

# CIFR Submission to The Financial System Inquiry

March 2015

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*Disclaimer: The views in this submission represent the views of the professional and scholarly staff of the Centre for International Finance and Regulation (CIFR). They do not include or represent the views of any member of the Consortium that funds and supports CIFR.*

## **Introductory note from CIFR's CEO**

It is my great privilege to provide this submission responding to the FSI Final Report on behalf of the Centre for International Finance and Regulation (CIFR). CIFR was set up by the Government in response to the Johnson Report of 2009 to promote public policy development, research and thought leadership in the Australian financial system. CIFR was established such that our researchers could make significant research and educational contributions to better equip financial regulators and industry stakeholders. We would suggest that publicly-funded, independent research centres, like CIFR, significantly contribute to a financial system that is vibrant, stable, innovative and well-regulated. CIFR performs an important role in Australia by engaging scholarly experts with financial industry regulators and other stakeholders for the benefit of public policy development. Many other advanced economies have similar centres, and the Commonwealth and NSW Governments should be commended for their vision and commitment in funding an organisation such as ours.

### **FSI Workshops**

CIFR has invested in three high quality FSI Workshops addressing each stage of the Financial System Inquiry. This submission summarises the key issues discussed at our third FSI Workshop, held at the Westin Hotel in Sydney on 11 March 2015, and provides feedback on many of the 44 recommendations put forward in the FSI's Final Report. This Workshop included a diverse group of over 150 participants from industry, academe, government and regulatory organisations, and highlighted the important role that high quality scholars can play in a constructive analysis and debate on the key issues impacting the financial system.

Videos from CIFR's third FSI Workshop are accessible via the following link:

[http://www.cifr.edu.au/site/Latest\\_news/CIFR\\_FSI\\_Workshop\\_III\\_-\\_The\\_Final\\_Report.aspx](http://www.cifr.edu.au/site/Latest_news/CIFR_FSI_Workshop_III_-_The_Final_Report.aspx)

### **Increasing Scholarly Engagement and Alignment in Financial Regulation and Innovation**

Australia has developed many world-class scholars, and these scholars undertake financial research of very high quality. One observation however, is that the degree of engagement by academics in Australian institutions could be significantly enhanced. In addition, research outputs could also be improved in that they are directly relevant to current issues and also translatable to a diverse group of stakeholders. The impetus for increased academic engagement with the financial (and business) sector lies in reviewing the incentives that govern academics' participation in the roles they fulfil. In general, Australian academics are professionally evaluated according to three criteria or key performance indicators (KPIs). These are: the quality and quantity of their research (including competitively awarded research funding); their teaching contribution; and their administrative service and contribution to their faculty and the wider university.

It follows that academics seeking to advance their careers will naturally concentrate on these three key measures. Perhaps unsurprisingly, research output is typically a point of particular focus. It is the most visible and quantifiable, and has the most immediate impact in terms of raising the public profile of both the individual academic and the university they represent. Indeed, it could be argued that publication of research is the sole area in which Australian academics are incentivised to perform. This is because the reputation of universities, and their all-important share of government funding, is largely determined by the success that their academics achieve in having their research published in leading scholarly journals.

Recognising the need to foster closer ties with business, UNSW Australia (as one example) now applies a fourth performance indicator that requires its business academics to engage more closely with the commercial sector. This is an important development, which should encourage academics to be mindful of the potential benefits to society when prioritising their work. However, much more should be done.

While CIFR (and other similar centres) operate successfully in coordinating research effort for the benefit of financial regulators, I believe it is also important that regulators and government develop a more formal mechanism by which engagement by scholars can be coordinated. While any requirement for Australian academics to become more closely involved with the financial sector is laudable in theory, there may be practical considerations that make this difficult to achieve. Physical locality is one such consideration. Although electronic communications have brought the world closer together, face-to-face contact remains a critically important element of successful business relationships. This can create a significant hurdle for scholars located outside of Australia's financial capital – the Sydney CBD – and to a lesser extent, the Melbourne CBD, where financial regulators and financial leaders are headquartered.

#### **FSI Text Analytical Research**

The FSI's Final Report is extensive in its coverage and has benefited from wide consultation and feedback over the two previous submission rounds. I compliment David Murray, his Panel members and the Secretariat for the quality of their work and the consultative process that was undertaken. CIFR has been privileged to have had many opportunities to directly engage with members of the Secretariat. This included a text analysis of both the Interim and Final Reports published by the Secretariat. The purpose of this work was to provide assistance in summarizing what was contained in the Final Report, in a manner which highlighted key themes, words, and issues identified using algorithms. We trust that this analysis provides a unique insight and is of further help in better understanding the breadth of issues raised in the Final Report.

#### **Financial Data Architecture and Scholarly Research**

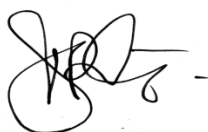
While not explicitly addressed in the FSI's terms of reference, we would like to re-assert the importance of ensuring that all data captured, stored and accessed within the financial system, by regulators and others, is

complete, accurate, readily-usable and, where appropriate, able to be shared by market participants and regulators. Establishing an inventory of all financial data that is captured, and assessing whether such data helps promote a more efficient and healthy financial system, could be of significant importance and benefit to the economy. A data architectural model allowing the safe and efficient sharing of information and intelligence right across the financial regulatory space should be a significant national priority, and involve regulatory organisations (including the ATO, RBA, APRA, ASIC and ACCC), industry and senior scholars. A world-class data architecture model could further enhance regulatory quality by ensuring that policy changes are truly evidence-based. It would also enable researchers to undertake more targeted and high value work relevant to Australia, and Australia's needs. I stress this point further by saying that many scholars in Australian institutions elect to use North American and European datasets for empirical work, not least because these international datasets can be more granular, better designed and also more easily accessible than Australian datasets. Regulators should seriously address this issue and help researchers with domestic data that can be applied to research problems in Australia's own backyard. Leveling the playing field is critically important here, and would more appropriately tie the investment of public funding of research with actual problems experienced within Australia.

### **Concluding Remarks**

Despite the constraints placed on the Inquiry by its terms of reference, resourcing restrictions and tight reporting timeframe, the Inquiry's recommendations make a significant contribution to the development of good public policy outcomes. Importantly, the Inquiry also highlights a number of issues that require further research or analysis. To the extent CIFR has the relevant expertise and resources, we will continue to provide input to these issues and endeavor to add value to the policy formulation process.

CIFR wishes Treasury and the Commonwealth Government every success in their consideration of the submissions received, and implementation of many of the Report's recommendations.



