

# Recent Trends in the Structure of the Financial System

This article describes some recent developments in financial flows and associated changes in the institutional structure of the Australian financial system, including the emergence of conglomerates. These (and other) developments are likely to be scrutinised carefully during the course of the Government's forthcoming inquiry into the financial system.

## Shares of Financial System Assets

Financial institutions in Australia fall broadly into two categories: *intermediaries*, comprising banks, building societies, finance companies and others which borrow and lend money (many also provide payment services), and *insurers and funds managers*, which pool risks and/or invest funds on behalf of others.

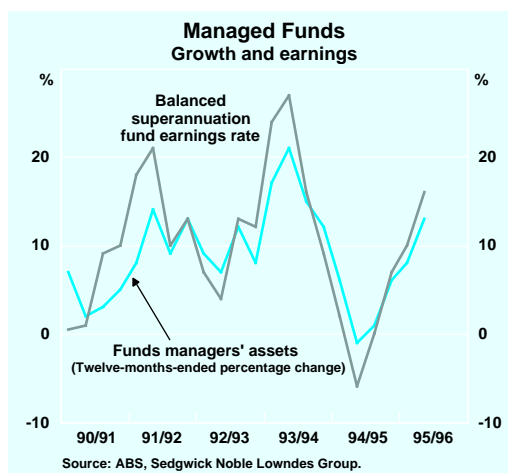
The share of financial system assets controlled by intermediaries has fallen over the past 15 years or so, while the share of funds managers and insurers has risen (Table 1). Within the intermediaries group, banks have improved their position following deregulation, with non-bank financial intermediaries contracting through conversion or absorption into banks or exit from the system.

**Table 1: Financial System Assets**  
(Per cent of system)

	At June 1980 %	At June 1995 %
Banks	42	47
Non-bank financial intermediaries	32	15
<b>Total intermediaries</b>	<b>74</b>	<b>61</b>
<b>Funds managers and insurers</b>	<b>26</b>	<b>39</b>

Source: Reserve Bank of Australia (RBA), Australian Bureau of Statistics (ABS), Insurance and Superannuation Commission (ISC).

**Graph 1**



The strong growth of funds managers since 1980 reflects, in part, Government initiatives in relation to retirement income, taxation concessions on some products, and rising asset prices over much of this period. Assets held by fund managers are influenced heavily by fund earnings, which reflect both income flows and changes in the market values of the relevant assets – mainly equities, fixed interest securities and property (Graph 1).

## Saving Flows

While much of the fluctuation in asset holdings by fund managers can be explained by price movements, the long-term growth in their share of financial system assets also reflects changes in the pattern of household saving. Around half of households' net new investments in financial assets are now with life offices and superannuation funds, compared with around 20 per cent in the 1970s; the share of these flows accruing to banks and other intermediaries has fallen significantly since that time (Table 2).

**Table 2: Households<sup>(a)</sup> – Net Acquisition of Financial Assets**  
(Proportion of flows by type of investment)

	Bank deposits	Life office, superannuation contributions	Other <sup>(b)</sup>
	%	%	%
1970s	42	20	38
1980s	36	39	25
1990s	28	50	22

(a) Includes unincorporated enterprises.

(b) 'Other' includes building society and credit union deposits, government securities, debentures, shares, unit trusts, etc.

Source: RBA and ABS.

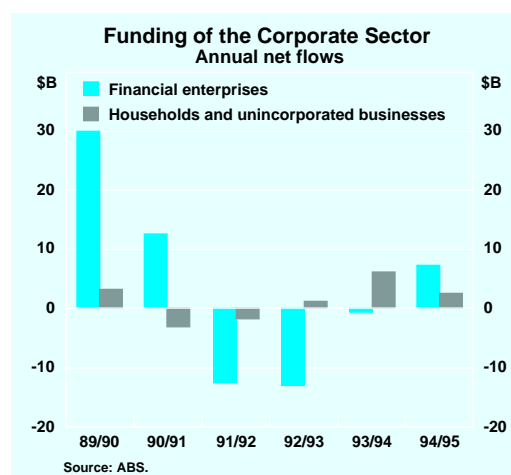
## Provision of Finance

Notwithstanding the changes in savings patterns in recent years, intermediaries remain the main providers of finance in Australia.

