Mr Tas Luttrell
Secretary
House of Representatives Standing Committee on
Economics, Finance and Public Administration
Parliament House
CANBERRA ACT 2600

Dear Mr Luttrell

INQUIRY INTO THE INTERNATIONAL FINANCIAL MARKET EFFECTS ON GOVERNMENT POLICY

Thank you for the opportunity to provide a submission in regard to the above inquiry. ASFA agrees that the globalisation of international financial markets has raised important issues for the conduct of macroeconomic policy and the operation of financial markets both in Australia and elsewhere.

The Association of Superannuation Funds of Australia (ASFA) is a non-profit, non-party political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. As such it is the “Voice of Super”.

ASFA’s 582 constituent members have been estimated to be responsible for around $300 billion of assets, about 80 per cent of the total superannuation funds under management of around $377 billion as at December 1998. ASFA member funds in aggregate also represent around 6.5 million Australians with superannuation. This amounts to the bulk of the working age population and around 80 per cent of Australians with superannuation.

One of the most effective methods for minimising the impact of any volatility in international financial markets on finance markets and the level of economic activity and employment in Australia is to have an adequate level of national savings in Australia. It is economies with undue reliance on foreign borrowings, particularly short term borrowings, that are the most susceptible to volatility in capital flows and capital markets.

The Australian Government is to be commended for the significant improvement in the level of public savings that has been achieved. However, household and private savings remain low in absolute terms and by historical standards. This has led to national savings being at a level that is less than is desirable, and a current account deficit which is forecast to exceed 5 per cent of GDP for some time to come.

This continuing reliance on overseas borrowings by Australian private sector businesses means that Australia remains exposed to potential volatility flowing from developments in international capital markets. One way of reducing this potential problem is by lifting national savings and reducing reliance on overseas borrowings. Another is to conduct sound domestic economic management, thereby reducing any objective grounds for foreign investors to switch or divert capital from Australia in either the long or short-term.

In addition to being potentially affected by volatility in capital inflows to Australia, Australian businesses and financial institutions also have substantial investments overseas. For instance, around 16 per cent of the $377 billion in superannuation assets are invested overseas. Volatility in the value of such investments by superannuation funds and financial institutions more generally could have implications for the domestic economy. This is particularly so if the financial performance and capacity of a major financial institution such as a bank is impaired by an investment in a highly leveraged institutions or financial products, or by an investment in a country which is significantly affected by international financial developments.

ASFA considers that the best protection against such adverse impacts is a combination of prudential regulation and disclosure. For instance, superannuation fund trustees are subject to both common law and statutory “prudential investor” duties which require the preparation of investment strategies which take into account both risk and potential returns, and discourage excessive exposure to one investment or one investment class. There also are prohibitions on funds borrowing so as to leverage an investment.

More generally, there is a strong case for any financial entity regulated by the Australian Prudential Regulatory Authority (APRA) to have limits on their exposure to highly leveraged institutions or financial products. Financial institutions such as banks, insurance companies and superannuation funds are subject to APRA surveillance and prudential regulation largely because of the potential for systemic problems to flow from the failure of one or more such financial institutions.

The operation of financial markets can also be assisted by effective disclosure by financial institutions so that depositors, creditors and shareholders can be aware of the extent of the financial risk of failure in a financial institution they are dealing with. Effective disclosure can also assist in the orderly working through of any problems that might develop for a financial institution due to its exposure to a specific investment or range of investments. Where a financial institution operates in more than one jurisdiction there is a strong case for information sharing between relevant national regulators and more general public disclosure where appropriate.

ASFA also notes that reforms to international and national accounting standards are currently in train. Such reforms, together with improvements in standards for reporting investment returns, have the potential to provide markets with improved information. Increasing attention is also being given internationally and nationally to how to improve corporate governance. Improvements in this area have the potential to enhance the ability of corporations to monitor and respond to changes in the risk profile of their investments.

ASFA supports measures which enhance the operation of financial and other markets. ASFA would not in general support measures that were designed to more generally limit investment in specific types of investments, including leveraged institutions. Any such restrictions would be unlikely to be workable, and the costs of limiting investment opportunities need to be weighed against potential benefits in terms of less risk.

We hope that these brief comments are of assistance to the Committee.

Yours sincerely

Philippa Smith
Chief Executive Officer