A A Brief History of Regulatory Capture Scholarship

The vast literature on regulatory capture has been dominated by scholars in the United States. The first detailed analyses from the twentieth century onwards warning of industry's capacity to obtain control of the regulatory process were those of Huntington[17] and Bernstein in the 1950s.[18] These accounts of agency capture showed how regulation, initially enacted in the public interest, had been subverted to serve the private interests of industry groups through a reorientation of regulatory agencies' policymaking. Bernstein posited a life-cycle theory of the agencies he studied.[19] He studied a number of commissions and concluded, in relation to commissions generally, that although embarking in youth on its task in 'aggressive, crusading spirit',[20] in maturity it lost vitality,[21] its functions becoming 'less of a policeman and more like that of a manager of an industry'.[22] The commission 'becomes more concerned with the general health of the industry and tries to prevent changes which adversely affect it' and 'the commission's standards of regulation are determined in the light of the desires of the industry affected'.[23] The result is that there 'is a desire to avoid conflicts and to enjoy good relations with the regulated groups'.[24]

Bernstein explained that by the end of the period of maturity, the agency had fully surrendered to its regulatees. Finally, in old age, passivity deepened into debility.[25] Bernstein's proposed solution to this problem was greater executive and political supervision of these agencies.[26]

Despite the absence of any express reference to the term 'capture' in his work, the notion of regulatory capture is most commonly associated with Chicagoan economist, George Stigler.[27] Building on insights of the public choice theory articulated by the Virginia School,[28] and taking aim at idealistic public interest theories of regulation,[29] Stigler's thesis asserted that, 'as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit'.[30] This explained why 'the announced goals of a policy are sometimes unrelated or perversely related to its effects and the *truly intended effects should be deduced from the actual effects*'.[31] In short, regulation could be explained in purely economic terms 'as the outcome of the forces of demand and supply'.[32] Regulation was a commodity[33] traded in the marketplace by self-interested utility-maximizers: legislators seeking votes and resources[34] on the one side, and interest groups seeking a regulatory rent on the other. 'Temporary accidents aside', well-organised, concentrated industry groups, with higher per capita stakes and lower costs of political action would always fare better in the market for regulation, than large diffuse groups, with lesser benefits and higher costs (the so called 'collective action problem').[35] This is said to explain why regulation favours industry groups over consumers, one industry over another, and larger, established firms over smaller, newer firms.[36] The implication of Stigler's theory of regulation was clear: regulation inherently[37] exacerbated market failures by 'delivering illicit regulatory favours to those who already enjoy excessive market power'.[38] Institutional reform was, therefore, not the answer.[39] The only solution was the dismantling and abandonment of regulation.[40]

Croley summarised the public choice account of regulation as based on five key premises: (1) interest groups seek regulatory decisions that advance the selfish interests of their members, regardless of the social-welfare implications of these policies (the 'interest group motivation claim'); (2) small, narrowly focussed interest groups, whose members individually have much at stake, are able to overcome the collective action problem that besets groups representing wider, more diffuse interests, giving the former a superior capacity to obtain the regulatory treatment they seek (the 'collective action claim'); (3) legislators trade favourable regulatory treatment for needed political resources from the interest groups best able to provide them (the 'legislator motivation claim'); (4) legislators have sufficient control over regulatory agencies to ensure that those agencies provide the regulatory treatment sought by the interest groups mentioned in (2) (the 'legislative dominance claim'); (5) regulatory agencies, for their own independent, self-interested reasons, and on their own initiative, provide the favoured regulatory treatment sought by interest groups (the 'agency favouritism claim').[41] In this account, premise (5), 'the 'agency favouritism claim', functions as an alternative to a combination of 'legislation motivation' and 'legislator dominance'.[42]

This theory of regulation proved remarkably influential in the United States, holding sway over much academic discourse,[43] and underpinning deregulatory initiatives such as the Council on Competitiveness introduced in the 1980s by the Reagan administration, the 1994 Contract with America, and the Reinventing Government movement of the 1990s.[44] While slow to attract attention in the United Kingdom,[45] public choice theory ultimately became a significant force there too, largely due to the efforts of the free market economics think tank, the Institute of Economic Affairs.[46] The academic community in the United Kingdom may have been reluctant to take up the theory,[47] but it was seized upon by the Thatcher Government as a justification for its program of wholesale privatisation and deregulation in the 1980s.[48] In contrast, public choice theory has received far less academic attention in Australia,[49] where its influence has been correspondingly weaker.[50]

Despite its success, the public choice theory of regulation has been subject to much academic criticism.[51] At the very least, the theory can be said to overstate the case.[52] The theory fails to account for the numerous instances of regulatory decisions which, in fact, appear to advance the broad public interest, sometimes in the face of opposition from powerful private industry groups. Its claims of regulatory capture have also been said to be unreliable, in that they proceed, all too often, from 'vast inferences' drawn from statistical correlations.[53] Furthermore, many of the theory's underlying assumptions can be criticised as implausible or unrealistic.[54] The relevant parties' motivations and preferences may, in fact, be more complex than suggested. In overemphasising self-interest, public choice theory denies the reality that politicians, bureaucrats and powerful interest groups do sometimes pursue ideological goals or act altruistically.

