

CHAPTER 41: HOUSEHOLD SECTOR

A. BACKGROUND

41.1 This chapter examines some aspects of the interaction between the household sector¹ and the financial system.

41.2 A technically efficient and competitive financial system will tend to ensure **neutrality of treatment** between individuals. Neutrality of treatment implies:

- equal opportunity to invest, in the sense that equal risk/return combinations are priced equally to everyone and information is equally available; and
- equal opportunity to seek finance, in the sense that those with the same risks and prospects have the same access to finance and face the same costs.

41.3 This is not to say that in such a system intermediaries will be willing to lend the same amount to all individuals nor that the rate charged will be the same for everyone. Indeed, in assessing both the volume and price of loans to particular individuals, many factors including income, wealth, lending risk and transaction costs need to be assessed since they differ from case to case. Similarly, neutrality does not mean that large and small investors will always have the same range of investment choice on exactly the same terms.

41.4 It is clear that all individuals do not enjoy equal access to the financial system, any more than they have equal wealth or have equal incomes to purchase the goods, services and facilities in our economic system.

41.5 It is equally clear that an economically efficient distribution of funds determined purely on commercial criteria may not necessarily be the most appropriate distribution on social grounds: some individuals have greater market power than others and so will be more successful in obtaining finance or in locating attractive investments. Even a perfectly functioning market may give rise to what may be considered social inequities. While recognising that governments have an important and legitimate role in redressing such social inequities, the judgments involved are complex and well beyond the scope of this Inquiry. In any event, the Committee believes that, in general, social objectives are most cost-effectively pursued through measures that interfere least with market processes (see Chapter 36).

41.6 The Committee has approached the issue of neutrality of household funds flows in the following ways,

- (i) it has tried to identify:

1 For many purposes, the Australian Bureau of Statistics includes the unincorporated business sector as part of the household sector. However, the Committee discusses the problems of small businesses in Chapter 38. Housing is separately discussed in Chapter 37.

- any factors originating from within the financial system which might impede or bias the flow of funds to particular groups;
 - the basic source of such factors;
- (ii) where the impediments identified reflect:
- government intervention (e.g. regulations, controls and taxes);
 - inherent market imperfections, such as information barriers, inadequate competition etc.;
- the Committee has made suggestions aimed at overcoming the impediment; and
- (iii) where the unequal distribution of funds reflects not technical deficiencies but certain basic economic differences (incomes, risks, transaction costs etc.), the Committee has regarded it as a matter for governments to judge whether any corrective action needs to be taken.

41.7 Table 41.1 shows lending by selected major financial institutions to householders.

TABLE 41.1: HOUSEHOLDS' DEBT OUTSTANDING TO SELECTED FINANCIAL INSTITUTIONS (\$m)

Year ended 30 June				%				%				%
	1955	1960	1965	Total listed	1970	Total listed	1975	Total listed	1980	Total listed		
Major trading banks												
Housing	211	196	219	6.1	297	4.5	614	4.1	1 060	3.2		
Personal loans	—	—	—	—	65	1.0	613	4.1	2 236	6.7		
Bankcard	—	—	—	—	—	—	—	—	798	2.4		
Not included elsewhere	111	114	206	5.7	419	6.4	1 221	8.2	1 630	4.9		
Savings banks												
Housing	175	404	955	26.6	1 898	28.9	4 502	30.4	10 640	32.0		
Finance companies												
Instalment credit	366	806	978	27.3	1 373	20.9	1 922	13.0	2 873	8.6		
Personal loans	n.a.	n.a.	n.a.	—	187	2.8	601	4.1	1 459	4.4		
Life offices												
Housing	140	267	338	9.5	422	6.4	491	3.3	488	1.5		
Personal loans	37	68	114	3.1	212	3.2	284	1.9	312	0.9		
Permanent building societies												
Housing ^(a)	78 ^(c)	119 ^(c)	250	7.0	929	14.1	3 128	21.1	8 510	25.6		
Credit unions ^(b)	2	5	23	0.6	94	1.4	537	3.6	1 818	5.5		
Terminating building societies												
Housing	216 ^(c)	347 ^(c)	504	14.1	682	10.4	894	6.0	1 432	4.3		
Total	n.a.	n.a.	3 587	100.0	6 578	100.0	14 807	100.0	33 256	100.0		

(a) Includes some loans for other purposes.

(b) Includes some loans for housing.

(c) Estimates.

Sources: Australian Bureau of Statistics: Catalogue Nos 5.1, 5.2, 5603.0, 5605.0, 5.5, 5632.0, 5633.0, 5614.0, 5621.0, 5618.0, 51 & 52; Reserve Bank of Australia: *Statistical Bulletin; Flow of Funds Supplement; Staff Paper, 'Flow of Funds, Australia' 1953-54 to 1961-62*; M. R. Hill, 'Housing Finance Institutions' in R. R. Hirst & R. M. Wallace (eds), *The Australian Capital Market*, Cheshire, Melbourne, 1974; Australian Federation of Credit Union Leagues, Submission to the Inquiry.

B. MAJOR ISSUES CONCERNING DISTRIBUTIONAL INEQUITIES

41.8 Several groups have argued before the Committee that the financial system fails to provide appropriate finance or outlets for the particular needs of the household sector. Some of the major complaints raised are discussed below.

(a) Consumer Finance

41.9 Consumer finance, it is claimed, should be available at lower rates of interest. This claim is made particularly forcefully with reference to low income earners.

41.10 The Committee has noted the Law Reform Commission's recommendation that there be an investigation of consumer credit interest rates in Australia, having regard to apparent disparities in rates between USA and Australia and given the reliance of low income earners on this form of finance. The Committee commissioned a comparative study of consumer finance interest rates in Australia and a few other countries. The study,² although of a limited nature, suggests that the cost of consumer finance in Australia is broadly comparable with the cost in USA and Canada but generally lower than in UK and Japan, when viewed in relation to the cost of other forms of finance.

41.11 Apart from some information-communication problems, which are discussed later, the Committee cannot see any obvious evidence of intrinsic market failures in the area of consumer finance. It would make two general observations in this connection:

- despite a fairly high degree of market concentration (see Chapter 32), the industry appears to be intensely competitive; it is serviced by a wide range of actively competing institutions (e.g. banks, finance companies, credit unions); generally there are few market-originated impediments to competition (although it has been argued that market neutrality is lessened by perceived barriers to the common use of established infrastructures for the cheque payments system and bankcard);³
- where 'gaps' or anomalies exist in the availability and cost of consumer finance, they are often a reflection of inappropriate government regulation.

41.12 The distortive impact of government intervention on the cost of consumer finance is most apparent in the following cases:

- Ceiling interest rates currently apply on personal loans from banks. On some (low risk) loans, rates within the ceiling may give banks an adequate (even attractive) return but this is not so for many of the higher risk loans. As a result, the regulation simply 'splits' the market — banks tend to lend to safer clients while high risk clients seek accommodation from intermediaries not subject to interest rate limitations. A 'credit gap' may thus be created for some personal borrowers who presently do not qualify for bank loans but have risk characteristics which would justify lower interest rates than those charged for example by finance companies. Building societies and credit unions are also subject, at least at times, to direction by state authorities as to interest rates they can apply; while less formal than similar regulations on banks, they nonetheless can give rise to the same distortions.

2 R. K. Anstie and I. R. Harper, 'The Cost of Consumer Finance in Australia', in *AFSI Commissioned Studies and Selected Papers*, Part 4, AGPS, Canberra, 1981.

3 The question of entry to various areas of the payments system is discussed in Chapter 23. There it is suggested that free entry subject to normal commercial and prudential criteria should be overseen by the authorities; commercial arrangements need to be satisfactory to all parties to the arrangements; competitive neutrality is only disturbed when there is collusion to exclude other parties. The competitive structure of consumer finance (and other financial) markets is fully discussed in Chapter 32.

- Stamp duty on loan instruments in some states applies when interest rates exceed a certain threshold and this has the effect of penalising high risk borrowers.
- Some government policies to protect investors (e.g. prospectus requirements) and borrowers (e.g. state consumer credit and money lender legislation) may well have had the incidental effect of increasing the cost of consumer credit generally. The lack of uniformity in state legislation introduces an additional element of distortion.

(b) The Small Investor

41.13 The difficulties small investors are said to face would appear to be basically technical in nature, arising from the fact that they are relatively small transactors within the system. Numerous examples can be cited of how the small investor is at a disadvantage. For instance:

- he may be unable to participate in some markets because the minimum transaction is beyond his means (e.g. a minimum level of subscription is required for investment in Commonwealth bonds through the 'tap', certain unit trusts, Life 'bonds' etc.); as well, minimum amounts are required on term deposits by many institutions and this tends to confine the small investor to the call end of that market, which typically carries lower interest rates;
- costs of transacting are generally higher for small transactions;
- small transactors are often the last in line to receive 'current' market information; and
- the small investor has only limited opportunities for 'spreading his risks' or hedging against inflation.

41.14 The issues which the Committee has had to consider are:

- Do these difficulties represent a technical failure in the allocative mechanism of the financial system?
- If so, what role should the government play?

41.15 The fact that small transactors cannot avail themselves of all market opportunities does not necessarily imply 'bias' in the financial system against these groups. For purely technical reasons, such as indivisibilities in the processing of transactions (dealing, paperwork etc.), costs tend to be greater for small transactors than large ones and this explains the requirement for minimum size.

41.16 There are informational advantages that come with greater size because of economies of scale in the collection of information, or from the fact that most large transactors are continuously active in financial markets.

41.17 Finally, it is true that minimum size requirements and the inability to diversify into a large well-spread portfolio limit the small investor's capacity to hedge against inflation and other risks; but this arises out of his smallness and does not necessarily indicate a market 'failure' or 'gap'.

41.18 Small investors can of course avoid many of these problems by channelling their funds through investment intermediaries. Life office and pension funds, for example, provide small investors with an indirect channel to purchase a stake in a wide portfolio including shares, real estate and natural resources. Property and equity trusts facilitate a similar spread of ownership over large real estate and share portfolios. More recently, cash management funds have enabled many small investors to participate in the money market.

41.19 While these investment alternatives through intermediaries have expanded the possibilities available to the small investor, they nevertheless remain more limited and costly than those available to larger investors. The latter, for example, do not have to pay the front-end selling and continuing management costs involved in investment through an institution.

41.20 The Committee notes that many small investors are unable to invest in superannuation funds and are therefore excluded from the tax advantages attached to them. The question of investment via superannuation for small investors has been considered by the Committee. It has noted the taxation changes introduced on 19 August 1980 to enhance the investment opportunities, via superannuation, for non-employer-sponsored employees and self-employed persons. Further changes have been considered by the Committee and are outlined in Chapter 15.

41.21 The Committee recognises that the scope for small investors to avail themselves of investment opportunities may be constrained in some cases but at the same time it is difficult to establish a strong case for government intervention on the grounds of inherent market failure. The fact is that small transactions are relatively more expensive than large ones and any attempt to subsidise them, either directly or indirectly, would amount to the fostering of an inefficient scale of transactions.

41.22 The Government certainly has a responsibility to ensure, as far as possible, that taxation and regulation impact 'neutrally' on the small investor (as indeed on everyone else); the recommendations in this Report (and especially those relating to taxation in Chapter 14) are designed to achieve broadly such results. Beyond this, as the Committee has repeatedly argued in this Report,⁴ if governments wish to promote wider direct participation in financial markets (say for social or other reasons), assistance provided directly through the Budget is to be preferred on efficiency grounds. Reference is made to some policy alternatives in Chapter 33.

(c) Disadvantaged Borrowers

41.23 The Committee is conscious that **low income earners** face special difficulties in obtaining access to the financial system. For example, in housing finance, despite active competition for business, many people are unable to qualify for savings bank and building society loans. This does not, of course, represent a failure of the financial system per se, and government intervention in the system is not the appropriate response.

41.24 Indeed, government intervention has in many ways compounded the problem for low income home seekers. It is argued in Chapter 37 that existing portfolio and interest rate controls give rise to a number of distortions — including perverse effects on lower income groups. The Committee has suggested removal of the controls.⁵

41.25 Recent years have witnessed major changes in the social and professional roles of **women** in society. In particular, they have become more active participants in the workforce and their greater financial independence has enabled them to engage in financial transactions individually rather than as part of the traditional family unit.

41.26 The Committee notes there have been some claims that the financial

4 See especially Chapter 36.

5 See Chapter 37 for a fuller discussion of housing finance issues.

system is not sufficiently responsive to the financial needs and demands of women. Instances cited include:

- loans being refused on the grounds that the applicant is a woman;
- requirements that husband or parent act as guarantor on a loan; and
- lower income women having particular difficulty obtaining finance.

41.27 In the Committee's view, the financial system does, on the whole, extend neutrality of treatment⁶ to women. In considering these allegations of discrimination, two situations must be differentiated. One is where the lack of success of a loan application simply reflects the **economic status** of the woman involved, i.e. her capacity to meet repayment obligations. In this regard, the claim of discrimination is rejected, as the same criteria are being applied as would be used for any other person.⁷ There may be situations, however, where the **sex** of the person is the **sole** reason for the loan being refused or for harsher terms and conditions being imposed. Such situations would be rightly viewed as discriminatory, but, in the Committee's view, they are not common. The way to minimise such cases is to ensure vigorous and open competition between intermediaries. The Committee does not believe that any other special action is necessary.

41.28 The Committee notes favourably that a number of banks have set up women's advisory and information units within their banking operations and expresses the hope that such a practice would spread to other financial institutions.

41.29 There have been similar claims of discrimination against **migrants**. It is suggested, for example, that a constantly recurring problem for newly arrived migrants is the need to have a credit record. Generally, it appears to the Committee that banks and other intermediaries have actively competed for the business of migrant groups in the community. Some banks, for example, run migrant advisory services. Competition would be further enhanced if the Committee's recommendations for the removal of various regulations on the financial system were adopted.

41.30 The Committee accepts that, both now and in the less regulated environment envisaged, some individuals and groups will have legitimate grievances against certain financial institutions. It is important that they have an opportunity to make their grievances known. Various channels currently exist; for example, most intermediaries offer arrangements whereby complaints can be taken to higher levels in the organisation. There are also various private sector organisations or government bodies charged with supporting consumer interests. The Committee does not see the need for further special initiatives by the authorities, although some of its comments with regard to education and information in Chapter 44 will be relevant. There is a need, for example, for full information about rights and obligations under financial contracts to be made available to consumers.

41.31 The Committee has frequently noted in this Report that assistance to 'disadvantaged' groups is best pursued through welfare allocations from the Budget rather than through direct intervention into the operations of the financial system (see in particular Chapter 36).

⁶ In the strict sense used in paragraph 41.2.

⁷ This is not to deny that the criteria used by institutions does sometimes give weight to certain factors unique to women, such as the likelihood of income interruption due to child-bearing. But this would reflect financial prudence rather than any sex bias.

(d) Information Deficiencies

41.32 The Committee has sought to determine whether a necessary minimum amount of information is readily available to people to allow them to undertake basic financial transactions.

41.33 It believes that there is increasing public awareness of the interest rates available on various forms of household savings. Informal, though persuasive, evidence of this can be drawn from the shift in savings between banks, permanent building societies, credit unions and finance companies during the 1970s (and more recently) in response to interest rate differentials. This increasing public awareness partly reflects the growth in advertising by financial intermediaries and more widespread and accessible media discussion of financial matters. Other notable factors are the numerous free publications of various financial intermediaries (banks, building societies, credit unions, unit trusts etc.) which offer a wide range of information and advice on personal finance matters.

41.34 This is not to deny, of course, that significant gaps in knowledge may still exist. This is apparent from public opinion surveys; as well there is clear evidence that many people still hold considerable sums in non-interest or low-interest-bearing accounts; some others borrow at what might appear to be unnecessarily high interest rates having regard to their situation; others again are not fully aware of the risks inherent in various assets and the extent to which deposits with various institutions are 'protected' by government.

41.35 The Committee's essential view, however, is that where there are deficiencies in the household sector's knowledge of financial matters, market forces tend to work to overcome them over time, provided the market is competitive. The Committee believes that if its various recommendations elsewhere in the Report were adopted, the competitive climate would intensify.

41.36 The Committee accepts that the authorities have a responsibility to ensure that investors have access to a minimum level of information and are properly aware of the limits of government interests and powers in protecting investors, and has offered a few suggestions in Chapter 44. However, the Committee sees the role of providing information as primarily one for the private sector. Indeed, beyond a certain point, government action may actually be counter-productive in this area. Official information services dealing with matters relating to individual intermediaries would immediately encounter problems of which intermediaries or services it should or should not include. Those intermediaries included may be perceived by the public as having received some form of official sanction or imprimatur. If one of these institutions ran into difficulties, the Government might be viewed as having a moral obligation to assist it in some way.

C. DEREGULATION AND THE DISTRIBUTION OF FINANCE

41.37 A number of parties have expressed concern that the widespread deregulation of the financial system will skew the distribution of finance away from small, less sophisticated investors and borrowers. On this view, low income earners may have to pay more to obtain finance and simultaneously would be provided with fewer investment opportunities and services by the major financial intermediaries.

41.38 The Committee appreciates but does not share this concern. It would stress

that the present distributional effects of regulation have tended to be somewhat arbitrary, and indeed, in many cases, have disadvantaged the 'poor'. The anticipated effects of deregulation are:

- Many savers will receive greater returns on their funds. This applies both to funds held in savings accounts and those held through life offices and superannuation funds. This may be of particular benefit to small savers who do not have the incentive to go beyond traditional savings facilities provided by such intermediaries.⁸
- It will stimulate competitive forces across the board, presumably leading to an **expanded** range of services to transactors and, in some cases, **cheaper** facilities. If some groups are currently neglected, the greater competition that would accompany deregulation could be expected to rectify this.
- Although interest rates on loans from presently regulated institutions might be expected to increase following deregulation, there should be a greater ability on the part of those institutions to lend in hitherto neglected areas. For example, the effect of deregulation may well be to reduce the cost of finance to high risk borrowers (especially those on low incomes) who are presently forced to obtain finance from 'fringe' lenders at relatively high interest rates.

41.39 While the Committee cannot be specific about the net distributional effects of deregulation it does not believe they will be, in general, regressive. To the extent that the financial system is made more efficient, there is general benefit to the community.

D. CONCLUSIONS

41.40 The preceding discussion, although on a broad level, suggests a number of conclusions:

- While it is evident that access to the financial system is not equal for everyone, the Committee is of the view that, by and large, the inequalities in the system reflect either the perverse effects of government intervention, or underlying inequalities of income and wealth, and accompanying risk-cost differentials; only to a minor extent do they reflect imperfections or failures in market processes.
- There are a significant number of areas where governments, in attempting to direct special assistance through the financial system, have employed policy instruments which have had unintended effects on the distribution of finance. The Committee's discussion in Chapters 36 to 42 draws attention to some of these perverse effects.
- Government social policy to reduce inequities in access to finance, particularly those which reflect differences in underlying income and wealth, is in general not best pursued through the financial system. Elsewhere in the Report the Committee has sought to highlight the uncertain cost-effectiveness of implementing social policy directly through the financial system, and has recommended that social policy to redistribute income and wealth be pursued directly through the Budget.

⁸ It should be remembered that the household sector as a whole is a large **net lender** to the rest of the community. Within the sector, home buyers in the early years of their loan are usually net borrowers, while most other households are net lenders.

- In respect of deficiencies in households' knowledge of financial matters, there may be scope for the private sector to take a more active role in the provision of information to investors and borrowers. In the long run, this must happen in the competitive environment envisaged by the Committee. Chapter 44 takes up this issue.

It was, however, concluded that the level of responsibility for the provision of financial information should be shared between the public and private sectors. It was also noted that the private sector should be encouraged to take a more active role in the provision of financial information to investors and borrowers.

Although interest rate controls have been abolished, the Committee considers that the government should continue to monitor the money market and to intervene in it where necessary to ensure that the money market remains stable and that the government's monetary policy objectives are achieved.

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44.14. CONCLUSIONS

44.14.1. The preceding chapters have set out the Committee's recommendations on a broad level, suggesting a number of conclusions:

- Which is evident that there is a need to improve the system for the provision of financial information to investors and borrowers. The Committee is of the view that the provision of financial information should be shared between the public and private sectors. It was also noted that the private sector should be encouraged to take a more active role in the provision of financial information to investors and borrowers.
- It is also a significant number of cases where government intervention is warranted to ensure that the money market remains stable and that the government's monetary policy objectives are achieved.
- Government social policy to reduce inequalities in access to financial services should be continued. The Committee is of the view that the provision of financial information should be shared between the public and private sectors. It was also noted that the private sector should be encouraged to take a more active role in the provision of financial information to investors and borrowers.

CHAPTER 42: REGIONAL DISTRIBUTION OF FINANCE

A. INTRODUCTION

42.1 In an economy with geographically and politically diverse regions, there need to be efficient channels through which funds can be transferred from surplus to deficit regions. Two questions require particular discussion in this connection:

- whether the many state government interventions in the financial system are impeding the interstate transfer of funds; and
- whether the financial system itself is discriminating against particular regions, in the sense that loan or investment propositions with similar risk/return prospects are being treated differently in various regions.

B. GOVERNMENT-INDUCED BARRIERS

42.2 Of the state-based regulations that have attracted the Committee's attention, amongst the most important are regulations which have the effect of deterring building societies from lending or borrowing interstate.¹ Given that building societies are a substantial institutional group (accounting for 7% of the financial assets of all financial institutions) these regulations are potentially a significant blockage to interstate flows of funds.

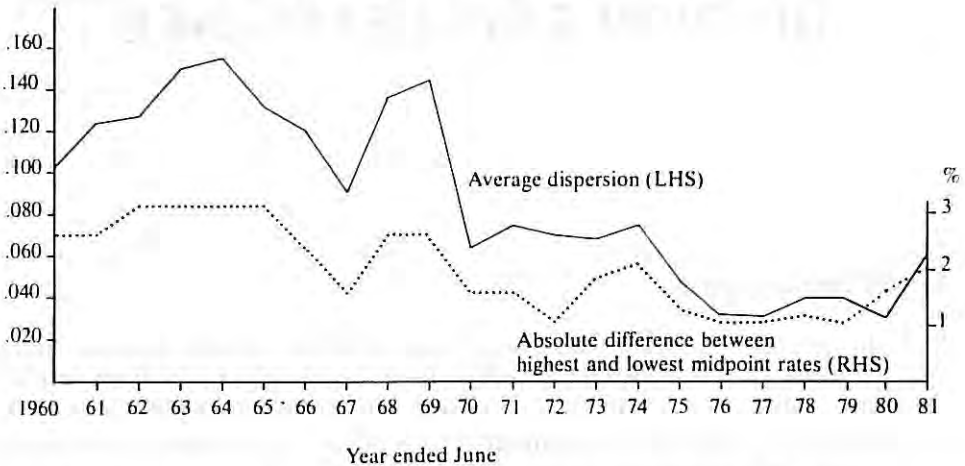
42.3 The Committee's interest in this issue does not arise solely from considerations of efficiency; a broader question of equity is also involved. Where these regulations are intended to keep local borrowing rates below the predominant national level, local depositors as a group receive a lower rate of return on their savings and are effectively subsidising local borrowers. (Housing finance arrangements are discussed in Chapter 37.)

42.4 However, the restrictions placed on building societies must be viewed against the fact that most other substantial financial intermediaries in Australia operate at a national level, and are free to respond fairly readily to interest rate differentials. Nationally marketed assets offered by banks, finance companies etc. will absorb regional funds and possibly transfer them interstate unless local building societies bid for funds at close to national interest rate levels. As can be seen from Figure 42.1, broad national influences have increasingly led building societies in different states to price funds on a comparable basis.

42.5 Nonetheless, significant interstate differences remain. The Committee's suggestion elsewhere in this Report that building societies be allowed to operate on

¹ See paragraph 15.58 of the Interim Report.

FIGURE 42.1 DISPERSION OF PBS AT-CALL INTEREST RATES ACROSS STATES



Source: Australian Bureau of Statistics, Financial Corporations Statistics, Australian Catalogue 5617.0

a national basis (or at least trade in mortgages on an Australia-wide basis) should facilitate the flow of funds between states.

42.6 A further barrier to the flow of funds is created by state-based trustee arrangements. The view put forward in Chapter 10 is that these effectively create captive markets for the favoured securities, and are frequently used to promote the securities of various authorities in the particular state in a way which reduces efficiency. From a national viewpoint it tends to fragment capital markets, and may distort the pattern of public sector financing across Australia. Within individual states there may be important allocative effects coming from the granting of trustee status to some borrowers and not others. In Chapter 10, the Committee proposes a more uniform approach to trustee arrangements.

42.7 Another impediment to interstate flows of funds is state government intervention aimed at discouraging or preventing takeovers of major local companies by interstate companies. Such intervention, while still uncommon, can have perverse effects:

- The mobility of capital is impaired and with it the allocative efficiency of the financial system.
- The managements of local companies (in the affected state) may feel 'protected' and this may delay a restructuring of management, or a desirable rationalisation of the company's operations.
- If shareholders are denied in certain states the opportunities that arise from time to time from the act of takeover, investors in those states may prefer to place their funds elsewhere.² As a consequence, local companies could find it relatively more difficult or expensive to raise capital.

42.8 While local concerns regarding employment, ownership and so on can be appreciated, the Committee places great importance on efficient transfers of funds

2 There are, of course, other considerations affecting investors' preferences, e.g. death duties.

throughout all areas of the Australian financial system. Greater efficiency in the financial system will ultimately yield benefits across all regions. The Commonwealth is urged to take up the matter of interstate takeovers with the relevant state authorities at an early opportunity

42.9 Finally the existence of state government-owned banks (and other intermediaries), operating within restricted geographical boundaries, may be a factor impeding at times the geographical mobility of funds. This is all the more so where state authorities seek to shield financing in their state from the general impact of national economic and monetary policy. The Committee recognises, however, that state governments may wish to promote industrial diversification and growth within their region and their involvement in financial intermediation may be seen as part of this desire. Moreover, any concerns on this count must be tempered by the fact that most of Australia's major financial institutions are nationally based. The issues relevant to the operations of state government-owned banks and other intermediaries is taken up in more detail in Chapter 27.