Professor David R Gallagher  
CEO, CIFR

## Foreword from CIFR's Chairman

I believe the Murray Report is wonderfully comprehensive. It was written by an extraordinarily experienced group of practitioners and academics, supported by a first-class secretariat. The Inquiry's terms of reference were extremely broad and, despite the tight timeframe, the Inquiry was willing to go even further to ensure that all of the key issues were addressed.

We look forward to the Government's response to the Report and are delighted that the Shadow Treasurer, The Honourable Chris Bowen, is committed to being part of a bipartisan approach to the analysis and implementation of the Report's recommendations.

Four important concepts underpin all of the Inquiry's 44 recommendations: efficiency, resilience, fair treatment and competition. Because Australia is reliant on importing capital, we must have a financial system which is trusted internationally.

Most of the Inquiry's recommendations focus on the 'big picture' and require more work before they can be implemented. Some of this work should be done by the regulators, some by industry, and some by academics. One of the issues associated with reports of this nature is that by the time the recommendations are adequately analysed, the next crisis has arisen and it's too late.

It is incumbent on us to make sure that we keep the pressure on industry practitioners, policy makers and politicians to ensure that we either advance the Inquiry's recommendations or dismiss them. It is in the best interests of the industry to take the initiative. Resisting change will not work. The Murray Report has given us clear guidelines, many of which will inevitably be implemented. For example, the recommendations in relation to bank capital are probably going to be adopted. There has already been a lot of work published by banking analysts that shows that the big four Australian banks have the resilience to recapitalise over a sensible period of time and with relatively little potential impact on shareholders. I think the market understands that and it's time to get on with it.

It is important to recognise the significance of the Federal Government's action in stepping in during the GFC to guarantee the bank deposits of most investors and stimulate the economy. This provided an enormous boost to the resilience of the Australian economy. The fact that our banks are well managed and relatively well capitalised certainly helped, but it needed the Government, in the face of enormous pressure, to say "we're in this together". We must also recognise that, when the next financial crisis occurs, our Government might not have the resources to be able to provide such comprehensive assistance.

We are also fortunate to have been blessed with outstanding leadership within our regulators over a long period of time – people who are highly experienced, widely respected, understand the industry and work extraordinarily hard to achieve positive, practical outcomes. They also understand the need for regulators to let industry get on with the job.

I firmly believe we need to raise the level and breadth of financial literacy in Australia because so many consumers fail to comprehend the financial risks associated with their investments, and suffer the consequences. The language we use can be mystifying and yet so many of the concepts are fundamentally simple. We need to get financial literacy into the school curriculum and have been irresponsible as an industry for not pushing harder to achieve this.

It is important to recognise that academia has a significant role to play and, as we have seen at CIFR, can make a major contribution. With this role comes an obligation to ensure that the research work is first class in terms of its academic rigour and its practical application.

CIFR has sponsored about 70 research projects and many of them are now coming to fruition. There has been some first class work done by our researchers and we are working with them to deliver high quality, relevant outputs to stakeholders. One of our key objectives is to translate academic work, so it is not just available for publication in academic journals but is also read by a wider, non-academic audience, including policy makers, regulators and industry.

This report summarises the views of the regulators, academics and industry practitioners who participated in CIFR's third Financial System Inquiry Workshop on 11 March 2015. We trust you will find it useful.



Peter Mason AM  
Chairman, CIFR

## Chapter 1: Resilience

### CIFR Responses to FSI Recommendations

- Leverage should not be used as an investment tool in the management of superannuation funds. The aim of superannuation should be the accumulation of assets to provide income in retirement, not wealth management.
- CIFR supports the recommendation of introducing higher capital requirements for Australian banks.
- Additional capital should be mainly in the form of common equity.
- With regard to bail-in provisions, taxpayers should not be called on to support banks.

### Contextual Background

- Academic research demonstrates that the potential tax disadvantage for banks of higher capital requirements is reduced by dividend imputation.
- Empirical research suggests that a larger base will reduce the cost of equity for Australian banks, and mitigate the impact on their overall funding costs.
- The benefits of leverage are significantly dependent on differences in the respective tax rates applicable to borrowing costs and income. Accordingly, although leverage may make sense in the general commercial environment, it becomes less attractive in superannuation, where tax differentials are smaller.
- A bail-in is one of several, admittedly less than ideal, mechanisms to ensure that a bank can continue to meet its obligations.
- One of several practical drawbacks associated with bail-in mechanisms is the achievement of fair treatment across the spectrum of creditors.
- Bail-in provisions may incur an economic cost. This is because many corporate bond holders are foreign investors, who may react to such a scheme by demanding a market premium before placing their funds.
- Regulations related to loss absorption recognise clear trigger points for action. At such points, greater clarity should be provided regarding the purpose of any action, namely whether to implement a bail-in or to commence insolvency.
- Several propositions have been made with regard to a crisis management toolkit. Although potentially attractive at first glance, they would entail significant implementation challenges.
- Concentration within the banking sector may increase the implicit cost of bank guarantees.
- Empirical evidence indicates that the guarantee support provided by the government to the banks during the GFC was worth between 2 and 3 credit rating notches.

- There is broad similarity in the respective approaches taken by the FSI and the Basel Committee to mortgage risk weightings.
- Idiosyncratic risks are relatively well reflected in the current system, however systemic risks are not. This underpins the merit in developing a reporting template for ADIs that is transparent against the minimum Basel III capital framework.

## Chapter 2: Superannuation and Retirement Incomes

### *System Efficiency and Competition*

#### CIFR Responses to FSI Recommendations

- Consumer confidence in the superannuation system would be enhanced if the Government’s primary focus was on the system’s strategic objectives, and adjustments to the system were removed from the annual budgetary cycle. The key policy framework of superannuation, such as tax rates and preservation age, should be set with at least a five-year timeframe in mind.
- The assertion that the superannuation system is inefficient and that fees are too high does not hold true for the majority of superannuation fund members.
- A targeted approach of identifying and addressing specific inefficiencies or barriers to competition may be more effective than introducing a formal competitive process for default funds, as contemplated by the FSI.

#### Contextual Background

- The FSI’s contention that the superannuation system is inefficient due to a lack of competition, that fees are too high, and that economies of scale are not being passed on to investors, can be disputed.
- The fee debate often draws on inappropriate data in a number of ways:
  - Examining data which reflects fees charged to ‘retail’ investors - This can obscure some crucial differences that exist between the wholesale and retail segments.
  - Co-mingling of data from choice and default products - Fees for choice products are higher, and those who select them make an active decision to pay higher fees. The focus should be on MySuper default products.
  - Use of simple averages - Simple averages may not reflect what the vast majority of members pay.
- Members of larger MySuper funds effectively invest as wholesale investors, and get the benefit of the scale of their fund provider.
- Most retail investors may be better off investing in passive portfolios, given that retail active management fees often exceed any above-index returns delivered by active managers. This is less of an issue for MySuper members, who pay much lower, wholesale management fees.
- There are 29 MySuper providers with in excess of \$5 billion in default assets under management. This group is responsible for 79% of total default asset and 75% of members; and charges an average fee of 0.90% pa on an average balance of \$50,000. This group competes vigorously, and is efficient.

