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INSIGHT: FSI Report By Atchison Consultants

Fixed Interest Investments
Asymmetry in financial markets means that one party has better information than another. Generally this is for the advantage of the issuer or product promoter not the investor. It is prevalent in the fixed interest markets.

Bold and incisive recommendations reducing asymmetry have been made by the FSI panel that has recognised that there is a major shift from financial intermediaries, largely banks, into the capital markets in the fixed interest markets. Investment management products, superannuation funds and peer to peer lending are participants in the markets.

As this shift evolves they are advocating a single regulator for conduct and disclosure in financial services. The proposed Corporation and Financial Services Commission will have the task of ensuring consistent and comprehensive disclosure by all participants in the fixed interest markets.

Facilitation, not discouragement, of new exchange markets for debt investments will be part of the brief of the CFSC. A single exchange regime is recommended with the CSFC having authority to approve a new financial market which is fair and efficient.

Among the comprehensive proposed responsibilities of the CFSC is regulatory market conduct thereby promoting orderly and efficient price discovery, trading and settlement. In an environment of new information technology, the regulations must keep up with the emergence of new means of delivery such as peer to peer lending and crowd funding.

Opaque markets will be eliminated by a regime requiring high standards of disclosure. A retreat from intensive prudential regulation to market conducts and disclosure is proposed.

An essential component of enhanced fixed interest markets is an efficient clearing structure. Authorisation and oversight of clearing houses for clearing and settlement of transactions would be a responsibility of the CFSC. An integral component of enhanced liquidity of debt markets would be provided by this enhancement.

Greater transparency in markets through reduction in asymmetry would result from implementation of the recommendations of the Financial System Inquiry panel regarding conduct and disclosure and new markets and clearing houses.

INSIGHT: FSI Report Other comments

The report from the Financial Systems Inquiry was delivered on December 7, 2014. Overall there were 44 recommendations from the 350 page Financial System Inquiry Report. The recommendations have been designed to improve the ability of Australia's financial system to withstand future financial crisis and ensure our financial system is efficient, resilient and fair. The report can be accessed by the above link and covers a range of topics from bank capital, superannuation, insurance and financial advice, regulation, tax and retail services and products. Some pertinent points are outlined below.

FSI recommends renaming 'General advice' and advisers disclose ownership structures
A large part of the FSI report focuses on independence and stability and this seemingly innocuous recommendation number 40 could prove to be quite significant. David Murray makes the point that 55% of investors don't understand that their advisers were not independent. He also states that investors do not understand the difference between General Advice and Personal Advice saying "the most significant problems relate to "shortcomings in disclosure and financial advice, and over-reliance on financial literacy." He goes on to say that research shows consumer behaviour is affected by terminology used and by disclosures about relationships of financial advisers.

Bank capital
Banks in Australia are highly profitable but too much of that profit is generated from housing. "Housing is an issue" and "risk weights have fallen noticeably," said David Murray. "Housing assets used to make up 50% of bank assets. That ratio now stands at 65%." The big four banks presently use their own models to calculate risk weightings on housing and set aside around 18% of capital to protect themselves against those mortgages. The regional banks, mutuals and credit unions are required to use an independent model and set aside around 39%. The FSI report calls for an increase in bank capital for the big four (and Macquarie) of between $20bn and $28bn to bring the average capital level held to the top quartile of their international peers. If implemented this will remove some of the advantages the big four banks have over their competition.