The Global Financial Crisis (GFC) marked a turning point for the scholarship on regulatory capture. In the United States regulatory capture was repeatedly identified as a significant cause of the GFC.[55] The regulatory capture identified in the lead up to the GFC was not the traditional Stiglerian 'entry-barrier capture', which involves the creation of *more rent-enhancing* regulation.[56] Rather, its effect was to corrode or weaken regulation, either by diminishing its capacity to serve the public interest or through the dismantling of such (public-interest serving) regulation (so called 'corrosive capture').[57] Furthermore, a new 'non-materialist' mechanism was said to be implicated, in part at least, in the capture of financial services regulation. Unlike the traditional materialist mechanisms of capture—typically incentives in the form of implicit bribes, votes, or lucrative jobs with the regulated industry—the mechanism at play here was said to be 'cultural',[58] 'cognitive',[59] 'intellectual',[60] or 'deep'[61] capture. Thus, capture need not 'imply that regulators are corrupt, or that their actions are motivated by their personal interests. By contrast, regulatory capture is most effective when regulators share the worldview and the preferences of the industry they supervise'.[62] In other words, victims of this phenomenon are captured without realising it. As regulators (politicians and bureaucrats) are prone to the same cognitive biases and irrationality as everyone else,[63] there is potential, so the argument runs, for interest groups to manipulate the regulator's perception of what, in regulatory terms, represents 'the public interest'.[64] This explains why Wall Street was able to persuade regulators that what was good for the Street—financial deregulation—was in the public interest.[65]

On the traditional Stiglerian view, the answer to regulatory capture was clear: further deregulation. Thus, capture was considered not only a cause of the GFC, but in some quarters, 'a constraint upon any realistic solutions'.[66] Ultimately, however, the post-Crisis financial regulatory reform process in the United States was a catalyst for a more constructive, and positive, focus on regulatory capture. Recent capture scholarship has increasingly focussed on identifying the conditions under which public-interested regulation can emerge and how new agencies and regulations might be designed to render them less vulnerable to regulatory capture.[67] It aims to develop a more nuanced view and understanding of capture, capable of distinguishing between 'strong'[68] and 'weak'[69] forms of capture, and to identify solutions tailored to the particular types and mechanisms of capture that might be in play.[70] In particular, these scholars observe that where the capture identified is of the corrosive variety, the solution is less likely to be deregulation than it is replacement of the regulatory framework, with one that is more effective.[71] Whereas the old public choice account of capture had been pressed into the service of deregulation, the agenda of the new capture scholarship is that of more effective (re)regulation.[72]

B Regulatory Capture in the Context of Financial Services Regulation

The financial regulation environment, in jurisdictions including the United States and Australia, exhibits several features that predispose it to regulatory capture. Firstly, as Baxter observes, despite the common perception of banks as wholly private institutions, they actually perform a number of important public functions, namely as vehicles of public finance, conveyer belts of monetary policy, and bailout agents for government.[73] In view of banks' quasi-public nature, Baxter suggests that we should be surprised and concerned if strong industry influence, particularly by the largest banks, over the regulator was not evident.[74] This quasi-public nature also explains the persistence of the too-big-to-fail phenomenon, and the appeals made to financial stability, as a reason for refusing to adequately discipline large banks or their top executives.[75] Furthermore, and quite apart from the vast resources the financial sector devotes to lobbying, the complexity and technicality of many financial transactions inevitably places the public at a severe participatory disadvantage, vis-à-vis industry, in the policy formation and rule-making process. This technicality and complexity, coupled with our understandable desire to ensure that regulators have a complete grasp of the issues and industry they are seeking to regulate, necessitates substantial input from those with deep knowledge. In rapidly evolving financial markets, such as in the United States and Australia, this generally translates, in practice, primarily to input from industry.[76]

The 'revolving door' phenomenon is also very much in evidence in the context of financial regulation. Nowhere is this truer than in the United States, where the revolving door has been described as a defining feature of the major financial regulatory institutions.[77] There are two sides to the revolving door problem: pre-regulator and post-regulator employment with regulatee firms (including their professional services providers, such as law firms).[78] The concern in the pre-regulator-industry-employment situation is that regulator-employees with strong industry backgrounds and connections will be ideologically and socially predisposed to prioritise the interests of industry. Post-regulator industry employment raises more materialist issues: regulator-employees might be tempted to curry favour with regulatees (or their law firms) by the prospect of lucrative, post-regulator industry employment, and thus provide the regulatory favours sought, whether in terms of policy-formation and rule-making or supervision and enforcement. There are also concerns that firms hiring former regulator-employees may obtain an unfair advantage through insider knowledge and privileged access to those within the regulatory agency.[79]

Finally, financial regulation is said to entail a high degree of regulator discretion, which creates obvious scope for regulatory capture.[80] Regulation also involves ongoing supervision and monitoring which necessitates a level of close, almost daily regulator-regulatee engagement—at least in the case of the largest financial institutions[81]—that has been said to give rise to a cosiness or 'intense mutual empathy' between the regulator and the regulated.[82]

Some of these factors may be more germane to the capture of prudential regulators such as APRA than a market conduct regulator such as ASIC. Under the 'twin peaks' model of financial regulation, ASIC is not exclusively focused on financial stability considerations, but must tackle issues of market integrity and consumer protection. In theory, at least, ASIC should be less swayed by the 'too big to fail' argument than a prudential regulator. However, in the Australian financial services sector it has been ASIC, rather than APRA, that has arguably been the regulator subjected to the greatest degree of regulatory capture. There is a distinct revolving door between ASIC and industry, and its professional services firms. A 2009 OECD study found that a 'key feature' of ASIC as an organisation was the high proportion of commercial lawyers at ASIC with previous employment experience with law firms servicing corporate clients, including the banking and finance industry.[83] A perusal of the biographies of ASIC's current senior executives suggests an even higher incidence of previous employment with such law firms.[84]

