Competition and the Murray Inquiry

1. Overview: - what was "philosophy" of Inquiry re financial sector competition, what were key issues; what were recommendations; what effect is likely
2. Identified 12 recommendations with particular implications for competition
3. Philosophy: importance of competition for efficiency, fairness, but concerns re consequences for financial stability and for efficiency/fairness given asymmetric information, behavioural decision-making, culture/incentives and possible "race to bottom". Wayne Byres, APRA Chair commented, regarding loan standards, "We were a bit surprised by how much the competitive pressures in the industry and the competitive dynamic in the industry had led people to do things, albeit at the margins but nonetheless do things that were really in our view lacking common sense".
4. Also significant emphasis on consequences of digital revolution and implications of technological change for financial sector competition via "disruptive" business models involving new processes, products, risks.
    a. And recognition that financial sector structure and legislation / regulation reflects historical process shaped by available technology in overcoming financial frictions
    b. Examples: deposits and payments system (Ladbrokes debit card on CMT linked to betting account); paper documents / cheques, regulation of P2P (are they a MIS or a market operator or form of securitiser, or…?)
5. Illustration of need for adaptive regulation (graduated, functional) via evolutionary finance example
6. What areas of regulation needed consideration re competitive effects
    a. Allocation of regulatory responsibilities re competition (ACCC role), mandates of regulators
    b. Competitive distortions: mortgage risk weight differentials; implicit guarantees (reduce value towards zero via "unquestionably strong" requirement
    c. Product design and sales – financial consumer protection: undesirable competitive effects from product design/sales / advice and self-interest leading to "follow the leader" to protect market share/profits – even if unfair behaviour

            i. Examples internationally such as: NINJA (subprime) loans; payments protection insurance; endowment mortgages; "mini-bonds" (CDOs) – Hong Kong; foreign currency loans (Euro area)
            ii. Domestic: financial advice; unsuitable products etc
            iii. Proposals – regulatory requirements "targeting" offenders, ideally no impact on reputable operators concerned about reputation (and with good governance / culture?)
                1. Product manufacturer/distributor requirements re product suitability considerations
                2. Temporary banning power for ASIC

7. Unfortunately, not evident that financial sector culture gives adequate recognition to fairness. Problem of "credence goods" (and financial literacy etc).
8. If information/ behavioural problems are so severe, can we assume that appropriate competition will occur to drive efficient outcomes
    a. Supply side – yes (if not cosy cartels) although innovations / new technology can create (systemic and micro) risks
    b. Demand side – questionable: super (past returns no guide to future returns); ex ante and ex post financial product/service assessment with asymmetric information, credence goods
        i. Proposal for consideration of new default members – such as some form of regular competitive process (auction/tender) for allocation of new non-engaged entrants into the super system.
    c. Also particularly relevant re Intermediaries /Advisers – FOFA, life insurance commissions (and churning)
9. Structure, Conduct, Performance
    a. Have referred to some aspects of conduct, view was that ACCC general powers also appropriate for financial sector (and ASIC continued responsibility for financial consumer protection – with better resources etc).
    b. Financial Sector Structure –no substantive recommendations
        i. Tax distortions – outside mandate (but very relevant)
        ii. Vertical integration – not seen as a problem if wrong incentive structures avoided, standard anti-competitive behaviour restraints apply, information is publicly available regarding ownership

    iii. Horizontal integration – similar approach, provided benefits from perceptions of implicit guarantees removed (but is financial literacy and, for example, awareness of boundaries of FCS adequate).
    iv. Network features – payments regulation via RBA / PSB. The New Payments Platform will have significant effects, with potential for marked changes in fees and possibly new participants

10. Conclusion
    a. Competition a fundamental requirement
    b. But recognition of caveats
    c. Financial sector structure ripe for change
        i. Effect of new technology – incumbents or "newbies"