- Analysis of the top 10 funds reveals a relation between the level of fees and the use of passive management and alternative assets. Further, funds with higher allocations to these investments have delivered commensurately higher gross returns on average.
- There are several areas where the superannuation industry might be able to reduce costs, without sacrificing net returns. Initiatives in these areas could potentially support a material reduction in annual MySuper fees. These areas include:
  - More discerning use of active versus passive management – Greater scrutiny could be placed on active management to ensure it is used where it adds value. For instance, paying active fees is hard to justify in international equities, where funds have typically struggled to outperform the benchmark.
  - Consolidation – The industry is still too fragmented with too many small funds. Consolidation might reduce overall system costs and increase supervisory efficiency.
  - Cross-subsidisation in the retail sector – Retail fund members are often over-charged, typically paying a rack rate of 120-140 basis points per annum, to support discounts of up to 60-70 basis points for the largest corporate funds.
- Product proliferation and legacy products add to system costs and hence fees paid by members. Also, it is confusing for investors to have a large number of products. However, there are major challenges involved with closing legacy products, including tax implications and the need to ensure that investors are not disadvantaged when they are moved to another product. Addressing these issues might provide further scope to reduce costs and fees.
- While funds set their fees in a largely competitive manner, two notable barriers to competition remain:
  - Nomination of default funds under modern industrial awards; and
  - Approved product lists (APLs) of integrated product providers.

Easing restrictions on default fund nominations and APLs would lead to broader access for a range of providers, and hence level the playing field. However, this might be best achieved in conjunction with an emphasis on the best-interest duty, and establishing a quality filter on MySuper products.

- Other competitive forces exist that need to be acknowledged. These include the feasibility for investors with larger balances to set up an SMSF; and the emergence of new players (disruptors), who are already offering products at an annual charge of less than 50 basis points.

## ***Comprehensive Income Products for Retirement (CIPRs)***

### **CIFR Responses to FSI Recommendations**

- The design of CIPRs requires dealing with the complexity of member heterogeneity.

- The name assigned to these products should provide a clearer understanding of what they are designed to achieve. ‘CIPR’ is not a user-friendly name, nor does it succinctly convey a meaningful message to consumers
- The challenge is to deliver products that are simple, transparent and well-presented, to ensure they are clearly understood and widely-accepted.

## Contextual Background

- Addressing retirement needs is complicated by the fact that peoples’ financial circumstances are more heterogeneous in retirement. A suite of products will probably be required.
- Although the FSI did not term CIPRs a ‘default’ product, they may effectively become such a product. To the extent that this may occur, care needs to be taken in CIPR design, as people, especially the less informed, tend to adopt the default option.
- Designing a CIPR requires balancing trade-offs in combining three components:
  1. Adequate income in retirement;
  2. Risk management (taking account of longevity, volatility, sequencing, inflation); and
  3. Flexibility.
- CIPRs should be regulated, approved and qualitatively rated by APRA. Their regulation should be normative (principles-based), rather than prescriptive. Furthermore, regulation should accommodate innovation.
- Interaction with members at the point of retirement will be essential, creating the need for both members and advisers to be informed about the options available. Accordingly, the aim should be to design CIPRs that are simple and easy to understand. Complexity should be avoided, to engender understanding and limit cost. There should be flexibility to adapt to an investor’s needs, and the capacity to opt-out if desired.
- The potential demand for longevity insurance is substantial.

## Chapter 3: Innovation

### CIFR Responses to FSI Recommendations

- As opposed to a regime of 'buyer-beware', it should be the responsibility of the banks to market appropriate products.
- Bank customers should not incur an interchange fee when accessing their funds via debit cards.
- Interchange fees on credit and charge cards should be set at levels that reflect the ubiquitous nature of these payment mechanisms.
- The drive to become good corporate citizens should come from the banks, as opposed to being prescribed by the regulator.
- The growing tendency among consumers to interact directly with service providers correspondingly increases the need for greater transparency regarding product features.
- At an overall level, the overarching responsibility of regulators is to promote trust in the system.

### Contextual Background

- There are three essential features of an efficient and effective regulatory system:
  - Regulators who are actively engaged in the system;
  - An operational structure that is adaptive. This applies not only to the regulators, but to the broad spectrum of system stakeholders; and
  - Participants that bring a pragmatic perspective to their roles.
- The ideal regulatory framework enables and promotes innovation.
- Digital financial services (DFS) have had mixed success in terms of take-up rates in developing countries. The reason for this is the approach taken by regulators. In countries such as India, where regulatory settings have not been adjusted for DFS, take-up rates have been low. In contrast, a more accommodative regulatory stance in Kenya has led to almost 80% of adults in that country having an e-money account.
- In the micro-payments space, where the pace of change is rapid, regulators need to take a patient approach. The full implication of emerging trends should be analysed before regulatory measures are imposed.
- Mobile payments are going to become a large segment of the financial sector in America, where, despite its status as a leading nation, many consumers do not have access to a bank account or credit facilities.
- In Australia, there is greater financial inclusion, as most consumers have access to a bank account, and the contactless methods of payment that go with them.
- The latest generation of smart phones readily facilitate contactless payment.

- With regard to high frequency trading (HFT):
  - HFT may be thought of as having facilitated more widespread access to the financial markets. Over the time that HFT trading has grown, there has been a similar rise in the number of exchanges on which securities are traded.
  - HFT presently accounts for approximately 50% of all public market trading activity in the US, down from more than 70% before the GFC.
  - There is significant academic debate as to whether HFT is a good or a bad thing.
  - Academic studies show that HFT brings added liquidity and volume to the market. This reduces spreads, which represents an improvement in the efficiency of the market.
  - Historically, exchanges have operated with computer systems that have been developed specifically for supervisory functions. However, these systems have not kept pace with the change in technology within the broader marketplace.
- With regard to data management:
  - Data allows people to develop a realistic understanding of what is occurring, rather than relying on their perceptions.
  - A greater volume of relevant data leads to a corresponding increase in the quality of decision that can be made on the basis of that data.
  - Complex system analysis facilitates a series of interactions between a user and their phone, the phone and the network, and the user and the network billing system.
  - In a sense, the system has the ability to perform a real-time credit check on every user accessing a network. In its simplest form, the check determines whether the user can pay for their call to be continued.
  - This type of data facilitates a detailed analysis of customer activity, which can be used to predict future demand trends.
  - Despite the degree of system functionality, firms often have difficulty accessing data. This may be because of disparate record sources or privacy issues.
  - When there is information asymmetry in favour of a small number of companies, the scene is set for disruption.
  - Innovation in the area of data management is going to be tremendously disruptive.
- More broadly, there is significant disruption on the horizon in financial services. The timing of its arrival is uncertain, but it will nevertheless be significant.
- Technology has provided a means of conducting business in the financial services sector for many years, typically taking the form of a business-to-business model.
- The end consumer is now moving closer to the service provider. In this regard, greater transparency regarding products and product features is critical.