In recent years there have been several notable examples of ASIC's regulatory capture. In April 2017 Ben Butler of *The Australian* newspaper reported on several documents his paper had obtained from ASIC through a freedom of information request.[85] Butler asserted that the documents showed that over nearly a decade 'the corporate regulator regularly bowed to demands from big banks and financial players—NAB, CBA, Westpac, Macquarie and AMP—to water down the language used in press releases dealing with industry wrongdoing'.[86] In February 2015 Michael West of the *Sydney Morning Herald* newspaper asserted that we 'know from last year's Senate inquiry into the Australian Securities & Investments Commission that, undisclosed to the public, people from NAB's wealth management business MLC have been working at the regulator on secondment, formulating policies and laws which are in the interests of the banks'.[87] There is also the misleading evidence ASIC provided to a Senate inquiry, because it had relied upon information concerning compensation paid to customers provided by CBA's financial planning business, Commonwealth Financial Planning Limited (CFPL). ASIC revealed in its own media release on 16 May 2014 that some 'of the information ASIC put to the Senate Inquiry about the compensation process was inaccurate because it was based on its understanding of information from CFPL, in particular CFPL's submission to the Senate Inquiry'.[88] Evidence far more damning of the state of capture of ASIC has emerged before the Royal Commission on a number of occasions. Examples include:

> In relation to CBA, it might be thought that if the largest company in Australia, by market capitalisation, is negotiating with ASIC on the premise that it could seek to persuade ASIC to issue a media release rather than insisting upon an enforceable undertaking, after ASIC has provided a document outlining the contraventions that ASIC believed CBA had engaged in, that suggests the collapse of ASIC's regulatory authority.[89]

These are examples of the close relationship between ASIC and some of the banks it regulates and a willingness by ASIC to accept submissions made by banks without subjecting those submissions to their own scrutiny. ASIC's defence of itself in the Senate Committee Inquiry was based, chiefly, on two grounds: that it was underfunded and under-tooled. It pointed to a 2012 International Monetary Fund report, which highlighted the link between proactive supervision and funding and raised concerns about ASIC's lack of resources, flexibility and control over its operational budget.[90] ASIC was supported on this point by a number of other submissions which noted that increases in its funding had not kept pace with the huge expansion of its responsibilities.[91] In fact, as underlined in the final report of the

Financial System Inquiry in November 2014, its funding had been reduced in the 2014–15 budget and by whole-of-Government-efficiency-dividends since 2011,[92] resulting in job cuts at ASIC.

One of the main criticisms levelled at ASIC related, of course, to its enforcement record, in particular its apparent reluctance to take-on complex cases and investigate and take enforcement action against big businesses.[93] In instances where such action had been pursued against big businesses, there was said to be a notable over-reliance on lesser remedies, such as enforceable undertakings, rather than court action.[94] In his submission to the Inquiry, Professor Robert Baxt AO,[95] suggested that, as was the case with other Australian regulators, the mismatch between ASIC's finite resources and those of some of its large regulatees gave rise to a significant inequality of litigious power, such that ASIC might be dissuaded from bringing cases against those with deep pockets.[96] Yet in its submissions to the Inquiry, ASIC made no attempt to argue that its failure to bring adequate enforcement action against firms like CFP/CBA was a result of being underfunded or under-tooled.[97] In fact, it was quick to dismiss any suggestion that it lacked the resources to pursue big businesses, pointing to its Enforcement Special Account.[98]

That the true reason for ASIC's wholly inadequate response in the CFP scandal is the sort of deep capture described above is quite apparent from the response given by ASIC's Greg Kirk[99] to the Senate Committee's questions on the adequacy of the ASIC-approved compensation arrangements made by the CBA for affected CFP clients. The aim of those arrangements was to put affected clients in the position they would have been in had they been provided with appropriate financial advice instead of the inappropriate advice they received. One part of this was an internal review by CFP of all relevant client files, many of which were either incomplete or contained documents and signatures that had been fraudulently falsified by CFP advisers.[100] It was alleged that in the majority of cases this internal review process had resulted in the under-compensation of affected CFP clients. The evidence was that an independent review of each client file would have cost somewhere in the region of $35,000 per client. Mr Kirk was asked why ASIC had not insisted on the compensation scheme providing for such independent reviews to be *fully* funded by CFP given that the whole problem derived from CFP's own failure to maintain proper records and its advisers' fraudulent falsification of documents and signatures? As the Committee noted, the 'excessive regard' that ASIC gives to the burden enforcement action might impose on a company was quite evident in Mr Kirk's response[101] that 'doing that for 7,000 clients, at $35,000 or $40,000 would be a few hundred million dollars'.[102]

Adequate funding[103] and enforcement tools[104] are, of course, vital for the proper discharge of any regulator's duties. Nonetheless, the words of one former regulator bear repeating here:

> Even though regulators can plead that often there are insufficient legal backing or tools to take tough regulatory action, the degree of regulatory capture in any industry will depend on

the regulatory will. Those that are willing to be captured will be, despite the best rules and tools available.[105]

The culmination of these series of scandals; various inquiry reports calling into question the regulator's efficacy;[106] and the identified examples of degrees of regulatory capture,[107] was the establishment of a Royal Commission of Inquiry in late 2017.

The background to the establishment of a Royal Commission, and the implications thereof, is discussed below. Those implications, coupled with aspects of regulatory theory analysed in Part II above, then present opportunities to draw conclusions about the current performance of our regulators; and to understand the root causes of failings now identified. In doing so a more informed analysis becomes possible for the appropriateness of a 'regulator for the regulators', as discussed in Part III, below.

