Chapter 6

FUTURE APPROACH TO REGULATION

In addition to the key question of what changes should be made to existing regulation, which are discussed in the following chapters, a number of important overarching regulatory issues need to be considered. They are:

- how regulation and supervision should occur - by institution or function;
- who should be responsible for regulation and supervision;
- how should the blurring of boundaries between financial institutions be dealt with; and
- how should the adaptability of the regulatory framework be assured.

These issues are not straightforward. They are complicated because any regulatory approach needs to take account of:

- differences in the nature of the obligations financial institutions incur in their dealings with customers; and
- the varying objectives of regulation.

This chapter first addresses these “umbrella” issues and then makes recommendations on how the approach to regulation should be structured so as to balance the need for stability and consumer protection with that of an efficient financial system.

6.1 The Nature of Financial Institution Obligations

6.1.1 Distinction between guaranteed and non-guaranteed investments

The nature of obligations incurred by financial institutions in their dealings with customers varies considerably depending on the product and the nature of the ‘promise’ underpinning the transaction. Broadly speaking, a distinction can be drawn between obligations:

- where there is an institutional guarantee as to the amount and timing or circumstances of any payment; and
- where there is no such institutional guarantee, the eventual payment depending on the performance of the underlying investments.

Whether or not repayment is guaranteed, users expect to be treated fairly and equitably when they are dealing with financial institutions and markets. Confidence that this will happen is central to the efficient operation of financial markets.

The provision of a guarantee by institutions is usually regarded as being of sufficient importance to warrant *prudential supervision*[1] on an institutional basis to ensure that the obligations are met. Particularly for banks, any lack of confidence that the obligations may be met poses a threat to financial system stability and soundness. Examples of institutional prudential supervision include the supervision of banks by the Reserve Bank, building societies and credit unions by AFIC, life insurance companies by the ISC and friendly societies by State Supervisory Authorities.

There is also a body of regulation designed to ensure that users of financial products and markets are fully informed and are treated fairly and equitably. This is organised on a functional basis and takes the form of what can generally be termed *financial practice regulation*. It involves setting appropriate standards to be observed, particularly relating to disclosure. It does not involve prudential supervision, relying instead on penalties at law to ensure observance.

Examples of the regulation of business conduct or market practices include the regulation of futures, foreign exchange and securities markets, the provision of consumer finance under the Uniform Consumer Credit Code, and prospectus requirements administered by the ASC.

6.1.2 Obligations affecting savings and investment choices

The major obligations incurred by institutions and which attach to the broad classes of savings and investment choices can be summarised as follows:

At-call deposits

At call deposits are capital guaranteed and repayable on demand. Banks bear the risk of managing the mismatch of assets and liabilities. The only risk customers have is that the deposit-taking institution will remain solvent, and even here depositors with a bank have a preferential claim on its assets in the event that it fails. (This preferential status does not apply with building society and credit union deposits.) The need for protection arises because a typical depositor is not in a position to assess fully the nature of the assets in which their deposits are 'invested'. As depositors use their deposits for making payments, the inability of a bank to meet its obligations would also have repercussions for others in the community.

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1 It is useful to draw a distinction between *regulation* and *supervision*. This has been done by the Bank of England in the following terms:
"Regulation ... is about rules and about the precise formulation and policing of those rules. In respect of financial services it calls for the codification of a corpus of strictly defined and detailed rules relating to particular activities, products and services. It entails specialised techniques of monitoring and enforcement and is usually accompanied by sanctions which are equally precise in their nature and in the circumstances of their application...
Supervision is different, both in content and style: the law sets the framework within which authorised companies may operate, rather than prescribing in detail how the relevant goods and services shall be provided. Within that context, the companies providing those goods and services are, broadly speaking left to make their own business decisions." [*Bank of England Quarterly Bulletin*, May 1993, pages 260-1; cited in Sixth report of the UK Treasury and Civil Service Committee on *The Regulation of Financial Services in the UK*; Volume 1].
In this Submission, *supervision* is taken to mean a more flexible approach involving the setting of rules and guidelines within which financial institutions operate and the monitoring of the extent to which they do so by supervisory authorities. *Regulation* is taken to mean requirements which are generally more prescriptive, with penalties being imposed for breaches. There is no on-going supervision, although approval for specific actions may be required.

Currently the only institutions permitted to accept deposits include banks, building societies and credit unions, and they are known as deposit-taking institutions (DTIs). At-call deposits warrant prudential supervision and are currently supervised by Reserve Bank (for banks) or AFIC/SSAs[2] (for credit unions and building societies).

Term deposits

Term deposits are also capital guaranteed, but are not time-critical in the same way as at-call deposits, being payable on maturity. The proposed Retirement Savings Accounts are effectively an extended-term, compound interest deposit account and thus functionally fit within this category. Again, term deposits are only offered by prudentially supervised deposit-taking institutions.

Finance company debentures

Finance company debentures are functionally similar to term deposits, meeting broadly the same customer need and being capital guaranteed. However, finance companies are not supervised and their debenture holders have no priority in the event of a company's failure. Such debentures therefore offer a rate premium over that on deposits for the greater risk associated with repayment of capital on maturity.

Making finance companies subject to the same prudential supervision as non-bank DTIs would reduce the diversity of choice, in terms of the range of risk and return available to investors. Unless raising funds by prospectus were prohibited, this would lead other institutions to fill the gap, taking advantage of less regulation and the community's desire for a risk spectrum for savings. While finance companies are not prudentially supervised, there is an expectation that investors will be treated fairly and equitably in their dealings with finance companies and the ASC seeks to achieve this by regulating the way they raise funds.

Insurance

Insurance products are obligations which commit the insurer to make payments to policyholders when certain events occur or at pre-specified times. There is thus an unequivocal commitment as to the amount and circumstances in which payment will be made. This, together with their generally long term "event risk" nature, sets insurance products aside from managed funds. The customer risk, as with deposits, is related to the solvency of the insurance company.

The nature of the event which triggers the payout varies. In the case of life insurance, it is the death of the insured. With disability and health insurance, it may be an accident or illness. In the case of property insurance, it may be fire or theft. Prudential supervision provides confidence that an insurer will be able to pay claims when the insured event occurs. This is crucial to efficiency and community welfare, as it means that the only risk a policyholder has to be concerned about is the risk for which they have insurance.

[2] AFIC sets prudential standards under the Financial Institutions Scheme, with State Supervisory Authorities being responsible for the day to day supervision of credit unions and building societies to ensure that the standards are observed.

