The four methods of financial system regulation: An international comparative survey
Andrew D Schmulow*

This article provides a description of the four methods of financial system regulation currently in use internationally, with case studies illustrating each system. Analysis is provided of the strengths and weaknesses of each. Research indicates that the “Twin Peaks” system is superior to its peers. However, this article also concludes, by reference to failings observed in “Twin Peaks” arrangements to date, that “Twin Peaks” alone is no panacea against financial crises, or market and consumer abuse. It is merely the best form of regulatory architecture. Other factors, such as the capacity and willingness of the regulators to discharge their mandate, even within a sound regulatory architecture, are as important to the success of financial system regulation, as evidenced by the failures in the United Kingdom around the time of the global financial crisis, and as evidenced by the success of the Monetary Authority of Singapore, despite Singapore’s sub-optimal regulatory structure.

INTRODUCTION

In the aftermath of the 2008 global financial crisis (GFC), and the catastrophic scale of regulatory failure, much attention has been paid to the various systems of financial system regulation currently in force. Of the total of four financial regulatory systems currently in use, “Twin Peaks” has garnered the most interest, and gained widespread recognition; as has Australia both as an exemplar of “Twin Peaks”, and in its success in navigating the worst of the GFC. As a result of these factors, several countries have moved or are moving towards a “Twin Peaks” system, most notably the Republic of South Africa (RSA) and the United Kingdom (UK).

In an effort to place “Twin Peaks” in context, this article makes a comparative analysis of the four systems in use, along with descriptive case studies. Particular attention is paid to the failings of the previous UK regulatory arrangement, and the success of Singapore, in order to demonstrate that the solution to successful prudential regulation, and regulatory enforcement, is not simply the regulatory architecture.

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* Senior Research Associate, School of Law, University of Melbourne; Visiting Researcher, Oliver Schreiner School of Law, University of the Witwatersrand, Johannesburg. The research for this article was supported with funds from the University of Melbourne Law School and the Centre for International Finance and Regulation (Project 018).


architecture. It is as much a function of regulator culture, inter-agency coordination, and regulatory philosophy. Additional analysis is also provided for Germany, due to the importance of its banking sector.5

The four systems are described in the following order: first, the institutional or traditional approach (with emphasis on China, Mexico and Hong Kong); second, the functional approach (with a description of Italy and France); third, the integrated approach (as employed in Japan, Singapore, Germany, and formerly in the United Kingdom); and finally, fourth, the “Twin Peaks” approach (as found in The Netherlands, Switzerland, Qatar, and Spain).

INSTITUTIONAL, TRADITIONAL, OR SILOS APPROACH

This approach6 focuses on the form of legal entity under regulation and, accordingly, assigns a particular regulator. This mode of financial system regulation is used in China, Mexico7 and Hong Kong.8

China

In the case of the People’s Republic of China, primary responsibility for the supervision of the banking sector was moved from the People’s Bank of China (China’s national central bank (BoC)), to the China Banking Regulatory Commission (CBRC) in 2003. The CBRC’s remit includes banks, financial asset managers, trust and investment companies, and other depositary financial institutions. Its responsibilities include approving new banking licences, formulating prudential rules, and conducting compliance examinations. The People’s Bank of China is limited to setting monetary policy and acting as LoLR. The China Securities Regulatory Commission (CSRC) regulates and supervises the securities and futures markets, and enforces sanctions.9

In future, as financial entities in China increasingly offer products that “blur the boundaries”, thereby creating issues of supervisory prerogative and, by implication confusion, contradictions and potential conflicts are more likely to arise.

Mexico

Similarly with Mexico, an institutional approach holds sway; what the Mexican authorities refer to as a “silo” approach.10 Mexico maintains separate regulators for the regulation and supervision of financial entities, namely the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores) (CNBV), which is a decentralised entity and a division of the country’s finance ministry. The CNBV is responsible for maintaining and promoting the stability of the financial system and protecting depositors. The CNBV supervises and regulates all financial institutions including banks, non-bank finance companies, stockbrokers and mutual funds.11 The National Insurance and Bond Companies Commission (Comisión Nacional de Seguros y Fianzas) (CNSF) is responsible for

8 Rajendaran, n 6.
regulating the insurance and surety bond markets, and the National Commission for the Retirement Savings System (Comisión Nacional del Sistema de Ahorro para el Retiro) (CONSAR) is both regulator and supervisor of Mexico’s pension system. Its main objective is to regulate private financial institutions in charge of the administration and investment of retirement savings. There is no consolidated supervision and no lead supervisor of financial groups. The National Commission for the Protection of Financial Services Users (Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros) (CONDUSEF) is in charge of protection of consumers of financial services. Its main objectives are to “promote, advise, protect and defend the rights of people who use financial services offered by institutions operating within Mexico”. CONDUSEF operates under the authority of the Department of Finance and Public Credit, and is the premier consumer protection organisation in Mexico. Finally there is the Deposit Insurance Agency (Instituto para la Protección al Ahorro Bancario) (IPAB), responsible for the administration of deposit insurance. IPAB focuses on four functions, namely: it guarantees bank deposits up to 400,000 Investment Units (UDIs); it implements resolutions for insolvent banks, with the objective of protecting depositors; acts as receiver and liquidator of assets for insolvent banks; and manages its own debt, primarily, through the issuance of Savings Protection Bonds.

**Hong Kong**

In Hong Kong, the Hong Kong Monetary Authority (HKMA) is the Hong Kong government’s authority charged with responsibility for the maintenance of monetary and banking stability. Its main functions include the promotion of the stability and integrity of the financial system, including the banking system, the maintenance of Hong Kong’s status as an international financial centre, the management of the Exchange Fund and the maintenance and development of Hong Kong’s financial infrastructure. It is also Hong Kong’s central bank.

The HKMA enjoys a high degree of autonomy, and is accountable through the Financial Secretary of Hong Kong, and through the laws passed by the Legislative Council that set out the Monetary Authority’s powers and responsibilities. In his control of the Exchange Fund, the Financial Secretary is advised by the Exchange Fund Advisory Committee.

Securities and Futures are regulated by the Hong Kong Securities and Futures Commission, whose purpose is to “ensure orderly securities and futures market operations, to protect investors and help promote Hong Kong as an international financial centre and a key financial market in China”. It is an independent statutory body.

The institutional approach to financial system regulation tends towards a heavily fragmented regulatory environment, ill-equipped to deal with financial entities that are hybrids, such as bank-cum-insurers. Such hybrids then face overlapping and potentially contradictory regulations. In such an environment, typically, each regulator will be responsible for both financial system stability

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15 Currently set at 1,900,000.00 MXN pesos, equivalent to approximately US$143,000.
16 Instituto para la Protección al Ahorro Bancario (IPAB), *About the IPAB*.
17 Hong Kong Monetary Authority (HKMA), “The HKMA”, in *About the HKMA* (2014).
21 *Securities and Futures Ordinance*, No 5 of 2002, ss 1-409, (enacted 27 March, 2002), Hong Kong Special Administrative Region.
and market conduct and consumer protection issues. This approach is regarded as least capable of dealing with financial conglomerates, the activities of which blur the boundaries between different types of financial firms.

While it is true that the type of legal entity will determine the types of transactions in which it may engage, and the types of products it may offer, financial firms typically seek to define new products so as to circumvent the regulations on the types of products they may offer. Contemporaneously, regulators seek to broaden their jurisdiction to accommodate these new products.

Thus, over time, entities with different legal status have been permitted to engage in the same or comparable activity and be subject to disparate regulation by different regulators.