C. MARKET-INDUCED BARRIERS

42.10 Some parties have claimed that the financial system contributes to perceived regional disadvantages. They argue that the financial system is inefficient in allocating funds to different regions and thus accentuates regional imbalance.

42.11 Those who put forward this view argue that the smaller urban and rural areas are not well provided for in terms of financial services. Limited choice of banks, absence of financial services apart from retail banking, and unwillingness of intermediaries to lend in such regions have all been mentioned as examples of this. As a consequence, it is claimed, there is a net transfer of funds — especially bank funds — away from rural to metropolitan areas, i.e. deposits and loans (or liabilities and assets) are not balanced between regions.

42.12 In the Committee's view these are not valid objections. As a general principle, national output will tend to be maximised if savings are directed to where they will yield the highest return, regardless of whether or not these funds are used in their region or state of origin. There is no evidence, as far as the Committee is aware, that financial intermediaries fail to allocate funds efficiently in this sense (subject to prudential and regulatory considerations). If banks were to aim to balance deposits and loans in all regions, it would require the application of different credit standards or criteria to different regions; this would amount to effective discrimination — not neutrality. Moreover, in a competitive environment any intermediaries that 'favoured' borrowers in a particular region would find it more difficult to attract and hold a broad deposit base.

42.13 Financial services in rural areas are more widely available than is often thought. Several financial institutions, most notably pastoral finance companies, are geared to providing specialist financial services to rural producers. These institutions, together with banks, provide people in rural areas with access to a very wide range of investment opportunities, extending into the finance company and merchant banking areas. The fact that these intermediaries are not present in every town is evidence, not of any bias in the system, but of a sensible and desirable economising of resources in a geographically diverse market. Were this not the

case, there would be very high transactions costs resulting from rural financing.³ The uneven regional dispersion of financial institutions and services is not a cause but a **consequence** of the uneven regional spread of industry and economic activity.

42.14 It has been argued that this unevenness in the geographic dispersion of financial institutions and services can, especially in the existing regulatory environment, distort the way in which monetary policy impacts on regional funds flows.

42.15 For example, measures of monetary policy applicable directly only to banks (subject to the Banking Act) tend to have a greater impact (at least initially) in regions where their facilities dominate the provision of finance. In practice this is likely to mean the small non-metropolitan centres of population.⁴ Again, measures that impact most severely on particular NBFIs, like building societies, can be expected to have an uneven regional incidence because the relative importance of these institutions varies considerably from region to region and the institutions operate within state limits.

42.16 The Committee accepts that monetary policy cannot be neutral in its regional impact so long as:

- it is discriminatory as between institutions;
- there are significant regional differences in the 'institutional mix' (the same problem arises with regional differences in 'industrial mix' but this is outside the terms of reference of this Inquiry); and
- there are impediments to the regional flow of funds.

42.17 However, if the Committee's recommendations in Chapter 4 and elsewhere in this report were adopted, monetary policy would be expected to have a more uniform regional impact in the future because:

- it would be more even-handed in its impact on different groups of institutions;
- capital funds would be more mobile between states.

42.18 It is relevant to consider the likely implications of any easing in conditions of entry to banking (as proposed in Chapters 24 and 25) on the branch banking system. This is an issue on which there might be some potential conflict of objectives between efficiency and regional balance (as sought by governments). The Committee does not consider it appropriate to impose branch requirements on new banks and it is possible that in the new competitive environment existing banks may wish to rationalise their branch structure. While possibly desirable on efficiency grounds, it may lead to a decline in the range of banking facilities available in some outer country areas. The effect on country facilities would be lessened if, as part of the rationalisation of branch banking, banks and other financial intermediaries were more willing to use agency arrangements (e.g. with post offices, shopkeepers and others) in providing banking services in outlying areas. Technological developments may help make these alternatives more attractive in the future than they have been in the past.

3 It is far from clear that the rural sector would wish to meet all of these costs. On the other hand, if cross-subsidisation by other customers was used to meet them then questions of both efficiency and equity would be raised.

4 There is, however, scope (sometimes availed of) for state banks not to adhere fully to national banking and monetary policy.

D. METHODS OF INTERVENTION

42.19 An activist policy stance to remove regional differences is advocated by some. One argument underlying these views is that there are various externalities associated with very large differences in regional growth rates (e.g. pressures on public facilities and infrastructure, on wage structures, environmental problems etc.). Because these social costs are generally not reflected in prices, it is argued there is a need for official intervention. One suggestion is that this intervention should take the form of a financial institution the task of which is to provide finance for a specific region or regions.

42.20 While it is recognised that governments might wish to pursue policies to smooth out regional differences the Committee does not support the pursuit of such policies through intervention in the financial system. As with other issues, primary consideration needs to be given to the relative cost-effectiveness of different policies.

42.21 The alternative to direct intervention in financial markets is a system of taxes and subsidies favouring certain categories of expenditure or activities in a particular area. For example, instead of issuing lending directions to private financial institutions or employing government-owned institutions to reduce the cost of certain financial services in non-metropolitan areas, a direct subsidy (zone allowance) might be paid to affected residents of these areas.⁵ The latter type of approach is preferable as a rule: it has a less distorting effect on the efficiency of capital markets, as well as being more visible and direct.

42.22 Similar observations apply to proposals for government-sponsored, regional financial intermediaries. Clearly a proliferation of bodies, each concerned with one particular region, could fragment the capital market, as pressures would be created for preference to be given to investment projects in the region concerned.⁶ Further difficulties would arise in deciding which regions could establish such a body.

E. CONCLUSION

42.23 To sum up, the Committee is aware that there are important regional differences in income, wealth, living standards, quality of life and investment opportunities. It is also aware that a 'technically efficient' financial system will do nothing per se to reduce these regional differences. However, as with welfare considerations, the situation is not one created or compounded by the financial system. If governments wish to promote a more even dispersion of economic activity and welfare, there are a variety of policy instruments available to them (see paragraph 42.21). To attempt to achieve similar results by means of direct intervention in the financial system (e.g. by way of directions or guidance to certain financial institutions or the establishment of GFIs) would appear to the Committee to be both inappropriate and counter-productive.

⁵ There is also, of course, the Grants Commission machinery.

⁶ Furthermore, any such bias would create a subsidy for local borrowers the cost of which would be borne by depositors.

GENERAL

- Ch. 43 Inflation and the Financial System
- Ch. 44 Information Gaps in the Financial System
- Ch. 45 Summary of Conclusions and Recommendations

CHAPTER 43: INFLATION AND THE FINANCIAL SYSTEM

A. INTRODUCTION

43.1 The Committee sees high and variable inflation as having major implications for the efficiency of the financial system. It can interfere with the neutrality of funds flows, accentuate uncertainty, shorten investment horizons, undermine the market for longer term debt securities, distort the meaning of corporate balance sheets and reduce the usefulness of conventional measures of profit as guides for rational investment decisions. If inflation is severe and sustained and if the financial system is not free to respond and adapt, inflation can also threaten the viability of many commercial and financial corporations.

43.2 This chapter draws together a number of points — many of them discussed in other chapters — about the effects of a high and variable rate of inflation on the financial system. The effects are surveyed under four headings: equity, allocative efficiency, stability and the overall monetary environment.

B. EQUITY

43.3 The first and most basic problem arising out of inflation is that, being uncertain (and with markets often slow to adjust), it generates an arbitrary redistribution of income and wealth. In the 1970s, the redistribution was principally from net lenders to net borrowers because interest rates did not rise sufficiently to compensate fully for the effects of inflation on real capital values. If the total value of financial claims outstanding is of the order of \$200 billion, then every one percentage point by which the interest rate falls short of the rate of inflation entails an annual redistribution of \$2 billion from lenders to borrowers. Of course, the cost to lenders is even greater if one accepts that they are entitled to a positive real return and if one makes some adjustment for taxation.

43.4 Since there was a 'negative' real rate of interest on government bonds of about 1 to 2% in the decade to 1980¹, it is clear that the redistribution from lenders to borrowers arising from inflation has been very large.² One of the major beneficiaries has been the Government: the sharp decline in the real value of the public sector debt can be viewed as a 'tax on wealth' — one that is largely arbitrary in its incidence. The household sector, being the main accumulator of monetary assets during the past decade, would have been the principal loser — but of course there have been both gains and losses within that sector.

¹ See Table 9.3 and Figure 9.1 of Interim Report.

² If one took for illustrative purposes a positive real return of 2% as an appropriate benchmark, the redistribution effect would have been of the order of \$5–\$6b, without allowing for the effects of taxation.

43.5 The redistribution effect of inflation in the 1970s may well have been socially perverse in its incidence because:

- a high proportion of lenders are — or indirectly represent — people of modest means (e.g. retired people);
- small savers tend to hold a high proportion of relatively liquid monetary assets and have only a limited capacity to hedge against inflation;
- small investors are inhibited from frequently rearranging their investment portfolios in response to changing circumstances because of high unit transaction costs; and
- those able to borrow considerable amounts are the more affluent members of the community.

43.6 The impact of inflation on lenders and borrowers³ can therefore be regarded as a potentially serious social problem.

43.7 Government controls have compounded the distributional effects of inflation. For example, the institutions that have principally attracted the funds of small investors, e.g. banks and building societies, have been subject to interest rate controls⁴, and governments have been slow at times to alter the controlled rates in line with changes in the rates of inflation.

43.8 The taxation system has tended to accentuate the distorting impact of inflation. In Chapter 17, the Committee pointed out that inflation causes capricious changes in the effective rate of tax on various incomes and on the relative after-tax returns available to different investors. As a consequence there is an inequitable distribution of the tax burden.

43.9 In particular, the Committee noted that lenders are taxed on interest received — including that part which is compensation for inflation and which can be viewed as repayment of real capital — while commercial borrowers not only claim interest payments as a deduction from their taxable income but, in some cases, are able to invest the funds in such a way as to obtain part of their income in the form of tax-free capital gains. **In the Committee's view, the Government should undertake a full review of the effects of inflation on the equity of the tax system.**

43.10 Of course, markets are not static: prices and yields tend to adjust to take account of the effects of both inflation and taxation. For example, interest rates have moved up sharply in recent years and are now showing a positive (before tax) real return both in Australia and in most other countries. (It is indeed possible that, having underestimated prospective inflation in the past, markets may now be overestimating what it will be in the future.)

43.11 However, in practice, debt markets — no matter how efficient they might be in a technical sense — will not correct fully and speedily for the effects of future inflation. In particular, interest rates may not adjust adequately because:

- many other variables, besides expected rates of inflation, obviously have a strong bearing on movements in interest rates, especially in the short run⁵;

3 The impact on lenders and borrowers is, of course, only a part, but a very significant part, of the income redistribution process brought about by inflation.

4 The distortive effects of interest rate regulations are discussed in detail in Chapters 4 and 37. The primary concern here is the inequitable impact on savers.

5 See Interim Report paragraph 9.7.

- markets do not normally have sufficient knowledge to forecast what future rates of inflation will be, especially when there is a tendency for inflation rates to fluctuate;
- there may be a considerable lag in the reaction of interest rates to changes in the rate of inflation, although this may now be changing; and
- markets are not always permitted to operate freely; for example governments may impose interest rate controls and may be slow to alter the controlled rates in line with changes in the rate of inflation⁶; as already mentioned, this has particularly affected the small saver.

43.12 For these various reasons, markets, particularly regulated markets, cannot be expected to fully correct for the distributional effects of inflation, although they do respond significantly, especially over the long term. Against this background it is argued in Chapter 1 that a well-functioning financial system needs to have a 'risk spectrum' which ideally includes an asset that can serve as an effective hedge against inflation.

43.13 In Chapter 33, the Committee drew attention to the high after-tax return on owner-occupied housing, arising partly from various taxation concessions, and suggested that this may have been one possible explanation for the withdrawal of the individual investor from the share market. This form of investment, and real estate in general, has provided a more than adequate hedge against inflation through the 1970s. However, it is virtually impossible for most small savers to invest in real estate beyond the home which they occupy, although this difficulty has been somewhat alleviated by the growth of property trusts. Moreover, many small savers do not qualify for a housing loan and cannot, as a consequence, even invest in owner-occupied housing.

43.14 Various other assets might have been expected to provide a hedge against inflation in the 1970s. Some commodities and collectables (antiques, coins, stamps etc.) yielded a return in the 1970s which was high enough to offset inflation, particularly when it is remembered that the return came typically in the form of a non-taxable capital gain. These assets are not, however, suitable for most investors (particularly small investors) because:

- there is a substantial price risk involved and the markets can be viewed as highly speculative⁷;
- most investors do not have the special knowledge required for investment in these fields; also, they cannot afford sufficiently large portfolios to enable them to reduce the risk involved through diversification;
- investment in these assets does not generally yield any ongoing returns. This could create cash flow difficulties for investors paying high nominal interest rates on the funds borrowed to purchase the assets.

6 Of course controlled institutions often respond to such a situation by increasing the non-monetary services they provide to their customers. For example, an 'implicit interest' is paid on current accounts by under-charging for the use the customer makes of them. It is noted in Chapter 4 that this method of paying interest represents an inefficient way of using resources and does not provide consumers with an adequate range of choice.

7 A number of these items suffered price reverses in the first half of 1981. The effects of this become more formidable as investors 'gear up' their investments or buy on margin. Then a small fall in prices could wipe out their equity with effects familiar to students of the 1929 share market crash in the United States.

43.15 Shares are often regarded as a good hedge against inflation. This has been only partly the case in the 1970s, although shares did yield a higher after-tax return (on dividends and capital gains combined) than, for example, a two-year bond. The evidence is discussed further in Chapter 33.

43.16 In addition, there have been periods of significant duration (e.g. during the early 1970s) in which shareholders suffered large capital losses. The risk in share investment is magnified for the small investor by the fact that he is limited in his ability and opportunity to assess the potential of investments, by his inability to spread his risks over a wide range of shares, and by his need to transact in small amounts.⁸ He does, however, have access to unit trusts and equity-linked insurance policies and pension funds. These reduce but do not, of course, eliminate the risk.

43.17 It is clear that the small investor may have some difficulty in finding an inflation hedge which involves only a small degree of risk.⁹ This is one reason why in Chapter 11 the Committee recommends that consideration be given by the Government to the introduction (in appropriate circumstances) of either a variable rate security or an indexed security or both. Variable rate securities — which are now common in the private sector — would remove the risk of future adverse movements in interest rates, while indexed government securities would provide a risk-free return (at least before tax).¹⁰ The recent freeing of bank deposit rates should also be helpful in this regard.

43.18 It is not only investors (lenders) who suffer from inflation. High interest rates, in conjunction with conventional long-term loan contracts, also create short-term problems for many borrowers. Even if the rates turn out to be negative in 'real' terms over the long term, there may be cash flow difficulties in the early years of a loan if repayment commitments are high — relative to the income of the borrower. This is true of many home buyers, for example.

43.19 Financial markets can — and do — adapt to this problem over the long term. For example, mortgages can be arranged so that the size of repayments increases with the borrower's income, or simply increases over time. A further approach under consideration by many institutions is one whereby the lender participates in the capital gains received from housing through equity-participation mortgages.¹¹

C. ALLOCATIVE EFFICIENCY

43.20 The argument that inflation discourages saving is no longer accepted. In an appendix to Chapter 35, the Committee points to the complex ways in which inflation affects the level and structure of saving. It is suggested that the sharp rise in household savings in the 1970s may in part have reflected a desire to maintain the real value of assets in an inflationary environment.

8 There is also the question of his ability (and that of many others) to assess economic conditions and their likely impact on share values.

9 This gap in the availability of hedges against inflation may provide an explanation of the observed lag in the adjustment of some interest rates to changes in the rate of inflation.

10 In some countries (e.g. United Kingdom) indexed bonds are marketed on the basis of a guaranteed 'tax-free' real return.

11 This approach has been adopted to a limited degree in the United States.

43.21 On the other hand, inflation has, at least for a period, reduced corporate profits.¹² At the same time the government sector has been in substantial deficit for some years (although the deficit has been declining in recent years). All this has resulted in a dramatic increase in the importance of household saving relative to government and corporate saving — especially during the course of the 1970s.

43.22 Inflation has also had a considerable influence on the relative demand for short and long-term forms of saving and investment. This in turn has been reflected in the pattern of funds flows and the institutional structure of the financial system.¹³ For example, it has had a significant influence on:

- the growth of certain short-term deposit-taking intermediaries (such as building societies and credit unions) relative to longer term intermediaries such as life assurance companies;
- the strong expansion in superannuation business, a trend influenced by the inflation in wages and salaries in the 1970s;
- the rapid development of property trusts; and
- more recently, the growth of cash management funds.

43.23 To the extent that these institutions have specialised in particular areas of investment, these changes have had a significant impact on the distribution of funds to different sectors of the economy.

43.24 Inflation can affect the efficiency of investment analysis and decision making. If the financial system is to perform its allocative role efficiently, it must be backed by an information system that is relevant, reliable, free from bias, timely, comparable and understandable. Even the best conceived accounting and disclosure systems will have deficiencies in some of these respects; but many have argued that inflation has added immeasurably to the problems of interpretation — to the point where the conventional accounts of many companies no longer provide a truly reliable measure of relative returns and financial performance.

43.25 The Committee is aware of the deficiencies of the historical cost accounting system as a source of financial information. It is conscious that in an environment of high and variable inflation, financial reports based on historical costs of assets and liabilities can be very misleading, particularly for long-term decision making. These issues, although certainly relevant to the efficiency of the financial system, are extremely complex and the Committee has not been able to seriously examine them. It draws attention to the problem here in order to illustrate yet another way in which inflation can impede the efficiency of the financial system as an allocative vehicle.

43.26 Finally, it needs to be pointed out that the equity or distributional problems discussed earlier in this chapter have equally significant implications for the ‘neutrality’ of funds flows and allocative efficiency.

12 Inflation of the ‘demand pull’ variety is, of course, less likely to squeeze profits than inflation of the ‘cost push’ variety.

13 See Interim Report, Chapters 1 and 2. Corporate saving has tended to recover in the last few years.

D. STABILITY

43.27 A high and variable rate of inflation generally means high and volatile interest rates. This has certainly been the experience in Australia and most other countries. In turn, such an environment generates additional uncertainty in financial markets.

43.28 In the first place it adds to the risks faced by lenders. Lenders providing funds on a fixed rate for long terms are uncertain about the long-term real return they will obtain. It is not surprising therefore that the availability of long-term debt at fixed interest rates (other than convertible notes) virtually dried up in the 1970s.

43.29 One element in the declining availability of longer term debt funds is illustrated in the substantial fall in the average maturity structure of government security holdings of life offices in the period 1970 to 1980. (See Table 10.1.) It is likely also that the life offices did not replace long bonds as they moved closer to maturity. As noted elsewhere, they would have been unwilling, in many instances, to actually sell long bonds and crystallise the capital loss.

43.30 Conversely, many corporate borrowers have been forced to finance long-term capital projects out of relatively short-term borrowings. This has added further uncertainty to estimates of the ultimate capital cost and returns on projects.

43.31 Another way in which markets have adjusted to inflation has been through the provision of long-term funds at 'variable' or 'floating' rates (at interest rates that fluctuate with the cost of funds). However, these types of loan arrangements, like the shortening in average debt maturities, while helpful to lenders (by reducing their risk exposure), have not always adequately served the needs of corporate borrowers. Indeed, there is a risk that the introduction of variable rate debt might add to the 'fragility' of the corporate sector because any increases in interest rates immediately extend to a high proportion of outstanding debt. (Of course, this also occurs when the average maturity of debt is shortened.)

43.32 Inflationary pressures (coupled with the tax treatment of interest rates) may have encouraged companies to increase their debt/equity ratios — at least in periods when nominal interest rates have not risen to fully reflect inflation.

43.33 To an extent this can be viewed as a natural and healthy adjustment by the system to the pressures of inflation and changes in the relative cost of capital. Nevertheless, it does have some potential dangers, as it increases the vulnerability of companies to downturns in economic activity and increases in interest rates.

43.34 These issues are discussed in Chapter 34 where the view is put that corporations have generally responded well to the changing environment; however, there remains cause for some unease about the future, unless inflation can be effectively controlled.

43.35 The authorities have indicated some concern about the potential effects of volatile interest rates on the stability of financial intermediaries and markets. Unstable interest rates mean fluctuating asset values and greater risks from any temporary mismatch of the maturities of assets and liabilities. These factors, and the fact that interest sensitivities of loans and deposits might differ for many intermediaries, can also lead to greater instability of earnings and its consequences.

43.36 The Committee does not see interest rate volatility as a serious threat to the stability of the system as a whole — **provided the system is free to adapt** (and

allowing some time for participants to become attuned to the changed environment). The risks arising from inflation and volatile interest rates tend to be most pronounced when financial institutions are subject to interest rate controls, because such controls lead to greater instability in funds flows, with problems for prudential management, and operational efficiency.

43.37 Inflation has also affected the capital gearing of deposit-taking financial institutions. Faced with a rapid growth in their balance sheet liabilities, they have had to set aside larger amounts from profits or to raise additional capital in the market in order to maintain an appropriate capital base. This has not, however, proved particularly difficult for fixed-capital institutions with a high standing in the market (although it is possible the cost of such capital has risen). Co-operative institutions have had to look to their lending margins to ensure an adequate build up of capital and reserves.

43.38 Inflation has important implications for superannuation funds, especially where ultimate benefits are related to final earnings; this is commented on in Chapter 20. However, other than by its general reference to indexed securities, the Committee has not addressed itself to the problems that might be posed for certain superannuation funds in the future if present (or even higher) rates of inflation were to persist and traditional equity investments were to prove ineffective safeguards against them.

E. THE OVERALL MONETARY ENVIRONMENT

43.39 In various chapters of this Report, the Committee has explicitly or implicitly drawn attention to some of the ways in which inflation bears on the overall stability of financial markets.

43.40 In particular:

- in Chapter 3 attention is drawn to the problems the authorities face in maintaining a stable rate of monetary growth when there is a strong undercurrent of 'autonomous' or cost push inflation;
- in Chapters 9 to 12 the Committee argues strongly for a realistic interest rate policy, but the difficulties of marketing government securities in a highly unstable interest rate environment are also acknowledged.

F. CONCLUSIONS

43.41 Two major conclusions can be drawn from this survey of the effects of inflation on the financial system. Firstly, a high and variable rate of inflation has interacted with the regulatory constraints and the taxation system to impose, at times, severe stresses on the financial system. This has been associated with arbitrary and often regressive effects on the distribution of wealth and incomes.

43.42 Secondly, while the system has effectively responded to many of these stresses, some potential problems remain. In particular, the Committee notes:

- the continuing capital and debt structuring problems for many corporations;
- the continuing climate of uncertainty in financial markets generally and, associated with that, the virtual disappearance of longer term debt markets;
- the lack of an adequate hedge against inflation for the small investor;

- the difficulties which inflation presents for the interpretation of corporate financial accounts and investment analysis; and
- the distortions created for the pattern of funds flows.

43.43 The Committee believes the solution to these problems should be sought on four basic fronts. First and foremost governments must continue to give a high degree of priority to the control of inflation. This represents an important way in which government action can assist the efficiency and equity of the financial system.

43.44 Secondly, on the assumption that some inflation will continue for a time, the Committee would stress the importance of having a financial system which is intrinsically flexible and adaptable. A system that was highly competitive and free of rigid regulatory constraints would meet this requirement. The program of deregulation the Committee has proposed in this Report, if implemented, will move the system a long way in this direction and greatly strengthen the capacity of the financial system to respond to inflationary pressures.

43.45 In this regard, the recent relaxation of some regulations on bank interest rates, the adoption of more market-oriented interest rates for government securities and the more competitive and aggressive investment approach adopted by financial institutions generally have contributed to an increased range of investment facilities offered to investors and at more 'realistic' rates of return. Innovations include the development of new types of property and equity trusts, cash management trusts, and the issue of Australian Savings Bonds on more attractive terms and made more readily accessible to small investors.

43.46 Thirdly, the Committee has proposed that consideration be given to the issue of indexed government securities in certain circumstances, so that small investors have an adequate hedge against inflation.

43.47 Finally the Committee has pointed to the effects of present taxation arrangements in compounding the problems caused by inflation and has urged the Government to undertake a comprehensive review of the taxation of incomes in an inflationary environment.

CHAPTER 44: INFORMATION GAPS IN THE FINANCIAL SYSTEM

A. INTRODUCTION

44.1 Throughout this Report the Committee has stressed the importance of:

- effective communication between the authorities and the community at large on the aims and processes of economic and prudential management;
- an adequate range and quality of information on the sources of funds and investment opportunities available;
- broad equality of access to information by all participants in the system; and
- consistency in disclosure requirements as between different financial intermediaries.

44.2 These four elements are crucial to the functioning of an efficient and equitable financial system. They can help to ensure that:

- the authorities are more fully accountable to the community for their economic performance;
- investment decisions are made with full knowledge of the risks and returns;
- borrowers are fully aware of the various sources of funds available and the terms and conditions thereof;
- all borrowers and lenders have equal opportunity to participate;
- participants have confidence in the fairness and viability of financial markets;
- the incidence of fraud and malpractice is kept to a minimum; and
- private corporations and institutions are more effectively accountable to their members and shareholders.

44.3 It must be recognised that compulsory information and disclosure requirements represent another form of regulation and, as such, frequently entail significant costs. Often the costs will outweigh the benefits. This is likely to be so where the information appears late or in a form that is of limited use, and the costs of collection, processing and compliance are relatively high.

44.4 It should also be recognised that an efficient, competitive capital market will generate a considerable volume of information without any pressure from the authorities. For example, the stock exchanges have a direct interest in promoting confidence in securities markets and have traditionally led the demand for adequate and timely disclosure.

44.5 The ultimate sanction rests with the market: investors can refuse to invest in a corporation that does not meet their standards of financial disclosure or they can 'price' the securities (debt or equity) of that corporation accordingly.