Life insurance bonds

Life insurance bonds issued by friendly societies and life insurance companies have features akin to both term deposits and managed funds. They are in practice little different to a managed fund in that they are not necessarily capital guaranteed but rely on the performance of the underlying investments. They have no inherent capital guarantee and are quite different from a term deposit. Their long term nature also suggests they are not directly competitive with bank term deposits.

Life insurance bonds offered by life insurance companies are subject to ISC prudential supervision, while those offered by friendly societies are the responsibility of State Supervisory Authorities[3]. The assets and liabilities of life bonds are held on the accounts of the life company, within a statutory fund.

Managed funds

Managed funds have similar characteristics to equities in that neither their capital, much less their performance, is guaranteed. All the risk is carried by the investor, who has a claim on the investments in which their funds are invested rather than on the institution which pools the funds and manages the investments. As their investments are usually tradeable and can be liquefied at short notice (a notable exception being unlisted property trusts), they are less likely to be exposed to crises of confidence, even though payment may be on demand. Managed funds are therefore subject to financial practices regulation by the ASC, including disclosure rules, rather than prudential supervision.

Superannuation

Defined benefit funds, by their nature, involve an expectation by employees that they will receive a certain sum, usually related to salary, on retirement. *Accumulation funds* do not carry such a promise, their value to contributors on retirement depending on the performance of the underlying investments.

With compulsory superannuation having been a major part of the Retirement Incomes Policy of successive Governments, there may be a general community expectation that potential beneficiaries will not lose their savings. Aside from this expectation and the long term nature of investments, superannuation funds are functionally the same as other managed funds, although the preserved benefit is payable only on the retirement of contributors or transfers to another super fund. All superannuation funds are supervised by the ISC, although that supervision is less concerned with solvency than is the case with insurance companies. This involves the setting of rules for fund trustees concerning their approach risk, diversification and liquidity. Supervision is also related to the ISC's role as agent for government in ensuring that tax concession guidelines are observed.

6.1.3 Obligations affecting other financial services

The obligations incurred by institutions in providing other financial services relate primarily to the fair and equitable treatment of users of those services.

[3] In 1994, it was proposed to bring friendly societies into the Financial Institutions Scheme from 1 July 1995. However, this has not happened to date.

Provision of credit

The obligations involved in extending credit are similar to those applying to non-guaranteed investments. They relate to products rather than institutions. Obligations centre on the needs and expectations of users that they will be treated fairly and equitably. The need for regulation of business practices associated with lending arises out of a perceived imbalance in market power between financial institutions and their customers, particularly their smaller personal customers.

Responsibility for regulation designed to protect borrowers is widely spread, with the ACCC, Australian Payments System Council and State Governments (through their responsibilities for the Uniform Consumer Credit Code) all being involved. The banks have also set down minimum standards in the Code of Banking Practice, with credit unions and building societies addressing the same issues in their respective Codes.

Payments services

The obligations incurred by institutions providing payments services relate primarily to ensuring that their customers are informed of the terms and conditions on which those services are provided. Obligations relating to the clearing and settlement functions of the payments system (see Chapter 8) relate ultimately to a guarantee to deliver finality of payment across deposit accounts, subject to ensuring the integrity of the payments instructions. Inability to deliver against these instructions may have consequences for financial system stability. Responsibility for regulation rests with the Reserve Bank and the Australian Payments System Council. The industry Codes of Practice also lay down minimum standards of disclosure.

Risk management products

The provision of risk management products and their trading in financial markets are dependent on the competence of the institutions involved and confidence in the fairness of the markets concerned. However, as there is not the same perceived imbalance of market power, this objective is achieved primarily through disclosure rather than prescriptive regulation and supervision. The main regulator is the ASC for exchange traded derivatives and Reserve Bank for over the counter derivatives (see Section 7.9).

Financial advisers

The provision of financial advice is an area where the competence of those providing the advice is of considerable importance, due to the increasing complexity of the product alternatives that users face. This is closely regulated by the ASC, which limits who can provide advice and the training and experience they are expected to have.

6.2 Aligning the Regulatory Approach with Financial Obligations

6.2.1 Assessment of the existing approach to regulation

The existing approach to regulation and prudential supervision is outlined in Figure 6.1. As is readily apparent, responsibility is very fragmented, a situation which has resulted in inconsistencies between different regulators as well as additional costs and a lack of competitive neutrality for different financial institution groups in important areas of their business.

Figure 6.1
EXISTING APPROACH TO FINANCIAL SYSTEM REGULATION

STATES | **COUNCIL OF FINANCIAL SUPERVISORS**

	State Supervisory Authorities	**Australian Financial Institutions Commission**	**Reserve Bank**	**Insurance & Superannuation Commission**	**Australian Securities Commission**	**ACCC**
Prudential Supervision	• Supervision of: - Credit Unions - Building Societies • Friendly Societies (outside F.I. scheme)	• Prudential Standards for Credit Unions and Building Societies	• Banks	• Life Offices • General Insurance		
Protection of Retail Consumers (Investors and Borrowers)	State Consumer Affairs Depts: • Uniform Consumer Credit Code		• APSC: Codes of Practice for Banks, Credit Unions and Building Societies; EFT Code	• Superannuation Funds[1] • Life Offices • General Insurance Companies • Industry Codes of Practice Insurance Brokers	• Finance Companies • Fund Managers • Financial Advisers	• Consumer Policy • Prices Surveillance
Other Industry Regulation			• Payments System Oversight		• Securities and Futures Markets Companies Regulation	• Competition Policy

1 Whereas prudential supervision of life offices and general insurance companies involves setting out and monitoring solvency standards, superannuation funds are the focus of standards relating to internal disciplines and controls, and disclosure to members. Similar standards apply to funds managers.

The regulatory framework is, however, broadly consistent with the nature of the obligations involved. Regulation designed to achieve prudential objectives is provided on an *institutional* basis, because it is institutions that fail and thus are unable to fulfil their obligations to investors.

On the other hand, regulation intended to ensure that investors and borrowers are treated fairly and equitably (eg. by ensuring they have adequate information on terms and conditions), and regulation that is designed to ensure competition, are largely *functional* in nature, that is, institutions providing the same or a similar financial product or service are regulated in the same way.

There are, however, exceptions to this functional approach. For example, some consumer regulation is institutionally based. The Australian Payment System Council (and through it the RBA) has certain responsibilities for monitoring implementation of the Code of Banking Practice. The ISC has responsibility for "fair and open dealing between the insurance and superannuation industries and their customers".