### Corporate funding

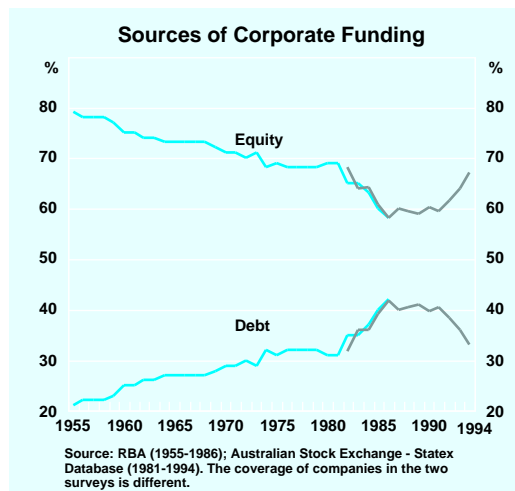
Corporations are customarily large net borrowers from domestic financial enterprises, although in the three years prior to 1994/95 they reduced their outstanding debt by repaying existing loans and borrowing less. In 1994/95, they resumed borrowing (in net terms) from financial enterprises; they also continued to raise funds directly from households, primarily through equity raisings (Graph 2).

**Graph 2**



Forty years ago, the average funding mix for the corporate sector was 20 per cent debt and 80 per cent equity. As shown in Graph 3, this conservative gearing ratio changed gradually so that, by 1980, debt had edged up to 30 per cent. In the five years to 1985 it had jumped to 40 per cent, where it remained through the second half of the 1980s. The fall in the proportion of debt funding in the 1990s represents a correction from those high levels.

Graph 3



Intermediaries in Australia provide the bulk of corporate debt, with their share having increased a little over the 1990s (Table 3). There is no evidence during this period of a trend towards more reliance by Australian corporations on direct access to domestic or overseas capital markets for debt. Amounts raised from these and other sources are, of course, significant and have probably increased over the longer term.

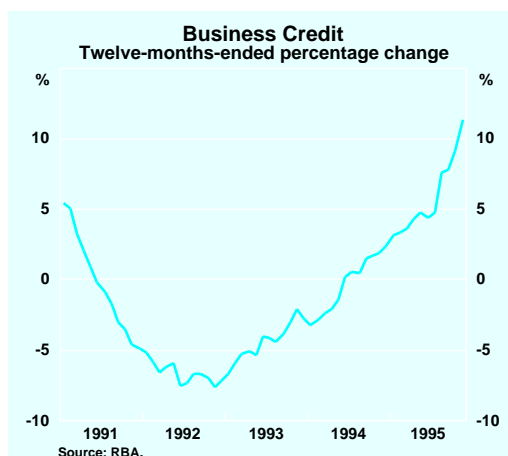
**Table 3: Sources of Corporate Borrowings**  
(Percentage share)

	At June 1990 %	At June 1995 %
Banks	26	34
Non-bank financial intermediaries	26	20
<b>Total intermediaries</b>	<b>52</b>	<b>54</b>
<b>Rest of world</b>	<b>24</b>	<b>24</b>
<b>Other</b>	<b>24</b>	<b>22</b>

Source: ABS.

The revival in commercial lending in the past couple of years is reflected in Graph 4. Business credit extended by all financial intermediaries rose by around 11 per cent in the year to December 1995, after declining

Graph 4



during the two years or so up to mid 1994. Within this total, credit from banks has shown a similar pattern.

Non-banks (including banks' finance company subsidiaries) also have performed more strongly in the business loan sector over recent times. A buoyant motor vehicle market has underpinned the performance of finance companies while the strong capital position of some foreign banks has encouraged their Australian merchant bank subsidiaries to compete keenly for new business.

### Lending to households

Intermediaries provide over 90 per cent of total funding to households, with the bulk of this lending related to housing. Building societies, credit unions and (until recently) the regional banks, have expanded their lending for owner-occupied housing much faster than the major banks over the past three years. Nonetheless, the major banks still accounted for over 60 per cent of owner-occupied home loan outstandings at the end of December 1995.

Mortgage originators have enjoyed notable success in the home lending market in recent times, benefiting from the distributional cost advantages they have over traditional mortgage lenders with their expensive branch networks. Part of the loans generated by mortgage originators end up on the books of banks and other intermediaries. New finance commitments for owner-occupied housing by

mortgage originators, where the loans are to be funded through securitisation vehicles, account for around 5 per cent of total commitments for owner-occupied housing. This is up from an estimated share of 1 to 2 per cent a few years ago.

While the loan products securitised initially were relatively simple (standardisation was necessary for pooling), more features have been added over time. As mortgage originators offer increasingly sophisticated products, competition in the marketplace can be expected to intensify further.

