31 January 2020

Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Via email: prebudgetsubs@treasury.gov.au

Dear Treasury

2020-21 Pre-Budget Submission

The Australian Financial Markets Association (**AFMA**) represents the interests of over 110 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets.

We are pleased to provide a submission to Treasury to assist in the formulation of the Government's 2020-21 Federal Budget.

1. Executive Summary

The proposals which form the basis of AFMA's 2020-21 Pre-Budget submission are:

- **Provide a coherent development strategy for the role of financial markets in the economy:** Australia's national interest is served by having strong competition in the financial system alongside a competitive tax and regulatory regime for internationally mobile financial services business. For a growing and more productive economy, the Government needs to make a policy commitment to the continued development of Australia's financial markets to ensure Australia remains an attractive place to conduct financial services business. This will require the formulation of a coherent strategy with clear objectives, timelines and a process that integrates policy measures covering tax, international trade, innovation and business investment, as well as implementing outstanding recommendations of both the Johnson Report and addressing issues observed in the Financial System Inquiry (**FSI**).

- **Intervene to ensure the continued debt characterisation of bail-in instruments:** Given the expanding range of instruments on which global prudential regulators impose non-viability conditions, the Government should clarify that adherence

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to prudential regulatory requirements does not alter the appropriate characterisation of such instruments from a taxation perspective.

- **Abolish the LIBOR Cap ahead of the end of LIBOR:** With the support of financial regulators, the industry in Australia and elsewhere is taking practical commercial steps to manage their exposure to the effect of the planned discontinuation of LIBOR by end-2021. Accordingly, the Australian Government should act this year to remove the legislative reliance on the "LIBOR Cap," which cannot be sustained and remains deeply flawed from a policy perspective.

- **Maintain the Competitiveness of the OBU Regime:** The OBU regime allows Australia to leverage its significant non-tax competitive advantages to attract international financial services business, including access to highly skilled and competent staff, a stable political system, strong economic performance and market access. To the extent that the Government is looking to announce reforms to the OBU Regime in the 2020-21 Federal Budget, it should ensure that any such reforms protect Australia's interest in remaining a viable location for internationally mobile financial business.

- **Prioritise the removal of interest withholding tax for financial institutions:** Implementation of the G20-led reforms to OTC derivatives regulation and the expansion of Australia's tax treaty network, enhance the case already made by the Johnson Report and the Henry Tax Review to remove interest withholding tax on non-resident funding by financial institutions. This would serve multiple objectives including competition in banking, less friction in cross-border capital flows and enhanced international competitiveness.

- **Government to respond to Board of Tax Permanent Establishment Paper:** In April 2013, the Board of Taxation delivered to Government its report of its Review of Tax Arrangements Applying to Permanent Establishments. This report contains key observations and recommendations in terms of ensuring that Australia's taxation arrangements are aligned with key trading partners and financial centres. The Government has not responded to this report in the six years since its release and should do so in the 2020-21 Federal Budget.

- **Exempt withholding tax on payments made to/from CCPs:** The Government should conclude its consideration of industry submissions on the withholding tax treatment of payments made to/from CCPs to ensure that Australia's financial markets do not continue to suffer an ongoing competitive disadvantage due to the tax system not properly reflecting the G-20 OTC derivative reforms that have been implemented.

- **Rationalise Regulator funding models:** The Government should centralise the administration and co-ordination of the various industry funding models adopted for different regulators (ASIC, AUSTRAC, APRA) to ensure consistency of approach, alignment of quantification models and to determine the collective funding burden on relevant entities. In addition, the cost of the Enforcement Special Account should be removed from ASIC's industry funding model, as it is

inequitable in the way that it operates and is inconsistent with the principles that underpin the model.

- **Funding for Monthly Publication of CPI:** The Government should allocate funding to the Australian Bureau of Statistics to publish the Consumer Price Index on a monthly basis, to allow for more efficient transmission of monetary policy into the broader economy and to align Australia's approach to other G-20 countries.

2. Introductory Comments

The 2020-21 Federal Budget will be handed down at a time of great change in Australia's financial system. Key factors influencing this process include the development and application of new technology, the growth of superannuation allied with demographic change, stronger mechanisms to support professionalism and evolving global economic and financial conditions, including innovations in monetary policy.

Government policy reform is obviously another major influence on financial system change, as reflected in the ambitious program to implement the recommendations of the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**). It is important that the associated regulatory measures are implemented in a timely and effective manner and that they are calibrated to support the efficient functioning of the financial system. AFMA's focus is on financial markets and we actively contribute to consultations on this regulatory change, offering a necessary wholesale business view.