6.2.2 Separation of prudential and financial practices regulation

It is clear that the regulation of financial practices and solvency-related prudential supervision each require a very distinct range of skills. Prudential supervision, which is intended to encourage the prudent, sound management of financial institutions, involves detailed assessments of risk management capabilities and performance. Financial practices regulation, whether it is designed to protect borrowers or investors, largely involves setting standards for disclosure and market behaviour. Competition policy involves assessments of market structure and the interplay of market forces.

In these circumstances, a single regulator is highly unlikely to generate cost savings through economies of scale. Indeed, in the same way as large institutions with multiple businesses can experience diseconomies of scale, a regulator pursuing multiple objectives at any given time could be unwieldy and difficult to manage.

There are some other compelling arguments against a single regulator:

- Concentration of power in the hands of a single authority may also foster a strong pro-regulation mentality and thus an increase in the overall level of regulation. The Reserve Bank has put the scenario more starkly:

  > " ...a monolithic supervisory structure might bring about inefficiencies through stifling innovation and forcing financial activities into the one mould."[4]

- Regulation and supervision by a single regulator may also unintentionally extend the range of obligations which are perceived to be guaranteed and thus "moral hazard" to the detriment of efficiency and community welfare.

- The need for such a regulator to operate with separate divisions means that the risk of competitive inequalities will be no less than a system in which responsibilities for regulation are aligned on a more functional basis and whose activities are effectively co-ordinated by the Council of Financial Supervisors.

Consequently, prudential supervision and financial practices regulation need to be conducted by different regulatory agencies.

***Recommendation 6.1*: Separate agencies should be responsible for prudential supervision and for the regulation of financial practices.**

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4 *Regulatory Policy Issues in Australia*, G.J. Thompson, July 1996, page 3

6.3 Approach to Prudential Supervision

6.3.1 Institutional basis for prudential supervision

Prudential supervision of life offices, banks and other deposit-taking institutions involves monitoring the performance of individual financial institutions to ensure they manage risk effectively, remain solvent and thus are able to meet their obligations at all times. This reflects the importance of their obligations to investors to make payments at a specified time or under specified circumstances. The Governor of the Reserve Bank observed recently that:

> "Prudential regulation aims to ensure the prudential soundness of financial institutions and is, by definition, institution-based. It is the failure of institutions, not particular products, which poses the greatest threat to those who seek maximum security for their savings and, at the macro level, to stability in the financial system."[5]

Institutional solvency is also the basis for prudential supervision of banks in all OECD countries. Australian banks would find it difficult to maintain their high international credit ratings and would be competitively disadvantaged internationally if they were not supervised on an institutional basis and thus did not fall within the Basle supervisory framework.

Consequently, there are compelling reasons why prudential supervision should be applied on an institutional basis.

It has been suggested that a functional approach to prudential supervision would be more flexible than an institutional approach and would thus be more consistent with economic efficiency and the free flow of market forces. While Westpac is a strong supporter of functional regulation where it relates to the regulation of financial practices, such an approach is not consistent with supervision designed to ensure that institutions can fulfil their obligations to investors.

An adaptable regulatory framework based on institutional supervision can be achieved through the closer alignment of regulation and the nature of the obligations to investors incurred by different institutions. This is discussed further below. Such an approach will ensure that similar functions are regulated in a similar manner. This will, in turn, enable financial institutions to respond flexibly to change by adapting their form. This is clearly demonstrated by the way financial services are becoming disaggregated, which was discussed in chapter 4. So long as supervisors permit equity investments in industries which, while not traditionally part of banking, fall within a broadly defined “field of finance”, banks will gradually evolve in new directions. (See further discussion in Section 7.5.)

Recommendation 6.2**: Prudential supervision should be applied on an institutional basis where institutions incur obligations to investors in the form of guarantees as to the timing or circumstances in which payment will be made and the amount of that payment.**

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5 *Financial regulation and the Financial System Inquiry*, B.W. Fraser, July 1996, page 2

6.3.2 Responsibility for prudential supervision

Existing responsibilities for prudential supervision comprise the following:

- The Reserve Bank is responsible for the prudential supervision of banks.
- The ISC is responsible for life and general insurance companies and superannuation funds.
- AFIC is responsible for setting prudential standards for credit unions and building societies, with supervisory responsibility resting with State Supervisory Authorities.
- Friendly societies are supervised by the State Supervisory Authorities.

While the ASC regulates finance companies and managed funds, this is confined to minimising the risk of fraud and malpractice and enabling investors to make informed decisions by appropriate disclosure and ensuring that independent trustees perform their role effectively. It does not involve prudential supervision designed to protect investors against loss.

Suggestions that prudential supervision of banks and insurance companies should be the responsibility of a single supervisor are primarily based on the blurring of institutional boundaries. It is argued that this would mean these institutions being regulated in a consistent manner, in the interests of competitive neutrality. Westpac does not share this view. It believes that prudential supervision of banks and insurance companies should remain the responsibility of different agencies for a number of reasons:

Differences in the nature of risks

There are important differences in the nature of the obligations of life offices and general insurance companies on the one hand and banks and other DTIs on the other. Insurance products and deposits are both capital guaranteed (ie. the principal or insured value are guaranteed), but the nature of the risks which have to be managed (and thus supervised) are different.

Given the different nature of the risks, supervision of insurance companies and DTIs require different skills. Supervisors of DTIs need to be skilled in understanding credit, market, liquidity and operational risk management whereas life office and general insurance supervisors need to understand operational and actuarial considerations which are specific to insurance companies. This functional complexity and diversity is a compelling argument for separate supervisors.

Maintaining the spectrum of risk

Retaining separate regulatory agencies will help avoid a public perception that all investments have the same risks and obligations as each other. The separation thus contributes to greater diversity of choice (on a risk/return basis) for the community, and a reduction in moral hazard. This would particularly be the case if the RBA were the single regulator and supervisor.

Reserve Bank as lender of last resort

It is important that the Reserve Bank, as lender of last resort to the financial system, should be in a position to respond quickly to a liquidity crisis. This would be difficult with a single regulator which was not the Reserve Bank, as the latter would need to satisfy itself that support was not being provided to an insolvent institution and also that the level of support provided was commensurate with the problem. Such an outcome means that the Reserve Bank would have to "shadow" regulate to discharge its lender of last resort role, thereby raising the overall cost of regulation.

