

COMMENTS

THE SHORT TERM MONEY MARKET IN AUSTRALIA AND ITS REGULATION

BY MICHAEL CASHION*

I INTRODUCTION

A money market, in its widest and most literal sense, includes all financial institutions in the capital market which cater for the money needs of the economy. However, in a more technical sense, a money market refers to that sector of the capital market which specialises in borrowing and lending for short periods against highly liquid assets. A short term money market has been defined as "a market embracing dealings in short term financial assets and, as their counterpart, short term credit".¹ Holders of short term government securities and similar financial assets can, with minimum risk and at short notice, exchange them for cash or other assets. Conversely, holders of temporarily surplus funds can lend these funds at interest confident that their loan will be repaid when required. Such loans are repayable either at call or within a specified period of time which may be as short as overnight, but is generally no longer than six months. These borrowers and lenders and the financial institutions which cater for their needs constitute the short term money market.

An effective and efficient short term money market requires the coexistence of:

- (1) Substantial funds seeking short term investment.
- (2) Quality, interest-bearing, easily negotiable "short"-dated securities in which funds may be invested.
- (3) Dealers with the expertise to use the available funds.
- (4) Adequate procedures for the speedy, efficient and safe handling of cash and securities.
- (5) "Lender of last resort" facilities to ensure continued liquidity in the market.²

However, until the late 1940s, the opportunities for short term investment in Australia were largely limited to bank fixed deposits for terms of three, six, twelve or twenty-four months.³ The minimum period of fixed deposit was then, and still is, three months and persons and institutions with funds available for shorter periods generally held a demand deposit which rarely earned interest. Inter-company loans

* B.Com., LL.B. (N.S.W.).

¹ Comment, "The Short Term Money Market in Australia" *"Jobson's" Year Book for 1975/76* 669; Securities Institute of Australia, *Australian Money Markets* 10, 21.

² Comment, note 1 *supra*, 669; Securities Institute of Australia, note 1 *supra*, 10, 22.

³ *Ibid.*

provided a more profitable alternative, but because risk was often high, such lending was generally limited to companies with related interests such as common directorship, a buyer-seller relationship or a parent-subsidiary relationship.

By 1949-1950 this situation began to change. Several hire purchase companies issued to the public, at attractive rates of interest, short term debentures for terms of three to twelve months. At about the same time, several of the larger stockbroking firms, which had built up considerable portfolios of government securities, began to accept loans at several days' call or for up to a month or more on a "buy back" basis. Government securities were sold by the broker to the lender subject to an agreement that the broker would buy them back at an agreed price when the loan matured or was called. The lender's return on the loan was the difference between the selling price of the security and the pre-arranged repurchase price. Such an arrangement provided lenders with the security of government bonds and an opportunity to profitably utilise short term funds.

This method of operation, whilst providing a reasonably effective short term money market did, however, have several disadvantages. First, the system depended to a very large extent upon the lender's confidence in the broker's ability to repurchase the securities at the pre-arranged price.⁴ Secondly, there was a notable absence of suitable short term government securities and thirdly, there was no lender of last resort facility to ensure continuing liquidity.⁵

However, during the 1950s, these "buy back" transactions continued to increase as an avenue for the profitable investment of short term funds. It was becoming increasingly necessary that the market be placed on a sound basis so as to operate in the national interest. Thus, in February 1959, the Governor of the central bank (then the Commonwealth Bank of Australia and now the Reserve Bank) announced the establishment of the official market and the extension by the Bank of lender of last resort facilities to four approved dealer companies. By October 1960 there were nine such approved dealers⁶ and no further dealers have been accredited since that time.

II THE OFFICIAL SHORT TERM MONEY MARKET

1. *Users of the Market*⁷

The short term money market provides an attractive investment opportunity to lenders in that it allows profitable investment of very temporary cash surpluses at short call with almost no capital risk. The official market draws its funds from a variety of sources, the major

⁴ Securities Institute of Australia, note 1 *supra*, 2.

⁵ Comment, note 1 *supra*, 669.

