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Regulating the Regulator: Improving consumer protection under a Twin Peaks regulatory framework

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ABSTRACT

Australia is in the midst of a financial regulatory crisis. Evidence of malpractice, fraud, criminality, contempt for the law, and the abuse of consumers on an industrial scale, all while Australia's Twin Peaks regulators looked on, has come as a shocking surprise. The implications stretch well beyond Australia: they are relevant wherever the Australian 'Twin Peaks' model has been adopted or is under consideration. This article argues that the Twin Peaks model must be analysed from the perspective of regulatory design, as well as implementation. The design - the architecture of Twin Peaks - remains optimal. However the implementation - the plumbing - requires urgent reforms. Drawing on the work of notable international scholars, this article proposes a new accountability framework for the two, peak regulators, in order to enhance their efficacy. In the process of rescuing Twin Peaks from its current inadequate plumbing, consumers may expect to enjoy levels of protection commensurate with those of a developed economy possessed of rule of law.

Keywords: Twin Peaks; consumer protection, regulatory theory, financial system regulation, Sentinel, Sunshine Commission, regulatory enforcement, regulatory implementation, Australian financial services Royal Commission

I. Introduction

This article analyses a proposed framework, the goal of which is to improve protection of consumers of financial products and services, within the Australian Twin Peaks regulatory model.

While Twin Peaks is widely regarded as the optimal

model by which to regulate the financial system, and while its adoption is steadily increasing across the globe, the model's progenitor, Australia, is in the midst of a financial regulatory crisis. Consumer abuse and market misconduct in Australia has become a national emergency. As a consequence the Australian Federal government established the Australian Royal Commission of Inquiry into Misconduct in the Banking, Superannuation and Financial Services Industry¹ (hereafter 'RCI' or 'Royal Commission') in November 2017. So widespread and egregious has been the litany of misconduct, dishonesty and fraud perpetrated against consumers of financial products and services which has emerged in the first six months

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¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, "Home", Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2018, accessed: 11 January, 2018.

of testimony before the Commission, that the Australian public has been left reeling. A recitation of instances of misconduct (which is primarily in the form of consumer abuse), or a description of the types of harm visited upon consumers is not within the purview of this article. Suffice it to say that even before the establishment of the RCI, the extent and gravity of consumer abuse was sufficient to deem the establishment of such a Commission a necessity. What has emerged during testimony indicates that the abuse that was known of, and which precipitated the establishment of the Commission was a mere tip. The remainder of the iceberg is still to be uncovered.

What has been of equally great concern is the evidence that has emerged of how Australia's consumer protection peak, the Australian Securities and Investments Commission (ASIC), ignored evidence of misconduct or actively colluded with regulatees, and failed consistently for over ten years to protect consumers or punish wrongdoers. It is for this reason that the current crisis may accurately be described as a 'financial regulation crisis'. What this writer describes as Australia's GF(r)C – *Great Financial (regulatory) Crisis*.

Consequently this article will focus on how to improve the efficacy of consumer protection within the Twin Peaks regulatory architecture. To that end this writer will draw upon the work of a number of leading scholars, each of whom has put forward mechanisms for enhanced oversight, and with that, the prospect of enhanced regulator efficacy. Together these mechanisms are termed a 'regulator for the regulators'.

II. A regulator for the regulator

In the aftermath of the Global Financial Crisis (GFC) the prevailing narrative asserted that the GFC was as a result of poor market conduct and wide-scale consumer abuse (principally in the US subprime lending market). Similarly, the perceived solution appeared at first blush to require ceding more power to the regulators.² This narrative-cum-solution assumed that the regulators were inadequately empowered to begin with.³ Whether this

was correct requires a deeper analysis, and one which takes account of regulatory capture.

This cannot be stressed enough. As emphasised by a vast literature, financial institutions pay virtually unlimited sums to shape financial policies, regulations and supervisory practices to serve their private interests. As emphasised by an equally vast literature, narrow political constituencies work tirelessly on tilting the financial rules of the game so as to collect a greater share of the economy's resources.⁴

Not only because a thorough investigation of the causes and possible solutions requires an investigation of all potential culprits, but more importantly, because there is existing scholarship which specifically points to the existence of capture of regulators prior to the GFC.⁵ Solutions aimed at addressing capture then become relevant to an inquiry into the enhancement of Australia's Twin Peaks regime (and other, later Twin Peaks adopters), in light of the evidence of regulatory capture also in Australia, which in turn precipitated our GF(r)C.

