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Address to the Bloomberg Australia Economic Summit

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A strong, fair and sustainable financial system

*****Check against delivery*****

Thanks, it's great to be here. I thought I'd take the opportunity today to do something a bit different and unpack what I think is an untold story of our economic success. Five years on from the darkest days of the global financial crisis, it's not surprising we've talked less about the strength of our financial system. But with the transition now underway in our economy from mining to non-mining growth, we need to have a mature discussion about what's happening in really important industries like the financial sector. Our financial system employs hundreds of thousands of Australians. And as some of the world's biggest economies have learned; if you don't have a strong financial system, you don't have a resilient economy. What the global financial crisis really brought home is just how fragile confidence can be when it comes to the financial system. That's why everyone in our economic debate has a responsibility to acknowledge that our financial system is one of the world's strongest. So it was pretty disappointing last week to hear the really dangerous suggestion that our financial system is even in the same stratosphere as the basket-cases that are dragging down countries in Southern Europe. Australia's $1.5 trillion superannuation system is one of our unique national strengths which sets us apart from the rest of the world. Together with our $3 trillion banking system, it helped get capital to where it was needed most during the GFC to support the economy.

Even more importantly, our super system gives millions of Australians the peace of mind that they'll have the savings for their retirement. Our reforms will boost this country's national super savings by $500 billion to 2037, including increasing contributions from 9 to 12 per cent. This will see Australia's pool of superannuation savings grow to around $6 trillion by that time, making it 1.2 times the size of our 2037 economy. But we always have to be ahead of the game in keeping it strong, fair and sustainable and that's what this government has done from day one.

I want to talk a bit about this today, and I'll do so in three parts. First, I want to give you a bit of the backstory on how we got ahead of the curve on strengthening our financial sector before the GFC hit. Then I want to take you through some of the reasoning behind the steps we've taken in the five years since. And finally, I want to talk about the way forward. Let me start by taking you back to a date that's seared in our collective memories. 15 September 2008. The day Lehman Brothers imploded. It was a day which redefined the way we think about financial safety. It felt like the global financial system was ripping apart at the seams. Credit markets froze. Investors ran for cover. Everyone wanted their money back. And they wanted it back yesterday. In many ways, the global financial crisis is still with us five years later. Rolling crisis to rolling crisis, with most of that playing out in Europe now. We know from the work of highly-regarded researchers like Reinhart and Rogoff that economic recoveries after a financial crisis are much more painful and protracted than other recoveries. And with a financial crisis the likes of which had not been seen for 80 years, the ramifications have been far greater and more protracted than anyone could have predicted 5 years ago. We still see dislocation in banking sectors, economies that have not made up lost ground and unemployment queues that continue to grow. Of course, despite our economic resilience we haven't been immune from the full force of the GFC or the wreckage of its aftermath. We've seen the global economy take a sledgehammer to our budget revenues, wiping off more than $160 billion since the GFC started. And as I've said a number of times, the high dollar and difficult global conditions are contributing to subdued price pressures across the board, which have hit profitability. As a result, we're seeing further hits to revenues and it's clear this will be felt right across the forwards. But we've still come out of the biggest global recession in 80 years with one of the most resilient economies in the developed world. Our economy is over 13 per cent bigger than it was five years ago. We've created over 900,000 jobs. Unemployment starts with a ‘5'. We've got contained inflation and low interest rates at the same time as we're coming through the biggest mining investment boom in our history. In fact, we've seen over $1 trillion of business investment in Australia since this Government came to office in November 2007.

A big part of our success came from being ahead of the game with the right policy settings in our financial system before Lehman's hit. Since the early 1980's when Paul Keating and Bob Hawke had the courage to open our financial sector up to the world, we have been working to strengthen it against the challenges this inevitably brings. Now here I want to pay credit where credit's due; my predecessor Peter Costello took some important steps through the Wallis Inquiry. We also learned a lot from the collapse of HIH in 2001, something our regulators were determined would never be allowed to happen again. One of those regulators was Dr John Laker, who in 2003 began his decade at the helm of APRA in the wake of the HIH calamity. In 2006, he was joined in the regulatory vanguard by Glenn Stevens as Governor of the RBA, where Laker himself used to work. That year, the IMF sent a team here to undertake its first Financial System Stability Assessment which gave us very high marks. By contrast, the United States didn't complete its first IMF assessment until 2010, two years after the Lehman's crisis. Last week I acknowledged the huge contribution both Glenn Stevens and John Laker have made to our world-beating economic performance through their no-nonsense supervision of our financial system. I was very pleased to reappoint Glenn for another three years, with John agreeing to stay on for another 12 months until Wayne Byres gets back from doing us proud at the Basel Committee on Banking Supervision. Wayne Byres may be less well known to some of you, but let me tell you that along with Glenn and John he was a calm voice and a wise head that helped prepare us for the worst and steer us through when it came. It's not until you're actually in the trenches with someone that you see what they're really made of. And it's no exaggeration to say that Glenn, John and Wayne are three of the most highly regarded regulators in the world. But it's what they did before the crisis that really separated Australia from other countries. Yes, our commercial bankers had learned the harsh lessons of the early 90s collapses of the state banks of South Australia and Victoria, as well as the insolvency of Pyramid Building Society. But it was our regulators who vigilantly enforced a culture of sound risk management, prudent lending, and safer liquidity and capital management at our financial institutions. What's not widely known is that some of our lenders increasingly wanted to dabble in the types of risky sub-prime lending we saw in the US. Fortunately our regulators took a very different approach to their counterparts in the US, making it clear to Australian lenders that higher risk lending would mean higher capital requirements. In doing so, they ensured that this type of risky behaviour didn't become a feature of our financial system.

