

Measuring Regulation and Regulatory Performance: Benchmarking Through Key Performance Indicators

JUSTIN O'BRIEN*

ABSTRACT

The Australian Securities and Investments Commission has embarked on a fundamental shift in policy. Five key priorities have been identified: (1) focus on outcomes; (2) develop initiatives to help retail investors manage and protect wealth; (3) introduce new investigative and other techniques to reduce identified or perceived systemic problems; (4) reduce red-tape in delivery of administrative function; and (5) facilitate inward and outward investment in capital markets with minimum roadblocks to investment flows, commensurate with adequate protection. These are enveloped within a wide-ranging strategic review informed by extensive stakeholder consultation. The review offers a time-limited opportunity to reconstitute the parameters of capital market regulation. Its success, however, is dependent on the degree to which the agency is successful in explicitly aligning the interests of market participants to its conception of what constitutes integrity. This requires that performance indicators are extended to wider market behavior, with progress measured against the relative restraining efficacy of formal and informal nodes of control.

INTRODUCTION

The most visible manifestation of a change of emphasis within the Australian Securities and Investments Commission can be found on its website homepage.¹ The prior emphasis on enforcement has been replaced by a formal announcement that 'ASIC is committed to better regulation' in which the goal of securing integrity is understood in the context of the agency, financial intermediaries and participants 'working together for fair and efficient markets.' Corporate communication strategies reflect a determination that the agency should simultaneously narrow and deepen its operating definition of what constitutes regulatory impact. While enhanced disclosure remains the primary mechanism to leverage behaviour above the minimum prescribed by law or regulatory guidance, the shift also demonstrates a heightened appreciation of the need to pro-actively manage the

* Professor of Corporate Governance, Centre for Applied Philosophy and Public Ethics (An Australian Research Council funded Special Research Centre) and Faculty of Business, Charles Sturt University. Email: justin.obrien@anu.edu.au Tel: 02 61251383. The author acknowledges the generous support of the Australian Securities and Investments Commission and the time provided by its staff, in particular Tony D'Aloisio (Chairman) and Malcolm Rodgers (Executive Director, Strategy). I am also grateful to Liz Roberts (Project Manager, Regulation) for logistical support. The views expressed here, informed by interviews with ASIC staff, are those of the author and do not necessarily represent settled ASIC policy.

¹ <<<http://www.asic.gov.au>>> [accessed 29 August 2007].

balance of forces within the overarching regulatory domain.² To help achieve this aim a separate strategy directorate is in the process of being established. Although the reporting lines remain unclear, as does the extent to which it will perform an internal meta-regulatory function, the changes represent recognition that efficiency and integrity in contemporary financial markets do not correlate without intervention.

What constitute the optimal form and level is contingent on the strategic management of the variable interaction between material and ideational factors. The extent and direction of change are further determined by the environmental impact of professional norms and behavioural mores on the structural architecture.³ This complex interaction influences who is given voice, authority and legitimacy within the regulatory matrix.⁴ Moreover, it also inevitably frames the strategic focus and tactical deployment of regulatory techniques, including emphasis on ex ante prevention or ex post punishment.⁵ The priority suite of measures announced by ASIC and its establishment of a strategy directorate implies strongly that the agency's prior emphasis on enforcement is antithetical to broader conceptual and practical goals.

This paper examines how this re-conceptualisation of regulatory purpose transforms and potentially transcends the increasingly sterile debate over how to refine

² For an example of this integrated approach, see Australian Securities and Investments Commission, *Unlisted, Unrated Debentures: Improving Disclosure for Retail Investors* (CP 89, Sydney, 23 August 2007); for wider discussion, see n 56-59 below and accompanying text.

³ Neil Fligstein, *The Architecture of Markets: An Economic Sociology of Twenty-First Century Capitalist Societies* (2001); Steven Vogel, 'Why Freer Markets Need More Rules' in Marc Candy, Martin Levin and Martin Shapiro (eds), *Creating Competitive Markets* (2006), 25, 27.

⁴ The matrix has also been characterised as a regime, see Christopher Hood, Henry Rothstein and Robert Baldwin, *The Government of Risk* (2nd ed, 2004) 8-21 (a regime is constituted by 'the complex of institutional [physical and social] geography, rules, practice and animating ideas that are associated with the regulation of a particular risk or hazard': at 8).

⁵ For the importance of framing, see Jonathan Nash, 'Framing Effects and Regulatory Choice' (2006) 82 *Notre Dame Law Review* 314; for how differences in emphasis impacts on regulatory decision-making, see Ashutosh Bhagwat, 'Modes of Regulatory Enforcement and the Problem of Administrative Discretion' (1999) 50 *Hastings Law Journal* 1275.

the application of authority within the regulatory pyramid that has long informed theoretical and practical paradigms.⁶ It is important to emphasise at the outset what this does not mean. It emphatically does not mean that ASIC is considering or should consider jettisoning enforcement action against major malefaction. Enforcement, credibly applied, has undoubted deterrence value. As such it plays an important component in the admonition for regulators to focus on big problems and fix them.⁷ There are no bigger problems, for example, in contemporary securities regulation than those identified by ASIC. Market manipulation and insider trading cause substantial harm to the specific entities, raise the cost of capital, lower the integrity of the wider market and, if implicitly tolerated by non-prosecution, the reputation of the regulator.⁸

Given the complexity of market manipulation and the concomitant difficulty in obtaining a secure evidential base, enforcement alone cannot, however, necessarily address underlying problems. In fact, the obverse is true. If coercion dominates regulatory objectives market participants are much more likely to retreat to narrowly-defined interpretations of obligation. It is undoubtedly true that the low to mid-level fraud that typically informs insider trading cannot be tackled by appeals to community interest (requiring, therefore, stringent prosecution). Wider questions of what constitutes compliance and how definitional imperatives facilitate or stymie product or market

⁶ Ian Ayres and John Braithwaite, *Responsive Regulation* (1992); see also Malcolm Rodgers, 'The Conceptual Underpinnings of Australian Securities Regulation' in Justin O'Brien (ed), *Private Equity, Corporate Governance and the Dynamics of Capital Market Regulation* (2007) 18.

⁷ It is trite but true that given finite resources, regulators must identify policy priorities and target resources accordingly, see Malcolm Sparrow, *The Regulatory Craft* (2000); see also Robert Nakamura and Thomas Church, *Taming Regulation: Superfund and the Challenge of Regulatory Reform* (2003).

⁸ The Financial Services Authority, widely regarded as the most responsive of the major securities regulators, has significantly recalibrated its enforcement directorate in light of an internal review that suggested no less than thirty per cent of all mergers and acquisitions were tainted by market manipulation, see Jennifer Hughes, 'Enforcement Shake-up at UK Watchdog', *Financial Times Online* (London), 15 August 2007, ; Jennifer Hughes, 'Watchdog Attracts a New Breed of Staff', *Financial Times Online* (London), 15 August 2007,

manipulation are susceptible, however, to the leveraging influence of reputation within and between specific cultural and legal domains.⁹

Identifying and repositioning the precise intersection between law and ethics in anonymous markets requires, therefore, the design and implementation of much more nuanced strategies. To be effective, these must align the interests of institutional actors to overarching regulatory ‘mission’ or ‘purpose’. In this regard, the motivational rationale of specific actors is irrelevant. By building on a foundation of common *stated* values, an agonistic understanding of what constitutes the problematic core is generated, in which deviation lowers reputational standing and access. This is then sustained through an interlocking dissemination network comprising and reinforcing formal and informal nodes. The resulting synthesis has three key practical and normative advantages.

First, it reduces real and artificial incommensurability problems between participants in the regulatory conversation (irrespective of whether or not they have been accorded formal surveillance authority).¹⁰ Deconstructing the ideational foundation of stated preferences decouples the measurement and ranking of integrity issues from the negative connotations associated with discourses that castigate cost-benefit analyses and performance indicators as facile attempts to commodify (and thus debase) virtue.¹¹

Second, it reduces the retreat to legal formalism, deescalates confrontation and

⁹ For fascinating account of the importance and restraining power of informal networks, utilising multiple mechanisms, see Barak Richman, ‘How Community Institutions Create Economic Advantage: Jewish Diamond Merchants in New York (2006) 31 *Law & Social Inquiry* 383.

