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Dear Mr McNamara

## **CERTIFICATION OF FINANCIAL SYSTEM INQUIRY AS AN EARLY ASSESSMENT REGULATION IMPACT STATEMENT**

This letter certifies that the Financial System Inquiry (the Inquiry) conducted over 2014 satisfies the requirements of an early assessment regulation impact statement (RIS).

The Inquiry's Final Report, released in December 2014, made 44 recommendations. Combined with the material of the Interim Report which was released in July 2014, the Inquiry reports address the first four RIS questions for each of these recommendations.

### **The Financial System Inquiry process**

The Inquiry was established by the Treasurer in November 2013, with Mr David Murray AO appointed as the Inquiry Chair. The final Terms of Reference of the Inquiry and appointment of four other panel members were announced on 20 December 2013, and an International Advisory Panel to provide expertise about global technology and other developments was appointed in March 2014.

Two phases of consultation were conducted by the Inquiry. The first phase sought comment on the issues raised in the Inquiry's Terms of Reference. Over 280 submissions were received in the first phase. The second phase was conducted after the release of the Inquiry's interim report on 15 July 2014, and sought comment on the observations and policy options raised in that report. Over 6,800 submissions were received in this second phase, including over 5,000 submissions on the issue of credit card surcharging. In addition to the written submission process the Inquiry panel held a wide range of bilateral meetings and stakeholder roundtables.

The Inquiry delivered its final report to the Government in November 2014, and this was publicly released by the Treasurer on 7 December 2014. At this time the Treasurer announced a further phase of consultation on the recommendations to assist the Government in forming its views. Written submissions to this process closed on 31 March 2015.

### **The Inquiry's recommendations and RIS requirements**

The Inquiry made a total of 44 recommendations, across the themes of resilience, consumer outcomes, superannuation and retirement incomes, innovation and regulatory system. A number of these recommendations have been addressed through separate RIS processes. In other cases OBPR has agreed that the measure is non-regulatory and that costings are not required (Table 1 of the Attachment).

All other recommendations are detailed below.

### **Addressing the RIS questions**

Treasury considers that in providing the analysis underpinning its recommendations, the Inquiry has addressed the first four RIS questions set out in *The Australian Government Guide to Regulation*.

## **Problem and need for government action**

The Inquiry made recommendations that sought to address five main weaknesses in the Australian financial system. The Inquiry identified a need to:

- strengthen the economy by making the financial system more resilient;
- lift the value of the superannuation system and retirement incomes;
- drive economic growth and productivity through settings that promote innovation;
- enhance confidence and trust by creating an environment in which financial firms treat customers fairly; and
- enhance regulator independence and accountability, and minimise the need for future regulation.

The final report considered each of these specific themes in detail, and developed a case for measures to respond to these weaknesses at both a theme and individual recommendation level.

### *Resilience*

The Inquiry noted that “Australia’s financial sector is not invulnerable to risks to stability, and the costs of crises can be wide-ranging and severe”. The Inquiry considered that more can be done to strengthen Australia’s economy and financial system to reduce the risk of financial crises and mitigate their impact. The Inquiry noted that government actions required to stabilise the financial sector during the global financial crisis reinforced perceptions that some institutions are implicitly guaranteed, which “create market distortions, altering the risk-reward equation and conferring a funding cost advantage on financial institutions perceived as guaranteed”.

The Inquiry’s resilience recommendations seek to remove perceptions of these guarantees, improving the efficiency of the financial system and economy and reducing the Government’s contingent liability. They also seek to improve the resilience of banks and enhance resolution arrangements that minimise the cost of any failure.

### *Superannuation and retirement incomes*

The Inquiry noted that the Australian superannuation system is large by international standards and that “Australia needs an efficient superannuation system given the system’s size and growth, the role it plays in funding the economy and its importance in delivering retirement incomes”. The Inquiry considered that there was scope to improve the efficiency of the superannuation system in a number of areas. In particular, the Inquiry considered that there is a need to improve price-based competition in order to fully realise the benefits of its scale; and to improve the efficiency with which superannuation assets are converted into retirement incomes, in order to increase the standard of living of Australians in retirement.

The Inquiry considered that reforms to the superannuation system would improve outcomes for superannuation fund members, support the stability of the financial system and help Australia to manage the economic and fiscal challenges of an ageing population.

### *Innovation*

The Inquiry noted that the arrival of digital technology “has been, and continues to be, revolutionary for most industries, altering business operations and resulting in major productivity gains”. The disruptive effects of innovation have the potential to deliver significant efficiency benefits and improve user outcomes. The Inquiry also identified that there is a need to manage the risks of innovation, including the challenges they pose to regulatory frameworks, and that “[failure] to manage these risks may result in system-wide impacts and/or adverse consumer outcomes”.

The Inquiry considered that there is a role for government in working with industry to identify innovation opportunities and emerging network benefits, and to support data-driven business models through facilitating access to data. The Inquiry also noted that there is a need for the Government and regulators to remove unnecessary impediments to innovation, and to ensure regulators have appropriate flexibility to respond to future developments.