44.6 The Committee nonetheless accepts that a free market, of its own accord, may not generate the right amount or kind of information — or on a sufficiently consistent basis. Yet the stability and efficiency of the financial system may well depend on the confidence of participants in the veracity, reliability and comprehensiveness of the information available. Up to a point, therefore, there may be net social benefits from government intervention.

44.7 The issue is not whether governments should be involved but **how much government involvement** is appropriate, i.e. how much information governments should themselves provide and legally **require** private enterprises to provide, on the one hand, and how much they should leave to the free forces of the market, on the other. The Committee recognises that the costs and benefits involved are often difficult to measure and that it is a matter of judgment where the balance lies. There is perhaps a role here for the National Companies and Securities Commission (NCSC) and like bodies: **in conjunction with the Australian Bureau of Statistics they could sponsor or conduct research into the costs of additional information, and the incidence of these costs, so that a more considered judgment can be made on the issues.**

44.8 While, on balance, the Committee has recommended changes that will broaden the area of government involvement in the generation of information, its aim has been not to increase the volume of information but rather to **improve its quality** and timeliness and thus its usefulness to investors.

44.9 In this chapter, the Committee addresses itself to two broad types of information deficiencies:

- **insufficient knowledge by both borrowers and investors of the nature and range of the facilities available** — this is discussed in Section B; and
- **inadequate official statistical data** in certain operational areas, such as rates of interest charged, funds lent to particular classes of borrower etc. — this issue is discussed in Section C.

44.10 This chapter seeks to identify some of the gaps. It also offers suggestions as to the role of both government and the private sector.

B. OPERATION OF THE FINANCIAL SYSTEM

(a) Outline of the Problem

44.11 The Committee has sought to determine whether:

- there is insufficient information available; or
- the available information is adequate in volume but is not sufficiently accessible, i.e. is not being effectively communicated; and/or
- the information is unevenly distributed, i.e. more accessible to some than to others.

44.12 Many individuals have tended to expect that their bank manager or someone similar will provide a full range of financial advice. Unfortunately, with the increasing range and complexity of sources and uses of funds, it is evident that such traditional sources of information are no longer adequate. With the greater competition between various intermediaries for household funds in recent years, it is perhaps unrealistic to assume that independent, unbiased advice will be available from those who are actively seeking to attract those funds. It is nevertheless clear

that some finance industry groups have sought to educate investors about investing in their respective areas and, in at least some cases, efforts have been made to provide broader general information.

44.13 For example, the Committee is aware of at least two freely available booklets¹ which usefully describe alternative sources and uses of funds to the non-professional. They are written in the form of a personal money management guide and provide a broad look at the deposit/investment and lending facilities offered by various financial institutions and government. These and like documents are not 'complete' publications, in that there is a natural tendency to emphasise the benefits offered by the particular class of institution or related companies. Nevertheless, a useful public educational service is provided at no (visible) charge to the user.

44.14 The Committee noted in Chapter 38 some of the financial information facilities currently available to small businesses:

- The State Governments, through their small business agencies, provide basic referral, counselling and advisory services to small businesses. From the Committee's discussions with the small business community, it has formed the view that this service has become increasingly known over recent years.
- The Commonwealth Government, through the Department of Industry and Commerce, is directly involved in the publication and distribution of small business literature and management training packages.²
- A number of trading banks have, in recent years, established specialist advisory units, as extensions of their financial information and advisory services to small business customers. Services include assisting the preparation of loan applications and other accounting services.
- A number of business and financial newsletter services, specifically directed at small businessmen, have emerged in recent years, providing summary up-to-date information over a wide range of financial and taxation matters relevant to small business.

44.15 Complaints have often been made that suitable funds are not available to small businesses. In many cases it is apparent that the difficulty lies in an overgeared balance sheet structure. If small business advisory services are able to indicate a more suitable balance sheet structure, a perceived financing gap may also be removed.

44.16 To those unversed in the workings of the share market, educational services are available at the various stock exchanges.

44.17 The Committee is also aware that an important informational role is played through migrant advisory services. For those new to Australia there are two specific difficulties in the financial area. These relate to:

- inexperience in dealing with the financial system in Australia, leading to lack of knowledge of the institutions and the range of services offered;
- lack of fluency in English and sometimes lack of literacy.

44.18 Government agencies, banks, welfare groups and many individuals

1 *The Money Book*, The National Bank of Australasia Ltd; and *Money Matters . . . for the family and Money Matters . . . for the 40 plus*, United Permanent Building Society.

2 A series, *Managing the Small Business*, is produced by the Department.

working with migrants all participate to some extent in attempting to bridge this particular gap. Financial information is one of the most significant and continuing needs of migrants in Australia.³

44.19 News media have assisted in reducing the search costs involved in borrowing and investing. Regular financial guides appear increasingly in newspapers and popular magazines, written in a manner designed to help the less financially sophisticated. They frequently contain, for example, information on the range of opportunities available to small investors and borrowers. To an increasing extent radio and television have provided a similar service. Financial journalists have a particularly important role and responsibility.⁴

44.20 In the more specialised area of business finance, the Reserve Bank has published a booklet titled *Money for Business — A guide to types and sources of finance*. As well as describing types and sources of finance, it provides a basic introduction to corporate financing problems. In addition, there have been a number of private publications on this subject. There are also many professional financial advisers servicing those with larger financing needs.

44.21 There would appear to be, therefore, a reasonable volume of information available to those seeking to borrow and invest⁵, **if they are willing to make the effort and take the initiative to seek it out**. Individual institutions freely provide information concerning facilities they offer — a number of broad, detached publications are available — and a number of specialist government agencies assist with financial advice.

44.22 Yet the evidence points to significant gaps in understanding. For example, the Committee has found that:

- some small businessmen appear to be unaware of the facilities available;
- many small investors do not take full advantage of the range of investment opportunities available — witness the substantial volumes of funds held on cheque or pass book accounts;
- there is apparent public confusion over the extent of official protection of banks and other institutions⁶;
- there is some lack of understanding of the rights and obligations involved in many financial contracts;
- few investors are able to evaluate corporate financial statements.

44.23 One must conclude that the effort or expense of information search and inquiry is seen by many as prohibitive (or, in some cases, the quality of the information is viewed with cynicism). As a result, the information that is available,

3 *Survey into the Information Needs of Migrants in Australia*, April 1980, Report to the Commonwealth Department of Immigration and Ethnic Affairs by W. D. Scott and Company.

4 Some have raised the question of whether they should be subject to minimum qualifications. See submission from Professor J. K. Winsen, University of Newcastle, 'A Proposal for Empirical Research into the Costs and Benefits of Government-required Financial Disclosure by Public Companies in Australia'.

5 This is not to say that further improvements are not feasible. The Committee notes, for example, that the publication put out by the United Kingdom Consumers Association, *Which?*, regularly contains in-depth articles comparing the costs of different ways of borrowing and the returns on different types of investment.

6 This emerges from public opinion and community attitude surveys such as the one conducted by the Australian Bankers Association and made available to the Committee on a confidential basis.

although clearly tending to improve in quantity and accessibility, is not being fully or effectively utilised.

44.24 This is not to say that the overall level of community awareness of markets for financial products and services is any more deficient than its knowledge and understanding of markets for goods and services generally. The Committee, however, believes that there could be special social and economic benefits from an improved level of understanding of financial products and processes. In catering for this need there may be a role, perhaps only limited, for governments.

(b) Some Guidelines for Change

44.25 In the Committee's view, it is neither reasonable nor practicable to require by regulation that individual private financial institutions adopt a broad financial advisory role for those who lack information regarding alternative sources and uses of funds. The competitive environment envisaged by the Committee will be such that individual institutions will attempt to attract and lend available funds in the most profitable manner available to them, having due regard for competing sources and uses of funds. The Committee believes that this competitive process will help to promote a wider dissemination of information about different aspects of the financial system.

44.26 Nevertheless, the Committee has made a number of specific recommendations in other chapters, which reflect its view that some areas require continued and specific formal regulation to ensure more thorough disclosure of relevant information.

44.27 In particular, the Committee has proposed that:

- (i) all financial institutions be required to maintain standards of disclosure broadly comparable to those applying to companies (see Chapters 19 and 20);
- (ii) the life insurance industry and Life Insurance Commissioner should work toward the development of a document providing potential policyholders with up-to-date information on the distinguishing features of the various types of policies available;
- (iii) where life offices do not already do so, they should be required to:
 - issue potential policyholders with information on their past and current performance in respect of such matters as earning rates, surrender values, bonuses etc.; and
 - provide policyholders with a short summary of their annual reports (Chapter 20).
- (iv) superannuation funds should be required to observe improved reporting standards⁷ as one of the pre-conditions to contributors receiving tax concessions (Chapter 20);
- (v) a range of measures should be considered or implemented to improve the frequency and quality of company reporting and to simplify the presentation of financial accounts (Chapter 21); and
- (vi) the NCSC might study various ways of improving corporate accountability to shareholders.

⁷ For example, in respect of the level of funding in relation to the obligations of employers under trust deeds and the overall financial position of superannuation schemes, including certain details of investments.

44.28 At the same time, having regard to the complexity of the information presently being required in prospectuses and the consequent cost burdens imposed on companies, the Committee has advocated the issue of approved, abridged prospectuses to the general public (with more detailed prospectuses being available for inspection from the appropriate regulatory authority).

44.29 Apart from these specific regulatory interventions, the Committee believes that there exists a wider and more general government responsibility in the provision of information on aspects of the financial system. It is useful to recall here the views expressed on this general question in various parts of the Report.

44.30 Firstly, the Committee believes that the authorities have a responsibility to keep the community well informed on the aims of economic and other policies. As well, they should provide information helpful to the market in both assessing the economic and financial outlook and in evaluating the performance of governments and their authorities. For example, a more active educational role by the Reserve Bank in respect of monetary policy and current economic and financial conditions is recommended in Chapter 2; the benefits of announcing monetary targets are argued in Chapter 3; in Chapter 6, the Committee recognises the role of the Reserve Bank in facilitating intelligent anticipation of seasonal liquidity requirements.

44.31 The need for the authorities to keep the foreign exchange market as fully informed as possible, thus limiting the need for official intervention, is stressed in Chapter 7.

44.32 The need for the Reserve Bank to set out clearly the principal features of the prudential regulation of banks, including criteria for the entry of new banks, is emphasised in Chapter 19. The Committee would like to see the Reserve Bank (and other bodies responsible for prudential oversight) prepare exposure drafts for public discussion on the key elements of prudential policy in a similar manner to the Bank of England.

44.33 In Chapter 9, the Committee points to the uncertainty that often prevails in the market for government and semi-government securities because of lack of prompt, comprehensive information regarding the level of bond sales, and the volume and maturity of securities outstanding.⁸ In the case of 'commercial' public authorities, the Committee has suggested that they might supply a greater amount of information regarding projects to be undertaken.

44.34 Finally, the Government has a clear responsibility to ensure financial statistics that are crucial to the operational needs of financial markets are produced. This particular aspect is discussed in Section C of this chapter.

44.35 A second broad area in which governments have a responsibility to ensure a well-informed public is in regard to the nature and extent of official responsibilities for the protection of investors.⁹ It is important that the extent and

⁸ It has been argued that the difficulties experienced by the bond market in the first half of 1981 were heightened by the fact that participants in the market had insufficient data to make their decisions and had to rely partly on guesswork to assess the level of bond sales. Details of tap bond sales are released weekly, while ASB sales are on a monthly basis.

⁹ There is also a view that unsophisticated investors show insufficient awareness of the influence of risk on investment yields. The acceleration of inflation during the 1970s and the intensified competition for household savings among an expanded group of intermediaries has led to a much greater sensitivity of investors to the yields on alternative investments. It is argued that this has not been matched by any increased awareness of the risks of investing. In turn, this has generated pressures for greater regulation of intermediaries competing for household savings.

limitations of government powers and obligations in protecting investors be fully understood. With this in mind, the Committee has made a number of recommendations, the effect of which would be to require the appropriate authorities to define their responsibilities clearly and to require the relevant institutions to make this known to their investors.¹⁰

44.36 The third major role for governments in the dissemination of information is to use its influence to discourage the flow of 'mis-information' by private corporations, including financial institutions — irrespective of any legal requirements that might exist. In this respect the Committee strongly endorses, for example, the efforts of the Life Insurance Commissioner to discourage misleading advertising by some life offices in respect of equity-linked insurance; it also welcomes the issue by the Trade Practices Commission of a series of advertising guidelines to deposit-taking institutions. There is also, of course, an important role for consumer groups in this area.

44.37 At the same time the Committee would like to see efforts made by State Registrars of Co-operative Societies to ensure that investors in building societies are made fully aware of the difference between 'shares' and 'deposits' when depositing so-called withdrawable funds (see Chapter 19).

44.38 Finally, the Committee recognises that governments have a general educational role. There are a number of initiatives governments can take (through their appropriate agencies or authorities) to enhance the skills and understanding of small investors and borrowers:

- they could see that basic concepts and functions are covered in school and other educational curricula¹¹;
- they can act as a catalyst in promoting improvements in corporate reporting¹² and accounting standards so as to make corporate accounts more meaningful to the unsophisticated investor;¹³
- they can actively encourage industry groups to make information on sources of funds and investment opportunities more readily accessible to small personal investors and borrowers;
- there may be scope for greater development of consumer education and counselling programs to ease the problem of consumer debt insolvencies¹⁴;
- governments can also directly help to disseminate and co-ordinate information for the benefit of small borrowers and lenders. The Reserve Bank has for example, been pursuing community education through its various publications; the Committee would like to see an even greater contribution from the Reserve Bank and has suggested that it should produce an appropriate information booklet for small investors (Chapter 21);

10 See Chapters 19 and 20.

11 In assessing the needs of the community for financial information, the Committee believes that educational institutions, both secondary and tertiary, have an important responsibility to bring together the range of general information on the operations of the financial system. It is through the education system that the widest dispersal of **factual** information can occur that will provide the community with an initial ability to assess alternative sources and uses of funds open to them.

12 One of the regulatory reforms proposed in Chapter 21 is that individual investors should have the right to obtain quarterly and half-yearly reports from companies on request; they would thus be better informed, and not be at a disadvantage relative to institutional investors.

13 The Committee has received some detailed suggestions for reform, e.g. submissions from J. B. Ryan, Accounting Department, University of Wollongong, and R. J. Chambers, University of Sydney.

14 See Chapter 22.

- governments have an overriding obligation to ensure that any official information they choose to provide is equally accessible to all interested parties.

44.39 However, for reasons stressed earlier in this chapter, governments need to proceed cautiously along these paths.¹⁵ While governments certainly have a role, it must also be impressed upon private institutions that they too have a responsibility to clearly explain rights and obligations under financial contracts, the range of services offered and the benefits and costs of such services.

C. OFFICIAL STATISTICS

(a) General Approach

44.40 The Committee is not well placed to ascertain the extent to which improvements in the coverage and quality of financial statistics are feasible, nor the costs involved (both to the informant supplying the information and the agency collecting, compiling and disseminating it). Thus the Committee does not make specific recommendations but instead outlines some broad guidelines for action.

44.41 It is the role of the Australian Bureau of Statistics, with regard to the provision of financial statistics generally, and of the Reserve Bank, in more specific areas, to attempt to make an assessment of data needs and to set about providing data on matters regarded as appropriate to their roles in the community. There may also be a role for the private sector in providing specialised data to more limited users.

44.42 A full assessment of the most appropriate data series to collect needs to take account of:

- cost to the suppliers of data and to the statistical agency in gathering and processing data;
- competing demands for data;
- the difficulty in assessing the precise value of the data to ultimate users; and
- difficulties in fully recovering data collection costs.¹⁶

(b) Assessment

44.43 A number of specific statistical gaps¹⁷ became apparent to the Committee during the course of the Inquiry. They significantly hindered the Committee's work. The list, which is not exhaustive, includes information on:

¹⁵ See paragraph 44.3.

¹⁶ This means that it is not possible to determine the true 'market demand' for each statistical series.

¹⁷ In addition to **gaps** in the coverage of official statistics, deficiencies in the **quality** of existing statistics have been identified. The main types of deficiency include:

- *Timeliness* — i.e. some statistics are not available soon enough after the time period to which they relate;
- *Insufficient state-level disaggregation* — i.e. not enough of the statistical series compiled on a national basis are also broken down into individual state figures; and
- *Lack of complete comparability* — i.e. less than perfect consistency in the definitions of data items etc., so that statistics relating to different classes of financial institutions do not allow meaningful comparisons to be made across classes.

These types of criticisms apply to most financial statistics; the degree to which they apply varies across statistical series. The Committee is particularly concerned to see timely releases of flows of funds statistics.

- activities of financial intermediaries in functionally defined financial markets, such as rural finance, consumer credit etc.;
- sources of funds to small business;
- functional cost and other performance indicators relating to financial institutions;
- the structure of interest rates, covering a broader range of financial institutions;
- maturity patterns of local and semi-government securities on issue;
- inter-company lending;
- leasing finance and commercial bill transactions, on a more comprehensive scale;
- the activities of separately constituted private superannuation funds;
- intra-household sector financing, e.g. direct or through solicitors, brokers etc.;
- volume of money — more broadly defined data; and
- national share turnover and ownership trends.

44.44 It is the Committee's view that the regular collection and timely publication of broad-based statistical series, such as flow of funds data and balance sheet data of major financial groups, would overcome many of the above deficiencies. It recognises, however, that some special needs cannot be accommodated by such a comprehensive and co-ordinated approach. It is at this stage, in particular, that a cost-benefit assessment needs to be applied. It is hoped that consideration will be given to overcoming the abovementioned statistical deficiencies at an early date.

44.45 A Working Group, under the co-ordination of the Australian Bureau of Statistics (ABS), for the Rationalisation of Financial Statistics was established in 1978. The Group is made up of representatives of the Treasury, Reserve Bank and the ABS. The Working Group is investigating ways in which rationalisation of general statistical collections from financial institutions can be achieved; the aim being to provide an adequate, integrated set of statistics, whilst keeping the reporting burdens of informants to a minimum. The establishment of the Working Group arose out of a concern that the expansion in the number of statistical collections had resulted in some areas of overlap and an undue burden on some respondents.

44.46 The Committee understands that work is currently being undertaken (or is soon proposed) in three strands:

- (i) revising and extending, where appropriate, proposed collections for NBFIs covered by the Financial Corporations Act 1974 (FCA);
- (ii) developing some additional collections for banks; and
- (iii) developing proposed collections for four specific 'financial activities', for collection from the perceived major providers of the type of finance involved; the 'activities' are:
 - housing finance for owner occupation;
 - non-housing consumer finance;
 - leasing finance; and
 - non-leasing commercial finance.

44.47 The Committee is encouraged by the purpose of the Working Group but is concerned at the delay in the results of their work being brought to fruition, and the apparent exclusion of insurance and superannuation statistics from the Working Groups's brief. It is the Committee's assessment that the activities of the Working Group (in regard to the provision of general statistics) should be accelerated and expanded.

GOVERNANCE OF THE FINANCIAL SYSTEM
(Chapter 1)

44.1 The Committee was invited to examine the financial system and to report on its findings. It has done so in this report. The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14.

44.2 It is important that the financial system be able to provide the resources needed to fund the Government's policies. It is also important that the financial system be able to provide the resources needed to fund the Government's policies in a way that is consistent with the Government's objectives for the financial system.

44.3 The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14. The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14.

44.4 In order to ensure that the financial system is able to provide the resources needed to fund the Government's policies, it is important that the financial system be able to provide the resources needed to fund the Government's policies in a way that is consistent with the Government's objectives for the financial system.

44.5 The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14. The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14.

44.6 The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14. The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14.

44.7 The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14. The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14.

TABLE OF THE RESERVE BANK (Table 1)

44.8 The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14. The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14.

44.9 The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14. The Committee's findings are set out in chapters 2 to 10. The Committee's recommendations are set out in chapters 11 to 14.

CHAPTER 45: SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

GOVERNMENT INVOLVEMENT IN THE FINANCIAL SYSTEM (Chapter 1)

45.1 The Committee starts from the view that the most **efficient** way to organise economic activity is through a competitive market system which is subject to a minimum of regulation and government intervention.

45.2 It is recognised that markets do not always work perfectly and that governments need to have regard for other important objectives besides efficiency — e.g. macroeconomic management, stability of financial markets, distributional equity.

45.3 The particular methods of intervention adopted by governments to pursue these objectives can have an important bearing on the efficiency of the financial system.

45.4 In evaluating each case of government intervention, the Committee has attempted to assess its 'cost-effectiveness' i.e. it has tried to weigh up the total efficiency costs of the intervention against its effectiveness in achieving its objectives.

45.5 Where the balance of benefits and costs has seemed fairly even, the Committee has recommended against government intervention.

45.6 The Committee has drawn attention to some of the significant distributional implications of its recommendations. In those cases where it was thought a change might cause short-run disruption but the long-run benefits were considered to be sizeable, it has recommended the change but has suggested appropriate transitional arrangements.

45.7 Circumstances which may (in the Committee's judgment) justify government intervention in the financial system are outlined in the chapter.

ROLE OF THE RESERVE BANK (Chapter 2)

45.8 An issue before the Committee was the appropriate degree of independence for the Reserve Bank, within the framework of government, in the discharge of its policy responsibilities — monetary, external and prudential.

Recommendations

- Existing provisions of the Reserve Bank Act defining the overall policy

relationships between the Bank, the Government and the Parliament should be retained. (2.35)

- In particular, the Committee sees no need for change in the present provisions for resolution of differences of opinion between the Reserve Bank Board and the Treasurer (section 11). (2.35)
- Arrangements relating to the implementation of monetary and banking policy should be such as to ensure that the Bank has clear capacity to respond to market developments. (2.35)
- The Secretary to the Treasury should continue to be, *ex officio*, a member of the Board of the Reserve Bank. (2.40)
- There should continue to be regular liaison between the Reserve Bank and the Treasury, and appropriate liaison between the Bank and other economic policy areas in the public sector. (2.40)
- The overall principles of prudential regulation should be agreed between the Treasurer and the Reserve Bank. (2.54)
- The Reserve Bank should be responsible for the formulation and implementation of (prudential) policy and the principal characteristics of the policy should be publicly recorded. (2.54)
- The Reserve Bank should keep the Treasurer informed of, and its Annual Report should make appropriate reference to, the administration of these prudential responsibilities. (2.54)

45.9 The Committee considered a number of options regarding the character of the Bank Board; it concluded that the present arrangements are satisfactory and allow an adequate degree of flexibility. However, the Committee is concerned to ensure that the Board of the Bank is structured to avoid possible conflicts of interest.

Recommendation

- The present provisions of the Reserve Bank Act, designed to preclude from Board membership persons involved wholly or mainly in the business of banking, should be extended to apply to persons associated with the operation or management of businesses which are wholly or mainly financial intermediaries. (2.61)

45.10 The Bank is encouraged to adopt a more 'open' public stance in its communications with the general community, so as to promote more informed financial markets and greater accountability to the community and the Parliament.

Recommendation

- The Reserve Bank should:
 - through its Annual Report, and elsewhere as appropriate, inform the community clearly of the *monetary policy* it is seeking to implement, its underlying rationale and any specific constraints on the Bank's capacity to implement that policy;
 - provide ongoing analysis and commentary concerning *current economic and financial conditions* and the interplay of market forces and policy influences leading to those conditions; and
 - undertake a *continuing review* of the structure, regulation and operation of *the financial system* with the object of, from time to time, canvassing options for change. (2.74)

45.11 The Committee considered the arrangement under which the Reserve Bank provides banking and other services to governments and the financial community.

Recommendations

- The Reserve Bank should adopt the practice wherever reasonably practicable of recouping costs for services provided. (2.79)
- As far as possible, the financial dealings of the Government with the Reserve Bank should be on a commercial basis. In particular:
 - the Reserve Bank should pay a market interest rate on government account balances; and
 - the Government should pay a market rate of interest in respect of its indebtedness to the Reserve Bank. (2.82)

45.12 The matter of the Bank's internal operational efficiency, both with regard to investment and accounting procedures, led to a consideration of whether the Note Issue Department should necessarily retain a separate identity.

Recommendation

- The Reserve Bank Act should be amended to remove the legislative requirement for a separate Note Issue Department and in particular the need for a separation of related investments. (2.85)

45.13 The financial independence of the Reserve Bank underwrites its functional independence. It is believed that financial independence would be enhanced if the Bank Board determined the appropriation of the Bank's profits, subject to the agreement of the Treasurer.

45.14 It is considered desirable that the Bank's costs of operation be set out in sufficient detail to enable reasonable assessment of its performance by the Parliament and the community.

45.15 The Committee examined matters relating to the issue and distribution of currency.

Recommendation

- Responsibility for both note and coin issue should be vested in the Reserve Bank. (2.96)

Conclusion

- In the interests of overall efficiency the costs of distribution, supply and exchange of currency should be borne by users and not subsidised by the monetary authorities. (2.101)

45.16 The involvement of the Reserve Bank through its Rural Credits Department in the provision of marketing finance in respect of rural produce is considered unnecessary and in some important respects inappropriate.

Recommendation

- The Rural Credits Department of the Reserve Bank should be phased out, with appropriate transition arrangements to enable existing customers to make alternative arrangements. (2.106)

45.17 It is believed that the Reserve Bank should assume a general responsibility to monitor the operation and development of the domestic payments system (a matter discussed more fully in Chapter 23).

POLICY OBJECTIVES AND MONETARY TARGETING (Chapter 3)

45.18 The Committee sees advantages in the Government announcing a commitment to intermediate economic targets: it acts as a useful discipline on policy makers; it can have a favourable impact on inflationary expectations and influence the process of wage and price determination; it can provide the market with useful information and an early standard by which to judge the performance of the authorities; and, if it leads to a steady and restrained growth in monetary aggregates, it can promote a general economic environment conducive to stability of financial markets and institutions.

45.19 The target should be applied on a medium-term basis (e.g. annually) rather than on a long-term (three or four years) or very short-term basis. It should also be expressed as a range and applied flexibly within that range.

