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Transcript CIFR FSI WORKSHOP III

The Final Report: Panel Discussion 2-Regulation & Public Policy Implications

J O'Brien: Welcome back to the graveyard shift. This is the second round-chair panel discussion, and what we really wanted to do in this session was to expand beyond the core financial regulators to get the insights of regulators in cognate areas who may have a role to play, or who can provide additional insights.

So in terms of regulating or measuring and evaluating regulatory performance, we heard a lot today about the need for enhanced levels of accountability, particularly if there is going to be enhanced powers. We need to measure and evaluate performance and of course this is something that the Productivity Commission itself looked into in 2011.

Likewise, if we're looking at what is the role of competition and should there be the insertion of an additional layer of competition into regulatory mandates, basically what is going to be the impact of that? So it's important to hear the perspective of the ACCC. Is this actually a good idea, or is there a risk that it will actually reduce capacity to operate in other areas?

And then finally throughout the report we see an emphasis on the need to improve standards within the financial system and in particular the provision of financial advice and the idea that we should perhaps move towards professionalising the financial planning sector.

Well, if we're going to do that, then perhaps one agency that might have a role to play is the Professional Standard Council. And of course, this is one of the recommendations of the Parliamentary Joint Committee.

Now, whether or not that is a poisoned chalice for the Professional Standards Council is very much an open question. We can get Dean Sanders to talk to that in a moment.

What we wanted to do first of all is give each of the regulators five minutes for opening reflections on how their agency and their experience can actually help inform the government's response to Murray. I'll start with Karen Chester from Productivity Commission.

K Chester: Thanks very much, Justin, and thanks to CIFR for this opportunity to be here this afternoon.

I'm going to focus a little bit higher-level first on the policy architecture before we get into what we expect and need of our regulators. If you were to ask me how to sum up in 20 words or less what I thought of the FSI Review, I'd need to say it was a very comprehensive and accessible health check of the Australian financial system with a bunch of

recommendations for what I'd call in-system renovations.

Now what I mean by in-system renovations should hopefully become clearer as I try in the next few minutes to forge a link between consumer outcomes and policy settings by sharing my thoughts on just two aspects of the inquiry. The first one is banking sector competitiveness and the second one, which we've touched on earlier today, is around the action plan for retirement incomes.

But before I run through these two, I'd like to convey the Productivity Commission's thanks to David Murray, his committee members and the very hardworking team behind the scenes headed by Treasury's John Lonsdale.

Why should the PC be thanking the Murray committee? It's because at the Productivity Commission we like to be kept productive. And there are two key areas where the FSI Report recommends that we do some really meaningful inquiry work over the coming years.

They relate to innovation driven by the better use and sharing of data. This is an area of opportunity. The second area is reviewing whether My Super is delivering the competitive forces envisaged, an area of scepticism in the report.

Turning now to the two aspects of the report I'd like to touch on, for they share two common themes and I'll start to connect the dots for you shortly.

First, that consumer and regulatory outcomes are first and foremost driven by getting the policy fundamentals right. This for me is the primary binding constraint for our regulators being able to do their job properly.

And second, a handful of those fundamental policy issues remain missing in action for me in the final report, which suggests a potential handbrake on consumer outcomes regardless of how well policy is implemented or the calibre of our regulators or how well they're supervised or reviewed.

Turning first to banking sector competitiveness – and I'm sure Graeme would probably have better informed insights to share on this one – but simply through my economist lens, I was kind of surprised that the report was light-on in assessing the competitiveness or the degree of competitiveness in the banking sector, and whether more structural change is needed.

Now, the report did recommend a handful of in-system changes to inject competition at the margin and improve competitive neutrality across a few of the players.

Importantly for this session, it also heeded an all-important warning not to go heavy handed and adopt a one-size-fits-all for the regulation of emerging funding innovators, because these innovators potentially represent a new source of competitive pressure to our financial sector, albeit in niche markets.

Now, perhaps in this area I should be quoting Shaun Micallef with "I'm not a commentator", but I was kind of prompted to lift the bonnet on the report's assessment of the banking sector and its competitiveness by some stress testing that was undertaken in 2014 by one of the big four who shall remain nameless. I found this starkly revealing.

The stress test was a mini-Armageddon: house values down 30%, unemployment up over 11% over three years. But was revealing for me was that this stress test didn't really materially knock about their profitability, nor intuitively their return on equity. Good news perhaps for a prudential regulator, but not so good news for a shareholder in terms of balance sheet energy, and ultimately and perhaps arguably consumers in terms of competitiveness and outcomes for them.

Let's just say it surprised me that such a lens on the underlying competitiveness of the big four kind of appeared to be missing in action. This was especially surprising given the report found that conduct and prudential regulators have a natural tendency to prioritise equity and stability over competition and long-term efficiency.

So you see how I'm sort of connecting the dots between the policy architecture and then what we then expect of our regulators if we don't have the policy architecture quite right.

Second and finally on retirement incomes, and perhaps the policy area that we've all agreed today in discussions needs some tender loving care to ultimately deliver on consumer outcomes, and wearing my now dusted-off public policy hat, I absolutely get the need for a sustainable retirement income policy, given we have a means-tested universal age pension and a largely universal healthcare system. So we know base level longevity risk resides with government under the current policy mix.

But we heard earlier today that the policy and retirement incomes has arguably specialised by default, an unspoken default. The focus has been on the accumulation phase and little endeavour on the de-ccumulation phase, which today actually represents over 27% of far more assets within our super system.

While the report had a number of pretty sensible recommendations that require a lot of implementation work on post-retirement incomes policy, they are what I would describe as in-system changes on the supply side.

