Legislation Review

This Inquiry has been commissioned by the Commonwealth Government to fulfil its commitment under the Competition Principles Agreement (CPA) in respect of the main financial sector regulations. In letters of appointment, the Treasurer informed the Committee that the Inquiry was to be included in the Commonwealth's Legislation Review Schedule prepared in response to the April 1995 Inter-Governmental Competition Agreement. The legislation under review by the Inquiry was listed in Table B.1 in the Discussion Paper.

The Legislation Review Schedule also refers to separate reviews of legislation falling within the ambit of this Inquiry, such as the *Corporations Act 1989*, the *Banking Act 1959*, the *Insurance (Agents and Brokers) Act 1984*, the *Life Insurance Supervisory Levy Act 1989*, and various Acts relating to superannuation.

The CPA required all Australian governments to develop, by June 1996, a four-year program to review all existing legislation which significantly restricts competition. Any such legislation must be reformed by the year 2000, unless it can be demonstrated that the public interest benefits outweigh any costs, using criteria specified in the CPA.

Reviews of legislation must:

- clarify the objectives of the legislation;
- identify the nature of the restriction on competition;
- analyse the likely effect of the restriction on competition and on the economy generally;
- address and balance the costs and benefits of the restriction; and

- consider alternative means for achieving the same result, including non-legislative approaches.[1]

The review undertaken by this Inquiry, of necessity, focused on the overall regulatory framework and objectives of financial sector regulation. Before embarking on a detailed cost-benefit analysis of all aspects of legislation, it is necessary to review the general regulatory framework and its main features. The Inquiry regarded that general review as its task. The detailed reviews of particular pieces of financial sector regulation being carried out separately, as set out in the Legislation Review Schedule, can proceed with the benefit of the outcomes of the Inquiry's examination of the overall regulatory framework.

The Inquiry used the following process to conduct its general review:

- it sought public submissions on all aspects of the financial system regulatory framework;
- it was briefed by the main regulatory agencies and their major stakeholders and customers;
- it conducted inquiries overseas to ascertain alternative approaches;
- on the basis of these sources, it produced a Discussion Paper summarising the key issues and outlining the options for dealing with those issues; and
- it sought further submissions, held public consultations and accepted speaking engagements to promote debate on the options outlined in the Discussion Paper.

Chapters 6 to 12 contain a detailed discussion of the objectives of each aspect of the financial system regulatory framework, the nature of the restrictions on competition imposed by them, and the Inquiry's recommendations about the future shape of the framework. This Appendix summarises, in Table D.1, the results of that review.

The restrictions on competition noted in the table include restrictions that arise:

1 Council of Australian Governments 1995, *Competition Principles Agreement*, clause 5(9).

- under the primary Act identified in the table;
- under subordinate legislation pursuant to the primary Act; or
- under regulator's pronouncements, such as prudential standards, circulars or policy statements, arising from the regulator's responsibility for administering the primary Act.

The table does not include restrictions on competition arising under State or Territory legislation or financial exchange rules, since the Commonwealth's commitments under the CPA do not extend to reviewing those restrictions.

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Banking Act 1959	To regulate the banking system, inter alia by defining who can do banking business, and providing the RBA with powers to supervise banks, protect depositors and regulate transactions in foreign exchange	Requirement for a licence to conduct banking business in Australia. Restrictions on entry, ownership and corporate structure to ensure that ➢ owners are fit and proper' to conduct licensed activities ➢ the safety and stability of a financial institution are not prejudiced by its ownership structure ➢ regulated entities have the capacity to undertake financial activities for which they are licensed ➢ corporate structures do not impair regulatory arrangements for depositor or investor protection	Institutions offering payments services or conducting the general business of deposit taking — including retail banks, building societies and credit unions — are clear candidates for prudential regulation The nature of deposit taking, particularly transformation of illiquid assets into liquid liabilities, the information asymmetry for depositors and the potential for financial failure to cause systemic instability, warrants intense prudential regulation Restrictions on entry, ownership and corporate structure play an important role in prudential regulation, and are therefore a justified restriction on competition, except as outlined in recommendations below The APRC should be empowered to deal with such applications rather than the Minister	Sections 8.3, 8.4 & 8.4; Recs 30, 33 to 37