AFMA believes that the Government, in setting its Budget objectives for 2020-21, will need to look beyond its vital Royal Commission reforms to also embrace forward-looking initiatives targeted to promote competition within the financial system and improve its international competitiveness. The diversity of cost-effective product and service options that this would provide to users of the financial system would support economic productivity and development.

In this context, we note that effective financial markets depend on interrelated conditions that are subject to significant government influence:

i. Low transaction costs – affected by taxes and government charges/levies;
ii. Efficient operations – affected by licensing conditions and rules set by regulators; and
iii. Effective regulation – affected by the precision and proportionality of regulation.

As we outline through our proposals in this submission, the Government's Budget for 2020-21 has the capacity to materially influence each of these factors in a positive manner.

We appreciate that the Royal Commission process is consuming considerable resources within Treasury, however, most of the policy groundwork for the proposals we make has already been done through previous government consultation and policy development programs. Therefore, we believe our proposals are feasible and, indeed, are necessary for the Government to meet its objectives for financial system development.

3. Strategic policy recommendation

AFMA recommends that the Government, in framing its 2020-21 Budget, should commit funding to the process required to develop a comprehensive strategy for the future development of the financial system, including its role in the Australian economy and its integration with the rest of the world. The strategy should provide a mechanism to ensure that implementation of individual policy reforms systematically takes account of other government policy objectives and priorities.

Australia's open financial system brings the benefit of competition to business and consumers, while domestic financial institutions enjoy extensive business and funding opportunities offshore. Australia is also the base for many firms that export financial services, adding income and employment in the community. However, government policy that supports this positive outcome has not kept pace with change.

For instance, many of the deficiencies in the tax system raised in this submission reflect technical rules and policy positions that have not been adjusted over the years to enable them to operate in a manner consistent with, and supportive of, major financial sector policy reforms enacted in the post-GFC environment. This problem makes clear the need for a more systematic approach to the coordination of policy change so that government policy settings for tax, regulation and other areas, like competition, operate in a coherent and fully effective manner.

Regulatory reform is another important area that needs to be better managed to effectively reconcile the various government policy objectives and actions. For example, Australia has historically been a global leader in positioning our financial regulation to be consistent with global standards and facilitate cross border trade and investment. This priority should place us well to meet the commitment by G20 members in June 2019 to improve international regulatory and supervisory cooperation. However, there is concern here and overseas that Australian regulation is now moving in a contrary direction and may cause fragmentation of the type G20 is trying to prevent.

In the wholesale markets area, ASIC is proposing to lessen its reliance on equivalent overseas regulation and expand its exterritorial reach by extending its licensing regime to capture overseas providers of services to wholesale clients in Australia. The consequence will be increased costs for these services to Australian clients, and in some cases a likely reduction in their availability, at a time when their offshore investment is growing. This outcome is further evidence of the need for a disciplined financial system strategy to properly reconcile competing policy priorities in a manner that minimises harm to the economy.

There is a need for an ongoing process to give assurance about balance being achieved in policy settings from a whole of government perspective, as new matters will emerge on a regular basis. We believe that an effective response to issues arising from such matters will not emerge without a clear strategy that encompasses all government policy, including international trade and investment, taxation and regulation.

The Government should commission a review of the operation of the policy development and implementation process and, building on its findings, implement a strategy to ensure that the broad range of government policies are well coordinated and operate cohesively in a manner that supports an open and competitive financial system.

4. Taxation recommendations

4.1 Introductory Comments

In considering AFMA's taxation recommendations below, we reiterate the importance of the Government committing to and implementing reforms that rectify the competitiveness of Australia's tax system as it applies to the financial sector. While many of these specific recommendations arise from the Johnson Report, and remain outstanding in the decade since the release of that report, there is an opportunity for the Government to undertake a wholesale review of the taxation observations arising from the Financial System Inquiry, which provides a stocktake of pertinent issues and concerns.

4.2 Ensure Debt Treatment for Bail-In Instruments

A specific issue that has recently arisen requiring urgent intervention by the Government in the 2020-21 Federal Budget, if not sooner, is the effect of solvency/non-viability conditions attaching to certain instruments issued by foreign banks acting through their Australian branches that may call into question the characterisation of such instruments from a tax perspective.