⁶ See Appendix 1.

⁷ Comment, note 1 *supra*, 671; Securities Institute of Australia, note 1 *supra*, 24-26; Wilkins, "Some Aspects of the Short Term Money Market in Australia" January/February 1974 *Journal of the Australian Society of Security Analysts* 12, 15.

ones being trading and savings banks, trading companies, insurance offices, building societies and finance companies, Commonwealth and State Governments and local and semi-government bodies. Periodic timing discrepancies between cash inflows and expenditures in such organisations provide funds temporarily available for investment.

2. *Patterns in the Supply of Money to the Market*⁸

First, there is a yearly pattern. Large seasonal fluctuations in liquidity are generally cushioned by the fact that different types of lenders generally have their peak deposits with the market at different times of the year. However, there is usually a peak about November, a low at Christmas, another peak in February and a run down in June as tax is paid.

Secondly, a monthly pattern of peaks in the first and third weeks of each month exists due to Commonwealth payments to the States on the first and fifteenth of each month.

Thirdly, there is a weekly pattern due to the popularity of Thursday as a pay-day.

However, unusual events such as changes in interest rates, S.R.D. ratios⁹ or currency alignments can also have a very significant impact on the flow of funds to the market.

3. *The Role of the Reserve Bank*¹⁰

When the short term money market was officially recognised in 1959, formal working arrangements were developed to ensure the efficient and secure operation of the market. The Reserve Bank plays a vital role by providing a number of facilities for the market.

(a) *Lender of last resort*

This is the most important facility provided by the Reserve Bank. The Bank supports the market by providing the dealers with funds when their borrowings are inadequate to repay loans which have been recalled. In these circumstances, the dealer may sell securities to the Bank, or alternatively, may borrow from the Bank against government securities maturing within five years which he has lodged with the Bank. To ensure the latter facility is used only as a last resort, such loans carry a penalty rate of interest and also, as a further penalty, they may not be repaid in less than seven days. This facility provides the dealers with liquidity and ensures the essential stability of the market.

(b) *Special clearing accounts*

The Bank maintains special clearing accounts for the dealers which facilitate the speedy transfer of funds and securities from one point in

⁸ Wilkins, note 7 *supra*, 13.

⁹ Every trading bank is required to maintain a Statutory Reserve Deposit (S.R.D.) Account with the Reserve Bank, and to have a credit in that account equal to a specified proportion of its total Australian deposits. Banking Act 1959 (Cth) ss 17-31.

¹⁰ Securities Institute of Australia, note 1 *supra*, 11, 26; Wilkins, note 7 *supra*, 16.

Australia to another. This service ensures the smooth and efficient operation of the market in its Australia-wide operation.

(c) *Safe custody system*

The Reserve Bank operates a safe custody system for the dealers' Commonwealth Government security holdings. When a dealer accepts a loan, safe custody certificates issued by the Bank are delivered by the dealer to the lender, thus providing him with security for his loan. The use of this safe custody system obviates risks involved in handling large amounts of bearer bonds (or transfer of stock) as security for loans.

(d) *Daylight overdrafts*

The Reserve Bank allows dealers substantial overdrafts during the day to bridge the gap between the repayment of an amount called and the organisation of replacement funds. Similarly, to assist the rapid movement of safe custody certificates as security cover between lenders, the Bank, throughout the day, issues to dealers certificates and securities in excess of their holding. However, by the end of the day each dealer must have repaid his overdraft and must have lodged sufficient Commonwealth Government securities with the Bank to cover the safe custody certificates which have been issued.

(e) *Direct access dealing*

Official money market dealers, together with stockbrokers, are the only institutions that have direct access to the Reserve Bank to deal in securities. This is designed to ensure an orderly market for government securities and maintain liquidity and stability in the market.

(f) *Collection and publication of information*

Dealers are required to regularly consult with the Reserve Bank and to provide detailed information relating to their assets and liabilities and current interest rates. Much of this information is published by the Bank in its *Statistical Bulletin*. Other financial publications, such as *The Financial Review*, publish information on the dealers' trading in Commonwealth Bonds.