C The Banking Royal Commission: Background and Implications

The Federal government established a Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry[108] on 30 November 2017.[109] It had responded to threats by three back-bench government parliamentary members to cross the floor and vote in support of a Parliamentary Inquiry[110]—a potentially existential development for a government that lacked even a one seat majority in the House of Representatives at the time.[111]

We argue that the creation of the Royal Commission allows three important conclusions to be drawn. These are:

a. that misconduct in the financial sector was perceived to be so egregious, and the perceived prejudice to electors (especially those reliant on agriculture in northern Queensland) so detrimental, that three members of the government were willing to defy, and potentially bring down, their own government, so strong was the desire to tackle misconduct in the sector. Properly, these instances of misconduct should have been addressed by the market conduct and consumer protection peak—ASIC. Had ASIC discharged its obligations effectively, a Royal Commission would likely not have been needed;

b. that during the debate that took place in Australia about how to address misconduct in the financial sector, and ASIC's well-publicised failings, it became clear that the market conduct and consumer protection regulator had lost the faith of a significant number of electors. This loss of faith is reflected in a search for a solution which at no time envisaged assistance from either of the regulators, ASIC or APRA. Indeed, there were times when evaluating the role of the regulators achieved prominence in the debate surrounding potential inclusions in the Inquiry's terms of reference;[112]

c. that parliamentary oversight of regulator performance has failed, and this is supported by the findings of other inquiries which identified gaps in accountability of, and performance by, Australia's financial services regulators.[113]

Critical assessments of the performance of our financial regulators has not been limited to those issues that gave rise to the establishment of a Royal Commission, and nor have they been limited to ASIC. More recently, in what has been described as 'a withering assessment of the state of competition in financial services',[114] the Productivity Commission Report of January 2018[115] concluded that competition in the Australian banking sector is weak (and prices unnecessarily high) and laid much of the blame on the prudential regulator, APRA.[116] According to the Commission, in an effort to curb a housing bubble in Australia APRA imposed restrictions on investor lending, only to deliver a $1 billion a year windfall to bank profits.[117] That Report specifically addresses gaps in our regulatory architecture, principally regarding competition. It too makes reference to the identified need for a board of oversight over the regulators.[118]

In a further implied rebuke to ASIC's and APRA's reputation, the Australian Competition and Consumer Commission (ACCC) has commenced two inquiries into competition in the Australian banking system. The first inquiry looks into manipulation of mortgage-market interest rates[119] by the big four banks. The second looks into the implications for competition presented by the manipulation of Australia's benchmark interest rate (BBSW), by the big four banks (two of the four, the National Australia Bank and the Australia New Zealand Banking Group, have admitted guilt and between them agreed to pay $100 million in fines.[120] CBA pleaded guilty and was fined $25 million.[121] Westpac chose to defend the charges in court, and was found not guilty of rigging rates, but guilty of attempting to rig rates, and as such that it behaved unconscionably[122]). It is of note that s 12 of the Commonwealth Criminal Code[123] provides ASIC with the jurisdiction to pursue charges of corporate criminal liability, while s 12(3) provides grounds upon which ASIC may pursue such charges and includes liability for misconduct attributable to poor 'corporate culture'.[124] There are no judicial precedents defining s 12(3) because there has been no litigation based upon it to date.[125] This may be attributable to the difficulty in proving a link between poor corporate culture, or indeed even a definition thereof, and then the ensuing misconduct. However, APRA conducted a review of Commonwealth Bank's culture, and found systemic deficiencies,[126] some of which were already known to the bank.[127] Moreover, this review was called as a direct result of revelations that CBA had breached anti-money laundering and counter-terrorism financing laws in excess of fifty-three thousand times.[128] Nonetheless, to date ASIC has launched no proceedings based upon s 12 of the Criminal Code.

The ACCC's reports would have made uncomfortable reading at APRA. The first inquiry's interim findings regarding competition in the mortgage market found that one of the most significant constraints on market abuse among banks is not regulator prosecution, but rather public condemnation. In the same report the Commission found that APRA's management of prudential standards allowed Australia’s big four banks to generate substantial profits, and that those banks in turn supported these policies, precisely because they predicted they would gain ‘substantial economic benefit[s]’.[129] That closeness between APRA and the regulatees is underscored by the fact that ‘six of the nine executives running the Australian Prudential Regulation Authority are former senior banking executives’.[130]

The second ACCC inquiry relates to BBSW manipulation;[131] a scandal that has done as much damage to ASIC’s reputation as it has to the banks involved.[132] The intercession of the ACCC into an area currently enlivened by litigation, and one that is primarily the jurisdiction of one of the two peaks—ASIC—is unusual, to say the least. Adverse findings by the ACCC from this or from the mortgage market investigation will not cast a positive light on the ACCC’s peers. Its mere involvement in BBSW prosecutions, it has been suggested by some, is evidence of frustration within the ACCC at ASIC’s dithering. In certain instances of alleged rate manipulation ASIC’s delays resulted in claims and evidence proscribing.[133] As one commentator described ASIC’s tardiness in prosecuting alleged rate-rigging, relative to its international peers: ‘[ASIC] is the last regulator in the world to take action [about alleged rate-rigging] since the Libor scandal broke in 2012’.[134]

At a broader level, the Productivity Commission report asserts that APRA’s priorities are predominantly concerned with protecting banks, regardless of whether that may prejudice consumers.[135] This comports with what some argue is a deeper malaise at the prudential regulator: a goal-induced myopia that may be described as ideational and ideological and operates at less technical and more philosophical levels. Specifically, that APRA adheres to the view that *what’s good for financial stability is good for Australia.*[136] But phrasing that hypothesis differently, yet equally accurately, and with the benefit of the latest government inquiries, we see that the slogan could equally be: *what’s good for the big four banks [is higher profits which delivers higher capital levels. That improves their resilience which is good for stability. That in turn] is good for Australia.* That can easily become truncated to: *the more profitable the big four banks, the better for Australia*—and that is almost certainly untrue.