Despite the ever-increasing body of evidence that points to the failures of our regulators, the response from the Australian Federal government was, initially at least, to provide our regulators with more power, such as the new bank executive accountability regime.⁶ Again, this begs the question: was the poor performance of Australia's

³ See: Frederic S. Mishkin, NBER Working Paper Series, *Over the Cliff: From the Subprime to the Global Financial Crisis*, National Bureau of Economic Research No 16609 (2010); Paul G. Mahoney, Law, Economics, & Business Workshop, *Deregulation and the Subprime Crisis*, Berkeley Law: Legal Scholarship Repository (2016).

⁴ Ross Levine, "The governance of financial regulation: reform lessons from the recent crisis", series edited by Monetary and Economic Department, in *BIS Working Paper*, Vol. 329, Bank for International Settlements, November, 2010, p 10.

⁵ Stijn Claessens & Laura Kodres, "The Regulatory Responses to the Global Financial Crisis: Some Uncomfortable Questions", in *IMF Working Paper*, no. WP/14/46, Research Department and Institute for Capacity Development, International Monetary Fund, March, 2014, p 6/12; Andrew Baker, "Restraining Regulatory Capture? Anglo-America, Crisis Politics and Trajectories of Change in Global Financial Governance", *International Affairs (Royal Institute of International Affairs 1944-)*, Vol. 86, no. 3 (May, 2010); Eric Monnet, Stefano Pagliari & Shahin Vallée, "Europe Between Financial Repression And Regulatory Capture", in *Finance & Financial Regulation*, Bruegel Working Paper 2014/08, Bruegel, July, 2014; Simon Johnson & James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, 2010.

⁶ *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 (Cth)*, 2017.

² See for example: Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 (Cth) 2017.

regulators a result of inadequate power and resources? Or was it as a result of inadequate enforcement of existing powers? This question is crucial, because if the cause was the latter, then providing more power to our regulators will not fix an underlying unwillingness to exercise the powers already provided. Extending more power to regulators that do not exercise the powers they already have is not a uniquely Australian response. As Barth et al state:

Unfortunately, in the wake of the [global financial] crisis, we now seem to be lurching from one simplistic, unqualified ideology— that private markets will look after society’s interests—to an equally flawed, if not more perilous, ideology—that the Guardians will always act in society’s interests, so let’s give them more power to do so.⁷

Evidence before the RCI, and anecdotal evidence leading up to the establishment of the RCI indicated that Australia’s peak regulators, ASIC and APRA (Australian Prudential Regulation Authority) were, at best missing in action, or at worst actively colluding with dishonest, and at times criminal financial services providers.

It’s not that the Australian Securities and Investments Commission (ASIC) is in need of added muscle. It needs to grow a spine... ASIC is the law enforcement agency that shies away from enforcement, particularly in the top end of town.⁸

Evidence abounds of serious misdeeds in the Australian financial services industry so widespread and so common, that there is a credible argument to be made that criminality, fraud, and consumer abuse has become systemic. Australia’s banc assurers have rigged interest rates, repeatedly stolen from their customers – including customers who were deceased⁹ - and rejected legitimate insurance claims for

death and permanent disablement, including from customers who had been left paralysed;¹⁰ despite having paid premiums, in some cases, for decades. In other cases banks foreclosed on borrowers who had never missed a payment, or had never been in arrears.¹¹

Since the financial crisis, they have forked out more than \$1 billion in fines and compensation for their misdeeds. But not one senior banking executive has faced a court room for any of this.¹²

Despite being invested with the power to launch criminal and civil proceedings, for the past 15 years ASIC has instead chosen to use, almost exclusively, enforceable undertakings¹³ - described as a *slap on the wrist*, replete with a *hollow threat*¹⁴ to take stronger action if the undertaking is breached. Criticism of the manner in which these undertakings are heavily negotiated, and the comparatively small fines that are attendant thereto has been withering.¹⁵ At other times financial service providers have simply ignored the undertakings given to ASIC, without repercussions.¹⁶

It is within the context of these failings that the 2014 Financial System Inquiry (‘Murray Inquiry’ or ‘FSI’)¹⁷ recommendation for the creation of a Financial Regulator Assessment Board¹⁸ (hereafter referred to as the ‘FRAB’; ‘Assessment Board’; ‘Board of Assessment’; or simply as the ‘Board’) to oversee the regulators warrants examination.

2018, 4:50 pm, accessed: 4 July, 2018.

¹⁰ Dr Benjamin Koh, “The Price of Silence: by Commonwealth Bank whistleblower Dr Benjamin Koh”, series edited by Michael West, in *Finance*, Michael West, 30 May, 2018 accessed: 4 July, 2018.

¹¹ Elizabeth Redman & Cliona O’Dowd, “Banking royal commission live: CBA may have breached ASIC Act, Hayne told”, ‘News’, *The Australian*, 2018 at 4:43 PM.