45.20 The choice of a target variable rests mainly on three key criteria: controllability, predictability (relevance to ultimate objectives) and extent to which it imposes useful disciplines. The target should also be capable of being easily understood by the public.

45.21 On the basis of these criteria, the Committee prefers an intermediate monetary indicator to a high level economic indicator like nominal GDP. At the same time it rejects interest rate targeting and favours a quantity target. It sees many advantages in an M3 target (it is widely recognised, it is reasonably controllable etc.) but in certain circumstances, especially if bank controls are in force, it may not be as relevant a target as a broader monetary aggregate. However, the latter is less easily controlled by the authorities. A narrow monetary aggregate such as the monetary base is more controllable but the effects of changes in it are less predictable.

***Recommendations* (3.27)**

- The authorities should formulate, announce and seek to achieve a monetary target expressed in terms of a band of growth rates for a period of, say, one year.
- The authorities should examine alternatives to M3 as a target — including broader monetary and credit aggregates and ‘monetary base’.
- Whatever target is chosen, other variables should be closely monitored.
- It is recognised that special problems will occur during the transitional period of deregulation.

INSTRUMENTS OF MONETARY POLICY (Chapter 4)

45.22 It is noted that direct interest rate and lending controls involve costs — in particular: they divert funds to possibly less efficient intermediaries or channels of financing; they blunt the competitive and innovative drive of controlled institutions; and they tend to cause an uneconomic degree of fragmentation in the intermediation industry.

45.23 Moreover, such controls are often ineffective or can have perverse effects. Where they are effective, the desired objective can generally be achieved by other, less distortive, means.

45.24 It is accepted, however, that in the transitional period following deregulation, a variable reserve requirement may usefully complement open market operations. This is because these two instruments can have different effects on the structure of interest rates and funds flows and their effects are transmitted through different channels. Provided interest rates are allowed to move flexibly, there is no need to prescribe a fixed government security 'tranche' for monetary policy purposes.

45.25 The Committee therefore proposes the continued application of a variable **cash** reserve requirement on banks but with some important changes to present arrangements.

45.26 It is believed that payment of a near-market interest rate on reserve assets will generally assist, not hamper, the effectiveness of changes in the variable reserve ratio: in particular, it will leave the banks willing and able to compete effectively for deposits against non-bank financial intermediaries (NBFIs).

Recommendations

- All official intervention in the determination of bank deposit and lending interest rates should cease and existing controls abolished. (4.26)
- As part of this deregulation process, banks should be permitted to pay interest on all current account balances at their individual discretion. (4.26)
- The power to impose direct interest rate controls should be removed from section 50 of the Banking Act and from section 15 of Part IV of the Financial Corporations Act. (4.26)
- Maturity controls should be abolished. (4.29)
- The power to impose quantitative or qualitative lending controls should be removed from section 36 of the Banking Act and section 14 of Part IV of the Financial Corporations Act. (4.38)
- A variable cash reserve ratio on banks should be available to the authorities as an instrument of monetary control. (4.44)
- A fixed government security tranche, over and above the cash reserve ratio, should not be prescribed for monetary policy purposes. (4.52)
- Banking groups should be appropriately considered as consolidated units for the purpose of determining their minimum reserve requirements. (4.60)
- The reserve requirements should be extended beyond deposits to embrace all appropriate liabilities of the banking group. (4.60)
- The monetary authorities should give careful consideration to the desirability of differentiating reserve deposit requirements according to different classes of deposit and other liabilities. (4.60)
- A near-market interest rate should be paid on required deposits with the Reserve Bank. (4.68)

45.27 The Committee considers that a wider application of the variable reserve ratio to NBFIs would pose complex administrative problems, and its effectiveness would be doubtful in the long term.

Conclusion

- A variable reserve ratio should *not* be extended to NBFIs. (4.84)

45.28 It is believed that suasion based on genuine consultation and the provision of information may have a role in certain special circumstances, but as a monetary policy instrument it is generally ineffective and inequitable. When suasion relies on a latent power to impose penalties on the recipients of the 'advice', it has even less to commend it than direct controls.

CENTRAL BANK LIQUIDITY SUPPORT FACILITIES (Chapter 5)

Market-initiated Facilities

45.29 At present there are two channels by which funds can flow from the Reserve Bank at the initiative of ('on request' from) private sector participants:

- a Treasury note rediscount 'cashing' facility;
- line-of-credit facilities available to the authorised dealers (and, in limited circumstances, banks).

45.30 The Committee recognises the need for a general cashing facility, at the market's discretion, to provide a 'safety valve' for the financial system. Present 'cashing' facilities could be made more effective for this purpose.

45.31 In respect of lines of credit, the Committee considers that such a facility may initially need to remain available to the authorised dealers to enable them to carry out their market-making role effectively, but the ongoing need for it should be subject to review. The Committee sees no justification for allowing banks access to a central bank line of credit at their discretion.

Recommendations (5.55)

- A Treasury note rediscount facility should be offered by the Reserve Bank on all Treasury notes, with the rediscount prices set so as not to conflict with the Reserve Bank's open market operations.
- A cashing facility should be available for certain nominated government securities with initial maturities perhaps up to two or three years. The Reserve Bank should be willing at all times to purchase such nominated securities — but only when they have, say, twelve months or less to maturity. The purchase prices should be determined by the Bank, having regard for market conditions and the stance of monetary policy, and should be free to vary in the course of the day.
- The banks should not have direct rights of access at their discretion to Reserve Bank credit.
- The Reserve Bank should continue to extend a line of credit to the authorised dealers, at least in the initial stages of deregulation (see Chapter 9).

45.32 In the opinion of the Committee, information should be published on acquisitions of Treasury notes and other cashable securities in terms of rediscounting arrangements. This could be done in conjunction with the publication of secondary market transactions in government securities including Treasury notes.

Contingency Funding Arrangements

45.33 The Committee believes that it is the function of a central bank to ensure a sufficient availability of liquidity to preclude a financial crisis stemming from a loss of confidence in the capacity of viable financial institutions to meet their obligations. Therefore, in addition to the facilities available at the market's own discretion, the Reserve Bank should be prepared **at its discretion** to assist in funding sound, viable individual institutions in temporary but emergency situations of liquidity shortfall. When the Bank decides such assistance is necessary, banks, authorised dealers, and approved national industry bodies, all of which would be subject to Reserve Bank prudential supervision, would normally receive direct assistance; other viable institutions in difficulty would have access to liquidity from their bankers and, where necessary, support would be channelled indirectly from the Reserve Bank. The discussion emphasises that usage of such a facility in any but exceptional circumstances, or by institutions which are not viable, would be prejudicial to good disciplines of prudential financial management and should therefore be avoided. Further discussion of these matters is in Chapter 19.

SEASONAL FLUCTUATIONS IN LIQUIDITY (Chapter 6)

45.34 It is desirable to remove seasonal fluctuations which are purely financial in origin. Such fluctuations generate a number of unnecessary costs to the extent that they:

- induce seasonal fluctuation in economic activity;
- give rise to difficulties in the formulation of monetary policy;
- create uncertainty in capital markets.

45.35 The domestic budget outcome is the main source of seasonal fluctuation in primary liquidity. Most of the seasonal variation in the budget originates on the revenue side, mainly in non-PAYE personal 'provisional' tax collections and to a lesser extent company tax.

45.36 The Committee considered a number of possible ways of alleviating seasonal liquidity fluctuations including:

- **A restructuring of taxation collection** arrangements, particularly those for provisional tax, with a view to achieving a more even spread of payments over the year.
- **Sales of government securities** to absorb the seasonal run-up in liquidity.
- A proposal from the Australian Bankers' Association for the **Government** to hold **working balances** with banks, an approach used in various ways in Canada, New Zealand and the USA.

Recommendations (6.44)

- The Government should review as soon as possible:
 - the arrangements for collecting provisional tax, with a view to early introduction of a system of instalment payments; and
 - arrangements for the collection of other taxes.
- To the extent that a seasonal imbalance continues, the monetary authorities (consistent with not weakening their capacity to implement monetary policy)

should seek to take offsetting action through open market operations and if necessary a broadening of the range of 'seasonal' securities available; the objective would be to tailor maturities of Treasury notes and other government securities held by the private sector to closely match dates on which taxes are payable. Enhanced discounting facilities could also play a part.

45.37 If the above courses prove inadequate, some consideration should also be given to the ABA proposal relating to government working balances.

EXCHANGE RATE POLICY (Chapter 7)

45.38 Exchange rate policy raises two major questions:

- the institutional arrangements for intervention that are most appropriate;
- the desirable levels of official intervention to manage the exchange rate.

45.39 In regard to the former, the Committee is not inclined to favour continuation of the present method of exchange rate intervention, which may be called a 'flexible peg' system. The same level of intervention could be achieved more directly by open market purchases or sales of foreign exchange, i.e. through a system of 'managed floating'. Such a system would offer greater flexibility, would be less susceptible to non-market pressures and would be more consistent with the Committee's other recommendations on foreign exchange policy.

Recommendation

- At an early date, the present institutional arrangements for fixing the exchange rate should be terminated. The exchange rate should thereafter be determined in the market and the authorities should deal in the market if they wish to promote a particular rate. (7.13)

45.40 The Committee accepts that it may be necessary to maintain a significant degree of official intervention in the early stages of development of the foreign exchange market. This aside, it believes that:

- (i) There is a case for intervention to smooth out erratic market movements.
- (ii) There may also be a case for limited short-period intervention in circumstances (which the Committee believes will be infrequent) **where the authorities clearly have better information than the market.**
- (iii) However, prolonged, one-sided intervention, designed to hold the exchange rate substantially away from the free market rate for extended periods (exchange rate targeting), is not favoured by the Committee, because:
 - monetary policy (and indeed overall economic policy) is more effective under a regime where the exchange rate is not a target of policy itself but rather is allowed to respond to market pressures;
 - it is doubtful that traders would face more risk and uncertainty under 'floating' (more market-oriented) exchange rates than under a relatively fixed exchange regime; nor is there evidence that short-term variability of the exchange rate discourages international trade;
 - the studies of official exchange rate intervention seen by the Committee suggest that while markets have frequently been wrong, they have (on average) been at least as efficient as governments in forecasting exchange rate movements.

Recommendation

- Any official intervention in foreign exchange markets (apart from technical smoothing) should be relatively light, infrequent and only for short periods. (7.59)

45.41 The move to a more market-oriented foreign exchange system should be implemented progressively but fairly rapidly. Forward markets must reflect and be consistent with spot market arrangements.

Recommendation (7.68)

- A broadly based forward foreign exchange market, with non-resident participation and with the value of the \$A being determined basically by market forces, should be allowed to develop simultaneously with the gradual freeing up of the spot market.
- The Reserve Bank should intervene in this forward market in a manner consistent with the principles adopted for the spot exchange market.

45.42 The basis on which foreign exchange licences should be allocated was also examined. The Committee sees advantages in the present arrangement of confining this role to **banks**. Banks are most likely to possess the required expertise, and it would not be necessary to set up another supervisory structure or extend the present area of official protection. The Committee's recommendations on entry to banking should ensure that margins are competitive and that a degree of neutrality is preserved between intermediaries.

Recommendation

- Foreign exchange licences should be restricted to banks. (7.74)

EXCHANGE CONTROL POLICY (Chapter 8)

45.43 The principal aim of exchange controls is to assist the authorities to manage the exchange rate without forgoing monetary independence.

45.44 However, the Committee believes that:

- if exchange controls are in place continuously they eventually lose much of their effectiveness;
- even if they are effective to some degree, exchange controls are not needed to support the relatively 'light' exchange rate management envisaged (over the long term) by the Committee;
- the efficiency costs associated with the controls, while not always apparent, are usually substantial and these costs must be weighed against any macroeconomic benefits.

45.45 There is a strong argument, therefore, for dismantling the wide range of controls. It may, however, take a little time before the foreign exchange market develops sufficiently to enable a substantial reduction in the level of official exchange rate intervention. Until then, some controls may need to be retained. An early start to the process of liberalisation can nevertheless be made; such an early start would indeed facilitate the development of the foreign exchange market. During the transitional period, a price-related control, such as the Variable Deposit Requirement, or like instrument, would — if used sparingly — have less distortive effects than some of the ongoing controls presently in use.

Recommendations

- The present exchange control mechanism should be progressively dismantled. (8.35)
- At an early date, the administration of exchange controls should be changed to permit all foreign exchange transactions freely, except those specifically designated. (8.41)
- An appropriate ongoing monitoring and reporting system should be developed immediately, based on notification of transactions as they occur. (8.41)
- The controls on the timing of payments for trade and services should be abolished at an early date. (8.43)
- Embargoes on short-term borrowings should not be used as an instrument of exchange control. (8.46)
- The scrutiny of borrowing contracts should cease. (8.46)
- The restriction on the listing of foreign corporations on Australian stock exchanges should be lifted. (8.54)
- Controls on resident foreign currency balances and resident holdings of interest-bearing investments overseas should be progressively dismantled.
 - In the transitional period, however, some degree of control and surveillance might be retained.
 - The controls could take the form of threshold limits. (8.64)
- During the transitional period, while the foreign exchange market is developing, the authorities should retain a reserve power to apply (as a last resort measure) a VDR or like instrument. Preferably the instrument would have the capacity to cover flows of both debt *and* equity portfolio investment. (8.76)

45.46 The issues involved in establishing an ‘offshore market’ are discussed in some detail in a consultancy report, which is referred to the Government for study. If the Government believes there is a place for an offshore market, such a market could be integrated into a phased program of exchange control deregulation.

THE MARKETING OF GOVERNMENT SECURITIES AND THE ROLE OF AUTHORISED DEALERS (Chapter 9)

45.47 It is clear that a passive approach to the marketing of government securities will not suffice in the competitive environment envisaged — in which private institutions will no longer be subject to interest rate or portfolio controls.

45.48 The Committee considers that the most effective way of ensuring that the desired volume of securities is sold is to offer them through a tender system.

Recommendation

- The authorities should follow a market-oriented approach in the sale of government securities: pursuant to this policy they should adopt a tender system as the preferred system for the issue of securities (other than savings bonds). (9.20)

45.49 There are benefits to be gained from having an active secondary market in government securities. ‘Market making’ can be conducted by the Reserve Bank or

by specialist private sector institutions. The Committee's preference is for the latter.

Recommendations (9.36)

- Specialist market-making intermediaries in government securities should, for the time being, continue to be recognised and 'encouraged' by the Reserve Bank.
- The Reserve Bank should keep this policy under close review.

45.50 Authorised dealers are currently officially 'encouraged' by certain facilities offered by the Reserve Bank and a prohibition against banks paying interest generally on deposits for less than thirty days. Implementation of the Committee's recommendations on interest rates will make the market in which the dealers operate more competitive. Although yields on government paper will also be more competitive, the Committee believes that special official facilities should continue to be available to dealers, at least for a time.

Recommendations

- The Reserve Bank should continue to deal primarily through the authorised dealers when dealing in the secondary market, subject to such authorised dealers as a group continuing to perform the principal role of market makers. (9.46)
- The authorities should undertake regular reviews to ensure that individual authorised dealers are fulfilling their market-making function. (9.48)
- The Reserve Bank should continue to provide a line-of-credit facility to authorised dealers and should be more willing to depart from the application of the seven-day loan rule in appropriate circumstances — e.g. by the provision, at times, of an overnight facility. The interest rate should be at the discretion of the Bank. (9.56)
- The facility should come under official review periodically, and should be maintained only to the extent necessary to ensure a stable, competitive and efficient market in government securities. (9.56)

45.51 Stockbrokers presently have similar direct rights of access to the Reserve Bank's portfolio as authorised dealers, regardless of whether they are active in the government securities market. This seems anomalous to the Committee.

Recommendation

- Stockbrokers who wish to retain their right to deal direct with the Reserve Bank should be subjected to a turnover review and an accreditation (for this purpose) similar to that recommended for the authorised dealers. (9.51)

45.52 Authorised dealers are subject to portfolio constraints which require them to hold the bulk of their funds in the form of short-dated government securities. The Committee regards this as appropriate for a group making a market in such securities, but sees scope for somewhat greater flexibility in holdings other than Commonwealth government securities.

Recommendations

- Authorised dealers should be required to invest at least 70% of their portfolios in Commonwealth securities with terms to maturity of up to five years. (9.63)
- Authorised dealers should be permitted to hold up to 30% of their portfolios in

securities of approved major public authorities, bank certificates of deposit and bank bills (all with maturities of up to five years), but the relative proportions held within the 30% tranche should be left to their discretion. (9.65)

45.53 Generally, the Committee considers any organisation with the capacity to undertake substantial dealings in government securities (and willing to observe the requirements) should be accredited as an authorised dealer. Issues uniquely concerning non-resident participation should be resolved within the general context of government policy bearing on foreign investment. Present policy which discourages Australian banks from participating in the ownership of authorised dealer companies raises more contentious issues.

Recommendation

- The policy of discouraging banks from holding, directly or indirectly, ownership interests in authorised dealer companies should be kept under close review to ensure it remains appropriate in a changing financial environment. Ultimately there may be no need for a formal restriction but initially the Committee believes that a restriction can be justified. (9.75)

CAPTIVE MARKET ARRANGEMENTS APPLYING TO GOVERNMENT AND SEMI-GOVERNMENT SECURITIES (Chapter 10)

The 30/20 Rule

45.54 The aim of the 30/20 rule is to ensure a minimum continuing take-up of government securities. It is also seen as a *quid pro quo* for taxation benefits received by life offices, superannuation funds and individuals investing in life insurance and superannuation; the taxation aspects are separately examined later.

45.55 A number of advantages have been claimed for the rule — e.g. that it reduces the cost of government borrowing and promotes greater stability in interest rates. In the opinion of the Committee, these aims have not always been realised. By contributing to the thinness of secondary markets, the 30/20 rule may have lessened the general appeal of government paper; any increased stability of **official** rates may have been achieved at the expense of greater variability of other — more market-determined — interest rates. Moreover, portfolio constraints tend to impact inequitably and are harmful to efficiency.

45.56 It is believed that many of the objectives of the rule can be achieved by other, more cost-effective, means. The best way to ensure a continued take-up of government debt is to make the return on, and the range of, government securities more responsive to market preferences.

Recommendation

- The Government should abolish the 30/20 requirement and rely on market-directed initiatives to appropriately fund its borrowing requirements. (10.38)

45.57 It has been suggested that the rule should be removed gradually; however, the Committee believes this approach may well be more disruptive to the marketing of government debt than if the rule were abolished in one step.

Recommendation

- The Government should remove the 30/20 rule without a transition period. (10.44)

Other

45.58 The portfolio restrictions on the authorised dealers, which must be distinguished from other captive arrangements, are discussed in Chapter 9. Issues relating to the trading bank LGS ratio are discussed in Chapters 4 and 19. The requirement on savings banks to hold a minimum percentage of assets in public securities raises issues similar to the 30/20 rule and is opposed by the Committee for the same reasons.

Recommendation

- Savings and trading banks should not be subject to any formal portfolio requirements aimed at supporting the market for public securities. (10.60)

Trustee Status

45.59 Frequently, trustee status is granted as a way of promoting the sale of securities of particular local and semi-government authorities rather than as a measure of the security of the asset. It is believed that, as a consequence, securities which may otherwise have very similar risk and return characteristics become very different to investors in different States — with possible distortions in the process of resource allocation.

Recommendation

- The Commonwealth and States should seek to ensure that arrangements for granting trustee status are on a consistent and uniform basis. (10.63)

RANGE OF GOVERNMENT SECURITIES (Chapter 11)

45.60 Government debt instruments could be better tailored to the needs of the market.

45.61 Treasury notes with a wider maturity range could be issued and there may be an advantage in the authorities being more willing to meet demand for very short notes from official portfolios. The proposal in Chapter 5 to issue some nominated bonds with a discounting facility also bears on this issue.

45.62 Variable rate and indexed securities can be attractive to lenders and borrowers when there is uncertainty about interest rates.

45.63 The issues involved are complex but the Committee believes instruments of this type may facilitate sales of government paper, allow the Government to borrow for longer terms, and widen the range of choice available to investors. It is important that private sector borrowers should be free to issue indexed debt without any hindrance from governments; the Committee does not see insurmountable tax problems.

Recommendation

- Both 'variable rate' and 'inflation-linked' government securities should be viewed as ongoing policy options and should be introduced in appropriate market circumstances. (11.48)

LOAN COUNCIL REGULATION OF LOCAL AND SEMI-GOVERNMENT BORROWINGS (Chapter 12)

45.64 The objectives of regulating local and semi-government borrowings through the Loan Council are:

- to control the overall public sector borrowing requirement (lessen ‘crowding out’);
- to permit some national priority ranking of projects and an orderly approach to the market;
- to aid in the control of overseas capital flows.

Some qualifications need to be made to each of these claims, but the Committee does not question the basic rationale of Loan Council regulation.

45.65 However, the coming decade will require greater flexibility in Loan Council arrangements. The following options for reform are considered:

- complete borrowing freedom for certain local and semi-government authorities;
- centralisation of borrowing powers in the Commonwealth Government;
- centralisation of borrowing powers in State Central Borrowing Authorities.

45.66 The first option can be reasonably applied to ‘**commercial**’ statutory authorities — to the extent that they are sensitive to the interest costs of their projects. Otherwise it must be rejected on the grounds that it leaves the authorities free of any discipline on their expenditure. The second alternative is attractive on marketing grounds, but would probably be unacceptable to state and local governments. The third alternative is less open to the above criticisms and, if applied to the **non-commercial** authorities, would have certain advantages, e.g. smaller authorities would not be disadvantaged by their relative size.

45.67 While the Loan Council should retain control over the total volume of borrowings of non-commercial authorities, certain restrictions could be relaxed.

Recommendations

- Where it can be clearly demonstrated that a public authority is basically subject to market disciplines, it could be viewed as a ‘commercial’ authority. (12.18)
- The volume of borrowing by ‘commercial’ local and semi-government authorities, and the terms and conditions of such borrowing, should be free from Loan Council control; borrowings by these authorities should not be government guaranteed. (12.18)
- ‘Non-commercial’ authorities should continue to enjoy a government guarantee and remain under Loan Council oversight in respect of the overall volume of borrowings; however, terms and conditions (including maturities) of borrowing should not be subject to Loan Council control but be negotiable between the government guarantor, the borrower and the lender. (12.22)
- Consideration should be given to the establishment of State Central Borrowing Authorities to borrow on behalf of individual ‘non-commercial’ local and semi-government authorities. (12.32)

TAXATION POLICY: GENERAL APPROACH (Chapter 13)

45.68 The Committee has not examined the taxation system as a whole. It has concentrated on those taxation arrangements which impact unevenly on different areas of the financial system and on funds flows. The aim has been to point the way to a more neutral tax system.

45.69 While it is recognised that governments may sometimes wish to inject a tax 'bias' in favour of particular groups or sectors, the Committee's search for a neutral tax system is important for two reasons:

- often a bias is accidental rather than intended; if so it should be removed wherever practicable;
- where the bias reflects deliberate government policy, there may be other, more cost-effective fiscal methods of achieving the same results — with less adverse effects on the efficient workings of the financial system.

COMPANY TAXATION (Chapter 14)

I The Overall System

45.70 The separate taxation of corporations and their shareholders has significant distorting effects on the pattern of funds flows. In particular:

- it operates inequitably as between corporate shareowners in different income brackets;
- it encourages companies to retain profits and, in some cases, to use debt financing to an excessive degree;
- it may deter many individual investors from direct participation in the equity market.

45.71 The Committee believes that a fully integrated system of company and personal income tax would come closest to achieving neutrality. It recognises that implementation of such a system would create new administrative complexities but it does not consider that these are insurmountable.

45.72 It is further believed that alternatives such as imputation and split-rate systems fall well short of neutrality and conceptually are much less appealing.

Recommendations

- The Government should work towards the introduction of a system of full integration of company and personal income tax. (14.41)
- An administratively suitable scheme could involve tax being collected (withheld) from companies at the corporate tax rate (at present 46%) and credited against the personal tax liability of shareholders, whose taxable income would include their share of the pre-tax income of the company (i.e. their share of both dividends received and retained earnings, grossed up to include the tax withheld by the company). (14.41)
- As an interim step, the *minimum* personal tax applying on a shareholder's 'allocated' share of corporate income could be set at the existing company tax rate (at present 46%). A shareholder whose personal tax rate is less than the company rate would pay no additional tax on his dividend income. In contrast,

such a taxpayer is (or may be) taxed on dividend receipts under the present system. (14.44)

45.73 Following the introduction of the interim arrangement, the Committee envisages that there would be in due course further moves towards full integration. The next stage could be, for example, a reduction from 46% to 32% in the minimum personal tax rate on company incomes allocated to individuals.

II Private Companies: Division 7 Tax

45.74 Division 7 of the Income Tax Assessment Act, which draws a distinction between public and private companies and requires the latter to make minimum distributions or incur additional tax on excess retention, has been criticised on the grounds that it:

- constrains the ability of small businesses (operating as private companies) to finance their growth through retained earnings;
- penalises private companies relative to public companies which are not subject to these provisions; and
- disadvantages lower income shareholders in private companies compared with their opposite numbers in unincorporated businesses; this is not so with higher income shareholders.

45.75 The Committee does not believe, however, that the financing problems of small businesses are significantly affected by Division 7; it is satisfied that the present 70% retention allowance represents a 'workable ratio' for such businesses.

45.76 Given that the majority of public companies are already voluntarily making greater distributions (than that prescribed under Division 7 for private companies), the Committee does not see a need at present for an extension of the Division 7 provisions to public companies.

45.77 The Committee is concerned, however, about the disadvantage suffered by some lower income shareholders.

Recommendation

- A private company should be given the option to be treated as a partnership for tax purposes with the shareholders being taxed accordingly. (14.89)

45.78 This is subject to certain pre-conditions (see paragraph 14.91). The adoption of a fully integrated system of company and personal tax would, of course, render the recommendation redundant.

III Group Taxation

45.79 Because there is no provision for a group of companies with common ownership to be taxed as a common entity, it has been put that company groups are being treated unfairly vis-a-vis single companies operating along divisional lines.