But if you actually stand back and take a look at the policy levers that really drive post-retirement behaviour – especially on the demand side, which really matters for financial products to respond and super funds to respond in securing a retirement income stream, and mindful of system affordability – they were kind of missing in action.

We heard this morning that had to do with the scope and the terms of reference that the inquiry received and there are issues like treatment of lump sum, taxation treatment of contributions earning and draw-downs, preservation age and pension eligibility – a veritable herd of sacred cows.

Now, I'm not suggesting that the missing herd is all that surprising. To get those four levers working contemporaneously and in alignment is probably one big inquiry all of itself. And there were some sequencing matters, with a tax white paper having been instigated as well.

Here comes my only plug for the day, I promise. We have a modest project underway at the Commission that fellow Commissioner Angela MacRae and I are leading to look at just two aspects of post-retirement income policy, being the impact of preservation age on labour

force participation in current lump sum behaviour.

So whilst perhaps it's quite understandable that these policy levers were largely missing in action in the final reports, I'd suggest that we all kind of collectively pause for a quiet moment of policy reflection, or should I say policy patience, because that is what post-retirement income policy appears to need.

This for me is what emphasises about in terms of delivering consumer outcomes, getting that policy architecture right, and then the regulators can work well within it.

And policy patience, it's interesting. Having a daughter who's studying Latin in the HSC, the word "patience" actually comes from the Latin word "patior" which means to suffer. So I'll leave it there in terms of my views on policy architecture and consumer outcomes. Thank you.

[Applause]

G Samuel: Unwittingly, Karen, you've given me a nice segue into what I wanted to comment on. You talked before about perhaps I have some perceptions on competition and competiveness in the banking sector. I think I've got two.

One relates to the many years I spent with the National Competition Council – that's preceding the time I spent with the ACCC, and that was through the 1990s and early 2000s. We were talking about this morning in Rob Nicholls' session and discussing the removal of anti-competitive impediments that appeared in 2,100 pieces of legislation.

I observed at the time that what we were encountering through the process of the examination of those 2,100 pieces of anti-competitive legislation, we encountered two areas of resistance.

One is expected. It's from all the vested interested groups that are protected from competition and want the protections to remain in place.

The other was a very interesting group, because the principles under the HILMA Competition Policy Reforms were: Remove anti-competitive detriments unless you can find a good public interest reason for them to be retained.

And you'd be amazed how many people thought that there were various issues that should be retained as part of the public interest – not because they were protecting interests, that was a separate group, very easily identifiable and quite transparent. But these were groups who genuinely believed that there were regulations that were required to serve the public interest, to serve issues of public safety and the like.

The constant debate that we had was to say why is it so, why do you really need *that* regulation or *that* legislation? Surely what it's doing is hampering competition; it's hampering the ability of the consumer to make a choice by being more fully informed and be able to exercise that right of choice.

Interestingly, the biggest area where we encountered this – and frankly I had that experience through the 1980s, through the crash of the 1980s and preceding that the takeover boom with the securities industry. Because the securities industry is one that has very interestingly been quite unique in that it has layered protection upon protection upon protection for investors in a way that we don't see in almost any other industry in Australia.

Think about this: that when you make probably the biggest investment in your lifetime – that is, the purchase of a house, which is now costing millions of dollars in many cases – there is no protection there that says you shall be told if the foundations are sinking, or you shall be given proper reports of a builder as to whether or not there are termites in the rafters or whatever.

That's up to you to find out. You make that informed decision if you want to. Alternatively you ignore it and then you suffer the consequences later. There's no obligation on a vendor to tell you these things and there's no obligation on a regulator to actually inform you as to those sorts of issues.

But in the securities industry, for many, many times much smaller investments, we layer

protection upon protection upon protection and that's imposed by policymakers.

There's another perception issue which Karen referred to and that is competition in the financial services industry and particularly in the area of banking. I was always bewildered and sometimes bemused (when not being too frustrated) back in the post-GFC days to be hearing various politicians from both sides of the house complain about the lack of competition in banking, and the various actions, for example, the ACCC took in terms of mergers of Westpac and St George and Commonwealth Bank and Bank West, to suggest that had damaged irretrievably competition.

I have to say, my predecessor in the Office of the ACCC bettered Nostradamus in that he said that the merger of Commonwealth with Bank West had destroyed competition in the banking industry for decades to come. I challenged him on that and asked him for proof. There was none.

These are perception issues that are raised and they've been raised, if I might say so with a degree of criticism in the FSI, that is that competition in the banking industry is … I think the word used is adequate or is workable but is not aggressive. Competition in the banking industry may not be aggressive but at times it's pretty tough.

If you can look back even post the GFC, there was some very aggressive competition that was occurring not so much in the interest rate levels but in the approach, for example, in the residential lending and the aggressive approach that was being taken back then by the two Sydney-based banks, Westpac and CBA, to go into low-doc residential lending in a way that ANZ and NAB decided not to. NAB in particular went into small business lending. It was pretty aggressive competition.

The rate differentials were not large. We talked this morning about the issue of switching between banks and one of the propositions I put was that it actually wasn't something that mattered an awful lot and doesn't matter an awful lot to those that are dealing with the banks.

Not because of switching costs – Wayne Swann eased off a lot of those issues back post the GFC – but rather because if you have a look at interest rate levels, particularly in the area

of residential mortgages, the differences were very small indeed and they tended to switch month by month, so that the ANZ might be the cheapest in one month by a couple of percentage points, and then NAB might move down the next month once the Reserve Bank moved its rates, the cash rate. Then the next month there might be the CBA and there tended to be little movements between them which basically as a borrower you would say to yourself: "Is it worth the trouble and the time and the irritation of changing banks for that small shift that might occur, when in fact it may resolve itself another way a bit later on?"