¹⁰ Tony Prosser, ‘Regulation and Social Solidarity’ (2006) 33 *Journal of Law and Society* 364 (suggesting many regulatory conflicts centre on values rather than technicalities: at 372);

¹¹ See Eric Posner, ‘The Strategic Basis of Principled Behavior: A Critique of the Incommensurability Thesis’ (1998) 146 *University of Pennsylvania Law Review* 1185 (emphasising the importance of differentiating warranted and unwarranted reputation). For wider discussion of incommensurability, see Frederick Schauer, ‘Instrumental Commensurability’ (1998) 146 *University of Pennsylvania Law Review* 1215; Cass Sunstein, ‘Incommensurability and Valuation in Law’ (1994) 92 *Michigan Law Review* 779; Henry Mather, ‘Law-making and Incommensurability’ (2002) 47 *McGill Law Journal* 345, 351.

contributes to behavioural modification across the regulatory matrix. Third, by clarifying accountability responsibilities it offers greater certainty for corporations and the market in which they are nested, thus facilitating investment flows. The pay-off is immediate, particularly in the Australian context, where embedding agonistic dialogue speaks directly to statutory obligation¹² and juridical exhortation.¹³ It provides a more meaningful baseline from which to measure and evaluate subsequent regulatory performance. Moreover, it will be argued that a time-limited opportunity exists to refine the constitutive parameters of Australian securities regulation.

The remainder of the paper is structured as follows. First, the rationale and problems for using performance measurements for regulatory agencies is examined. This allows for a deeper understanding of the dynamics of regulatory action, i.e. how conceptions of 'best-practice' are arrived at and legitimated. Second, the paper traces the contours of an alternative approach to the embedding of restraining values: (1) integrity; (2) procedural fairness; (3) transparency; and (4) accountability within the regulatory matrix as a whole and offers indicative suggestions as to embed this interlocking approach into both internal agency processes and external communication strategies. The paper concludes with a warning of the cost of not grasping the reform window offered.

¹² *Australian Securities and Investments Act 2001* (Cth) s 1 (2) (a).

¹³ This derives from the need to reconstitute corporate and regulatory objectives in the aftermath of the Australian Securities and Investments Commission decision to undertake (and lose) high-profile litigation as a mechanism to clarify fiduciary obligations, see *Australian Securities and Investments Commission v Citigroup* (2007) FCA 963. The paper is not designed to engage in a retrospective audit of the case or the strategies behind it, although it recommends that ASIC conduct such a review as a matter of urgency. For the legal and policy issues, see Pamela Hanrahan, 'ASIC v Citigroup: Investment Banks, Conflicts of Interest, and Chinese Walls' in Justin O'Brien (ed), *Private Equity, Corporate Governance and the Dynamics of Capital Market Regulation* (2007) 115.

I POLICY RATIONALES FOR AND OPPOSITION TO FINANCIAL REGULATION

At the heart of the contemporary debate on regulation is a paradox. The goal of reducing and simplifying red-tape has been accompanied by an exponential increase in both regulatory domain and form.¹⁴ Managing this expansion has required an administrative apparatus that is governed by conflicting imperatives. Across the globe cross-cutting agencies have been established to manage the material and ideational conflict.¹⁵ This process has gone furthest in the United Kingdom, where the problem of ascertaining the limits of regulatory reach is now under the purview of an eponymous cabinet department.¹⁶

Notwithstanding a stated emphasis for regulatory initiatives to be subject to stringent and ongoing cost-benefit analysis, the triadic logic of governance leads to constant arbitrage with outcomes dependent on which imperative temporarily triumphs.¹⁷ The tension is essentially one of determining opportunity costs. One of the simplest ways to resolve a pressing political problem is to introduce or enhance regulatory oversight. The capacity to engender or diminish salience influences political calculation.¹⁸

¹⁴ The process is best described not as re-regulation, see Mike Marinetto, 'Governing Beyond the Centre: A Critique of the Anglo-Governance School' (2003) 51 *Political Studies* 592; Michael Moran, *The British Regulatory State* (2003). This does not necessarily mean that autonomy is forsaken. Private sector interests can be furthered drastically in dense policy-making networks; see James March and Johan Olsen, *Democratic Governance* (1995); Ian Marsh, 'Neo-Liberalism and the Decline of Democratic Governance in Australia: A Problem of Institutional Design' (2005) 53 *Political Studies* 22.

¹⁵ Examples include the Productivity Commission here in Australia, the Better Regulation Taskforce in Ireland.

¹⁶ The Department for Business, Enterprise and Regulatory Reform, established when Gordon Brown took over as prime minister in June 2007, incorporates the Better Regulation Executive, previously a Cabinet Office initiative. For its blueprint, including suggestions to place risk-based enforcement on a statutory footing, see DBERR, *Next Steps on Regulatory Reform* (July 2007) 5; see also National Audit Office, *Reducing the Cost of Complying with Regulation* (2007), reporting that 80% of business were 'less than confident' that government would succeed.

¹⁷ Martin Shapiro, 'Politics and Regulatory Policy Analysis' (2006) (Summer) *Regulation* 40 (suggesting that traditional mechanisms of cost-benefit analysis only gain traction when aligned to political imperatives).

¹⁸ Geoffrey Brennan, 'The Political Economy of Regulation: A Prolegomenon' in G Eusepi and F Schneider (eds), *Changing Institutions in the European Union: A Public Choice Perspective* (2004) 72.

Conflicting political imperatives make it exceptionally difficult, however, to dislodge regulatory authority, particularly if framing discourses feed perceptions that the reduction in oversight could leave target communities vulnerable. Irrespective of ideological persuasion, incumbent governments rarely respond well to accusations of panic-derived policy design.¹⁹ In practice, this necessitates a preservation order mandating the maintenance of the external architecture (albeit within specified timeframes). While external sight lines remain unchanged incremental change can hollow out the regulatory construct, fundamentally altering its purpose.²⁰ Populist discourse often bifurcates (without necessarily having a solid empirical grounding) between the accountable and responsive political party structure seeking to reduce regulatory burden and a didactic unaccountable bureaucracy, which undermines legislative intent by setting ill-considered strategic priorities.²¹ This meta-narrative necessarily informs agency priorities, which are, in turn, framed by the construction and interpretation of the specific and overarching cost-benefit analytics. The formulation and deployment of key performance indicators are themselves, therefore, the outcome of an inherently political process and reflect the result of prior conflict. Here too lies a further manifestation of the paradox. The efficacy of

¹⁹ For accounts that highlight the importance of politics, see Roberta Romano, 'Sarbanes-Oxley and the Making of Quack Corporate Governance' (2005) 114 *Yale Law Journal* 1521 (condemning the flawed empirical justification); John Cioffi, 'Revenge of the law: Securities Litigation Reform and Sarbanes-Oxley's Structural Regulation of Corporate Governance' in Marc Landy, Martin Levin and Martin Shapiro (eds), *Creating Competitive Markets* (2007) 60 (emphasising the contingent nature of interest group power); Donald Langevoort, 'The Social Construction of Sarbanes-Oxley' (2007) 105 *Michigan Law Review* 1817 (arguing that the Act was designed to achieve a much more coherent objective but that its legitimacy is undermined by the dominance of the ill-conceived panic discourse). For how preferences are translated in policy outcomes more generally, see Peter Gourevitch and James Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (2005).

²⁰ Murray Edelman, 'Symbols and Political Quiescence' (1960) 54 *American Political Science Review* 695.

