

COMMUNICATION FROM AUSTRALIA

Australian Experience with Financial Market Reform

The attached paper has been received from the delegation of Australia with the request that it be circulated to Members of the Committee on Trade in Financial Services.

1. The aim in this paper is to set out the recent experience in Australia, where there has been substantial reform in financial market regulation to enhance the soundness, competitiveness and efficiency of Australia's financial markets. These and other reforms in Australia have seen a sustained period of strong growth in economic activity in Australia.

2. This reform has been done consistent with the liberalising principles that underpin GATS' provisions on financial services so that Australians and other Members could benefit from the expansion of the Australian financial market. This paper is presented to help Members understand the reforms and the regulatory structure that now applies in Australia for both domestic and foreign suppliers of financial services in Australia.

THE WTO/GATS AND THE AUSTRALIAN FINANCIAL SERVICES MARKET

3. Australia has scheduled its commitments on financial services in accordance with the Understanding on Commitments in Financial Services.¹ These commitments give a high level of openness to Australia's financial market. The WTO Trade Policy Review of Australia (WT/TPR/S/104) found that Australia has a liberal financial sector although some restrictions remain on trade in banking and insurance services.²

4. Australia supports negotiations on financial services in the WTO round of trade negotiations and has submitted its Negotiating Proposal for Financial Services to the Council for Trade in Services³. This document outlines Australia's high priority for the current round of financial services negotiations under the GATS.

¹ The commitments are set out in the *Fifth Protocol to the General Agreement on Trade in Services*, Australian Treaty Series, 1999 No 9, Commonwealth of Australia.

² The Trade Policy Review, WT/TPR/S/104, 2002, pages 114 to 117, provides a summary of the structure and size of Australia's financial sector.

³ S/CSS/W/66

BACKGROUND TO FINANCIAL MARKET REFORM IN AUSTRALIA

5. The Australian currency trades freely in the market. Foreign banks operate freely alongside Australian banks in a domestic market. There is a growing pool of savings in the market with the compulsory superannuation scheme, and privatizations and demutualisations have expanded the equities market. Australia has the seventh largest funds management marketplace in the world, and the largest in the Asia-Pacific region outside Japan. Total funds under management are now in excess of \$US350 billion and RBA projections are for these to continue to increase substantially over the next two decades.

6. As indicated in recent Trade Policy Reviews of Australia, Australian financial sector reforms have followed reports of inquiries known as the Campbell inquiry report in 1979 and the Wallis inquiry report in 1997.

7. The reforms have been based on promoting greater efficiency through enhanced competition; removing unnecessary regulation; and maintaining confidence and stability in the financial system while preserving the ability to be responsive to innovation and market developments

8. Following the Financial System Inquiry, otherwise known as the Wallis Report, reforms were made so that three institutions share supervision of the financial system: the Reserve Bank of Australia (RBA) whose powers include those on payment systems such as credit cards; the Australian Prudential Regulation Authority (APRA), dealing with deposit taking institutions, life and general insurance providers and superannuation funds (i.e., pension funds); and the Australian Securities and Investments Commission (ASIC), that enforces company and financial services laws to protect consumers, investors and creditors. A key aspect of improving competitiveness and stability in the banking sector has been the wider application of prudential regulation to deposit taking institutions. The prudential regulation by APRA applies to these institutions whether they operate in one locality, in several places in an Australian State, or nationally.

9. Competition laws also apply nationally across Australia and, following agreement in 1996 among the State and Commonwealth Governments, all governments apply the principle of competitive neutrality. This principle is to ensure that competition between private and public business is done on a basis that is competitively neutral, which means that a public business gains no commercial advantage from having a government as its owner.

10. In July 2001 Australia commenced a new national legislative scheme for its companies. The *Corporations Act 2001*, the *Australian Securities and Investments Commission Act 2001* and associated Acts form an historical package of legislation to finally deliver with certainty a single national legislative scheme for governing the affairs of more than one million companies. All State Governments have enacted their own legislation to refer the relevant powers to the Commonwealth. The Commonwealth Acts operate throughout Australia.