**FUNCTIONAL**

The functional approach pays no regard to the type of legal entity in question, but rather focuses on the types of transactions or products under regulation. Consequently, one firm engaging in multiple types of transactions will be subject to multiple regulators. Each regulator is then responsible for the safety and soundness of the firm, as well as the business conduct of the firm, as it applies to each type of product covered by the jurisdiction of each regulator. This approach is currently employed in Italy, France, and Brazil.

**Italy**

In Italy, banking, investment services, asset management, and insurance each have their own supervisor, legal framework, and rules. The Italian NCB, The Bank of Italy, sets monetary policy and is a member of the European System of Central Banks (Eurosystem). It is also the bank regulator and supervisor, and is charged with financial system stability. The Bank of Italy not only sets prudential rules and supervises adherence thereto, but may also impose the full range of sanctions in instances of breach, which includes the power of intervention and liquidation.

Italy’s Companies and Stock Exchange Commission’s focus is primarily conduct-of-business oriented, and as such contains an element of “Twin Peaks”. In particular CONSOB is responsible for: protecting the investing public, by ensuring transparency and correct behaviour by financial market participants; ensuring the disclosure of complete and accurate information to the investing public by listed companies; ensuring accuracy in the prospectuses of transferable securities offered to the public; compliance with regulations by auditors entered in the Special Register; and the conduct of investigations of potential infringements of insider trading and market manipulation.

**France**

Similarly, France’s regulatory model is a functional one, with elements of “Twin Peaks”. The French Prudential Supervisory Authority (Autorité de contrôle prudentiel et de résolution) (ACPR), established in January 2010, is an “independent administrative authority attached to the Banque de
France\textsuperscript{33}, which monitors the activities of banks and insurance companies, and provides for consumer protection. The ACPR acts as supervisor, regulator and enforcer of rules, and is also responsible for system stability.\textsuperscript{34} The market conduct regulator is the Autorité des Marchés Financiers (AMF). The AMF is an independent body responsible for safeguarding investments in financial products; ensuring that investors receive material information by way of disclosure; and the maintenance of orderly financial markets.\textsuperscript{35}

The obvious shortcomings of this model relate chiefly to safety and soundness considerations, with different regulators potentially taking different views on the threat posed to the financial system, of particular firms. Moreover, the types of activities being regulated must be definable with sufficient clarity, in order to determine which regulator has jurisdiction.

While this system of financial regulation is common, and can be effective, provided there is a high degree of communication and cooperation between regulators, it is nonetheless regarded as sub-optimal.\textsuperscript{36} Again the obvious shortcoming of this approach pertains to hybrid financial products. In addition it is doubtful whether this regime can adequately address the growth, importance, and potential threat posed by shadow banks.

**INTEGRATED OR UNIFIED APPROACH**

Under this model there exists a single financial regulator responsible for both safety and soundness and business conduct considerations.\textsuperscript{37} This model is often referred to as the “FSA Model”, as the former Financial Services Authority in the UK was this model’s most prominent example,\textsuperscript{38} (and one to which this article will return). This model differs from the “Twin Peaks” model in that it combines both stability and business conduct considerations, whereas the “Twin Peaks” model separates stability and market conduct oversight.

The integrated approach is currently employed in Japan, Singapore, Germany and the Scandinavian countries.\textsuperscript{39} It was formerly employed in the UK. Under the aegis of this system, the United Kingdom weathered the GFC (poorly), and through various inquiries, declared that this mode of regulation had failed, and should be replaced. As an insight into this mode of regulation, the failure that it represented in the UK is discussed in detail, under the section “The United Kingdom, or Pride before the fall”, below.

**Japan**

In Japan, The Financial Services Agency is responsible for overseeing banking, securities and exchange, and insurance, in order to ensure the stability of the financial system. It is responsible for the protection of depositors, insurance policy holders, and securities investors. It is responsible for the inspection and supervision of private sector financial institutions, and the surveillance of securities transactions.\textsuperscript{40} It is an external organ of the Cabinet Office of the Government of Japan.\textsuperscript{41} The agency is headed by a Commissioner and reports to the Minister of State for Financial Services.\textsuperscript{42} It has

\textsuperscript{33} Autorité de contrôle prudentiel et de résolution (ACPR), “Ensuring the Stability of the Financial System”, in Missions (2014).

\textsuperscript{34} ACPR, n 33.

\textsuperscript{35} Autorité des Marchés Financiers (AMF), “Who We Are”, in Duties and Powers (16 July 2013).


\textsuperscript{37} Rajendran, n 6.


\textsuperscript{41} Financial Services Agency, n 40, p 2.

\textsuperscript{42} Financial Services Agency, n 40, p 8.
jurisdiction over the Securities and Exchange Surveillance Commission (SESC) and the Certified Public Accountants and Auditing Oversight Board. Its remit includes the maintenance of fair and transparent financial markets, the protection of users of the financial system, increased user convenience, and, as mentioned, the establishment of a stable financial system.43

Singapore

In Singapore, the Monetary Authority of Singapore (MAS), is the NCB, the market conduct regulator, and the prudential regulator. It is an “integrated supervisor overseeing all financial institutions in Singapore – banks, insurers, capital market intermediaries, financial advisors, and the stock exchange”. It also promotes retail investor education.44 While the MAS is a unitary supervisor, it is nonetheless highly regarded and is exceptionally effective, and maintains tight control of the financial sector in Singapore.45

The Singaporeans have transcended the limitations of compliance and the heretofore dominance of risk management systems designed in terms of minimizing the risk to the institution. Instead, it has very consciously aligned the “end” – market integrity – with the “purpose” of risk management – protecting the public interest. Firms are assessed on their demonstrable capacity to protect the public interest. This very clever exercise in regulatory engineering, combined with demand to report suspicion rather than evidence of wrongdoing and power of compulsion, creates a Panopticon effect. It may also lead to warranted confidence in banking industry exhortations that they are committed to professional integrity. It is a framework that is deserving of attention and emulation.

“The inspections and reprimands from the Monetary Authority of Singapore are everything,” a European banking veteran said. “Not respecting the rules risks huge fines, and even prison.”46

There is, therefore, something to be said for organisational culture in the degree of efficacy of the regulator; be it of the system stability or the market conduct type. Consequently, while the Singaporean regime is sub-optimal (although not the least effective – this dubious honour is reserved for the institutional approach), there is evidence that that sub-optimality is mitigated by the aggressive and “no-nonsense” manner in which the Singaporean authorities approach their responsibilities. As an example, in 2011, DBS, the Development Bank of Singapore, suffered an automatic-teller outage, which lasted a mere seven hours (3 am to 10 am), of which only one and a half hours, fell during normal business hours of operation. Nonetheless they were punished by the MAS, which required DBS to hold an additional S$230 million capital buffer against operational risk.47 DBS was required to maintain this additional (and effectively non-profit generating) capital until October of the following year.

As a key economic pillar, banks are expected to keep their services up and running all the time. MAS has emphasised this point in its IBTRM guidelines, saying users expect online banking services to be accessible “24 hours every day of the year” and this is “tantamount to near-zero system downtime.”48

This contrasts starkly with the manner in which the British authorities, albeit possessed of a better regulatory model, managed to produce far less beneficial outcomes among their regulated entities. By way of contrast, the Singapore model, we discuss the British experience leading up to the global financial crisis, and the role of the “light touch” approach to regulation, below.