Balance sheet differences

As the Reserve Bank has noted, there is unlikely ever to be a merging of the different sorts of balance sheets within the one institution:

> "There could be formidable legal obstacles - stemming from the different claims available to classes of stakeholders such as depositors, policyholders and investors - to the co-mingling of different product classes in the one entity."[6]

Clearly, banks and insurance firms have very different balance sheet structures, thereby requiring different regulatory approaches.

Concentration of power

Concentration of power in the hands of a single prudential authority may foster a strong pro-regulation mentality, and thus an increase in the overall level of regulation.

Cost-effectiveness

It is sometimes suggested that a single prudential supervisor would be more cost-effective than several supervisors. In its evidence to the Martin Committee, the ISC doubted that there were any savings likely from the creation of a single regulator:

> "The supervision of banking and the supervision of life and general insurance are quite different indeed. The expertise that is required is quite different ... there are no economies of scale by combining supervision". [7]

Given the difference in risks which need to be supervised and the different expertise required, a single regulator would need to operate with separate divisions, as indeed, the Office of Financial Supervision does in Canada[8].

Regulatory flexibility

While the ability of regulation to adapt to innovation and a changing market place is very important, these objectives can be achieved by individual regulators where:

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6 *Prudential supervision and the changing financial system*, G.J. Thompson, March 1996, page 9

7 *A Pocket Full of Change*, 1991, page 237

8 While the Canadian approach to supervision is often cited as an example of a single supervisor, in fact three different agencies are involved: the Office of the Superintendent of Financial Institutions, which supervises all federally regulated banks; insurance, trust, loans and investment companies; co-operative credit associations; and pension plans, the Canada Deposit Insurance Corporation and the Bank of Canada, which is lender of last resort for banks.

- there is a closer alignment between regulatory responsibilities and functions;
- there is sensitivity about the need for regulation to adapt to change; and
- individual regulators operate in a lead regulator capacity and are supported as necessary by a strengthened Council of Financial Supervisors (as proposed in section 6.5.3).

Competitive neutrality and consistency

The risk that overlaps and gaps in supervision will give rise to competitive inequalities where there are different regulators will increase as the financial system evolves. While a single regulator might reduce that risk, the need for such a regulator to operate with separate divisions means that it will not be eliminated. Equally effective would be co-ordination between regulators whose responsibilities are aligned on a more functional basis than at present, with a strong co-ordinating role being undertaken by the Council of Financial Supervisors.

In the final analysis, it is the sensitivity of supervisors to this issue and their co-ordination which will ensure competitive neutrality, not whether there are one or several supervisory entities.

Regulatory arbitrage

Regulatory arbitrage occurs where institutions performing essentially the same function look to do so under a less onerous regulator. This has happened in Australia in the sense that it has been a factor in the decision of several building societies to seek banking licences. The scope for this will be less if some rationalisation of regulators takes place, if use is made of lead regulators (see section 6.5.2) and if the Council of Financial Supervisors is strengthened (see section 6.5.3).

Conclusion

It was concluded in section 6.2.1 that there were compelling reasons why prudential supervision should be applied on an institutional basis. There are equally compelling reasons why prudential supervision of DTIs and insurance companies should be undertaken by separate agencies.

***Recommendation 6.3*: In the interest of insuring the integrity of the payments system and the protection of deposits, the prudential supervision of banks should be undertaken by the Reserve Bank. To protect policy holders, the prudentail supervison of life and general insurance companies should be undertaken by the ISC.**

6.3.3 Prudential supervision of non-bank deposit-taking institutions

In line with recommendation 6.3, Westpac believes that there is scope to align responsibility for prudential supervision of all deposit-taking institutions on a more functional basis by abolishing AFIC and transferring responsibility for the supervision of credit unions and building societies to the Reserve Bank. This does not imply that these institutions would become banks.

There is a significant difference between the role played by banks, as distinct from non-bank deposit taking institutions, in the provision of critical elements of the financial system. Any blurring of this distinction would increase the risk that adverse developments with a building society or credit union could lead to an erosion of public confidence in the payments system and in financial system stability more generally. An additional concern would be that problems encountered by individual credit unions or building societies may also spill-over into confidence in regional banks which were once building societies.

Consequently, credit unions and building societies should continue to maintain their separate identity, and not be called 'banks'. In addition, reflecting their limited risk management capability and scale, these non-bank institutions should not have direct access to the clearing and settlement systems, but continue indirect access via agency arrangements with banks or industry Special Service Providers (see Chapter 8).

At present, credit unions and building societies are subject to primary objects tests:

- Credit unions are required to ensure that, at all times, no less than 60% of their total assets comprise assets derived from financial accommodation to members. Where this is for commercial purposes, this must not exceed 10% of total assets.

- Building societies must ensure that, at all times, no less than 50% of their total assets are derived from financial accommodation to members secured by the purchase of residential dwellings or residential development.

In each case, State Supervisory Authorities can exempt individual institutions, on unspecified grounds.

Credit unions and building societies also are permitted to use derivatives only to reduce market risk and thus cannot undertake trading in derivative products on behalf of their customers, but only in connection with their own liquidity management. Given the nature of non-bank deposit taking intermediaries, Westpac believes continuation of this restriction is appropriate.

Following the proposed shift to Reserve Bank supervision, however, non-bank deposit taking institutions, as with banks, should have an incentive to improve prudential management.

In line with this approach, individual institutions should be able to receive full or partial exemption from the 'primary objects' requirements, on a case-by-case basis, where they can satisfy the Reserve Bank that:

- they have the necessary management skills and board members with relevant experience to ensure that they can evolve beyond these primary business areas, without compromising their ability to meet their obligations to depositors; and

- they maintain a level of capital which is consistent with the riskiness of the activities being undertaken and the relative importance of those activities to the institution.

Institutions which have access to equity markets for additional capital would have this taken into account when determining the level of capital which would be required.

Thus, where the Reserve Bank chooses to maintain restrictions on the activities of credit unions and building societies, it should indicate the circumstances in which it would be willing to relax these. This would provide the scope for these institutions to evolve and the incentive for them to ensure this is done in a controlled and prudent way.