Whether an instrument is debt or equity for taxation purposes is determined with reference to Division 974 of the *Income Tax Assessment Act 1997*. The distinction is of significance as it determines whether returns on the instrument are deductible (debt) or frankable (equity). Under Section 974-135, for an instrument to be debt, it is a necessary condition that the instrument contains an "effectively non-contingent obligation" (**ENCO**) to repay at least the principal, having regard to the "pricing, terms and conditions" of the instrument.

Regulations have been made in the past to address the intersection between the ENCO requirement and the requirements of prudential regulators, including both APRA and international counterparts. The most recent regulation, 974-135F, specifically deals with Tier-2 instruments and the implementation of the Basel III reforms in 2013, particularly the non-viability condition that a Tier-2 instrument have the ability to be written off or converted to equity if the prudential regulator considers that the issuer would be non-viable absent the writing-off/conversion. In the absence of Regulation 974-135F, such a non-viability condition called into question whether the ENCO condition may be satisfied for such instruments. Regulation 974-135F addresses this issue by stating that "the fact that the obligation is subject to a non-viability condition does not in itself prevent the obligation from being a non-contingent obligation."

In the intervening period since Regulation 974-135F became operative, prudential regulators in a number of jurisdictions have imposed non-viability conditions on a broader range of instruments, including bonds and notes that are not subordinated, such that Regulation 974-135F does not apply to such instruments. The ATO has expressed that, with respect to such bonds and notes, in the absence of a Regulation, there is a technical view that such instruments may not be characterised as debt for Australian tax purposes as the ENCO requirement is not satisfied. Ironically, therefore, instruments that would commercially be more considered to be debt under the hierarchy of claims in ordinary insolvency proceedings are at greater risk of not being

characterised as debt from a tax perspective given the absence of an applicable regulation.

In 2015, the Board of Tax released its final report into the Review of the Debt and Equity Tax Rules. In this report, the Board of Tax broadly recommended that the inclusion of APRA required features in a financing arrangement does not, of itself prevent an obligation from being a non-contingent obligation. Given that, in instance where instruments are issued out of the Australian branch of a foreign bank, it is the prudential regulatory requirements of the home country that are paramount, our recommendation is that the Government announce in the 2020-21 Federal Budget that a regulation will be proposed, with an effective date of the commencement of Division 974, with the effect that the inclusion of features in a financing arrangement required by a prudential regulator globally does not, of itself, prevent an obligation from being a non-contingent obligation.

4.3 Abolish the LIBOR Cap

AFMA has long advocated the abolition of the "LIBOR Cap," a statutory provision that operates to deny deductibility of intra-entity interest for an Australian branch of a foreign bank above the applicable LIBOR. However, due to looming changes brought about by the authorities in the United Kingdom and the United States of America regarding key benchmarks to be used, it is the case that an announcement by the Government of the abolition of the LIBOR Cap in the 2020-21 Federal Budget is crucial. This is due to the fact that authorities have directed the market to move away from use of LIBOR by the end of 2021 by withdrawing their support for its continued functioning. The result is that many institutions, including many AFMA members, are already transitioning away from LIBOR as the key reference rate for debt instruments, derivatives and loan contracts in advance of LIBOR ceasing to exist. This transition is officially supported by the Council of Financial Regulators in Australia and the regulators within their spheres of responsibility are working on relevant consequences flowing from the transition process with industry. In the absence of LIBOR being quoted, the continued existence of a statutory provision that references LIBOR is untenable and contrary to financial sector public policy.

The transition from LIBOR by the end of 2021 follows on from a development in 2013 when the British Bankers Association ceased to quote AUD LIBOR. This resulted in a situation where there was no applicable LIBOR in respect of AUD borrowings and consequently, in AFMA's view, no cap on the deductibility of interest where the Australian branch borrowed in AUD. The industry, through AFMA, took a responsible approach in responding to this legal conundrum and negotiated an Administrative Solution with the ATO that may be adopted by taxpayers to address AUD borrowings to which the LIBOR Cap previously applied. Such a compliance approach was only ever considered a temporary fix pending an appropriate amendment to the legislation to abolish the LIBOR Cap, and the fact that the compliance solution remains in place is unsatisfactory.

From a policy perspective, it has always been AFMA's steadfast view that the LIBOR Cap unnecessarily inhibits the flow of capital into Australia through foreign bank branches and therefore increases pressure on the availability and cost of credit to Australian

business. It is defective tax policy because it conflicts with internationally accepted transfer pricing norms that rely on arm's length pricing/conditions. It also has serious technical flaws, most notably because LIBOR is not a representative funding rate for individual banks or for funding at a maturity greater than twelve months. The non-continuation of LIBOR is, in part, due to the extent to which LIBOR is not representative of true funding costs.