44 Monetary Authority of Singapore (MAS), About MAS (2014).
Germany

In Germany the Deutsche Bundesbank (DB) and the Federal Financial Supervisory Authority (BaFin) are responsible for system stability, and a smoothly functioning banking supervision regime. The DB’s regulatory philosophy is one of safeguarding the viability of the financial sector, which is sensitive to fluctuations in confidence, by pursuing creditor (note, not purely depositor) protection.

The intensity of supervision depends on the type and scale of the regulated entity’s business, that is to say, in essence, its risk profile (a risk-based supervision regime). In this regard, the regulator concentrates its attention on whether institutions maintain adequate capital and liquidity, and on whether they have appropriate risk control mechanisms.

The division of supervision between these two entities, in its most simple form, is that BaFin is the lead supervisor, whereas the Bundesbank is responsible for macro-prudential supervision. BaFin’s supervisory guidelines are issued in consultation with the Bundesbank, and cooperation between the two is mandated by the Banking Act.

The supervisory guidelines delineate areas of authority and are intended to prevent overlap. The delineation remits to the Bundesbank the function of ongoing monitoring, pursuant to s 7(1) of the Banking Act, within the framework of the Supervisory Review and Evaluation Process (SREP). The monitoring function, in turn, comprises ascertaining facts, analysing the information received and collected, evaluating current and potential risks based upon that information, and appraisals of audit findings. The Bundesbank performs its monitoring function, while taking account of findings from its macro-prudential inquiries, in accordance with the Financial Stability Act (Gesetz zur Überwachung der Finanzstabilität (FinStabG)), as well as the guidelines, warnings and recommendations of the relevant European Union institutions and the Committee for Financial Stability (CFS).

The CFS has a broad range of powers and responsibilities contained in its enabling provision, most notably overall financial stability (including the causes of potential future crises), and inter-agency coordination and cooperation.

Information obtained from supervision and analysis of audits is evaluated in order that the Bundesbank may construct a risk profile of a regulated entity. The risk profile includes an institution’s risks, its organisation and internal control procedures and an assessment of its risk-bearing capacity.

BaFin makes the final summation and assessment of whether the risks that a given institution has assumed are matched by its policies, strategies, procedures and mechanisms aimed at ensuring sound financial stability.

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51 Federal Financial Supervisory Authority (BaFin) (Bundesanstalt für Finanzdienstleistungsaufsicht), “Supervision Guideline, Guideline on Carrying Out and Ensuring the Quality of the Ongoing Monitoring of Credit and Financial Services Institutions by the Deutsche Bundesbank of 21 May 2013”, in Cooperation between BaFin and Deutsche Bundesbank, (21 May 2013).
52 Section 7(1) of the Banking Act 1999 (Kreditwesengesetz, KWG), Federal Law Gazette I No 54, p 2384 (enacted 8 December), (Federal Republic of Germany).
55 Section 2 of the Financial Stability Act 2012 (Gesetz zur Überwachung der Finanzstabilität, FinStabG).
56 Federal Financial Supervisory Authority, n 51.
risk-management, and whether the institution has ensured that the risks that it has assumed are matched by adequate capital. The primary basis for these assessments is, therefore, the institution’s risk profile.  

Notwithstanding the Bundesbank’s authority to evaluate regulated entities, the final decision on all supervisory matters and questions of interpretation rests with BaFin. In reaching its decision, BaFin is expected to draw on the Bundesbank’s advice.

The United Kingdom, or Pride before the fall

Prior to the GFC, this model enjoyed a high degree of support, particularly for smaller economies, where it was deemed a reasonably effective method for the regulator to gain oversight of a broad range of financial services. In larger, more complex markets, this method of regulation had demonstrated a strength in its ability to offer what was regarded as a streamlined and flexible approach. In addition, it presented a unified focus on regulation and supervision, without giving rise to jurisdictional disputes, or the possibility of regulatory arbitrage. At the time its principle shortcoming was regarded as its capacity to present “a single point of regulatory failure”.

The effects of the GFC in the UK, however, exposed flaws and repeated and serious failures on the part of the regulator; failures that provide an insight into the critical shortcomings of this method of regulation.

The United Kingdom, (which has now moved to its own version of the “Twin Peaks” model) had its erstwhile integrated regulatory regime held-up as an exemplar of excellence in financial regulation. The Financial Services Authority (FSA) was responsible for both prudential regulation and enforcement, and market conduct. On the eve of the GFC it was described by the Group of Thirty’s 2008 Report as:

a model of an efficient and effective regulator, not only because of its streamlined model of regulation, but also because it adheres to a series of “principles of good regulation,” which center on efficiency and economy, the role of management, proportionality, innovation, the international character of financial services, and competition. This overlay of pragmatic business principles, in addition to the traditional goals of regulation, has been a distinguishing feature of the UK regulatory approach.

That analysis was provided prior to the global financial crisis, and the collapse of notable British banks such as Northern Rock, Royal Bank of Scotland (RBS) and Halifax Bank of Scotland (HBOS). At the time of its collapse HBOS was one of Britain’s “big four” banks and, consequently, its failure represented a systemic-threat event for the UK’s economy.

57 Federal Financial Supervisory Authority, n 51.
58 Federal Financial Supervisory Authority, n 51.
60 Working Group on Financial Supervision, n 7, p 14.
64 The Bank of Scotland (BOS), founded in 1695, was merged in 2001 with Halifax, a 150-year-old building society that had recently converted to a bank. The new entity became known as HBOS (Halifax Bank of Scotland). This catapulted HBOS into the “big four” of UK banks. McConnell P, “Reckless Endangerment: The Failure of HBOS” (2014) 7(2) Journal of Risk Management in Financial Institutions 204.
After the GFC, the FSA was described as "thoroughly inadequate" in its oversight of HBOS by the House of Lords, House of Commons Commission. The Commission stated in its conclusion that:

the FSA was not so much the dog that did not bark as a dog barking up the wrong tree. The requirements of the Basel II framework not only weakened controls on capital adequacy by allowing banks to calculate their own risk-weightings, but they also distracted supervisors from concerns about liquidity and credit; they may also have contributed to the appalling supervisory neglect of asset quality. The FSA’s attempts to raise concerns on these other fronts from late 2007 onwards proved to be a case of too little, too late … The experience of the regulation of HBOS demonstrates the fundamental weakness in the regulatory approach prior to the financial crisis and as that crisis unfolded. … The regulatory approach encouraged a focus on box-ticking which detracted from consideration of the fundamental issues with the potential to bring the bank down. The FSA’s approach also encouraged the Board of HBOS to believe that they could treat the regulator as a source of interference to be pushed back, rather than an independent source of guidance and, latterly, a necessary constraint upon the company’s mistaken courses of action.66

At the time the FSA failed to understand the pernicious nature of HBOS’s funding: HBOS had returned spectacularly high rates of return on equity through aggressive lending – in excess of 20%,68 and the Bank’s Corporate Division had seen an increase in assets (in other words loans to borrowers) of 26% in 2002 alone.69

However, such a rapid growth in assets was not matched by traditional customer deposits and HBOS was forced to turn to the short-term wholesale markets to cover its funding gap. As early as 2002, the UK banking regulator, the Financial Services Authority (FSA), raised concerns about the bank’s funding strategy, returning in 2003 to express disappointment that the warnings had not been properly heeded, and also increasing the bank’s capital requirement by 0.5 per cent.70

In response, the HBOS Board simply dismissed the regulator’s concerns as unwarranted. By 2009, and in the aftermath of the GFC, HBOS could no longer raise capital in the wholesale funding markets, and the Board of HBOS engineered that the bank be taken-over by Lloyds TSB.71 A bank that had operated for 350 years ceased to exist. By the time the Lloyds take-over had been digested, and more conservative accounting standards employed, it became apparent that £25 billion of Corporate Division loans were impaired, a staggering 20% of HBOS’s Corporate Division loan book.72 The graph below provides a comparison of non-performing loans in Australia, Canada, the UK, the Eurosystem, the remainder of Europe, and the United States over the same period.73

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68 McConnell, n 64 at 205.
69 McConnell, n 64 at 205.
70 McConnell, n 64 at 205.
71 In 1995 Lloyds Bank merged with the Trustee Savings Bank and from 1999 to 2013 traded as Lloyds TSB Bank plc. Today it trades as Lloyds Bank plc.
72 McConnell, n 64 at 205–206.
At the time the FSA had developed what came to be termed the “light touch” approach to regulation – an approach exemplified as one that regarded banking as a favoured industry, and sought to impose the lowest possible regulatory burden on banks. This policy significantly contributed to the financial crisis in the UK.