- Digital disruption has proceeded at a slower pace in industries where there is a great degree of trust involved between the provider and the end consumer, for example financial services and health.
- Regulators have a key role to play in ensuring that trust in the system remains intact.
- Peer-to-peer (P2P) lending is an online marketplace that connects borrowers with investors. This enables participants to bypass the banks.
- The scale of margins available in banks' consumer lending books makes this business attractive for disruption.
- Increasing customer dissatisfaction represents an early warning signal to relevant stakeholders that the industry is vulnerable to disruption.
- A relative lack of product innovation in the banking sector enhances the scope for disruption.
- The issue of consumer fairness is another area that has disruptive potential. For example, consumers are typically charged a uniform interest rate on their borrowings, irrespective of their creditworthiness. This is profitable for the banks, but is hardly fair on the consumer.
- The object of disruption is not to replace the banks, but to look at a specific area where there is potential to create a better value proposition for customers.
- Once an area of potential service improvement has been identified, the next step is to obtain regulatory approval for a proposed new solution.
- It is difficult for the regulator to evaluate new products or solutions on the basis of existing parameters, as these may not be entirely relevant for the new product or solution.
- Responsibility for being good corporate citizens rests with the individual banks, not the banking sector regulator.
- In terms of the payments system, the regulatory goal is to provide a safe, efficient and competitive system.
- The regulatory system ought to restrain abuses of collective setting of bank interchange fees, and eliminate access barriers for new entrants. However, the banking industry has undermined the achievement of these objectives.
- Banks have increased the complexity of the interchange fee regime in order to increase revenues at system transition points.
- Banks charge more for their card services to smaller companies and low income card holders, relative to more affluent individuals and larger entities.
- Relevant stakeholders should ensure that Australia does not fall behind other countries in its regulation of interchange fees.
- Potential new entrants are denied access to the card payments system by the big four banks.

## Chapter 4: Consumer Outcomes

### CIFR Response to FSI Recommendations

- The product design and disclosure regime should reflect the wide divergence in financial literacy levels across society.
- Regulatory policies need to reflect the notion of fairness, specifically in the context of ensuring equal and fair treatment of consumers.
- Similar to the philosophical approach taken in section 52 of the Trade Practices Act, product providers should be held liable for consumer losses arising from the sale of inappropriate investment products.
- The financial advice industry should be further encouraged to adopt a code of conduct that is similar to those of other professional bodies, and seek to achieve global best practice outcomes.

### Contextual Background

#### *Financial literacy*

- Financial literacy programs are important. However, whether the majority of individuals are able to attain sufficient financial literacy is open to debate.
- Achieving financial literacy takes time, and may involve a generation-long learning curve.
- Limited financial literacy among individuals is pitched against the vast marketing resources of product providers, who typically make their offerings particularly complex.
- Limits to financial literacy increase the onus on product providers to make products 'safe'.

#### *Behavioural insights*

- It is insufficient to rely only on information disclosure, in light of behavioural influences, which, in turn, can be reinforced by apathy, poverty of time, limited understanding and complexity.
- Intervention may be justified where behavioural influences result in unfair outcomes.
- There is a need to focus on how people make decisions, and how they actually use products.
- There are several techniques to address behavioural effects. These include:
  - Simplification – To ensure the product is understandable in plain language. Choice variables should number no more than three, and start with a set of questions to identify the core issue, which can then be converted into a simple choice set.
  - Presentation and framing - The 'choice environment' is important. Notable choice mechanisms include: opt-out versus opt-in; default settings; controls over advertising; and providing simple rankings.

- Controls over product features - Restrictions on exit fees, teaser rates and free gifts at the point of product entry, as these obscure the realities of the product.

### *Fairness*

- The FSI's 'step-change' in emphasising fairness as one of three building blocks of future regulatory philosophy in Australia, and as a way of building confidence amongst consumers, is welcomed.
- The FSI definition of fairness emphasises the following process values:
  - Integrity, specifically in terms of consistency;
  - Honesty;
  - Transparency, specifically ensuring that relevant information is disclosed; and
  - Non-discrimination.
- Fairness in regulation should also encompass what may be termed substantial values:
  - Client needs, and, in turn, product suitability;
  - Value for money; and
  - Consideration of the least advantaged in society, namely those without access to banking services.
- Fairness is only one yardstick. The FSI also advocates a balance between resilience and efficiency, which may lead to tension with regard to fairness under some settings.
- Fairness is a concept that in some people's minds mainly relates to products, and hence is limited in coverage. However, the obligation of fiduciary intermediaries, such as advisers and investment managers, to put the investor first is a long-established and important concept. It is an illustration of fairness, because the law requires the intermediary to place the client's interests first, especially where the client is dependent on the intermediary.

### *Financial product governance and product intervention powers*

- Financial product governance should demonstrate fairness, and should promote a client-focused culture. The aim is to get product providers to focus on, and take responsibility for, delivering fair outcomes to consumers.
- A possible alternative to giving ASIC a product intervention power is to make product providers liable for losses incurred when supplying products that are unsuitable for particular consumers. This is similar to the liability incurred for deceptive conduct under section 52 of the Trade Practices Act.
- It is desirable to have financial product governance, to promote suitability in design and distribution, and to impose sanctions for distributing unsuitable products.
- Product standardisation is useful, especially for advisers.

### *Financial advice*

- The best-interest duty for financial advisers is of key importance.
- The financial advice business needs to move more quickly towards becoming a 'profession', with standards that are adopted with conviction and strongly enforced.
- With regard to conflicts in financial advice:
  - These have been substantially reduced by the banning of commissions under FoFA, with the notable exception of commissions on life insurance.
  - Complete alignment will remain a difficult target within a system of vertical integration.
  - It is debatable whether investors prefer an independent adviser, or one that has the backing of an institution.
  - Approximately 40% of advisers' income comes from commissions on legacy products. The diminishing market presence of these products will lead to a corresponding change in the business models, and hence income sources, of advisers.