4. *Conditions of Operation*¹¹

The Reserve Bank requires the approved dealers to observe certain conditions designed to preserve their financial strength, protect lenders and integrate money market operations with general monetary policy. These conditions are as follows:

(a) The paid-up capital of the dealer company must not be less than \$400,000 in cash. This requirement ensures the financial stability of the dealers and also that each dealer is of sufficient size to operate efficiently.

(b) The great bulk of dealers' assets must consist of government securities (including Treasury Notes) maturing within five years. Dealers are also permitted to hold limited amounts of local and semi-

¹¹ Wilkins, note 7 *supra*, 17; Comment, note 1 *supra*, 674; Securities Institute of Australia, note 1 *supra*, 12, 27.

government securities, Australian Industry Development Corporation securities maturing within five years, bank-endorsed commercial bills, bank certificates of deposit maturing within five years and short-dated, non-bank commercial bills. A very small proportion (about two and a half per cent¹²) may be held in other assets of their choice such as long bonds, shares and debentures. It is through commercial bills that dealers can now lend funds to clients. The client is given a loan and in return gives the dealer a bill as security.

(c) Each dealer company must, at all times, be ready and able to buy or sell securities.

(d) The maximum amount of loans a dealer is allowed to accept (the "gearing limit") is determined by a prescribed gearing ratio to shareholders' funds. The exact ratio is not officially disclosed but it is generally believed to be approximately thirty times shareholders' funds.¹³

(e) The dealers must provide the Reserve Bank at regular intervals with information pertaining to the composition of their assets and liabilities and the interest rates they are paying and must provide copies of balance sheets and profit and loss accounts. Dealers are in constant contact with the Bank and supply information yearly, quarterly, monthly, weekly, daily and sometimes even hourly.

(f) The minimum deposit or repayment is \$50,000. The minimum parcel of Treasury Notes is \$50,000 and the minimum parcel of Commonwealth Bonds is \$100,000.

(g) A loan to a dealer must be made by bank cheque and each loan must be covered by the delivery to the lender of appropriate security. The determination of an appropriate security margin in each case is a matter for negotiation between the lender and dealer.

5. *Method of Operation*¹⁴

The activities of the official dealers extend throughout all the Australian capital cities. Unlike the stock market, there is no central market place and arrangements are made by telephone. Negotiations and commitments as to prices, amounts, interest rates, security cover and loan periods are made orally. If an agreement is reached, the dealer will usually send a messenger to the client to receive a bank cheque and give, in return, safe custody certificates issued by the Reserve Bank. Notice of withdrawals is usually required on the preceding afternoon or at the latest by 11 a.m. of the day the funds are required. When a loan is to be repaid, a cheque will be delivered to the client in exchange for the safe custody certificate. The dealer can raise the funds to meet the call by either borrowing new money from the public, selling securities from his portfolio or, as a last resort, borrowing from the Reserve Bank with the associated penalties.

¹² Wilkins, note 7 *supra*, 18.

¹³ *Id.*, 17; Comment, note 1 *supra*, 675.

¹⁴ Comment, note 1 *supra*, 679; Securities Institute of Australia, note 1 *supra*, 13.

6. *Securities*¹⁵

As already discussed, the Reserve Bank maintains close supervision over the type of securities which dealers can hold. The securities for a dealer's portfolio may be acquired in several different ways. They can be purchased from holders, or the dealer may subscribe to Treasury Notes, Commonwealth Bonds and other government securities. He may sell securities to willing buyers or, as may all holders, he may rediscount Treasury Notes with the Reserve Bank.

7. *Interest Rates*¹⁶

The rate of interest offered by a dealer to lenders depends largely upon the general supply of money and the dealer's demand for money. Thus, interest rates can vary from day to day and even from hour to hour. In addition, because dealers are strongly influenced by what they can earn with the money they borrow, that is by bond yields, interest rates paid by dealers are also closely related to prevailing bond rates.