²¹ The Department of Justice in the United States has been particularly susceptible to the rise of a (partially justified) meta-narrative, see Justin O'Brien, 'Accounting and Accountability Failure: The Implications of the Kaplan Ruling on Corporate Enforcement Strategies' (2006) 1(1) *Compliance and Regulatory Journal* 28.

cost-benefit analysis as a restraining force on regulatory creep is, at best, inconclusive.²² Moreover, even when used, raw indicators of performance can obfuscate as much as they illuminate.

This is particularly evident in the case of enforcement. On one level, it is, perhaps, not surprising that enforcement remains a widely used indicator of measuring regulatory performance against risk amelioration. Prosecutorial records provide a highly visible and easily quantifiable metric, particularly when individual agency performance is benchmarked against international practice (with absolute levels adjusted according to market capitalisation). Embedding market integrity may include - but not necessarily depend on - coercive imperatives (and degree to which electoral calendars influence political support or opposition to that policy choice). Indeed, emergent orthodoxy links robustness to increased costs, reduced choice and capital flight.²³

Stark variance in regulatory styles between the United States and the United Kingdom – the most liquid capital markets – also demonstrate, however, the critical importance of mediating cultural differences, legal frameworks and the political environment.²⁴ At a more fundamental level, they also point to competing (and potentially conflicting) interpretations of what constitutes risk. Viewed in isolation,

²² Peter May, 'Regulatory Regimes and Accountability' (2007) 1 *Regulation & Governance* 8; Cary Coglianese and David Lazer, 'Management-Based Regulation: Prescribing Private Management to Achieve Public Goals' (2003) 37 *Law and Society Review* 691; Cary Coglianese, Jennifer Nash and Todd Olmstead, 'Performance-Based Regulation: Prospects and Limitations in Health, Safety and Environmental Regulation' (2003) 55 *Administrative Law Review* 705.

²³ The concern about cost is prevalent in the dynamics of capital market regulation in the United States, see McKinsey Report, *Sustaining New York's and the US' Global Financial Services Leadership* (2007); Committee on Capital Markets Regulation, *Interim Report* (2006). Conversely, recent studies highlight the lower cost of capital in New York vis-à-vis London, which has been used to justify the aggressive enforcement imperatives in the former – at least in the public sphere, see John Coffee, 'Law and Enforcement' (Paper delivered at 'The Dynamics of Capital Market Governance,' Australian National University, 14 March 2007).

²⁴ Robert Kagan, 'Understanding Regulatory Enforcement' (1989) 11 *Law & Policy* 89 (emphasising the interaction between 'regulatory legal design, the social and economic task environment, and the agency's political environment': at 95).

therefore, enforcement proclivity can skew policy direction, budgetary priorities, operational capacity and overarching effectiveness. If, for example, the offences prosecuted are trivial the un-weighted data becomes misleading. Much more problematically, an active but misaligned enforcement strategy may also evidence a dysfunctional accountability regime within the agency or in its relation to external stakeholders.

A much more granulated picture of the socio-economic environment must be presented if the data (and the underpinning regulatory styles which generate it) is to be interpreted accurately. One highly influential approach to map this process is to transplant to the regulatory environment corporate sector multi-dimensional ‘balanced scorecard’ reporting.²⁵ This integrated suite of measurements includes financial and non-financial indicators. The information undoubtedly improves the quality of internal intelligence. If appropriately packaged, it can also indicate (episodic) responsiveness to core external stakeholders.

Even within the corporate sector itself, explanatory value is clouded, however, by a lack of clarity over methodological rigour and extent to which results are replicable (rationale governing indicator choice, specific ranking or interpretation etc). To what extent the balanced scorecard reflects actual practice or engenders cultural change is also far from certain. These problems are magnified in the transition to regulatory agencies. Framing imperatives may distort the baseline for analysis. Regulated entities tend to

²⁵ See Robert Kaplan and David Norton, *The Balanced Scorecard* (1996). For review of mode and conceptual refinements since its introduction, see David Bryde, ‘Methods for Managing Different Perspectives of Project Success’ (2005) 16 *British Journal of Management* 119. For specific application to securities market regulation, see John Allen, ‘Performance Measurement for Securities Supervisors: Report on the Findings of a Workshop on the Balanced Scorecard’ (Toronto Centre for Leadership in Financial Supervision, 8-14 July, 2007).

over-estimate direct costs (a process driven, in part, by those who seek opportunistic rents by exaggerating the threat).²⁶ While certain aspects of regulatory mission can be monetised (e.g. the time it takes to process routine regulatory filing), setting time-management or cost reduction targets as the critical indicator of performance in other areas can be problematic. Reducing the length of time it takes to conduct an investigation may, for example, result in sub-optimal oversight, which in turn, lowers the demonstration effect of institutionalising a randomised inspection regime. How, for example, does one rank progress in cost reduction against the risk that such a process may embed mechanistic compliance? If the reduction of the latter is a legitimate goal, how does one ascribe value to the resulting trade-off?

In addition, the depleted size of the comparative pool, differing statutory objectives and the indirect nature of regulatory goals combine to make holistic benchmarking against international practice problematic. This is not to suggest that the normative value of the KPI is irredeemably lost in translation. It does mean, however, that regulatory agencies must be cognisant of how the chosen indicators impact on both the cost and integrity vectors. In other words, they must be amenable to specific and holistic analysis against the transformative priorities set by operational directorates and cross-cutting inter- and intra-agency taskforces. Ultimately, performance needs to be measured against the goals not just the processes of regulation and this cannot be achieved by abstracting the agency from the specific socio-economic, legal and political environment in which it is nested.

²⁶ For regulatory creep through opportunistic rent seeking behaviour, see Bridget Hutter and Clive Jones, 'From Government to Governance: External influences on Business Risk Management' (2007) 1 *Regulation & Governance* 27 (identifying consultancies and insurance premium pricing as 'not well understood... background influences': at 41).

A *Key Performance Indicators and Regulatory Governance*

Properly designed and explicitly linked to public articulation of strategy, a KPI can resolve the tension over the form and substance of market oversight. Periodic weeding of the regulatory code, associated guidance notes and practice imperatives can – and should – ameliorate unnecessary duplication and provide for a more certain legal framework. Greater consultation over the cost implications of compliance can – and should – improve both the framing and implementation of regulation. Clearer internal governance and accountability structures can – and should – place the exercise of regulatory discretion within accepted parameters.²⁷ Adaptive and responsive design can – and should – minimise the risk of privileging indicators designed for administrative convenience. Finally, reconstituting regulatory ‘purpose’ can reduce inconsistency and provide a clearer conceptual underpinning.²⁸ It is important, however, to articulate and differentiate what constitutes performance. As the twentieth century’s most celebrated mathematician recognised ‘not everything that counts can be counted, and not everything that can be counted counts.’²⁹

Perception of what constitutes value differs among institutional actors in any given regulatory matrix. Relative ranking inevitably impacts on the design and authority of deployed indicators and indeed the approach the overarching regime takes to risk management. It is unhelpful simply to advocate calibrating the regime towards a

²⁷ See Martin Lodge, 'Accountability and Transparency in Regulation: Critiques, Doctrines and Instruments' in J Jordana and D Levi-Faur (eds), *Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (2004) 124; Colin Scott, 'Accountability in the Regulatory State' (2000) 27(1) *Journal of Law and Society* 38.