#### *Consumer outcomes*

The financial system plays a vital role in meeting the financial needs of individual Australians. The Inquiry noted that a range of recent failures and cases where consumers have been advised to invest in unsuitable products “reveal poor industry standards of conduct and areas for enhancement in the current framework”. The Inquiry considered that there is a need to reform the regulatory framework so that it is not focused solely on disclosure, financial advice and financial literacy, with a view that the framework “needs to more effectively align the governance and corporate culture of financial firms, employees and other representatives”.

The Inquiry considered that there is a role for government in increasing the accountability of product issuers and distributors. It also noted that there is a need to ensure that “regulators are strong, independent, accountable and focused on enforcing the existing framework in a timely and proactive way” to minimise the need for additional government action. While it recognised some areas where there was a need for government action, it also looked to options that were deregulatory and to self-regulation where appropriate.

#### *Regulatory system*

The Inquiry noted that “Australia needs strong, independent and accountable regulators to help maintain trust and confidence in the financial system”. It considered that well-functioning regulators are an important way of delivering the outcomes sought under the consumer, superannuation and innovation themes. The Inquiry noted that Australia’s regulatory system has undergone significant change since the Wallis Inquiry in 1997, and did not “see a strong case for change in this area”.

While the Inquiry overall considered that the regulatory system was performing well, it considered that there was a need for the Government to take action to improve regulatory processes. Specifically, the Inquiry formed the view that “Government lacks a process for holding regulators accountable for their overall performance; some significant weaknesses exist in regulator funding arrangements and enforcement tools, particularly for ASIC; and competition and efficiency in designing and applying regulation may not be adequately considered”.

#### **Options considered and option costs and benefits**

The Inquiry’s Interim Report made over 60 observations and raised a number of policy options to address these, seeking stakeholder views on the costs, benefits and trade-offs associated with these options or alternatives. Excluding the large number of submissions made relating to credit card surcharges and too-big-to-fail, around 300 submissions were received that made comment across issues and provided views on the policy options raised.

The Final Report did not address all of the policy options raised in the Interim Report. In part this reflects the stakeholder feedback in the second phase of consultation indicating that some options were preferable to others. Other options were not pursued as feedback indicated that the issue they sought to address was not a priority for stakeholders.

Where the Final Report did make recommendations, it considered the relative merits of the recommendation against making no change. In some cases the recommended option is also compared against alternatives that were canvassed in the Interim Report or suggested by stakeholders. Examples of Inquiry recommendations and alternatives that were considered and ultimately not recommended in the Inquiry’s Final Report are provided in Table 2 of the Attachment.

## **Consultation plan**

The Government has consulted on the recommendations of the Inquiry through 2015. This included wide-ranging bilateral consultation and stakeholder roundtables on the resilience, superannuation and consumer outcomes recommendations. Written submissions were invited, with over 180 submissions received.

The Government intends to continue to consult widely on these measures as it moves towards implementing specific recommendations. Some recommendations of the Inquiry were made at a relatively high level, and did not address specifics of design issues and sensitivities. Stakeholders have already raised some issues for consideration to minimise the risk of unintended consequences in implementing the Inquiry's recommendations. These issues will be canvassed through discussion papers and ongoing consultations were legislation is developed.

Once the Government response is finalised, these processes will be undertaken on a recommendation-by-recommendation basis to allow for better targeted consultation, and recognises that some recommendations are to be progressed on a faster or slower timeline than others.

## **Estimation of the regulatory burden**

The overall package of reforms is estimated to result in a regulatory saving of approximately \$167 million (Table 3 of the Attachment). The Office of Best Practice Regulation has agreed these costs.

## **Final matters**

Final assessment RIS requirements will be met as the Government makes final decisions to introduce legislation or otherwise implement these recommendations.

Should the OBPR have any queries in relation to this matter please contact Susan Havyatt on (02) 6263 2113 or [susan.havyatt@treasury.gov.au](mailto:susan.havyatt@treasury.gov.au).