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Banking Act 1959	To regulate the banking system, as set out above	Current policy generally requires the separation of the ownership of banks from activities in non-financial sectors of the economy	The case for continued separation is sufficiently strong for it to be retained as a broad guiding principle However, the desirability of fostering innovation and greater competition justify greater flexibility in the application of this principle, having regard for ➢ the congruity of non-regulated activities with provision of financial services ➢ relevant experience in the intended regulated financial activity, and ➢ whether prudential regulations will be met on a continuing basis, including any additional requirements deemed necessary	Rec. 46
		Mutual ownership of banks is generally prohibited	Mutual ownership of all types of licence and authority holders should be accommodated, provided they can satisfy essential tests of probity and financial standing and ongoing compliance with capital requirements	Rec. 47

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Banking Act 1959	To regulate the banking system, as set out above	Initial licensing requirements include minimum capital requirements, directed at ensuring the substance of potential licensees	These requirements are justified for prudential reasons, but the APRC should take a flexible and facilitative approach to issuing new DTI licences where the entities meet other prudential requirements and are assisted by industry support organisations	Rec. 48
		Under current policy, the issue of a banking authority generally requires the parent entity to be a bank	Subject to meeting prudential requirements, the APRC should permit a financial conglomerate to adopt a non-operating holding company structure, if satisfied as to the adequacy of capital, management, firewalls, reporting of intra-group activities and independent board representation on subsidiary entities	Rec. 49
		Under current policy, the extent to which groups including a bank can engage in other financial and non-financial activities is restricted	A conglomerate should not be prohibited from obtaining a number of classes of licence and the conduct of other non-regulated financial activities should be permitted subject to maintaining prudential standards More than one licence of each class should be permitted, provided that the APRC is satisfied that arrangements do not compromise prudential standards and that deposit holders and other investors are treated equitably	Rec. 50
		Provides for the licensing of foreign exchange dealers, subject to probity, prudential and operational requirements	Special prudential requirements are not necessary - licensing should form part of the general licensing regime for financial markets dealers	Section 9.2; Recs 13 & 18

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Banking Act 1959	To regulate the banking system, as set out above	Treasurer's approval is required for a sale, amalgamation or reconstruction, or to form a partnership or association of banks (s. 63) No criteria are specified for exercise of Treasurer's discretion, which may take competition issues into consideration	Some restrictions are justified for prudential reasons However, the APRC should be the body responsible for assessing the prudential implications of a merger, sale, amalgamation or reconstruction, or formation of a partnership or association involving, an Australian regulated financial entity The Treasurer should only retain the responsibility for such arrangements involving non-regulated or foreign entities The only assessment of the competition implications of a merger should be that required by the Trade Practices Act	Recs 45, 81 & 82
Banks (Shareholdings) Act 1972	To ensure a wide spread of ownership in order to minimise the possibility of a bank being prejudiced by the influence or varying fortunes of a particular shareholder	Limits individual shareholdings in banks to 10%, subject to exemptions granted by the Treasurer for shareholdings of up to 15%, or by the Governor-General for shareholdings above 15% The 'six pillars' policy of the previous Government prohibited mergers between any of the four largest banks and the largest life companies	Spread of ownership protects institutions against undue influence by a major shareholder and creates a broad interest group in the shareholder base A dispersed ownership base also protects against a form of contagion risk that may otherwise occur if a financial institution is associated with adverse changes in the fortunes of a major shareholder However, the Inquiry believes the regulation of ownership should be streamlined, and recommends introduction of a single acquisitions act covering all regulated financial institutions	Recs 45, 81, 82 & 83

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Banks (Shareholdings) Act 1972	To ensure a wide spread of ownership in order to minimise the possibility of a bank being prejudiced by the influence or varying fortunes of a particular shareholder	Limits individual shareholdings in banks to 10%, subject to exemptions granted by the Treasurer for shareholdings of up to 15%, or by the Governor-General for shareholdings above 15% The 'six pillars' policy of the previous Government prohibited mergers between any of the four largest banks and the largest life companies	The large shareholding threshold should be set at 15% with approval for higher levels provided by the APRC where the shareholder is an existing Australian regulated financial institution Approval for foreign ownership or ownership by non-financial entities above this limit should be determined by the Treasurer who should give consideration to the prudential regulator's advice on prudential matters, such as 'fit and proper person' tests and ability to meet prudential standards on a continuing basis The 'six pillars' policy should be removed and the only assessment of the competition implications of a merger should be that required by the Trade Practices Act	Recs 45, 81, 82 & 83
Cheques and Payment Orders Act 1986	To establish rules for the issue and presentment of cheques	Only banks can issue cheques in their own name	The Inquiry supports foreshadowed amendments to the Cheques and Payment Orders Act to allow building societies, credit unions and their Special Service Providers to issue cheques in their own name Issuers of cheques should meet objective performance benchmarks	Rec. 66