AUSTRALIA'S ECONOMIC AND FINANCIAL SECTOR PERFORMANCE

11. From regulatory reform Australia has seen benefits in the financial sector and the economy more generally. Notably among these, is that it has helped Australia to sustain strong economic growth in recent periods and to confidently manage shocks from external downturn in its trading partners and internally from significant corporate shocks, including in the insurance industry in Australia.

12. Australia has traditionally been an importer of capital and financial services. However, exports of financial services (\$A 1.5 b in 2001/02) have expanded rapidly over the past 15 years. Between 1986/87 and 2001/02 exports from the financial sector recorded an average annual growth

rate of 12.5%, outstripping the annual average growth rate of total services of 9.6% and total goods of 8.3%.

13. The financial services sector is now the third largest in Australia, contributing 6.6% of GDP, a 0.6 percentage point increase from 6.1% of GDP in 1996/97, when Australia was considering its commitment to the Understanding on Commitments in Financial Services⁴.

14. Over the past 20 years, the growth in financial services has been more rapid than the average of the economy as a whole. Between 1986/87 and 2001/02 the finance and insurance industry recorded an average annual growth rate of 5.1%, well above the average annual growth rate of 3.3% for the economy as a whole.

15. Over the past decade services-based companies have become predominant in the Australian share market. There are almost 4,000 significant financial institutions operating in Australia, controlling about \$A1.9 trillion in financial assets as at September 2001 (banks- \$830 billion, superannuation funds \$291 billion, life insurance- \$169 billion).

16. As noted in the recent Trade Policy Review of Australia, increased competition and deregulation has caused Australia's major bank's interest rate spread (between interest rate received and interest rate paid) to fall substantially⁵. Competition has been particularly strong in the home mortgage lending market from non-bank lenders using funds financed from securitised mortgages.

17. Innovation in products has been spurred by foreign bank competition. There are for example some 13 foreign banks operating in the retail market, as well as 14 Australian banks and more than 200 authorized deposit taking institutions such as credit unions and building societies, delivering a wide range of financial products to customers.

18. Banks and other institutions use and trade a range of technologies. At the retail level there is widespread availability of Automated Teller Machines, EFTPOS terminals, telephone and internet banking and internet share trading.

19. Changes in the number and location of bank branches and charges for bank services have led to expressions of public concerns about the availability of bank services for those less able to access more electronic technology backed services. Improved performance in this regard is fostered largely by the application of competition law, disclosure rules, voluntary codes of practice and the government's Rural Transaction Centre program to support remote and regional access for transaction centres where they are not provided on commercial grounds.

KEY ELEMENTS OF REFORM IN THE CONTEXT OF THE GATS

20. The reforms are trade-expanding as they increase certainty in the regulatory structure, offer more flexibility for business to adopt corporate structures that are suited to the needs of consumers with a full range of services and products and flexibility for markets to grow and innovate. The reforms have also provided for competitive neutrality across the financial industry. The streamlining is making redundant some regulations in Australia's reservations to the Understanding on Commitments in Financial Services and may provide scope for Australia to increase its level of commitment.

21. Reform focused on competitive neutrality between private and government business activity, on prudential measures, and on financial market regulatory measures. With the latter directed to

⁴ Source: ABS Cat. No. 5206.0

⁵ Trade Policy Review of Australia, WT/TPR/S/104, 2002, paragraph 89 and Chart IV.2.

preventing deceptive and fraudulent practices, dealing with the effects of default on services contracts and fostering well informed markets with comparability and consistency in the information available to consumers about financial products.

22. Transparency and legal certainty of business law have increased with a constitutionally sound shift in legal powers from the States to the Commonwealth.

23. Australia, with an open financial sector through adopting a high level of commitment under the Understanding on Commitments in Financial Services, can be seen as an example of where recent experience supports the view that an open, soundly regulated financial sector is key to fostering economic activity and wellbeing in a country.