The misgivings expressed by the Productivity Commission on APRA’s use of macro-prudential tools related to matters that had been prominently in the public domain for at least a year, prior to the Productivity Commission’s Interim Report.[137]

We argue that the establishment of the Royal Commission is a symptom of this malaise, and while the Royal Commission will likely prove effective in discharging its mandate, it does not, at least in its terms of reference, focus on regulatory efficacy, specifically weak enforcement, hesitancy to prosecute[138] and evidence of industry capture of the regulators. The higher risks of capture which financial regulators face, and the need for a strong and on-going remedy addressing failures in the efficacy of our regulators, and the need for a regulator for the regulators becomes all the more urgent. If we take an ad hoc approach to monitoring regulators, as has been the approach to date with annual parliamentary reviews, these forms of misconduct may be expected to re-occur.

In Part III, below, a key recommendation of the 2014 FSI: to establish an Assessment Board to monitor the performance of financial services regulators is examined. In the Australian context an Assessment Board, as proposed by the FSI, would function as a key mechanism to minimise the risk of regulatory capture and evaluate the performance of our two peaks against their mandates. It is crucial, therefore, that subject matter experts on fixed-term appointments, and at arms-length from the regulators and the regulatees, conduct oversight in order to provide on-going advice to government and the public on how to improve the efficacy of our regulators.

III A Regulator for the Regulators

In order to provide a more comprehensive analysis of a proposed Financial Regulator Assessment Board, an inquiry into its progenitors is warranted. To that end, and in response to the problem of regulatory capture and concomitant weak, inadequate, ill-informed, and potentially equally captured political oversight, several proposals have been put forward for the creation of a mechanism for the review of financial regulators, that is, a regulator for the regulators.

The most developed proposal is that of Barth, Caprio and Levine, put forward in response to regulators' failures, primarily in the United States, prior to the GFC, namely: an expert panel of oversight, called a 'Sentinel'.[139] They recommended the creation of an institution that would, acting on the public's behalf, provide informed, expert, and independent assessment of financial regulation. Their proposal envisaged (i) an authoritative institution, independent of short-term politics and independent of the financial services industry; (ii) with the power to demand and obtain information necessary for assessing and monitoring the 'Guardians of Finance' (the regulators); (iii) with the multidisciplinary expertise necessary to process that information; (iv) with the prominence to deliver such assessments to the public and its elected representatives; and (v) in an on-going manner capable of affecting the open discussion of financial regulatory policies. They argue that each of these characteristics 'is necessary for improving the still seriously flawed financial regulatory institutions operating around the world today'.[140] Such an institution would fill a gap that the authors assert exists world-wide. They argue that the 'absence of an institution with these five traits means that the public cannot effectively evaluate financial regulation and, therefore, cannot constantly oblige the Guardians to act in the public interest'.[141] In Levine's view the 'Sentinel would improve the entire apparatus for writing, enacting, adapting and implementing financial regulations.…reduce the ability…to obfuscate regulatory actions…make regulators more accountable for the societal repercussions of their actions. …[and] reduce the probability and costliness of regulatory mistakes and supervisory failures'.[142] In addition 'the Sentinel's reports to legislators would help reduce the influence of special interests'[143] and 'help inform…and…augment public influence over financial regulation'.[144]

Levine (writing alone) argues that the Sentinel would 'be both politically independent and independent of financial markets' and that senior members 'would be appointed for staggered terms to limit political influence'.[145] To shield it from market influences, 'senior staff would be prohibited from receiving compensation from the financial sector after completing public services for a timely period'.[146] The objective 'is to create an institution in which the personal motives, ambitions, and prestige of its employees are inextricably connected to accurately assessing the impact of financial regulations on the public'.[147]

This proposal for a Sentinel runs contrary to the prevailing post-GFC narrative, which proceeds thus: because the GFC was caused by poor market conduct and consumer abuse (in the US subprime lending market), the solution would be to enhance the regulator's market conduct and consumer protection powers.[148] But this begs the question: was it a lack of power and authority, or was it regulatory capture and a lack of enforcement that caused the regulatory failures that led to the sub-prime mortgage disaster and, in turn, metastasised into the GFC?[149] In the case of the GFC, Barth et al argue that it was regulatory capture and that, 'in the wake of the crisis, we now seem to be lurching from one simplistic, unqualified ideology—that private markets will look after society's interests—to an equally flawed, if not more perilous, ideology—that the Guardians will always act in society's interests, so let's give them more power to do so'.[150] They go on to say that successful and lasting reform 'requires addressing a core cause of the systemic malfunctioning of financial systems—poor governance of the Guardians of Finance'.[151] Levine (writing alone) notes that 'financial institutions pay virtually unlimited sums to shape financial policies, regulations and supervisory practices to serve their private interests' and that 'narrow political constituencies work tirelessly on tilting the financial rules of the game so as to collect a greater share of the economy's resources'.[152]

It is against this background that the recommendation of Australia's FSI for the creation of an Assessment Board to oversee the regulators should be examined. Because regulation of the financial system is essential, particularly for the maintenance of confidence in the system, it follows that it is crucial that a mechanism be constructed to ensure that the regulators are effective in discharging their statutory goals and tasks.