So. Why don't we have aggressive competition – truly aggressive competition? I think the banks are in a parallel position to that in the grocery market as it was at one stage. That is, that aggressive competition in terms of interest rates to simply increase market share does very little because market share doesn't change that much, and what it does is it cuts margins.

Regulation, and particularly in this area, does have an anti-competitive impact. As I said, many believe it's in the public interest to have regulation designed to protect the public. But often, that leads to regulatory policy overreach. That is, we need to protect even more. Each protection that's layered on has an anticompetitive or provides an anticompetitive … a competitive-stifling impact on the industry.

Then the one I've just mentioned, consumer apathy. That is, consumers actually don't worry too much about the sort of investments they make. They in fact have become accustomed to expecting the regulator to protect them.

I've been fascinated to notice the increasing implied burden being placed on ASIC, by those in the commentariat, and those in both sides of Parliament at the present time, suggesting what ASIC has got is a responsibility not only to deal with miscreants after they've misbehaved, but to actually pre-empt the miscreance and prevent investors losing money as a result of their actions.

So one of the things that is proposed in the FSI is that we should, quote, "promote", close quotes, more competition.

I'm not sure how you do it. I'm not sure how you do it. I'm not sure how you can say to a regulator "Promote more competition." You can say to a regulator, and particularly the ACCC, "Remove impediments to competition." You can say to a regulator, "Don't allow structures to develop in a market that may impede competition." But regulators don't have the capacity to bring about structural adjustments, structural changes, in the structure of the market that might bring about a, quote, “promotion”, close quotes, of competition. That requires an artificial interference in the market structure, which more often than not can be very expensive and is not long lasting.

I say it somewhat with a little bit of a joke on this. It's a bit like the AFL funding GSW into Western Sydney, very expensive. There would be a question mark as to whether it would be longer lasting. My mate, Tony Shepherd, won't like me saying that. But that's all right.

Sustainable competition will provide benefits of competition and stability. I recall Ian Macfarlane, former Governor of the Reserve Bank, once saying at a conference, an ASIC conference that we were sitting on a podium together. He noted that the four pillars policy has prevented rampant competition before and during, or before the GFC, leading to no disasters flowing in Australia than the GFC.

I took Ian to task on that because I really thought it actually didn't bear up to analysis. I thought that the real reason we actually survived the GFC without any significant disasters was that we had very effective prudential oversight by APRA and the Reserve Bank and that proved to be the effective deterrent.

What level of regulation do we need? Well, I’ve always had a view that there should be a presumption that completion is the best regulator. It's the best discipline of all. It's the most flexible regulation that you will get. It's the most flexible discipline that you will get.

Competition requires consumers to be sufficiently informed so that they are able to exercise choice. But – and this is a bit but – in my view, that doesn't require necessarily mandating of information dissemination.

It’ll surprise you. But you see, if competition is actually operating very effectively, consumers

should be able to react negatively to the lack of information provided as much as they can to information that is provided as a result of a legal requirement, that is a mandatory requirement to do so. The fundamental requirement, I think, of regulation should be that information should not be false or misleading.

We've got to remember- I go back actually before many of you in here were born, but go back to the Poseidon boom. I'll never forget the prospectus that had the shortest sales pitch of all. It was a company called Leichardt Minerals and it said, "We have no idea what we're going to explore for. We do know that Australia is rich in minerals. We're going to explore for it."

It boomed on the share market. I can't tell you how well it boomed. And you'd say to yourself, why would people buy it? Well, they were informed. It was there in black and white on the front page. But actually, they just didn't care that much.

That brings me to the real problem I think we have in this area. That is, that the consumers can be informed and interested in what is made available to them to be able to make an informed choice. Or – as per the English year 12 student who in response to an exam question seeking a definition of ignorance and apathy simply wrote, "I don't know and I don't care".

So, can we legislate to protect the ignorant and the apathetic? Well, in fact we do, and we do that more and more in the area of financial securities. In doing so, we impose the impediments to competition.

The FSI says rely more on ASIC and imposed more obligations on sellers to provide information. My own view is that balance is wrong.

We should impose more obligations on consumers to look after themselves and perhaps provide simple, what I'd call vanilla investments for them, with regulated constrictions for unsophisticated investors.

Regulators. I think they need to – when I say "I", this is not simply my own view, but it is the

view of the Monash Business Policy Forum who have provided a paper that has been published on the Monash website and also was provided to the Harper Review about a fundamental restructure of regulators.

We can't ask existing regulators to promote competition or to take account of competition in exercising their responsibilities for two reasons. Competition culture is bred into a DNA of a regulator or alternatively it doesn't exist at all.

I'm fascinated at the number of those that are involved in what I'd call price regulation or prescriptive regulation who just don't get it as to what competition's about. Their approach to competition is, yes, once you've gone over this hurdle of regulation, this high level of regulation. So it's bred into the DNA and it requires a particular culture.

Secondly, regulators, particularly in the financial services industry – and I'm thinking particularly of ASIC – are provided with very prescriptive regulations. I've forgotten how many centimetres high the corporations and security law now is, but it's at many, many… And you can't simply say to them in one sentence at the beginning of that law, "Irrespective of all the prescriptive regulations we want you to put a balance in favour of competition." It just doesn't work. It is so hard for a prescribed regulator, a regulator that is subject to prescriptive regulations, to suddenly have to turn around and say, "Yes, we'll put competition as an overwhelming balance in the way we administer those prescriptive regulations."