8. *Dealer Profitability*¹⁷

A dealer's business concerns first money and secondly securities. The method of profit-making varies between dealers but basically there are two main profit areas.

First, profit may be derived from the margin between the buying and selling prices of securities, the money activities being used to finance the portfolio of securities.

Secondly, profit may be derived from the margin between the yield on portfolio securities and interest paid to lenders.

9. *Monetary Policy*¹⁸

The official short term money market is related to monetary policy in several respects. First, the market provides a not-insignificant demand for government securities and thus the market helps fund the Government debt. Secondly, the market provides valuable information about monetary movement within the economy. Thirdly, the market can be used by the Reserve Bank to influence, to some degree at least, the money supply and related interest rates.

III THE UNOFFICIAL SHORT TERM MONEY MARKET¹⁹

Although an unofficial money market has existed in Australia for many years in the form of mutual corporate financing, it was not really until the proliferation of merchant banks in Australia during the period 1969 to 1972 that unofficial dealers began to organise an

¹⁵ Comment, note 1 *supra*, 676; Securities Institute of Australia, note 1 *supra*, 16.

¹⁶ Securities Institute of Australia, note 1 *supra*, 15, 29.

¹⁷ Wilkins, note 7 *supra*, 18.

¹⁸ *Id.*, 19.

¹⁹ The information contained in this section was obtained by speaking to dealers in the unofficial market.

unofficial short term money market, which was in many respects akin to the official market. Most merchant banks now operate extensive unofficial short term money market divisions. In addition, some merchant banks have important links with authorised dealers in the official market, such links arising from either a subsidiary company or a common shareholder. Detailed information on the size and activities of the unofficial market is not generally available, although the Australian Bureau of Statistics does provide some comparative aggregate figures.

Mutual corporate financing still forms a significant portion of unofficial market activities. Brokers or agents arrange inter-company loans between firms with surplus liquidity and other firms wishing to borrow funds for short periods. As most of these transactions are unsecured, most companies will only lend to affiliated organisations or companies of high standing and repute. Occasionally, although it is more the exception than the rule, a bill of exchange may be given in respect of the loan. A bill of exchange is defined by section 8 of the Bills of Exchange Act 1909 (Cth) to be "an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer".

However, a considerable proportion of the unofficial market is now comprised of activities by dealers operating in a similar fashion to official dealers. Unofficial dealers borrow funds on both a secured and unsecured basis. Some borrow almost all their funds on an unsecured basis. Thus, the reputation and integrity of the dealer is of vital importance. More commonly, however, dealers give bills of exchange as security for a large percentage of their borrowed funds. The funds are deposited by the lender on the basis of a 24-hour call, a seven-day call or a fixed short term. It is usual for the dealer to be able to terminate the arrangement and return the funds to the lender, if he so desires, upon the same basis as the loan is made.

How a dealer uses the borrowed funds varies slightly between different dealers. A few, especially those associated with the large banks, deposit a sizeable proportion (usually between a half and two-thirds) of their borrowed funds with other dealers or with official dealers on terms similar to those of the original loan. This is designed to ensure that the dealer will be able to meet commitments when funds are called upon by the lender. Experience enables dealers to predict with reasonable accuracy when funds are likely to be called upon and, it is on the basis of such predictions that dealers estimate what proportion of their borrowings should be invested in this way. The profit earned on funds invested by the dealer in this manner is small—usually in the vicinity of one quarter per cent. With the remainder of the borrowed funds the dealer buys bills of exchange. He usually buys a combination of bills which have been endorsed or accepted by a bank and non-bank bills. The payment of a bank-endorsed bill is

guaranteed by the bank according to the terms of the bill. As banks charge an endorsing fee, the rate of return is lower for the dealer on bank-endorsed bills, but the risk of loss through failure to honour the bill is eliminated. The dealer's profit arises here from the difference between the rate of return on the bills and the interest paid by him to the lender. The dealer may, of course, invest in securities other than bills of exchange.

