

Regulatory Co-ordination

Introduction

10.1 The various objectives for government regulation of the financial system can:

- come into conflict with one another (eg there may be a conflict between prudential regulations which restrict entry to a market and competition considerations which favour more open access); and
- change over time (eg innovation in financial products may shift the required focus of prudential regulation or disclosure regulation to new or different institutions).

10.2 It is important to have in place sound mechanisms for the review and co-ordination of regulatory agencies and their regulations, to ensure that regulatory arrangements always appropriately balance the objectives of effectiveness and cost efficiency, meet changing expectations and respond to changing community needs.

10.3 In addition, regulatory agencies themselves must be equipped to be responsive to market developments. For this, they must have the structures, management, staffing and other resources required for the attainment of best practice.

10.4 Together these elements are essential to the pursuit of flexibility and responsiveness in regulation. This chapter considers these requirements, noting some options for improving future review and co-ordination processes.

10.5 Around the world, a wide variety of mechanisms to meet these requirements has been established. In response to the need for co-ordination,

some countries have established a single ‘mega-regulator’ for the financial system. This internalises much of the task of co-ordination into a single agency. Other countries have used a variety of formal and informal means of co-ordinating separate agencies, while some have relatively limited co-ordination arrangements. Further information on the different approaches is presented in Appendix D.

10.6 Deciding the best approach to policy review and co-ordination for Australia will depend in part on the approach to the particular elements of regulation adopted for the financial system. It will also be influenced by the allocation of responsibilities between the Commonwealth and the States/Territories. However, this chapter concentrates mainly on co-ordination requirements at the Commonwealth level.

10.7 It can be argued that there is no single best structure for the co-ordination of financial sector regulations — that any number of alternative structures can be made to work well (or, conversely, that any arrangement can work badly if not well managed). Whatever arrangements are adopted, it is clear that performance will depend greatly on the accountability of the regulatory bodies, and it is essential that their performance be transparent to others.

Existing Arrangements

Policy Co-ordination

10.8 In recent times, responsibility at the federal level for the various aspects of financial sector regulation has increasingly been brought under the Treasurer and the Treasury portfolio. While this portfolio has long had responsibility for banking, insurance and superannuation, it now also has responsibility for:

- competition policy, including the Australian Competition and Consumer Commission (ACCC) and competition laws; and
- companies and securities, including the Australian Securities Commission (ASC) and the exchanges, which were transferred to the Treasury in 1996.

10.9 The Treasury portfolio is also responsible for taxation and foreign investment legislation. These 5 areas of responsibility (financial institutions, taxation, foreign investment, competition and business law) are all represented within the Department of the Treasury by separate policy divisions. The principal exception is the responsibility of another ministry, Small Business and Consumer Affairs, for the consumer protection parts of the trade practices law.

10.10 Apart from the co-location of most policy responsibilities within one portfolio, the co-ordination of some aspects of financial sector policies is also pursued through the Council of Financial Supervisors (COFS). This Council, established in 1992, comprises representatives of the Reserve Bank of Australia (RBA) (Chair), the ASC, the Insurance and Superannuation Commission (ISC) and the Australian Financial Institutions Commission (AFIC). The Treasury is not a member, nor is the ACCC.

10.11 COFS has no statutory basis, no staff and no budget. Its expenses are met by its member bodies. Given its membership, its principal focus is prudential regulation, although it also assists its member organisations to monitor broader developments.

10.12 Apart from COFS, and arrangements for bilateral discussions, there are no formal, regular co-ordinating interfaces between:

- Commonwealth and State/Territory regulatory agencies; or
- policy or regulatory agencies responsible for competition and taxation on the one hand and agencies responsible for prudential regulation or product regulation on the other.

10.13 At the State/Territory level, portfolio responsibilities are more diverse. In particular, responsibility for financial sector matters is vested in some cases in the Treasurer and, in other cases, in the Attorney-General. Consumer matters are covered by Ministers for Consumer Affairs.