The Monash Business Policy Forum sees the need for five independent regulatory agencies. This has caused a bit of a stir, as you can imagine.

For each regulator, we have tried to align the analytical functions, the core skills and the cultural approach in determining what fits best and where. Grouping by analytical type has both the advantages of making it less likely the regulators will be captured, and also significant management advantages in terms of moving staff between functions. It's easier to move a staff member who's been doing, for example, electricity pricing to telephone pricing than it is moving someone from doing consumer protection to merger analysis. That was certainly the experience we had at the ACCC.

So the market regulators that we think ought to apply- and this may impact on some of the commentary we'll have later on – are these. There should be an Australian National Markets Commission to replace the National Competition Council and the Australian Electricity Market, Energy Market Regulator.

There should be a dedicated regulator dealing purely with competition issues. It's the culture. It's the whole understanding of what competition is about.

There should be a dedicated regulator dealing with all consumer protection issues, and that includes removing the quite strange corollary or flow-on from Wallis, which was to separate consumer protection of financial services away from consumer protection in the other areas.

There needs to be an essential services commission to regulate monopolies in central services. I'm thinking there of water, power, telecommunications, the terms and conditions of access.

Then there needs to be a body like the Reserve Bank, including APRA and the Payments Systems Board, to deal with the prudential issues which are so fundamental to the securities industry.

Let me make one final comment. Should we have a supervisory board? No, I cannot contemplate why you would want a supervisor board sitting over and above those regulators. If they're properly appointed, they've got proper mandates and they have got proper skills; that ought to be the end of it.

You put a board over on top and then you start to have a disagreement about the board's adjudication. Then should we have an appeal from the supervisory board? We can keep on going. It just adds yet another layer of regulation on top of the fundamental simplifying of the regulatory processes that we'd be advocating.

[Applause]

D Sanders: Thanks Graeme, thanks Justin and thank you CIFR. I actually had hoped that you might have given me at least as easier a segue as Karen had given to you but regulators is a good place to start from my conversation.

I have to admit, I've been pleased to be here for today and to listen to some of the conversations. I don't want to say my opinion has changed because those who know me know that that's a difficult thing to do. But it has been modified, which is pretty brave in this world, by some of the thinking and some of the conversation I think we've heard today.

I know that the audience that's managed to stay – congratulations of the committed and strong amongst you – to participate in this conversation probably have, I hope you have, felt as frustrated as I have through the day. Not so much by the quality of the conversation – in fact that has been extraordinary – but by the inherent and obvious constraints of the FSI process that I think has emerged strongly in some of the dialogue that we all understand. That's been clearly stated I think on many occasions through the day.

Certainly I know that the committee and the learned participants are aware of, but those constraints I think have been significantly hampering in some of the thinking, especially when it comes to the idea of regulators and the nature of regulation.

There are a number of ways it can be constrained. I tend to think about when we talk about the concepts of regulation, even the language of things like innovation. I've heard that mentioned quite a lot. It's a fundamental topic within the FSI, but not necessarily much given to the consideration of innovation of regulator.

The idea of what is an innovative regulator? How does an innovative regulator respond? Not innovations in the market, but how does in fact a regulator respond as an innovative regulator. That's a wholly different set of questions to how do you respond to innovations in market, including down to issues of core skill and capability, etc.

But also, even simpler sort of concepts around language and – in fact, in the last session, I thought there was some great dialogue in there about the issues of the sort of fallacy of simplicity that drives much of regulatory theorising. "If we just simplify things that will all make

it fantastic."

We live with that today. The Corporations Act has done a great job of trying to take complex concepts and simplify them. The word "advisor" to mean, well, 30 different types of participants in the marketplace. Even the terms like AFSL, a single licence construct, to describe extraordinarily variances in the way that people engage with their licence obligations and the way that they provide services or participate.

The idea of simplicity is dangerous and I think that's a constraint in some of our thinking too. All of that sort of thing leads me to think about the idea of regulators and the way that that sort of uniqueness I think is part of the challenge.

That when you are constrained within a universe of financial services, there's an automatic – and I want to be very cautious. I have to walk across the stage in front of eminent lawyers and economists, despite the fact that I'm about to say that I think the biggest, the most frustrating sadness I find in regulatory theorising is the boundarising of economics and law, as though they are the only frameworks of consideration in relation to regulation or regulators, the construct of regulators.

One of the great challenges I think in regulatory theorising is that in my personal view – and it's obviously a personal bias – is that psychology has at least as much to tell us about regulators as does economics and law in terms of the way that you engage with the regulator population, or even the concept of the way you engage with regulation. These are significant concepts that I think we haven't properly explored in relation to the spaces.

I guess that's what we're here to have a conversation about today. It is this idea of how do we build in particular when we link those two concepts of innovation and regulator. The thing that I think will open up our conversation hopefully – Justin's brief to us was obviously very wide and very broad and I'm trying to bring it home for him into a conversation that we can lead to – this idea of innovation in regulators.

Generally, I think the most significant concern and one that's been raised, if you like, in the context of the FSI, is the way regulators – both within the securities market but also externally

to that – can be reflexive, can respond to issues present and emergent in the marketplace. What skills do they need to do that? What funding models do they need to do that? What sort of tools and power do they need to do that? These are central questions to how you live within your regulated space, not in a captured way but in a responsive way.

Those questions open up a whole different set of conversations, to my mind, than is even contemplated within the FSI. The FSI appears to, in the context of – obviously identify what's not working now, what do we need to do now, rather than what might the world be like in five, 10 or 15 years.