45.80 In the Committee's opinion, group assessment would redress this bias because the choice of corporate structure for particular operations would be less influenced by the way losses are treated for taxation purposes. Group assessment might also give established corporate groups greater inducement to finance high risk ventures. The tax treatment of enterprises without group links would be unaffected.

Recommendations

- A loss suffered by one company should be permitted to be offset against the taxable income of another company in the same group. (14.111)
- This option should be made available either by a consolidated tax return or by permitting a transfer of tax losses within a group. (14.111)
- The options be available only to company groups satisfying the 100% common ownership requirement. However, consideration could be given at a future date of some relaxation of this requirement. (14.113)

TAXATION OF INTERMEDIARIES (Chapter 15)

45.81 In this chapter the Committee seeks to determine the most equitable and neutral basis for taxing certain intermediaries which are not, at present, taxed on the same basis as conventional corporations. The intermediaries considered are:

- life offices;
- superannuation funds;
- permanent building societies; and
- credit unions.

The social merits of the existing arrangements are not discussed. However, views are offered on the most cost-effective way of giving encouragement with least disturbance to the efficiency of the financial system.

I Taxation of Life Insurance Companies

45.82 The Committee agrees that the 'trustee' principle, where life offices are seen as acting in the capacity of trustees for their policyholders in the management of collective funds, is an appropriate basis for taxing mutual life offices. Related issues are also considered and certain conclusions reached.

Conclusions

- There is little need for change in the present tax treatment of expenses. (15.25)
- For life insurance arrangements that are accompanied by long-term savings contracts, the appropriate rate of tax should be as closely related as practicable to the weighted average of the marginal rates of policyholders; the rate would need to be reviewed where life insurance arrangements are initiated for shortish terms. (15.26 and 15.28)
- It would be desirable to strive for greater consistency in the treatment of realised gains and losses as between life offices and individual investors so that the effects of taxation on investment choices are similar for both groups. (15.33)
- The s. 46 rebate and s. 115 deduction are both inconsistent with the trustee concept. (15.35 and 15.42)

45.83 Proprietary life offices are seen as being in the business of underwriting for profit; the underwriting profits arising therefrom are conceptually no different from the operating profits of other incorporated businesses.

Conclusion

- Underwriting profits earned by these joint stock companies and belonging to their shareholders (as distinct from policyholders) should be taxed at the full company rate. (15.47)

45.84 The Committee expresses no view on whether special encouragement should be given to life insurance. If tax concessions are provided in this area they should, however, continue to be on the basis of a tax rebate for personal expenditure on life insurance premiums.

II Taxation Arrangements for Superannuation

45.85 The scope for greater neutrality in the present arrangements is examined.

Conclusions (15.82)

- The taxation of superannuation funds could be made more neutral and equitable by adopting a basis of income taxation whereby the funds are taxed on annual 'income received', net of operating expenses, at a rate representative of the weighted average of the marginal rates of members. 'Income received' would be defined as investment income plus the contributions to the fund by employers or self-employed persons or *non-employer-sponsored* employees — where these contributions are allowed as a tax deduction.
- Pension benefits and lump-sum payments, when ultimately received by beneficiaries from the fund, should properly be exempt from tax.
- The Government should consider the implementation of such a scheme with appropriate transition arrangements to cater for existing superannuation and like commitments.

45.86 A problem may arise with 'unfunded' schemes, i.e. schemes where employers do not make contributions which in turn can be taxed. This could be overcome — e.g. by taxing the benefits directly as they were received by the employee at a comparable rate or by the entitlement being received on an after-tax basis, with tax being collected from the fund. Whichever method is chosen, the need for equality with other schemes is stressed.

45.87 The Committee is conscious that the Government may not desire neutrality in the area of retirement saving.

Conclusion

- If the Government wishes to continue to encourage saving through superannuation, it could more efficiently do so through a tax concession on individuals' contributions to superannuation schemes. (15.99)

45.88 The suggested change in the **form** or **method** of encouraging saving for retirement need not mean any decline in the overall volume of such saving. If, for example, the Government chose to allocate the **same** amount of revenue for the Committee's proposal as it does through the present arrangements, the net overall impact on retirement saving could well be favourable. In particular, the benefit of the concession would be available directly to individuals over a broader spectrum of the community and any financial institutions prepared to set up approved schemes would be encouraged to do so.

45.89 If the Government chose to allocate less revenue for this purpose, the effect on the supply of long-term capital would depend on:

- the alternative uses made of the revenue;
- the associated effects of the removal of the 30/20 rule;
- the capacity of an unfettered capital market to adapt effectively to any structural gaps that may emerge.

45.90 The Committee see no basis for concern about future shortages of long-term capital, provided the financial system is not shackled by too many restrictions. It does not accept that the Government should resile from moving towards greater neutrality simply because of supposed implications for the existing pattern of resource allocation.

III Taxation of Building Societies and Credit Unions

45.91. A minor tax anomaly in respect of building societies is noted.

Conclusion

- The Committee does not see the need on competitive neutrality grounds for changing the way building societies are treated for tax purposes except to the extent of disallowing the deduction for dividends on existing, but more particularly new, capital of a non-withdrawable nature. (15.130)

45.92 In the Committee's opinion, however, there may be a need to review the tax treatment of credit unions when they are in obvious 'commercial' competition with taxable organisations, including building societies. This is particularly important where the common bond is so broadly defined (for example covering a wide spectrum of the population) that the unique identity and purpose of the mutuality is lost.

Conclusion (15.135)

- On competitive neutrality and efficiency grounds, it would be appropriate to put credit unions on the same tax basis as other financial intermediaries in respect of the treatment of retained earnings.
- Should the Government wish to offer special tax advantage to mutual organisations for social or other reasons, the membership of such organisations, including credit unions, should be closely and continuously monitored to ensure that the principle of mutuality is strictly applied.

TAXATION OF SPECIFIC TRANSACTIONS (Chapter 16)

I Stamp Duties on Financial Instruments and Transactions

45.93 The Committee believes that stamp duties, as presently structured, distort the flow of funds, inhibit the development of a secondary securities market, and often impact regressively on borrowers.

45.94 While the total abolition of stamp duties has much to commend it, this may be impracticable in view of their revenue-raising implications for the States. It would be desirable, however, from the point of view of efficiency, for the Commonwealth and States to implement a uniform approach on a more 'neutral' basis.

Recommendations (16.40)

- The agreement of the States should be sought at an early date to abolish the existing system of stamp duties on financial transactions and instruments and replace it with a uniform and Australia-wide duty for similar kinds of financial transactions and instruments.
- If such an agreement cannot be reached, the States should be at least encouraged to achieve greater uniformity of duty as between loans, advances and securities and as between the States.

II Interest Withholding Tax

45.95 It is believed that the present interest withholding tax arrangements, and especially the selective exemptions, impinge on efficiency in the financial markets because competition and choice are reduced. Overseas borrowings are thus not necessarily transacted by the most cost-efficient financiers or allocated to the most efficient users.

45.96 The interest withholding tax nonetheless serves to ensure that income derived in Australia by overseas financiers does not escape Australian tax altogether.

45.97 The Committee has had regard both for these revenue aspects and the non-neutralities, inequities and other problems created by the present tax exemptions.

Recommendation

- The case by case exemption from interest withholding tax for private borrowings meeting the 'Australian entity' tests should be withdrawn. (16.77)
- 45.98** If, nevertheless, the Government decides to retain such exemption provisions (e.g. because it wishes to assist Australian-owned borrowers), the exemption tests should be reviewed to see how they might be simplified and rationalised. Some suggestions are made by the Committee.

III Taxation of Gains from the Disposal of Property

45.99 Section 26AAA of the Income Tax Assessment Act, which taxes gains arising from the sale of investments within twelve months of purchase, is said to discriminate against 'shorter term' investments. As such, it may inhibit portfolio optimisation and the depth and breadth of the share markets.

45.100 Conversely, benefits are seen in terms of greater certainty for investors and for revenue.

45.101 While s. 26AAA could have contributed to reduced participation in the share markets, there are other more important influences involved. On balance, the Committee does not see strong efficiency grounds for repealing s. 26AAA. However, some anomalies need to be looked at — namely, the treatment of s. 26AAA losses and the treatment of forced sales of equities.

Recommendations (16.91)

- Section 26AAA of the Income Tax Assessment Act should be amended to permit the offset of s. 26AAA losses against s. 26AAA gains arising in the

same taxable year, with provision for any such losses that are unrecouped to be carried forward for up to seven years against future s. 26AAA gains.

- Provision should be made for exemption from s. 26AAA tax of gains arising from compulsory acquisition of shares consequent upon a takeover.

45.102 No recommendations are made on s. 26(a) because it involves issues extending well beyond an inquiry into the financial system, including the issue of a comprehensive capital gains tax.

IV Taxation of Foreign Exchange Gains and Losses and Related Transactions in Respect of Borrowings

45.103 In the Committee's judgment, foreign exchange gains and losses cannot be sensibly separated from other borrowing costs such as interest charges, which are treated as revenue items for tax purposes.

Recommendation

- The present tax treatment should be amended so that:
 - all realised foreign exchange gains and losses in respect of borrowings are treated as revenue items, whereby gains are taxed and losses deductible,
 - hedging and forward contract costs in respect of borrowings are deductible with any proceeds therefrom assessable. (16.102)

INFLATION AND TAXATION (Chapter 17)

45.104 Inflation affects the tax burden in two distinct ways:

- through the tax rate structure — as increases in nominal incomes push households into higher marginal tax brackets;
- through the tax base — since assessable income is determined in nominal rather than real terms.

45.105 The tax base problem is particularly pertinent to this Inquiry. In an inflationary environment, present tax arrangements impact unevenly as between investment income derived from financial assets and that derived from physical assets. They also impact unevenly between borrowers and lenders. Distortions in the pattern of funds flows can result. The Committee is mindful that, to some extent, the market has adjusted to the effects of inflation. It also recognises that full consideration of the issues would have to encompass wider social, budgetary and economic matters. It therefore makes no specific recommendation.

Conclusion

- The Committee urges the Government to review again the procedures for taxing income in an inflationary environment because of their important and wide ramifications for efficiency and equity in the financial system. (17.20)

INVESTOR PROTECTION: GENERAL APPROACH (Chapter 18)

45.106 While it is acknowledged that governments have a responsibility to ensure public confidence in the soundness of the financial system as a whole, prudential regulation should be structured so as to minimise adverse effects on

efficiency. With this in mind, certain principles have guided the Committee in formulating its recommendations in Chapters 19–21. The more important ones are:

- financial intermediaries should be allowed to fail, in the same way as non-financial companies;
- there should be a liquidity ‘safety valve’ available to intermediaries;
- the legal and regulatory framework should offer reasonable protection to investors against fraud and malpractice;
- there should be a ‘fair’, well-informed market in securities;
- requirements for entry will be more compatible with efficiency objectives where they are concerned only to protect potential depositors, and not with determining the desirable level of competition in the industry as a whole;
- prudential requirements should be applied in a flexible manner and intermediaries allowed maximum freedom to adjust to changing circumstances;
- investor protection arrangements should aim at competitive neutrality among financial intermediaries;
- while self-regulation has some appeal, a degree of government oversight is considered necessary to ensure that self-regulation is broadly based, equitable and effective;
- a reasonably full spectrum of risk/return combinations should be available to investors;
- governments should ensure that information necessary for risk evaluation is disclosed by financial intermediaries. However, disclosure requirements do not always represent a clear alternative to other forms of regulation. Nor is the question necessarily one of **increased** information; what has to be considered is the quality and cost-effectiveness of information that is disclosed;
- shareholders, policyholders or superannuation fund contributors should have a meaningful opportunity to express their views on the policies of the companies or funds in which they have invested.

INVESTOR PROTECTION: DEPOSIT-TAKING INTERMEDIARIES (Chapter 19)

45.107 The present fragmented approach to regulation makes it difficult to achieve competitive neutrality, inhibits the development of nationally oriented deposit-taking intermediaries (DTIs), and may discourage longer term rationalisation. It might also constrain the natural, flexible evolution of these institutions in the changing competitive environment.

45.108 In the approach recommended by the Committee, financial intermediaries soliciting funds from the public would fall, for purposes of prudential regulation, under five categories:

- banks;
- authorised dealers;
- non-bank DTIs which solicit small deposits from households, without issuing prospectuses;

- institutions which also solicit small investments from households but through the issue of prospectuses; and
- other institutions which **only** accept **large** ('wholesale') deposits, predominantly from the business sector.

Recommendation

- A national framework for the prudential regulation of non-bank institutions which accept deposits primarily from households without issuing prospectuses should be developed, possibly along the lines of the co-operative approach to national regulation of companies and the securities industry. (19.24)

Banks

45.109 While careful consideration needs to be given to the impact of new entrants on stability, the Committee considers that an efficient banking system is most likely to be achieved where prudential entry requirements are structured so as not to unduly discourage new entrants.

Recommendation

- New domestic banks should be required to demonstrate that they have:
 - an appropriate capital base; and
 - management of an acceptable quality, including their capacity to meet prudential standards laid down for established banks. (19.46)

45.110 The Committee does not believe that it is necessary on prudential grounds to restrict ownership of banks, so long as there are appropriate constraints in respect of loans to shareholders, directors and single customers.

Recommendation

- The Banks (Shareholdings) Act should be repealed. (19.56)

45.111 However, it is desirable that the Reserve Bank should be fully aware at all times of the identity of substantial shareholders in a bank and be able to take appropriate action, for the protection of depositors, where a need arises.

Recommendations (19.58)

- The Banking Act should require that anyone acquiring a substantial shareholding in a bank (a beneficial interest in 10% or more of the voting rights attaching to a bank's share capital), or increasing an existing substantial shareholding, notify the Reserve Bank within two business days of that shareholding being acquired.
- The Reserve Bank should be empowered to order divestment of shares held in excess of the 10% benchmark where, in its view and in the view of the Treasurer, this would be in the best interests of depositors.

45.112 In general, prohibitions on the portfolio structure and type of business activity of intermediaries are regarded as incompatible with an efficient, flexible financial system, and may generate instability.

Recommendation

- There should be no official prohibitions (on prudential grounds) on the nature of financial intermediation undertaken by banks or on the kinds of assets they may hold arising therefrom. (19.61)

45.113 It is believed that capital, being the last line of protection for depositors, should be seen as the cornerstone of prudential regulation. If the efficiency of financial intermediation is not to be impaired, any capital requirements should take into account the special circumstances of each bank.

Recommendations

- Individual banks should be subject to appropriate capital adequacy requirements. (19.79)
- Consideration should be given to the introduction of a two-tier capital ratio. (19.79)
- The ratios should have regard for the interrelationship between capital and other criteria such as the quality of a bank's assets, its management, earnings performance and the maturity structure of its liabilities. (19.79)
- The broad criteria used in determining the ratios should be publicly available, though the specific ratio for each bank should not be publicly disclosed. (19.80)

45.114 It is also proposed that 'risk asset limits' should apply to certain more risky types of assets so that any increase beyond that which is prudent, having regard to a bank's capital base, is matched by an appropriate increase in capital.

Recommendations

- Loans by a bank to a single customer should not exceed a prescribed proportion of its capital, with a specified number of the largest loans, in aggregate, being limited to a prescribed proportion or multiple of bank capital. (19.88)
- Loans to 'controlling' shareholders and directors should be subject to a conservative risk asset limit. (19.92)
- Consideration should be given to the imposition of risk asset limits in respect of investments in, or aggregate lending on the security of, certain classes of property (such as low or non-income-producing property of a developmental or speculative nature). (19.95)

Conclusion

- The Reserve Bank might consider the application of risk asset limits for banks in respect of:
 - their spot dealing exposure in each individual foreign currency;
 - the aggregate of these individual spot exposures;
 - their forward dealing exposure in each individual foreign currency; and
 - aggregate forward dealing exposure. (19.103)

45.115 The Committee believes that a liquidity ratio is desirable on prudential grounds.

Recommendations (19.119)

- Each bank should be required to meet a liquidity ratio for prudential purposes.
- The liquidity ratio should be generally maintained at or above the required level. An averaging process would apply over short periods.
- The eligibility of assets for a bank's liquidity ratio should be determined having regard to their period to maturity and their quality.

45.116 In the Committee's view, prudential considerations do not warrant retention of maturity restrictions on interest-bearing bank deposits. As well, banks should be free to borrow from whatever sources they wish; such freedom encourages innovation and greater flexibility in financing arrangements.

Recommendation

- The restriction on sources of savings bank deposits should be removed. (19.123)

45.117 Interest rate controls on bank loans impede the ability of banks to compete for deposits.

Conclusion

- There is insufficient justification for retaining interest rate controls as an instrument of prudential policy. (19.127)

45.118 The Committee believes competing financial intermediaries should be subject to consistent disclosure requirements.

Recommendation

- Banks should be required to maintain a standard of disclosure comparable to that applying to companies under the Companies Act, in addition to providing information that is particularly relevant to their financing activities. (19.130)

45.119 Having regard to the safety 'haven' characteristics of banks, the Committee favours retention of the depositor protection provisions of the Banking Act.

45.120 In the interests of public education and competitive neutrality, the extent of the Reserve Bank's responsibility for the protection of depositors should be made clear.

Recommendation

- The Reserve Bank Board, in its Annual Report, and the Governor in his public addresses, should seek to explain the extent of the Bank's responsibility to bank depositors. (19.143)

45.121 Chapter 5 lays down some general principles for the provision of central bank liquidity; this chapter discusses the application of these principles.

Recommendations (19.146)

- Any official agreements or arrangements (such as the LGS convention) which might be viewed as providing an individual bank with access, at its discretion, to Reserve Bank liquidity in certain circumstances should be avoided.
- Provision of liquidity support by the Reserve Bank to an individual bank (like any other DTI) should be provided only at the Reserve Bank's discretion and be subject to:
 - the Reserve Bank satisfying itself that the bank is viable and well managed, and that it cannot meet its liquidity needs (e.g. from the sale of assets) without jeopardising market confidence in its viability;
 - the imposition of a substantial penalty, except where the circumstances involved are clearly beyond the influence of the bank.
- Details of any liquidity support provided, including the size of the loan and

associated terms and conditions, should be publicly disclosed, with a discretionary lag which would have appropriate regard for the potential impact of disclosure on confidence in the bank.

45.122 The Committee believes consideration should be given to structuring supervisory processes so as to permit the Reserve Bank to concentrate its efforts on periodic in-depth examinations as well as the resolution of special problems as they arise, with less emphasis on continuous detailed oversight. In particular, consideration might be given to the greater use of bank auditors in the supervisory process.

Recommendations (19.155)

- The supervisory efforts of the Reserve Bank should continue to involve close liaison with bank management and place particular emphasis on periodic in-depth examinations as well as the resolution of specific problems as they arise.
- In performing his duties (under s. 61), the Auditor-General should have assured access to the full reports of the bank's auditors.

45.123 While the Reserve Bank should continue to rely on the co-operation of banks in relation to prudential requirements, disagreements may arise. The Treasurer has the ultimate sanction of withdrawing a bank licence, but in the opinion of the Committee this would be an extreme response. The Banking Act should therefore confer power to make regulations, although the Committee emphasises its preference for a flexible approach.

Recommendation

- The Banking Act should provide for the capacity to impose prudential requirements by regulation, but in the expectation that formal regulation would not generally be used. (19.158)

45.124 The Committee notes that, in the event that they are permitted to operate in Australia in their own right, **prudential** considerations suggest that it might be preferable for a foreign bank to establish as a fully guaranteed subsidiary rather than as a branch or unguaranteed subsidiary.

Recommendation

- Foreign banks should be subject to the same minimum capital requirements, risk asset limits, liquidity ratios and other prudential requirements as domestic banks. (19.166)

45.125 The Committee understands that there is an emerging view among the prudential authorities in the major Western countries that the supervision of a bank's total operations, including its overseas branches and subsidiaries, should be primarily the responsibility of the authorities in the parent's country. Of course, the branch or subsidiary, as an independent unit, would have to meet the local prudential requirements.

45.126 It is strongly believed that the uncertainty surrounding the existing relationship between banks and their non-bank affiliates needs to be resolved.

Recommendation

- For the purposes of prudential regulation (and monetary policy), banks should be required to consolidate the operations of intermediaries which are

subsidiaries. Minimum capital and other requirements should apply to the consolidated group. (19.178)

Non-bank Deposit-taking Institutions (DTIs)

45.127 The Committee considers that the principles of prudential regulation applying to non-bank DTIs should generally be comparable with those applying to banks, but should be less rigorous. Basic supervision of non-bank DTIs would remain essentially a state responsibility.

Recommendation

- New non-bank DTIs (including those credit unions which borrow funds from the public) should be required to:
 - have a significant, non-withdrawable capital base;
 - satisfy the authorities as to the quality of management; and
 - be capable of meeting prudential standards laid down for established non-bank DTIs. (19.190)

45.128 Prohibitions on the types of assets DTIs may hold, geographic limitations on their lending activities, or restrictions on the maturity of investments are not favoured by the Committee.

Recommendations

- Non-bank DTIs should be:
 - unrestricted in the range of lending they may undertake and investments they may hold; and
 - free to lend interstate, where they cannot already do so. (19.198)
- If an existing DTI chooses to broaden substantially its asset structure, it should first seek the consent of its shareholders and, where appropriate, its depositors. (19.198)
- Non-bank DTIs should not be subject to restrictions on the maturity of their investments, other than in respect of those assets held to meet prescribed liquidity requirements. (19.200)

45.129 It has been claimed that existing capital requirements for building societies and credit unions are often inadequate; as well there is a lack of uniformity among the States. If building societies diversify their lending activities or credit unions borrow extensively from the public, the Committee believes that their asset quality/capital adequacy ratios should be adjusted accordingly.

Recommendations (19.209)

- Non-bank DTIs should be subject to appropriate capital ratios.
- The precise ratio for individual institutions should be determined having regard to the quality of their assets and management, the maturity structure of their liabilities, and their earnings performance.

45.130 Consistent with the discussion in respect of banks, it is believed that risk asset limits (RALs) should be applied in certain circumstances (e.g. in respect of loans by credit unions to a single customer) in preference to asset restrictions.

45.131 A more flexible approach to the method of setting liquidity ratios is considered desirable.

Recommendations (19.216)

- The liquidity ratio of each non-bank DTI should have regard to the maturity structure of its assets and liabilities.
- The ratio should be maintained in normal circumstances at (or above) the required level. An averaging process would apply over short periods.
- The eligibility of assets for a liquidity ratio should be determined on a consistent national basis, and should have regard for their quality, their period to maturity and their marketability.

45.132 For reasons similar to those applying in the case of banks, it is believed that DTIs should be free to borrow on whatever terms and from whatever sources they wish.

Recommendations

- No notice-of-withdrawal requirements or restrictions should be imposed by governments on the right of a depositor to be repaid at any specified date or time. (19.220)
- If withdrawable funds deposited with non-bank DTIs are to be classified as 'shares', the distinction between 'shares' and 'deposits' should be made clear to investors. (19.222)

Conclusion

- There is insufficient justification for retaining interest rate controls (including suasion) as an instrument of prudential policy. (19.225)

45.133 The Committee considers it an important discipline that building societies and credit unions should make full disclosure to their members.

Recommendations (19.232)

- Non-bank DTIs should be required, at least annually, to publicise adequately an audited, simplified statement of financial condition or send copies of such a statement (together with the Annual Report) to all members and depositors.
- Annual Reports should be available to all members and depositors upon request, and should maintain a standard of disclosure comparable to that applying to companies under the Companies Act, in addition to providing information that is particularly relevant to their financing activities.

45.134 The Committee is concerned about the lack of public awareness of the true nature and extent of the responsibilities of the regulatory authorities.

Recommendation

- State Registrars should, in their Annual Reports and public addresses, seek to explain the extent of their responsibilities for the protection of depositors. (19.237)

45.135 The Committee sees a potential conflict of interest inherent in existing liquidity support arrangements provided through the banking system.

Recommendations (19.245)

- The Government should explore with State Governments the feasibility of encouraging the establishment of industry-based liquidity support instrumentalities for non-bank DTIs by permitting certain funds lodged with such instrumentalities to count towards prescribed liquidity requirements.

- The Reserve Bank should be prepared to make loans, at its discretion, to any industry-based liquidity instrumentality, subject to conditions similar to those applying in the case of banks.
- Any such instrumentality should be subject to supervision by the Reserve Bank and be fully accountable to the Bank for any liquidity support provided.

Finance Companies

45.136 While a case can be made for compulsorily bringing finance companies into the regulatory framework within which DTIs operate, the Committee is opposed to this as it might create a gap in the investment risk spectrum.

45.137 Competitive neutrality can be safeguarded by allowing finance companies the option to come under the DTI prudential framework.

Authorised Dealers

45.138 Assuming that no significant changes are made to the assets which authorised dealers are permitted to hold, the Committee believes the quality of these assets justifies a continuing high gearing ratio.

Merchant Banks

Conclusion

- In future, if they solicit small deposits, merchant banks should be subject to the proposed non-bank regulatory framework or issue a prospectus. If, on the other hand, they deal only in 'wholesale' markets, the Committee sees no need for prudential regulation. (19.255)

INVESTOR PROTECTION: LONG-TERM SAVINGS INTERMEDIARIES (Chapter 20)

I Life Insurance Companies

45.139 The philosophy underlying the existing approach to regulation of life insurance companies is that while efforts should be made to minimise the likelihood of insolvency, the solvency of individual insurers should not be guaranteed by the authorities. The Committee endorses this approach. However, it believes greater flexibility would be desirable in some respects, e.g. the valuation for solvency tests.

Recommendation

- The life insurance industry and the Life Insurance Commissioner should consult with the objective of recommending amendments to the Life Insurance Act to provide for a basis of valuation related to current market rates of interest and current market values. (20.17)

45.140 In general, the Committee does not favour the Life Insurance Commissioner having discretionary powers in respect of life offices' individual investments or investment strategy. Prudential safeguards would best be met by ensuring that life offices spread their investments.