However, it is more common, especially for dealers associated with merchant banks, to use borrowed funds to finance longer-term (usually three to five years) lending activities. This method of operation is far more profitable for the dealer than the practice discussed above of lending out borrowed funds on similar terms. This is not to say that such dealers never lend borrowed funds on similar terms. But when they do so, it is only as a temporary measure designed to profitably employ the funds until they can be lent out on a longer-term basis. When borrowed funds are called, the dealer will usually try to raise the money by borrowing new funds. However, to avoid the possibility of not being able to raise a sufficient sum through new borrowings, dealers usually have standby facilities arranged with a bank. These standby facilities generally comprise an overdraft limit and an arrangement whereby a dealer can create a bill of exchange and the bank will endorse or accept it so that the dealer can sell it in the bills market. It is usual that such arranged standby facilities total about one half of borrowed funds.

In addition, persons or institutions suffering from a temporary lack of liquidity can borrow from a dealer. The dealer provides the loan from funds borrowed from his lenders or by selling bills of exchange or other securities. Once again, loans made by a dealer may be secured or unsecured depending on the dealer, although more commonly they are secured. The bills of exchange which are received by the dealer as security are generally sold by him in the bills market to raise further funds. Dealers will only lend to reputable and reliable clients and there is a limit to how much each client can borrow. The terms of the loan will depend upon the agreement between the dealer and his client.

From the viewpoint of a party who lends to a dealer, the dealer's role is important for one major reason. Because of the reputation of the dealer, the lender is prepared to lend funds which he would not be prepared to lend directly to a less reputable individual or institution. Thus, he is able to profitably invest short term funds which he would not otherwise be able, or at least prepared, to lend. From the viewpoint of a party who borrows from a dealer, the dealer's role is of importance because he is able to borrow funds which otherwise would not be available.

Apart from borrowing and lending funds, dealers also make profits from trading in securities where they are able to predict fluctuations in interest rates.

IV REGULATION OF THE OFFICIAL AND UNOFFICIAL MARKETS

1. *Existing Controls*

Apart from the conditions imposed by the Reserve Bank upon dealers in the official market, there are two sources of regulation of both the official and unofficial markets.

The first source is the Financial Corporations Act 1974 (Cth). Section 3 states that the object of the Act is

to assist the Australian Government to achieve effective management of the Australian economy by providing a means for—

- (a) the examination of the business activities of certain financial and trading corporations; and
- (b) the regulation of those activities for the purpose of contributing to economic stability, the maintenance of full employment, the efficient allocation of productive resources, the ensuring of an adequate level of finance for housing and the economic prosperity and welfare of the people of Australia.

Section 8 specifies the corporations to which the Act applies. There can be little doubt that the terms of section 8(1)(a) are sufficient to bring all short term money market dealers within the Act. That provision covers foreign corporations, trading and financial corporations formed within the limits of Australia if "the sole or principal business activities in Australia of the corporation are the borrowing of money and the provision of finance".

Section 9 of the Act requires certain information to be lodged with the Reserve Bank. This includes details of the corporation itself and related corporations, the borrowing and financing methods of the corporations, and a copy of its last audited balance sheet. The Reserve Bank records such information in the Register of Corporations. Section 11 of the Act empowers regulations to be made which require registered corporations to supply requested information of almost any type which relates to the business of the corporation to the Reserve Bank or the Statistician. Section 13 makes provision for the controlling of asset ratios by the Reserve Bank. Section 14 permits the Reserve Bank to control the lending policies of registered corporations. Section 15 provides for control by the Reserve Bank of interest rates receivable and payable by registered corporations. However, to date no regulations have been made pursuant to these powers. Informal discussions are currently in progress between Reserve Bank officials and representatives of the dealers to determine what form the controls should take. Thus, at present, apart from requiring dealers to register and provide the requisite information, the Financial Corporations Act 1974 does not provide any regulation of the short term money market. Its future role could, however, be of considerable significance.