Yours sincerely

Michael Willcock  
Acting Deputy Secretary  
Markets Group

**Table 1: Agreed process for recommendations not included in this letter**

Recommendation	Agreed process	OBPR reference
1 – Capital levels	RIS requirements to be met by APRA	17874
2- Narrow mortgage risk weight differences	RIS requirements to be met by APRA	17874
3 – Loss absorbing and recapitalisation capacity	RIS requirements to be met by APRA	17874
4 – Transparent reporting	RIS requirements to be met by APRA	17874
6 – Financial Claims Scheme	Covered by existing RIS processes	15198/ 19156
7 – Leverage ratio	RIS requirements to be met by APRA	17874
9 – Objectives of the superannuation system	Non-regulatory	17874
10 – Improving efficiency during accumulation	Non-regulatory	17874
12 – Choice of fund	Covered by existing RIS processes	18484
13 – Governance of superannuation funds	Majority of independent directors covered by existing RIS processes. Other elements costed in Table 3.	18484
14 – Collaboration to enable innovation	Non-regulatory	17874
15 – Digital identity	Covered by existing RIS processes	17755
17 – Interchange fees and customer surcharging	Non-regulatory	17874
18 – Crowdfunding	Covered by existing RIS processes	17537
19 – Data access and use	Non-regulatory	17874
20 – Comprehensive credit reporting	Non-regulatory	17874
26 – Improve guidance and disclosure in general insurance	Non-regulatory	17874
27 – Regulator accountability	Non-regulatory	17874
28 – Execution of mandate	Non-regulatory	17874
29 – Strengthening ASIC funding and powers	Covered by existing RIS processes	18454
30 – Strengthening the focus on competition in the financial system	Non-regulatory	17874
31 – Compliance costs and policy processes	Non-regulatory	17874
34 – Unfair contract term provisions	Covered by existing RIS processes for extension of protections to small business. Non-regulatory for industry action on loan covenants.	16279 / 17874
36 – Corporate administration and bankruptcy	Non-regulatory	17874
38 – Cyber security	Covered by existing RIS processes	17987
41 – Unclaimed monies	Covered by existing RIS processes	18400
42 – Managed investment schemes regulation	Covered by existing RIS processes for Asia Region Funds Passport.	15195
44 – <i>Corporations Act 2001</i> ownership restrictions	Non-regulatory	19263

**Table 2: Examples of Inquiry recommendations and alternative options canvassed**

Inquiry recommendation in Final Report	Alternative option discussed in Final Report
Raise internal ratings-based mortgage risk weights (Inquiry recommendation 2)	Lower standardised mortgage risk weights
Set an objective of the superannuation system (Inquiry recommendation 9)	Establish a publicly-funded independent body to assess superannuation system performance and report on policy changes
Develop a new formal competitive process for MySuper unless a review by 2020 concludes that the Stronger Super reforms have been effective (Inquiry recommendation 10)	Allow employers choice of MySuper default products
Superannuation trustees to pre-select retirement income products for their members; remove impediments to offering retirement income products (Inquiry recommendation 11)	Develop policy incentives to encourage retirees to purchase retirement income products; mandate specific retirement income products
Introduce product issuer accountability (Inquiry recommendation 21)	Introduce an individual appropriateness test at the point of sale for complex financial products
Introduce a product intervention power (Inquiry recommendation 22)	Introduce default products for a range of basic financial needs; and/or Prohibit distribution of certain classes of non-mainstream products to retail consumers
Introduce a Financial Regulator Assessment Board and provide clearer guidance to regulators through their Statements of Expectation	Introduce an Inspector-General of Regulation; place ASIC and APRA under the control of boards comprising executive and non-executive directors

**Table 3: Regulatory costings for Inquiry recommendations**

<b>Inquiry recommendation</b>	<b>Business (\$m)</b>	<b>Individuals (\$m)</b>	<b>Total Cost (\$m)</b>	<b>OBPR ID</b>
5 – Crisis management toolkit	\$6.5		<b>\$6.5</b>	19265
8 – Direct borrowing by superannuation funds	\$0.0		<b>\$0.0</b>	19302
11 – Retirement phase of superannuation	\$29.9		<b>\$29.9</b>	19288
13 – Governance of superannuation funds	\$0.1	\$0.1	<b>\$0.2</b>	19301
16 – Clearer graduated payments regulation	\$1.6		<b>\$1.6</b>	19268/19269
21 – Strengthen product issuer and distributor accountability	\$59.1		<b>\$59.1</b>	19244
22 – Introduce product intervention power	\$3.8		<b>\$3.8</b>	19299
23 – Facilitate innovative disclosure	<b>-\$179.8</b>		<b>-\$179.8</b>	19252
24 – Align the interests of financial firms and consumers	\$17.4		<b>\$17.4</b>	19246
25 – Raise the competency of advisers	\$165.1		<b>\$165.1</b>	19130
29 – Strengthen ASIC’s funding and powers	\$7.1		<b>\$7.1</b>	19300
32 – Impact investment		\$0.3	<b>\$0.3</b>	19319
33 – Retail corporate bond market	<b>-\$6.9</b>		<b>-\$6.9</b>	19318
35 – Finance companies	\$0.2		<b>\$0.2</b>	19270
37 – Superannuation member engagement	\$20.6		<b>\$20.6</b>	19308
39 – Technology neutrality	<b>-\$87.4</b>		<b>-\$87.4</b>	19320
40 – Provision of financial advice and mortgage broking	\$5.5		<b>\$5.5</b>	19247/19248
42 – Managed investment scheme regulation	\$11.4		<b>\$11.4</b>	19277
43 – Legacy products	<b>-\$223.3</b>		<b>-\$223.3</b>	19253
<b>Total by Sector*</b>	<b>-\$169.1</b>	<b>\$0.4</b>	<b>-\$168.7</b>	

\*Note: Totals may not add up due to rounding.