¹² Ian Verrender, op cit.

¹³ Ian Ramsay & Miranda Webster, “ASIC Enforcement Outcomes: Trends and Analysis”, *Company and Securities Law Journal*, Vol. 35, no. 5 (November, 2017).

¹⁴ Ian Verrender, op cit.

¹⁵ Dan Ziffer, “Banking royal commission casts doubt on regulator ASIC’s enforceable undertakings”, series edited by Australian Broadcasting Corporation, in *News*, Australian Broadcasting Corporation, 17 May 2018, 7:48pm, accessed: 4 July, 2018.

¹⁶ Clancy Yeates, “Funeral insurer targeting Indigenous Australians ignored court orders”, ‘Business’, *The Sydney Morning Herald*, Business Day ed., 2018.

¹⁷ Financial System Inquiry, “Financial System Inquiry Final Report”, series edited by The Treasury of the Australian Government, The Treasury, Commonwealth Government of Australia, November, 2014.

¹⁸ *Ibid*, p 239.

⁷ James R. Barth, Gerard Caprio & Ross Levine, “Making the Guardians of Finance Work for Us”, Chap. 8, in *Guardians of Finance: Making Regulators Work for Us*, 2012, p 211.

⁸ Ian Verrender, “Banking royal commission: How ASIC went missing in action with the banks”, series edited by Australian Broadcasting Corporation, in *Analysis*, Australian Broadcasting Corporation, 25 April 2018, 1:09 pm, accessed: 4 July, 2018.

⁹ Emily Stewart, “Banking royal commission: How dead people can be charged bank fees”, series edited by Australian Broadcasting Corporation, in *News*, Australian Broadcasting Corporation, 19 April

This recommendation forms part of an international body of scholarship aimed at enhancing regulator efficacy – a body of scholarship that dates back to the late 1800s and the contribution of Charles Francis Adams Jr.¹⁹

Arguably the most developed proposal is that of Barth, Caprio and Levine.²⁰ Published in 2014, the authors address the failures exhibited by the regulators’ prior to the GFC. Their proposal for a panel of oversight comprised a committee of experts called a ‘Sentinel’.²¹ Their thesis builds upon the work of Charles Adams Jr who, observing the unfettered market power exercised by the railroad barons, argued in the late 1860s for the creation of an expert, permanent, apolitical body – a regulatory commission:

To organize that intelligence should be the labor of a new commission, composed of such men in material life as Story was in law, Mann in education, and Bache in science. These men must study causes, point out effects, and indicate remedies.²²

McCraw²³ christened this proposed commission a ‘Sunshine Commission’: ‘a commission that would shed the cleansing light of disclosure on the hitherto secret affairs of business corporations’²⁴ to which Breger et al added: ‘an impartial body of experts that would investigate, examine, and report on railroad activities but would not have enforcement power.’²⁵

Informed by this scholarship, Barth et al’s proposal is for an institution that would act on the public’s behalf. This would entail providing informed, expert, and independent assessments of financial regulation. To that end they envisaged an authoritative institution, and independent of short-term politics; independent of the financial services industry; vested with the power to demand

the information necessary for assessing and monitoring the regulators – the ‘Guardians of Finance’; possessed of multidisciplinary expertise to enable it to process the information it gathers; sufficiently prominent to deliver assessments to the public and Parliament; and capable of influencing an open discussion of financial regulatory policies. Barth et al argue that these characteristics are ‘necessary for improving the still seriously flawed financial regulatory institutions operating around the world today.’²⁶

An institution such as this would plug a gap that the authors assert exists world-wide. They assert that the ‘absence of an institution with these five traits means that the public cannot effectively evaluate financial regulation and, therefore, cannot constantly oblige the Guardians to act in the public interest.’²⁷

The Sentinel would improve the entire apparatus for writing, enacting, adapting and implementing financial regulations. ... reduce the ability ... to obfuscate regulatory actions ... make regulators more accountable for [their] societal repercussions ... reduce the probability and costliness of regulatory mistakes and supervisory failures. ... the Sentinel’s reports to legislators would help reduce the influence of special interests ... sole objective ... to evaluate the state of financial regulation from the [public’s] perspective ... help inform ... and ... augment public influence over financial regulation.²⁸

Barth et al and Levine target this new framework squarely at enhancing regulator efficacy, by providing a structure that addresses what is currently lacking:

Successful and lasting reform requires addressing a core cause of the systemic malfunctioning of financial systems – poor governance of the Guardians of Finance.²⁹

Examples exist, but are relatively rare. They include (to a limited policy-extent – that is to say limited to the function of the provision of independent expert advice, at arms-length from both the regulator and the regulatee)

¹⁹ Adams, Jr., Charles Francis, “Boston”, Vol. 106, no. 218 (January, 1868).