In its short life, the FSA failed to rein in the banks, and even encouraged the City to explode in the mid-2000s with a “light touch” approach to regulation. It did not notice that Northern Rock was built on such shaky foundations that it could easily run out of money, and failed to prevent the takeover of ABN Amro by RBS just as the credit crunch was biting in late 2007.

As an indication of just how blinded the FSA was to the extent of the crisis metastasising in the UK, its report into the RBS acquisition of ABN Amro – an acquisition which was disastrous for RBS, and which culminated in the bank’s collapse – asserted that:

[...] while RBS’s governance, systems and controls and decision-making may have fallen short of best practice, and below the practices of a number of peer firms, the FSA could not take action where decisions made or systems in place were not outside the bounds of reasonableness given all the circumstances at the time, including FSA awareness of issues and the approach it took at that time. The FSA may not apply standards of conduct retrospectively against the firms and individuals it regulates, on the basis that to do so would raise serious issues of unfairness.

These assertions however, appear open to question. First, if it is the regulator’s responsibility to regulate in order to prevent future crises, or at least to prevent systemic weaknesses if it cannot prevent individual firm weakness, then one must rightly conclude that warning signs were either

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76 Financial Services Authority, n 66, § 40, p 31.
missed or left unheeded. The “light touch” culture within the regulatory agencies would support the latter conclusion. Secondly, it is suggested that the failure to prosecute is not only a function of the prohibition on retrospectivity; it is also a function of legislative drafting that is not termed broadly enough to punish – criminally – past reckless conduct. It is of note also that the RBS-ABN Amro deal went through after the wholesale money markets, upon which RBS relied through its subsidiary, NatWest, had become paralysed, and four weeks after the run on Northern Rock. All of which point to a regulator asleep at the wheel.

The FSA report acknowledged the poor timing of the ABN Amro deal, and by implication their complicity in allowing the deal to proceed.

In his foreword to the FSA report on the RBS-ABN Amro takeover, Lord Turner, FSA Chairman, stated that readers of the report may be surprised to find that prior to the takeover, RBS had procured two lever-arch folders and a CD as the sum total of their due diligence. Hosking’s response to this point is to argue that:

His suggestion is clear: if only RBS had garnered more information, if only there had been more lever-arch files, disaster might have been averted. This is the philosophy of the deluded bureaucrat. If only there had been more reports, more meetings; if only more boxes had been ticked, more forms filled in. On the Origin of Species, the Bible and the collected works of Shakespeare could be contained in two lever-arch folders and a CD. How much more information does Lord Turner think RBS needed? … It’s not volume of information that matters. It’s quality.

In the three and a half years prior to RBS’s collapse, the FSA met with RBS 511 times. But, again, as Hosking points out:

It’s typical that there is someone to count them, but no one to explain what on earth went on in them … would [it] have been better had there been a thousand? The FSA tells us that 0.5 of an FSA manager and 4.5 team members were assigned to RBS as it was mounting the bid. The clipboard-hugging precision of those decimals speaks volumes … The report is a blizzard of acronyms and bogus science: RBS was scored as a “medium high minus” risk, whatever that is.

There were other notable examples of regulatory failure that emerged after the GFC, such as price-manipulation of the London Interbank Offered Rate (LIBOR). The Parliamentary Select Committee investigation into LIBOR found, inter alia, that:

The manipulation was spotted neither by the FSA nor the Bank of England at the time. That doesn’t look good … It will be a great step forward if the regulators get away from box-ticking and endless data collection and instead devote more careful thought to where risk really lies… It will involve a change in culture on the part of the regulators and is a major challenge for the future.

77 Anonymous, Lest We Forget: British Banking During the Global Financial Crisis, (Institute of Hazard, Risk and Resilience, Durham University, 25 September, 2013).
79 Hosking, n 78. See also, Financial Services Authority, n 66, § 330, Pt 2, Ch 1, p 161; § 30, p 28.
80 Financial Services Authority, n 66, p 7.
81 Hosking, n 78.
82 Financial Services Authority, n 66, Pt 2, Ch 3, p 277.
83 Financial Services Authority, n 66, Table 2.18, p 280 and Pt 2, Ch 3, p 260; Hosking, n 78.
85 Treasury Select Committee, n 84, § 3, “Barclays and the FSA”.

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Glaringly inconsistencies were exposed: the FSA had pressured Barclays CEO Bob Diamond to step down, over his bank’s role in rigging the LIBOR. But as the Treasury Select Committee found, this was in response to public pressure and not, for example, the FSA’s Final Notice,86 issued to Barclays, some 12 months earlier.87

On Monday night, Adair Turner, chairman of the FSA, called Barclays asking that “any obstacle” be removed in resolving the crisis, according to a person familiar with the matter. Mr. Diamond tendered his resignation shortly after.88

In its findings, the Commission of Inquiry into the LIBOR rigging, as recently as 2013 – fully five years after the GFC – found that:

[T]he scale and breadth of regulatory failure was also shocking. International capital requirements led to the FSA becoming mired in the process of approving banks’ internal models to the detriment of spotting what was going on in the real business. … They neglected prudential supervision in favour of a focus on detailed conduct matters … the FSA left the UK poorly protected from systemic risk. Multiple scandals also reflect their failure to regulate conduct effectively. (Paragraph 931).89

In the aftermath of the GFC one of the conclusions reached on the performance of the FSA found, inter alia, that:


Serious regulatory failure has contributed to the failings in banking standards. The misjudgement of the risks in the pre-crisis period was reinforced by a regulatory approach focused on detailed rules and process which all but guaranteed that the big risks would be missed. Scandals relating to mis-selling by banks were allowed to assume vast proportions, in part because of the slowness and inadequacy of the regulatory response.90

What this belies was that prior to the GFC, the FSA had fallen prey to form over function; to process over outcomes. Its Approved Persons Regime was described as a “flagrant” failure.91

Prior to the GFC, the UK regulatory authorities had moved to a principles-based as opposed to a rules-based approach to regulation. That is to say, the FSA laid out a set of principles, primarily related to risk, and allowed financial firms to decide how to address those principles.

Firms’ managements – not their regulators – are responsible for identifying and controlling risks. A more principles-based approach allows them increased scope to choose how they go about this. In short, the use of principles is a more grown-up approach to regulation than one that relies on rules.92

86 Financial Services Authority, “Final Notice”, issued by the Financial Services Authority to Barclays Bank, PLC (27 June 2012).
87 Treasury Select Committee, n 84, § 4, “The Resignations”.
92 Tuner J (Chief Executive of the FSA), speaking in 2006, quoted in Treanor, n 75.
By 2009, John Turner’s successor, Hector Sants, had abandoned the principles-based approach, stating at the time that “A principles-based approach does not work with individuals who have no principles”.

