Foundations of Finance Revision

Financial Markets and Regulation

Functions of the central bank include:
- Developing and implementing monetary policy
- Issuing currency
- Providing banking services for the government
- Overseeing the operations of the financial system
- Facilitating the payments system

RBA responsible for monetary policy, payments system and stability of whole financial system
APRA responsible for prudential supervision of financial institutions including banks, credit union, building societies, insurance and superannuation companies.
ASIC responsible for enforcement of company and financial services laws with the objective to protect consumers, investors and creditors. They're also responsible for licensing and monitoring financial markets and advisors while also monitoring disclosure and conduct of Australian companies and service providers. (protect, licensing and disclosure)

RBA is accountable to the government, but is independent from the government.

Objectives of monetary policy:
- Stable economy
- Full employment
- Prosperity and welfare of the people of Australia

RBA inflation target 2-3%

The payments system is a set of arrangements that enables consumers and businesses and other parties to enter into and settle financial transactions.
Clearing is done through Austraclear and CHESS, RITS and RTGS and deferred net settlement.

APRA's functions:
- Development, implementation and supervision of prudential regulation
- Monitoring regulated entities to ensure they are complying with relevant legislation and prudential policies
- Advising the government on the development of regulation and legislation affecting regulated institutions and the financial markets in which they operate

Importance that ADIs do not take excessive risk
- To maintain investors confidence
- To avoid contagion
- To ensure the stability of the financial system

ASIC responsible for:

- Regulating financial markets
- Regulating securities, futures and corporations
- Consumer protection in superannuation, insurance, deposit-taking and credit

ASIC aims to:
- Assist and protect retail investors and consumers in the financial economy
- Build confidence in the integrity of Australia's capital markets
- Facilitate international capital flows and international enforcement
- Manage domestic and international implications of the global financial turmoil
- Increase operational effectiveness and service levels for all ASIC stakeholders
- Improve services and reduce costs by using new technologies and processes

Managed Funds, Super and Loans

Managed funds refer to money that investors have put with professional managers through trust vehicles.
Important classes of managed funds include **superannuation funds** and **public unit trusts**. This form of investment has the advantage of providing investors with risk intermediation by investing in a diversified portfolio of assets.

Public unit trusts are trusts in which investors can buy units in which funds are invested by a fund manager. Income is paid on a pro rata basis (proportion to the units held). Income is taxed in the hands of the investor.

There are 2 typed of PUTs:
- **Limited PUTs** – listed on the ASX and are highly liquid because units can be easily traded via the exchange at the current market prices
- **Unlisted PUTs** – units purchased via prospectus at price determined by formula based on valuation of the fund's assets

Advantages of managed funds:
- Investments are professionally managed
- Investors gain access to a wide menu of asset types
- Enhanced liquidity

Disadvantages of managed funds:
- Funds can exhibit short-termism and herd behaviour
- The investor faces the principal-agent problem – will MF's reflect investor preferences?
- The investor incurs the high cost of fees

Active strategies – Fund managers seek to outperform the market. They do this by selecting asset classes, individual investments and by trading frequently
Passive strategies – This if offered by an index fund. An index fund is a type of mutual fund with a portfolio constructed to match or track the components of a market index. An index fund provides broad market exposure, low operating expenses and low portfolio turnover