Recommendations (20.29)

- For the purposes of actuarial solvency valuations, the value of any individual asset (including ‘closely related assets’) should be taken into account only up to 5% of a life office’s total assets.
- Where the value of an individual asset exceeds this figure (arising, for example, from an asset revaluation or a change in the market valuation of an investment), a life office should be allowed a period of twelve months to conform with the applicable solvency test discipline in respect of that asset.
- Where any of a life office’s assets exceed the 5% limit at the time these arrangements are implemented, an exempt period of three years should be permitted.

45.141 There may also be a case for imposing a further ceiling — in terms of acceptability for the solvency test — on upstream or cross-stream investments in related companies or with related or associated persons.

45.142 The Committee does not see significant prudential benefits flowing from the 30/20 requirement.

Recommendation

- The Government’s decision on whether to abolish the 30/20 requirement should not be influenced by the prudential implications for the life insurance industry. (20.36)

45.143 There is no perceived need for a government-initiated ‘safety net’ for policyholders.

Conclusion

- There is no need for government involvement in any arrangements along the lines of those provided for in the Policyholders Protection Act in the United Kingdom. (20.42)

45.144 However, it is of concern to the Committee that the general public may not be fully aware that existing regulatory arrangements do **not** guarantee solvency.

Recommendation

- The Life Insurance Commissioner should seek to explain, in his Annual Reports, the extent of his responsibility for the protection of policyholders. (20.43)

45.145 It is considered important that potential policyholders have the fullest opportunity to obtain the policy best suited to their needs.

Conclusion

- The Life Insurance Federation of Australia and the Life Insurance Commissioner should work toward the development and maintenance of a document providing up-to-date information on:
 - the role and responsibilities of the Life Insurance Commissioner;
 - the distinguishing features of the various types of policies available within the life insurance industry; and
 - how additional information can be obtained. (20.51)

Recommendations

- The Life Insurance Act should be amended to provide for a fourteen-day cooling-off period during which the policyholder may cancel his contract without penalty. (20.54)
- Where life offices do not already do so, they should be required to issue new policyholders with a booklet providing information on past and current performance in respect of such matters as earning rates, bonuses etc. and in respect of surrender values. (20.61)

45.146 It is believed that policyholders of all kinds should be provided with a report annually, providing an overall view of their life office's activities.

Recommendation

- Where life offices do not already do so, they should be required — in sending their premium renewal notices or annual bonus certificates — to provide policyholders with a short summary of their Annual Reports. Their summaries should, at least, contain meaningful details of the investment spread of the relevant statutory fund. (20.65)

45.147 In the Committee's view, certain anomalies relating to disclosure and reporting should be corrected.

Recommendations

- Life offices should continue to meet the special disclosure requirements laid down in the Life Insurance Act, but the requirements of the Act should be revised to ensure that life offices maintain a standard of disclosure not less than that applying under the Companies Act. (20.69)
- The provision of the Companies Act which exempts directors of life offices from presenting a directors' report setting out prescribed information should be repealed. However, the nature of disclosure in such reports should reflect the special nature of life insurance business. (20.72)

45.148 The change in emphasis from an arm's length investment role to one where life offices have greater entrepreneurial and management responsibilities is welcomed by the Committee, but it does underscore a need for the life offices concerned to be fully accountable to their policyholders.

Recommendations (20.80)

- Mutual life offices should be required to
 - send a formal application for inclusion on the voters' roll to all policyholders at the time they take out a policy;
 - advertise their annual meetings prominently in the newspapers and include in the advertisement an application for registration on the roll and a voting coupon that policyholders may complete.
- The provision that the name of a policyholder who does not exercise his right to vote on three consecutive occasions may be removed from the voters' roll should be retained, but this action should only be taken if no response is received within fourteen days of notification of the life office's intention.

II Superannuation Funds

45.149 While the Committee sees a need for greater prudential oversight of

superannuation funds, it does not favour an increase in the overall level of ongoing government regulation and supervision. It does not, therefore, advocate an approach to regulation fully comparable with that of life offices.

45.150 There are possible constitutional difficulties associated with the regulation of superannuation funds other than by way of the taxation power.

Recommendations (20.107)

- Only contributions to an 'approved' superannuation fund should be rebateable (or deductible) for income tax purposes.
- An 'approved' fund would be one that met certain minimum prudential requirements. These should be set (and reviewed regularly) by the Life Insurance Commissioner (who would *not*, however, have any ongoing supervisory responsibilities).
- The requirements should be incorporated in the trust deeds of superannuation funds.
- The auditor for each superannuation fund should provide the fund with a certificate each year confirming that the minimum requirements have been met.
- The superannuation fund should lodge this certificate with its annual tax return; this would provide the basis for rebateability (or deductibility) of contributions.

45.151 In the opinion of the Committee, employers should be free to determine the level of contributions and benefits, in respect of benefit promise schemes. However, members need to be made fully aware of the situation.

Recommendations

- As a condition of qualification as an 'approved' fund, the trust deed of superannuation schemes should require that members be kept regularly informed of the level of funding in relation to the obligations of employers under trust deeds. (20.117)
- Benefits accrued in superannuation schemes in respect of previous service should not be revocable by the employer, except where the trust deed so provides. (20.122)

45.152 It is considered important that the security of members' benefits should be protected. To qualify as an 'approved' fund, the following conditions should be satisfied:

Recommendations

- A superannuation fund (other than one administered by a life office or other pooled fund) should be required to restrict its investment in any single asset to not more than 5% of the total assets of the fund, both values to be current market values. A pooled fund should be required to observe the same constraint in respect of its overall portfolio. (20.125)
- Where the value of an individual investment exceeds this figure (arising, for example, from the revaluation of an asset or a change in the market valuation of an investment), the fund should be permitted twelve months to reduce its holding to the 5% level. (20.125)
- Where any of a fund's investments exceed the 5% limit at the time these

arrangements are implemented, a transitional period of three years should be permitted. (20.125)

- In general, not more than 5% of the assets of a superannuation fund should consist of an investment (equity and/or loans) in the employer's business. (20.128)
- To enable employers to rearrange their financing, a longer transitional period should be permitted, before the 5% ceiling is applied, than is proposed in respect of other investments. (20.130)

45.153 To a certain degree, disclosure by superannuation funds can serve as a substitute for regulation. While the Association of Superannuation Funds of Australia has taken steps to improve disclosure by superannuation funds to their members, there is no compulsion on funds to adopt the recommended reporting standards. It is of concern to the Committee that the funds least likely to conform may well be those where there is greatest need for members to be aware of their funds' operations.

Recommendation

- Observance by funds of reporting standards, along the lines of those advocated by the Association of Superannuation Funds of Australia, should be made a condition of qualification as an 'approved' fund. (20.139)

45.154 The Committee believes it is desirable to ensure that funds are administered more clearly in the interests of members.

Recommendation

- A condition of qualification as an 'approved fund' should be that the trust deed provide for the annual election of at least one representative of non-management employee-members as a trustee of the fund. (20.144)

III General Insurance Companies

45.155 There is concern about the stability of the general insurance industry.

Conclusion

- The Committee endorses the suggestion that the minimum paid-up capital and the solvency margin of general insurers should be increased, as it believes the present requirements may be inadequate to enable the Insurance Commissioner to achieve the objectives of the Insurance Act. (20.153)

45.156 The suggestion that long-term stability in the industry could best be achieved by allowing a degree of industry regulation of premium rates is not supported.

Conclusion

- On efficiency grounds, self-regulation of premium rates should not be given special exemption from the Trade Practices Act. In any event, such action would set an unfortunate precedent for other industries. (20.158)

45.157 However, certain action is seen to be desirable to promote the long-term stability of the industry.

Conclusions (20.160)

- The objectives of stability and industry rationalisation would best be achieved

by encouraging increased disclosure by insurers and greater risk awareness among the insured.

- Greater risk awareness might be promoted if insurers that observe high prudential standards were to publicise this fact and if information were included in policy documents on the role and responsibilities of the Insurance Commissioner, similar to that which the Committee has proposed in respect of the Life Insurance Commissioner.
- Consideration should be given to amending the Insurance Act to enable the Commissioner to take prompt action to facilitate the quick exit from the industry of failing insurance companies — so as to minimise losses to policyholders and avoid adverse effects on public confidence.

45.158 In the opinion of the Committee, the retention of premiums by brokers and investment of these funds on their own account is clearly not in the best interests of insurers.

Recommendation

- Premiums should not count as an asset for solvency purposes under the Insurance Act where they are unpaid three months after becoming due. (20.170)

45.159 The desirability of spreading investments has been emphasised elsewhere.

Recommendations (20.173)

- For the purposes of calculating the solvency test, the value of any individual asset (including related assets) should be taken into account only up to 5% of an insurance company's total assets.
- Where the value of an individual asset exceeds this figure (arising, for example, from an asset revaluation or change in the market valuation of an investment), an insurance company should be exempt for twelve months from the applicable solvency margin discipline in respect of that asset.
- Where any of an insurance company's assets exceed the 5% limit at the time these arrangements are implemented, an exempt period of three years should be permitted.

45.160 Criticism has been expressed of the need to comply with both Commonwealth and State Government prudential requirements, because of the costs of compliance, anomalies and inconsistencies and the fact that State requirements are usually more onerous.

Recommendations (20.177)

- Where State Governments impose prudential requirements in respect of insurance companies transacting business in their States, the Government should endeavour to secure their agreement to greater uniformity across the States and greater consistency with requirements under the Insurance Act.
- To the extent that different arrangements continue to apply at State and Commonwealth level, the Government should seek to establish a consultative mechanism to co-ordinate regulation and supervision, so as to minimise costs of administration and compliance.

45.161 While generally favouring co-regulation, the Committee believes self-

regulation may be appropriate for mortgage insurers because purchasers of mortgage insurance are financial institutions which should be expected to have sufficient expertise to evaluate the financial standing of a mortgage insurer. Nonetheless, if favoured by the industry, consideration might be given to regulating mortgage insurers under the Insurance Act.

IV Insurance Brokers and Agents

45.162 The question of whether insurance **agents** are to be regulated should be determined through consultation between the industry and the appropriate authorities.

45.163 The issues pertaining to the regulation of insurance **brokers** have not been fully explored. While certain considerations point to minimal direct government involvement, the Committee would not favour sole reliance on self-regulation. Governments clearly have a role in protecting individual consumers against fraud and misrepresentation.

Conclusion

- The Committee favours a system of 'co-regulation', with government legislation laying down the ground rules for an arrangement basically involving self-regulation by an appropriate industry body on which there would be some government representation. It believes early action should be taken by the Government to ensure that appropriate co-operative national legislation is developed. (20.206)

45.164 In the Committee's view, it is also desirable that guidelines for the disclosure of information by brokers to their clients should be developed.

INVESTOR PROTECTION: COMPANIES AND THE SECURITIES INDUSTRY (Chapter 21)

45.165 Co-regulation, under which the stock exchanges are responsible for ensuring that requirements set under legislation (or by the exchanges themselves) are enforced, offers many advantages that are not available with either a statutory or self-regulatory approach.

45.166 At present, the Ministerial Council may only disallow an amendment to an Exchange's business or listing rules; this unduly limits the scope of co-regulation.

Recommendation

- The Securities Industry Act should be amended to provide the authorities with the power to require a stock exchange to amend its business or listing rules where this is considered to be in the public interest. (21.16)

45.167 The Committee believes that there should be a national approach to the co-regulation of futures exchanges.

Recommendation

- The Sydney Futures Exchange, and any other futures exchange that might be established, should be subject to an approach to regulation comparable to that

applying to stock exchanges, with the authorities having responsibility for approving and requiring changes to the exchange's articles and business rules. (21.24)

45.168 While it is acknowledged that some regulation is necessary, an active, broadly based market and an informed public will do much to reduce the incidence of undesirable practices.

45.169 In the Committee's view, reporting requirements may not, in some respects, represent desirable minimum levels of disclosure. The provision of information cannot be left entirely to market forces.

Conclusion

- The National Companies and Securities Commission (NCSC) should confer with the Australian Institute of Management (and other appropriate bodies) on the need, or otherwise, for government action to improve the standard of reporting by public companies and like institutions. (21.36)

45.170 Financial intermediaries are subject to a range of disclosure requirements: the variations in requirements appear to have no clear rationale.

Recommendation

- All financial intermediaries should be subject to consistent reporting requirements, which should be prescribed in regulations to the relevant legislation. (21.44)

45.171 The Committee believes that accounting standards must also be capable of producing the information necessary for investors to make comparisons and undertake evaluation of risks.

Recommendations (21.57)

- The two professional accounting bodies should continue to be responsible for the design and development of accounting standards.
- An Accounting Standards Review Board should be established with responsibility for deciding on the adoption of accounting standards, having regard to the needs of different users; the NCSC, professional accounting bodies and other interested parties should be represented on the Board.
- Accounting standards recommended by such a Board should be given legislative support.

45.172 The Committee stresses the importance of ensuring that accounting standards are adequately enforced.

Recommendation

- The National Companies and Securities Commission should arrange with the two accounting bodies for representation of the relevant Corporate Affairs Commission, at its discretion, on any committee appointed to inquire into public interest cases, and on any disciplinary committee that may be established. (21.62)

45.173 In the Committee's opinion, increased frequency of reporting would contribute to a more informed market and should not be a burden to public companies.

Recommendations (21.72)

- Stock exchange listing requirements should include provision for quarterly reporting.
- The requirements of such reports should be less onerous than for annual reports.

45.174 The independence of auditors from management is seen to be of particular importance given their role as independent ‘watchdogs’ of shareholders’ interests.

Recommendations (21.80)

- Auditors should be required to declare each year in their reports to shareholders the nature of any other services provided to the companies concerned.
- Consideration should be given to amending the Companies Act to give auditors who resign the explicit right to call an extraordinary general meeting for the purpose of considering the circumstances of their resignation. Such a meeting should resolve whether the company or the auditor should bear the direct costs associated with the holding of the meeting.

45.175 While the NCSC might usefully include an examination of various suggestions for increasing corporate accountability, the Committee sees the problem of shareholder participation as largely one of apathy.

45.176 The Committee notes that some important gaps exist in the Community’s knowledge in respect of many aspects of the financial system. It believes that governments, financial intermediaries and their associations, and the media should play an active role in educating the public about basic principles of investing, sources of financial advice, the responsibilities of governments and the operation of the financial system generally.

45.177 There are a number of market practices where, it has been suggested, regulation to protect investors may be modified so as to increase the efficiency of the market, but without loss of protection for investors.

Conclusions

- The National Companies and Securities Commission should consider, at an early date:
 - whether companies might be permitted to purchase their own shares, provided there are appropriate safeguards for shareholders and creditors; (21.99)
 - the feasibility of allowing companies to issue no par value shares and to convert existing shares to shares with no par value; (21.110)
 - the feasibility of allowing short selling, subject to the imposition of appropriate requirements to discourage the development of a false market and to prevent the development of unfunded speculation. (21.116)

45.178 The structure and operation of financial markets have changed substantially since the insider trading provisions were last reviewed in 1970.

Conclusion

- The National Companies and Securities Commission should, as a matter of

priority, review the insider trading provisions of the Securities Industry Act, with a view to strengthening them. Consideration should be given to the inclusion of provisions that:

- permit superannuation funds to deal in the securities of a sponsor company provided trustees make appropriate disclosure to the stock exchanges; and
- make insider dealings subject to civil and criminal penalties. (21.123)

45.179 In the Committee's view, companies borrowing from the public need to be able to respond quickly and flexibly to changes in market conditions. While recent administrative action by the Corporate Affairs Commission is expected to ease many problems that have existed in the past, increased volatility in interest rates suggests a need for additional changes to existing prospectus requirements to ensure competitive neutrality between public borrowers soliciting funds through prospectuses, on the one hand, and DTIs on the other.

Recommendations (21.158)

- All public borrowers should be permitted to issue an abridged prospectus, in a form and content approved by the relevant Corporate Affairs Commission, containing only the basic, essential information needed by investors. More detailed information should be made available to the Corporate Affairs Commission and to members of the public on request.
- Consideration should also be given to requiring companies issuing abridged prospectuses to make more frequent disclosure to the authorities, the stock exchanges and investors (on request).
- Occasional borrowers — like continuous borrowers — should be permitted to vary interest rates and maturities in prospectuses without having to issue new prospectuses.
- The National Companies and Securities Commission should give early attention to clarifying the definition of public and non-public issues.

45.180 It is believed that existing restrictions on the advertising of prospectuses unduly inhibit the ability of finance companies to compete with banks and other deposit-taking institutions.

Recommendations (21.165)

- Existing restrictions on advertisements should be revised to permit any advertisement that:
 - is not inconsistent with the prospectus or other material lodged with the relevant Corporate Affairs Commission;
 - is not likely to deceive, mislead or confuse investors; and
 - contains a statement that funds may only be lodged together with an application attached to a prospectus.
- The National Companies and Securities Commission should be empowered to require a company to withdraw any advertisement which does not meet these requirements.

45.181 The prospectus provisions of the Companies Act are designed principally for corporate fund raisers and not collective forms of investment such as unit trusts; existing requirements should be revised to take account of their special nature.

Conclusion

- The NCSC should investigate, at an early opportunity, the possibility of regulating collective investment institutions under a separate Act. (21.171)

45.182 The Committee considers that certain of the requirements to which unit trusts are subject should be changed.

Recommendations

- Unit trusts should be permitted to issue an abridged prospectus. More detailed information should be made available to the relevant Corporate Affairs Commission and to members of the public on request. (21.175)
- Unit trusts should be:
 - subject to the same general requirements in respect of advertising as those applying to companies raising funds from the public; and
 - free to advertise an indicative yield provided it is clearly stated whether it is guaranteed. (21.181)

45.183 The Committee's recommendation in respect of abridged prospectuses strengthens the need for restrictions on the soliciting of investments from the public. The relaxation of restrictions on advertising should also enhance the ability of unit trusts and others to attract funds from the public by advertising, and reducing the need for door-to-door canvassing.

45.184 The Committee nonetheless is conscious of the potential competitive advantages enjoyed by life offices in marketing equity-linked policies and, while it does not support a general relaxation of restrictions on sharehawking, suggests that the NCSC might examine the matter.

45.185 Older trust deeds usually exclude reference to more recent types of financing and investment instruments. As well, as mentioned in Chapter 10, there are anomalies in the definition of trustee securities.

Recommendation (21.197)

- State Trustee Acts should be amended, where appropriate, to:
 - bring their prescribed securities up to date with modern instruments of financing and investment;
 - provide for a consistent national approach to the definition of trustee securities; and to
 - provide arrangements for periodically reviewing the status of trustee securities.

45.186 Deposit taking has become a significant part of the operations of some trustee companies.

Recommendations (21.210)

- A uniform Trustee Companies Act should be developed; to the extent that trustee companies borrow from the 'public', they should be subject to prudential requirements consistent with those applying to non-bank deposit-taking institutions or institutions which borrow by way of prospectuses (see Chapter 19).

- The Trustee Companies Act should include criteria for the entry of new trustee companies and provide for some form of ongoing supervision.
- There should be no restriction on share ownership, but anyone acquiring a substantial shareholding in a trustee company (a beneficial interest in 10% or more of the voting rights attaching to its share capital), or increasing an existing substantial shareholding, should be required to notify the relevant State Minister within two days of that shareholding being acquired.
- The Minister should be empowered to order divestment of shareholdings under this test where, in his view, this would be in the best interests of beneficiaries.
- The right of directors to refuse to transfer shares should be abolished.
- The requirement for trustee companies to have partly paid shares should be abolished.

CONSUMER CREDIT: PROTECTION OF BORROWERS (Chapter 22)

45.187 The Committee endorses efforts being made to achieve a co-operative uniform approach to the regulation of credit providers. However, it is concerned at the delay in reaching agreement on uniform legislation, and the possibility that governments might proceed to enact legislation independently of each other.

Conclusion

- The Committee urges the Government to take an active role in seeking to secure agreement among the States on a co-operative scheme to achieve uniformity in the regulation of consumer credit providers. (22.10)

45.188 It is believed that such legislation should balance the interests of credit providers and borrowers, and have particular regard to the impact of regulation on competitive neutrality and the cost and availability of consumer finance.

45.189 The basis for making some intermediaries subject to the legislation, but not others, is questioned. It is desirable that a functional approach to regulation be adopted.

Recommendation

- Credit legislation should apply to all institutional providers of consumer finance. (22.21)

45.190 The Committee has some reservations about the proposed change in the basis of taking security from a system of hire purchase to one of chattel mortgage because of the loss of protection for credit providers against fraud. The Committee believes a registration of charges scheme, where prospective purchasers can check whether the goods concerned are encumbered, might be more cost-effective than title insurance.

45.191 It is also believed that the proposal to link credit providers with suppliers in warranting the fitness and quality of goods sold is likely to affect adversely the cost and availability of finance.

Recommendation

- Credit legislation should not include provisions which impose a liability on linked credit providers in relation to the supply of goods or services. (22.27)

45.192 The means of protecting borrowers favoured by the Committee is to provide them with whatever information is reasonably necessary to understand the terms and conditions on which finance is provided; a cooling-off period might also be required.

45.193 There may be a need to prescribe the broad rights and obligations of providers and users of electronic funds transfer systems (EFTS). However, it is believed that regulation should be consistent for all intermediaries and should not impede the efficient development of EFTS.

45.194 It is considered that the prohibition on the sending of unsolicited credit cards, imposed by the Trade Practices Act (s. 63A), may be unduly restrictive in that it adversely affects the ability of intermediaries to issue credit cards in competition with banks.

Conclusion

- The Government should set up a task force with the States and Territories, the providers of EFTS services and related consumer groups to examine the need for legislation to protect users of EFTS. This examination should include a critical assessment of section 63A of the Trade Practices Act. (22.44)

45.195 The Committee suggests various matters which need to be considered in connection with the proposal by the Law Reform Commission for the program for the regular payment of debts by non-business debtors and the establishment of a government-sponsored debt counselling service.

45.196 It also records that if class actions were introduced in respect of consumer finance, they could have a serious effect on the cost and availability of such finance.

PARTICIPATION IN THE DOMESTIC PAYMENTS SYSTEM (Chapter 23)

45.197 Submissions have been received expressing reservations about the present degree of competition in the provision of domestic payments services. One particular aspect is the general reluctance by banks to extend to non-bank intermediaries direct and indirect access to cheque (and 'Bankcard') clearing facilities.

45.198 The Committee believes that the underlying objective of policy should be the evolution of a payments system which is:

- secure;
- cost efficient;
- competitively priced;
- responsive and innovative; and
- as neutral as possible in its consequences for the competitive position of different financial intermediaries.

In the view of the Committee, such a payments system will be best promoted if:

- (i) there is a core unit — at present the cheque — in which there is undoubted confidence in the capacity of all participating intermediaries;
- (ii) there is adequate opportunity for:

- new intermediaries to enter the payments system as cheque-issuing institutions;
- non-cheque-issuing institutions to offer, **in conjunction with a cheque-issuing institution**, a range of cheque facilities to their customers; and
- all institutions to participate in offering payments instruments other than cheques.

45.199 The Committee is most unwilling to countenance a reduction in the underlying safety of the cheque payments system now established or of any ultimate substitute for it.

Recommendations (23.54)

- Only banks should be granted the authority to have cheques (or their ultimate substitute) drawn on them.
- There should, however, be no other legal barrier to the participation of any class of business or person in the provision of payments system services generally.

Conclusion (23.55)

- A cheque-issuing institution should not be required to carry on the full range of banking business currently associated with a trading bank.

45.200 The Committee attaches importance to effective competition between cheque-clearing participants to ensure fair and reasonable terms of direct and 'indirect' participation for others.

Recommendations

- The Reserve Bank should exercise general oversight of applications for direct participation by new banks in the Australian cheque-clearing system and, if invited to do so, give evidence to the Trade Practices Commissioner on any undesirable restrictions. (23.57)
- Similarly, the Reserve Bank should exercise general oversight to encourage the availability of agency facilities for non-clearing banks on reasonable but commercial terms and conditions. (23.58)
- It is the Committee's clear preference that (to facilitate indirect participation by non-banks) there should be no barriers to individual cheque-issuing banks entering into agency arrangements with non-bank institutions on terms mutually agreeable, subject to the conditions that:
 - the participating cheque-issuing banks so structure the arrangements as to ensure valid cheques (and like claims) are met on presentation; and
 - the Reserve Bank is informed of the terms of the arrangement so as to facilitate its prudential supervision of banks. (23.68)

45.201 The Committee's recommendations favouring the deregulation of banking and making entry to banking easier would promote a more competitive climate in the provision of domestic payments system services.

45.202 The Committee does not see a need to place the future development of the system under the central direction of government but envisages that the monetary authorities would take a close interest in the development of the system.

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45.203 It expects continued development and growth in the relative importance of payment instruments other than cheques.

DOMESTIC ENTRY TO FINANCIAL INTERMEDIATION (Chapter 24)

45.204 The Committee sees banks distinguished primarily in terms of their high standing in financial markets; banks' distinctive payments system functions flow from that status. It is envisaged they would continue to have a special relationship with the monetary authorities (stemming from the latter's responsibilities to protect bank depositors) and would be subject to stringent prudential disciplines.

45.205 The Committee does not accept that the possibility of economies of scale offers sufficient justification for limiting domestic entry to banking. Official attitudes to the authorisation of new banks should be conducive to new entry. Ambiguities in present policy should be removed.

Recommendations (24.34)

- Recognition of a resident-owned financial intermediary as a bank should be primarily determined on the basis of its established or potential high standing in the general community and its capacity and willingness to observe the high prudential and operational standards appropriately required of a banking business.
- Eligibility for recognition as a bank should not require a broad-ranging banking and financing operation as a pre-condition; conversely, and subject to appropriate prudential safeguards, authorised banks should not be precluded from diversifying their operations as market opportunities permit.
- It should not be mandatory for new banks to adopt a joint stock corporate structure. Subject to appropriate prudential safeguards, registered co-operative institutions (or central institutions owned by a group of co-operatives) should be eligible for authorisation as a bank.
- Any monetary policy controls (e.g. variable reserve requirements) should apply on a consistent basis to all banks, according to the nature of their activities.