10.14 At the State/Territory level, the 2 most important legislative areas (prudential regulation under the Financial Institutions Scheme and consumer protection through the *Uniform Consumer Credit Code*) are subject to laws determined co-operatively and applied in all jurisdictions. While this achieves greater regulatory uniformity, it also means that changes to the rules must be unanimously agreed by 8 governments before they can be given effect. Policy advice to those governments is provided by separate departmental and regulatory agencies.

Policy Reviews

10.15 From time to time, formal reviews of the financial system (or aspects of it) have been conducted, enabling a broader focus than may otherwise apply when policy considerations are restricted to specific regulatory functions.

10.16 The Campbell Committee in 1981 set considerable store by the need for review and co-ordination. In enunciating 6 broad principles for the role of government, it said of the sixth:

... it is clear that the need for government intervention and the appropriate methods of intervention change over time. Consequently, it is incumbent on the authorities to maintain a continuing oversight of the benefits and costs.¹

10.17 The frequency with which formal policy reviews are required depends in part on the scope and performance of policy co-ordination processes. If the regulatory arrangements are well co-ordinated and highly responsive to change, formal major external reviews should not be required so often. The pace of change and the need for continuous regulatory response emphasise the need for comprehensive co-ordination, with formal reviews left to less frequent strategic evaluations.

1 Australian Financial System Inquiry 1981, p.13.

The Regulators

10.18 The current corporate structures for the major financial regulators are as follows (their functions and operations are described in Appendix C).

- The RBA lies within the Treasury portfolio and has a Board of 10 members appointed by the Governor-General. Board membership comprises the RBA Governor as Chair, the 2 RBA Deputy Governors, the Secretary to the Treasury and appointees from industry or other sectors. The Board undertakes its functions pursuant to the *Reserve Bank Act 1959*, which specifies its duties in very broad terms.
- The ASC lies within the Treasury portfolio and is governed by 3 Commissioners, including the Chair, appointed by the Governor-General pursuant to the *Australian Securities Commission Act 1989*, which specifies a series of goals for the ASC. The Companies and Securities Advisory Committee provides an advisory body for policy matters, with most members drawn from industry.
- The ISC lies within the Treasury portfolio and is governed by the Insurance and Superannuation Commissioner, who is appointed by the Governor-General under the *Insurance and Superannuation Commissioner Act 1987*. While the ISC has no board, 3 consultative committees (for superannuation, life insurance and general insurance) provide a means for private sector input to policy and administrative processes.
- The ACCC lies within the Treasury portfolio, but also reports to the Minister for Small Business and Consumer Affairs (within the portfolio of Industry, Science and Tourism) on consumer affairs matters. It is governed by full-time Commissioners, including the Chair, appointed by the Governor-General, and part-time Associate Commissioners appointed by the Treasurer. One of the full-time Commissioners is required by law to have knowledge of, or experience in, consumer protection. The Australian Competition Tribunal is an independent body which deals with applications for review of decisions of the ACCC.

- AFIC is a portfolio responsibility of 8 State and Territory Ministers. It is governed by a Board of 9 members—8 chosen by the State/Territory Ministers and an Executive Director chosen by the other Board members. AFIC's responsibilities are contained in uniform State and Territory legislation, the *Australian Financial Institutions Commission Code* and the *Financial Institutions Code*.

10.19 Funding and staffing arrangements for the various regulators are not consistent. The RBA funds itself through its operations and has been able to establish its own career and salary structures. AFIC is funded through an industry levy at a level determined by its Board, and has its own career and salary structures. In contrast, the other financial regulators are funded from the Commonwealth Budget and subject to general public service rules regarding staffing and salaries. This is despite the fact that industry charges more than cover the cost of the regulators in the case of the ASC and ISC. While this means that the regulators are often unable to meet market conditions in recruiting staff, they have the same salary structures as the Treasury and other public sector agencies, often recruiting from those sources.

Views Presented in Submissions

10.20 The views on these matters in submissions can be grouped under 3 headings—mega-regulation, other co-ordination models, and regulatory performance. Many submissions placed the Treasurer or Treasury at the pinnacle of regulatory structures, implying that co-ordination was to be achieved at that level.