In response to these findings, Black and Baldwin provide a spirited defence of risk-based regulation, that is to say, regulation that is principles-based. Evidently they have failed to learn from the experience of the UK and, it appears, the school of thought to which they subscribe is anything but out of fashion. They argue, for example, that regulators need to be responsive to, inter alia, “regulated firms’ behaviour, attitude, and culture”. Admirable a goal as that may appear to be, it neglects the fact that regulating behaviour, attitude and culture is highly subjective, least able to be quantified, and therefore susceptible to regulatory forbearance, and susceptible to industry and political pressure.

In defence of their position, Black and Baldwin assert that risk-based regulation should not be regarded as completely discredited by the financial crisis that befell the UK, because similar crises did not befall other countries in which risk-based regulation was also employed, such as Australia or Canada.

It is argued, however, that it was not risk-based regulation that failed to fail, as it were, in Australia or Canada. Rather it was more conservative banking strategies, less prone to highly derived, opaque and esoteric investment instruments, than risk-based regulation that saved those two countries. Put differently, Australia and Canada survived the GFC not because of the efficacy of risk-based regulations, but through sheer good luck – Australian banks’ under-exposure to the CDO market, coupled with targeted, government largesse.

Clearly not all the blame for the failure of HBOS or RBS can or should be laid at the feet of the FSA. In the case of HBOS’s, the Board of Directors must shoulder a significant degree of blame as well. But it is in the nature of the failings of the conduct of HBOS’s directors that we find further evidence of the failure of a system that seeks to manage risk, not conduct. The House of Lords, House of Commons Commission had this to say:

The corporate governance of HBOS at board level serves as a model for the future, but not in the way in which Lord Stevenson and other former Board members appear to see it. It represents a model of self-delusion, of the triumph of process over purpose … We are shocked and surprised that, even after the ship has run aground, so many of those who were on the bridge still seem so keen to congratulate themselves on their collective navigational skills.

Summarising the entire debacle, and the challenges it presented to the very foundations of financial system safety, Andy Haldane stated:

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95 Black and Baldwin, n 94, p 181.
96 Black and Baldwin, n 94, p 210, fn 2.
99 In the form of a cash bonus to families, and infrastructure spending. Austin A, “We Really Must Talk About What Actually Did Save Australia”, Independent Australia (published electronically, 21 August, 2013); Hill, n 98, Pt VI2, p 34ff.
For the most part the financial crisis was not the result of individual wickedness or folly. It is not a story of pantomime villains and village idiots. Instead the crisis reflected a failure of the entire system of [the UK’s] financial sector governance.\textsuperscript{102}

The FSA has now been dissolved, and replaced with a separate market conduct authority, the Financial Conduct Authority,\textsuperscript{103} and a separate bank regulator, the Prudential Regulation Authority,\textsuperscript{104} a division of the Bank of England. Put differently the UK has, as a result, adopted a “Twin Peaks” system.

What this indicates is that the authorities, in the UK at least, have rejected the integrated approach as inadequate to the task. The failures of the FSA, however, cannot be ascribed to the design of the regulatory architecture alone. Pervasive and profound shortcomings in the organisational culture of the FSA played a significant role in its failures and, it is argued, these would be addressed, only in part, by reforming the regulatory regime.\textsuperscript{105} Thus far, that message has been lost because the most recent incarnation of the prudential regulator presents a case of déjà vu: its location as a division of the Bank of England.

After the failure of the venerable Barings Bank in 1995, regulation (or more correctly, self-regulation) of the banking industry in the UK was ripped away from the Bank of England … In the new structure, prudential regulation was hived off to the Prudential Regulatory Authority (PRA) and, in an illustration that governments never learn the lessons of history, this body was handed back to the Bank of England.\textsuperscript{106}

One aspect mitigating the likelihood of regulatory capture, and consequently forbearance is, therefore, the location of the regulator, and the degree of independence that the regulator enjoys: in effect the degree to which the regulator is insulated from political and industry pressure or interference. In this respect this author is firmly of the view that a “non-monopolist approach” – in which the regulator is a separate entity from the NCB – like that followed in Australia, but unlike that followed in the UK, is preferable. It bears repeating however, that post-FSA, the regulator has again been located within the Bank of England, and this, it is argued, is sub-optimal.

In response to the failures of principles-based regulation, regulators in the United Kingdom have embraced instead a judgment-based system of regulation.\textsuperscript{107} That is to say that, instead of measuring banks risk against a set of stated principles, regulators will instead exercise their discretion to ensure that problems are tackled early – in theory. But, it is argued, a judgment-based approach is malleable, subjective, and open to political and market pressure. Indeed, as Demirgüç-Kunt and Detragiache point out:

> When we explore the relationship between soundness and compliance with specific groups of principles, which refer to separate areas of prudential supervision and regulation, we continue to find no evidence that good compliance is related to improved soundness. If anything, we find that stronger compliance with principles related to the power of supervisors to license banks and regulate market structure are associated with riskier banks.\textsuperscript{108}

Further complicating the issue of financial regulation in the UK under the new regime, is the establishment of a third body, the Financial Policy Committee (FPC), the remit of which is to look for


\textsuperscript{103} Financial Conduct Authority, About Us, (2014).

\textsuperscript{104} Prudential Regulation Authority, About the Prudential Regulation Authority (Bank of England, 2014).


\textsuperscript{107} House of Lords, House of Commons, Changing Banking for Good, n 112, § 37, “Risks to the Competitiveness of the UK Banking Sector”, p 21.

the roots of the next crisis. Its remit is to identify, monitor and take action to remove or reduce systemic risks. It has a secondary objective, which is to support the economic policy of the Government.

The FPC is a statutory sub-committee of Court of the Bank of England, and its members include the Governor, three of the Deputy Governors, the Chief Executive of the Financial Conduct Authority (FCA), the Bank’s Executive Director for Financial Stability, Strategy and Risk, four external members appointed by the Chancellor of the Exchequer, and a non-voting representation of the Treasury.

Of course, in regulation, one can never have enough acronyms and to oversee these two new regulators there is yet another regulator, the FPC (or Financial Policy Committee) which is to be part of the Bank of England. In other words: BOE 2, FSA 0.

TWIN PEAKS

This method is exemplified by regulation by objective. As the name suggests, this regime comprises two regulators, whose objectives are, alternatively, systemic stability, and market conduct and consumer protection. Examples include Australia, the Netherlands, Switzerland, Qatar, and Spain. Italy, France, and the United States have indicated an interest in adopting this method of financial regulation, the UK has adopted “Twin Peaks”, and South Africa is well advanced towards adoption.

The Netherlands

The Kingdom of the Netherlands was second to adopt a “Twin Peaks” approach in 2002, retaining prudential supervision within De Nederlandsche Bank NV (The Dutch Bank (DNB)). This is similar to the arrangement in the UK, but in contradistinction to Australia, where the prudential regulator (APRA) is separate from the NCB.

While it is asserted that the Netherlands fared relatively well during the GFC, success for the Dutch authorities in staving-off a financial crisis in an economy with such an important financial sector, was not achieved without drastic government intervention.