²⁸ See Rodgers, above n 6; see also Richard Parker, 'The Empirical Roots of the “Regulatory Reform” Movement: A Critical Appraisal' (2006) 58 *Administrative Law Review* 359 (arguing that democratic accountability is defeated when agency explanations [for actions] are so long, diffuse and technical that no-one can understand them: at 397)

²⁹ The quotation was appended to a sign outside Albert Einstein’s office at Princeton University. See also Alan Carlin, 'The New Challenge to Cost-Benefit Analysis' (2005) (Fall) *Regulation* 18.

principles-based approach. Rules, after all, are merely the clarification of principles.³⁰ Those providing corporate advisory services have long adopted a range of ‘perfectly-legal’ strategies to transact around both rules and underpinning principles governing compliance obligations, including justified (if not necessarily ethically justifiable) deviance internally devised and policed codes of conduct.³¹ This is not to suggest that corporate practice is inherently ethically challenged; rather, law and legal obligation are inherently indeterminate.³²

The interaction of these core conflicts raises a fundamental but often neglected question of regulatory design. What is the purpose of regulation? The appropriate first order question is not how to regulate but why? From this cascade the second and third order questions that clog academic discourse.³³ If new rules, principles or standards (each altering the appropriate mix of regulatory strategies) are to be introduced what should the benchmark be? Who should set it and on what basis? When core values conflict, which approach or approaches should be privileged and why? Should

³⁰ Cass Sunstein, 'Problems with Rules' (1995) 83 *California Law Review* 953; John Braithwaite, 'Rules and Principles: A Theory of Legal Certainty' (2002) 2002 *Australian Journal of Legal Philosophy* 47.

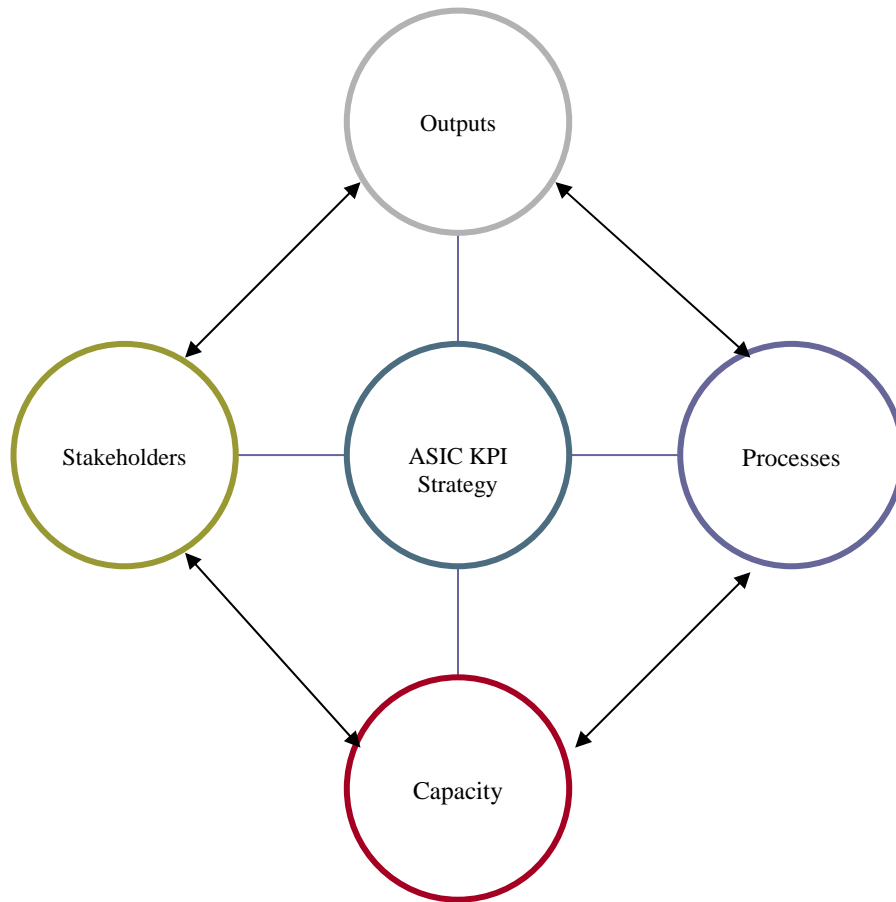
³¹ See Doreen McBarnet and Chris Whelan, 'The Elusive Spirit of the Law: Formalism and the Struggle for Legal Control' (1991) 54 *Modern Law Review* 848; for the role of gatekeepers in this process, see Martin Shapiro, 'Dishonest Corporatism: Who Guards the Guardians in an Age of Soft Law and Negotiated Regulation' in Marc Landy, Martin Levin and Martin Shapiro (eds), *Creating Competitive Markets* (2007) 319.

³² See Sol Picciotto, 'Constructing Compliance: Game Playing, Tax Law, and the Regulatory State' (2007) 29(1) *Law and Policy* 11; for discussion of the conceptual issues, see Sunstein, 'Problems with Rules', above n 30, 953, 959. Indeterminacy can also, however, perform a restraining force if the restraining mechanisms are identified, see Geoffrey Brennan and Philip Pettit, *The Economy of Esteem* (2005); see also Richman, above n 8.

³³ Discretion can be limited by internalisation of market-ordering terms of reference, see Clifford Shearing, 'A Constitutive Conception of Regulation' in John Braithwaite and Peter Grabosky (ed), *Business Regulation and Australia's Future* (1993) 67, 72. For a US perspective, see Brian Gerber and Paul Teske, 'Regulatory Policymaking in the American States: A Review of Theories and Evidence' (2000) 53(4) *Political Research Quarterly* 849, 867. See also Bronwen Morgan, 'Technocratic v. Convivial Accountability' in Michael Dowdle (ed), *Public Accountability, Designs, Dilemma and Experiences* (2006), 243, 253-259 (criticising 'ostensibly objective, relatively opaque, expert knowledge': at 253. This process 'mutes the discretionary, value-laden dimensions of those decisions': at 257). Morgan argues for a conceptualisation based on inculcating 'a particular *tenor* or *texture* of debate, a texture that transmits and generates implicit senses of community': at 259 (emphasis in original).

interpretation of (non-) compliance and censure rest with the corporation itself, the market, the regulator or wider society (through legislative reinterpretation of the core responsibilities owed by the corporation)? Can this be done in a piecemeal manner?

Agency Accountability Mechanism



Societal Accountability Mechanism----->
 Political Construction & Calibration Operational Deliverables

Figure 1: A Putative Adaptive Performance Model.³⁴

Ultimate resolution of these issues requires the articulation of a common standard of what constitutes responsibility and concomitant clarification of requisite accountability

³⁴ The Adaptive Performance Model derives from ongoing research collaboration between Professor Kerry Jacobs at the ANU and the current author.

structures both within the organisation and in its relations with external stakeholders.

This approach to regulatory dynamics is mapped above (figure 1). Central to its utility is the capacity to simultaneously detail and navigate a corporate social contract, comprising terms which are explicitly negotiated (and continuously reinterpreted) within a dynamic agonistic dialogue across both vertical (internal accountability) and horizontal axis (external accountability).

The exact parameters and the resulting performance indicators are necessarily the result of political negotiation (points west of the north-south vector) and subsequent internal organisational capacity to deliver effective processes (points east) to deliver on those objectives. Benchmarking the absolute and relative performance of each component of the wider regulatory matrix against these more exacting standards in an ongoing basis strengthens the interaction between legal and non-legal norms.³⁵ This requires, in turn, a commitment by regulated entities to themselves commit to providing detailed narrative accounts of what is meant by their stated commitment to nebulous concepts such as integrity.

Integrity represents a much more finely grained concept than can be encompassed within a legal definition. Securing agonistic agreement on its definition and application reduces the space and justification for contestation. Furthermore, it provides legitimacy and authority for the agency to use the enforcement mechanism against those whose actions threaten public confidence in the restraining efficacy of professional norms and

³⁵ It is important to emphasise, however, that it is unwise to countenance specific key performance indicators in a vacuum. The exact wording and measurement apparatus need to be integrated within a strategic redesign. ASIC has just begun this process so only the conceptual framework can be presented here, along with indicative examples drawn from the priorities set by ASIC (see Tables 1-6). That being said, the stated emphasis on integrity demonstrates the efficacy of the conceptual framework developed here.

informal associational norms. How to achieve this goal is examined further below. First, however, it is necessary to map the institutional context of securities regulation in Australia and demonstrate why a high profile enforcement failure and the changed leadership at ASIC offers a time-limited opportunity to achieve this richer objective.