## Chapter 5: Regulatory System

### CIFR Response to FSI Recommendations

- Independence and accountability should be primary considerations in regard to the framing of financial regulators' roles and responsibilities. Adequate resourcing should be a key consideration in this process.
- Any changes made to the regulatory system, or to regulators' responsibilities, should be done on the basis of a comprehensive body of supporting evidence.
- The power of intervention would enable ASIC to extend its area of operation beyond disclosure. Furthermore, it would allow ASIC to address market-wide problems, rather than simply focusing on specific entities, and enable it to make decisions with a view to benefiting competition.
- Responsibility for fostering responsible corporate culture lies with the corporate sector. It should not be prescribed by the regulator. However, the regulator might consider giving industry participants an annual 'score' as a feedback mechanism to the market about culture as the regulator sees this each year.

### Contextual Background

- The philosophical starting point for the FSI was whether there was any strong argument for change, for example whether APRA should be re-incorporated into the Reserve Bank. In the event, no compelling argument was found to support any such change.
- The FSI has produced a balanced package of recommendations. This represents a sound endorsement of the current regulatory model.
- Adequate funding and support for regulators are issues that feature in several areas of the Final Report. There are also a number of recommendations regarding regulators' mandates.
- Recognising the difficulty involved in developing regulations that have universal application, APRA instead contends that the ideal regulatory model is typically unique to its local jurisdiction.
- The FSI has re-affirmed the need for strong, independent, and accountable regulators. Good regulators are not merely a cost burden on the system, but instead are a source of added value. This added value is difficult to measure and often unappreciated by consumers and market participants.
- Notwithstanding the systemic importance of effective regulation, APRA recognises there is a delicate balance between over- and under-regulation.
- There is a necessary correlation between independence and accountability of regulators.
- In the design of any new regulatory body, the question must be asked as to how it might fit into the broader regulatory environment.

- Competition should not be an end in itself. Regulatory measures to boost competition should be designed with a view to fostering sustainable benefits to consumers.
- Competition and stability should not be mutually exclusive outcomes. The regulatory goal of a competitive environment should not be achieved at the cost of undue upheaval, which may in fact harm consumer interests.
- In the period leading up to the GFC, excess remuneration was not as evident in Australia as it was in certain overseas countries, such as the US. Nevertheless, ASIC has set out principles to align remuneration with risk and return factors.
- An effective regulatory regime may be characterised by targeted and timely intervention.
- Any changes to the regulatory system should be evidence-based.
- ASIC supports the concept of a well-designed power of intervention, as it would facilitate more timely and targeted action.
- Contrary to suggestion, a power of intervention would not represent a radical departure from ASIC's present field of operations.
- The application of powers of intervention should extend beyond product bans.
- It is important for regulators to have substantial powers, even if these are only rarely used.
- Formal regulation is problematic to design and implement in the areas of organisational culture and executive remuneration.
- Although ASIC cannot, and should not, be expected to remedy all market problems, an effective and pro-active regulatory regime can make a significant contribution to consumer welfare.
- Having in place an appropriate level of penalties for wrongdoing provides a powerful incentive for appropriate market behaviour.
- Industry must play a leading role in improving corporate culture. It cannot rely on regulators to establish sound corporate culture. The alternative to an industry-led improvement in culture is a burdensome regulatory environment.

## *Regulation and Public Policy*

### **CIFR Response to FSI Recommendations**

- The focus on superannuation regulation thus far has been on the accumulation phase, rather than on retirement incomes. It would be timely to address the system's many post-retirement issues, such as the tax treatment of lump sums.
- Policy measures should be framed with a view to promoting competition, as it is the best and most efficient regulator.

## Contextual Background

- Having separate regulatory bodies dedicated to competition and consumer protection is an ideal regulatory framework.
- Desired consumer and regulatory outcomes are dependent on the appropriate underlying policy fundamentals.
- Competition within the banking sector may not necessarily always be aggressive, but it is tough. A notable episode of aggressive competition was the tussle between Commonwealth Bank and Westpac Bank in the low-doc loan market.
- Aggressive competition in mortgage lending rates does not encourage consumers to switch banks, it simply erodes bank margins.
- Excess regulation in the banking sector may erode competition.
- It is difficult to envisage how the FSI can implement the notion of promoting competition, as regulators do not have the power to alter the number of entities competing in the market.
- The securities industry has layers of protection for investors. There is no similar protection regime when buying a house, which is typically the single most important and valuable asset acquired by most Australians.
- Efficient competition requires that consumers be informed. The onus of responsibility for providing clear and accurate information should be on the provider of goods / services, not on the consumer.
- It is difficult to incorporate a theme of competition into prescriptive regulation.
- There is no need for a supervisory board overseeing the existing regulators. This would simply add another layer of regulation.
- The field of psychology merits an equal footing with economics and law in the development of regulation. Cross-disciplinary understanding is imperative for improved regulation.

## Competition

### CIFR Response to FSI Recommendations

- Competition policy should be applied in a uniform manner across the financial and other industry sectors. Exceptions should be made solely on the basis of consumer welfare.
- The FSI has not recommended any structural changes to the banking sector. However, our ‘twin-peaks’ regulatory approach creates a potential blind spot in the oversight of the banks.
- A lowering of switching costs that makes it easier and more convenient for customers to switch from one bank to another may help promote systemic stability as customers could more readily move from distressed banks. Greater ease of switching by customers would also help to promote competition.
- The protection of consumer interests does not fit seamlessly with ASIC’s other responsibilities. More broadly, the various regulatory bodies should co-operate in areas of overlap.
- The use of crowdfunding as a source of corporate financing requires regulation to provide mechanisms to deal with fraudulent raisings, and to address business failures in an orderly manner.

### Contextual Background

- In the context of ensuring a competitive market, the vibrancy of competition is more important than the number of competitors.
- Concentration in the financial services sector is high, when measured in terms of the retail presence of service providers.
- When considering potential barriers to entry to the domestic financial sector, it is noteworthy that overseas competitors have generally failed to gain a meaningful foothold in the market.
- The four pillars policy has prompted increased vertical integration within the banking sector, particularly in the area of mortgage products.
- Vertical integration also impacts the degree of systemic risk within the sector.
- The issue of concentration is also linked to oligopolies, namely those entities that are regarded as too-big-to-fail.
- It is possible that the degree of concentration within the financial sector could exacerbate the effects of a domestic crisis. However, it is difficult to envisage, and thus prepare for, such a scenario.
- In terms of competitiveness, Australia’s banking sector lies broadly between those of the US and the UK, and is comparable with the global average.
- The industry-standard statistical measure of competition (the Lerner Index) indicates that competition in Australia’s retail banking sector peaked in 2004.