The Government asked the Board of Taxation to review the appropriateness of the LIBOR Cap as part of its review into the Tax Arrangements Applying to Permanent Establishments. The Board of Taxation made only one recommendation in its report to the Government. This recommendation was:

> "subject to confirmation that the removal of the LIBOR Cap would result in no material cost to revenue, the cap should be removed. That would assist in fostering competition in the domestic market."

In providing context to the recommendation, the Report stated:

> "The Board agrees that the LIBOR Cap has the potential to reduce bank competition. Put another way, it is hard to see how a cap on the amount of deductions that can be claimed in respect of intra-entity debt can assist in promoting banking competition by foreign banks with their domestic counterparts that do not face the restriction. The LIBOR Cap has the effect of potentially increasing the funding costs for foreign bank branches and hinders their ability to compete in the business loan market. Moreover, new entrants into the Australian banking market are likely to be disproportionately affected by the LIBOR Cap because they are relatively more reliant on head office funding to which the cap applies."

Such comments are consistent with those included in the Johnson Report, which made the recommendation to:

> "remove the LIBOR Cap on deductibility of interest paid on branch-parent funding."

This recommendation was made on the basis that:

> "(a)s the financial crisis clearly demonstrated, in periods of stress in credit markets, there can be appreciable differences between the LIBOR rate and the rates that parent banks are able to offer their Australian branches on a commercial basis. While conditions in credit markets have eased significantly, Australia needs policies to ensure access to alternative funding sources at competitive rates should such tensions re-emerge. The Forum believes that any tax avoidance concerns from removing the LIBOR cap could be adequately dealt with by applying the usual transfer pricing guidelines in respect of interest paid to foreign banks by their Australian branches."

At the Government's request, AFMA provided both the Government and Treasury with revenue estimates of the cost of the removal of the LIBOR Cap, based on survey responses from its members. These estimates demonstrated that the cost of removing of the cap was immaterial (ie there is no material cost to revenue) and removal would deliver significant deregulation benefits, in addition to materially enhancing banking

competition and the provision of product and service innovation by foreign bank branches.

Given the planned discontinuation of LIBOR by end-2021 and the defective nature of the LIBOR Cap from a policy perspective, it is untenable for the Government to continue to rely on the LIBOR Cap. Therefore, we strongly recommend that the Government should remove the current uncertainty by announcing the immediate abolition of the LIBOR Cap in the 2020-21 Federal Budget.

4.4 Maintain the Competitiveness of the OBU Regime

AFMA notes the continuing review by the OECD Forum on Harmful Tax Practices (**OECD Forum**) into Australia's Offshore Banking Unit (**OBU**) regime, the specific concerns raised by the OECD Forum and the announcement from the Treasurer on 26 October 2018 committing to reform of the OBU regime consequent to the OECD Forum's review. At the time of writing, no specific reforms to the OBU regime have been confirmed and AFMA understands that potential reforms to ameliorate the OECD Forum's concerns will be discussed at a meeting of the OECD Forum in April 2020. Giving this timing, it is conceivable that the reforms to the OBU regime may be included in the 2020-21 Federal Budget.

AFMA continues to support the OBU regime as a key pillar of Australia's competitiveness as a location for financial services businesses and maintains that the regime is entirely legitimate, particularly noting that the tax burden imposed on eligible OB activities is higher than that imposed by similar regimes in competitor jurisdictions that have been reviewed and judged not to be harmful by the OECD Forum. The OBU regime merely allows Australia to leverage its significant non-tax factors to attract international financial services business, such as access to highly skilled and competent staff, its stable political system, strong economic performance and market access.

To the extent that the Government is looking to implement reforms to the OBU Regime in the 2020-21 Federal Budget, it should ensure that any such reforms protect Australia's interest in remaining a viable location for internationally mobile financial business.

4.5 Remove non-resident interest withholding tax for financial institutions

AFMA continues to advocate the removal of non-resident interest withholding tax (IWT) for financial institutions, given the economic benefits that would result.

As outlined below, the case to remove interest withholding tax on funding from non-residents by financial institutions has already been made by the Johnson Report and the Henry Tax Review. Since then, the structural reduction in interest rate levels and the significant extension of withholding tax relief through the updating and expansion of Australia's international tax treaty network, have reduced the direct tax cost of this reform. Moreover, the return to greater fiscal discipline provides the capacity to address deficiencies of this nature in the tax system. Thus, there is a good case to act now.