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Corporations Law, Chapters 7 and 8	Generally, to enhance investor confidence in securities and futures markets, dealers and brokers and advisers	Offering of securities without a prospectus is prohibited	This restriction should be retained, but ➢ disclosure requirements generally should be reviewed by the CFSC to ensure they provide information that enables comparison between products, and are consistent with that for similar products regardless of which institution offers them ➢ the law should be amended to require the issue of brief profile statements about offers of retail financial products, including initial public offerings, and ➢ the CFSC should encourage use of shorter prospectuses and abridged due diligence procedures commensurate with the size of those offerings	Rec. 8 Rec. 9 Rec. 10
		Licence required to operate as a securities dealer or adviser or futures broker or adviser	Convergence in investment products offered by different financial institutions and the emergence of new distribution methods require an overhaul of the existing framework Problems arise where participants are subject to more than one regime, sometimes with contradictory rules	Recs 13, 14 & 19

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Corporations Law, Chapters 7 and 8	Generally, to enhance investor confidence in securities and futures markets, dealers, brokers and advisers	Licence required to operate as a securities dealer or adviser or futures broker or adviser	The CFSC should establish a single regime to license institutions and independent advisers There should be separate categories of licence for investment advice and product sales; general insurance brokers; financial market dealers; and financial market participants	Recs 13, 14 & 19
		Current law makes a distinction between securities and futures and has separate authorisation and licensing regimes for each There is uncertainty about (and therefore added costs in) the application of the law to new products	The current distinction in the Corporations Law between securities and futures contracts should be replaced by a single regime for financial products This regime should apply generic requirements, supplemented by specific regulation for particular classes of products The CFSC should have the flexibility to declare certain products covered by, or exempt from, the law	Rec. 19

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Corporations Law, Chapters 7 and 8	Generally, to enhance investor confidence in securities and futures markets, dealers and brokers and advisers	Ministerial approval required to conduct a stock market or futures market	The blurring of the distinctions between exchanges and OTC markets suggests that it will be difficult to specify which kinds of markets should be required to seek formal authorisation as a financial exchange Instead, the law should permit any corporate to apply for authorisation to conduct a financial exchange, provided that it can satisfy specified eligibility criteria The CFSC should be empowered to deal with such applications rather than the Minister	Rec. 21
		Clearing houses require regulatory approval	The efficiency of clearing arrangements should be assessed as part of the approval process for any financial exchange Authorisation of clearing houses should be retained because ➢ clearing houses take on major risks in the event of counterparty failure ➢ systemic risks do not currently pose a sufficient threat to warrant transferring responsibility for their regulation from the markets regulator to the prudential regulator, and ➢ Australia's international standing could be adversely affected by reducing the current regulation of clearing houses	Section 7.3; Rec. 24 & 57

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Corporations Law, Chapters 7 and 8	Generally, to enhance investor confidence in securities and futures markets, dealers and brokers and advisers	Existing regimes for public offer superannuation funds and collective investment schemes require different structures to operate the funds	The regulatory framework for public offer collective investments and superannuation should be harmonised to the greatest possible extent by ➢ making both types of products subject to a single consumer protection regime (including disclosure rules) administered by the CFSC, and ➢ bringing the structure of collective investments into line with that for superannuation funds, by introducing a requirement for a single responsible entity	Rec. 89
Financial Corporations (Transfer of Assets & Liabilities) Act 1993	To facilitate transition of entities to banking status - eg allows tax losses to be carried forward	Facilitates the transition of certain entities to banking status and does not impose any restrictions on competition	n/a	n/a

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Foreign Acquisitions and Takeovers Act 1975	To control the level of foreign investment in Australia	An acquisition of 15% or more by a foreign interest requires the permission of the Treasurer Applications are approved if not contrary to the national interest	The Inquiry supports the retention of Foreign Acquisitions and Takeovers Act procedures for assessing foreign acquisitions in financial institutions as being reasonable in the national interest Foreign investment regulations as they apply to foreign owned or controlled managers of life companies and other collective investments should be reviewed and, if possible, removed	Rec. 85 Rec. 86
		Foreign owned banks are not precluded from bidding for the regional and smaller banks and insurance companies The policy of the previous Government, however, was that it would not approve the foreign takeover of any of the four major banks	The Inquiry believes that a large scale transfer of ownership of the financial system to foreign hands should be considered contrary to the national interest However, this does not preclude some increase in foreign ownership of aspects of the Australian financial system, including its major participants	Rec. 85