- Although the ACCC has primary responsibility for the regulation of competition, other regulatory bodies cannot be absolved of responsibility for aspects of competition that fall within their sphere of influence.
- Stability of the financial system is critical to the provision of effective consumer protection. The focus of policy ought to be on promoting vibrancy within the sector.
- In seeking to strike a balance between competition and stability, it is necessary to determine whether any proposal to increase competition does in fact have an associated stability benefit.
- Effective prudential regulation within a competitive environment should enhance systemic stability.
- With regard to crowdfunding:
  - It is a means of addressing the lack of access to equity funding for small- and medium-sized companies.
  - In setting and establishing appropriate crowdfunding regulation, a balance is required between consumer protection and the ease with which companies can raise finance.
  - Requiring investors to sign an acknowledgement of risk statement represents another means of disclosing the nature of risks inherent in this type of investment.
  - The public company exemption regime, envisioned by the Corporations and Markets Advisory Committee (CAMAC), may prove complex and cumbersome. The regime currently in place in New Zealand appears simpler and more practicable.
  - Instead of applying a \$2 million limit on the amount of money that may be raised at any one time, funds could instead be raised according to progressive milestone targets related to the progress of the underlying business.

## Tax

### CIFR Recommendations

- A thorough review of the tax system should be informed by key data, such as tax revenue and concession breakdowns by age group, the impact of grandfathering provisions, etc.
- There should be a harmonisation of measures in the superannuation and age pension systems.
- Bracket creep is an ongoing issue that needs to be addressed.
- Removing dividend imputation would create a distortion in favour of foreign investors.
- Genuine tax reform requires all tax measures to be considered, including the GST, and consideration of Commonwealth / State relations.

### Contextual Background

- The Australian tax system significantly distorts the supply of, and demand for, saving and investment and encourages tax avoidance.
- Given that only one full recommendation and another part recommendation from the 2009 Henry Review have been enacted, comprehensive changes to our tax system are overdue.
- Australia is more reliant on direct taxation, as opposed to indirect taxation, than the average of its OECD peers.
- The tax-free status of the family home has encouraged the growth of McMansions and contributed to the housing price bubble.
- Negative gearing and the CGT discount on assets held for more than twelve months have further contributed to the housing bubble and reduced tax revenue. Australia's stance in relation to negative gearing is out of step with the rest of the world.
- Super tax concessions are overly generous for high income earners. These concessions should be designed to encourage people to use their own savings to fund the cost of their retirement, which will reduce the cost of funding the age pension.
- The current concession cap at \$35,000 (about 50% of average earnings) appears reasonable for those with consistent income. The issue is how to deal with those who earn irregular income, or those that want to catch up late in life. Options include having a lifetime cap, or linking contribution caps to the amount already accumulated.
- There should be greater consistency in super tax concessions. For example, small business owners can use their super to buy commercial property, but wage earners can't.
- The superannuation and age pension systems need to be looked at together and any inconsistencies eliminated. For example, there is an inconsistency in the age at which super (60 years) and the age

pension (67 years) can be accessed; and the super system focuses on the individual, while the age pension focuses on the family situation.

- Super fund members need assurance that they will be able to access their super savings when they need it to fund their retirement.
- Non-resident investors are incentivised to provide debt finance, rather than equity finance, because the withholding tax rate applicable to interest income is significantly lower than the company tax rate.
- By 2016, the marginal tax rate of the average employee will again be at the second highest level.
- Any review of the Australian taxation system must consider the GST rate and base. Australia's GST rate is low relative to OECD peers. Adding all food to the GST base would increase tax revenue by \$21 billion – a 42% increase on current revenue of \$50 billion – and would not impact lower income earners as much as is commonly thought.
- Removing dividend imputation would benefit foreign investors (who don't benefit from imputation credits) at the expense of Australian investors (who do benefit from them); remove an incentive for Australian companies to pay tax in Australia, rather than overseas; and encourage more debt financing at the expense of lower risk equity financing.
- Removal of duties on insurance policies would remove a regressive tax and address a significant problem within the Australian financial system – the fact that Australians are underinsured.
- State-based taxes and duties make life difficult for business because they often involve different rates and calculation methodologies.
- The reintroduction of wealth taxes applied at the time of death should be considered. This could represent a new revenue source for the States, who are currently heavily reliant upon their allocations of GST revenue.

*This submission relied on the teamwork of a number of CIFR personnel. These included:*

*Zhe Chen, James Cummings, Clifford Gadd, David Gallagher, Tim Gapes, Veronique Henrisson, Madeline Johan, Kingsley Jones, Evelyn Mike, Kala Miranda, Rob Nicholls, Camille Schmidt, Emily Stevenson and Geoff Warren.*

**Appendix 1:**  
**Financial System Inquiry Topical Analysis**

**Two page summary of research paper.**

The full research paper can be found at:

<http://www.cifr.edu.au/project/T019.aspx>

## Financial System Inquiry Topical Analysis

*Kingsley Jones*

Centre for International Finance and Regulation

*Richard Lawson*

Centre for International Finance and Regulation

**This research paper describes the merit of developing a text analytics engine to index public submissions to the recent Financial System Inquiry (FSI).**

**Public inquiries such as the FSI typically involve processing a substantial number of documents, with content that represents a diverse range of opinions. Managing the diverse authorship and viewpoints reflected in a body of submissions presents a unique challenge.**

**This research demonstrates the use of automated topic analysis to enhance the productivity of panel members who are responsible for reading and analysing a large body of submission material. The result is a heat-map of topic exposure by submissions.**

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The development of public policy often starts with a public inquiry. This involves setting out the terms of reference, the appointment of an expert panel, and a call for public submissions. The input to a public inquiry typically comprises a substantial volume of textual content, reflecting a widely divergent spread of authors and viewpoints. Effective management of such a large inventory of submission material presents a unique logistical challenge.

This working paper describes a research program undertaken to develop a text analytics tool to assist in the topical indexing of a large body of public submissions. The intention in developing an effective index mechanism is to facilitate the compilation of a topical survey of the overall body of submission content.

This text analytics tool was developed with the immediate aim of providing assistance to the recently completed Financial System Inquiry, chaired by Mr David Murray AO. The program's specific aim was to compile a topical survey of the submissions to the Inquiry's Final Report. The report was released on 7 December 2014, and reflected the input of over 6,500 submissions made to the Inquiry following its interim report in July 2014.

A larger research goal of the program was to understand how topical analysis might be employed to enhance the productivity of panel members, who have responsibility for reading and analysing a large body of submission material.