B *Regulating the Australian Capital Market*

The capital markets in Australia are regulated through a ‘twin peaks’ model of oversight. The model is integrated within a wide-ranging Corporate Law Economic Reform Program.³⁶ Within this rubric, the Australian Prudential Regulation Authority has responsibility for ensuring capital adequacy, banking regulation and the superannuation industry. Market integrity issues, including continuous disclosure, the regulation of directorial conduct and fiduciary obligations imposed on intermediating professions, fall within the ambit of the Australian Securities and Investments Commission.³⁷ The peak regulatory agencies interdict with Treasury and specialist organizations, including the Reserve Bank of Australia (on macro-economic stability), the Australian Taxation Office

³⁶ See *Corporate Law Economic Reform Program* (Commonwealth of Australia, 1998) < <http://www.treasury.gov.au/documents/264/PDF/clerp.pdf>>. The CLERP process retains as a core objective ‘the need to encourage free enterprise for the benefit of all Australians’: at iv. It has been accompanied by a similarly wide ranging review of regulatory policy, see *Rethinking Regulation, Report of The Taskforce on Reducing Regulatory Burdens on Business* (Commonwealth of Australia, 2006); *Rethinking Regulation: Australian Government’s Response* (Commonwealth of Australia, April 2006 and August 2006). For a useful summary, see Gary Banks, ‘Rethinking Regulation: ‘The Way Ahead’ (Speech delivered at Monash Centre for Regulatory Studies, Melbourne, 17 May 2006).

³⁷ ASIC’s objectives are set out in the primary legislation constituting the regulator, *Australian Securities and Investments Commission Act 2001* (Cth). Under section 1 (2), ASIC must strive to (a) maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and (b) promote the confident and informed participation of investors and consumers in the financial system; and (c) administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements; and (d) receive, process and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it; and (e) ensure that information is available as soon as practicable for access by the public; and (f) take whatever action it can take, and is necessary, order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.’

(on the impact of financial engineering on corporate revenue), the Australian Consumer and Competition Commission (on trade practices) and the Takeovers Panel (as the primary adjudicator of contractual disputes during merger and acquisition process).

This hybrid architecture contrasts with the unitary approach to market governance adopted by the United Kingdom's Financial Services Authority. In contradistinction with the multiplicity of organisational forms given authority in the United States,³⁸ the formal separation of prudential and disclosure regulation is conceptually neat and intellectually cogent. The separation allows for the simultaneous adoption of coercive and less intrusive forms of market surveillance within an integrated framework.³⁹ Unlike its major counterparts in London and Washington, neither ASIC nor APRA, however, has the capacity to set rules.⁴⁰ Independence is further circumscribed by specific policy guidelines, which are framed within a legislative requirement that explicitly requires the reduction of transactional costs.⁴¹

All major policy revisions require an accompanying Regulatory Impact Statement (RIS). Following standard public policy formulations, the RIS defines the problem, sets out objectives, delineates options, evaluates cost and benefit, includes a consultation and

³⁸ The Securities and Exchange Commission has oversight for the capital markets but regulation of banks fall to the Federal Reserve and the Office of the Comptroller of the Currency. In addition, state regulators have formal delegated authority and State Attorney Generals have emerged as increasingly important autonomous actors.

³⁹ The formal separation has not been trouble free. See, for example, *The HIH Royal Commission* (Commonwealth of Australia, Canberra, 2003). APRA 'was aware of its lack of general insurance experience, [yet] there was no evidence that any steps were put in place to monitor the progress of the individuals who had the front-line jobs supervising this industry': at 24.1.6. This systemic problem was exacerbated by the 'light and non-obtrusive supervisory methodologies adopted': at 24.1.7. The Commission concludes APRA 'did not give adequate consideration to creating systems to ensure it would meet its regulatory responsibilities. This resulted in systemic weakness in APRA's supervisory regime': at 24.1.12.

⁴⁰ While discretion is limited to interpretation of legislative intent, this is not an insubstantial power.

⁴¹ *Australian Securities and Investments Commission Act 2001(Cth)* s 1 (2) (a).

recommendation statement and outlines the strategy for implementation.⁴² Despite these restrictions, an independent taskforce charged with evaluating effectiveness has identified signs of ‘regulatory creep’ across the institutional framework.⁴³ According to its report, ‘risk aversion’ imperatives were particularly present in the financial sector.⁴⁴ This apocalyptic vision stands in contrast to cross-country comparisons, which suggest that Australia has one of the least burdensome regulatory regimes.⁴⁵ The taskforce ruminated that enforcement strategies were in part to blame, thus having a detrimental impact on the ‘overall efficiency and dynamism of the economy’.⁴⁶ The approach implies a minimalist *ex post* approach to regulatory intervention, with legitimacy accorded only to cases in which there has been a demonstrable ‘market failure’. This is underscored by the emphasis on direct costs rather than embedded value.⁴⁷

⁴²Office of Best Practice Regulation, *Best Practice Regulation Handbook* (2006). The Productivity Commission expresses a clear policy preference for time-limited intervention, for example through sunset clauses: at 4.7.6); for wider discussion questioning the efficacy of cost-benefit analysis as a restraining mechanism, see Parker, above n 23; for spirited defence of cost-benefit analysis, see Alan Carlin, ‘The New Challenge to Cost-Benefit Analysis’ (2005) (Fall) *Regulation* 18; Lewis Kornhauser, ‘On Justifying Cost-Benefit Analysis’ (2000) 29 *Journal of Legal Studies* 1037.

⁴³ *Rethinking Regulation*, above n 19 (citing increased ‘risk aversion’ as a primary cause for increasing the burden and dysfunctional incentives facilitating its growth, for example, the lack of integration between cost and benefit, policy silos and heavy-handed and legalistic approach to enforcement: at 14-15).

⁴⁴ *Ibid*, 89-90 (Recommending development of performance indicators that speak directly to the need to enhance ‘efficiency and reduce business costs’: at 90).

⁴⁵ See Thomas Hopkins, ‘An Assessment of Cross-National Regulatory Burden Comparisons’ (2005) 33 *Fordham Urban Law Journal* 1139, 1145. The Heritage/Wall Street Journal Index ranks Australia the third freest (after Hong Kong and Singapore), see Heritage/Wall Street Journal, *Index of Economic Freedom* (2007) <<http://www.heritage.org/research/features/index/country.cfm?id=Australia>> at 15 August 2007. The OECD also commended Australia are having the least regulated product markets and a system of oversight that minimised impact on economic decision-making, see OECD, ‘Economic Policy Reforms: Going for Growth’ (OECD, 2006).

⁴⁶ *Ibid*, 90 (Recommendation 5.3). The Taskforce, included a statement from the Association of Australian Permanent Building Societies on guidance material emanating from APRA and ASIC: ‘their observance has become almost mandatory and those that treat them as non-binding do so at their own peril. They are now in effect de facto law’: at 91. The Taskforce implicitly agreed with this formulation in its recommendation that regulators refrain from overly prescriptive measures: at 91. In addition, it appeared to reject any use of enforceable undertaking that imposes obligations to a higher standard of compliance than that mandated by law: at 93.

⁴⁷ In this the Australian framework mirrors the UK Treasury’s SMART regime, see *The Green Book: Appraisal and Evaluation in Central Government* (HM Treasury, Stationary Office, 2007). SMART is an acronym for ‘specific, measurable, achievable, relevant and time-bound’: at 13. If no market value can

This approach pervades Australian regulatory practice and political discourse. The legislation establishing ASIC charges the regulator to strive to ‘maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy’.⁴⁸ There are, of course, strong normative benefits associated with this approach, not least of which is the curtailment of regulatory adventurism. There is also the risk that setting the overarching objective as one measured by the reduction of business costs generates not just contestation over *ex ante* risk minimisation but also multiple veto points. What remains unclear, therefore, is how the regulator should mediate the potential conflict between market promotion and market integrity or how its preferred resolution impacts on political perceptions of performance.