The second source of regulation for the short term money market is the Securities Industry Act 1975 (N.S.W.).²⁰ Section 32(1) provides

²⁰ Act No. 3 of 1976. Similar legislation exists in Queensland, Victoria and Western Australia.

that a person shall not carry on a business of dealing in securities unless he is the holder of a dealers licence. However, this does not apply to an "exempt dealer"²¹ which is defined²² to include a corporation declared to be an authorised dealer in the short term money market.²³ Section 33 provides that any person who is employed by, or who acts for or by arrangement with, a dealer (not being an exempt dealer) shall not do an act on behalf of the dealer in relation to a business of dealing in securities carried on by the dealer, unless such person has a dealers licence or a dealers representatives licence. "Securities" are defined in the Act to include debentures, stocks, shares or bonds issued by a government or by any body corporate or unincorporate; any right or option in respect thereof; and any interest as defined in section 76 of the Companies Act 1961 (N.S.W.). As many short term money market dealers deal in such "securities", these dealers (excluding exempt dealers), and those who deal on their behalf, must obtain licences. Section 37 empowers the Corporate Affairs Commission to grant a dealers licence to an applicant. Section 40 states that the licence may include conditions and subsection (1)(b) gives the Commissioner for Corporate Affairs wide power to impose conditions either when granting the licence or at any time during which the licence is in force. Part VI controls the holding of securities in safe custody by such dealers and also provides that such dealers keep certain records. A dealer's accounts are to be audited²⁴ and the auditor is to report to the Commissioner in certain cases.²⁵

Thus, the Act imposes upon some short term money market dealers certain requirements such as the keeping and auditing of proper accounts and records. However, dealers in the short term money market regard such regulations as a matter of mere formality. In addition, there is a large number of short term money market dealers who do not deal in such "securities" and thus are not caught by the Act.

For those caught by the Act, the real source of control lies in section 40(1)(b) which gives the Commissioner for Corporate Affairs virtually unlimited power to impose conditions upon the issue of dealers licences. Except for the imposition of asset ratios in a few cases, as yet this power has not been widely used to regulate short term money market operation. It remains, however, potentially a highly significant source of regulation for the market.

Thus, apart from the conditions imposed by the Reserve Bank on official dealers, the controls imposed on the short term money market by the Financial Corporations Act 1974 and the Securities Industry Act 1975 are essentially of a formal nature rather than substantive controls. It should not be overlooked, however, that both these Acts

²¹ S. 32(2).

²² S. 4(1).

²³ All official dealers have been so declared and are thus "exempt dealers" under the Act.

²⁴ S. 61.

²⁵ S. 65.

provide considerable scope for the regulation of dealers and the market which as yet has virtually not been utilised. This is largely due to indecision by the relevant authorities as to the appropriate form of regulation and indeed as to whether any further control is necessary at all.

2. *The Need for Control*

Opinion as to the need for control of the short term money market varies widely. Some advocate greater control. The United States and European markets are closely controlled and owe much of their strength to this fact. Others would say that, apart from the regulation provided by the Securities Industry Act and the controls imposed by the Reserve Bank on official dealers, both of which are designed principally to ensure the financial strength and stability of the dealers, the market operates efficiently and effectively on a self-regulation basis. However, the recent rapid growth of the short term money market, as one of the Non-Bank Financial Intermediaries (NBFIs)²⁶ in the uncontrolled finance sector, has posed a number of problems for the implementation of monetary policy in Australia. These arise first from the present lack of control by the Reserve Bank of the non-bank financial sector and the ineffectiveness of monetary control instruments on NBFIs. Secondly, problems arise because of the rapid growth of the short term money market and other NBFIs in comparison to the growth of the banking system, through which the Reserve Bank traditionally has administered the Government's monetary policy.