Life offices are also returning to the housing market. They are sometimes referred to as a 'new force' in home lending, but in the early 1960s they held around a quarter of the market, compared with 1 per cent today. In addition, life offices provide housing finance through trusts and subsidiaries, and are substantial holders of residential mortgage-backed securities. Some superannuation funds participate in the housing loan market through investment in trusts.

### Intermediaries' Sources of Funding

Although intermediaries remain the main providers of finance in Australia, their share of household saving has declined. Partly as a

**Table 4: Financial Intermediaries' Net Borrowings Overseas**

(As a proportion of intermediaries' borrowings from the private sector)

	At June 1985 %	At June 1995 %
Banks	1 <sup>(a)</sup>	11
Other	8	30
Total	4	16

(a) May exclude some overseas borrowings denominated in Australian dollars.

Source: RBA.

result, intermediaries have turned increasingly to offshore markets to fill the gap in their funding needs.

This outcome is not unexpected, given Australia's recourse to overseas saving to satisfy its national funding needs. Intermediaries, as institutions with high credit ratings, are better placed to access overseas markets than many companies and then on-lend these funds to customers.

Increased use of overseas funding by intermediaries is captured in Australia's foreign debt figures, with the share of non-official external debt owed by financial enterprises more than doubling in the past ten years (the share of banks within the total has risen from 16 to 43 per cent).

**Table 5: Non-Official Gross External Debt**  
(Percentage owed by)

	Banks	Other financial enterprises	All financial enterprises
1986	16	14	30
1990	29	23	52
1994	43	21	64

Source: ABS.

### Investment by Life Offices and Superannuation Funds

It is apparent from the foregoing that life offices and superannuation funds have not yet made significant inroads into providing either the corporate or household sector with debt financing. It is the case also that there has been little growth in the proportion of borrowing by intermediaries which is met from funds managers.

Life offices and superannuation funds have financed the domestic private sector mainly through increasing their investments in equities. They have also increased their offshore investment. Investment in

**Table 6: Life Offices and Superannuation Funds  
Net Acquisition of Assets**  
(Proportion of type of investment)

	Equities %	Government securities %	Loans, securities & deposits %	Property %	Other (including foreign) %
1970s	20	29	23	23	5 (-)
1980s	26	15	32	17	10 (2)
1990s	34	23	25	-1	19(17)

Source: ABS.

Government securities has remained substantial, while property financing has declined over recent years.

## Financial Conglomerates

Financial conglomerates are becoming an increasingly important feature of the Australian financial system. A conglomerate is essentially a number of financial institutions under common ownership or control and operating in more than one of the main financial sectors of banking, insurance, funds management and securities.

Over the past decade, technological and regulatory changes have encouraged many institutions to expand their activities beyond traditional areas of operation. Some life offices, for example, now have bank or building society subsidiaries. Banks have responded to competition from funds managers by establishing life office and other funds management subsidiaries which have been increasing their share of the funds management sector over the 1990s, mainly due to the growth of funds management operations owned by foreign banks. In contrast, non-bank-owned life offices' share of the managed funds industry has fallen as a consequence of a decline in traditional life insurance business (Table 7).

**Table 7: Assets of Funds Managers**

	At June 1990 %	At June 1995 %
Insurance groups	45	39 <sup>(a)</sup>
Banking groups	21	25
Other	34	36

(a) Includes State Bank of NSW and subsidiaries.

Source: ABS, ISC, Investment Funds Association of Australia (IFA).

**Table 8: Financial System Assets**

	At June 1980 %	At June 1995 %
Banking groups	53	56
Insurance groups	18	23 <sup>(a)</sup>
Other	29	21

(a) Includes State Bank of NSW and subsidiaries.

Source: RBA, ABS, ISC, IFA.

As a result of these trends, banking groups have strengthened their overall position, and now control slightly more of financial system assets than they did in the early 1980s (Table 8).

The 25 largest financial conglomerates operating in Australia account for around

70 per cent of total financial system assets. Of these 25 conglomerates:

- 11 are foreign owned (and account for 17 per cent of the assets of the 25 conglomerates), 2 are government owned (17 per cent) and, with one exception, the remainder are headed by a listed or mutual entity (64 per cent);
- all are headed either by a dominant operating entity, such as a bank (75 per cent of assets) or insurance company (12 per cent), or by a non-operating entity (13 per cent); and
- about half engage in non-financial activities, although in most cases non-financial assets do not form a significant part of the group's total assets. (Banks' involvement in non-financial activities is limited by Reserve Bank guidelines.)