²⁰ James R. Barth, Gerard Caprio & Ross Levine, op cit.

²¹ Ibid, p 203-232.

²² Adams, Jr., Charles Francis, op cit, p 25.

²³ Thomas K. McCraw, *Prophets of Regulation: Charles Francis Adams; Louis D. Brandeis; James M. Landis; Alfred E. Kahn*, 1986.

²⁴ Ibid, p 15.

²⁵ Marshall J. Breger & Gary J. Edles, *Independent Agencies in the United States: Law, Structure, and Politics*, 2015, p 27. See also a proposal along similar lines for an ‘Expert Review Panel’: Stefano Pagliari, “How Can We Mitigate Capture in Financial Regulation?”, Chap. 1.0, in *Making Good Financial Regulation. Towards a Policy Response to Regulatory Capture*, edited by Stefano Pagliari, series editor: ICFR (International Centre for Financial Regulation), 2012, p 4.

²⁶ James R. Barth, Gerard Caprio & Ross Levine, op cit, p 204.

²⁷ Ibid, p 203.

²⁸ Ross Levine, op cit, 2.

²⁹ James R. Barth, Gerard Caprio & Ross Levine, op cit, p 213.

the Inspector General of Taxation in Australia,³⁰ and the UK's Financial Policy Committee (UKFPC),³¹ established as a Statutory Body in April 2013,³² with binding authority over the agencies under its jurisdiction. UKFPC has been charged with looking for the next 'bombshell' that may strike the financial system, by identifying, monitoring, and acting against systemic risks.³³ Notwithstanding the scarcity of operational precedents however, and in light of the failures of the Australian regulatory responses to date, the notion of an over-arching framework of independent, expert evaluation nonetheless bears analysing.

III. The Australian Response to regulatory failures

On 7 December 2014 the FSI released its Final Report. The Report made a number of recommendations, one of which specifically addressed the need to enhance regulator efficacy - Recommendation 27:

Create a new Financial Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates. Provide clearer guidance to regulators in Statements of Expectation and increase the use of performance indicators for regulator performance.

This Financial Regulator Assessment Board would provide annual reports to government on the performance of both APRA and ASIC, as well as on the Reserve Bank of Australia's regulation of the payment-system.³⁴ The proposed Board would analyse the regulators' performance relative to their mandates and priorities as specified in their Statements of Intent (SOIs), but not the mandates themselves.³⁵ In a similar vein, the proposed 'Sentinel's'

ambit of responsibility would entail the provision of annual reports only, in order to prevent a blurring of the boundaries of accountability.³⁶ The proposed Assessment Board was more closely aimed at improving the efficacy of ASIC,³⁷ which had been found to be severely lacking.

'[analysis of ASIC's performance] showed ASIC as a timid, hesitant regulator, too ready and willing to accept uncritically the assurances of a large institution that there were no grounds for ASIC's concerns or intervention.'³⁸

The FSI's aim in establishing such an Assessment Board was to: 'help to ensure ASIC has the appropriate skills and culture to adopt a flexible risk-based approach to its future role. Its overall performance would also be subject to annual review by the [Assessment Board].'³⁹ To that end the Board was intended to provide annual, independent advice to the Federal government on the performance of the regulators,⁴⁰ and crucially, that these reports would be made public.⁴¹ In so doing this proposal would emulate, at an ideational level, the proposal put forward by McCraw⁴² that relies upon public exposure and opprobrium, as opposed to formal legislative instruments, to ensure that regulators remain true to their duty to protect the public interest. The FSI envisaged that the Assessment Board would evaluate the full gamut of regulator efficacy: how they discharge their mandates, balance competing priorities, allocate resources, and respond to challenges.⁴³

In putting forward this proposal, the FSI took account of the current framework of Parliamentary oversight in Australia, but found it to be materially deficient, and inadequate to the task of monitoring the regulators, in order to ensure that they maintained a minimum level of efficacy. In particular, the occurrence of parliamentary

³⁰ Inspector-General of Taxation (IGT), "Our Role", in *About us*, Inspector-General of Taxation (IGT), 2018, accessed: 24 July, 2018.

³¹ Financial Policy Committee, "Financial Policy Committee", series edited by Bank of England, in *Financial Stability*, Bank of England, 2014, accessed: 26 September, 2014.

³² *Financial Services Act 2012* (United Kingdom).