A A Regulator for the Australian Financial Regulators

1 Recommendation 27 of the Financial System Inquiry

Currently in Australia accountability mechanisms exist but have proved to be imperfect. APRA, the financial system stability regulator, has a high degree of statutory independence,[153] but is to a degree answerable to the Treasurer.[154] In addition, both APRA[155] and ASIC[156] are accountable to Federal Parliament by way of submission of Annual Reports, and by way of testimony before Parliamentary committees.[157] Nonetheless, the establishment of a Royal Commission into misconduct in the financial services industry[158] would suggest that Parliament and its committees have failed to ensure an adequate level of performance by APRA[159] or ASIC[160] in the pursuit of their mandates.[161]

This was borne out in the Commonwealth government-constituted FSI in its final report which, at recommendation 27,[162] proposed that the Federal government create a new Financial Regulator Assessment Board (the Assessment Board), to provide annual reports on the performance of both APRA and ASIC, and the payment-system-regulation function of the Reserve Bank of Australia (RBA).[163] The proposed Assessment Board would assess regulators against their mandates and priorities, listed in their Statements of Intent (SOIs).[164] The purpose of such an Assessment Board would be to improve the regulator accountability framework.[165] Specifically aimed at addressing ASIC's poor performance, and strengthening its performance in the future, the FSI asserted that establishing an Assessment Board would 'help to ensure ASIC has the appropriate skills and culture to adopt a flexible risk-based approach to its future role. Its overall performance would also be subject to annual review by the [Assessment Board]'.[166]

The FSI recommended that an Assessment Board evaluate how effective the regulators had been in discharging their mandates, allocating resources, responding to challenges, or balancing competing objectives, such as 'promoting competition and efficiency, maximising business certainty and minimising compliance costs'.[167] At times these goals can be contradictory, for which the Inquiry provided the following example: lowering barriers to market entry may strengthen competition, and thereby benefit consumers. However, that same policy may also increase risks for end-users through, for example, the introduction of smaller firms with lower capital buffers. The corollary, in respect of higher barriers to entry, would also be true.[168] Moreover, the FSI envisaged that these reviews would be broader than those conducted under the Regulator Performance Framework,[169] which was part of a 2014 Federal government commitment to reducing the costs of unnecessary or inefficient regulations imposed on individuals, businesses, and community organisations. The FSI report argued that an Assessment Board would have the capacity to provide guidance to regulators which, while possessed of clear mandates, do not always enjoy guidance.[170]

The FSI report envisaged therefore that the government would receive annual, independent advice on regulator performance,[171] and that the reports would be made public.[172] To this end, the FSI concluded that it was the lack of regularity of assessment of the regulators that made it difficult for government to judge their overall performance. While the FSI noted that Parliament reviewed regulators' annual reports, parliamentary scrutiny was ad hoc and focused on particular issues or decisions. This, the FSI concluded, made effective monitoring of the regulators difficult, especially considering the complexity of the regulator's mandates. Furthermore, Parliament's review of regulators' annual reports was not supported through regular, independent input into the assessment process.[173]

The FSI proposal did not call for the Assessment Board to be constituted as a separate agency, but it did propose a separate secretariat be provided by Treasury. This would keep the Assessment Board's secretariat at arm's length from the remainder of Treasury, which is important considering Treasury's policy role as a member of the Council of Financial Regulators.[174]

Moreover, it was not intended that the Assessment Board would direct the regulators. Its role would be to submit reports to Government on how the regulators had used their powers and discretions.[175] It was proposed that the Assessment Board would replace the Financial Sector Advisory Council (FSAC). The Board would be comprised of between five and seven part-time members with industry and regulatory expertise, but to the exclusion of current employees of regulated entities.[176] The Inquiry was of the view that the Assessment Board would be able to avoid undue influence through diversity, and/or a code of conduct.[177] Overall, this would strengthen the accountability framework to which Australia's financial sector regulators would be subject.[178]

To that end, the FSI's proposal mirrors the internal checks and balances envisaged by Levine:[179] independent of industry and politics; with appointments for staggered terms to limit political influence. Only prohibitions on opportunities for gain post-regulator employment (the 'revolving door') were absent in the FSI proposal. 'The goal is to create an institution in which the personal motives, ambitions, and prestige of its employees are inextricably connected to accurately assessing the impact of financial regulations on the public'.[180]

Among the risks identified by the FSI was the possibility that the Assessment Board could become another layer of accountability that added costs without adding value, and that it could attempt to interfere in the work of the regulators or undermine the Treasury's relationship with the other members of the Council of Financial Regulators (CFR).[181] However, the Inquiry asserted that: by ensuring diversity of membership, by limiting the Board's mandate to overall *ex post* assessments, by ensuring that assessments were based upon existing outputs, and by suggesting support from a separate secretariat within Treasury, these risks would be mitigated.[182] Moreover, the Inquiry recommended clear limitations on the ambit of the Assessment Board's powers. Specifically, the Assessment Board would not, under the FSI proposal, have jurisdiction over the merits of relief for particular transactions, enforcement actions or individual complaints against the regulators, nor would it have authority to enquire into matters of financial system regulatory policy, such as the appropriateness of regulators' mandates.[183]

In recommending the establishment of the Assessment Board, an Inspector-General model was rejected by the FSI, as it would have involved the creation of a new agency.[184] Moreover, one of the advantages of an Assessment Board over that of an Inspector-General was that, in the case of the latter, much reliance would be placed on one person, whereas an Assessment Board would include expertise across regulators. Finally, the FSI asserted that the modes of inquiry that an Inspector-General would typically perform would be better suited to detailed assessments of administrative processes, whereas an Assessment Board would be more inclined towards modes of inquiry better suited to overall reviews of performance.[185]

The Inquiry also rejected a suggestion that the CFR be formally constituted as an oversight body, on the grounds that such a proposal would fundamentally change the regulatory system, weaken accountability, and interfere with the CFR's ability to facilitate cooperation between the regulators.[186]

In relation to the option of placing APRA and ASIC under the control of boards (as was presented as an option by the Senate Economics References Committee[187]), and likewise for the ACCC (as suggested by the Draft Report of the Competition Policy Review[188]), this too was rejected by the Inquiry. The Inquiry relied upon the findings of the HIH Royal Commission,[189] which had recommended that the board of APRA be dismantled. The FSI concluded that 'creating a new Assessment Board to review regulator performance is the best way to address the gap it has identified in the current accountability framework' and that such an Assessment Board 'would facilitate improved scrutiny of regulator performance without creating new agencies or compromising existing accountability…not intended to reduce the independence of regulators in executing their statutory mandates'.[190]

The recommendation of the FSI to create an Assessment Board has, therefore, significant merit. In the following section a more detailed examination of the benefits of the FSI's recommendation is undertaken.

