JCP Investment Partners - Investing in Practice

Grandson of Campbell, Son of Wallis - What could the review entail?

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The 1981 Campbell Committee Report was the catalyst for deregulation and innovation in Australian financial services. Tight restrictions, such as fixed/zero rates on loans and deposits (some an artefact of the 1941 National Security Regulations) hampered licensed banks and stimulated a largely unregulated/shadow financial system of merchant banks (the cash management account), finance companies (risky personal credit) and building societies (high rate deposits and mortgage finance).

The 1997 Wallis Report was launched as stocktake or appraisal of the effect of the Campbell Report, and formulate a path to the second curve. Treasurer Peter Costello stated the primary terms of reference were to seek - "recommendations… on the nature of the regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system'. In March 1997, 115 recommendations were tabled. The essence of the report was to implement the 'twin peaks model' to address a fragmented, complex, inefficient and expensive regulatory framework, replacing four institutional regulators with three agencies:

1. **Australian Prudential Regulation Authority (APRA)** - created as the single prudential regulator for authorised deposit taking institutions, insurers and superannuation entities;
2. **Australian Securities and Investment Commission (ASIC)** - strengthened to administer issues of governance, integrity and protection in financial services.
3. **The Reserve Bank of Australia (RBA)** - mandated to focus on systemic stability & payments.

The Wallis Report was administered by a five member panel: one industrialist, Stan Wallis (Amcor MD); two academics, Professors' Jeffrey Carmichael and Ian Harper; and two corporate advisers, Bill Beerworth (lawyer/investment banker) and Linda Nicholls (accountant/company director).

Fifteen years hence, the Coalition, if elected, proposes the third instalment in the natural evolution of modern financial reform system in Australia. In this note, we outline our view of who may constitute the review and its likely terms of reference; based on proprietary contacts, industry experience and general crystal ball gazing, given our view of the current state of affairs of financial services in Australia. We expect it to be wide ranging and all encompassing.

Who could do the review?

A panel of professionals with broad commercial, academic and advisory experience representative of the terms of reference, along the lines of:

1. **Banking** – credit, capital, liquidity & funding e.g.: David Murray, Helen Lynch, Mark Johnson?
2. **Wealth** – growth, position & objectives of super e.g.: Peter Scott, Andrew Mohl, Ian Silk?
3. **Insurance** – underwriting, actuarial & capital e.g.: Terry Towell, Craig Dunn, Brian Schwartz?
4. **Industry** – real economy/user perspective e.g: Brian McNamee, Terry Davis, David Thodey?
5. **Academia** – theory, research & analysis e.g.: Kevin Davis, Rod Maddock, Warwick McKibbin
6. **Advisory** – top down overview e.g.: Carolyn Hewson, Shane Doyle, Brian Johnson?

What could be in the review?

The coalition is typically guarded about enunciating too many specifics on what the terms of reference may entail or what solutions it already has in mind. Politics aside, this is what JCP thinks should/could be considered in the formation of an appropriate terms of reference:

1. **Industry structure** - four major banks, one major life company, two major domestic insurers, industry centric super concentration and a rapidly growing self-managed sector. Is it competitive enough to deliver balanced utility to a wide array of diverse stakeholders?
2. **Regulatory framework** - is the 'twin peaks' model the most effective and efficient structure to design, coordinate and execute policy, prudential requirements and ensure stability? Does the current framework adequately accommodate more radical policy measures?
3. **Intermediation of risk, return and capital** - is the interaction of markets and regulators efficiently pricing and allocating capital throughout the entire financial system? That is, should we seek and consider initiatives to enhance the pace of dis-intermediation?
4. **Banks' 'special status'** - does the desire for economic and financial stability create a 'special status' for the banking system, and is the cost incurred and return generated appropriately balanced between all economic and social constituents?
5. **Superannuation** - on track to dwarf the credit aggregates, what is the most efficient allocation of this asset base, is the governance in control of its growing importance, are the future needs of a changing demography adequately met and is there scope to be a creator of financial assets?
6. **Relationship between the Sovereign and the industry** - a unique and powerful interdependence; does it have to be this way?
7. **Funding and liquidity** - Loan/deposit ratio ~141%, proportion of pure retail deposits ~45%, proportion of external wholesale funding ~64% and no active domestic bond/debt market; the system appears too vulnerable to an external strike, is there a path to greater financial independence?
8. **Asset mix** - with ~60% of credit in residential mortgages is the system appropriately diversified and does the ~40% return on equity in mortgages reflect the true underlying risk? Is the system failing by diverting too much capital to non-productive, and in some cases speculative assets?
9. **Technology and innovation** - is the system harnessing technology to suitably evolve the management of operating risk, productivity and improve the customer product offering (cost efficient with features to surpass non-regulated alternatives) across the full suite of financial products: payments, credit, wealth and risk inter alia?
10. **Global context** - whilst the regulatory reaction to the GFC has been to suppress cross border financial capital flows, looking beyond this reflex response, how should Australia think about its longer term position with respect to Financial Services regionally and globally (revisit the thinking of the 2009 Johnson Report)?

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