But we couldn't rely solely on our regulators' vigilance. Even before Lehman's hit, we'd been taking steps behind the scenes to get our financial system ahead of the game. At the core of this were the plans we'd been making to put in place a Financial Claims Scheme – to protect ordinary household deposits. In fact, this was something that should have been done much earlier. But the previous government had - for reasons I still don't understand - ignored six separate warnings from our financial regulators, the IMF and independent experts to introduce a Financial Claims Scheme. Well, I can tell you we didn't waste any time when we came to office. I was a bit over two months into the job – in early February 2008 - when I sat down with the Council of Financial Regulators in Sydney to discuss the need to bring in new crisis management arrangements. Just four months later, I announced we would introduce a Financial Claims Scheme to give Australian depositors quick access to their money in the event of a collapse of a financial institution. We knew we had to act – the US sub-prime crisis had already morphed into a global credit crunch and the UK had literally seen a bank run on Northern Rock. Let me tell you this, if we hadn't moved early through the first half of 2008 to get the legislation ready, it is not clear we would have been able to move so swiftly to secure deposits as trouble hit. But as the impacts of Lehman's were reverberating around the globe, we had the legislation ready to go and accelerated the introduction of a Financial Claims Scheme. As Governor Stevens put it at the time, Australians were already "ringing money programs on TV" and asking "'is my money okay in the banks?". Now of course we all know the rational answer was yes, but rational behaviour often goes out the window in the grips of a financial crisis. We also took some other very important measures before Lehman's collapsed, like giving APRA vital new crisis management powers and taking steps to maintain the liquidity of the CGS market. But right from the start, I knew one of the biggest challenges in the banking sector from the global financial crisis was going to be competition. Despite the prudence of our regulators, we were not immune from the dislocation in securitisation markets globally - our RMBS market was an innocent casualty of 'brand damage' from US sub-prime. Since the deregulation of our financial system in the 1980s and 1990s, securitisation was one of the key drivers of competition in the mortgage market by providing a low-cost funding channel for smaller lenders. That's why just 11 days after the collapse of Lehman Brothers, I announced our initial $4 billion investment in AAA-rated RMBS market to preserve the market's infrastructure and boost liquidity. But preserving competition wasn't just about supporting smaller lenders; it was about maintaining the competitive pressures on the big four.

What isn't widely known is that there was growing pressure in the winter of 2008 to see an end to the four pillars policy. That's why in June 2008 I publicly reaffirmed it, at the same time as I announced the new Financial Claims Scheme. The four pillars policy has endured, in one form or another, through seven successive Treasurerships over more than two decades and has served Australia well in all that time. Not only is it hugely important for banking competition, but it wouldn't be prudent to have the soundness of our banking system resting on the strength and risk management skills of three banks rather than four. I think everything we've learned since 2008 about systemically important financial institutions shows this decision was the right one. And the world-class performance of our financial system over the last five years really demonstrates the success of our policies. The Financial Claims Scheme ensured Australians had confidence their money was safe no matter wherever it was held - preventing bank runs. The wholesale banking guarantee secured the flow of credit to our economy by allowing our banks to borrow in global capital markets on competitive terms, allowing them to raise more than $160 billion. That allowed them to fund the equivalent of more than half a million additional home loans while world financial markets were dislocated. And the banks have paid for access to our AAA-rated balance sheet – they've so far paid over $4 billion in fees to Australian taxpayers. As taxpayers the world over have been forced to bail out their banks, here in Australia we haven't had to inject a cent of new capital. Not one Australian financial institution collapsed during the GFC, and not one dollar of principal was lost on an investment in Australian RMBS.