Mega-regulation

10.21 A small number of submissions saw the solution to co-ordination in a single mega-regulator. Under this option, a single line of organisational control is established to undertake each of market regulation, consumer protection and prudential regulation. In some submissions, notably that of the National Australia Bank (NAB), the mega-regulator was seen as an integrated organisation, while in others, notably the Treasury submission, it

was proposed that this could be achieved by a common board over a number of semi-autonomous regulatory units.

10.22 Those advocating a mega-regulator model saw this structure as best meeting the need to balance prudential and other objectives. The NAB also recommended that close links be established between the proposed mega-regulator and the (separate) RBA — including the Chair of the former being the Governor of the latter. It also proposed that co-ordination be strengthened by the establishment of a Standing Committee of the RBA, the Financial Institutions Division of the Treasury and the mega-regulator. This would meet at least quarterly at a senior level to exchange information and views on policy matters. Finally, NAB proposed a protocol between the ACCC and the mega-regulator to deal with overlap in the consumer protection area (principally related to s.52 of the *Trade Practices Act 1974*).

10.23 Attitudes to a mega-regulator may be influenced by the broader policy setting in which it might operate. For example, Thinkbank in its submission suggested that renewed regulatory emphasis on the market suggests a mega-regulator as a natural consequence, but that the benefits of this would depend on the wider range of policy adjustments concurrently made. The NAB submission similarly was based on a particular vision for regulation of the financial system, with the role of more intensive prudential regulation focused narrowly on bank-like core institutions within broader financial conglomerates.

Other Co-ordination Models

10.24 A number of those who did not favour a mega-regulator suggested a ‘twin peaks’ structure, with one regulator responsible for prudential regulation and the other for product (or consumer) regulation.²

- In some cases, the RBA was favoured for the first role, for example by Credit Union Services Corporation (Australia) Ltd and the Australian Association of Permanent Building Societies.
- A variation was the proposal for 3 financial regulators — the RBA responsible for monitoring and containing systemic risks, a

2 Broadly as recommended in Taylor, Michael 1995.

prudential regulator separate from the RBA and responsible also for setting product disclosure standards, and a third regulator responsible for regulation of advice and complaints resolution. This approach was suggested by the joint submission from the Australian Investment Managers' Association (AIMA), the Investment Funds Association of Australia (IFA) and the Life, Investment and Superannuation Association of Australia (LISA).

- That submission, among others, recommended some common directors among the financial regulators as part of otherwise strong working links among them.

10.25 The Australian Mutual Provident Society (AMP) suggested another approach: establishing a Supervision Council chaired by the Treasurer or Treasury to co-ordinate the regulatory agencies and to maintain strong links with the RBA (which AMP sees as separate from the supervisory regime).

10.26 A number of submissions recommending the retention of more than one prudential regulator, as under existing arrangements, still saw a need to strengthen co-ordination arrangements. Westpac Banking Corporation, for example, favoured the 'lead regulator' model with the RBA always the lead regulator when the conglomerate includes a bank (this model is discussed further in Chapter 5). It also proposed a clearer and stronger role for COFS, including a charter requiring it to balance efficiency and stability objectives with consumer needs. Westpac also recommended that the boards of regulatory agencies should have strengthened representation from those with industry experience, and that the broader implications of regulation should be assessed through independently prepared regulation impact statements for all formal and informal regulations.

10.27 The Australian Stock Exchange (ASX) was another to oppose both a mega-regulator and a 'twin peaks' approach. Again it saw a need to buttress COFS, but even more so. It saw the Treasury as having the peak policy advising responsibility and establishing a new unit close to the markets to bring together the various elements in a co-ordinated way. This unit would also provide the secretariat for COFS. The ASX and the International Banks and Securities Association also proposed a Financial Markets Council as a standing national industry advisory body.

10.28 The Treasury favoured a combination of mega-regulation and ‘twin peaks’, with separate prudential and disclosure regulators coming under a common board with legislative responsibility for the entire financial system. The Treasury also suggested that consideration be given to appointing an advisory panel of representatives drawn from participants in the financial system and from the regulatory and policy bodies. It saw this as a standing consultative and review procedure, independent of any one regulatory body.