To guide the computer analysis on the selection of topical material, the text and words of the Inquiry Panel were used to frame a proxy for the editorial input of that expert panel in framing the public process of submission and consultation.

A key task of computer text analysis is to assemble an entire collection of documents into a form where they can be mechanically read, parsed, and indexed. Following the compilation of a database of suitably formatted text, the contributing authors are classified according to their area of representation. The next step entails conducting a frequency analysis of words and word patterns related to popular topics.

A specific advantage of this approach is an inherent ability to stipulate particular topics of focus. This ensures that the text analysis process captures specific issues, in this case those that had been identified as important by the Inquiry Panel. This functionality allows for greater control over the analytical process, facilitating its application in what may be termed a semi-supervised manner.

For the purpose of this analysis, topic labels and categories are generated from an analysis of what had been set out by the Panel Inquiry. These subsequently comprise the framework within which the text analysis is conducted. In this way, the expertise of the Panel members, and their enunciation of the Inquiry's key ideas, is reflected in the collation of the body of submission material.

From a policy formation perspective, this text analysis methodology appears consistent with the general approach taken by a public inquiry process. Public input is sought on a specific set of issues defined in the terms of reference. An expert panel then collates the body of information received and identifies a set of key findings. The publication of these key findings represents an important part of the consultation process, as this feedback sets the agenda for subsequent submission rounds before a final inquiry report.

Developing a new approach to a task is one thing. Appraising the performance of the new approach against more traditional methods is another. The appraisal of this program centres on demonstrating the application potential of machine-learning based methods to the partial automation of the reading and discovery task of a major public policy inquiry. As topics are somewhat subjective by nature, the assessment takes the form of a check against other manual means of topic assignment.

A parallel exercise of manual reading and interpretation of the documents by a different research team produced results that are similar in many respects to the automated approach of this program. There are differences of nuance and emphasis, reflecting the chosen category labels, but the automated methods appear to capture the essential features of the overall body of text.

Accordingly, this paper contends that text analytic tools are valuable aids in the segmentation and labelling of verbal data in research-oriented projects.

Text analytic tools cannot replace the wisdom and experience of those charged with leading and framing the exchange of information involved in public policy development. Where they can contribute is in helping to identify and clarify the topics and viewpoints raised as part of the submission and recommendation process.

## **Appendix 2: Submission to the Financial System Inquiry on Purchased Payment Facilities**

### **Authors:**

**Ross Buckley, CIFR King & Wood Mallesons Professor of International Finance Law, UNSW**

**Louise Malady, Senior Research Fellow, UNSW**

**Evan Gibson, Research Fellow, UNSW**

## Submission to the Financial System Inquiry on Purchased Payment Facilities

### Introduction

Australia's purchased payment facility (PPF) market is relatively underdeveloped. Ironically the PPF regulatory regime was introduced following the previous financial system inquiry (the Wallis Inquiry) to encourage growth and innovation in new payment methods, yet today a major impediment to the growth of PPFs in Australia is the PPF regulatory regime.

PPFs are growing and innovating rapidly in other developed countries. In Hong Kong, the Octopus stored-value card was introduced in 1997 as a transport ticketing system and led to the implementation of the Oyster card in London some six years later. Octopus now has a penetration rate of 99% in Hong Kong, with over 6,000 service providers, and 15,000 retail outlets.<sup>1</sup> Octopus is one of the world's most universally accepted smart-card payment systems.<sup>2</sup> There is no reason Australia cannot replicate a success story like Hong Kong's Octopus system. This would benefit all Australians by making daily transacting quicker and easier, and should be of great interest to the Government as it moves the economy away from cash and the potential it offers to evade taxation. However, for such important policy goals to be achieved, the existing PPF regulatory regime needs extensive revision.

We support reform of the current PPF regime, however, would recommend a different path to that proposed in the FSI Recommendations.

This submission outlines our recommendations for the PPF regime and explains why we believe the FSI recommendations will not achieve their desired aim.

### Complexities in Current Regulatory Regime

The current regulatory regime established in 1998 has developed so that PPFs are subject to supervision by either the Reserve Bank of Australia (RBA), the Australian Prudential Regulation Authority (APRA), and/or the Australian Securities and Investments Commission (ASIC). PPF providers may need to hold an Australian Financial Services Licence (AFSL) and/or an Australian Credit Licence (ACL) under the supervision of ASIC, be authorised or exempted by the RBA, or be an authorised deposit-taking institution (ADI) authorised by APRA.

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<sup>1</sup> OCTOPUS, "Company Profile" (October 2014), at 9, available at [http://www.octopus.com.hk/web09\\_include/\\_document/en/company\\_profile.pdf](http://www.octopus.com.hk/web09_include/_document/en/company_profile.pdf)

<sup>2</sup> Michelle Li, "OCTOPUS: Making Everyday Life Easier" (October 2008), at 9, available at <http://michelleli.ca/wp-content/uploads/writings/octopus.pdf>; OCTOPUS, "Company Profile" (October 2014), at 9, available at [http://www.octopus.com.hk/web09\\_include/\\_document/en/company\\_profile.pdf](http://www.octopus.com.hk/web09_include/_document/en/company_profile.pdf)

The Australian PPF landscape is currently principally regulated by exemptions. The only authorised PPF in Australia is PayPal. This approach is not ideal as a market characterised by regulatory exemptions is shaped by those exemptions. Our current system adversely influences market development, innovation and growth. With exemptions dominating this regulatory space, supervisors are also not well placed to monitor the PPF market and could be taken unawares by future developments.

Too often today when a foreign payments provider seeks legal advice on establishing a new type of PPF in Australia and is told it will need to apply for a AFSL or ACL straight away and that when its services grow to a significantly profitable scale it will need to be regulated as an ADI, the provider chooses not to enter our market. The payments providers who do enter our market typically have to craft their offering to qualify for an exemption often with the loss of much of the innovative functionality of their service.<sup>3</sup>

No record is available of the potential innovative services lost due to the potential regulatory burden deterring new market entrants or of the lost innovative approaches due to compliance with our exemptions regime but anecdotal evidence suggests both losses are considerable.<sup>4</sup>

For the PPF market to grow safely and freely, and for supervisors to be able to keep abreast of market developments and innovations, the widespread use of exemptions needs to be phased out; simple, expeditious authorisations should become the norm; and market data should be collected by the supervisor from all PPFs. The current authorisation and exemption regime under the *Payment Systems (Regulation) Act 1998* should be significantly amended or repealed. As it stands it does not balance innovation with regulation, market developments are being inhibited and we have no way of quantifying the extent of this inhibition because no data is collected on exempted entities or business ventures not proceeding due to regulatory burdens.