In the spaces we regulate and the communities we engage with there is constant dialogue about disruption and innovation and change. The communities and professions are obsessed with the fact that their business models are changing rapidly, and how they might respond to the concept of legal services, a whole different concept that those of you directly in the legal services market will know how that world changing as we speak.

There are different providers, different products, different systems, and different ways of engaging that aren't even contemplated in financial services. I thought it was amazing, the dialogue about the stress testing of the banking system, and I recall reading those reports.

We're not seeing those sorts of … really as an industry structure, despite all of the innovation and product design and distribution and technologies in administration, fundamentally they're still big buildings that hold money that you go to get.

So the concept of – I mean, we've heard of course and it hasn't been discussed here today, which did surprise me – that of course we're now seeing telecommunications companies claim that they are in fact technology companies, who can and happen to deliver telecommunications, but also financial services and a whole raft of things.

So the idea that disruption is not on the horizon or not on the direct and immediate horizon, whether that's a competition question or whether it's a regulated responsiveness question, I think is what we need to be discussing. How might we build regulators that are different, and what might we learn from other regulators in the space outside of financial services, I

think is the context for this conversation.

We certainly think there's opportunity in that space. There is opportunity to have a whole different dialogue about innovation, about the language of trust.

In our world, trust actually has a prescribed meaning. It's a powerful and important process about the way you embed and engage in the management and the systems of trust, not just the use of the word.

These are important ways of engagement that I think we need to probably import, or rather might benefit the financial services structural regulatory architecture might benefit from a more porous boundary, a more relational concept around the way it engages with regulators.

I noted Graeme's suggestion of a new universe of regulators, all of which sounded pretty scary and centralised. None of them to my mind spoke to concepts of professional.

They may be in there – I just didn't hear them in that particular framework of that language. They weren't about the idea of how do you encourage individual actors to act differently. How do you encourage markets to respond to social obligation differently?

You might construct rules and processes by which you can encourage that. I think that's the sort of conversation that other regulatory models, domestic and global, might be able to assist in some of that conversation. That's I think where we can have a conversation about that today.

[Applause]

J O'Brien: Deen, I'll start with you, in fact. You mentioned the notion of the truncated nature of the FSI process, in part because of the timing, of course. I mean, there was limited amount of time to do it.

But I thought in the previous session there was a very interesting comment from my colleague, Dr Scott Donald, who suggested maybe there's a problem of language here. That if we're looking at this in the realms of the financial sector participants as consumers, that has a total difference in meaning to looking at them as members or as clients. The set of obligations might be different as a consequence.

So perhaps did the FSI miss a trick, do you think, by narrowing the emphasis to one of consumers and consumer protection?

D Sanders: Well, I think on the issue of consumer protection that's certainly broader. I think some of the constraining elements of the FSI process, even – and I'm not sure whether this was a formal constraint, in fact, or just an apprehended one in relation to the idea of being a continuation of the outcomes-based regulation model. And even that language is constraining.

If you focus on the concept of – which was the Wallis language, the adoption obviously for The Corporations Act and a continuation of that paradigm – I think it was more than the terms of reference speak to the idea of let's talk about what has been done or we can do since Wallis.

Arguably, there were existing constraints that were unable to be moved. Even outcomes, even the language of outcomes, closes down an entirely other consideration of what regulation is about. If consumer protection is not so much about outcome, but about a whole raft of engagement with consumer, where is the consumer structure and voice in regulatory architecture?

I'm not here suggesting that consumers should be panelled and participants in the entire regulatory process. More the idea that if its outcomes based, a whole lot of evil can be hidden in the bit before the outcome.

How do you engage in a better conversation about that if you focus so much on outcome? Improving outcomes is a danger. Even that's a simple constraint. Even in simpler – if that's too esoteric from the concept of outcome – there's even larger simplicity gaps, in that simplicity is a seductive concept when you're in regulation.

When you're in government and certainly when you're a regulator you do want to be able to just have five or six things to sort of focus on that are big. If those five or six things are as large as universes themselves then it is actually a false simplicity. And I think that's the danger that the FSI has led to.

We haven't necessarily nuanced or sophisticated or engaged more deeply in understanding the elements of those components. And I think without them, it doesn't allow for a more refined and nuanced regulatory response.

J O'Brien: One of the things that I think is interesting about adding the competition dimension into the main financial regulator or the moderate conduct regulator, there was an attempt in the United Kingdom and in Ireland to put the expansion of the financial services market as part of the regulator's core responsibility. And look where that got the United Kingdom and Ireland, both of which have decided that was not a good idea.

What are the risks associated with adding a layer on to the existing market structure of regulation in Australia?

G Samuel: It was interesting, Justin, when you comment about the UK. I'm very familiar with what they've done there with the Competition Markets Authority.

It was very interesting to see the way the debate took place there. They set up the Competition Markets Authority to take over from the Office of Fair Trading and the Competition Commission. It essentially was given the remit of dealing with all competition issues.

Then they said, "When it comes to dealing with the sectoral regulators, we want them to focus on competition issues – brackets, we don't think they're terribly good at doing that so therefore they ought to refer it to the Competition Markets Authority, the CMA, close brackets – but there's a political reason why we can't actually transfer all the competition into the CMA. So we'll leave them still there. That's the sectoral regulators. But we're really saying we're encouraging you to refer competition matters to the CMA."

It seemed to me that that was a halfway house, but there was a clear recognition in the debates that occurred when the legislation was set up that really said competition can be such an important, flexible, adjustable discipline. I say adjustable, not because it adjusts the vested interest, but it actually adjusts the market forces to circumstances right through.