Total foreign claims of Dutch banks amounted to over 300% of GDP. The Dutch financial system therefore depended heavily on external developments. Only the Belgian and Irish banking sectors were in a similar
position. The European average was less than half the Dutch figure at 135% of GDP. ... exposure of Dutch banks to the United States also was the highest in Europe, at 66% of GDP. ... whereas the average of European banks had kept limited exposure of less than 30% of GDP. By contrast, the exposure of Dutch banks to hard-hit Eastern European countries was at 11% of GDP just above the European average of 8% of GDP.\textsuperscript{119}

Intervention during the crisis took the form of measures to stimulate employment through construction and housing (6 billion); capital injections for banks and insurers (20 billion); State guarantees for banks (200 billion); a guarantee on all deposits up to 100,000;\textsuperscript{120} the nationalisation of the Fortis/ABN AMRO (16.8 billion) and ING banking groups (10 billion), comprising 85% of the Dutch banking sector;\textsuperscript{121} and the SNS REAAL insurance and banking group (3.7 billion);\textsuperscript{122} and a reform of the financial system and the capital levels that had been enforced to date. Thereafter the Dutch government was compelled to drastically reduce spending in order to reduce its deficit.\textsuperscript{123}

In the aftermath of the crisis, the conclusions reached about the performance of the Dutch regulators were less than positive:

Both in the run-up to and during the credit crisis, supervisory instruments fell short in several areas. These deficiencies emerged in both the scope and the substance of supervision. The trend towards lighter supervision, reflecting developments within the financial sector as well as changed social attitudes, has gone too far.\textsuperscript{124}

This finding supports the conclusions reached in the analysis of the performance of the UK regulatory authorities during the GFC, namely that regulatory architecture alone is not a panacea against financial crisis. Doubtless regulatory architecture is part of the solution, but no more so than the capacity of the regulator to foresee, at times, the unforeseeable, and regulate accordingly, and the willingness of the regulator to enforce its regulations.

**Switzerland**

In the case of Switzerland, the Swiss National Bank is responsible for financial stability. The Swiss National Bank (SNB) defines a stable financial system as “a system whose individual components – financial intermediaries and the financial market infrastructure – fulfil their respective functions and prove resistant to potential shocks”.\textsuperscript{125}

Oversight of systemically important payment and securities settlement systems is assigned to the SNB. In this regard the SNB cooperates with the Swiss Financial Market Supervisory Authority (FINMA), pursuant to a Memorandum of Understanding (MoU) with clear divisions of the individual mandates of the two institutions. The MoU also regulates this cooperation.\textsuperscript{126}

The SNB acts as lender of last resort (LoLR), by providing liquidity assistance against collateral, should domestic banks no longer be able to refinance their open-market operations. The supervision of the banking sector is the responsibility of the Swiss Financial Market Supervisory Authority (FINMA).\textsuperscript{127}


\textsuperscript{120} Government of the Netherlands, Ministry of Finance, “The Netherlands and the Credit Crisis” in Financial Policy (series edited by Ministry of General Affairs, undated).


\textsuperscript{122} Escritt T and Deutsch A, “Netherlands Nationalizes SNS Reaal at Cost of $5 Billion”, Reuters (US ed, 1 February 2013).

\textsuperscript{123} De Nederlandsche Bank, DNB Supervisory Strategy 2010 - 2014 and Themes 2010 (April 2010) p 5.


\textsuperscript{125} Swiss National Bank, n 123.

\textsuperscript{126} Swiss National Bank, n 123.
FINMA’s remit is the protection of creditors, investors and policyholders and the maintenance of the smooth functioning of financial markets. FINMA is responsible for supervision and regulation of participants in the financial markets.\textsuperscript{128}

FINMA has authority over banks, insurers, stock exchanges, securities dealers, collective investment schemes, distributors and insurance intermediaries. It issues licenses and is responsible for combating money laundering. In addition it imposes sanctions and, where necessary, conducts restructuring and bankruptcy proceedings. FINMA supervises “disclosure of shareholdings, conducts proceedings, issues rulings and, where wrongdoing is suspected, files criminal complaints with the Swiss Federal Department of Finance (FDF)”.\textsuperscript{129} It supervises public takeover bids and acts as an appeals tribunal against decisions of the Swiss Takeover Board (TOB). It participates in the legislative process, issues ordinances where authorised, “publishes circulars concerning the interpretation and application of financial market laws, and is responsible for the recognition of self-regulatory standards”.\textsuperscript{130}

**Qatar**

In Qatar the Qatar Financial Markets Authority (QFMA) is an independent regulatory authority, established to supervise financial markets and securities firms. It is empowered to exercise regulatory oversight and regulatory enforcement over the capital markets. Its remit is to protect investors, ensure fair and efficient financial markets, enhance transparency and market integrity, and prevent firms from engaging in misleading and deceptive conduct in the provision of financial products and services.\textsuperscript{131}

The Qatar Financial Centre Regulatory Authority is an independent regulator, the remit if which is to authorise and regulate firms and individuals conducting financial services. It is a principles-based regulator. Its objectives include the promotion and maintenance of efficiency, transparency, integrity and confidence, as well as the maintenance of financial stability and the reduction of systemic risk. Its remit also includes the development of financial awareness and protection for customers and investors.\textsuperscript{132}

Interestingly, Qatar has established a Qatar Financial Centre (QFC) Civil and Commercial Court, for resolving disputes between financial firms and their counterparties, and for the arbitration or the formal resolution of civil disputes. Qatar has also established the QFC Regulatory Tribunal for hearing appeals by entities, individuals and corporate bodies against decisions of the QFC Regulatory Authority.\textsuperscript{133}

**Spain**

In Spain, the Spanish regime includes three authorities: the Bank of Spain, the National Securities Market Commission (Comisión Nacional del Mercado de Valores) (CNMV), and the Directorate General of Insurance and Pension Funds (Dirección General de Seguros y Fondos de Pensiones) (DGS).

The Bank of Spain is responsible for prudential supervision and regulation.\textsuperscript{134} These functions are divided into two Directorates General: the Directorate General Banking Regulation and Financial Stability and the Directorate General Banking Supervision.\textsuperscript{135} The stated objective of the Bank’s supervisory process is to determine a risk profile for each institution, in order to provide the Bank of


\textsuperscript{130}Swiss Financial Market Supervisory Authority, n 129, p i.

\textsuperscript{131}Qatar Financial Markets Authority (QFMA), About QFMA (2014).

\textsuperscript{132}Qatar Financial Centre Regulatory Authority, “Role and Structure” in About Us (2013).

\textsuperscript{133}Qatar Financial Centre Regulatory Authority, “About the QFC” in About Us (2013).

\textsuperscript{134}Banco de España, “The Supervisory Model” in Banking Supervision (2014).