## Financial System Inquiry (FSI) Report

The Financial System Inquiry (FSI) Final Report has identified the complexity of the current PPF regulatory regime and recommendations 16 and 39 go some way towards removing the complexities.

Recommendation 16 (R16) of the FSI Final Report directly addresses PPF regulatory reform. R16 suggests that the thresholds for regulation by ASIC and APRA be clarified and enlarged, consumer protection be strengthened by mandating the application of the *ePayments Code*, and a separate prudential regime with two tiers of liquidity and other prudential requirements for PPFs be introduced.

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<sup>3</sup> Interview by Ross Buckley of a partner in a major national law firm practising payments systems law, March 4, 2015.

<sup>4</sup> Ibid.

Recommendation 39 (R39), which concerns technology neutrality, complements R16. R39 states that regulations should allow individuals to select alternative methods of financial service access to maintain fair treatment of all consumer segments. Technology neutrality is important because enabling any mode of technology whereby individuals can select alternative methods of financial service access promotes financial inclusion and competition among providers.

## Our Recommendations

### **1. The current licensing/authorisation regimes should be simplified from four to one.<sup>5</sup>**

Simplifying the current PPF regulatory regime will liberate the market. For example, Hong Kong's Octopus card stored value facility is regulated by one supervisor pursuant to one licensing regime. Octopus has become widely available and accessible, evolving into a multi-purpose stored-value facility that enables customers to pay for goods and services as well as transport. Indeed, over half of Octopus payments are now for non-transport related goods and services.<sup>6</sup> Octopus is also demonstrating its ability to adapt to financial innovation by progressively transitioning its services from smart-cards to smart-phones.<sup>7</sup>

A single licensing/authorisation regime should be light touch to foster financial inclusion and to promote technological innovations, and because PPFs are not extensive today in Australia the regulatory department initially doesn't need to be large. A single regime also offers greater flexibility and lower compliance costs.

### **2. The number of PPF supervisors should be reduced from three to one.**

The current regulatory regime is fragmented, complex, and lacks clarity because the three current supervisors' PPF regulatory roles are not functionally aligned with their regulatory design. The RBA is aware of this problem as illustrated in its Supplementary Submission to the Financial System Inquiry (August 2014), which stated that the RBA was not well placed to authorise and supervise individual PPFs as the regulatory functions are markedly different to those in relation to retail payments, which focus more on high-level policy and less on regulatory oversight. Furthermore, the RBA has stated that PPFs require less supervision and regulation than ADIs.

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<sup>5</sup> The four regimes being the Credit Licence and Financial Services Licence regimes administered by ASIC, and the regimes of the RBA and APRA.

<sup>6</sup> Ben Fung, Miguel Molico and Gerald Stuber, "Electronic Money and Payments: Recent Developments and Issues", Bank of Canada Discussion Paper 2014/2 (2014), at 27.

<sup>7</sup> Kanis Li, "Octopus takes mobile step to winning more customers", South China Morning Post (9 September 2013), available at <http://www.scmp.com/business/companies/article/1306562/octopus-takes-mobile-step-winning-more-customers>; See also, OCTOPUS, "Company Profile" (October 2014), at 9, available at [http://www.octopus.com.hk/web09\\_include/\\_document/en/company\\_profile.pdf](http://www.octopus.com.hk/web09_include/_document/en/company_profile.pdf)

Under the current regime, none of the supervisors are ideally placed to supervise all PPFs. Furthermore, judging by the predisposition for granting exemptions rather than applying the PPF regulatory regime, it is arguable that none of the supervisors are seeking an expanded supervisory role.

We recommend Australia establish a single new regulator, a “one-stop shop” to regulate PPFs. In our view, this new regulator should be within ASIC as its principal roles are consumer protection. New funding needs to be provided to ASIC to enable it to undertake this task properly. Payments system staff from the RBA will probably need to be seconded to ASIC, at least in the early phase.

**3. *The ePayments Code’s current prescriptive list of transactions should be replaced with a broad provision.***

The FSI recommends service providers subscribe to the *ePayments Code* in its current form as a means, inter alia, of extending consumer protection regulation to PPFs. We argue that mandating subscription to the current *ePayments Code* will not capture all innovations in the PPF sphere. The current *ePayments Code* provides a prescriptive list of transactions to which it applies and gives ASIC power to extend the list. It also falls somewhat short in terms of technology neutrality. A better approach would be regulation that is principles-based and functional in design, focusing on outcomes rather than prescribing the method by which these will be achieved. One way to remedy this regulatory design flaw is to amend the Code so it applies to digital financial services generally (involving payments, transfers, withdrawals, and any other transaction). This is simpler and cleaner than having ASIC discretionarily determine which transactions are captured by the Code beyond the prescriptive list.

**4. *The Data-Mining legislative provisions need to be consolidated and streamlined***

Data-mining is a key commercial driver of innovative financial products and services. Data-mining enables companies to profile consumers through their PPF spending patterns and target individualised marketing to them. Collecting and mining data from consumers in the PPF sphere gives rise to market conduct and consumer protection concerns. Currently, there are several key statutes that PPF providers have to consider when mining data: *Spam Act 2003* (Cth); *Privacy Act 1988* (Cth); and the anti-hawking provisions in the *Corporations Act 2001* (Cth). Compliance with these data-mining related legislative provisions places a disproportionate regulatory burden on small PPF providers that may stifle innovation, competition, and market growth.

A proportional regulatory approach should be adopted that streamlines the current PPF data-mining regulatory regime. These data-mining consumer protections and market conduct provisions should all be simplified and consolidated in an *ePayments Code*. Simplifying these provisions is important to allow for innovation, competition, and market growth to flourish.

5. ***Market information needs to be collected for all PPFs***

Market information concerning the turnover, structure and innovations in the Australian PPF market needs to be regularly collected. This information enables market reviews to identify risks, and will underpin future regulatory guidance and policy development.

The PPF regulator should substantially improve the information available on this market sector, both in terms of value and volumes of transactions and methods of access used when paying with stored value.

## **Conclusion**

By international standards Australia's current retail payments system is reliable but expensive. PPFs provide the vehicle through which innovative payments providers are likely to disrupt the current system to the distinct benefit of consumers across the nation yet our current regulatory regime stifles much of this innovation. The five recommendations we have made, particularly the establishment of a consolidated regulatory regime administered by a single regulator within ASIC, will lay the groundwork for innovative disruption to support Australia's prosperity while protecting the interests of consumers.

**Ross Buckley, CIFR King & Wood Mallesons Professor of International Finance Law, UNSW**

**Louise Malady, Senior Research Fellow, UNSW**

**Evan Gibson, Research Fellow, UNSW**

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