

Reform Of The Australian Financial System

The following provides a brief summary of the legislation which came into effect on 1 July 1998 to implement reforms to the Australian financial system. These Acts arise out of the Government's response to the Wallis Inquiry Final Report and create a new organisational framework for the regulation of the financial system.

INTRODUCTION

On 26 March 1998, the Treasurer introduced into Parliament a package of legislation to fundamentally reform the regulatory arrangements for the Australian financial system. A series of 12 Bills was passed by Parliament on 23 June and came into effect on 1 July 1998, and implements the first stage of the Government's response, announced in September last year, to the Financial System Inquiry chaired by Mr Stan Wallis.

The legislation puts in place a structure designed to improve the competitiveness and efficiency of the Australian financial system while preserving its integrity, security and fairness. The measures will ensure that regulation, consistent with the basic goals of maintaining financial system safety and stability: is better focussed on its underlying objectives; minimises restraints on new entry and competition; and applies in a competitively neutral way across existing and newly emerging market sectors.

Once fully implemented, Australia will have a stronger regulatory regime designed to better respond to developments in the finance sector, including globalisation and technological change and the needs of businesses and consumers.

A central part of the reform approach is the creation of a new organisational framework for the regulation of the financial system which is objectives-based, in place of the current institutionally-based structure.

AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

The legislation establishes a single prudential regulatory agency, the Australian Prudential Regulation Authority (APRA), and provides for the laws and regulations it will administer. APRA became fully operational, at the Commonwealth level, on 1 July 1998.

APRA is the independent prudential regulator of: authorised deposit-taking institutions (including banks and non-operating holding companies); life and general insurance companies; superannuation funds; and retirement savings accounts. Consistent with the need for regulatory flexibility, APRA has been provided with comprehensive powers, including over licensing. It is in the process of developing financial standards within the framework of laws established for it. This should ensure that APRA is adaptable and responsive to the changes occurring in the financial system.

APRA has the power to make standards on prudential matters in relation to authorised deposit-taking institutions. The standards making power is flexible, certain and able to be used very quickly in the event of a crisis to prevent contagion effects in the financial system.

Intervention powers to manage failure have also been improved. Amendments to the *Banking Act 1959* both clarify the mechanisms by which the prudential regulator may take control of a troubled deposit-taking institution, and allow the prudential regulator to appoint an administrator for that purpose. While these statutory management powers provide the means for control in a crisis, APRA also has the option of using less direct strategies, such as facilitating the takeover of a troubled institution or its business by other sound institutions. In Australia and elsewhere, such action has provided the most common response in practice to financial distress in deposit-taking entities.

These intervention powers are further supplemented by a new power enabling APRA, if necessary, to initiate the wind-up of a deposit taking institution that is insolvent and cannot be restored to solvency within a reasonable period. Such action may prevent further losses from accruing and would, therefore, be in the best interests of depositors. State Supervisory Authorities already have clear powers to wind/up building societies and credit unions.

In the case of superannuation and retirement savings accounts, APRA is also responsible for legislation designed to achieve retirement income objectives. This reflects the close association between regulation for that purpose and prudential regulation in these sectors. While APRA currently has regulatory responsibility for all superannuation funds, from 1 July 1999 self-managed superannuation funds will be regulated by the Australian Taxation Office, which will have responsibility for ensuring such funds comply with the non-prudential requirements of superannuation law.

APRA is accountable through an independent Board. To ensure that there is a close relationship between APRA, the Reserve Bank and the Australian Securities and Investments Commission (ASIC), two of APRA's Board members come from the Reserve Bank and one from ASIC. APRA operates under a charter that ensures the financial safety objectives of prudential regulation are balanced with efficiency, competition, contestability and competitive neutrality considerations.

APRA has drawn the bulk of its staff from the Insurance and Superannuation Commission (ISC) (which ceased to exist following the transfer of its responsibilities to APRA or ASIC) and the bank supervision area of the Reserve Bank.

APRA is funded by levies paid by regulated financial institutions and charges for certain services. The levies are based on a percentage of the assets held by the entity, subject to minimum and maximum levy amounts. These will be set each year by the Treasurer. This system ensures that the levy paid by each class of entity reflects the actual cost of supervising those entities and the benefits to entities and their customers of supervision.

With the exception of the banks, the net financial effect on the institutions will be small. While the banks will be required to pay a levy for the first time, they will no longer forgo a much greater amount of income on non-callable deposits held by the Reserve Bank.

The second stage of the reforms will include the proposed transfer of regulatory responsibility for financial entities presently regulated by the States and Territories. The Federal Government has sought to bring this transfer forward, with legislation now expected to be introduced in the Spring sittings of Parliament. The aim is to achieve a transfer of prudential and corporate regulatory responsibilities for building societies, credit unions and friendly societies in 1998, following agreement with the States and Territories.

THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

The Australian Securities Commission (ASC) has been renamed the Australian Securities and Investments Commission (ASIC). In addition to the corporate regulatory functions of the former ASC, ASIC has taken on responsibility for consumer protection and market integrity in the areas of insurance, superannuation and aspects of banking and the payments system. ASIC will ultimately take these responsibilities across the full financial system, which will result in it being the pre-eminent consumer protection and market integrity regulator across the system.

Responsibility for consumer protection and market integrity vested in a single entity (rather than shared between the former ASC and ISC) will enable ASIC to adopt a functional and objective-based regulatory approach, thereby promoting competitive neutrality and permitting better comparability by consumers of different financial products and services. ASIC and the Australian Competition and Consumer Commission (ACCC) will co-operate to ensure effective consumer protection is maintained. In this context, on 17 July 1998 ASIC and the ACCC signed a Co-operation Agreement which, among other things, provides for: the relevant consumer protection responsibilities of both agencies; the exchange of information between ASIC and the ACCC (where permitted by law); and the undertaking of joint responses to problems in the market.

While the legislation transferred responsibility for administration of laws from the former ISC to ASIC and APRA, it did not, except to a very limited extent, seek to alter the substantive rules applying in this area. In this regard, the task of rationalising and harmonising the financial system regulatory framework with that applying under the Corporations Law is still to be undertaken in conjunction with the implementation of the Corporate Law Economic Reform Program reforms relating to financial markets and investment products.

THE PAYMENTS SYSTEM

The payments system plays a central role in the financial system. The Government has strengthened, and made more transparent and accountable, the regulation of the payments system undertaken by the Reserve Bank.

With an increasing number of non-bank participants emerging to increase competition in the payments system, more direct means for achieving effective regulation was required. These reforms were necessary to ensure that the payments system retains its high standard of safety while adapting to the demands of new technologies and globalisation in the payments system.

The Reserve Bank remains the regulator of the system, given the importance of the payments system to the overall stability of the financial system and given the central role of the Reserve Bank itself in the core areas of the payments system, particularly settlement.

The Payments System Board (PSB) has been established within the Reserve Bank. The PSB is the policy making Board of the Bank in relation to payments system matters and is independent of the Bank's main Board. In particular it is responsible for ensuring that the Bank's powers are utilised to improve the efficiency of the payments system, to promote competition in the market for payment services and to control risk in the financial system. The Governor of the Reserve Bank is the chair the PSB. It also includes another Reserve Bank representative, one from APRA and up to five others.

The *Payment Systems (Regulation) Act 1998* implements a new regulatory framework for the payments system. While existing industry self-regulatory arrangements will be retained wherever these are performing satisfactorily (that is, where a payment system is financially safe for participants, stable, efficient and does not have unreasonable barriers to entry), the Reserve Bank now has the power to undertake more direct regulation by 'designating' payment systems where it is considered to be in the public interest to do so.

Once a payment system is designated, it may be subject to the imposition of rules of access for participants on commercial terms, the determination of standards, the issuing of enforceable directions, or the voluntary arbitration of disputes on technical standards. The development of access regimes and

standards will be undertaken, as far as possible, in conjunction and consultation with the private sector.

A comprehensive regime of prudential regulation of the store-of-value backing purchased payment facilities has also been implemented. This applies to all forms of such facilities, including stored value cards, travellers cheques and internet cash facilities. The holder of the store-of-value must either be an authorised deposit-taking institution regulated by APRA (in which case there is no requirement for further regulation) or otherwise be authorised (or exempted) by the Reserve Bank (in which case further regulation may be required).

FINANCIAL SECTOR SHAREHOLDINGS

The package of legislation passed by Parliament also includes a new *Financial Sector (Shareholdings) Act 1998* aimed at streamlining the existing legislation and rules governing ownership and acquisitions in the financial system, consistent with the recommendations of the Financial System Inquiry. It has replaced the *Banks (Shareholdings) Act 1972* and the relevant parts of the *Insurance Acquisitions and Takeovers Act 1991*.

The Act provides that all prudentially regulated financial sector companies will be limited to a 15 per cent shareholding by any one person (and their associates), or such higher percentage as the Treasurer may determine as being in the national interest. Provision is also made for the Treasurer to declare a person to have 'practical control', that is, the power to control the policies and operations of the financial institution, regardless of the size of their shareholding. Under such a declaration the person must relinquish practical control.

The streamlined provisions are particularly useful for corporate groups which contain more than one licensed entity. Common rules apply to each class of licence, simplifying regulatory applications and their assessment. Moreover, provision is made for authorisations applying to the non-operating holding companies of financial conglomerates to flow through to all members of the corporate group.¹

¹ For more details on these reforms please refer to previous press releases and copies of the legislation which can be accessed on the Treasury internet site <http://www.treasury.gov.au>.