***Recommendation 6.4*: Responsibility for supervision of credit unions and building societies should be transferred to the Reserve Bank. However, these institutions should remain separate from, and not be called, banks, and should continue to individually access the clearing and settlement systems through agency arrangements.**

***Recommendation 6.5*: Credit unions and building societies should be subject to the primary objects tests, but individual institutions should be exempted on a case-by-case basis where they can satisfy the Reserve Bank that:**

- **they have the necessary management skills and directors with relevant experience to ensure they can diversify without compromising their ability to meet their obligations to depositors; and**

- **they maintain a level of capital which is consistent with the riskiness of the activities being undertaken and the relative importance of those activities to the institution.**

6.3.4 Prudential supervision of insurance and superannuation

Section 6.3.2 concluded that there were compelling reasons why prudential supervision should be undertaken by separate agencies. The main focus of the ISC's responsibilities is policyholders with life and general insurance companies because of the nature of the obligations involved. The rest of this section proposes that the ISC's responsibilities should:

- continue to encompass superannuation funds; and

- be extended to include friendly societies.

Superannuation

A difficult issue is the appropriate approach to the regulation and supervision of accumulation and defined benefit superannuation funds and other managed funds.

As noted earlier, *defined benefit funds* involve an expectation by employees that they will receive a certain sum, usually related to salary, on retirement. It may be argued that this justifies prudential supervision to ensure that this expectation is realised. *Accumulation funds* do not carry such an expectation, their value to contributors on retirement depending on the performance of the underlying investments. Both kinds of superannuation funds are currently regulated by the ISC.

The ISC's objectives and approach in relation to superannuation funds are broadly the same as those of the ASC in relation to other managed funds. These involve minimising the risk of fraud and malpractice and enabling investors to make informed decisions by appropriate disclosure and ensuring that independent trustees perform their role effectively. The objective is not to protect contributors against loss associated with the performance of the underlying investments, through close prudential supervision.

While responsibility for regulation of superannuation could therefore be transferred to a financial practices regulator, a strong case exists for responsibility to remain with the ISC. Superannuation plays a central role in the Government's retirement savings policy. Overseeing the taxation compliance of superannuation funds is also critical. Finally, superannuation funds represent a substantial proportion of the assets of life office statutory funds, making it impractical to separate them in the context of prudential supervision.

***Recommendation 6.6*: Superannuation funds should continue to be subject to prudential regulation by the ISC.**

Friendly societies

Friendly societies operate only in some States, with their activities being concentrated in Victoria. The majority of them are small and do not provide financial services. However, some of the larger ones do - the main financial product offered being life insurance bonds which are invested mostly in highly liquid assets. These friendly societies thus compete directly with life insurance companies.

While it is currently proposed to bring friendly societies within the Financial Institutions Scheme, the main reason for doing so is one of convenience, as they are currently regulated by State Supervisory Authorities (SSAs), whose main role is to supervise credit unions and building societies. It would be more consistent with a functional approach for these societies to be supervised by the ISC. (Those which do not provide financial services should remain the responsibility of the SSAs.)

***Recommendation 6.7*: Friendly societies which provide financial services to their members should be supervised by the ISC.**

6.3.5 Conclusion

Prudential supervision should be applied on an institutional basis, as it is institutions which fail. Any advantages of using a single supervisor to achieve this are outweighed by the advantages of using separate supervisors. The Reserve Bank and the ISC should therefore be structured as separate regulatory bodies, with the responsibilities discussed in previous sections.

The restructure of responsibilities would align regulation more closely with the obligations incurred by different types of institutions. This would contribute to making the regulatory framework more competitively neutral and efficient.

6.4 Approach to Regulation of Financial Practices

6.4.1 Overall approach

There is a wide range of regulation designed to ensure that, in their dealings with financial institutions, investors and borrowers are treated fairly and equitably. This broadly sets down rules for the conduct of business involving the sale of products or services provided by financial institutions, the competence of those providing advice about those products and the integrity of financial markets. The major emphasis here is on protecting customers, particularly less sophisticated customers, against unfair terms and conditions, misrepresentation, negligence, incompetence, fraud, etc. Competition policy is also administered on a functional basis.

Westpac is a supporter of functional regulation where this is designed to protect investors and consumers and no institutional guarantee is involved of a kind which warrants prudential supervision. A functional approach is more likely to result in a regulatory framework which promotes financial system efficiency by enabling institutions to compete on a playing field where everyone plays by the same business conduct rules.

***Recommendation 6.8*: Regulation designed largely to protect consumers should be applied on a functional basis equally across all institutions.**

6.4.2 Responsibility for financial practices regulation

It is evident from Figure 6.1 that responsibilities for the regulation of financial practices is very fragmented, having developed in a piecemeal way over a long period:

- The State Government Consumer Affairs Departments are responsible for the Uniform Consumer Credit Code.

- The ISC is responsible for consumer protection issues as they relate to life offices and general insurance companies. It is also responsible for the protection of consumers dealing with insurance agents and brokers.

- The Australian Payments System Council (and through it the Reserve Bank) has monitoring responsibilities in relation to the Codes of Banking, Credit Union and Building Society Practice, as well as for the EFT Code.

- The ASC has responsibility for the licensing of financial advisers and funds raising by funds managers and finance companies.

- The ACCC is responsible for the administration of consumer protection provisions in the Trade Practices Act 1970 and the Prices Surveillance Act 1983.

With such extensive fragmentation, it is inevitable that there will be overlaps and underlaps, inconsistencies and a general lack of clarity in the objectives of all the different agencies involved. It is logical, therefore, that they should be drawn together under a single agency. This would not only be more efficient, by reducing overlaps and underlaps, but the similar nature of the regulatory activities involved means that there would be economies of scale in doing this.

One option is to build on the existing responsibilities of the ACCC or the ASC. This would involve broadening the role of either institution to include investor and consumer protection responsibilities. Another option is to establish an entirely separate authority which would be responsible for the regulation of financial practices which are designed to protect consumers whether they are borrowing or investing.

Recommendation 6.9: **Responsibility for the regulation of financial practices and conduct should be drawn together in one agency, involving the creation of a new Financial Practices Authority (FPA) or an extension of the existing functions of the ACCC or ASC.**

Financial Advisers

In its 1995 Annual Report, the Council of Financial Supervisors drew attention to the fact that financial advisers involved in the distribution of retail savings and risk products - securities advisers, insurance agents and brokers - operate under both ASC and ISC regulatory regimes. The ASC regime covers securities dealers, investment advisers and (indirectly) their authorised representatives, while the ISC regime (under insurance legislation and codes of practice) covers insurance agents, who are responsible to product providers, and insurance brokers, who are responsible to policyholders.

As a result, there were overlaps and inconsistencies in the areas of entry restrictions, advice and sales standards and complaints handling requirements, "which have the potential to create customer confusion, excessive compliance costs or unfair competitive inequalities".[9]

The objective of these different regimes is to protect consumers, i.e. those who are being given investment advice. This is the same objective as other consumer regulation, such as that designed to protect borrowers. In each case, industry codes and complaints handling procedures are involved.

