Submission to Productivity Commission's Inquiry into Competition in the Australian Financial System

I would like to add a few observations on the topic of this inquiry. Some of these are obvious but sometimes we lose sight of them as we dig into the complexity of the financial system.

- competition is not, in itself, the ultimate objective
- we pursue competition because it should result in the best value products and services for users and consumers
- however, if any market suffers from imperfections, simply removing barriers to entry will not result in the optimum outcome unless the imperfections are addressed
- the financial sector suffers from asymmetry of knowledge, conflicts of interest, oligopoly, agent-principal issues and, it would seem from the ongoing Royal Commission into the financial sector, regulatory capture
- unnecessary regulations should be removed but not those which are crucial to addressing significant market imperfections
- crucially, the financial market suffers from asymmetry in knowledge – the middle-people (the financial sector) know so much more than either the ultimate lenders or borrowers. This gives it much scope to accrue any possible surpluses to itself, at the expense of the ultimate lenders and borrowers
- conflicts of interest and agent-client problems are also rife within the industry, with advisers trying to get clients to take actions clearly not in the clients' interest but in the interest of the adviser. An example is the advice given to Fair Work commissioner Donna McKenna which would have resulted in her losing about $500,000 in super if she had followed it (also revealed by the Royal Commission into Financial Services)
- typically, where the risk is sufficiently great, societies have developed ways to address asymmetry in knowledge and conflicts of interest. For example, with the health market, most countries do not let just anyone operate as a doctor, recognising that most patients will not be able to differentiate between good advice and quackery. Instead doctors are required both to undergo extensive training which is fully accredited and to continue to be subject to complaint and review – though not always successfully. Currently, financial advisers are not subject to anything like these requirements nor to any others that would address these imperfections
- while most of us would agree that risk to life and death is more important than challenges to our material wellbeing, the latter can still have devasting effects, reducing our options for housing, education, holidays, entertainment, care in our old-age and even our options to address health issues
- financial advising should be made into a profession with agreed minimum qualifications and effective oversight, complaint and review mechanisms. The problem is that currently the industry, its association (the Financial Planning Association) and some of its regulators, would not be sufficiently trusted by the community to establish the entry and review requirements. An issue, then, is who should draw up these requirements and establish a system of accreditation? Perhaps a new regulatory body run by people who have not been associated with the current poor performance?
- just as doctors cannot directly sell medical products to their patients, so financial advisers and financial institutions should not be permitted to sell their own or their employers' financial products to their customers. Structural change will be required to achieve this

- the regulations that currently exist, and those that may be added, should be properly enforced – laws that are not enforced are almost invariably ineffective
- regulatory capture needs to be addressed, so that we will no longer see headings such as "APRA and ASIC have the legal power to sack bank heads, but they need willpower" in *The Conversation*, May 1, 2018
- if we can fix the market imperfections, then it is likely that competition will result in better outcomes for lenders and borrowers
- otherwise we are left with agents competing amongst themselves to more effectively deceive their customers in getting the best deal for themselves rather than for their clients.

Sincerely,

Sue Holmes
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