Monetary policy is the control of national expenditure in a desired direction through a change in the volume of money and the rate of interest in order to achieve a desired economic state of affairs.²⁷ Although the activities of the short term money market and other NBFIs do not directly affect the quantity of money, they do influence the velocity of circulation. This occurs because the NBFIs borrow money and use it to supply funds to other economic units to finance the purchase of goods and services. In economic terms, this results in a transfer from idle (speculative) balances to active (transaction) balances. By the activation of these cash balances, the pressure on national expenditure increases as the velocity of circulation of money rises. Thus, these institutions tend to accentuate economic fluctuations because they increase their scale of lending in boom times and restrict it severely in times of recession.²⁸

In relation to interest rates, the short term money market rates are determined largely by market conditions. They are particularly sensitive to basic economic conditions such as the demand for funds and the degree of liquidity in the economy and they can have some effect on interest rates generally within the economy.

It is, of course, true that the monetary authorities have some control over the money market, particularly through the official dealers. When

²⁶ See Appendix 2.

²⁷ Harris, *Money and Financial Institutions* (1968) 94.

²⁸ *Ibid.*

the monetary authorities decided to support the market, they undoubtedly realised that their action would have some bearing on their ability to effectively implement monetary policy. This it has done through the offering of various types of government securities in order to remove excess funds from the economy. It can also inject funds into the economy when required by purchasing bank bills and government securities. However, the use of securities is far from an effective method of ensuring that the official market acts in accordance with monetary policy. In addition, control through the use of securities is even less effective in the sizeable unofficial market where government securities form only a small proportion of dealers' portfolios.

However, whilst it is generally agreed among economists that effective monetary policy requires some control by monetary authorities over NBFIs such as the short term money market, agreement has not yet been reached as to the form such controls should take.

3. *Practicality and Desirability of Controls*

In recent times there have been many statements and discussions concerning possible forthcoming controls over the short term money market and the NBFIs generally. The types of controls which are being discussed are powers over asset ratios, powers over the volume and direction of lending and powers over interest rates. The major difficulty in developing a framework for such controls is the lack of data and effective understanding of the workings of especially the unofficial market.

Initially, even the introduction of federal legislation necessary to authorise the imposition of controls presented a difficulty. The Australian Constitution itself severely limited the powers that could be directly conferred on the monetary authority.

It would seem that the Financial Corporations Act 1974, which now grants wide powers to the Reserve Bank, was enacted pursuant to the decision handed down in the *Concrete Pipes* case.²⁹ In that case, the High Court of Australia overruled an earlier decision in *Huddart Parker v. Moorehead*³⁰ and threw new light on section 51(xx) of the Australian Constitution.

But, although it appears that the Reserve Bank, under the Financial Corporations Act, has power over money market dealers and other NBFIs, the power has still not been exercised. Again, the difficulty is in determining the most appropriate forms of control. The Rae Committee³¹ saw the danger in too stringent control and the Reserve Bank has expressed a similar view.³² Discussions on acceptable controls still continue on a general and informal basis.

²⁹ *Strickland v. Rocla Concrete Pipes* (1971) 124 C.L.R. 468.

³⁰ (1909) 8 C.L.R. 330.

³¹ Report of the Senate Select Committee on Securities and Exchange (The Rae Report) Parl. Pap. No. 98B of 1974, Pt II, Vol. 1, 591.

³² Such views have been expressed to dealers and their representatives at meetings with Reserve Bank officials.

An important consideration regarding the proposed introduction of a form of direct control at the federal level is the possibility of conflict with State legislation. The requirements under the New South Wales Securities Industry Act have already been discussed. It could be argued that various provisions of the State legislation could impose severe constraints on the operations of the NBF, particularly if similar controls were also introduced on a federal level. Such a problem may, however, be avoided by section 109 of the Constitution. From the point of view of a co-ordinated monetary policy, it may be said that controls currently being administered at a State level should be administered at a national level.

V STAMP DUTY PROBLEMS³³

The Stamp Duties Act 1920 (N.S.W.) has for several years presented a problem to the short term money market. For many years the Second Schedule of the Act set out the only duty payable on loan security instruments such as bills of exchange and promissory notes. The amounts involved here were, and still are, purely nominal. The real difficulty arose, however, out of the Stamp Duties (Further Amendment) Act 1974 (N.S.W.) which imposed a liability to stamp duty of one and a half per cent on any loan of more than \$500 at a rate of interest exceeding 14 per cent *per annum* or at a floating rate of interest. As most short term money market loans are at rates of interest in excess of 14 per cent, or are on the basis of a floating rate, the new stamp duty was clearly payable. This duty of one and a half per cent was, of course, disastrous for short term money market dealers as the profit margin on many of their secured dealings was often in the vicinity of only one quarter per cent to one half per cent. Such dealings thus clearly became quite unprofitable. In addition, the vast volume of documentation the new duty would necessitate would increase costs and further lower profits.