II ADDING SUBSTANCE TO THE ART OF NEGOTIATED REGULATION

As noted above, the transformative exercise begun by the Australian Securities and Investments Commission has the potential to profoundly change the regulation of the capital markets here. Significantly, the process pre-dates the negative outcome of *ASIC v Citigroup*.⁴⁹ The changed focus was formally articulated in a presentation to the Senate Standing Committee on Economics in May 2007 at which the ASIC Chairman, Tony D’Aloisio, unveiled five priorities.⁵⁰ These commit ASIC to:

easily be adduced, values should be calculated based on tabulating ‘willingness to pay’ against willingness to accept: at 23.

⁴⁸ ASIC Act 2001 (Cth) S 1 (2) (a).

⁴⁹ In a series of media briefings, Tony D’Aloisio, defended the agency’s handling of the case. Significantly, however, he foreclosed the option of an appeal. This calculation reflected the material and reputational costs already incurred; the comprehensiveness of the judicial defeat and an important signaling to the market of changed strategic focus.

⁵⁰ Tony D’Aloisio, Opening Statement on ASIC’s Priorities for the New Twelve Months (Senate Standing Committee on Economics, Canberra, 30 May 2007).

- 1) Focus on outcomes with performance measured against stakeholder feedback;
- 2) Develop initiatives to help retail investors manage and protect wealth through enhanced disclosure and better surveillance;
- 3) Introduce new investigative and other techniques to reduce insider trading and market manipulation;
- 4) Reduce red-tape in delivery of administrative function; and
- 5) Facilitate inward and outward investment in capital markets with minimum roadblocks to investment flows, commensurate with adequate protection.⁵¹

The ordering is instructive. Conscious of the need to counter negative perception, linked to his career trajectory as a corporate lawyer and former chief executive of the ASX, the new chairman has not foreclosed the (threatened) deployment of enforcement. Indeed, he endorses its use to the fullest possible extent in cases involving insider trading or market manipulation. Moreover, under his leadership, ASIC is investing significant resources to enhance the agency's investigative capacity. The aim, according to the chairman, is to enhance the suite of disincentives. The increased focus on investigative techniques is designed to alert potential participants in insider trading schemes that there is an increased risk of detection. Just as significantly, the priorities also indicate that the enforcement directorate needs to be integrated more closely with wider 'whole of agency' objectives. This represents a profound cultural and organizational shift for agency, which, if grasped by the agency and the market, has the potential to reconfigure the parameters of securities regulation in Australia. Each of these priorities is now examined in turn, along with indicative suggestions as to how these can be embedded within an overarching accountability framework.

⁵¹ Ibid.

A *The Clarification of Regulatory Impact*

Enforcement action, or its threatened use, is to be contemplated only where it can make a positive impact to lift business integrity. This narrows significantly the definition of what constitutes ‘regulatory impact’. Moreover, it also suggests that previous ambiguity over what this means in practice has marred the agency’s overarching capacity. The operational definition as presently understood with the agency is exacerbated by the perception (and, arguably, the reality of) sub-optimal organisational dynamics. The change in strategy raises inevitable questions about the role that enforcement is to play in the proposed new structure; whether the strategy directorate will (or should) curtail the calculations of the enforcement directorate; and whether enforcement itself, should be reconstituted as the service provider for individual directorates or the agency as a whole.

The need for change was underscored by the Federal Court’s judgment in the Citigroup case. At its heart were what, on the facts pleaded, unfounded allegations of a lack of business integrity. The appropriate counterfactual is whether such a case would have been taken under the new framework set out to the Senate. The prosecution, after all, identified both an apparent malaise (a perceived lack of business integrity) along with its symptoms (potential insider trading, failure to management conflicts of interest and unconscionable conduct). The regulator claimed that Citigroup had engaged in unconscionable conduct by trading on its own account while performing corporate advisory services for Toll Holdings in its — eventually successful — bid for Patrick, itself one of the most important takeovers in the current boom. Justice Jacobson ruled that insider trading did not take place and that the ‘law does not prevent an investment bank

from contracting out of or modifying any fiduciary obligation.⁵² The judge opined that the imposition of fiduciary responsibilities was ‘a matter for the legislature, not the courts.’⁵³ Judicial resolution does not solve the underlying problems identified in the litigation. Indeed, it is arguably the case that the range and intractability of potential conflicts have deepened, as the dynamics of financial capitalism reconfigure, in profound manner, institutional timeframes, conceptions of corporate duty, the efficacy of the shareholder-dominated corporate governance paradigm, and throw into stark relief the roles and responsibilities of financial intermediaries.

What the Citigroup case demonstrated, however, is how blunt and ineffective the enforcement instrument can be in dealing with this complex reality. The relief sought by ASIC on the conflicts case could arguably have been better secured by less intrusive means. The address to Senate explicitly ties enforcement strategies to outcomes. It implicitly suggests that the pursuit of a high-profile defendant through the courts, no matter how well-intentioned, to clarify an underlying principle is not necessarily the most appropriate mechanism to secure agonistic understanding of how that principle should be applied in daily business practice. Thus while enforcement is not precluded, it has to pass a more stringent cost-benefit analytic. This makes a repeat of the Citigroup litigation highly unlikely.

B *Redesigning the Rules of Engagement*

Any credible assessment of the efficacy of control mechanisms requires attention be paid to the critical interaction between how a regulatory agency gathers information; its degree

⁵² NSD 651 (28 June 2006) [601].

⁵³ Ibid [602].

of emphasis on the setting of minimum standards and its propensity or reluctance to advance strategies based on modifying behaviour.⁵⁴ The strategic priorities announced by ASIC make it clear that its objectives are to be understood within the context of improving market integrity. Interviews with senior ASIC staff make it clear that this can only be achieved if an alignment of interests can be effected between the agency and the institutional actors providing intermediating access. The announced strategic review provides a roadmap to a more informed, less polarized regulatory environment. It is informed by ‘an extensive survey of external stakeholders to assist us to assess our priorities, what we do well and where we need to improve’.⁵⁵ The first stage in this process has commenced with the commissioning of an independently administered climate survey.

The survey is designed to set a benchmark from which to measure subsequent progress, or lack of it. This is to be welcomed. However, a survey, in itself, is insufficient. Proactive communication strategies are required to disseminate much more widely regulatory aims and objectives. This needs to be accompanied by the creation of specific working groups to tease out the implications from the aggregated data. Consultation and engagement in national and international forums perform a dual function. First, they provide invaluable intelligence about latent and emergent problems. Second, this proactive approach acts as a transmission belt for dissemination of regulatory values. In this regard, it is useful to conceptualise the relationship as a constitutive stakeholder dialogue. Regular reports give both structure and depth to the

⁵⁴ Hood et al, above n 4, 180.

⁵⁵ Ibid.

consultation process.⁵⁶ This is, of course, not without risk, particularly when accountability for maintenance of market probity requires ongoing credible commitments from those given delegated oversight within ‘decentred’ processes of self-regulation and co-regulation.⁵⁷ However, as will be explored in the following section, these risks can be offset through the leveraging power of reputation.

C *If Not, Why Not: Disclosure and the Retail Investor*

It is axiomatic that when a complex trading model disintegrates, the clarion calls for action inevitably target the regulator. ASIC has been particularly vulnerable following three high profile property collapses, Fincorp, Westpoint and Australian Capital Reserve. In each case, investors loaned money to the investment vehicle in return for a debenture (or promissory note), periodic but higher interest repayments than provided in the mainstream banking sector and a return on initial capital at the end of the term. The market in unrated, unlisted bonds accounts for AUS\$8 billion and involves 92 vehicles.⁵⁸ ASIC has been careful to note that risk-levels vary considerably within this grouping. Its decision to publish the full list of providers in a consultation paper adds significantly to the demonstration power of reputation. Inevitably, benchmarking performance requires the sector to begin differentiating according to risk profile.