Recommendation 6.10**: The financial practices regulator should be responsible for the registration and regulation of all financial advisers involved in the distribution of retail savings and risk products - securities advisers, insurance agents and brokers.**

Managed funds

It can be argued that the spread of managed funds (including superannuation funds) between life offices and banks, independent superannuation funds and independent funds managers warrants a functional approach to their regulation. However, from the viewpoint of investors, superannuation funds are quite different from other managed funds because of their preferential taxation treatment and compulsory long term nature. As noted earlier, these considerations - together with their special place in the Government's retirement incomes policy - warrant supervision by the ISC.

If the ISC's responsibilities were extended to encompass other managed funds, there is a strong risk that the community would come to view managed funds as being 'protected' in the same way as policyholders with life and general insurance companies or having the same status as superannuation funds.

9 *Council of Financial Supervisors 1995 Annual Report*, page 35

***Recommendation 6.11*: The financial practices regulator should be responsible for the regulation of all funds managers.**

Finance companies

Only 11 out of 100 finance companies raise funds from retail investors through the issue of debentures. As continuous borrowers, they are required to register prospectuses every 12 months and supplementary prospectuses as appropriate. Such debenture funding accounts for more than one-third of external debt funds. The remainder is raised by finance companies on domestic and international wholesale markets, with many issuing securities in their own name.

The obligations incurred by finance companies to retail investors are, of course, quite different to those of insurance companies and managed funds. Nevertheless, they share with managed funds the fact that they raise funds continuously from retail investors by way of prospectus.

Finance companies are the only group of financial institutions other than managed funds which raise funds from retail investors, through the issue of prospectuses. As responsibility for managed funds is to be transferred to the financial practices regulator, responsibility for finance company retail fund raising should be transferred to the same body. The ASC would continue to regulate wholesale fund raising activities by virtue of its responsibility for securities markets and company regulation generally, whether or not it was the financial practices regulator.

***Recommendation 6.12*: The financial practices regulator should be responsible for the regulation of finance company fund raising from retail investors.**

Uniform Consumer Credit Code

The case for a national rather than uniform approach to consumer credit regulation is outlined in Chapter 10. It is recommended that a national approach be adopted to ensure that consumer credit regulation adapts with the market over time.

ASC responsibilities

The ASC would retain responsibility for companies regulation and for securities and futures market regulation. In particular, it would have responsibility for:

- prospectus requirements for one-off debt or equity fund raising where there is a need for closer prior vetting of proposed prospectuses than is the case with continuous borrowers; and

- market surveillance, to ensure they are fair and equitable in their operation.

Conclusion

The effect of this realignment of responsibilities is that the new financial practices regulator (whether it is the FPA or a revamped ACCC or ASC) would be responsible for the following functions:

- The licensing of financial advisers and registration of insurance brokers;

- The regulation of the fund raising activities of managed funds and finance companies;
- The Reserve Bank's and ISC's responsibilities for consumer issues, including industry Codes of Practice;
- The responsibilities of State Governments for the Uniform Consumer Credit Code (see discussion in chapter 10); and
- Consumer policy relating to financial services.

The proposed realignment of responsibilities is outlined in Figure 6.2.

Figure 6.2
PROPOSED APPROACH TO FINANCIAL SYSTEM REGULATION

COUNCIL OF FINANCIAL SUPERVISORS

	Reserve Bank	**Insurance & Superannuation Commission**	**Financial Practices Authority**[1]	**ACCC**	**ASC**
Prudential Supervision	• Banks • Credit Unions • Building Societies • Payments System	• Life Offices • General Insurance Cos. • Friendly Societies • Superannuation Funds[2]			
Protection of Retail Consumers (Investors and Borrowers)			• Financial Advisers • Insurance Brokers • Funds Managers[3] • Finance Companies[3] • Uniform Consumer Credit Code • Industry Codes of Practice • Consumer Policy	• Prices Surveillance	
Other Industry Regulation				• Competition Policy[3]	• Securities and Futures Markets • Companies Regulation

1 The Financial Practices Authority will either be a new body or possibly a division of the ACCC or the ASC.

2 Whereas prudential supervision of life offices and general insurance companies involves setting out and monitoring solvency standards, superannuation funds are the focus of standards relating to internal disciplines and controls, and disclosure to members.

3 The FPA would be responsible for prospectus requirements associated with continuous fund raising by financial institutions, but not by non-financial companies, responsibility for which would remain with the ASC.

Whether or not the ACCC is the new agency, it should retain responsibility for prices surveillance and competition policy.

Such a restructuring of responsibilities would draw together responsibility for financial practices under the one regulator, ensuring that regulation to protect consumers - whether they are investors or borrowers - was on a functional basis. It would also go a considerable way towards making the regulatory framework more competitively neutral.

6.4.3 Prudential implications of financial practices regulation

There is sometimes a tendency to pursue consumer protection objectives without regard for the long term health of the institutions being regulated, such as deposit-taking institutions and life offices. This may also have broader efficiency implications for the financial system.

It is therefore important that prudential supervisors which have responsibility for supervising these institutions and thus have detailed overview of trends in their respective finance industry sectors, should be formally involved when proposals for the regulation of financial practices are being developed by the FPA, or revamped ACCC or ASC.

***Recommendation 6.13*: The RBA and ISC should be consulted on any proposals for increased regulation of financial practices (including consumer regulation) and should have formal roles in any inquiries which may be undertaken on such issues.**

6.5 Co-ordination of Regulation

In the light of the trend towards diversified financial organisations[10] discussed in chapter 4, consideration needs to be given as to how these should best be regulated and supervised. There are three main issues:

- *Contagion risk* may be a problem where some parts of the group are unsupervised, as problems in them may infect other parts of the group. Contagion risk may also occur where customers:

  – lose confidence in a bank because of problems with a non-bank subsidiary; or

  – expect a guarantee of safety or performance from an institution simply because it is a subsidiary or affiliate of a banking group.

- Diversified financial organisations may be less *transparent* than simpler institutions, with intra-group linkages complicating assessment of the soundness of individual entities within the group. There is also the potential scope for double counting of capital in different parts of the group.

- *Different supervisors* with responsibility for different entities within “diversified financial organisations” may have different priorities, leading to an uneven approach and lack of competitive neutrality.