45.206 For non-bank financial corporations, efficiency considerations again favour freedom of domestic entry, subject only to observance of appropriate prudential standards and disclosure requirements.

45.207 The Committee stresses the need for financial intermediation operations conducted in conjunction with primarily non-finance businesses to be monitored for monetary policy reasons.

Recommendation

- Primarily non-finance corporations engaged in a financial intermediation operation in a substantial way should be required to supply statistics on that operation as if it were separately incorporated. (24.43)

NON-RESIDENT PARTICIPATION IN AUSTRALIAN FINANCIAL INTERMEDIATION (Chapter 25)

45.208 The Committee does not favour continuation of the present policy of

total prohibition of non-resident participation in banking. It believes that increased competition in the industry will enhance efficiency, and that foreign banks offer a more immediate prospect of stimulating competition than potential domestic entrants.

45.209 Unrestricted foreign bank entry, however, would create a potential for instability. A policy of carefully managed entry is therefore favoured.

45.210 The Committee's preferred approach is to limit, initially, the number of licences issued; it suggests some appropriate eligibility criteria.

45.211 Once a licence has been granted, the non-resident licensee should not be subject to restrictions on size, rate of growth, functions or range of activities or the imposition of any discriminatory taxes or regulations.

45.212 The Committee does not see a need for a long 'transitional period'; in particular, it does not support the view of the ABA that the present prohibition on foreign bank entry should be maintained for at least five years after full deregulation.

45.213 The Government may wish, as part of its foreign investment policy, to encourage a minimum local equity participation requirement. Such a requirement, if flexibly implemented, would not, in the Committee's judgment, totally deter new entrants or nullify the benefits of foreign bank entry. However, in terms of the efficiency of the financial system, this approach is regarded as 'second best' because some of the benefits of competition would undoubtedly be lost.

Recommendations

- The existing embargo on non-resident participation in Australian banking should be removed. (25.24)
- Initially, the rate of entry of foreign banks (to establish an Australian banking operation) should be carefully managed. (25.26)
- Foreign bank participation in domestic banking should only be restricted through the number of licences granted. (25.50)
- Banking licences issued to non-residents should carry no encumbrances additional to those attaching to licences held by residents; both resident and non-resident-owned banks should have the same privileges and responsibilities. (25.50)
- Banking licences issued to non-residents should not be subject to mandatory resident equity participation requirements. At the same time, the Committee recognises that the Government may wish to take into account the prospect of local equity participation when assessing applications from non-residents for a domestic banking licence, particularly when a limit on the number of such licences is envisaged. (25.59)
- The recommended relaxation of policy should not be deferred. (25.71)
- The existing foreign bank groups — the Bank of New Zealand and the Banque Nationale de Paris — should be given the option to restructure their Australian operations to enable them to operate on a similar basis to other new foreign and domestic bank establishments. (25.73)
- Foreign banks should be permitted to establish agencies in Australia which would be restricted to an 'offshore' ***lending*** role with no authority to borrow on Australian markets or undertake foreign exchange business. (25.76)

GOVERNMENT-OWNED FINANCIAL INSTITUTIONS: GENERAL APPROACH (Chapter 26)

45.214 Some general principles have guided the Committee in addressing itself to the role of particular government financial institutions (GFIs) in Chapters 27–31. The main focus is on the commercial functions of GFIs — their rationale and efficiency. (The conduct of non-commercial functions by GFIs can be a means by which governments pursue sectoral assistance objectives and is discussed mainly in Chapter 36.)

Conclusions (26.21 and 26.39)

- (a) Each existing government-owned financial institution should be carefully evaluated to ensure that it is filling a market gap in the most cost-effective way and is expected to continue to do so in the changing financial environment. In addition, the conduct of these commercial functions should, over a period:
 - be economically viable;
 - be operationally efficient; and
 - *not* cause market inefficiencies or distortions as a consequence of unequal competition with private sector competitors or, more generally, by inhibiting the development of a vigorous private sector.
- (b) Where the conditions set out in (a) are not substantially met and are not capable of being met, serious consideration should be given to ending (either by sale as a going concern or by winding up) the government ownership of the commercial operation, unless continuing government ownership of the institution is judged by the Government to generate overriding economic externalities or social benefits which could not be achieved more cost-effectively in any other way.
- (c) Reviews of the range of operations and efficiency of GFIs should be undertaken regularly (no less frequently than every seven years) to ensure that the tests under (a) and (b) continue to be met.
- (d) New GFIs should not be established unless they meet the tests under (a) and (b).
- (e) In all essential respects, including capitalisation and profitability objectives, taxes etc., the operations of GFIs should, as far as possible, be placed on an equal footing with those of private sector competitors.
- (f) If there are benefits in terms of borrowing status arising from government ownership (whether there is an explicit guarantee or not), these benefits should be assessed independently, priced as a fee and treated as an operating expense; (however, the imprecise character of any such assessment must be recognised).
- (g) If practical difficulties delay full capitalisation then a comparable capitalisation should be imputed before applying an industry-based profit performance test (see below).
- (h) If it is not practicable to achieve equality in operating taxes etc., the differences should be noted in the accounts of the institution.
- (i) GFIs should be expected to:
 - conduct their commercial functions so as to return an average long-term level of profitability similar to that of their private sector competitors

(subject, of course, to the proviso that industry profitability is not excessive), after appropriate adjustments to the GFIs' accounts (e.g. for any gearing, tax etc. differences that have not been explicitly eliminated) to make the comparison meaningful;

- pay a comparable rate of dividend.
- (j) Subject to meeting the above primary objectives, the **commercial** activities of GFIs should be no more fettered or subject to government interference than private sector institutions undertaking similar activities.
- (k) To assist meaningful comparison as far as possible, GFIs should account separately for their commercial and any non-commercial operations (the 'target' return mentioned in (i) applies only to the commercial operations). Where the two operations cannot be adequately separated, the notes to the commercial accounts should show the benefits and costs to the institution stemming from non-commercial rights and obligations bearing on the GFIs' commercial results.

GOVERNMENT-OWNED COMMERCIAL BANKS AND OTHER DEPOSIT-TAKING INTERMEDIARIES (Chapter 27)

45.215 An important issue is whether, in the light of the broad policy guidelines set out in the previous chapter, continued public ownership of existing government banks and other deposit-taking institutions is justified on economic grounds.

45.216 The Committee has focused on the efficiency implications.

Conclusion

- Once the Committee's recommendations (especially those bearing on the competitive structure of banking) have been implemented and their full effects have been felt, there would, on present indications, cease to be justification on efficiency grounds for continued government ownership of banks. The Government should review the efficiency implications at that stage, given the potential a government institution has for disturbing competitive balance. (27.9)

45.217 It is nonetheless accepted that the considerations are complex, extending beyond narrow economic efficiency criteria, and that governments may wish, for various reasons, to continue to own and operate these institutions.

45.218 Attention was therefore focused on the related issues of viability, operational efficiency and, especially, competitive neutrality.

45.219 From the limited information available, the Committee was reluctant to draw firm inferences concerning the comparative performance of 'government' and 'private' banks.

45.220 In the past, government banks appear to have operated on terms which have both assisted and hindered their growth — the balance is not clear. The Committee's concern is for the future, and in the pursuit of competitive equality a number of specific recommendations are made concerning:

- capital structure and operations;

- the Commonwealth Banks Act; and
- exclusive rights enjoyed by government banks in certain markets.

Recommendations

Capital structure and operations (27.44)

- The commercial operations of government banks and other deposit-taking institutions should be planned with the objective of earning a return on equity comparable over time with that earned by private banks (after appropriate adjustments for any capital and/or gearing differences). A comparable rate of dividend should also be paid. The performance of the institution should be evaluated periodically on that basis.
- Every endeavour should be made to ensure that government banks and other commercial deposit-taking institutions are fully capitalised to the standards of their private sector counterparts. (Such adjustments as may be necessary should be made as soon as possible. Pending these adjustments, it would be appropriate to impute comparable capitalisation when setting and measuring profit targets and performance.)
- Any *net* saving in operating taxes (income tax, stamp duty, local government rates etc.) arising out of government ownership, after deduction of any 'equivalent' payments made to government, should be noted in the annual accounts of the institutions in question.
- A special fee should be paid to the appropriate authorities by government deposit-taking institutions to neutralise any advantages in borrowing costs (reflected in the market) arising from government ownership.
- In all other respects government-owned deposit-taking institutions should be treated similarly — in respect of their commercial operations — to their private sector counterparts. The effects of any non-commercial operations, as well as any operational constraints imposed by their government owners, should be noted in their annual accounts.
- Subject to the above conditions being met, government banks should continue to be exempt from Loan Council requirements, but on the general understanding that borrowings would not be explicitly guaranteed — unless they already have such guarantees and it is not considered practical to withdraw them.

Commonwealth Banks Act (27.52)

- Sections 11 and 13 of the Commonwealth Banks Act should be repealed. Sections 14 and 16 should be amended to exclude the Secretary to the Treasury from the Board of the Commonwealth Banking Corporation, and the Act generally should be amended to establish arrangements between the Government and the Corporation fully consistent with the conduct of a basically commercial operation.

Exclusive Rights

- Where possible the relevant state authorities should:
 - allow the children of state schools freedom of choice in respect of the provision of school banking facilities; or
 - if it is desired to restrict the number of banks, establish a system of open

and competitive tendering for the rights to provide banking facilities to children in state schools. (27.62)

- The provision of bank agency facilities at Australian post offices should be governed by sound commercial principles. To this end, the arrangements for the provision of banking facilities should be reviewed by Australia Post to determine:
 - whether, if Australia Post continues to offer bank agency facilities at all or some post offices, the Commonwealth Savings Bank should continue to have exclusive rights to conduct this agency business;
 - the commercial practicability of extending the range of both the banking services provided at post offices and the banks (and possibly other institutions) for which Australia Post acts as agent, either generally or at particular locations. (27.76)
- The review should take appropriate account of the long-standing relationship of the Commonwealth Savings Bank with post offices. If it were decided to vary existing arrangements but to otherwise limit the number of principal banks (or other participants) then the agency facilities could be offered by tender to eligible principals. (27.76)

COMMONWEALTH DEVELOPMENT BANK (Chapter 28)

45.221 The Commonwealth Development Bank (CDB), unlike the Commonwealth Trading and Savings Banks, is viewed as an important vehicle for sectoral assistance and not primarily a commercial enterprise.

45.222 Considering the CDB as a vehicle for sectoral assistance (and mindful of the general approach developed about this in Chapter 36), the Committee is of the view that the CDB is not the most cost-effective vehicle for such assistance. The Committee would prefer that any desired assistance be given either directly or channelled through an established commercial institution.

Recommendation

- Any subsidies to farmers or small business should either take the form of direct grants or tax concessions or be channelled through appropriate, already established commercial institutions. (28.18)

45.223 The Committee believes that if the major recommendations in this Report were adopted, commercial financial markets would become highly competitive and innovative, and there would not be a continuing role for the CDB as a 'last recourse' commercial lender, i.e. to fill gaps in the commercial market.

45.224 It is nonetheless accepted that the Government may well wish to retain the CDB as a separate institution to supplement market facilities during a transitional period. If so, the 'new business' operations of the CDB in this interim period should be put on a fully commercial footing. At the same time, it should cease to act as an exclusive funnel of sectoral assistance or to operate solely as a lender of last recourse.

Recommendations (28.29)

- In the initial period following deregulation, the CDB should continue as a

separate entity but be required to operate with regard to new business on a fully commercial basis.

- Following this transitional period, the CDB should be absorbed into the commercial structure of the Commonwealth Trading Bank.
- Such merger should take place on fully commercial terms.

AUSTRALIAN INDUSTRY DEVELOPMENT CORPORATION (Chapter 29)

45.225 Although in respect of many of its activities the Australian Industry Development Corporation (AIDC) seems to have competed with, rather than complemented, other sources of finance, it has also provided finance on terms and conditions not always available elsewhere.

45.226 Given a less regulated financial environment in the future, and assuming that AIDC were required to operate on a completely equal footing with its competitors, it is not clear that it would be able to offer a unique range of services. It may well be able to operate as an efficient, commercially oriented intermediary providing the same kinds of services as others in the market, but there would be no need for it to remain under government ownership for this purpose.

45.227 Nor is government ownership of AIDC regarded as necessary to achieve national interest objectives.

Recommendation

- AIDC should be disposed of to private sector interests. (29.32)

45.228 It is believed that, while the more recent financial results of AIDC reflect considerably improved operational efficiency, commercial viability has not yet been clearly established — especially when one has regard for certain competitive advantages conferred on it.

45.229 If the Government were to decide that AIDC's links with government should remain, it would be important to ensure that, in the area of its commercial operations, it was economically viable and was placed on an equal footing with its private sector competitors.

Recommendations

- Sections 8(1) and 8(3) of the AIDC Act should be repealed. (29.44)
- The commercial activities of AIDC should be separated from those activities it undertakes on behalf of governments, in pursuit of national economic and social objectives. (29.46)
- Section 7(3) of the AIDC Act should be repealed. The AIDC's gearing ratio should be determined by its Board and be subject only to the approval from time to time of the Treasurer.
- In determining the AIDC's gearing ratio, particular regard should be paid to the prevailing gearing ratios of AIDC's competitors, whether these are set by regulatory authorities or as a matter of industry practice. (29.50)
- AIDC should be expected to:

- earn a return on capital comparable to that which would normally be earned by its private sector competitors; and
- pay a dividend to the Government comparable to that which would normally be paid by its private sector competitors to their shareholders. (29.52)
- The AIDC Act should be amended to permit the use of AIDC’s capital for all purposes associated with its role as a financial intermediary. (29.56)
- AIDC’s liabilities should not be subject to an explicit government guarantee.
- AIDC should be required to pay a fee to neutralise any advantages in borrowing costs (reflected in the market) arising out of its government ownership.
- The following special concessions AIDC enjoys in respect of its domestic borrowings should be abolished:
 - the exemption of its securities from any stamp duty on issue, transfer and redemption; and
 - the arrangement whereby its securities with a maturity of up to five years can be held by authorised money market dealers (up to 5% of gearing limits).
- AIDC should not be debarred from applying for a bank licence. (29.67)
- AIDC should not remain subject to the Loan Council in respect of its commercial transactions. (29.70)
- AIDC should be required to observe the same prudential standards as those observed by similar institutions and should be subject to the same legislative and monetary policy requirements as its private sector competitors, e.g. the Financial Corporations Act. (29.71)
- AIDC’s exemption from interest withholding tax should be withdrawn. (29.74)
- AIDC should not be exempt from any exchange control measures that might be applicable to private sector intermediaries. (29.77)
- AIDC should not be subject to limitations on the range of companies or industries to which it can lend. (29.81)
- The Loans (AIDC) Act should be repealed. (29.85)
- If AIDC were retained under government ownership its role, operations, performance and efficiency should be reviewed not less frequently than every seven years. (29.93)

HOUSING LOANS INSURANCE CORPORATION (Chapter 30)

45.230 The Government’s announcement in July 1979 of its intention to sell the Housing Loans Insurance Corporation (HLIC) to private interests has stimulated public debate on its role and functions. The Committee has considered the arguments for and against selling HLIC.

Recommendations (30.35)

- The Government should proceed with its declared intention to sell HLIC.
- HLIC should *not* be sold to one of the larger existing mortgage insurers.

45.231 This view reflects the Committee's assessment that, among other things, the sale of HLIC is unlikely to leave a market gap. Indeed, it may result in a greater level of competition and stimulate the continued development of a dynamic private market in mortgage insurance.

45.232 Nor is HLIC seen as the most appropriate vehicle for the provision of ongoing subsidies, if any, to non-urban areas or housing generally.

45.233 While some changes were made to HLIC's enabling legislation in 1977 with the intention of placing it on a more equal footing with its competitors, HLIC still appears to enjoy some competitive advantages as a result of its association with the Government. The Committee believes that, if the Government did not proceed with the sale of HLIC, the following recommendations would be needed to put HLIC on a competitively neutral footing.

Recommendations

- HLIC's insurance risks should be reinsured on a basis comparable to that of private mortgage insurers *or* an appropriate amount be paid annually to the Commonwealth. (30.40)
- HLIC should pay an appropriate fee to offset the competitive advantage associated with its government ownership and guarantee. (30.43)
- The capital of HLIC should be reviewed with the object of bringing its capital/total assets ratio into line with that of private mortgage insurers.
- HLIC should be expected to earn a rate of return on capital comparable (after charges for reinsurance and the government guarantee) to that of private mortgage insurers and to pay a comparable rate of dividend. (30.48)
- HLIC should be required to meet the same prudential standards as private mortgage insurers. (30.50)

STATE GOVERNMENT INSURANCE OFFICES (Chapter 31)

45.234 In the Committee's opinion, government ownership may have given State Government Insurance Offices (SGIOs) an unfair competitive advantage in a number of respects, with distorting effects on the structure and efficiency of the insurance industry.

Conclusion

- There is a strong case on efficiency grounds for the sale or winding up of existing SGIOs. (31.3)

45.235 It is recognised, however, that state governments attach considerable weight to what they see as SGIOs' social role. The question governments must consider is whether there are more cost-effective alternative methods of achieving the desired social objectives, such as a direct subsidy to the intended beneficiaries, or the channelling of assistance through existing commercial institutions.

45.236 If governments choose to retain SGIOs, the issue of competitive neutrality becomes critical.

Conclusions

- The 'commercial' insurance activities of SGIOs should be recorded separately

from those activities in respect of which, for 'social' or other non-commercial reasons, governments may wish to maintain an SGIO monopoly or premium rates below those obtaining in a free market. (31.17)

- Where government organisations are required to take out insurance, such business should, as far as practicable, be put to public tender so that private insurers are given the opportunity to compete. (31.22)
- SGIOs should pay an appropriate fee to offset the marketing advantage associated with their government ownership. (31.27)
- SGIOs (in respect of their commercial non-life business) should:
 - aim to maintain a capital/liabilities ratio similar to that of private insurers; and
 - be expected to earn a rate of return on that capital comparable to that of private insurers and to pay a comparable rate of dividend. (31.30)
- SGIOs should:
 - be required to comply with solvency and other requirements of legislation to which their private sector competitors are subject; (31.36)
 - be required to pay all taxes, fees and charges (or their equivalents) for which private insurers are liable; (31.40)
 - not be subject to restrictions or requirements to which their private sector counterparts are not subject; in particular, they should be free to invest in those areas which, in their judgment, offer the best risk/return combinations. (31.44)

COMPETITIVE STRUCTURE: FINANCIAL INTERMEDIARIES (Chapter 32)

45.237 A competitively efficient financial institutional structure would usually be characterised by:

- high levels of competition:
 - large number of independent participants
 - low market concentration
 - absence of collusion
 - freedom of entry
- equality of competitive opportunity:
 - equal opportunity to compete for business
 - equal access to information
 - consistency in the application of regulation/taxation
- diversity of choice
- adequate range of information

45.238 Measured against these criteria, the Committee's assessment of the existing institutional structure is as follows:

- Generally, levels of competition have increased in recent years and are adequate in most areas. Where levels of competition appear, in some respects, inadequate (e.g. in the payments system, the provision of low risk deposit facilities, and areas of high risk finance) the causes often lie in excessive or

inappropriate government intervention in the financial system. The causes are seldom to be found in inherent market imperfections — i.e. failure of the market to respond to demand signals and exploit commercially profitable opportunities.

- The Committee is far from satisfied that present conditions ensure **equality of competitive opportunity**. There is widespread unevenness in the impact of taxes, regulations, controls, reporting standards etc.
- There is a wide **diversity of choice** — as to types of institutions, instruments, markets and facilities. The only limitations are those imposed by regulation and by the small size and geographical dispersion of the Australian population. However, there is a tendency for a few large institutions to dominate the market.
- While some impediments in the flow and transmission of information (e.g. in the areas of small business, consumer and rural finance and corporate reporting) have been identified, the Committee is satisfied that overall the range of information available is adequate. (This is principally the subject of Chapter 44.)

45.239 In regard to the **future competitive structure**, the Committee asked itself three questions; assuming adoption of its recommendations throughout the Report:

- (i) Will the institutional structure be competitively efficient in terms of the efficiency criteria set out above?
- (ii) Given that some degree of government intervention will remain, will this intervention be even-handed in its incidence on participants?
- (iii) Will the institutional structure develop in such a way as to create an undesirable degree of concentration of ownership and control?

45.240 In regard to questions (i) and (ii), the Committee is confident that if its recommendations are adopted a vigorous competitive environment will become established, market imperfections will be of limited significance, and the impact of regulation and taxation will be much more even-handed. However, there will still be a continuing need for regular review of the functional operations of the financial system to ensure there are no unnecessary barriers to effective competition.

45.241 The Trade Practices Commission will have an important role to play in ensuring adequate competition.

45.242 It is recognised that there may be instances where conflict could arise between competition policy and other major objectives (e.g. stability) and it is therefore important that there be effective liaison and consultation between the Trade Practices Commission and other regulatory authorities.

Recommendation

- The Trade Practices Act should be amended to provide that the Commission, when examining the conduct or practices of particular groups of financial intermediaries, seek submissions from the relevant industry authority and take explicit account of these submissions in arriving at its judgment. (32.65)

45.243 In regard to question (iii) above a sharp distinction has been drawn between dominance by a group of institutions and dominance by individual institutions. The former should not be a matter for serious public concern provided

there is equality of competitive opportunity. As a general principle, therefore, the Committee does not favour government action to 'compartmentalise' institutional groups by means of regulation.

45.244 The problem of dominance by a few individual institutions is potentially more significant. The Committee notes that in many sectors of the financial system there has been a high and generally rising level of concentration. Nonetheless, it sees no immediate cause for concern on efficiency grounds — e.g. there is no clear evidence that present levels of concentration are causing a serious distortion in the structural flow of funds; but it acknowledges that, beyond a point, market concentration can become undesirable.

45.245 The most effective safeguard against abuse of market power is to ensure there are no unreasonable barriers to entry. Beyond that, if, at any stage, governments feel they need to intervene to bring about a greater dispersion of power in the financial system the Committee believes they should try, wherever possible, to minimise efficiency costs by choosing appropriate instruments such as trade practices legislation and stronger disclosure and accountability provisions; this is preferred to direct controls or a more active competitive role by government intermediaries, although the latter might have a role under special circumstances.

45.246 A need is seen for the appropriate authorities to review regularly the workings of the market.

Recommendation

- The Reserve Bank should undertake regular reviews of the overall functioning of the financial system, in the context of which it should diagnose and report on any structural problems that appear to exist and any barriers to effective competition, especially government-induced barriers. (32.60)

THE STRUCTURE AND EFFICIENCY OF SECURITIES MARKETS AND PATTERNS OF SHARE OWNERSHIP (Chapter 33)

45.247 There is no evidence that the Australian stock market has experienced a long-term decline in liquidity. The Committee sees no need for specific government action in this area.

Individual Investors and the Stock Market

45.248 Evidence has been gathered showing a declining participation by individuals in the share market and an increase in the relative importance of institutions (especially life offices and superannuation funds) and overseas investors. A similar decline in individual share ownership has also occurred in other countries.

45.249 These developments can be largely explained in terms of the relative unattractiveness to individual investors of investing directly in shares. There is no reason to believe that the increased importance of institutional investors has lessened the efficiency of the market.

45.250 While it recognises that governments may have other, non-economic, reasons for wishing to see greater individual participation in equity investment, the Committee is unconvinced of the need, **on efficiency grounds**, for government

measures to discriminate in favour of direct share investments by individuals. The social considerations are a matter for judgment by government.

Brokerage Rules and Entry Barriers

45.251 The various arguments against negotiated brokerage rates are considered.

Conclusion

- On the evidence available to the Committee, a qualified case has been made, on efficiency grounds, for the deregulation of brokerage rates. (33.106)

45.252 The qualification principally arises from the possibility that deregulation would fragment the market for securities. The Committee appreciates that there are other considerations which need to be taken into account. The TPC inquiry will, no doubt, fully allow for these.

45.253 As membership of the exchanges is regulated by member brokers and there is no right of appeal, there is a risk that the level and pace of entry may at times be incompatible with the public interest.

Recommendations

- The authorities should keep existing stock exchange business rules under frequent review and supervise their application, to ensure that they do not operate unreasonably to exclude applicants for membership.
- Any denial of membership should be subject to an appeal process. (33.119)

45.254 The Committee believes that the inability of stockbrokers to incorporate has impeded their ability to develop a flexible financial structure.

Recommendation

- Stock exchange rules should be amended to allow members to incorporate. (33.127)

45.255 However, incorporation should be subject to certain restrictions and conditions in respect of 'outside' shareholdings.

45.256 On the question of admission of corporations to stock exchange membership, many benefits from freer entry are seen, but the Committee is conscious that there are other considerations and reaches no firm conclusion on the issue.

Stock Exchange Listing Requirements

45.257 In the Committee's opinion, the development of a commercial 'unlisted securities market' might provide an opportunity to ease listing requirements.

Conclusion

- The matter of a 'Second Board', on which smaller and more speculative companies might be listed, and in respect of which less onerous listing requirements might apply, seems worthy of consideration by the NCSC. (33.147)

45.258 Delisting is a questionable method of ensuring compliance with listing

rules. The Committee therefore endorses the inclusion in the Securities Code of a provision enabling the enforcement of listing rules through the courts.

Conclusion

- The authorities should have the power to ensure that listing requirements are appropriate for the achievement of a liquid, informed market. (33.152)

Credit Rating Systems

45.259 Credit rating systems can offer a number of benefits to the financial system. Recommendations elsewhere in the Report may be expected to stimulate the demand for rating services, and in time the growing perception of the benefits of rating should further strengthen demand. This would enable a fully developed commercial service to emerge in the long term without government support.

45.260 The Committee's judgment is that the externalities are unlikely to be so significant as to warrant any government subsidy to accelerate the development of one or more rating agencies in the early years.