There is considerable commentary articulating the erosive nature of interest withholding tax on the Australian economy and Australian businesses. Starting with the

Johnson Report, where the AFCF expressed the view that "the application of interest withholding tax to offshore borrowings by Australian based banks is inconsistent with Australia's need, as a capital importing country, to access a diversity of offshore sources of funding." The AFCF went on to state that:

> "the continuing application of interest withholding tax on financial institutions' borrowing offshore sits uneasily with the Government's desire to develop Australia as a leading financial centre and is putting Australia at a competitive disadvantage with respect to overseas financial centres."

These comments were echoed and endorsed by the Henry Tax Review in 2010, which recommended that "financial institutions operating in Australia should generally not be subject to interest withholding tax on interest paid to non-residents."

Further, and compellingly, the Final Report of the FSI, observed:

> "(w)ithholding taxes generally increase the required rate of return for foreign investors, which reduces the relative attractiveness of Australia as an investment destination. Where foreign investors can pass on the cost to domestic recipients, this raises the cost of capital in Australia…reducing IWT would reduce funding distortions, provide a more diversified funding base and, more broadly, reduce impediments to cross-border capital flows."

The FSI Panel essentially agrees with previous observations made in the Johnson Report and the Henry Tax Review that it is incongruous that the Government persists with a measure that significantly hinders the free movement of capital into Australia and causes Australian businesses to pay a higher rate for debt finance. This ultimately renders Australian businesses less competitive relative to their global peers.

AFMA urges the Government to act on the advice of the Johnson Report, Henry Tax review and the FSI by implication, and remove non-resident interest withholding tax on borrowings by financial institutions.

4.6 Government to Respond to Board of Taxation Permanent Establishment Paper

In 2012, the Government commissioned the Board of Taxation to conduct a review into the tax arrangements applying to permanent establishments. This was a key review, particularly for AFMA members, as the Board was asked to consider the advantages and disadvantages of Australia adopting the "functionally separate enterprise" approach to determining the profits attributable to a permanent establishment, as adopted by the OECD Model Tax Convention, subsequent to changes in 2010. Our view is that aligning Australia's approach to other key trading partners and OECD countries will enhance Australia's standing as a financial centre. The Board also made a recommendation in this review for the abolition of the LIBOR Cap (refer to 3.3 above).

The failure to adopt the functionally separate enterprise approach to determining the profits attributable to a permanent establishment is resulting in significantly detrimental taxation outcomes for AFMA members. The implementation of the anti-hybrid rules and the ATO stance on the non-deductibility of costs incurred to meet prudential regulatory requirements on liquidity are two current examples of where Australia's approach is out of step with approaches taken in comparable jurisdictions. AFMA

understands that the adoption of the functionally separate enterprise approach is strongly supported by the ATO.

Unfortunately, and notwithstanding the public release of the Board's report in June 2015, there is yet to be any Government response to whether Australia will adopt the functionally separate enterprise approach and, if so, in which contexts. AFMA again calls on the Government to formally respond to the Board's report in the 2020-21 Federal Budget.

4.7 Exempt withholding tax on interest paid to CCPs

In February 2013, AFMA lodged a submission with Treasury seeking a withholding tax exemption for interest paid to central counterparties (**CCPs**).

As part of the G-20's commitment to improving the transparency of OTC derivatives, systemically important OTC derivatives (such as AUD interest rate swaps) are required to be collateralised and cleared through an appropriately structured CCP. The concern expressed in the submission was that where the CCP was located outside of Australia, interest paid on the collateral could result in Australian interest withholding tax.

The submission sought an exemption for any withholding tax that would arise, on the basis that the cross-border interest flow arose solely due to regulatory reform and any withholding tax arising would adversely affect the Australian derivatives market, with the detrimental impacts vastly exceeding any government revenue.

The point was acknowledged by the Final Report of the Financial System Inquiry, which observed:

> "Australia's IWT regime also applies to derivative transactions. Under G20 commitments, certain standardised over-the-counter derivatives need to be collateralised and cleared through a regulated central counterparty. In Australia, outbound interest payments on collateralised positions may be subject to IWT (flows from Australian participants to offshore CCPs, or flows from Australian CCPs to offshore participants). This may increase costs for Australian participants and adversely affect liquidity in Australian derivatives markets."