[10] These are called **financial conglomerates** by the Reserve Bank, as well as supervisory authorities in all OECD countries. For the sake of simplicity, this discussion focuses on the issues from the perspective of banks. But the issues are broadly the same from the insurance company perspective, except that the same systemic issues don’t arise.

Measures to deal with these issues are discussed in the following sections.

6.5.1 Use of holding companies

It is currently Reserve Bank policy "to have supervisory authority over the controlling entity in any conglomerate which includes a bank"[11]. Consistent with this, banks act as holding companies for their subsidiaries in most Australian banking groups. Similarly, life offices tend to act as holding companies in life office groups. This is different to overseas, where the use of non-operating (or financial) holding company structures is becoming more common, for example, in the US, UK, Canada and the Netherlands.

Westpac believes that, in some instances, such an approach may permit more cost-effective regulation and supervision (while preserving the objectives of such regulation) giving banking groups greater opportunity for efficiency in their operations. The benefits for prudential supervision have also been noted. The Council of Financial Supervisors has observed that:

> "Prudential concerns about contagion, conflicts of interest and transparency might be alleviated to some extent under a financial holding company, as opposed to parent/ subsidiary, structure. This could arise from the perception of greater 'separateness' of the different activities undertaken by the conglomerate." [12]

While adopting such an approach would clearly not remove all prudential concerns, if a bank were to become one of several subsidiaries of a holding company, it would stand alone more clearly from others in the group. This would somewhat reduce contagion risk by limiting perceptions that any problems of other holding company subsidiaries would flow through to the bank or that the bank would be liable for any aspects of a customer's relationship with those subsidiaries.

It is also true, as suggested by the Council of Financial Supervisors, that:

> "the existence of a financial holding company adds a layer of complexity and uncertainty (and cost) to the supervision of the group, as well as heightening concerns on management control and autonomy of supervised entities. Having a supervised entity at the head of a group also allows for greater supervisory control." [13]

This latter concern can be addressed in several ways:

- The holding company should be a non-operating company; [14]
- The bank subsidiary should be subject to capital and other prudential requirements in the same way as at present;
- Prudential supervision should ensure that there is no double counting of capital within the Group; and

[11] *Council of Financial Supervisors 1995 Annual Report*, page 27
[12] *Council of Financial Supervisors 1995 Annual Report*, page 30
[13] *Council of Financial Supervisors 1995 Annual Report*, page 30
[14] This is consistent with the approach accepted by the Government for Colonial Mutual when it demutualises and owns a bank and a life office of comparable size.

- The holding company should only operate in the financial services area or in areas that are required to deliver financial services (see Section 7.4).

Recommendation 6.14: **Banks should be permitted to establish non-operating holding companies and to become subsidiaries of the parent holding company.**

6.5.2 Approach to prudential supervision of diversified financial organisations: lead regulators

It is sometimes suggested that the blurring of lines between different intermediaries warrants having a single regulator. In fact, the use of a lead regulator approach would be equally as effective in addressing any supervisory concerns associated with the trend towards diversified financial organisations.

The approach is simple. A lead regulator would be responsible for monitoring the overall financial viability of a diversified financial organisation and co-ordinating action to resolve any major problems that arise within it, potentially affecting the whole group. Individual supervisors would remain responsible for supervising individual institutions within a diversified financial services organisation. This approach has been used overseas (eg. in the UK) quite successfully for some years, and was recommended by the Martin Committee.[15]

The issue which then inevitably arises is which supervisor should be the lead regulator of a diversified financial organisation where a bank and an insurance company are of a roughly equal size. This issue is one of several which is to be considered by a Joint Forum on Financial Conglomerates on which each of the groups of international supervisors and various countries, including Australia, are represented.

It would seem logical that the Reserve Bank should be the lead regulator where a bank represents a major part of a group, even if a life office is also a major part, as systemic risk issues requiring urgent action are more likely to arise with a bank than a life office. This reflects the central importance of the payments system and the greater likelihood of a liquidity crisis affecting depositors.

***Recommendation 6.15*:** **A lead regulator approach should be adopted to the prudential supervision of diversified financial organisations, with the Reserve Bank being the lead regulator where a bank represents a major part of the group.**

***Recommendation 6.16*:** **In instances where the Reserve Bank is the lead regulator, the Insurance and Superannuation Commission should still have responsibility for the prudential supervision of individual insurance companies, including their superannuation activities.**

6.5.3 Role of Council of Financial Supervisors

Proposals for a single regulator are, in part, based on a perception that the Council of Financial Supervisors has not effectively handled the overlap and underlap in responsibilities between different regulators and would be unable to handle issues relating to diversified financial organisations. There is, however, no evidence that the Council has been ineffective in its operations. There are two issues here:

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[15] *A Pocket Full of Change*, 1991, page 234

- how effective it has been in terms of its existing charter; and
- the adequacy of its charter.

Effectiveness of the Council of Financial Supervisors

The Council of Financial Supervisors seeks to enhance the overall quality of financial supervision and regulation in Australia. Its main objectives are to:

- facilitate exchanges of information which bear on the efficiency and well-being of the financial system, including the promotion of regular liaison among financial supervisors;
- assist each supervisor to be aware of, and to understand, developments in other parts of the financial system;
- identify trends and issues important to the financial system as a whole; and
- avoid unintended gaps, duplication and inconsistencies in regulation.

Westpac considers that the Council of Financial Supervisors has made reasonable progress in terms of this Charter. While gaps and inconsistencies in regulation remain, the Council has achieved harmonisation in important areas. For example, most of the requirements which apply to credit unions and building societies under the Financial Institutions Scheme have been brought into line with those applying to banks.

Furthermore, and of particular relevance, the Council has issued "Guidelines for Supervision of Financial Conglomerates",[16] which place emphasis on information-sharing and co-ordination among supervisors. Westpac is unaware of any concerns in relation to diversified financial organisations which would suggest that the Council has been ineffective in its work in this area.

More can certainly be achieved to harmonise prudential requirements and supervision generally, and this Submission puts forward a number of suggestions which will help establish an adaptable regulatory system for the future. Westpac would expect the Council to have a major role in implementing these changes.

While there will be fewer supervisors and regulators involved if Westpac's proposals are adopted, membership of the Council being the Reserve Bank, the ISC and the financial practices regulator, there will continue to be a need for co-ordination. This is evident from the situation overseas.