In light of the hardship caused to dealers, a temporary exemption from this duty was extended to certain types of transactions. The exemption provided that the duty was not payable in respect of loans for a term of less than 180 days between bodies corporate where the principal was not less than \$50,000 and where loans were:

- (a) loans to a bank
- (b) loans to or by an authorised dealer in the short term money market
- (c) loans to or by a dealer in the unofficial short term money market
- (d) loans by one body corporate to another body corporate by way of temporary investment of surplus funds.

This exemption provided at least some relief for short term money market dealers but did not solve the problem entirely. Short term money market loans of over 180 days still attract the one and a half per cent stamp duty. Thus, dealers and their advisers began, and still continue, to examine ways of avoiding this duty.

³³ The information contained in this section was obtained by speaking to dealers and their legal advisors.

A number of methods have been proposed. These include first the negotiating and signing of loan security instruments in the Australian Capital Territory or Northern Territory where such liability for duty does not arise. Secondly, it has been suggested that interest rates should be at a floating rate determined in accordance with fluctuating bond rates with a proviso that should this rate ever exceed 14 per cent then the loan is terminated and the money is to be repaid. A third suggested alternative is that the lender purchase bills of exchange from the borrower over a period of time rather than making a straight-out loan.

However, these and other suggested solutions to the market's stamp duty problem are by no means totally satisfactory and there is undoubtedly a need for legislative reform in this area.

VI CONCLUSION

In recent years, the short term money market has grown spectacularly as a portion of the Australian capital market. It has provided an efficient and effective avenue for the profitable, productive and secure utilisation of temporarily surplus funds. It has operated largely under a system of self-regulation, its "regulator" being primarily market forces. External regulation to date has been minimal, confined to the conditions imposed on official dealers by the Reserve Bank and to certain formalities required of dealers specified by the Financial Corporations Act 1974 (Cth) and the Securities Industry Act 1975 (N.S.W.).

The market has, however, now reached an important stage in its development. Its growth and present size now mean, together with other NBFI, that the market has an important role and influence in the Australian economy. The present lack of control by the monetary authorities over the market and other NBFI makes the effective implementation of the Government's monetary policies extremely difficult. It is for this reason primarily that regulation of the market is currently under re-examination. Discussions as to the most appropriate form of regulation so as not to hamper the market, yet so as to achieve the desired objectives, are continually in progress. The scope for added control definitely exists under both the Securities Industry Act and the Financial Corporations Act. It will be interesting in the future to observe what, if any, additional regulations are imposed on the market.

APPENDIX 1

AUTHORISED DEALER COMPANIES

All-States Discount Limited
A.M.P. Discount Corporation Limited
Capel Court Securities Limited
Delfin Discount Company Limited
First Federation Discount Company Limited
National Discount Corporation Limited
Short Term Acceptances Limited
Trans City Discount Limited
United Discount Company of Australia

APPENDIX 2**NON BANK FINANCIAL INTERMEDIARIES**

The non bank financial intermediaries (NBFI) are generally acknowledged as comprising:

1. Stock Exchange
2. Short Term Money Market.
3. Finance Companies
4. Life Insurance Companies
5. Building Societies
6. Public and Private Pension Funds
7. Pastoral Finance Companies
8. Trade Unions
9. Others—
 - (a) Non Life Insurance Offices
 - (b) Unit Trusts
 - (c) Land Trusts and Mutual Funds
 - (d) Friendly Societies
 - (e) Development Finance Companies
 - (f) Health Societies
 - (g) Investment Companies
 - (h) Trustee Companies