You need people who actually understand what competition is about to overwhelm what might be the sectoral regulation. That's what they've attempted to do in the UK. I'm not sure how well it's worked to date.

If you take regulation generally – and in a sense if you could take what the FSI has recommended – they are really going back to HILMA. They're going back to HILMA and saying, "Look at all the regulations that you have to administer, and administer them with a competition overlay that says we should presume the competition is the best discipline and only apply regulations where the public interest is best served by them being applied and that is overwhelms any anti-competitive detriments."

That's an impossibility, because the legislature has set out ultimate centimetres of prescriptive regulation, and says to ASIC for example, "Administer this regulation, take it to the courts, deal with it in its prescriptive form." You are not really permitted to apply what I call the HILMA concept of competition, being the best form or regulation or discipline, when you've got that prescriptive regulation.

Really, the FSI in many respects is saying to our legislators, "Do to financial services regulation what HILMA said should be done right across the board in Australia."

J O'Brien: I think it's interesting, if you look at the emphasis of expansion of players in the market place, you might get better outcomes through the forces of competition.

One of the things that we've seen with the Parliamentary Commission in Banking Standards in the United Kingdom was a really, really interesting report into the failure of HBOS international strategy made manifest by Bank West.

So Bank West expanded very rapidly, very quickly, and disastrously until it was brought over by CBA. But when you looked at that failure, what you really saw was HBOS's operations in the Republic of Ireland, their portfolio was down 37%, whereas it was loss making. In Bank West, it was 28%. I mean, that was scarily high.

G Samuel: I mean, if I was doing National Competition Council again, I'd be looking at, for example, the prudential regulations that APRA administers and I would say, yes, they are there for a very good reason, because competition can go so far, but when you're dealing with the stability of financial markets with confidence in those markets that is when you have got to have some prudential regulation.

I'm not so sure, by the way – Wayne Byers was talking about, quote, guidelines on executive remuneration. See, I'd shy away from that. That's starting to go to a tiny part of the perception of what caused the problems in the GFC.

Rather, I'd be saying, "Look, I don't care what you pay your executives. Do whatever you like. That's your business. What I'm focusing on as a prudential regulator is ensuring that the proper prudential requirements and standards are maintained. If you can't maintain them you can pay your executives what you like but they'll have nothing to do because you're out of business. We'll take you out. We'll stop you."

That seems to me to be fundamental requirements that you put in place because otherwise you will end up with a breakdown in confidence in the stability of those markets. They are a proper regulation.

But you can take so many others. There's a fascinating array of regulations in the corporations and securities law. I often say to myself, why do they do it? Why is it there? The more prescriptive they get, you then say to yourself, but surely investors ought to have the wit and intelligence and interest in making those sort of investments to be able to make their own judgements.

If someone says, "I'm not going to tell you what I'm doing…" The Leichardt Minerals I was talking about before, well, you say to yourself why would I invest in a company like that?

Unfortunately of course, in boom times, people invest in companies like that because that's the greed of the market. Sometimes people have got to lose money to actually learn that they don't do it again.

J O'Brien: One of the things that came out in the FSI report and has been part of the discussion today is the notion of, the creation of, financial regulator assessment board. From your opening comments, Graeme, you don't think this is a good idea.

G Samuel: If you've got the right people dealing with regulation, those agencies report to Parliament. They report to Parliament direct through Senate Estimates. And they are subjected sometimes, not always, to sensible questions at Senate Estimates that test what they're doing.

That ought to be the accountability to Parliament to be accountable through another intermediary body. It's almost a filtration point. What does that body do? What is it called, the "FRAN" or whatever it is? The "FRAN" goes off then to send estimates and says, "Well, now, we've had a look at ASIC and we don't think it performed in the following circumstances."

Senate Estimates says, "Well, that's interesting. We're not sure about that. We'd like to actually talk to ASIC." Well, ASIC should go there in the first place to talk to Senate Estimate, to talk to the Parliamentarians and actually talk about the issues that Parliament is concerned about. I just see it just as another layer of regulation, putting in place another board that is acting in many respects as a filtration point.

If a regulator says – whatever this body is called, "We don't agree with you" – they will debate it. It may be debated in the public arena. The debate ought to be directly with the parties to whom the regulators are ultimately responsible and that is Parliament.

J O'Brien: Alternatively, it could be done directly through into Treasury, the critical fact being that it has to be independent.

G Samuel: Sorry, through what?

G O'Brien: The oversight body could report to Treasury or to Parliament.

G Samuel: Well, I'm not so sure that … once you start reporting to Treasury, you lose the transparency and the public accountability. So it ought to go to Parliament.

But why put a filtration point in? If the agency is responsible for undertaking certain requirements, certain responsibilities, be it the Productivity Commission or ACCC or ASIC, whatever it might be, they should report to Parliament. They're accountable to Parliament. But let's not put a filtration point in.

Then you start to wonder about whether the judges … I say the judges in loose terms … the board members on that oversight body, whether they're the right people to be judging. And then suddenly Parliament says, "Hold on, you judged last year that ASIC was doing a good job but look what's happened since? Do you still have that view?" It just seems to be to be…

J O'Brien: So you need to have some longstanding credibility and authority, which I suppose segues directly to the Productivity Commission and indeed its 2011 report.

K Chester: Yes, so back in 2011 the Commission did some early work just looking at … I think it was an appendix to another report, looking at regulator effectiveness and looking internationally around what frameworks for assessing regulator effectiveness. I think from what I heard this morning, a large part of that is probably already in place today with the statement of expectations and statement of intent, the relationship between the regulators and the minister and effectively Parliament, as you say, Graeme.