AFMA has received no response from the Government or Treasury with respect to this issue, which continues to be an ongoing impediment to the efficiency of the Australian derivatives market and AFMA urges the Government to consider the request made in the submission as part of the 2020-21 Federal Budget.

5. Regulatory recommendations

5.1 Central Oversight for Regulator Funding Models

With the move to industry funding of ASIC from 1 July 2017, AFMA members now potentially contribute to industry funding of three regulators, namely ASIC, APRA and AUSTRAC. In addition, the Financial Institutions Supervisory Levy, which principally addresses APRA funding, also seeks to recover costs for the ATO's administration of the Superannuation Lost Member Register and the Unclaimed Superannuation Money framework and for the ACCC to administer the Financial Services Competition Unit.

These various funding models sit under different portfolios and adopt different metrics to determine the population of leviable entities and the amounts payable. Our concern is that there is no central oversight of each different funding model, and the administration thereof, such that the overall burden on entities is not understood. We therefore recommend that the funding models for each regulator are brought within the Treasury portfolio and that there is within Treasury a designated team responsible for the administration of all industry funding of financial regulator models.

5.2 Refinements to ASIC's Funding Arrangements

AFMA believes that ASIC should be a strong and well-resourced regulator, and that it should be appropriately funded to carry out its regulatory activities including taking enforcement actions that punish wrongdoing and create a deterrence effect. AFMA's position on industry funding is that industry should pay its fair share of the costs of regulation, having regard to the mix of public and private benefits flowing from regulation.

However, the current treatment of the Enforcement Special Account (**ESA**) under the industry funding model provides unfair outcomes, conflicts with the principles that underpin the design of the model, and is inconsistent with the approach taken to criminal cases. This problem can be rectified by removing the ESA from cost recovery arrangements. This approach would alleviate the unreasonable financial burden placed on entities who otherwise have conducted their business appropriately and are not the subject of enforcement action by ASIC.

5.3 Monthly Publication of Consumer Price Index

AFMA is a keen supporter of the proposal for the Consumer Price Index (**CPI**) to be published on a monthly basis and urges the Government to allocate funding in the 2020-21 Federal Budget to the Australian Bureau of Statistics to allow this to occur. We believe the more frequent publication of inflation data would contribute to more efficient and effective financial markets, facilitate better transmission of monetary policy and provide real benefits for the broader economy.

The CPI is a significant inflation benchmark index for the Australian economy and one of the most important inputs into the RBA's monetary policy deliberations. This important input to the RBA's monetary policy decision-making process is also one of the least timely by international standards. Australia is the only economy in the G20 that

publishes its primary inflation data on a quarterly rather than a monthly basis. The release of inflation data in a timely manner would assist the formulation, implementation and evaluation of monetary policy

The successful transmission of monetary policy through the economy relies upon the efficient operation of wholesale financial markets to transmit changes in the official interest rate to borrowing and lending rates in the real economy. The price signaling role of markets would be improved if they were to have access to more timely information on the actual inflation rate and were better placed to assess both the likely evolution of inflationary expectations and monetary policy.

AFMA's members and market participants strongly support the move to monthly publication and have been advocating for the move for several years. Discussions with members of AFMA's market committees confirm that the majority of participants trading in interest rate markets favour more frequent publication of the inflation data.

A move to monthly publication of CPI would also enhance the efficiency of products such as inflation-linked bonds, which offer a near-perfect hedge against the erosive effects of inflation on asset-values and, in certain conditions, are highly sought after by investors, both in Australia and offshore.

A monthly CPI would also help to facilitate offshore participation in Australia's inflation indexed bond market. Globally, most inflation-linked bonds are priced based on the Canadian Treasury model for the indexation of cash flows on a monthly basis. Australian inflation indexed bonds do not fit neatly into global bond portfolios based on a quarterly CPI and would benefit from harmonisation with the global standard.

Advances in technology and data collection have mitigated previously expressed concerns about the cost of moving to monthly publication of CPI data. If a higher frequency CPI leads to more timely monetary policy action and better transmission of policy, the economy-wide benefits could be very large. AFMA recommends that the ABS produce the CPI data at a monthly frequency and that the Government should provide funding in the Budget, given the anticipated economy-wide benefits.

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Thank you for the opportunity to contribute to the Government's consideration of matters that should be addressed in the 2020-21 Federal Budget. We would be happy to discuss any of the matters that we have raised in this submission. Please contact me on (02) 9776 7996 or rcolquhoun@afma.com.au .

Yours sincerely,

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