

## **Business Spectator Monday 01 June 2015**

### **ASIC chief fans a shift to force a proper look at real cost of super**

If the Greg Medcraft proposals for banking, stock exchanges and superannuation are adopted then it will change the face of all three sectors. It's the first time the chief of our securities regulator, the Australian Securities & Investments Commission, has issued such a wide-ranging manifesto.

And what makes the ASIC chairman's plan, revealed at the ADC Leadership retreat at Hayman, so powerful is that it is exactly what the federal government wants to achieve - better returns on interest-bearing deposits, much greater loan and equity funding for small enterprises (which are required if we are to avoid a massive rise in unemployment) and a reduction in government pension costs. But not all in the banking, stock exchange and superannuation industries will necessarily welcome the plan.

Medcraft confirms what few others admit to, that banking in Australia is becoming too costly for many areas of its operations. Most of the banks have plans to slash their costs over five to 10 years. In today's world of disruptive technologies they may not have that time. The chiefs of prosperous family businesses in Hayman say they are planning to go to Chinese banks if funding is restricted or too costly in Australia.

There is nothing new in the Medcraft plan, transferring bank loans to a securitisation fund financed by superannuation funds, including self-managed funds. But Medcraft wants it to take place on a major scale and be a key part of increased small and medium business funding. Of course investing in such a fund will carry a greater risk than bank deposits, but it also carries greater reward.

The key is that the bank would manage the loans and take part of the risk. But it would not be burdened with current costs, including capital costs, for the funding.

(Of course, on the negative side, it was badly managed funds in the US housing sector that helped trigger the global financial crisis) On Medcraft's second board/ equity proposal, when asked about a small miner raising money, he explained that the regulations being administered by ASIC made money raising very hard. Much simpler rules were required for small enterprise listing on a second board ... And that is what Medcraft is advocating.

And to underline the attraction of investing in smaller enterprises, an investment manager of a large family-linked fund said he found prices of listed securities too high so he was investing in family or other private businesses. There is greater risk but, as we have seen overseas, big gains are being made in new or developing businesses.

Small businesses are the employment engine rooms for the nation and the government has discovered that if small enterprises become more confident it not only transforms political support but also economic activity. In fairness to the banking sector, Westpac, and probably other banks too, supported the government's small enterprise incentives with increased unsecured lending.

When it comes to superannuation there are only two majors providing lifetime indexed annuities: Commonwealth Bank and Challenger. The CBA's product is seen as expensive. What is needed, among others, is for major providers to set up annuities backed by investments in property. The government could issue some form of guarantee for the first \$500,000 investment because these annuities slash pension costs. We might offer considerable incentives for people to take up these annuities.

Most of the Treasury's costing of super conveniently forgets the reduction to government pensions. The Medcraft plan would force a proper examination of the real cost of superannuation.

The ADC Leadership retreat is conducted under the Chatham House rule. Medcraft went outside that rule to be quoted. My guess is he picked up an important wind shift in Canberra or at least wants to create one.

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### **Medcraft calls for lending overhaul**

The chairman of the Australian Securities & Investments Commission, Greg Medcraft, has called on Australian banks to alter their lending and deposit practices to provide greater returns for depositors and lower the cost of borrowing for small enterprises.

He also backed the creation of a "second board", a junior stock exchange set up to enable smaller enterprises to gain access to equity capital. Such an exchange would require much lighter regulation.

Mr Medcraft believed that changes to capital and liquidity rules would mean banks would be less able to provide funding for small enterprises in the future and that capital markets would have to play a much larger role.

Mr Medcraft cited the role that Chinese e-commerce giant Alibaba played in providing working capital finance for small businesses in that country that could be adopted in Australia.

"A great example is what we see with Alibaba," he said. "They lend to nearly a million small businesses because they see the flows that occur through purchasing and selling. How do they fund it? Well, they don't fund it through the banking sector, they fund it through securitisation."

Alibaba's strength is (their) algorithms so they are good at managing the credit risk and with securitisation they retain the first loss, so they actually have skin in the game, which makes it more comfortable for investors." Mr Medcraft said there was an opportunity for Australian banks to alter their business models by securitising loans to smaller enterprises and selling them on to super funds and particularly self-managed super funds. "There's no reason why the banks (can't do that)," Mr Medcraft said.

"They are great at credit and risk management.

The borrower will get a lower rate and because (the banks) are getting a fee, (they) won't be using as much capital and so can provide a better return to shareholders." Mr Medcraft said banks were already considering such models but were likely holding back for fear of cannibalising their existing business.

However, given the speed with which companies like Alibaba were introducing such services, it may be something that banks might have to implement sooner rather than later.

"I think they need to rethink where they're going to be in a digital environment," he said.

Speaking on the sidelines of the ADC Leadership Retreat on Hayman Island, Mr Medcraft also suggested that a way for Australia to unlock the entrepreneurial potential of small firms would be for the creation of a second-tier stock exchange for small businesses.

He said that following a review of small business funding globally, he found that the majority of developed markets had such a mechanism.

"Of the 27 jurisdictions we looked at, 19 of them have second boards looking at financing for SMEs (small and medium enterprises). Canada's second board is nearly as big as the first board," he added.

Mr Medcraft said China was particularly progressive in this area, with four separate boards for each stage of business capital needs, with the exchange for early stage seed, only open to sophisticated investors. As a firm became more financially stable they graduated up to larger, more open bourses.

"It allows private equity to rotate their capital much faster because the start-ups can move to the first level much quicker.

You end up with a much more dynamic economy," Mr Medcraft said.

