (prospectus, short form prospectus, profile statement, offer information statement) provided for • Certain exemptions to need for disclosure documents • Seven day preview period for prospectuses for non-quoted securities replaced prospectus registration
Directors' Duties	• Duty of care and diligence requirements clarified • Protection of directors clarified by introduction of business judgement role and specification of acceptable reliance on information and delegation
Statutory Derivative Action	• Enables shareholders (with leave from the court) to bring action on behalf of company, supplementing common law rights
Financial Reporting System	• New Financial Reporting Commission introduced to oversee standard setting process
Takeovers	• Corporations and Securities Panel to hear disputes • Compulsory acquisition provisions strengthened • Disclosure requirements made more consistent with fundraising requirements • Allowable offer period extended to 12 months

Table 4

Financial Market Turnover

	$mill per day	
	1985	1999
Equities	50	1,000
Equity Futures	100	2,000
Bonds	1,000	4,000
Bond Futures	100	7,000
Money Market Securities	600	7,000
Money Market Futures	1,000	30,000
Repurchase Agreements	200	15,000
Foreign Exchange	5,000	77,000
Memo item		
Nominal GDP ($A mill. p.a.)	230,000	600,000

Source: Battellino (2000)

Figure 1

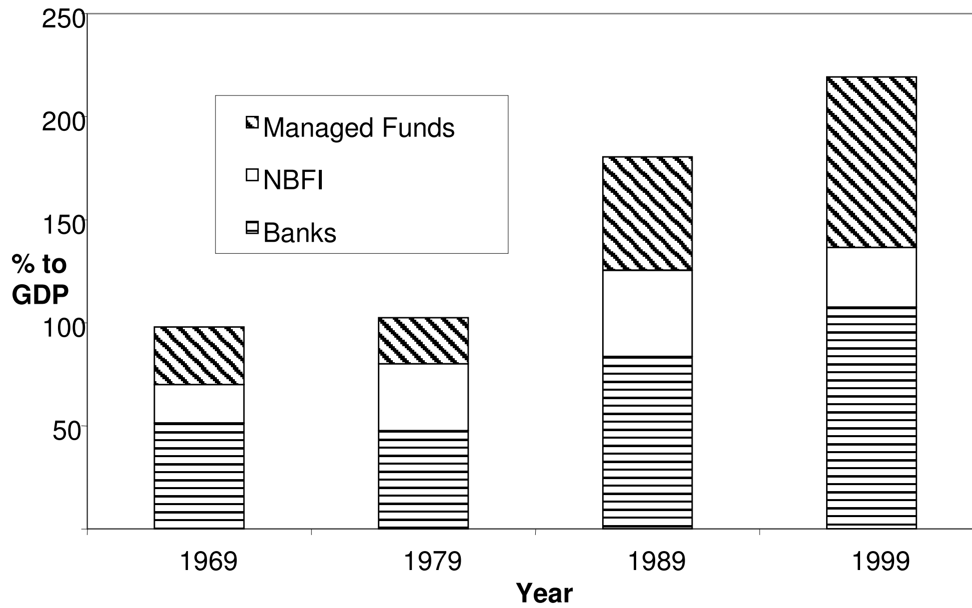

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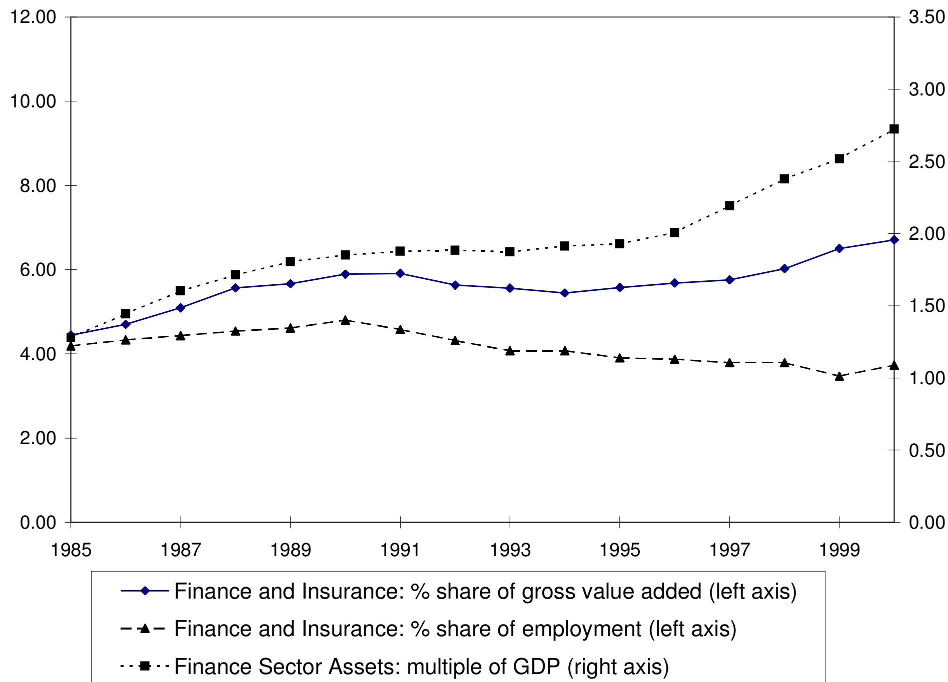
Figure 2



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