In Canada, the Office of the Superintendent of Financial Institutions supervises all federally regulated banks; insurance, trust, loans and investment companies; co-operative credit associations; and pension plans. However, other responsibilities remain with the Canada Deposit Insurance Corporation and the Bank of Canada. The heads of these three bodies, together with the Deputy Minister of Finance, form a statutory committee, the Financial Institutions Supervisory Committee, which plays an information-sharing and co-ordinating role very similar to the Council of Financial Supervisors.

[16] *Council of Financial Supervisors 1993 Annual Report*, page 37

In the US, co-operation among supervisors is achieved through the Federal Financial Institutions Examination Council, while in the UK a 'college of supervisors' normally meets annually.

Recommendation 6.17: **The Council of Financial Supervisors should continue to be responsible for co-ordinating prudential supervision and financial practices regulation.**

Adequacy of its Charter

In view of the likely pace of change in the financial system and the need for regulation to be adaptable, Westpac considers there would be merit in strengthening the role of the Council, in particular requiring it to:

- monitor trends and developments in the finance industry so as to ensure that regulation adapts to change;
- co-ordinate the responsibilities of individual supervisors effectively within the framework of a lead regulator approach, so as to avoid gaps, duplication and inconsistencies in regulation; and
- ensure that efficiency and stability objectives are balanced when making changes to the regulatory framework.

Recommendation 6.18: **The Council of Financial Supervisors should be given a charter requiring it to co-ordinate the responsibility of individual supervisors and to implement a regulatory approach which balances efficiency and stability objectives and consumer needs.**

The Council is, however, a co-ordinating body of equals, currently chaired by the Reserve Bank. As systemic risk issues are likely to be greatest among banks, the Reserve Bank should be made formally responsible for the Council's operations and progress.

Recommendation 6.19**: The Reserve Bank should chair the Council of Financial Supervisors and report annually to the Treasurer on actions pursuant to its charter**.

If the FPA is established as a new body and not a separate division of a revamped ASC, then the ASC would cease to be a member of the Council of Financial Supervisors. Nor would the ACCC become a member. The Council will then comprise the Reserve Bank, the ISC and the FPA.

6.6 Adaptability of the Regulatory Framework

Prudential regulation and supervision have, to date, struck a reasonable balance between stability considerations and allowing financial institutions to respond to competitive pressures, although at times the market has called for quicker responses to emerging issues.

One such instance involved securitisation, where the Reserve Bank followed a restrictive policy in the early 1990s at the same time as the US Federal Reserve was being more liberal in its approach. This prevented Australian banks moving to securitise assets at a time when market conditions made this a useful option.

While prudential regulation has largely achieved a fair balance between the goals of efficiency and stability, the same cannot be said for consumer regulation. The perceived need to compensate for some of the effects of increased competition has added to costs, reduced flexibility and innovation and, in some respects, has been of limited value to consumers. This issue is discussed in chapter 10.

6.6.1 How greater adaptability might be achieved - (1) Industry involvement

To achieve both effectiveness and adaptability, it is desirable that regulatory bodies should be able to draw on the experience of people in the industry who are well versed in the causes and nature of changes occurring in the market place. This would do much to ensure that the nature of innovation and competition was clearly understood, that future trends could be anticipated and that regulation could adjust to the changes as they occur.

***Recommendation 6.20*: The boards of regulatory agencies, including the proposed Financial Practices Authority, should include individuals with relevant industry experience and understanding of the changes occurring in the industry**.

In the event that conflicts of interest make this difficult, each agency should establish an Advisory Board comprising representatives of the institutional groups concerned and others with relevant industry experience.

6.6.2 How greater adaptability might be achieved - (2) Review processes

In recent years there have been inquiries into various aspects of the financial system. Several have had political objectives and rather than facilitate change, they have effectively stood in its way. While a few useful initiatives have arisen as a result of some of these inquiries, such as the formation of the Council of Financial Supervisors and the deregulation of credit card fees, Westpac believes the overall effect of these Inquiries on aspects of the financial system has been counter-productive, distorting funds flows, discouraging innovation and adding to costs[17].

The present Inquiry is the first in-depth, non-political review of the financial system in 15 years since the Campbell Committee reported. Westpac believes this is too long a period between reviews and that, given the likely pace of change over the next few years, a similar wait before the next Inquiry will inevitably mean that regulation becomes outdated, with adverse consequences for efficiency and possibly stability.

[17] For example, the Martin Inquiry recommended a contractually enforceable Code of Banking Practice, which led to extensive development of a Code by a Government Task Force, which then formed the basis of a Code negotiated with the banks. This proceeded separately and, in places, in conflict with the Uniform Consumer Credit Code. Another example has been the on-going monitoring of major credit card issuers with a view to recommending their declaration under the PSA Act if consumers did not benefit from deregulation. A third example is the PSA recommendations that institutions give priority to restructuring transaction fees rather than increasing them, as well as re-examining account balance fee exemptions and the merits of fee exemptions for certain groups of customers.

***Recommendation 6.21*: To ensure that the regulatory framework adapts in a timely way to evolving market changes, financial system reviews should be conducted every 7 years, with the specific intention of ensuring that regulation is not impairing the efficiency of the financial system.**

In putting forward this proposal, Westpac recognises that the Canadian Government has a review of its financial system every 10 years, but considers that such a period before the next review would be too long, given the speed with which changes are expected to occur.

As noted earlier, regulatory authorities in the UK are required to produce a cost-benefit statement of regulatory requirements they propose. In Australia, Commonwealth Government departments are required to prepare regulation impact statements when regulations are being reviewed, changed or introduced. Guidelines for their completion have been issued by the Office of Regulation Review and are intended to ensure a systematic and comprehensive analysis of the effects of regulatory proposals and must address four broad areas:

- the objectives being sought;
- alternative methods or options for achieving these objectives;
- an assessment of the impact on consumers, business, government and the community of viable options for achieving the objectives; and
- a strategy to implement and review the preferred option.

***Recommendation 6.22*: Regulatory impact statements should be prepared by the relevant Government agency and publicly issued for all new regulatory proposals, including those of an informal nature. These should be timely and should not delay the implementation of proposals for reform made by either the Government or business. They should specifically address the implications for:**

- **the efficiency, including the adaptability, of the financial system;**
- **the stability of the financial system and the interests of depositors and policyholders;**
- **consumers and business users, including equity among users; and**
- **the effectiveness of proposed regulation compared with fiscal intervention, where appropriate, so that market forces may operate more freely.**

Proposals for consumer protection may have repercussions for the ability of institutions to respond to the changing competitive market place and add to their costs in such a way as to impair their ability to compete. This needs to be recognised explicitly in any review process.