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
General Insurance Supervisory Levy Act 1989	To cover the cost of supervision of general insurance companies	Imposes an annual levy on general insurance companies	As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation Fees and charges imposed to recover costs of the financial regulatory agencies should be determined by the agencies, subject to approval by the Treasurer	Recs 104 & 106
Insurance Acquisitions and Takeovers Act 1991	To set out rules for the acquisition and control of insurance companies to protect the public interest	Requires shareholdings in life companies and general insurers in excess of 15% to be notified and not disapproved by the Treasurer The 'six pillars' policy of the previous Government prohibited mergers between any of the four largest banks and the largest life companies	Regulation of ownership should be streamlined, by enacting a single acquisitions act covering all regulated financial institutions The large shareholding threshold should be set at 15% with approval for higher levels provided by the APRC where the shareholder is an existing Australian regulated financial institution Approval for foreign ownership or ownership by non-financial entities above this limit should be determined by the Treasurer, giving consideration to the APRC's advice on prudential matters, such as 'fit and proper' person tests and ability to meet prudential standards on a continuing basis The 'six pillars' policy should be removed and the only assessment of the competition implications of a merger should be that required by the Trade Practices Act	Recs 45, 81, 82 & 83

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Insurance Act 1973	To protect the interests of general insurance policy holders	Restricts the conduct of general insurance business to companies meeting requirements for authorisation, and imposes ongoing prudential requirements	These restrictions play an important role in the prudential regulation of general insurance companies, and are a justified restriction on competition The rationale for prudential regulation of general insurance is one of consumer protection in the context of substantial information asymmetry and the adverse consequences for policy holders if insurance claims cannot be met	Section 8.3, 8.4 & 8.4; Recs 30 & 40
		Initial requirements include minimum capital requirements	These requirements are justified for prudential reasons, to ensure the substance of potential entrants	Rec. 48
Insurance (Agents and Brokers) Act 1984	To regulate the business of insurance intermediaries in both life and general insurance	Insurance brokers and foreign general insurance agents must be registered Other insurance intermediaries may only act as agents for an insurer or insurers pursuant to a written agreement with that insurer The insurer is required to accept liability for certain acts of its agents	Convergence in investment products offered by different institutions and the emergence of new distribution methods require an overhaul of the existing framework Problems arise where participants are subject to more than one regime, sometimes with contradictory rules The CFSC should establish a single regime to license institutions and independent advisers There should be separate categories of licence for investment advice and product sales; general insurance brokers; financial market dealers; and financial market participants	Rec. 13

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Insurance Contracts Act 1984	To regulate contracts of insurance	Imposes some minimum disclosure requirements and some basic requirements as to the behaviour of insurers and insureds	Disclosure requirements generally should be reviewed by the CFSC to ensure they provide information that enables comparison between products, and are consistent with that for similar products regardless of which institution offers them The law should be amended to require the issue of brief profile statements about offers of retail financial products, including initial public offerings	Rec. 8 Rec. 9
Insurance and Superannuation Commissioner Act 1987	To establish the ISC to regulate insurance and superannuation	Restrictions on competition derive from the legislation the ISC administers rather than this Act	Prudential regulation functions should be performed by a new agency, the APRC Consumer protection functions should be performed by a new agency, the CFSC	Rec. 31 Rec. 1
Insurance Supervisory Levies Collection Act 1989	To cover the cost of supervision of the insurance industry by collecting a levy from insurance companies	Provides for the collection of annual levies imposed by other acts on life and general insurance companies	As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation Fees and charges imposed to recover costs of the financial regulatory agencies should be determined by the agencies, subject to approval by the Treasurer	Recs 104 & 106

