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Improving Financial Regulation: Industry and Regulators explore the options

**Financial Regulation: Costs Benefits and the Process of Regulatory
Change**

A conference held on September 19th 2007
convened by the Melbourne Centre for Financial Studies
and sponsored by ASIC, APRA and FICA

****For Immediate Release****

At this specially organized conference, 55 executives from the finance sector, financial regulators and academics discussed six specially commissioned papers which explored options for improving the process of manufacture, design and appraisal of financial regulation.

The program developed jointly by regulatory agencies (APRA and ASIC), finance industry associations (FICA), and the Melbourne Centre, was designed to investigate further the issues raised and recommendations made by the Task Force on Regulatory Reform (the Banks Report), and reflected in the Best Practice Regulation Handbook released in August 2007. The delegates were also addressed by the Chair of the Task Force (Gary Banks) who provided an update on reaction to, and implementation of, its proposals.

The commissioned papers (five of which were prepared by academics liaising closely with the program sponsors to identify critical issues) made a number of suggestions for improving financial regulation.

Pamela Hanrahan (University of Melbourne Law School) argued that inadequacies in the drafting of regulatory utterances by legislators and regulators has contributed to problems in its subsequent implementation and in the development of productive dialogue between regulators and those affected by regulation in a highly complex and evolving financial system.

Andrew Serpell (Department of Business Law, Monash University) examined the role of Regulation Impact Statements (RIS) which are required as part of the process of regulatory change. While noting their potential value, he identified a number of difficulties. These included: quantification of benefits and costs and the resource costs imposed on both regulators and affected parties seeking input to the process; risks that clearly merited regulatory changes could be delayed; whether the RIS becomes seen as a compliance issue for regulatory agencies rather than as an opportunity to inform the choice between a range of regulatory options.

Ian Harper (MBS) in a joint paper with Hugh Green and Ric Simes of Access Economics, focused upon the issues of incentives for and accountability of regulators, arguing that there is a

bias (also held by politicians) towards regulation which minimizes their reputational risk. Arguing that this can lead to excessive regulation, they advocated the establishment of an independent Bureau of Financial Sector Regulation, and suggested that the time was right for a “mini-Wallis” Inquiry.

Gail Pearson and Steve Elliot of the University of Sydney focused upon the role of self regulation within the context of ensuring that regulation does not stifle innovation and international competitiveness in financial services. They argue that disclosure requirements are, by themselves, insufficient to ensure informed decision making by consumers, and that consumer education, regulation and recognition by industry of its responsibility in this area are also needed. They also note that in an innovative and constantly evolving financial system, gaps and overlaps in the ambit of Self Regulatory Organizations arise which may limit the effectiveness of self regulation.

Justin O’Brien (Centre for Applied Philosophy and Public Ethics) considers the implications of the recent shift in focus of ASIC from an enforcement emphasis to one involving improved dialogue with the private sector with the objective of achieving fair and efficient markets. He notes that consultation and engagement are an important component of this process and, given the “grey” areas involved in principles based regulation, identifies the important role of industry in developing and achieving adherence to industry standards and codes of conduct.

In the final paper presented, Charles Littrell and Phillip Anastopoulos of APRA explain the steps APRA is taking to quantify the benefits of proposed changes to prudential regulation using its “PAIRS” ratings system for financial institutions. By mapping PAIRS ratings into failure probabilities, and estimating how proposed regulatory changes will affect ratings, they are able to quantify the change in expected losses from financial institution failure following a regulatory change.

Key themes to emerge from the conference discussion included:

- The importance of consultation and of determining the optimal process of consultation (who, when, how)
- The importance of developing a shared understanding of the reason for, and choice of, specific changes in regulation (what is the problem which creates the need for regulation, how does the proposed change resolve that problem)
- The importance of incentives and accountability of both regulators and industry participants and associations in ensuring that good regulation occurs
- Recognition that the circumstances of a particular issue may determine whether principles based or rules based regulation is most suitable
- The complexity and ongoing innovation in the financial sector creates particular problems for financial regulation which creates a need for close collaboration between industry and regulators to identify effects of regulatory proposals and their likely costs and benefits.

Papers presented to the conference (which was hosted by Vanguard Investments) are available at: http://www.melbournecentre.com.au/FinRegConf/Financial_Regulation_Conference.htm

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