2 Advantages of an Assessment Board for the Australian Financial Services Sector

The FSI's recommendation for the establishment of an Assessment Board[191] would be a new development in the Australian regulatory landscape and, even though it was the FSI's only recommendation that was rejected outright by the Australian government,[192] it is a proposal that nonetheless deserves further investigation. That is particularly so considering the impetus for the Royal Commission, and the resulting implications that arise about the efficacy to date of Australia's financial regulators. It is a proposal even more deserving of attention in light of the evidence and testimony that has emerged before the Commission itself.[193]

This is, however, a proposal for which there is scant domestic or international precedent, and a relative scarcity of academic literature. Currently the only other examples of such boards of oversight are the Inspector General of Taxation in Australia, and the Financial Policy Committee[194] in the United Kingdom. The latter body was established by legislation promulgated in April 2013,[195] and has binding authority over the agencies over which it has oversight. Its purpose is to look for the next 'bombshell' that may hit the financial system by identifying, monitoring, and acting to reduce systemic risks.[196]

The benefits to Australia of the establishment of an Assessment Board are clear, and would include enhanced accountability, improvements in the regulator's culture, and enhanced capacity to prevent financial crises. In respect of accountability, this would be crucial, and would, thanks to the peculiarities of financial regulation, speak to the core of the democratic and parliamentary endeavour. As Levine puts it in respect of a very similar proposal—that of a Sentinel—it would shine a disinfecting light on to the financial system and improve regulator efficacy. He states further that:

> no existing entity has the prominence, information and expertise to challenge major regulatory agencies on financial policy matters. A monopoly on regulatory power and information is dangerous…particularly…when it is housed in…[an]…entity that is… independent of the public and elected representatives. A monopoly on financial information, regulatory expertise, and regulatory power in [unaccountable] hands…breaks the democratic lines of influence running from the public to the design and execution of policies that determine the allocation of capital.[197]

In agreement with Levine, we argue that accountability is indispensable for governmental efficacy, which includes regulator efficacy.[198]

Similarly, regulator accountability is important, not only to check abuse of power, but also to expose the under-use of power, such as typically occurs in instances of regulatory capture.[199]

It is submitted that the case studies suggest that the approach of neither APRA nor ASIC to regulation of superannuation entities is sufficient to achieve specific or general deterrence. The evidence suggests that APRA is reluctant to commence court proceeding and to take public enforcement action.[200]

This has been evident in ASIC’s failure to ensure good market conduct by market participants, and a trustworthy and fair market for consumers.[201] So too with APRA, and the findings by the Productivity Commission of the extent to which APRA has inhibited competition, favoured the big four banks,[202] and facilitated their increased dominances[203] to the point where they have become an oligopoly.[204] It has also failed to discipline banks for failures to adhere to bank soundness regulations.[205] This outcome may be attributed to Parliamentary oversight that has been ad hoc, while support for the regulators has been precarious and partisan.[206] As Pagliari has observed, the ‘oversight of parliaments may be affected by short-term electoral incentives’ and the ‘composition of the boards of regulatory agencies may skew their actions’.[207] He notes that the ‘limited transparency which often characterize financial regulatory policymaking, combined with the often limited resources public interest groups have at their disposal, may limit such groups’ capacity to scrutinize the operation of regulatory institutions’.[208]

Consequently, the current accountability framework—Parliament and its committees—would benefit from the creation of a Board, by being informed by independent and impartial reports, prepared by experts, into the state of regulation in the financial sector. Such a Board should, according to Barth et al, have an unfettered power to gain access to any information it deemed necessary for evaluating the state of financial regulation, including the power to compel information from regulated entities.[209]

Against this APRA, in what may be argued was a self-serving submission to the Financial System Inquiry, asserted that there was a difficulty in ‘demonstrating causality or an explicit link between the prudential regime or supervisory actions and the outcomes for individual financial institutions or the financial system as a whole’.[210] They argued further that the secrecy provisions of the *Banking Act* precludes 'offering public commentary on its day-to-day activities',[211] and that 'performance assessment of a prudential regulator does not lend itself to straightforward cost-benefit analysis'.[212] With the benefit of hindsight we see the poverty of these arguments in practice: the Productivity Commission Report has made explicit the failures of the regulator when assessed against individual financial institutions or the financial system as a whole,[213] while the Royal Commission has uncovered the extent to which our regulators have performed poorly.[214]

In the process of holding the regulators accountable, the Board would be expected to inquire into the appropriateness of the methodologies employed by ASIC and APRA,[215] question conclusions reached, and challenge regulators' prevailing orthodoxies. Because financial crises[216] are unpredictable,[217] and therefore difficult to foresee, such an expert panel of review would assist ASIC and APRA to *foresee the unforeseeable*—what Ford terms '[see] around corners'.[218] An Assessment Board could identify less obvious but more insidious forms of subornation, such as ideological capture, and the phenomenon of 'groupthink', which describes a tendency towards conformity in a group environment. McConnell explains that groupthink 'is unhealthy because, not only do people start to think alike, it is only a short step to believing people who are singing a different tune should be excluded and thrown out of the chorus'.[219] He argues that an Assessment Board would be well placed to avoid groupthink and, importantly, avoid being influenced by industry participants.[220]

In this way accountability and an open-minded culture become mutually self-reinforcing. As Llewellyn points out, corporate culture affects the extent to which a regulator holds itself accountable, how it exercises its discretion (which affects its efficacy, credibility, authority, and public standing), the degree of public trust and esteem the regulator enjoys, its resilience to regulatory capture and undue political influence, the appropriateness with which the regulator has used its own, considerable resources, and its international credibility.[221]

In addition, the Assessment Board would analyse the inter-connectedness of systemically important institutions, their role in the payments system, and the role of depositor protection that may not ordinarily enjoy the attention of the regulators.