³³ Jill Treanor, "Farewell to the FSA - and the bleak legacy of the light-touch regulator", 'Business', *The Guardian/The Observer*, 2013.

³⁴ Financial System Inquiry, op cit, p 239.

³⁵ Ibid, p 239.

³⁶ James R. Barth, Gerard Caprio & Ross Levine, op cit, p 217.

³⁷ Financial System Inquiry, op cit, p 235.

³⁸ Senate Economics References Committee, "The Performance of The Australian Securities and Investments Commission", series edited by Senate Standing Committees on Economics, in *Executive summary*, Parliament of Australia, 26 June, 2014, p xviii.

³⁹ Financial System Inquiry, op cit, p 237.

⁴⁰ Ibid, p 240.

⁴¹ Ibid, p 239.

⁴² See fn 23, above.

⁴³ Financial System Inquiry, op cit, p 240.

assessments were found to be irregular; that whilst Parliament reviewed regulators' annual reports, its scrutiny was ad hoc, and often focused on particular issues or decisions, as opposed to overall regulator performance.⁴⁴ This, in combination with the complexity of the regulator's mandates, made effective monitoring of the regulators difficult. Furthermore, Parliament's review of regulators' annual reports was not supported through regular, independent assessments.⁴⁵

Crucially, the FSI did not call for the Assessment Board to be a separate agency – doubtless in order to avoid a blurring of the boundaries of responsibilities and jurisdictional remit – but did propose that it be supported by its own secretariat, seconded from the Federal Treasury.⁴⁶ In so doing contamination between the functions of the Assessment Board and those of Treasury could be better avoided, which the FSI deemed valuable in light of Treasury's policy role as a member of Australia's Council of Financial Regulators.⁴⁷

The FSI envisaged a Board comprised of between five and seven members, who would serve in a part-time capacity, and would bring to the Board industry and regulatory expertise, but would not be drawn from current employees of regulated entities.⁴⁸ The Board's assessments would be strictly ex post, and limited to reporting its findings to government.⁴⁹ As such the Board would be precluded both from directing the regulators, or adjudicating upon individual complaints against the regulators,⁵⁰ and nor would it be permitted to enquire into financial system regulatory policy, such as the desirability of regulators' mandates.⁵¹ Rather it would determine if the regulator's mandates, as they stood, were being met. It would, however, replace the Financial Sector Advisory Council (FSAC). Curiously, despite the fact that FSAC would be dissolved only if a Board of Assessment was established under the FSI proposal, the Australian Federal government nonetheless announced that it would reconstitute the FSAC in 2016 to provide advice to the Australian government on, inter alia, the performance of Australia's

financial system regulators, and areas in need of regulatory reform.

To be clear, this is not a de facto Financial Regulator Assessment Board, as envisaged by the FSI. Here it is of note that of the nine members of the FSAC committee, four are in banks and merchant banks, one in a non-bank financial institution (shadow bank), one in a life-assurer, two in securities issuers, and one in a funds manager. All are in executive positions in those entities (CEO, Executive Chairman, or MD).⁵² This is, therefore, effectively a formally recognised peak industry lobby group.

Juxtaposed with that is the emphasis from the FSI on the need to avoid undue influence over the Board. As a result the FSI proposed reliance upon diversity in the composition of the Board, and/or a code of conduct.⁵³ As such these recommendations neatly reflect what was envisaged for a Sentinel by Levine:

[T]he Sentinel would be both politically independent and independent of financial markets. Senior members would be appointed for staggered terms to limit political influence. To shield it from market influences, senior staff would be prohibited from receiving compensation from the financial sector ... create an institution in which the personal motives, ambitions, and prestige of its employees are inextricably connected to accurately assessing the impact of financial regulations on the public.⁵⁴

The FSI proposal envisaged a Board capable of providing guidance to regulators on how to balance competing objectives, such as 'promoting competition and efficiency, maximising business certainty and minimising compliance costs.'⁵⁵ By way of example, the FSI cited that lower barriers to market entry may encourage competition and benefit consumers, but may also increase risks for consumers by allowing for the establishment of smaller, less well-capitalised, and more fragile institutions.⁵⁶ Taken

⁴⁴ Ibid, p 241.

⁴⁵ Ibid, p 241.

⁴⁶ Ibid, p 243.

⁴⁷ Ibid, p 239.

⁴⁸ Ibid, p 239.

⁴⁹ Ibid, p 235/239.

⁵⁰ Ibid, p 239.

⁵¹ Ibid, p 245.

⁵² The Honourable Kelly O'Dwyer MP, Minister for Revenue and Financial Services, "Financial Sector Advisory Council", series edited by The Treasury, Australian Government, in *Media Releases*, The Treasury, Australian Government, 6 May 2016, accessed: 25 July, 2018.