\textsuperscript{135}Banco de España, “Organisation Chart” in About Us (2014).
Spain with a capacity to maintain financial system stability, by foreseeing and preventing future bank crises.\(^{136}\) This risk profile aggregates the possibility of a credit institution developing solvency, profitability or liquidity problems in the future, into a single variable.\(^{137}\)

The method used by the Spanish Bank is known as “Supervision of the Banking Activity by Risk Approach (SABER)”, which aims to provide a uniform ratings framework. The elements analysed are represented in a risk matrix, which represent different ratings, some of which are objectively quantifiable, some of which are subjective in nature, such as management and control.\(^{138}\)

The SABER aims to determine which institutions are more likely to develop problems in the future. Special attention is paid to institutions with a supervisory risk profile above a certain rating. The supervision framework for the different institutions is based on the supervisory risk profile and systemic importance of the institution. The framework is updated as required, but always at least annually.\(^{139}\)

The Spanish National Securities Market Commission is responsible for supervising and inspecting the Spanish Stock Markets and the activities of all its participants.\(^{140}\) The CNMV’s remit is to ensure transparency in the Spanish market, correct price formation, and the protection of investors. The CNMV also promotes disclosure of information, in order to achieve investor protection.\(^{141}\) The CNMV audits and develops new disclosure requirements relating to remuneration schemes for directors and executives, linked to the company’s share price. It also aims to detect and pursue illegal activities by unregistered intermediaries. The Commission has jurisdiction over companies that issue securities for public placement, the secondary markets in securities, and investment services companies. The Commission also exercises prudential supervision over the last two in order to ensure transaction security and the solvency of the system.\(^{142}\) The entities over which the CNMV exercises its jurisdiction include: Collective Investment Schemes, which includes: investment companies (securities and real estate), investment funds (securities and real estate) and their management companies; Broker-Dealers and Dealers – entities engaging primarily in the purchase and sale of securities; and Portfolio Management Companies – entities focusing primarily on managing individuals’ assets (principally securities).\(^{143}\)

The Spanish Directorate General of Insurance and Pension Funds regulates and supervises private insurance and reinsurance, insurance brokers and reinsurance and pension plans. It protects policyholders, beneficiaries, third parties and participants in pension plans through a complaints resolution process. It handles inquiries about insurance and monitors compliance.\(^{144}\)

The DGS examines the valuation of assets and liabilities, conducts overall compliance reviews, and conducts reviews and assessments of risks and solvency. It controls mergers and other transactions between insurance companies aimed at improving the structure of the sector, in conjunction with the National Markets And Competition Commission. In addition, the DGS is responsible for the supervision of market conduct.\(^{145}\)


\(^{137}\) Banco de España, “The Supervisory Model”, n 136.

\(^{138}\) Banco de España, n 136.

\(^{139}\) Banco de España, n 136.


\(^{141}\) National Securities Market Commission (Comisión Nacional del Mercado de Valores (CNMV)), n 140.

\(^{142}\) National Securities Market Commission (Comisión Nacional del Mercado de Valores (CNMV)), n 140.

\(^{143}\) National Securities Market Commission (Comisión Nacional del Mercado de Valores (CNMV)), n 140.

\(^{144}\) Directorate General of Insurance and Pension Funds (Dirección General de Seguros y Fondos de Pensiones (DGS)), “Structure and Functions of the DGSFP” in *Directorate General* (2014).

\(^{145}\) Directorate General of Insurance and Pension Funds, n 144.
The “Twin Peaks” model was proposed by, and implemented on, the conclusion of the Wallis Commission of Inquiry in 1997. To wit, Australia has separated the market conduct and consumer protection authority – the Australian Securities and Investment Commission (ASIC) – from the bank regulator – the Australian Prudential Regulation Authority (APRA) – and the National Central Bank (NCB) – the Reserve Bank of Australia (RBA).

The RBA is tasked with, inter alia, overall responsibility for the financial system, and is lender of last resort (LoLR). The Australian model could therefore reasonably be described as a three-peak model.

Each one of these peaks is an independent, statutory body.

While the Australian model provides a high degree of statutory independence for the system stability regulator, APRA, it is to a degree answerable to the Treasurer, and both APRA and ASIC to the Federal Parliament by way of submission of Annual Reports. This comports with what Taylor envisages for the model as either Ministerial oversight or Parliamentary oversight.

The second entity is responsible for market conduct and consumer protection. It is argued such a system is more likely to resolve fragmentation, provide clarity of ambit, be more cost-effective due to rulebook simplification, and improve accountability – more likely, but not definitely, as the recent failings of ASIC in Australia have demonstrated.

If the consumer protection and market conduct regulator does prove effective, then advantages accrue to consumers for a “one-stop shop” for complaints against a regulated firm.

While in Australia the prudential regulator is an entity separate from the National Central Bank (NCB), such “non-monopolist” arrangements are not universal – that is to say there are instances where the regulator is part of the NCB (monopolist regimes, such as the Kingdom of the Netherlands and the United Kingdom), and others where the regulator is separate.

There is no definitive answer as to which regime is preferable, but the available evidence favours a non-monopolist approach.

Banking sectors in “monopolist” countries are more protected and somehow less developed and efficient than those in “non-monopolist” countries.

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147 Australian Securities and Investments Commission Act (Cth), No 51 of 2001; Australian Prudential Regulation Authority Act (Cth), No 50 of 1998; Reserve Bank Act (Cth), No 4 of 1959.
148 Section 11 of the Australian Prudential Regulation Authority Act (Cth).
149 Section 12 of the Australian Prudential Regulation Authority Act (Cth).
150 Section 59 of the Australian Prudential Regulation Authority Act (Cth).
151 Section 136 of the Australian Securities and Investments Commission Act (Cth).
154 Taylor (December 1995), n 152, p 11.
156 Di Noia and Di Giorgio, n 155, p 376.
There are, in addition, conflicts of interest\textsuperscript{157} that ought to be considered in the location of the PA. The NCB’s focus is primarily a macro-prudential one, whereas the PA’s focus is chiefly micro-prudential. Consequently, as lender of last resort, the NCB may find itself under pressure to assist regulated institutions, when the PA is located within the NCB. We argue that such conflicts of interest are best avoided.

Within this more usual context, the conflict of interest may arise between the monetary authorities, who wish for higher rates (eg to maintain an exchange rate peg, to bear down on inflation, or to reduce the pace of monetary growth), and the regulatory authorities who are frightened about the adverse effects such higher rates may have upon the bad debts, profitability, capital adequacy and solvency of the banking system.\textsuperscript{158}

A further instance for potential conflicts of interest between the NCB and the PA, include the expectation that the NCB will be influenced by stability considerations, when determining monetary policy,\textsuperscript{159} or that the NCB may employ open market operations and access to the discount window as a supervisory instrument.\textsuperscript{160}

Lastly, Di Noia et al\textsuperscript{161} assert that conflicts may arise between macro (monetary) and micro (regulatory) policy. Monetary policy tends to be anti-cyclical, whereas regulatory policy tends to be pro-cyclical.\textsuperscript{162} Di Noia et al\textsuperscript{163} cite an example where, during an economic slowdown, a bank’s non-performing assets may increase, precipitating higher loan-loss provisioning rules, and a pressure to increase the quality of the bank’s portfolio from the Regulator. As Tuya et al\textsuperscript{164} point-out, this leads to a restriction in credit, at precisely the time when monetary policy should be expansionary.

In terms of inter-agency cooperation and coordination, the Australian model addresses this through various memoranda of understanding.\textsuperscript{165}

Whereas the legislative framework for regulatory coordination is high-level and outcomes-focused, it does not, however, provide detailed provisions as to the nature of coordination and how it should be achieved.\textsuperscript{166} Instead, s 10A of the APRA Act\textsuperscript{167} provides in general terms as follows:

The Parliament intends that APRA should, in performing and exercising its functions and powers, have regard to the desirability of APRA coordinating with other financial sector supervisory agencies, and with other agencies specified in regulations for the purposes of this subsection. (2) This section does not override any restrictions that would otherwise apply to APRA or confer any powers on APRA that it would not otherwise have.