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Life Insurance Act 1995	To protect the interests of owners of life company policies	Restricts the conduct of life insurance business to companies meeting registration requirements, and imposes ongoing prudential requirements	There is a strong case for prudential regulation of capital-backed products offered by life insurers, because of the typically long-term nature of investments and the difficulty of assessing the creditworthiness of the provider	Section 8.3, 8.4 & 8.4; Recs 30 & 38
		Initial requirements include minimum capital requirements	These requirements are generally justified for prudential reasons, to ensure the substance of potential registrants	Rec. 48
Life Insurance Supervisory Levy Act 1989	To cover the cost of supervision of life companies	Imposes an annual levy on life companies	As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation Fees and charges imposed to recover costs of the financial regulatory agencies should be determined by the agencies, subject to approval by the Treasurer	Rec. 104 & 106

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Reserve Bank Act 1959	To establish the RBA and its Board and to set out the functions of the RBA Board, Governor and deputy governors and the powers of RBA as central bank	The RBA is responsible for establishing Exchange Settlement Accounts (ESAs) as part of its responsibilities as the central bank Its policy has been to restrict these accounts to banks and special service providers	The payments system should be regulated by the RBA under a Payments System Board (PSB) The PSB should have responsibility for implementing policies to improve payments system efficiency, including the adoption of the most efficient technology platforms, and enhancing the competitive framework, consistent with overall systemic stability The PSB should also have general oversight of the clearing streams	Rec. 61
			The PSB should be chaired by the Governor of the RBA and should also include one Deputy Governor of the RBA Other members should be appointed by the Treasurer, and should be drawn from payments system users and industry representatives who are knowledgeable and experienced in the operations of the payments system	Rec. 62

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Reserve Bank Act 1959	To establish the RBA and its Board and to set out the functions of the RBA Board, Governor and Deputy Governor and the powers of RBA as central bank	In so far as the Commonwealth requires it to do so, the RBA acts as banker and financial agent for the Commonwealth Subject to the provisions of the Banking Act, the RBA is able to offer commercial banking facilities	As a general principle, commercial activities (other than ownership and operation of high value payments systems, such as the RTGS system) are inconsistent with its regulatory responsibilities Where special considerations warrant participation, these should be clearly separated from regulatory responsibilities and be subject to transparent reporting arrangements	Rec 64
		Banks are required to settle their obligations to each other through ESAs, and only banks and special services providers are allowed to hold those accounts	The RBA should continue to determine access to ESAs on the basis of clear and open guidelines, including that the holder has extensive payments business with third parties Appropriate prudential and operational arrangements should apply with applications open to institutions other than banks Participants offering high-value settlement services should be regulated to the international standards for banks	Recs 69, 73, 74 & 75

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Superannuation Industry (Supervision) Act 1993	Provides for superannuation funds to elect to be regulated and qualify for tax concessions, if they comply with prudential and other standards	Trustees of public offer funds must be approved by the ISC and meet 'fit and proper person', minimum capital and other prudential tests	The compulsory nature of some superannuation savings, the lack of choice for a large proportion of members, the mandatory long-term nature of superannuation and the contribution to superannuation of tax revenue forgone, provide a case for prudential regulation of superannuation funds Prudential regulation of superannuation is necessarily at the lower end of the intensity scale	Section 8.3, 8.4 & 8.4; Recs 30 & 41
			Where superannuation investments are self managed through excluded funds, compliance enforcement should be transferred to the Australian Taxation Office	Section 8.3, 8.4 & 8.4; Recs 30 & 42
		Certain information must be given to existing superannuation fund members and prospective fund members	These restrictions should be retained, but ➢ disclosure requirements generally should be reviewed by the CFSC to ensure information is provided that enables comparison between products, and is consistent with that for similar products regardless of which institution offers them, and ➢ the law should be amended to require the issue of brief profile statements about offers of retail financial products, including initial public offerings	Rec. 8 Rec. 9

Table D.1: Legislation Reviewed by this Inquiry under the Competition Principles Agreement (continued)

Primary Legislation	Objectives	Nature of restrictions on competition	Inquiry view	Report reference
Superannuation Supervisory Levy Act 1991	To cover the cost of supervision of superannuation funds	Imposes an annual levy on superannuation funds	As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation Fees and charges imposed to recover costs of the financial regulatory agencies should be determined by the agencies, subject to approval by the Treasurer	Rec. 104 & 106
Trade Practices Act 1974, Part IV	To prohibit certain restrictive trade practices	Prohibits mergers which substantially lessen competition in a market	This restriction should be retained, and the ACCC should continue to be the competition regulator with respect to the financial system The Inquiry found no evidence to suggest that these general economy wide competition provisions should not apply to the financial system	Rec. 79