We didn't just maintain stability, we also preserved the competitive foundations of our banking sector. Our bank guarantees supported deposit funding for smaller lenders and allowed non-major banks to raise something like $65 billion in wholesale funding while global funding markets were seized up. And that's before you even consider the success of our RMBS program. As many of you would know, the RMBS market is now functioning well and has actually had its best first quarter of issuance since 2007. Primary and secondary market pricing have converged, and investors have a renewed sense of confidence and appetite for the asset class. The AOFM has been continually scaled out of transactions and hasn't had to put any money into an RMBS deal in the last six months. In late 2008, private investors were only buying 24 per cent of RMBS deals in the market. Now they are buying the whole lot. Smaller lenders have been comfortably issuing RMBS at economic cost without AOFM support, despite its willingness to invest. They've raised $3.9 billion this year on their own. Wholesale lenders raised around $1.7 billion in the first quarter of this year – more than two thirds their total issuance over the whole of 2012. In total, around $8.5 billion has been issued so far this year without AOFM support - which is more than half of total issuance last year.All up the Government has invested $15.5 billion in Australian RMBS since we started the program in 2008. We've supported 67 securitisation deals, helping 20 smaller lenders raise a total of $45 billion dollars. That's the equivalent of funding an additional 245,000 home loans. Treasury also estimates we've supported around $3.2 billion in small business lending since 2010, when I made this an additional objective. Of course, we all know that RMBS pricing is unlikely to ever return pre-GFC levels because there's been a structural shift in investor appetite. But pricing is now significantly better than for most of the last five years. Given the big improvement we've seen in the RMBS market, and the ongoing lack of demand for AOFM support, the Treasury has advised me that it's now time to stop making new investments. While I've accepted this recommendation, that obviously doesn't mean we'll be selling down our existing stock of RMBS any time soon. The AOFM will continue to manage our holdings as usual, including assisting price discovery from time to time as required. And of course we'll continue to monitor the market and we're ready to respond if market conditions were to take a dramatic turn for the worse. But I think that most people with a feel for the RMBS market would agree that this has been a hugely successful policy. We acted early to get ahead of the worst of the global financial crisis, and the dividend has been a much more competitive banking system.

And just as we kept our financial system ahead of the game before the crisis and through the worst of it, we've continued to do so since. Last week, we announced a package of reforms to make our super system fairer and more sustainable for the decades to come. In the banking sector, we've implemented a suite of competition reforms to empower consumers and support smaller lenders. Like the ban on mortgage exit fees which has helped unlock competition by making it easier to walk down the road and get a better deal. We've delivered reforms to help develop a deep and liquid corporate bond market, following our successful introduction of covered bonds. And we've introduced a new, permanent cap of $250,000 on the Financial Claims Scheme to reflect the strength of our banking system. Ours remains one of the most generous deposit insurance schemes in the world, protecting 99 per cent of Australian deposit accounts in full.

In November last year, the IMF again endorsed the strength of our financial system in our second Financial System Stability Assessment. Australia's financial system has come through one of the most turbulent periods in the global economy in 80 years with flying colours. But it's appropriate that after a global financial crisis, we find global solutions to the problems that caused it. That's why we're working through the G20, the Basel Committee and the FSB – with other like-minded nations like Canada and Korea - to get balanced outcomes on the new agenda for global financial reform. This has seen the most fundamental reform to the global financial system since the ending of the gold standard. And Australia has been at the heart of it, both in the development of appropriate global standards for our financial system and in the prudent application of these domestically. That is why our financial system remains the very best in the world. So you have to wonder at the motives of those calling for yet another financial system inquiry.

Do they think our system is not up to scratch? Unlikely.

Do they think it has not been through enough reform? Surely not.

Do they think the GFC was not a sufficient stress test? Impossible.

Or do they carry the baton of those who in 2008 urged me to weaken stability and competition by abolishing the four pillars policy? I wonder.

In the interests of the stability of our financial system, we must have a bipartisan consensus to end speculation that the four pillars policy will be scrapped. It's not good for the sector and it's not good for the country. This will ensure that we can focus on building a competitive and stable financial system that supports our modern economy and every Australian. A modern financial system that makes the most of our financial links to the region in the Asian Century. In fact, the Prime Minister and I have just agreed with the People's Bank of China to begin direct trading between the RMB and the Aussie dollar. This makes the Australian dollar only the third major global currency to achieve this exclusive status, after the Yen and US dollar. As we said in our *Asian Century White Paper*, we're focussed on reforms that will help us expand and integrate into our regional markets. We want a financial system that creates Australian jobs in Asia while continuing to employ hundreds of thousands here in Australia. A system that attracts new business in the region with the right policy settings, not simply through the lure of unsustainable tax concessions which brought countries like Ireland and Iceland unstuck. A system built on stability. Built on confidence. Built on competition. A financial system that serves our economy in the decades ahead. Thanks for having me here today. I look forward to your questions.