The RBA has asserted that cultivating a culture of coordination, under which the main focus is on regulatory performance, rather than regulatory structure, is crucially important. The Assistant Governor (Financial) of the RBA has attributed the efficacy of coordination between the regulators in Australia to a culture–

where we regard cooperation with the other agencies as an important part of our job, and there is a strong expectation from the public and the government that we will continue to do so... Key aspects [of

\textsuperscript{157}Di Noia and Di Giorgio, n 155, p 368.
\textsuperscript{159}Di Noia and Di Giorgio, n 155, p 369.
\textsuperscript{161}Di Noia and Di Giorgio, n 155, p 369.
\textsuperscript{162}Goodhart and Schoenmaker, n 158, p 362.
\textsuperscript{163}Di Noia and Di Giorgio, n 155, p 369.
\textsuperscript{164}Tuya and Zamalloa, n 160, p 670.
\textsuperscript{166}Godwin and Schmulow, n 4.
\textsuperscript{167}Australian Prudential Regulation Authority Act (Cth).
coordination] include an effective flow of information across staff in the market operations and macroeconomic departments of a central bank and those working in the areas of financial stability and bank supervision. Regular meetings among these groups to focus on risks and vulnerabilities and to highlight warning signs can be very valuable. A culture of coordination among these areas is very important in a crisis because, in many instances, a stress situation is first evident in liquidity strains visible to the central bank, and the first responses may be calls on central bank liquidity.\footnote{Edey M, “Macroprudential Supervision and the Role of Central Banks” (Paper presented at the Regional Policy Forum on Financial Stability and Macroprudential Supervision hosted by the Financial Stability Institute and the China Banking Regulatory Commission, Beijing, PRC, 28 September 2012).}

The success Australia achieved in addressing the challenges arising out of the global financial crisis and the 2010 Sovereign Debt Crisis has been attributed to this flexible approach to inter-agency cooperation. Indeed, in interviews conducted with the regulators in Australia, it was evident that over-prescription, or formalisation, would have stifled this flexibility.\footnote{Godwin and Schmulow, n 4.}

To facilitate this cooperation, Australia has established the Council of Financial Regulators (CFR),\footnote{The Council of Financial Regulators, The Council of Financial Regulators (Reserve Bank of Australia, 2001-2014).} whose purpose it is to oversee inter-agency cooperation.

The CFR is the coordinating body for Australia’s main financial regulatory agencies. Its membership comprises APRA, ASIC, the RBA and the Treasury. … It is a non-statutory interagency body, and has no regulatory functions separate from those of its four members.

CFR meetings are chaired by the Reserve Bank Governor, with secretariat support provided by the RBA. They are typically held four times per year but can occur more frequently… As stated in the CFR Charter, the meetings provide a forum for:

• identifying important issues and trends in the financial system, including those that may impinge upon overall financial stability;
• … appropriate coordination arrangements for responding to actual or potential instances of financial instability, and helping to resolve any issues where members’ responsibilities overlap;

…

Much of the input into CFR meetings is undertaken by interagency working groups, which has the additional benefit of promoting productive working relationships and an appreciation of cross-agency issues at the staff level.

The CFR has worked well since its establishment and, during the crisis in particular, it has proven to be an effective means of coordinating responses to potential threats to financial stability…

The experience since its establishment, and especially during the crisis, has highlighted the benefits of the existing non-statutory basis of the CFR.\footnote{Reserve Bank of Australia, Submission to the Financial System Inquiry (Financial System Inquiry, Reserve Bank of Australia, March, 2014) p 66.}

While this arrangement may have succeeded in insulating Australia from the ravages of the GFC in respect of system stability, the Australian regulatory model has not fared as well in respect of combating market misconduct, or the protection of consumers, as the financial advice scandals at the Commonwealth Bank (CBA) and Macquarie Bank have demonstrated.\footnote{Ferguson, n 153; Ferguson and Masters, n 153; Ferguson A and Butler B, “Commonwealth Bank Facing Royal Commission Call After Senate Financial Planning Inquiry”, Sydney Morning Herald (26 June 2014).} ASIC’s paltry performance in addressing these malpractices at CBA and Macquarie were heavily criticised by an inquiry led by the Upper House of Australia’s Federal Parliament.\footnote{Senators Mark Bishop (Chair), Senator David Bushby (Deputy Chair), Senator Sam Dastyari, Senator Louise Pratt, Senator John Williams, Senator Nick Xenophon, Senator David Fawcett and Senator Peter Whish-Wilson, Performance of the Australian Securities and Investments Commission (Economics References Committee, The Senate, Parliament of Australia, June 2014).} Considering the international fashionability of “Twin Peaks”, and in particular the influence of the Australian model, the failures and shortcomings of ASIC – one half of the two peaks – has been a significant and sobering practical failure.

\footnote{168 Edey M, “Macroprudential Supervision and the Role of Central Banks” (Paper presented at the Regional Policy Forum on Financial Stability and Macroprudential Supervision hosted by the Financial Stability Institute and the China Banking Regulatory Commission, Beijing, PRC, 28 September 2012).}

\footnote{169 Godwin and Schmulow, n 4.}


\footnote{171 Reserve Bank of Australia, Submission to the Financial System Inquiry (Financial System Inquiry, Reserve Bank of Australia, March, 2014) p 66.}

\footnote{172 Ferguson, n 153; Ferguson and Masters, n 153; Ferguson A and Butler B, “Commonwealth Bank Facing Royal Commission Call After Senate Financial Planning Inquiry”, Sydney Morning Herald (26 June 2014).}

\footnote{173 Senator Mark Bishop (Chair), Senator David Bushby (Deputy Chair), Senator Sam Dastyari, Senator Louise Pratt, Senator John Williams, Senator Nick Xenophon, Senator David Fawcett and Senator Peter Whish-Wilson, Performance of the Australian Securities and Investments Commission (Economics References Committee, The Senate, Parliament of Australia, June 2014).}
In its Final Report, the Australian Financial System Inquiry has recommended that in the future Australia establish a Financial Regulator Assessment Board, the purpose of which would be to annually provide advice to the government on how financial regulators have implemented their mandates, and “provide clearer guidance to regulators in Statements of Expectation and increase the use of performance indicators for regulator performance”.\textsuperscript{174}

This proposal has precedent in the UK, which has established a Financial Policy Committee (FPC), the remit of which is to look for the roots of the next crisis.\textsuperscript{175} Its remit is to identify, monitor and take action to remove or reduce systemic risks. It has a secondary objective, which is to support the economic policy of the government.\textsuperscript{176}

**CONCLUSION**

There are many elements that underpin the effectiveness of the “Twin Peaks” system of financial regulation, under which there are separate regulators for prudential supervision and market conduct. These include a clear allocation of objectives and responsibilities between each regulator; effective coordination between the regulators; transparency and accountability on the part of each regulator; effective powers of supervision and enforcement; operational independence of each regulator (vis-à-vis the executive government); a sound governance system and adequate resources.\textsuperscript{177}

However, even with all of these criteria in place, a “Twin Peaks” regulatory system is no guarantee against financial crises or even financial distress, as was evident in the Netherlands during the GFC. Nor is “Twin Peaks” a guarantee against financial firms engaging in market misconduct or consumer abuse, as the experience with ASIC and its oversight of the Commonwealth Bank and Macquarie Bank in Australia indicate, and as evidenced in the subsequent findings of the Senate of the Australian Federal Parliament.

What “Twin Peaks” does offer is a good start, by imposing what the evidence strongly suggests is the best and most optimal regulatory architecture. From there the avoidance of financial crises and market abuse will depend upon the culture and leadership of the two peaks, and their willingness to tackle difficult questions and powerful vested interests. That in turn is in large measure dependent upon the extent to which political leaders are insulated from industry pressure, and the extent to which the government will adequately fund and resource the regulators. To paraphrase Sir Winston Churchill, “Twin Peaks” is not the beginning of the end. It is merely the end of the beginning.


\textsuperscript{175} Treanor, n 75.

\textsuperscript{176} Bank of England, Financial Policy Committee, n 110.