⁵³ Financial System Inquiry, op cit, p 239/240.

⁵⁴ Ross Levine, op cit, p 2.

⁵⁵ Financial System Inquiry, op cit, p 241.

⁵⁶ Ibid, p 242, fn 18.

together, the FSI report asserted that such a Board would ‘strengthen the accountability framework governing Australia’s financial sector regulators.’⁵⁷ The FSI concluded that:

The Inquiry believes that creating a new Assessment Board to review regulator performance is the best way to address the gap it has identified in the current accountability framework. ... would facilitate improved scrutiny of regulator performance without creating new agencies or compromising existing accountability ... [it is] not intended to reduce the independence of regulators in executing their statutory mandates.⁵⁸

In light of the findings of the Senate Inquiry into the performance of ASIC,⁵⁹ handed down some five months prior to the publication of the FSI Final Report, the arguments in favour of the creation of a Financial Regulator Assessment Board were compelling. Subsequent to those developments of 2014, the arguments in favour of the establishment of a FRAB have moved beyond compelling. The Australian Federal government’s failure to accept the recommendation to establish an Assessment Board – the only recommendation from the FSI which the Abbott-Turnbull government rejected⁶⁰ – has proven catastrophic, and has been instrumental in the maintenance of a regulatory framework so unfit for purpose as to have facilitated Australia’s GF(r)C.

Whilst not within the scope of this paper to analyse in depth, two further seminal developments bear mentioning as great inflexion points in the collapse of the credibility of Australia’s regulatory framework: one has been alluded to earlier – the RCI. The RCI has exposed a venality and at times wickedness in the conduct of our largest financial institutions.⁶¹ As appalling as this behaviour

has been, the fecklessness, timidity, indolence and ineptitude of our conduct regulator, ASIC, has been equally shocking.⁶² This writer predicts that ASIC, at least in its current form, will not survive – and nor should it. In addition to its legion of other failures, too numerous and too disparate to mention here, ASIC stands accused, by this writer at least, of no-less than having undermined Australian rule of law.

The second significant inflexion point in the performance of Australia’s regulators was revealed in February 2018 with the release of the Interim Report of the Australian Productivity Commission’s inquiry into the financial industry.⁶³ The Commission concluded that Australia’s financial industry has devolved into a four-bank oligopoly,⁶⁴ bereft of competition, abusive and exploitative of its customers,⁶⁵ and comprising, now, the most profitable banks in the world by return on equity.⁶⁶ The Commission

⁶² John Durie, “Regulator bares its teeth”, ‘Feature Edition’, *The Australian*, Feature Edition ed., 2016; Andrew Schmulow, “New laws on bankers behaving badly don’t matter in light of ASIC inaction”, ‘Business & Economy’, *The Conversation*, 2016 3:09 PM AEDT; Ian Ramsay & Miranda Webster, op cit; Ian Verrinder, op cit; Dan Ziffer, op cit; Andrew Schmulow, “APRA and ASIC have the legal power to sack bank heads, but they need will power”, ‘Business & Economy’, *The Conversation*, 2018, 3:25 pm.

⁶³ Peter Harris, Julie Abramson & Stephen King, “Competition in the Australian Financial System, Draft Report”, Productivity Commission, Government of Australia, Productivity Commission, January, 2018.

⁶⁴ *Ibid*, p 32.

⁶⁵ Citizens Electoral Council of Australia, “APRA blatantly props up housing bubble to rescue the crooked banks”, in *Media Releases*, Citizens Electoral Council of Australia, Friday, 27 April, 2018, accessed: 25 July, 2018; Stephen Letts, “Big banks get \$19b benefit over rivals from financial rules”, series edited by Australian Broadcasting Corporation, in *News*, Australian Broadcasting Corporation, 16 November 2016, 12:26 pm, accessed: 25 July, 2018; Bendigo and Adelaide Bank Bank of Queensland, ME Bank and Suncorp Bank, “Levelling the Playing Field”, in *Financial System Inquiry*, Financial Services, Financial System Inquiry, Regional Banks Submission to the Financial System Inquiry, March, 2014; Anonymous, “Loyal bank customers exploited: Productivity Commission draft report”, 8 February, 2018, accessed: 23 July, 2018; Paul Karp, “Banks are exploiting loyal customers, warns Productivity Commission”, ‘News/Australia’, *The Guardian*, Australia edition ed., 2018 7:48 am AEDT; J Eyers, “How APRA became the regulator of choice”, ‘Banking & Finance’, *Australian Financial Review*, 2017 at 11:00 pm; Peter Ryan, “‘Four pillars’ banking policy is ‘ad hoc’ and ‘redundant’, Productivity Commission warns”, series edited by Australian Broadcasting Corporation, in *News*, Australian Broadcasting Corporation, 7 February 2018, 5:03am, accessed: 22 July, 2018.

