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Davis on Australian banks' rego check

It seems unlikely that a once-in-a-generation financial system inquiry (FSI) could be likened to periodic servicing of a car but Professor Kevin Davis did.

People may ask why another FSI was needed given Australia emerged from the GFC in good shape compared with many other countries.

It got through the crisis "but not without a lot of help from the government," said the University of Melbourne's Professor Kevin Davis, one of the panellists on the inquiry that was chaired by David Murray.

Just as we periodically lift the bonnet of a car to make sure the engine is functioning smoothly, "we were charged with lifting the lid and making sure things were OK," Davis said at a FSI workshop arranged by the Centre for International Finance and Regulation in Sydney on Wednesday.

The FSI was particularly interested in the efficiency, resilience and fairness of the financial system.

Under the bonnet

By efficiency, Davis meant is the system getting us from A to B, is it headed in the right direction and is it expensive in terms of doing what its passengers or users require.

Here the FSI found the superannuation part of the engine wanting.

The accumulation phase is comparatively expensive to run while the airbags aren't working in the retirement phase because there aren't enough products to manage longevity risks.

Resilience refers to the system being sufficiently strong so that it won't break down and leave us stranded.

As the panellists met with regulators and financial system participants around the world a recurring theme was don't assume another crisis won't hit soon because there are still a lot of risks.

Davis said that is why they recommend banks hold enough capital to be in the world's top quartile.

When assessing fairness, Davis revealed the car is actually a taxi and we need to check its meter hasn't been fixed.

Unfortunately there are too many incidents of poor financial advice and inappropriate products so the FSI recommended giving the Australian Investments and Securities Commission temporary product banning powers and proposed requirements around product design and manufacture.

Where Murray inquiry differs from Wallis

Davis is concerned that people may interpret the report as being in favour of ever more regulation so he took those two recommendations as an example of the FSI's attempts to reduce the need for less desirable forms of regulation.

If financial institutions are doing the right thing by their customers and already have the right processes in place, they wouldn't be affected by the new proposals. "You would like to think that isn't a problem."

He made the point that financial literacy is a problem in Australia so people need assistance and protection. Here the Murray inquiry differs from the Wallis inquiry.

The Wallis report assumed the world should be as it appears in economic textbooks, namely stable, competitive and efficient and that freedom of choice is good.

However, the GFC proved financial markets aren't always stable and the emerging field of behavioural economics indicates people don't always make economically rational choices.

Therefore there's no point designing policy for these ideal humans and ideal world which research and experience have proved don't exist.

"So we took where we are as the starting point and tried to make things better from there."

Graduated technology

There could be driverless cars in the future and given the pace of technological change occurring in financial services it would have been remiss for the FSI not to consult the crystal ball.

Davis sees great potential for technology changing the way frictions are overcome.

"So you want things that won't preclude development of the technology but it isn't without risk."

Hence the FSI recommended graduated technology. "That is trying to make sure we don't stifle innovation but managing the risks."

Just as cars need parking wardens and traffic cops, the financial system needs dedicated regulators.

"We asked are they appropriately resourced and accountable for what they do," explained Davis.

The FSI recommended that the financial regulators take more account of competition than they have previously and the establishment of a Financial Regulator Assessment Board to report to government annually on how the regulators have fulfilled their mandates.

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