As the investment vehicles seek to retain or grow market share, they are much more likely to provide the enhanced disclosure – benchmarked articulation of risk-benefit across credit rating, equity capital, liquidity, lending principles, portfolio diversification,

⁵⁶ Muel Kaptein and Rob Van Tulder, ‘Towards Effective Stakeholder Dialogue’ (2003) 108 *Business and Strategy Review* 203, 208-210.

⁵⁷ For an account of how the fragmentation of authority gives rise to competing legitimacy problems, see Julia Black, ‘Critical Reflections on Regulation’ (2002) 27 *Australian Journal of Legal Philosophy* 1.

⁵⁸ ASIC, ‘Unlisted, Unrated Debentures’, above n 2, 68-75.

valuation of stock, related party transactions and rollovers and early redemption possibilities and penalties; disclosure of relative ranking, which if not complied with should be justified; external gatekeepers such as trustees, advisors and auditors should explicitly take disclosure into account when issuing valuations.⁵⁹

There is a risk that enhanced levels of disclosure can obfuscate as well as illuminate, making the sector potentially more resistant to transparency. To counter this possibility, ASIC has suggested that attention must also be placed on and accountability demanded from those providing corporate advisory services and the creation and dissemination of technically legal but misleading advertising. These include not just trustees and auditors but also copywriters, production teams, publishers and broadcasters who sell the print, audio-visual and online space.⁶⁰ On one reading this could be construed as a further example of regulatory creep. On the other, it is recognition that the regulator lacks the resources to resolve the problem on its own. Rather, it requires professional groups to acknowledge their own responsibility and be accountable for their actions, meaning in this narrow sense acquiescing to external scrutiny of what codes of conduct mean in practice. None of this, however, is going to be of any use to those bewitched by the potential returns. While investment guides can and should be simplified by their very nature these products are exceptionally complex. Investor education programs are to be encouraged, particularly when couched in terms that highlight the investors' own personal responsibility. Behavioral change, however, needs to be inculcated at a higher level within the product market and it is for this reason alone that the consultation paper provided by ASIC is to be warmly welcomed and endorsed.

⁵⁹ Ibid, 15-16.

⁶⁰ Ibid, 38.

Although the unlisted debenture market is relatively insignificant in monetary terms, the reputational damage associated with public perception of sharp-practice is enormous. Harnessing this power has enormous benefits, particularly as one seeks to address broader questions of insider trading and market manipulation.

D *Insider Trading, Market Manipulation and the Problem of Alignment*

Regulators and those providing intermediating services are repeat players, whose interests are substantially harmed by those who defect from market convention. While the introduction of advanced training and investigative techniques are to be welcomed, in the absence of a catastrophic failure, it is unrealistic to expect a regulator to understand the dynamics and, therefore, design the optimal form of compliance for any given organisation. Even in such a case, it is arguable that the measures introduced may fail to deal with the substantive underlying problem. This partly accounts for the controversy over the role and function of enforceable undertakings and other innovative mechanisms to embed compliance, such as pre-trial diversion in the United States.⁶¹ This is not to suggest that the corporate probation that the enforceable undertaking permits is, as some critics argue, indefensible on legal, ethical or public policy grounds.⁶² Rather, it is to argue that efficacy is likely to be improved as a result of an agonistic dialogue and that this is unlikely to occur in circumstances in which the regulator imposes solutions. It is therefore necessary that the design and implementation of enforceable undertakings be the product of cross-cutting agency taskforces, which are, in turn, advised by high-level

⁶¹ Justin O'Brien, 'Securing Corporate Accountability or Bypassing Justice? The Efficacy and Pitfalls of Pre-Trial Diversion' (2006) 19(2) *Australian Journal of Corporate Law* 161; Karen Yeung, *Securing Compliance: A Principled Approach* (2003).

⁶² Yeung, above n 59; see also John Hasnas, 'The Politics of Crime: Ethics and the Problems of White Collar Crime' (2005) 54 *American University Law Review* 579.

working groups. This requires a much more sustained dialogue than has been evidenced to date in Australia. The climate survey commissioned by ASIC should go some way towards identifying the key areas of distrust and the confrontation that currently exist within the marketplace. Its longer-term effectiveness, however, is predicated on ASIC recognizing its own limitations. This does not mean ceding regulatory authority. Rather it means that the agency should establish and nurture mechanisms that build informal trust networks. This enhances the quality of market intelligence. It also reinforces the restraining power of articulated norms. By adopting a less intrusive approach to the construction of organizational frameworks – in return for access to the organizational blueprints, as required for wider demonstration effect –the regulator also fulfills a statutory objective to reduce regulatory burden without necessarily sacrificing effectiveness.

E *Red-Tape Reduction, Administrative Efficiencies and Inward Investment*

One of ASIC's key objectives is to reduce the administrative burden on regulated entities. While capacity to fulfill that objective is framed by legislative requirements set down in the Corporations Act, ASIC has considerable discretion to interpret both the meaning of the specific provisions and to allocate resources across intra-agency directorates. In this context, while there is considerable merit in the call to ASIC staff to be more responsive to indicators of client satisfaction, care must be taken to ensure that any reduction in informational flows does not compromise overarching surveillance capacity. This caveat aside, a reduction in administrative filing requirements can pay significant dividends. Not only is progress easily measurable, the wider impact is of significant value. It can help

change negative perceptions of an unaccountable regulator, aloof from the compliance burden imposed by inappropriate and out-of-date legal requirements. Moreover, further administrative reform can help secure the final objective, that of facilitating inward investment.

CONCLUSION

As with the social and political systems in which they are nested, financial centres depend on integrity. Disclosure, transparency and accountability mean little if the polity understands these in formal mechanistic fashion. The problems now apparent in the global securitisation market demonstrate the consequences of such an approach to governance. While the inappropriate and unrealistic pricing of risk are arguably commercial calculations best left to the market to price, it is necessary for the providers of the products to recognise their own responsibility for a systemic crisis of authority.

The risks posed of this kind of financial engineering are not new. In 1986 the noted political economist Susan Strange warned of the emergence of ‘casino capitalism’.⁶³ By 1998, on the cusp of global financial crisis, she argued that reckless gambling had degenerated into psychosis.⁶⁴ The glut in liquidity and rapid expansion of margin trading on complex derivatives had, she said, inculcated a pathological degeneracy. Arguably, the implications of that degeneracy are now being played out. The potential conflagration over excessive leverage was signalled repeatedly earlier this year; warnings that were routinely ignored. The market’s failure to inculcate the value of restraint appears to demonstrate, as Strange predicted, pathological tendencies. Diagnosis

⁶³ Susan Strange, *Casino Capitalism* (1986).

⁶⁴ Susan Strange, *Mad Money* (1998).

of the malaise leaves three critical questions unresolved. How could the markets get the fundamentals of risk so wrong? How could a system designed to minimise risk actually spread it? What can be done to ameliorate the dysfunctional relationship between law and ethics in contemporary markets?

At the operational level, a profound miscalculation of the likelihood or salience of risk factors resulted in suboptimal design. The producers, financiers and consumers of a highly leveraged variant of the American dream failed to appreciate the dynamics of integrating desire, delusion and greed with lower opportunity costs. Excess liquidity generated huge risk distortions. Arbitraging the difference between the cost of debt and rising house and commodity prices along with manufacturing profits led to abnormal returns that were enhanced exponentially by the power of leverage. The process and its rationale percolated throughout society. From the boardrooms of Manhattan to the inner cities of the United States no barrier to lending was imposed. Just as low-documentation loans became pervasive in the sub-prime market, multi-billion dollar lines of credit were extended with little or no covenants. In part, this could be justified because the underlying debt was securitised and on-sold in the form of esoteric financial instruments known as ‘collateralised debt obligations’ (CDOs). The debt repackaging was, in turn, fundamentally mis-priced by rating agencies.