⁶⁶ Anonymous, “FactCheck: do Australian banks have double the return on equity of banks in other developed economies?”, *The Conversation*, 2017 12:50 pm AEST; Adam Courtenay, “Aussie banks the world’s most profitable”, *Your Week InFinance*, (2016), (accessed:

⁵⁷ *Ibid*, p 240.

⁵⁸ *Ibid*, p 244.

⁵⁹ See fn 39, above.

⁶⁰ Australian Government, “Improving Australia’s Financial System, Government response to the Financial System Inquiry”, series edited by The Treasury of the Australian Government, The Treasury, Commonwealth Government of Australia, 2015, p 23.

⁶¹ See for example: Clancy Yeates, op cit; Elizabeth Redman & Cliona O’Dowd, op cit; Dr Benjamin Koh, op cit; Emily Stewart, op cit; Stephen Letts, “ANZ, NAB agree to \$100 million settlement of swap rate rigging case”, series edited by Australian Broadcasting Corporation, in *Analysis*, Australian Broadcasting Corporation, 10 November 2017, 3:03 pm, accessed: 20 March, 2018.

sheeted much of the blame for this outcome to the policies of the Australian bank regulator, APRA.⁶⁷ Under those policies Australia's big four banks (the Australia New Zealand (ANZ) Banking Group; the Commonwealth Bank; National Australia Bank (NAB); and Westpac Bank) have gone from enjoying significant market share prior to the GFC, to today, where their market share is now crushingly dominant.⁶⁸ In the process of becoming the most profitable banks in the world, Australia's banks have sapped-dry the remainder of the real economy.⁶⁹ While APRA may claim that it does not have a competition mandate, and whilst that may be true, it is also true that APRA is required to maintain regulatory neutrality.

In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality...⁷⁰

However, its deployment of internal ratings-based models (IRBs) for the four largest of Australia's banks is but one example of a lack of regulatory neutrality – one which according to Australia's second- and third-tier banks has consistently favoured the big four in respect of their costs of funding, and which in turn has enabled the big four to gain an unassailable competitive advantage in the market.⁷¹

29 March), published electronically; cf Gaurav Sodhi, "Why Australian banks earn so much profit", *Intelligent Investor*, (2016), (accessed: 4 October), published electronically.

⁶⁷ J Eyers, op cit; Citizens Electoral Council of Australia, "APRA blatantly props up housing bubble to rescue the crooked banks", (2018), (accessed: Friday, 27 April), published electronically; Stephen Letts, "Big banks get \$19b benefit over rivals from financial rules", op cit.

⁶⁸ Bendigo and Adelaide Bank Bank of Queensland, ME Bank and Suncorp Bank, op cit, p 2; Peter Harris, Julie Abramson & Stephen King, op cit, p 3.

⁶⁹ Industry Super Australia, "Financing Australia's Growth", series edited by The Financial System Inquiry, Reserve Bank of Australia, 31 March, 2014, p 56; Andrew Leigh & Adam Triggs, "A few big firms. Concentrated markets and a lack of competition are damaging the Australian economy", *The Monthly* (17 May, 2017).

⁷⁰ S 8 (2), *Australian Prudential Regulation Authority Act (Cth)*, No. 50 of 1998.

⁷¹ Stephen Letts, "Bank debt ratios expose Basel's faulty risk weightings", series edited by Australian Broadcasting Corporation, in *Analysis*, Australian Broadcasting Corporation, 18 June 2015, 4:23 am, accessed: 25 July, 2018; House of Representatives Committees, "Review of the Four Major Banks: First Report", series edited by Standing Committee on Economics, in *Review of the Four Major Banks*, Parliament of

There are further examples of deep, systemic distortions that are now evident in the Australian economy, which may not be possible to rectify, and which point to serious and sustained deficiencies in the manner in which Australia's bank regulator has approached its task. Possibly the most socially disruptive of these is the increase in the price of residential property in Australia's major population centres, particularly Melbourne and Sydney. There are credible arguments that have been made that these two property markets – now of the most expensive in the world – became so as a consequence of capital adequacy rules laid down by APRA.⁷² In particular, as residential property is classified as a 'tier 1' asset, the amount of capital that Australia's banks are required to retain in order to extend residential mortgages is lower than the amount of capital they are required to retain for any other kind of loan. As a consequence Australia's banks have channelled ever greater amounts of money into mortgages, and in the process activated a spiral of more money chasing ever more valuable property, leading to ever greater impetus to invest in property.⁷³ Indeed, residential property has, for the past twenty years at least, been Australia's slow-motion *Bitcoin*.

