

---

# The Australian Financial Sector Some Prospective Developments

Professor Kevin Davis,  
Research Director, ACFS

## Topics

---

Potential developments in the Australian financial system structure

How will these affect investment and financing opportunities?

What are the key risks for the Australian financial system?

---

## Some Key Messages re Fixed Income Market

---

- Interaction of superannuation developments and banking regulation a key influence
  - Tax (imputation) and hybrid structuring imply a segment market with different products for domestic v international investors
  - Fintech is blurring wholesale / retail distinction and enables creation and distribution of competing products (to corporate bonds) to retail investors
- 

## Potential Developments

---

### Political Background

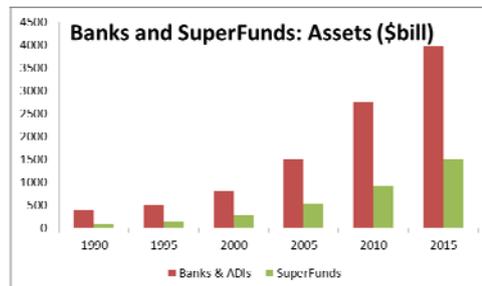
Australian Financial System (Murray) Inquiry  
Systematic tax review process abandoned  
Possibility of Royal Commission into Banking (if Labor elected)  
Federal Budget changes (May 3, 2016)

### Some Key Issues

Superannuation: sector growth and products  
Retirement Income Streams Review (Report, May 2016)  
Bank regulation: loan and capital market implications  
Basel IV, APRA, "Bail-In"  
Corporate Bond Market Development  
"Fintech" and Financial Intermediation  
2016 Budget - new corporate and limited partnership CIVs

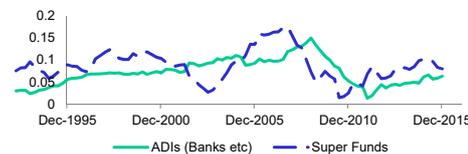
---

## The Superannuation System



This excludes SMSF  
Total super assets  
=\$2 trillion

**Banks and Superfunds  
annual growth rates - prior 3 years**



## Super Outlook and Implications

**Growth of SMSF (\$0.6 trillion)** → “retail” investable funds

**Stimulus to capital market growth**

- Equities and franked dividends
- Hybrids (bank bail-in securities)
- Corporate Bonds ?

**Fiscal cost and fairness** of superannuation tax concessions

- 2016 Budget changes: retard likely growth

**Retirement Income Products**

- Murray Inquiry – CIPRs
- 2016 Budget changes: stimulate deferred annuity market?  
and demand by providers for fixed interest products

**Concerns over competition and efficiency**

- Mysuper products and review of default allocation process

## Bank Regulation and Capital Markets

---

### Key Influences

Mortgage risk weights  
Basel IV (& leverage ratio implications)  
TLAC and bank hybrids  
Simple Securitisation

### Implications

Bank loan portfolio incentives  
    less on-balance sheet mortgage lending  
Debt capital market funding incentives  
Bank hybrid issuance

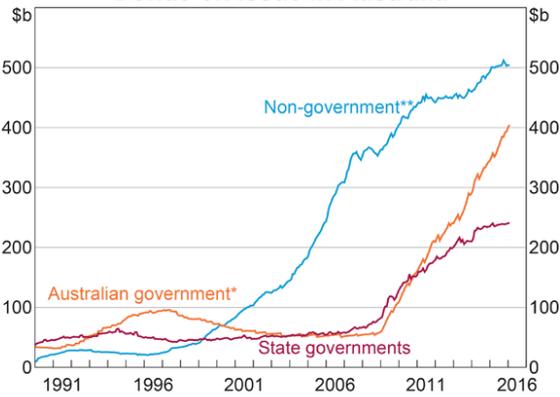
## Bond Market Development

---

- Demand side (super) stimulus from portfolio asset allocation with ageing population and retirement income products
- “Supply” side stimulus from bank responses to regulation
- Suggest potential for significant overall growth
  - From large growth over last decade (other than Australian corporate issuers into domestic market)

## Bond Market Development

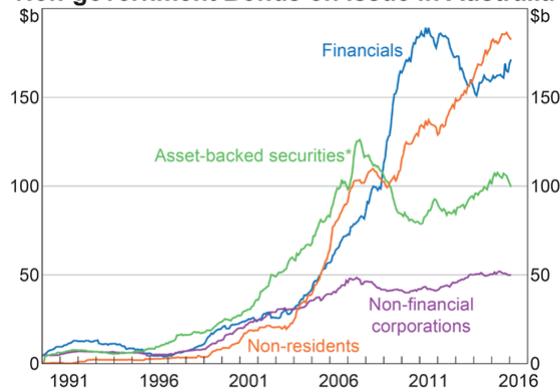
### Bonds on Issue in Australia



\* Excludes bonds purchased by the Australian Government  
 \*\* Excludes ADIs' self-securitisations, includes government-guaranteed bonds  
 Sources: ABS; AOFM; RBA; State Treasury Corporations

## Bond Market Development

### Non-government Bonds on Issue in Australia



\* Excludes ADIs' self-securitisations  
 Sources: ABS; RBA

## Bond/Fixed Interest Market Development

---

Domestic Corporate Debt Market still “nascent” but prospective growth – both wholesale and retail

### *Positive factors*

Legislative changes – “simple corporate bonds”  
Bank capital requirements  
Superannuation investment demands (including for deferred annuities)  
Simple Securitisation

### *Negative factors*

Imputation tax and debt/equity preferences (issuers & investors)  
Public Sector Debt growth – sovereign rating, “crowding out”  
Fintech (1) Market-based (P2P) lenders – wholesale & retail investors  
Fintech (2) Retail offerings of simple securitisation upper tranches?  
Bank “bail-in” securities & hybrids carrying tax credits

---

## Financial Sector Resilience and Stability

---

### Strengths

Large super system a benefit in absorbing asset price shocks  
Banking Sector strengths  
Capital levels, Liquidity management, Profitability

### Possible Concerns

Exposures to housing/property  
Restructuring of economy following resources boom  
Four majors or four “clones”?  
Government fiscal outlook

---

## Conclusion

---

On balance: Australian Financial System robust and low risk

Introduction of new Collective Investment Vehicles should facilitate foreign portfolio investment

Gradual proposed decline in corporate tax rate of benefit to foreign equity investors and foreign owned companies (but of limited benefit to resident investors/companies due to imputation)

Corporate bond market – poised for development, but challenges remain

---