10.29 COFS supported its existing roles but suggested that there may be merit in formalising its role in legislation and establishing regular consultations with industry bodies and other agencies with interests in the financial system.

10.30 Other submissions favoured regular independent formal inquiries along the lines of the present one. Westpac, for example, recommended such reviews be undertaken every 7 years.

10.31 Some submissions saw the future impact of technology as so important as to require special organisational responses. National Mutual and the Australian Consumers’ Association both recommended the establishment of special bodies to monitor and recommend on policies required in this area. These issues are addressed in Chapter 9.

Regulatory Performance

10.32 Some submissions, particularly those from industry, implicitly or explicitly were concerned that the governance of regulators needs to reflect a stronger commitment to flexibility and adaptability. Westpac, for example, argued for stronger industry experience on the boards of regulators and suggested that, if this were not possible for conflict-of-interest reasons, advisory boards be established.

10.33 Another concern related to the risk of capture of regulators, either by consumer interests or by industry. Bankers Trust Australia, for example, saw potential regulatory capture as a reason for maintaining a broad role for the ASC and for product regulation to remain with prudential regulators.

10.34 A frequent theme in discussions which the Inquiry has held with industry has been the need for regulators to get closer to their markets.

The ISC, which is Canberra-based, was frequently cited on this count. The joint AIMA/IFA/LISA submission proposed that a financial services regulator should be based in Sydney or Melbourne and report to a board of management. The ASX, in recommending a stronger role for the Treasury, suggested that its financial sector areas should be based near the markets. It also sought changes in the governance of the ASC that would move it more to a private sector operational style with a stronger policy focus and a mission more receptive to development of markets.

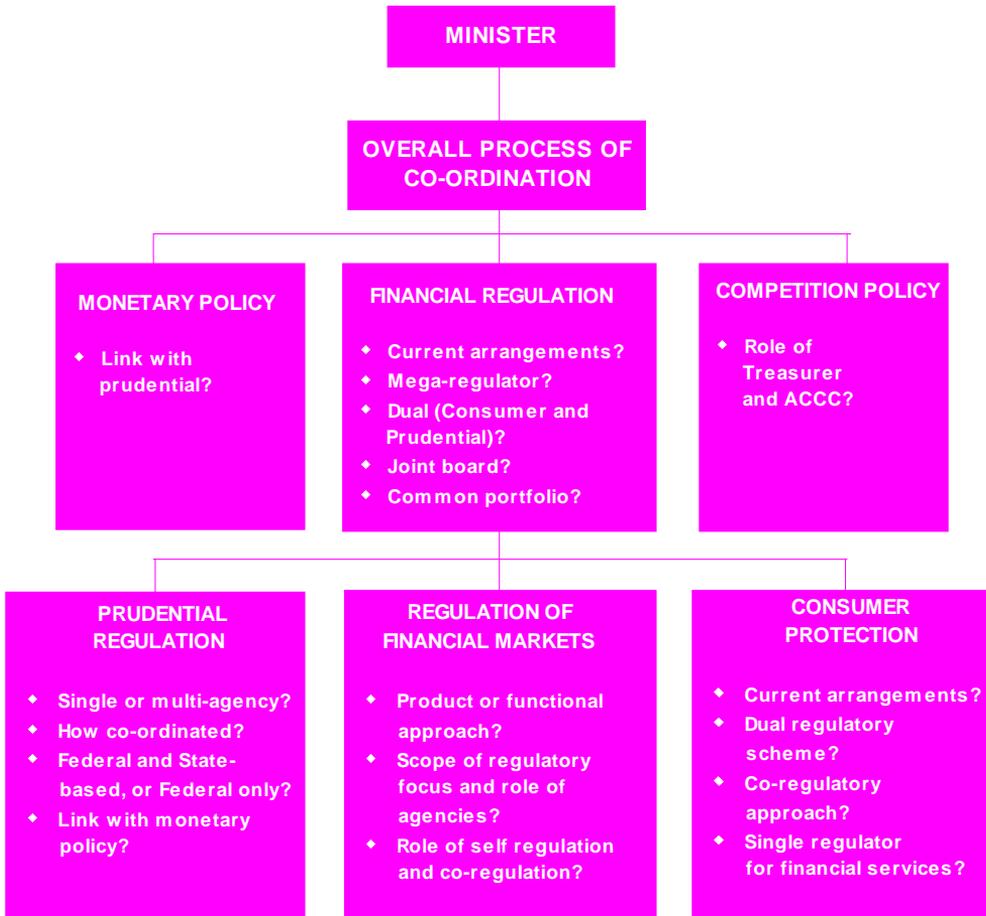
10.35 Bankers Trust also suggested that particular attention be given to the qualities of regulators, going beyond governance to the core of their operations. It suggested that better regulation may be assisted by location in Sydney, staffing budgets able to compete with those in the private sector, staff interchange with industry and matching legal staff with economic and policy components. Implicit in this is a shift in remuneration and employment standards away from public service norms towards those of the private sector.

