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The Chair
Financial Systems Inquiry
GPO Box 89
Sydney NSW 2001

Dear Sir,

In December of last year, my RMIT colleague and I published a paper “Informing Depositors: A Proposed Reform of the Australian Banking Sector” (Economic Papers, Vol. 32 (4), pp. 417–425) that proposes a consumer centred approach to financial regulation. A copy of that paper is attached to this submission. The abstract of the paper reads as follows:

Financial regulation has the perverse effect of reducing incentives for depositors to monitor the risks banks take. We propose a rating scheme – the Financial Stability Rating – that would work similarly to other product ratings to inform depositors of the risks they face. Our proposal entails greater disclosure of information that is already in the hands of the prudential regulator. There would be no additional regulatory burden on either financial institutions or the regulator. By linking our rating to a formal deposit insurance scheme, depositors would have both the incentive and ability to make informed decisions about the risk return profile of their deposits.

In the paper we rethink the way in which APRA employs the information it already gathers in the course of its supervisory activities. We believe that our proposal will foster competition, promote innovation, and result in banks offering products that will better reflect the preferences of depositors.

A further benefit of our proposal is that it will allow banks to match those depositors with a preference for high-risk/high-return investments, with borrowers who currently have limited access to credit. In this way, we expect that our proposal would promote the establishment and expansion of small business, in particular, with the consequent advantages to employment and economic growth.

I would be happy to discuss the proposal further, should you wish to do so.

Regards,

Martin Byford
Lecturer of Economics
RMIT University