I guess the only question is – I don't know the answer to this and I don't know if the FSI team looked at it – did they do a bit of a gap analysis between what was on our shopping list of what was sensible to look at versus what's in place today? And if there are gaps maybe expanding on that?

But I think we've got the mechanisms in place through the statement of intent, statement of expectations, reporting to Parliament. Treasury would as a normal course have a look at the metrics that are reported by a regulator to Parliament or to the Minister and give it independent advice to the Treasurer of the day. It's really making sure that, from our perspective, it's about transparency in that accountability.

So when someone rocks up to Senate Estimates, the senators that are asking the probing questions have got an information set, a fully informed information set, from which to ask those questions. So have we got that framework quite right? I don't know the answer to that question.

J O'Brien: My recollection of the report, there is a reference to problems and limitations of the financial sector assessment program, which is conducted by the IMF and not necessarily to the Productivity Commission reports in 2011. Was that referenced in the FSI report, Kevin? Maybe. Well, it may be worth looking at.

Okay, let's open it up to the floor. We have a few minutes before we have to close. I think it's been a very interesting expansion of the issues.

Question: Pamela Hanrahan from the University of Melbourne. I agree, as Graeme knows, with a lot of what he said. I think particularly in financial services and financial product disclosure the dreadful chapter seven of The Corporations Act is too wide, it's too shallow in the points where it really should be working, and it's too generic in that it tries to treat too many things in the interests of so-called simplicity. It tries to treat all things the same and doesn't work.

Chapter seven would be greatly improved if we could say to Parliament, right, you can keep five things and the rest of it just get out the scissors and cut it up. And if you did that then I think that would have a flow-on effect in competition which would be enormously beneficial.

It would also make the regulators so much more efficient if it was only trying to enforce five laws that really matter and not 383 separate criminal offences which are currently created by chapter seven.

But how do we get the political will to cut through this terrible forest of red tape that we've accumulated over the last 25 years?

G Samuel: Oh golly. Talk to your parliamentarians in Canberra at the moment about political will and they'll give you a pretty good indication of the lack of it when perhaps it's most desperately needed.

I'm not sure. We had a magical period in 1993, 1994, 1995 under Paul Keating with the HILMA reforms. Now that was extraordinary. He got all states and territories to agree that they would reform all areas of the Australian economy, large segments of it not subject to competition.

The fundamental tenant of the HILMA reforms was: competition is presumed to be the best form of discipline, unless you can demonstrate that the public interests is best served by anti-competitive structures and/or regulations being in place. And that was administered by the National Competition Council. We dealt with states and territories and there was a payment system, which basically offered initially $16 billion to the states and territories if they undertook reform.

That required courage and conviction, which Paul Keating had, as well as a communication process. That is, "This is why we should do it".

The industry commission, as it was at the time, did a superb report that almost – the most memorable part of it said – if we undertake these reforms and complete them, the impact will be …I think it was something like $5000 per household was the increase in GDP, I think is what flowed. But it explained why it was.

Now I'm hoping that is what Harper will produce. We don't have too much fussing around whether section 46 of The Competition Act should be omitted … load of nonsense. If we can get down to some really fundamental reforms and how they ought to be tackled and what they will mean…

Most importantly, see, Harper has already said, "I won't be able to tell you how to do these

things," and I can well understand why. But I'm hoping that what Harper will say is, "This is what you should do because this will be the consequence. This will be the benefit to the Australian community in doing it."

Then if government has got the right approach to communication, which at times it's actually not demonstrated a great skill at doing to date. But if it has, what it will do is it will take the report and say, "Look, we have got to deal with this. It makes sense."

But I'll never forget – I'll shut up after this, Justin – I'll never forget in this state many years ago Nick Greiner had a problem with the railways. What he did was, *Daily Telegraph,* every day, front page, another problem, late trains, something happened, something … this went on for three months. And then at the end of the three months, after the story had been told, he said, "I'm sick of this." He said, "We're going to fix it."

The unions went on strike for 24 hours and they gave up because there was no public sympathy no for it. Now, Harper stroke Government stroke Parliament has got to go through that process of talking about the sort of changes.

In the financial services industry a lot more difficult because we've built up an ethos, an attitude that says we should protect those who are not capable of protecting themselves. That includes, unfortunately, a group that are not only ignorant, that is don't have the knowledge, but also are apathetic. That's the worst part of it.

D Sanders: Far be it for me to give advice to government on these issues. I would only think though that the answer isn't in fact about political will or – sorry, about a list of strategies. It's more about the psychology of political will.

I think the challenge we have, Graeme, which is touching on financial services, is the volume of terror, the volume of horror. Dial down the constant carry-on about horror and evil and danger and scary and – which by every possibly measure in any other context is – I'm not saying it's good by any means but we use these tools, government uses the tools, the media use the tools. Frankly, the regulator uses the tools. It's a very common set of language.

And the consequence of Parliament is, we have to respond to the fear. I think Graeme's sort of thesis of earlier is that the language of competition law is one of enthusiasm. The point of competition law is to encourage enthusiasm and vibrancy in markets. That's a much better way of positioning financial services than constantly talking about how terrifying it is to be in the water with all these evil participants.

So I think the political will issue is a reflex to the use of the language of horror. It's not to diminish the horror, merely to reflect and properly put it in the place of…You will not get sufficient or sensible political debate when people think people are dying in the streets on an hourly basis because of evil financial advisors or product manufacturers or whatever other issues are the subject of the day.