Despite the inherently unstable nature of its core ingredients, the reconfigured parcels were provided with implausible and unsustainable credit rankings. Institutional actors, precluded by governance mandates from holding products with a less than investment-grade valuation, followed hedge funds into products in which the ownership of economic risk was, at best, unclear. The faith placed in these products and the ratings

system now appears unwarranted. The partial internal and external collapse of the CDO market is prompting increasing margin calls that can only be met by parting with liquid assets, particularly corporate equities, thus completing a vicious circle.

The credit freeze symbolises a profound climate change in global markets. The impact of all of this on the real economy is profound. Embedding restraint has become a policy priority for the entire regulatory community, not just in the United States but in every major securities market. The problem cannot be resolved by recourse to legal means. Securitisation is, after all, perfectly legal. What is also clear, however, is that the exponential growth was facilitated by the conceptual and practical bifurcation of capability and opportunity from accountability and responsibility.

The securitisation crisis offers an opportunity for a realignment, which can only be achieved by strengthening informal nodes of control. The opportunity exists now for a reinvigorated conversation about the purpose of regulation, the articulation of common goals and the alignment of interests. The strategy offered by ASIC offers an opportunity for Australia to take the lead in this process. It is in its own interests, the interests of domestic participants and the interests of wider markets that the opportunity is grasped.

Table 1: ASIC Priorities

	GOAL Improved and more cost-effective delivery of services	MISSION Facilitation of inward/outward investment	FRAMEWORK Pro-active risk management processes and educative initiatives	INSTRUMENTS Ex ante and ex post focus on disclosure, insider trading and market manipulation	PROCESSES Operational Filings
ASIC	X	X	X	X	X
Compliance	X	X	X	X	
Consumer Protection	X	X	X	X	
Enforcement	X	X		X	
Finance	X	X			X
Operations	X	X			X
Regulation*	X	X	X	X	X

* A new Strategy Directorate has been established. It is unclear what components of the Regulation Directorate (and other directorate level functions) will migrate to the new entity. It is also unclear whether the Strategy Directorate will perform a meta-regulatory function, acting as both ultimate arbiter of competing directorate level disputes and transmission mechanism for the embedding (and policing) of commission priorities. It is the view of this author that, to be truly effective, the new directorate must have an overarching deliberative function. It must be the primary arbitration venue for adjudication and management of competing interpretations of regulatory priorities and performance. The commissioners, as the ultimate accountable body within the organisation, must, of course, have the capacity to overrule Strategy Directorate decisions, but, in keeping with the 'comply or explain' framework, variance must be detailed in narrative form. Until more detail emerges in the strategic review, it is presumed that the function of performance will rest initially with the Regulation Directorate. The exact role played by a streamlined Regulation Directorate will be determined by what function it is subsequently ascribed.

Table 2: GOAL: Deliver cost effective services

Directorate	Action	Risks	Opportunities	Measurement
Compliance	Reduce prescription	Technical compliance	Responsibility	Climate surveys tailored to sectors; involvement in cross-cutting taskforces.
Consumer Protection	Education Programs	Advice ignored	More informed investor base	Investor Surveys Website Visits
	Alert Mechanisms	Litigation	Pro-active management	General and specialist media placement and analysis International benchmarking
Enforcement	Focused litigation strategies	Components of market activity un-policed	Reduction in contestation	Quantitative and qualitative statistical analysis (e.g. breaches; seriousness; monetary value of malefaction)
	Expeditious investigations	Lack of thoroughness	Corporate and Market disclosure	Numbers of investigations; involvement in and relational position within cross-cutting agency taskforces; action resulting in calibration of market codes of practice
Finance	Cost efficiencies	Emphasis on direct costs leading to downgrade in staff salaries and research capacity	Budgetary maximisation to further strategic priorities	Percentage of budget spent on overheads
Operations	Red-tape reduction	Qualitative material lost	Computer assisted modelling of patterns	Quantitative timeline statistics
Regulation	Strategic Overview	Emphasis on cost-reduction	Securing market to regulatory aims and objectives	Climate surveys measuring responsiveness
	Pro-active management of regulatory domain	Regulatory creep	Agonistic agreement	Media analysis; innovation endorsement at national and international forums

Table 3: MISSION: Facilitate Inward/Outward Investment

Directorate	Action	Risks	Opportunities	Measurement
Compliance	Priority and agenda setting	Pro-active focus	Pro-active focus on latent and emergent problems	Granular assessment of what constitutes non-compliance in 'comply or explain framework
Consumer Protection	Disclosure linked to embedding wider integrity norms Focus group with intermediaries	Industry failure to accept responsibility Lack of industry commitment	Educative enhancement and investor confidence Wider acceptance of restraint	Climate surveys; information flow to hotlines. Revision and strengthening of codes of conduct
Enforcement	Focus on high-profile enforcement as a last resort	Reputational risk of failure	Enforcement corralled	Extent to which information is shared; % settled and terms accepted; media and academic coverage
Finance	Enhance skill-base	Unavailability or low retention rates	Energised and more effective staffing	Statistical mapping of turnover; qualification base; involvement in executive education
Operations	Regulatory Pruning	Informational deficit	Inward investment	Benchmark performance to WSJ/Heritage survey; new authorisations; market expansion and exit
Regulation	Agenda setting through focus groups	Regulatory creep	Dialogue	Climate surveys; informational flows; publications in practitioner and academic journals

Table 4: FRAMEWORK: Pro-active Risk Management

Directorate	Action	Risks	Opportunities	Measurement
Compliance	Clarification of guidelines	Technical compliance	Educative enhancement	Climate surveys
Consumer Protection	Focus on latent and emergent problems	Lack of media and practitioner interest	Enrolment of stakeholder groups	Climate survey and attendant focus group analysis
Enforcement				
Finance				
Operations				
Regulation	Cross-cutting panel comprising whole of agency and advisory panel Use of summer school as key dissemination vehicle	Lack of industry commitment Talk at rather than with regulated community	Agenda setting intellectual leadership Intellectual leadership	Informational flows; % endorsing of ASIC; media management Industry and international participation at summer school (e.g. agenda setting; level of delegate; roundtable or speech)

Table 5: INSTRUMENTS: Continuous Disclosure, Insider Trading and Market Manipulation

Directorate	Action	Risks	Opportunities	Measurement
Compliance	Problem Diagnosis	Informational deficit	Better evidential base	Extent to which existing mechanisms catch malefaction
	Clarification of Guidelines	Technical Compliance	More efficient market mechanisms	Use of guidelines in corporate strategies
Consumer Protection	Educative programs	Lack of interest until crisis emerges; regulatory scapegoating	Greater confidence in market integrity	Informational flows into ASIC; mapping of complaint nature and what happens when enters regulatory space; analysis of impact on operating norms
Enforcement	Narrow regulatory impact definitions	Enforcement trumps other directorates	Reduced contestation when action taken	Mapping of specific investigations
	Disclosure of operating procedures	Facilitates evasive action	Greater certainty	Speed of investigations; degree to which investigation is slowed/speeded by legal challenge
	Better utilisation of ASX surveillance data	False positives	Richer intelligence base	Narrative account of informational strategies required
Finance				
Operations				
Regulation	Problem design	Lack of focus; incommensurable objectives	Agonistic understanding between industry and regulator	Involvement in national and international forums; degree to which best practice emulated.
	Build relations with national and international key-stakeholders through advisory panels	Perception of regulatory capture	Much richer intelligence base	Narrative reporting on outcomes not agenda recitation

Table 6: BUREAUCRATIC PROCESSES: Operational Filing

Directorate	Action	Risks	Opportunities	Measurement
Compliance				
Consumer Protection				
Enforcement				
Finance	Budgetary savings	Employment levels change	Deployment of Staff	% spent on overheads; % on educative programs; mentoring and fast-tracking schemes
Operations	Time Management reductions	Informational flows automated	Utilisation of deep search software to map connections	Benchmark to international comparators
Regulation	Gain intelligence on real costs	Information exaggerated	Testing of informational quality	Ranking of real and perceived threats