10.36 The ACCC, in proposing a co-regulatory structure for consumer protection regulation, suggested the establishment of a council, including industry, government and demand-side representatives, to oversee self-regulatory codes. The ISC also advocated stronger industry representation on the boards of management of regulators.

Approach of the Inquiry

10.37 In summary, there is a range of options for achieving the most effective regulatory co-ordination of the financial sector, linked with options for consolidating regulatory functions in single agencies, as illustrated in Figure 10.1.

Figure 10.1: Options for Regulatory Co-ordination



10.38 The Inquiry proposes to formulate recommendations in this area, having regard to its preferred approach to meeting regulatory objectives.

10.39 It is clear that the performance of the regulatory framework depends critically on arrangements for the co-ordination of regulatory functions. In addition, to ensure best practice, it will be necessary to consider the key elements in securing regulatory performance and accountability. The Inquiry will consider the extent, if any, to which these tasks would be better met by bringing agencies together under some form of mega-regulator.

10.40 Regulatory power is essential to the smooth and efficient functioning of markets, but its exercise should always be sensitive to its cost

and the rights of those to and for whom it is directed. Concern has been expressed to the Inquiry that regulators should not have excessive powers and that they should exercise their powers free of 'capture' by either industry or user groups. A particular concern is that if regulators are given relatively narrow, specific missions, which may be desirable from an organisational management viewpoint, they should not pursue these in isolation from the broader goals of financial sector policy.

10.41 The processes of policy review and co-ordination are essential to meeting these expressed concerns.

10.42 The primary responsibility for financial system regulation at the Commonwealth level rests with the Treasurer, acting on behalf of the elected Government. This has not been challenged by any of the submissions. The review and the co-ordination of financial sector policy are thus about seeking the means which will best assist the Treasurer in exercising his or her powers and responsibilities. It will be necessary to consider the appropriate portfolio arrangements for consumer protection in the context of any recommendations for change in this area.

10.43 In developing its recommendations, the Inquiry will pay close attention to the principles enunciated in Chapter 4. Of particular importance is the need to ensure the following:

- The regulatory system is to be fully accountable. This requires not only that lines of responsibility be clear but also that processes and performance be fully transparent. Given the technical complexity of much of the financial system and its regulation, there should be a capacity to expertly assess performance independently of the regulatory agencies themselves.
- The different objectives of regulation are to be optimally balanced over time. This requires that areas specialising in achieving one objective or another be subject to countervailing considerations of the impact of their activities on other financial system objectives. In particular, regulation must always be cost-effective and have minimal anti-competitive effects.
- The regulatory system is to be flexible and responsive to change. This requires that there be strong mechanisms in place for the involvement in monitoring and review processes of financial sector

participants and consumer interests, and that regulators be close to their markets.

- The arrangements are to ensure that there are strongly-performing regulatory agencies, with strong management, staff and other resources.
- Where, and if, more than one regulator has responsibility in the financial system, mechanisms are to be in place for the exchange of information and for ongoing co-ordination of regulatory functions among them.
- If necessary, means are to be established for linking or modifying the respective roles of the Commonwealth and the States/Territories.