To be clear, these distortions to the housing market and the lack of competition have seriously eroded consumer protection: in the case of competition, the provision of a fair and accessible market; in the case of the mortgages, home-ownership accessible not only to the wealthy or the very wealthy. While the FRAB, like the proposed Sentinel, would not inquire into *financial system regulatory policy*, and the concomitant regulator mandates that emanate there from, it would be empowered to evaluate a *financial system regulator's policies*, to determine whether they were well-suited to contributing to the dis-

Australia, November 2016, accessed: 25 July, 2018, p 27; Bendigo and Adelaide Bank Bank of Queensland, ME Bank and Suncorp Bank, op cit, p 4/5; Jim Minifie & Rodney Maddock, "FactCheck: do Australian banks have double the return on equity of banks in other developed economies?", 'Fact Check', *The Conversation*, 2017, 12:50 pm AEST, p 3. See also: Adrian Blundell-Wignall & Paul Atkinson, "German Bundestag Finance Committee Hearing on the Draft Bank-Separation Law (Drucksache 17/12601) – 22 April 2013. Statement by Adrian Blundell-Wignall and Paul Atkinson", Organisation for Economic Co-operation and Development (OECD)/Organisation de coopération et de développement économiques (OCDE), 22 April, 2013, p 5.

⁷² Gaurav Sodhi, op cit.; Citizens Electoral Council of Australia, "APRA blatantly props up housing bubble to rescue the crooked banks", op cit.

⁷³ Stephen Letts, "Big banks get \$19b benefit over rivals from financial rules", op cit.

charge of the regulator's mandate?

It should be noted also that examples of APRA's failures as a regulator and the concomitant detriment to consumers is not confined to distortions created by APRA's own internal policies. Included are implementation and enforcement failures. The RCI has heard evidence that APRA knew about misconduct, fraud and theft being committed against Superannuation members on an industrial scale - 15,000 criminal breaches at Commonwealth Bank for its failure to move default Superannuation accounts into 'MySuper' accounts,⁷⁴ which in turn attract no fees – to turning a blind-eye to 550,000 Superannuation members at various divisions of National Australia Bank being charged fees for no service – a form of theft. Remediation just for fees for no service is expected to top AUD\$ 1 billion.⁷⁵ Throughout this time APRA took no legal action of any kind. To this end APRA stands accused of colluding with regulatees, not simply so that the regulated entities in question could escape past instances of consumer abuse, but that they could continue to commit abuses against their customers, on an industrial scale, within sight of the regulator, and to continue doing so for several years further, without any form of sanction. In the case of a division of Commonwealth Bank's 15,000 criminal breaches of MySuper legislation, this was allowed to continue for a further two years after the regulator first became aware of this allegedly criminal misconduct.⁷⁶

It is submitted that the case studies suggest that the approach of neither APRA nor ASIC to regulation of superannuation entities is sufficient to achieve specific or general deterrence. The evidence suggests that APRA is reluctant to commence court proceeding and to take public enforcement action.⁷⁷

⁷⁴ Adele Ferguson, "Banking royal commission: APRA a 'hear no evil, see no evil' regulator", 'Business/Banking & Finance/Financial Services', *The Australian Financial Review*, 2018 at 11:00 PM.

⁷⁵ Joanna Mather, "Banking royal commission: APRA hasn't taken court action over super law breaches", 'Personal Finance', *Australian Financial Review*, 2018 at 3:00 PM.

⁷⁶ Ruth Williams, "'Behind closed doors?': super watchdog grilled over enforcement record", 'Business Day', *The Sydney Morning Herald*, 2018.

⁷⁷ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, "Module 5: Superannuation Closing Submissions", in *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 24 August, 2018, § 814, p 216.

IV. Conclusion

With these factors in mind it was already in 2014 important for the continued health and future prospects of the Australian economy that a framework be implemented to evaluate the performance of the financial sector regulators. This was evident at the time, thanks to the findings of the Senate Inquiry into the performance of ASIC, and it has become more evident with each passing year since.

The revelations before the RCI are of a kind that not only can they not be ignored, but they will not be ignored. Neither the current government nor a future Opposition-led government will be capable of resisting implementation, to some degree or another, of the far-reaching changes that the Australian electorate will undoubtedly demand. As a consequence the reconsideration of the proposal for the establishment of a Financial Regulator Assessment Board is more crucial than ever before. The time for that reconsideration is now.

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