K Chester: On the issue of the regulatory mountain – and it's something that is kind of near and dear to the Commission's heart – we try to chip away at it every year. And there's always good processes that we have recommended and governments have put in place, but they don't matter diddly squat, because nobody is doing it. So ministers are obliged every year to look at the regulatory red tape in their portfolio and get rid of the stuff that's not needed.

But the biggest bugbear for me is there's this little orphan child in Canberra called the Regulatory Impact Statement, RIS. When it started it was brilliant because it stopped a lot of bad regulation from happening.

I actually tried to find the RIS for…so when the GFC occurred and the Government decided to underwrite some deposits for some banks, I went and tried to find the regulatory impact statement for that. Couldn't find it.

That's where you do the balancing act between the net economic benefit test. What's the implications for competition? What's the implications for moral hazard? It's there. It's in theory. It's just not being put in practice. There's no discipline around the sort of getting the regulatory mountain down and stopping bad ones from being added to the long list.

J O'Brien: It doesn't help, however, at the same time, if we've got a dialogue on regulation which bifurcates between conformance and performance. So you've got performance of the

market on the one hand and regulation is always associated with conformance, an inhibitor on performance.

But I suppose in the end what we're left with is the recognition that the FSI has performed an exceptionally useful function. The regulatory design is not quite there; we're not quite at building control levels; where's a lot of work to do. There's a lot of engagement.

And with that I'd very much like to thank Deen Sanders, Graeme Samuel and Karen Chester. Thank you very much indeed.

[Applause]

D Murray: Thank you, Justin. Thank you also to the panel for again another excellent discussion and insights around implications and public policy. Just in short … I won't keep you too much longer. It's been a very productive but busy day. I just wanted to ask the question: What did you think we achieved today?

Well, I hope what we did achieve was rigorous discussion and also debate about the 44 recommendations and also the policy implications that come with those.

Also what our focus today, and I think we achieved this, is the role of our cornerstone financial regulators. And as we've heard, they're highly regarded. Perhaps some may consider under-resourced, but certainly do a fantastic world-class job.

It's exciting to see the final report in its current format and obviously submissions are going to be received by government by the end of this month.

Certainly today was also about getting a good cross-section of participants, academics, regulators, former regulators, industry stakeholders, associations, government, etc.

Essentially, we'll be synthesising everything that's been said today and we'll be putting

together a document that will highlight the achievements and the discussions that have been made at today's event.

Can I thank you personally and also professionally for your contributions and for your generosity in your comments?

Also what we'll be doing is my colleague, Kingsley Jones, has done a significant research project as one of the 60-odd projects that we've funded so far. He did a regulatory and data architecture project, and he turned a text analytics robot to the FSI documents. He did analytics on both the interim and the final report with a colleague.

That text analytics project has been completed. It's on our website but it also will be a feature of our submission to the FSI final report.

In summary, the text analytic is simply trying to come to terms with an efficient way of what was actually said. Now, we can obviously read the hundreds of pages and we would value obviously doing that. But looking at counts of popular words, looking at how words are associated with other words, as a way of trying to summarise or aggregate what the picture of the document says. And I think Kingsley and his team did a fantastic job with that.

The remainder of 2015 is about CIFR continuing on with its mission. This is our fourth year. We are seeking to significantly increase our productivity. That is our productive and quality in terms of our research, our executive education and public policy contribution.

We have three upcoming events that have been planned so far that I can let you know about. At the end of May, we have a small-scale pitching research event. As my chairman, Peter Mason, mentioned earlier today, CIFR has an important job to translate high-quality scholarly work into a way that can be easily understood, translated, digested, and public policy can be better served by. So this pitching event is an opportunity for our researchers and academics to be more open and to learn new techniques around how to translate their work to different audiences, not just a tier-one journal publication.

On 11 and 12 August, we have a significant event, which will be a financial markets focused

event. We have two keynote speakers coming. One of them is highly expected to win a Nobel Prize. So we'll be communicating more detail about that.

Towards the end of the year, we'll be announcing a regulatory conference, which will showcase the best research work that's been undertaken and funded by CIFR.

Just before I let you go, I have a number of thank yous. First of all, to our funders, certainly Commonwealth and NSW Government. We significantly appreciate their ongoing support and also the financial regulators that are significantly involved in our activities.

Can I also thank the universities who also match funding for government money that is invested into these research projects?

I'd like to thank all our participants today. We have had a very diverse, high-calibre group of people. I'd especially like to thank the Shadow Treasurer, Chris Bowen, Kevin Davis, who has done some great work with us today in a number of capacities, who served on the FSI Panel and Peter Mason as well in his speech.

Everyone that has been on the program, can I thank you? I don't have time to go through individually, but thank you for what you have contributed.

I'd just like to also acknowledge my team, CIFR. We're a bit like a family at CIFR. There's about 12 of us. If I could just get you to stand up if you could, just so I can embarrass you. Thank you, guys, for a great team effort.

I'd also like to particularly thank our program committee. Veronique is our events manager. Where is Veronique? Excellent job. Madeline, who has also been significant in planning.

I'd also like to thank Kingsley, Rob, Tim and also Geoff Warren for their involvement in the planning in terms of the program committee. I'd also like to thank Justin, who also provided input and was very willing to travel quite some miles to be here and participate. Thank you.

Okay, so what I'd like to again say is thank you. I hope you found today informative. Thank you for your contributions. Please stay and enjoy some refreshments with us outside in the foyer. I hope to see you soon. Thanks.

[Applause]

[End of recorded material 1:02:58.2]