45.261 No major official barriers to the establishment of a rating service have been found. However, some minor difficulties need to be resolved.

Recommendation

- The Government should raise with the Queensland and Tasmanian Governments the possibility of amending their codes of defamation to provide a defence at law where a company whose issue is being rated consents to the rating being revised at a later time by the rating agency. (33.176)

FINANCE FOR BUSINESS (Chapter 34)

45.262 The changing financial structure and profitability of business are examined. It is concluded that the disturbing trends evident during the 1970s are much less pronounced today. Many of these trends reflect the accelerating inflationary environment business had to operate in during this period. By and large they raise issues for macroeconomic management rather than the efficiency of the financial system. In the last few years, against a more stable economic and monetary background, most businesses appear to have adjusted to the problems and challenges. The Committee therefore sees no immediate need for government initiatives.

45.263 Intrinsic market imperfections, e.g. those arising out of institutional structure, levels of competition, risk aversion etc., are discussed. 'Wholesale' business finance markets are found to work well. Deficiencies in 'retail' business finance markets are seen largely as a by-product of inappropriate government interventions.

45.264 The Committee concludes that a freely functioning and competitive financial system offers the best framework for meeting the financing needs of business. The recommendations made in various parts of the Report will help to achieve such a system.

ROLE OF FOREIGN CAPITAL (Chapter 35)

45.265 There is likely to be a continuing strong demand for capital in Australia; this might lead to higher interest rates unless:

- the domestic saving ratio is increased; or
- the potential rate of economic growth and development is curtailed; or
- foreign capital is allowed to fill the gap.

45.266 Against this background, the implications of any change in foreign investment policy are examined. The Committee believes that:

- a more restrictive policy, without any reduction in planned capital expenditure, might impose excessive adjustment strains on the domestic financial system;
- on the other hand, a more 'open door' approach, while desirable on long-term efficiency considerations, might generate short-term economic disturbances.

45.267 Given a flexible, competitive financial system and an appropriate macroeconomic policy framework (to minimise the risk of a 'scramble' for productive resources or undue monetary disruption), there is no reason why the total volume and 'mix' of capital should not prove adequate, within the constraints imposed by present foreign investment policy.

45.268 The concept of a government-supported National Investment Fund to reduce dependence on foreign capital and facilitate the participation of small investors in resource development projects is considered and found wanting on economic efficiency and competitive neutrality grounds.

45.269 The Committee agrees with the broad approach of current policy which does not seek to inhibit foreign investment as such but to give Australian investors the first opportunity to participate wherever practicable, subject to net economic benefits.

45.270 If foreign investment policy is to have minimal impact on the efficiency of the financial system and the supply of funds, the broad rules and intentions need to be clear to all parties. This is believed largely to be true now.

SECTORAL ASSISTANCE: GENERAL APPROACH (Chapter 36)

45.271 Claims for sectoral assistance have been advanced on grounds of:

- market imperfections (e.g. information barriers or inadequate competition);
- economic 'externalities'; and
- distributional inequities.

45.272 Without questioning objectives, the Committee's concern in Chapters 37–42 is with the most appropriate methods of sectoral assistance.

45.273 In this chapter, some of the principles that have guided the Committee are outlined.

Conclusions (36.48)

- Where the need for sectoral assistance arises from market failure it should be met in the first instance, where possible, by removal of the cause (e.g. barriers to entry, restrictive trade practices, inappropriate government regulation).
- Where sectoral assistance is to be given because of perceived externalities or other social reasons it should be effected, as far as practicable, directly through the budget process — and not indirectly through intervention in the financial system, except where the source of the problem lies in the system itself.
- Generally, disadvantaged persons should be assisted by general welfare measures. However, where the social objectives are specific — e.g. the promotion of home ownership — a case for a tied credit-specific subsidy can be developed, even though strict economic logic would suggest that an overall improvement in welfare could be obtained more efficiently by a program of general assistance.
- Where credit-specific techniques are used, the Government should seek to disburse sectoral assistance by measures other than allocating non-commercial functions to government-owned financial institutions. The assistance should preferably be disbursed directly to the borrower. Another alternative approach would be to subsidise the performance of specified non-commercial functions by established financial institutions, both private and government-owned.
- Regulation of financial intermediaries and processes is the least desirable (most distortive) form of sectoral assistance and in almost all cases should be avoided.

HOUSING FINANCE AND SECONDARY MORTGAGE MARKETS (Chapter 37)

I Housing Finance

45.274 The Committee does not believe the housing sector should be insulated from general monetary conditions; this would throw a disproportionate share of the burden of monetary policy onto other sectors of the economy.

45.275 Interest rate controls on housing finance intermediaries tend to magnify the effect of general instability on housing finance flows. As well, they have had various perverse and regressive distributional effects.

45.276 The Committee does not believe that the **average** effective cost of housing finance will necessarily rise appreciably as a result of the deregulation of interest rates. Those wishing to borrow from savings banks and building societies may have to pay more, especially in the transitional period, but more borrowers will have access to these institutions — reducing their need for higher cost finance.

Conclusion

- There is no justification for retaining interest rate controls as an instrument of housing or welfare policy. (37.77)

45.277 No reason is seen for retaining portfolio constraints on savings banks and building societies, having regard for their cost-effectiveness, distributional effects and implications for allocative efficiency and competitive neutrality.

Recommendation

- Subject to appropriate prudential requirements — most important of which would be asset quality/capital ratios — the present restrictions on the asset structures of savings banks and permanent building societies should be removed. Shareholders/members should approve any substantial diversification of an intermediary's assets. Depositors should be advised of the changes after such approval has been received, and term depositors should be given the option of withdrawal of their funds. (37.91)

45.278 In the Committee's opinion, the Government should not 'encourage' financial intermediaries to undertake lending on terms and conditions which they do not judge to be in their own commercial best interest. The deregulation of housing finance institutions will encourage innovation in this area, without any government intervention.

Recommendation

- The provision in the Commonwealth Banks Act requiring the Commonwealth Trading and Savings Banks, in making housing loans, to give preference for the erection of homes and for the purchase of newly erected homes should be repealed. (37.99)

45.279 Where a decision is taken by governments to assist lower income groups in their access to home ownership, it is the Committee's view that, in the interests of an efficient financial system, such assistance should take the form of direct budgetary grants or subsidies.

II Secondary Mortgage Markets

45.280 A more developed secondary mortgage market (SMM) would permit a closer integration between housing finance and other financial markets and facilitate the transfer of mortgage funds between areas of excess demand and excess supply.

45.281 The Committee has reached the conclusion that the major impediments to the further development of the Australian SMM are those associated with stamp duty on financial transactions and/or regulation of housing finance institutions (especially on interest rate controls).

45.282 Other impediments suggested — notably those associated with the characteristics of the mortgages originated by the major housing financiers — do not, by and large, appear to pose insurmountable problems, although some adaptation of mortgage contracts may be necessary.

45.283 No case for establishing a government secondary mortgage market agency has been established, on efficiency grounds, to the satisfaction of the Committee. There is no reason why a private secondary market should not develop once the major regulatory and stamp duty impediments have been removed.

SMALL BUSINESS FINANCE (Chapter 38)

45.284 Inadequacies claimed to exist in the flow of finance to small businesses can be grouped under three headings:

- a 'credit gap' reflecting:
 - the disinclination of banks and other institutions to lend to small businesses; in particular their reluctance to provide debt finance to those which are unable to offer suitable and sufficient collateral;
 - interest rate controls on small bank overdrafts;
- an 'equity gap' reflecting:
 - the lack of organised market facilities for the sale of shares in small businesses;
 - the limited range of institutions providing high risk venture capital;
- an 'information gap' reflecting:
 - inadequate access by small business to information on available sources of finance;
 - management's lack of financial experience in presenting proposals to financiers.

45.285 It is obvious that small firms are not equal to large firms in their access to the financial markets but for the most part this does not reflect in-built technical deficiencies in the allocative role of the financial system. The Committee believes that the problems encountered by small businesses basically derive from the higher costs and risks involved and the inability of small business proprietors to take full advantage of the opportunities available, whether due to lack of financial sophistication or a reluctance to dilute control.

45.286 It is recognised that these factors may be compounded by:

- the size and geographical spread of the Australian market;
- the risk-averse characteristics of many investors — often accentuated by insufficient knowledge of or familiarity with high technology, science-based activities;
- the limited range of institutional or broking facilities for the placement of unlisted shares;
- inadequate awareness by many small businesses of the sources and types of funds available; and
- distortions caused by government controls and regulations.

45.287 The 'freeing up' of the financial system and strengthening of its competitive base (as recommended elsewhere in this Report) would remove most of the major constraints inhibiting the market from responding to unexploited opportunities.

Conclusion

- Against this background, the Committee sees no need, on efficiency grounds, to recommend further government initiatives in respect of small business and new ventures. (38.136)

45.288 Nonetheless, it is conscious that, on social or other grounds, the Government may consider it desirable to provide assistance in this area.

45.289 If this is so, the policy instrument needs to be carefully chosen to ensure it is the most cost-effective one available.

Conclusion

- Encouragement could be given to the establishment of private small business investment companies (whose primary role would be to invest in the equity of small businesses, including new ventures and innovations) by making subscriptions to their shares eligible for personal tax relief. (38.140)

RURAL FINANCE (Chapter 39)

45.290 The rural sector has some special requirements in respect of long-term finance, flexibility and structural adjustment.

45.291 The Committee makes no judgment on whether governments should assist rural borrowers but believes that assistance is not always effectively or best given by direct government intervention in the financial system:

Recommendations

- Assistance to the rural sector should be effected by means other than controls over the direction, volume or cost of lending by banks and other intermediaries. (39.46)
- As soon as reasonably practicable, the monetary authorities should cease to be formally associated with the banks' provision of longer term loan funds through the Term and Farm Development Loan Funds; thereafter whether these funds would continue to be separately maintained should be at the discretion of individual banks. (39.51)
- The Government should dispose of its direct shareholding in the Primary Industry Bank of Australia (PIBA). (39.63)
- The Government should stand aside from the commercial operations of PIBA. Alternative arrangements should be established to monitor the disbursement of any government funds through the agency of the Bank. (39.63)
- Government subsidisation, if any, of the cost of long-term loans made to primary producers and refinanced by PIBA should be effected by the provision of recurrent budget allocations. (39.63)
- The role and operations of PIBA as a vehicle of sectoral assistance should be kept under regular review. (39.63)
- The Rural Credits Department of the Reserve Bank should be phased out, with appropriate transitional provisions which have regard for the need of existing customers to make alternative arrangements. (39.67)

EXPORTS (Chapter 40)

45.292 The community's need for export finance and related facilities seems to be generally well catered for, but some reservations have been expressed concerning:

- the degree of competition in the provision of export finance and related services;
- the availability of certain forms of pre-shipment finance;
- the range of activities eligible for concessional export finance and buyer credit guarantees.

45.293 Competition in providing finance and financial services to exporters will be strengthened as a consequence of the recommendations made in Chapter 25 (on entry of foreign banks).

45.294 The Committee considers that obtaining pre-shipment and plant finance for exports is not substantially different from obtaining other production and working capital needs and thus proposes no special action.

45.295 Regarding the possible extension of concessional finance for exports of non-capital goods, the Committee appreciates the Government's concern to ensure that finance to domestic exporters is available on terms and conditions comparable with those available elsewhere. As a general principle, however, it believes that export finance subsidies can have unintended distorting effects on overall market processes.

Recommendations (40.36)

- Every effort should be made by the Government and the Export Finance and Insurance Corporation to limit the use of concessional export finance facilities here and abroad.
- Unless it can be clearly demonstrated that in other countries buyers of consumer goods exports are financed on more favourable terms than in Australia, the existing concessional finance scheme should continue to be limited to capital goods exports.
- Unless the Government is satisfied that similar schemes are generally offered overseas and material export contracts are being lost due to lack of matching support, facilities for buyer credit guarantees should not be extended to all exports.

45.296 Recognising the special payment risks which sometimes accompany international trade and commerce, the Committee accepts that there is a role for government in providing export payments insurance and related facilities. In respect of EFIC's direct lending and buyer credit guarantee operations EFIC is also considered generally to be filling a 'market gap'.

45.297 In each case it is believed that EFIC should observe certain standards in respect of its accounting disciplines. Ideally, any shortfall of revenues from full costs should be explicitly recognised as a measure of sectoral assistance.

HOUSEHOLD SECTOR (Chapter 41)

45.298 It is recognised that, even when the financial system functions efficiently, the resulting distribution of funds between household groups, although economically neutral, may not be considered by some to be socially appropriate.

45.299 The Committee has examined suggested inequities in the areas of:

- consumer finance;
- small investors;
- disadvantaged borrowers; and
- information deficiencies.

45.300 It is believed that:

- while access to the financial system is obviously not equal for everyone, this generally reflects either the perverse effects of government intervention or the underlying inequalities of income and wealth (and accompanying risk and cost differentials); only to a minor extent does it reflect imperfections or failures in market processes;
- there are a significant number of areas where governments, in attempting to direct special assistance through the financial system, have employed policy instruments which have had unintended or even perverse effects on the distribution of finance.

45.301 Throughout the Report, the Committee has recommended that social policy to redistribute income be best pursued directly through the Budget.

REGIONAL DISTRIBUTION OF FINANCE (Chapter 42)

45.302 In this chapter, the Committee examines whether there are any government-induced or intrinsic market barriers to the flow of funds between geographical areas.

45.303 It is noted that certain state government policies have had the effect of impeding the inter-regional flow of funds and with it the overall allocative efficiency of the financial system. These have included:

- restrictions on interstate lending or borrowing by building societies;
- state differences in trustee eligibility;
- intervention aimed at limiting or preventing takeovers of local companies by interstate concerns; and
- the state orientation of many government-owned banks.

45.304 In addition to their efficiency implications, such policies mean that investors in some states may receive a lower rate of return than investors in other states. However, concerns about regional fragmentation must be tempered by the fact that most of Australia's major financial institutions are nationally based.

45.305 Apart from the effects of government intervention, no clear evidence of a market failure to allocate funds to areas of highest return has been seen.

45.306 In the Committee's opinion, any requirement that financial intermediaries balance deposits and loans within each region would amount to effective discrimination, not neutrality, as such a requirement would involve the application of different credit standards or criteria to different regions.

45.307 The uneven regional dispersion of financial institutions and services is not a cause but a consequence of the uneven regional spread of industry and economic activity.

45.308 Monetary policy can be expected to have a more uniform regional impact in the future if the Committee's package of recommendations in this Report is adopted.

45.309 If governments wish to promote a more even dispersion of economic activity and welfare, there are a variety of policy instruments available to them such as through the Grants Commission machinery, or through regionally selective tax/expenditure policies. To attempt to achieve similar results by means of direct intervention in the financial system (e.g. by way of directions or guidance to certain financial institutions or the establishment of GFIs) would appear to the Committee to be both inappropriate and, in many cases, counter-productive.

INFLATION AND THE FINANCIAL SYSTEM (Chapter 43)

45.310 In this survey of the effects of inflation on the financial system, it is concluded that:

- a high and variable rate of inflation has interacted with the regulatory constraints and the taxation system to impose at times severe stresses on the financial system;
- while the system has effectively responded to many of these stresses, some potential problems remain. In particular the Committee notes the difficulties created for investment evaluation, the impact on longer term debt markets and more generally the uncertainty injected into financial markets. As well, it points to the lack of an effective inflation hedge for small investors.

45.311 The Committee believes the solution to these problems should be sought on four basic fronts:

- First and foremost, governments must continue to give a high degree of priority to the control of inflation.
- Secondly, a program of deregulation (as proposed in this Report) would greatly strengthen the capacity of the financial system to adjust to inflationary pressures.
- Thirdly, governments could assist in providing small investors with an adequate hedge against inflation; the Committee has proposed that consideration be given to the issue of indexed government securities in certain circumstances.
- Finally, because the workings of present taxation arrangements have compounded in many areas the problems caused by inflation, the Government should undertake a comprehensive review of the taxation of incomes in an inflationary environment.

INFORMATION GAPS IN THE FINANCIAL SYSTEM (Chapter 44)

45.312 The Committee recognises that an efficient and competitive capital market will generate a considerable volume of information without any pressure from the authorities.

45.313 It is nonetheless accepted that a free market, of its own accord, may not generate the right amount or kind of information — or on a sufficiently consistent basis. Beyond a point, however, the costs of government intervention will outweigh the benefits.

45.314 In the Committee's opinion, the issue, therefore, is not whether governments should be involved but how much government involvement is appropriate, i.e. how much information governments should themselves provide and legally require private enterprises to provide, on the one hand, and how much they should leave to the free forces of the market, on the other.

45.315 While, on balance, changes have been recommended that will broaden the area of government involvement in the generation of information, its basic aim has been not to increase the volume of information but rather to improve its quality and accessibility and thus its usefulness to investors.

45.316 In this chapter, the Committee addresses itself to two broad types of information deficiencies:

- insufficient knowledge by both borrowers and investors of the nature and range of the facilities available; and
- inadequate official statistical data in certain operational areas, such as rates of interest charged, funds lent to particular classes of borrower etc.

45.317 Recommendations on these issues are made throughout the Report and are summarised in this chapter.

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 Australian Council of Co-operative Building and Housing Societies
 Australian Council of Local Government Associations
 Australian Council of Social Service Inc.
 Australian Council of Trade Unions and the Council of Australian Government Employee
 Organisations
 Australian Farmers' Federation
 Australian Federation of Credit Union Leagues Ltd
 Australian Finance Conference
 Australian Fishing Industry Council
 Australian Industries Development Association
 Australian Industry Development Corporation
 Australian Institute of Valuers (Inc.)
 Australian Institute of Valuers (South Australian Division)
 Australian Insurance Association
 Australian Merchant Bankers Association
 Australian Mining Industry Council
 Australian Mutual Provident Society
 Australian National Industries Ltd
 Australian Natives' Association (Federal Council)
 Australian Resources Development Bank Ltd
 Australian Shareholders' Association
 Australian United Corporation Ltd
 A.G.C. (Insurances) Ltd
 BA (Australia) Ltd
 Bank of America

Bank of New South Wales
Bank of New Zealand
Bank of Queensland Ltd
Bank of Tokyo, Ltd
Banque de Paris et des Pays-Bas
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Beneficial Finance Corporation Ltd
Berwick City Council
Bethune, Dr G.
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Broadlands Dominion Group Ltd
Broken Hill Proprietary Company Ltd
Brooks, H.
BT Australia Ltd
Building Industry Credit Bureau
Building Societies Institute (Incorporated)
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Canberra Development Board
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Cerec Pty Ltd
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City Building Society
City Mutual Life Assurance Society Ltd
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Commercial Banking Company of Sydney Ltd
Commercial Bank of Australia Ltd
Commerzbank AG
Committee for Economic Development of Australia
Commonwealth Banking Corporation
Commonwealth Industrial Gases Limited
Commonwealth Mining Investments (Australia) Ltd
Confirming Houses Group
Continental Bank
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Council of Small Business Organisations of Australia
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Credit Lyonnais
Credit Union Savings Reserve Board of NSW
CSR Ltd
Cullen Egan Dell Australia Pty Ltd (Remuneration Taxation Centre)
Darlington Commodities Limited (formerly Robert Howes and Associates Pty Ltd)
David B. Nelson & Associates
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Department of Housing and Construction
Department of Industry and Commerce
Department of Productivity
Department of the Treasury
Department of Trade and Resources
Dominguez and Barry
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Earlstreet Historical Village
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Export Finance and Insurance Corporation
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Indosuez (Banque de L'Indochine et de Suez)
Industrial Bank of Japan, Limited
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Institute of Directors in Australia
Insurance Brokers Association of Australia
Insurance Brokers' Council of Australia
Insurance Council of Australia
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James, C. E.
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Juttner, Prof. D. J.
Kellogg Rural Adjustment Unit and Department of Agricultural Economics and Business
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Master Builders' Federation of Australia
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Mukherjee, Dr C.
Murdoch, D. B.
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Mutual Life and Citizens' Assurance Company Ltd
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National Council of Wool Selling Brokers of Australia
National Farmers' Federation
National Mutual Life Association of Australasia Ltd
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N M Rothschild & Sons Limited
Norquay, A. S.
Nottle, R. W.

NSW Permanent Building Society Ltd
Pacific Securities Limited
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Peel, A. H.
Perkins, Prof. J. O. N.
Permanent Building Societies Association Limited
Permanent Finance Corporation Ltd
Perpetual Trustees Australia Limited
Perth Building Society
Peter Hodgkinson Pty Ltd
Petersville Australia Ltd
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Philips, The Hon. P. S. M., M.L.C.
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Qantas Airways Limited
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Rural and Industries Bank of Western Australia
Rural Bank of New South Wales
Rural Marketing and Supply Association (NSW)
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Securities Institute of Australia
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Temens, K.
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Thomas, M. R.
Thompson, G.
Topper, P.
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Trans City Holdings Ltd
Turnbull, S.
Union Bank of Switzerland
United California Bank
United Permanent Building Society Ltd
Van Wyngen, G. J.
Victorian Chambers of Commerce and Industry
Victorian Farmers' Union
Wales Financial Services Ltd, CBA Managed Investments Ltd and A.F.T. Investors
Services Ltd
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Walker, J. A.
Walsh, F. M.
Walshaw, T. J.
Webber, L. C.
Wells, A. C.
Wells, Prof. M. C.
Wentworth, W. C.
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Wilshire, C. R.
Wilson, G. P.
Winsen, Prof. J. K.
Wise, H.
Withers, J.
Wormald International Limited
Zube, J.

Appendix 4 of the Interim Report contains a list of parties who appeared before the Committee at public hearings. Transcripts of the evidence taken at those hearings are available from the Commonwealth Reporting Service. Non-confidential submissions and transcripts of the proceedings of the Inquiry's seminars are available in microfiche form from Congress Information Centre, Sydney.

OVERSEAS ORGANISATIONS AND INDIVIDUALS VISITED, SEPTEMBER–OCTOBER 1980

The Committee wishes to express its appreciation for the assistance provided by many organisations and individuals in connection with the overseas visit by a Committee member and two members of the Secretariat. Discussions were held with the following:

SINGAPORE

1 September Bank of America
Oversea-Chinese Banking Corporation Limited

2 September The Monetary Authority

HONG KONG

3 September Acting Commissioner for Securities
Secretary for Monetary Affairs
The Chartered Bank
Commissioner of Banking

4 September Hongkong and Shanghai Banking Corporation

JAPAN

5 September Tokyo Ministry of Finance
Dai-ichi Kangyo Bank
Bank of Japan
Bank of Tokyo

6 September *Group discussion with:*
Industrial Bank of Japan
Mitsubishi Bank
Mitsubishi Trust and Banking Co.
Nomura Securities
Professor R. Tachi, Tokyo University

CANADA

8 September Ottawa Bank of Canada

9 September Department of Finance
Department of Industry, Trade and Commerce (Small Business Secretariat)
Superintendent of Insurance and Canada Deposit Insurance Corporation
Canadian Payments Association (Chairman-elect)

10 September Foreign Investment Review Agency
Inspector-General of Banks

Toronto Superintendent of Insurance and Registrar of Trust and Loan Companies, Ontario
Canadian Imperial Bank of Commerce
Wood Gundy Limited

UNITED STATES

11 September New York Federal Reserve Bank of New York
Morgan Stanley
National Association of Mutual Savings Banks

12 September		New York State Superintendent of Banking Salomon Brothers Morgan Guaranty Trust Company of New York Moody's Investors Service
15 September	Washington	National Credit Union Administration Securities and Exchange Commission R. Bryant (Brookings Institute) Federal Home Loan Bank Board Small Business Administration Federal Deposit Insurance Corporation
16 September		World Bank International Monetary Fund Department of the Treasury Comptroller of the Currency
17 September		World Bank Board of Governors of the Federal Reserve System
FRANCE		
19 September	Paris	Direction du Tresor OECD
SWITZERLAND		
22 September	Basle	Bank for International Settlements Swiss Bank Corporation
23 September	Geneva	Professor A. Swoboda (International Centre for Monetary and Banking Studies)
	Zurich	Banque Nationale Suisse Union Bank of Switzerland Swiss Credit Bank
	Berne	Federal Banking Commission
GERMANY		
24 September	Frankfurt	Deutsche Girozentrale-Deutsche Kommunalbank Deutsche Genossenschafts Bank (German Co-operative Bank) Deutschen Bundesbank Rheinische Hypotheken Bank
25 September		Deutsche Bank Bank fur Gemeinwirtschaft Deutschen Bundesbank
DENMARK		
26 September	Copenhagen	Danmarks National Bank Kjobenhavns Handelsbank Copenhagen Stock Exchange Inspector of Banks
NETHERLANDS		
29 September	Amsterdam The Hague	De Nederlandsche Bank De Nationale Investerings Bank NV (National Investment Bank) NV Bank voor Nederlandsche Gemeenten (Bank for Netherlands Municipalities) Ministry of Finance
30 September	Amsterdam	Amsterdam-Rotterdam Bank Algemene Bank Nederland Nederlandse Spaarbankbond (Association of Savings Banks) Bank Girocentral

BELGIUM		
1 October	Brussels	Bank Nationale de Belgique European Commission
UNITED KINGDOM		
2 October	London	Bank of England Nationwide Building Society
3 October		Development Capital Corporation Department of Trade HM Treasury Consumers' Association Department of Industry (Small Business Division)
6 October		The London Stock Exchange Lloyds Bank International Limited Department of Trade Round table discussions with academics and financiers
7 October		S. G. Warburg and Co. Limited Mr R. S. Skerman (The Prudential Assurance Company Limited) National Westminster Bank Limited Morgan Grenfell and Co. Limited Barclays Bank International Limited Central Trustee Savings Bank Limited Charterhouse Development Limited
8 October		Inter-Bank Research Organisation M. J. H. Nightingale and Co. Limited Finance for Industry Limited Bank of England
UNITED STATES		
9 October	Boston	National Consumer Law Centre The Massachusetts Co-operative Central Bank
10 October		Professor Ben Friedman (Harvard University and National Bureau of Economic Research)

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