Media Release: Addressing the Regulatory Cost vs. Benefit Trade-off
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For more than two decades, financial deregulation has helped spur efficiency gains and underpinned massive growth in financial services. Primarily, deregulation has occurred in the area of economic regulation. There has in fact been a compensating increase in other forms of regulation targeted at system stability and contractual integrity such that an ever growing cost of doing business is regulatory compliance. In 2006, the Federal Government responded with its Regulation Review Task Force.

In his article, "Financial regulation: trends and prospects", published in the May 2007 edition of *The Melbourne Review*, the finance academic Kevin Davis responds to a key recommendation of the Task Force. He argues that while there is a strong case for regular reviews of existing regulation, the application of standard cost-benefit techniques to prospective financial regulation is "highly problematic".

Professor Davis, who is Director of Melbourne Centre for Financial Studies, argues that "regulatory changes lead to a change in the dynamic evolutionary path of the financial system, and it is therefore necessary to compare the merits of one future path against another" rather than compare one static position with another. Davis highlights unexpected early outcomes from the seminal Campbell Inquiry of the early 1980s.

He notes that "regulation of the black letter type law which attempts to write rules to prevent particular specific actions or contractual features will struggle to succeed.

"Financial innovation and engineering will typically produce alternative techniques and financial products, not captured by the regulations, which achieve the same outcomes.

"Consequently, there is considerable merit in a 'principles based' approach to regulation, within which regulators can deal with specific cases as they arise."

He cautions about regulation which treats all market participants the same as being costly to both financial institutions and consumers.

Davis, a member of the Australia and New Zealand Shadow Financial Regulatory Committee, acknowledges that this "also has implications for the relative roles of politicians and regulators in the design of legislation and accompanying regulations."

He concludes that it would be worthwhile for further academic research to be conducted into "whether current approaches to the manufacture and design of financial regulation in Australia are optimal".

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The Melbourne Review features contributions from noted academics, business leaders, commentators and policy-makers and addresses critical issues lying at the nexus of business and public policy. Published bi-annually, *The Melbourne Review* is the flagship publication of Melbourne Business School's Centre for Business and Public Policy.

Melbourne Centre for Financial Studies is a partnership between public and private sectors, and between industry and academe. Seed funding has been provided by the Victorian Government as part of its Financial Services Strategy. Members of the consortium are Melbourne, Monash and RMIT Universities, and Finsia. They have joined together to enhance Melbourne's national and international reputation for excellence in financial practice, research and education. The Centre facilitates knowledge transfer between, and builds research synergies between, industry and academe by undertaking finance research, providing consulting services, and organizing research focused conferences, workshops, public lectures and other educational activities. Financial Regulation is a core research area for the Melbourne Centre.

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