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## Financial Sector Competition and the Financial System (Murray) Inquiry

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### FSI: competition-related recommendations

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Number	Description
2	Narrow mortgage risk weight differences
10	Improving efficiency during accumulation
14	Collaboration to enable innovation
15	Digital identity
16	Clearer graduated payments regulation
18	Crowdfunding
19	Data access and use
20	Comprehensive credit reporting
27	Regulator accountability
30	Strengthening the focus on competition in the financial system
39	Technology neutrality
42	Managed investment scheme regulation

## Competition: Integral to approach and recommendations

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- Inquiry Objectives: a financial system which is
    - Resilient, efficient, fair
    - Able to adapt to ongoing change and challenges
  - Competition
    - A driver of efficiency
    - Important for fairness – consumer choice
    - BUT
      - Implications for financial stability
      - Implications of information asymmetries and behavioural determinants of decision making
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## Technological Change and Competition

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- Financial sector overcomes “financial frictions”
    - Information problems, transactions costs
  - Its structure, products, services, & pricing reflect past technology available to overcome frictions
    - Digital world implies alternative possibilities
      - *Example*: why is payments system based around bank deposits?
    - Existing regulation/legislation may not accommodate and may inhibit new alternatives. *Examples*
      - Requirements for paper documents, use of cheques
      - P2P operators - MIS or market operators?
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## Evolutionary Finance: An illustration

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- X develops a web-site
  - Enables individuals to connect and enter and manage a loan contract, *then*
  - Provides anonymity and loan servicing, *then*
  - Provides pooling benefits (selects suitable loans for lender based on preferred characteristics), *then*
  - Provides some form of guarantee to lenders, *then*
  - Provides ability to lenders to sell loans to others (runs a market) in order to get cash prior to loan maturity, *then*
  - Provides lender access to cash by repurchasing loans for resale in "internal market", *then*
  - Issues a debit card to lenders which can be used at merchants etc.
- How/when should regulators respond? How to ensure a level playing field between new and old?

## Regulation and Competition

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- Regulator mandates and competition
  - Allocation of regulatory responsibilities
- Bank safety
  - Prudential regulation – risk weights
  - Implicit guarantees (TBTF)
- Investor protection
  - Product suitability
  - Product availability – ASIC banning power
  - Financial Advice

## Information and "Culture"

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- Competition can involve predatory behaviour
  - Where information imbalances favour producer, and products designed to exploit consumer to benefit of producer (& “credence goods”)
  - Where financial firm culture promotes "self-interest" at expense of "fairness"
    - Even where fairness/reciprocity is part of individual values, institutional arrangements can drive it out
- Arguably, rife in the financial sector as a range of international examples demonstrate

## Informed Choice and Competition

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- Is socially valuable competition feasible in financial markets where asymmetric information and opaqueness prevail, and where contracts are about future outcomes?
- *Supply side*: yes, incentives for reduced costs, adoption of new technology etc, but
  - Can consumers assess quality/risk characteristics?  
Effectiveness of disclosure?
- *Demand side*: Impossibility of informed choice?
  - Past returns are no guide to future returns
- *Agents and Intermediaries*
  - How to assess quality, alignment of interests?

## Financial Sector Structure

- Tax distortions to competition
- Vertical Integration - growth of “long intermediation” and supply chains
- Horizontal Integration – bank expansion into adjacent financial activities
  - Banking, insurance, funds management, wealth management
- Network features – eg payments policy

## Conclusion

- Recognition of benefits of competition and market forces fundamental to Inquiry approach
- But recognition of special features of finance and consequences for outcomes
- Technology a major determinant of the shape of the financial sector and competitive structure
  - Watch this space