If the regulator's role includes the prevention of financial crises, then any improvements to regulator efficacy that may flow from the establishment of a board of oversight would include enhancing Australia's capacity to prevent endogenous financial crises, or avoid the contagion of exogenous crises. As Miller and Rosenfeld have argued:

> [a] truly independent board, composed largely of people from outside the government, selected according to some principle of merit rather than political connections, and adequately funded and protected against retaliation for expressing unpopular views, would offer a potentially more efficacious approach to the problem of impartially and objectively

identifying systemic threats to the financial system and proposing possible remedies or solutions.[222]

Finally, there is one further and important benefit to be accrued from a Board of Assessment: corrective action taken by regulators in response to Board findings on their efficacy may serve to disrupt the otherwise predictable life-cycle of regulatory agencies, alluded to above.[223] McCraw's view is that agencies begin with 'determination and youthful exuberance [but] pass inexorably into middle-age and finally senescence'.[224] McCraw comments further that the same phenomenon is observed among the men and women who work for an agency; typically they lose interest in the reform premise upon which the agency was formed, thanks to stultifying routines underscored by a large case load of trivial matters. Whereafter some become friendly with the management of the regulated firms, and 'end up, even the best of them, far different in outlook from the idealists who entered institutional service while they were young'.[225] Oversight from highly-experienced individuals, appointed for a fixed-term, and independent, would be able to provide recursive reviews that would continually measure regulators against their mandates, and in so doing, provide a more fixed benchmark against which to make that measurement.

Accordingly, the introduction of an Assessment Board in Australia would serve as a timely and highly effective adjunct to the current Australian Twin Peaks financial regulatory architecture.

IV Conclusion

Effective consumer financial protection, and more broadly, the protection of the financial system, is an important role for government. Recent history, especially the GFC, has highlighted the complexity of financial products and the systemic risk to the financial system arising from inappropriate conduct of market participants.[226] This is especially so in circumstances where there have been failures of regulators to undertake their roles independently and with close scrutiny of the market participants that they are entrusted to regulate.

Although the GFC originated in the United States, its effects were felt worldwide, including in Australia. In addition, Australia has had its own financial sector concerns, primarily arising from the conduct of Australia's major banks. The issues that have arisen in both countries have highlighted a failure of the regulators. But providing the regulators with additional powers and resources is not the solution. Instead, the solution is more effective oversight of the key regulators in the Australian financial system. The recommendation of the FSI that there be an Assessment Board to provide continuous oversight of the financial regulators is an effective solution to the poor regulatory outcomes experienced in Australia in recent years. Parliament will be able to look to the Assessment Board to provide independent analysis of the regulators, ensure that those regulators are fulfilling their statutory duties, and have not been captured by industry—a phenomenon that is particularly prevalent and difficult to combat in respect of regulators charged with regulating the financial industry.

The consequence of not having such oversight is likely to be more financial scandals and further instability in the financial system.

Footnotes

1 'Consumer' here encompasses the functionally similar concepts of the consumer (used in the consumer credit context in the *National Consumer Credit Protection Act 2009* (Cth) ('NCCPA')—see NCCPA, s 5) and the 'retail client' (used in the financial services regulation context—see *Corporations Act 2001* (Cth) s 761G ('CA')).

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2 ASIC was originally established in 1991 as the Australian Securities Commission ('ASC'). Its remit was originally the administration and enforcement of the corporations legislation. The ASC was renamed ASIC on 1 July 1998, when its remit was extended to the protection of consumers in the financial sector. This remit was further expanded in July 2010, when it became the regulator of the new national regime for consumer credit regulation under the NCCPA.

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3 For detailed discussion, including a chronology of events, see Senate Economics References Committee, Parliament of Australia, *Performance of the Australian Securities and Investments Commission* (2014) ch 8 ('*ASIC Inquiry*').

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4 Also referred to as the bank bill swap reference rate ('BBSW').

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5 In 2016, ASIC finally brought proceedings against the Australian and New Zealand Bank, National Australia Bank and Westpac in relation to unconscionable conduct and market manipulation alleged to have occurred between 2010 and 2012.

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6 On the Commonwealth Bank (CommInsure) life insurance scandal, see http://www.smh.com.au/interactive/2016/comminsure-exposed/heart-attack/;

http://www.smh.com.au/interactive/2016/comminsure-exposed/mental-health/?%20prev=1; http://www.smh.com.au/interactive/2016/comminsure-exposed/terminal-illness/?%20prev=2.

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7 The financial planning arm of the Commonwealth Bank.

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8 After media reports of widespread misconduct of financial advisors at CFPL in 2012 and 2013, the Senate Economics Legislation Committee questioned ASIC in June 2013. ASIC's failure to provide satisfactory answers caused the Senate, on 20 June 2013, to refer ASIC's performance to the Economic References Committee for inquiry and report by 31 March 2014. Misconduct amongst financial advisers at Macquarie Private Wealth that came to light in 2013 was also considered by the Committee.

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9 *ASIC Inquiry,* above n 3. Although spectacular, the CFPL scandal was a far from isolated instance of ASIC allegedly failing to take timely, effective action. In a 2009 inquiry, the Joint Parliamentary Committee on Corporations and Financial Services highlighted the delay in ASIC's investigations into Storm Financial's collapse, noting that a more proactive regulator might have identified the problems with Storm's practices earlier, thereby limiting the losses ultimately suffered by investors: Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Financial Products and Services in Australia* (2009) 43–4 [3.99], 49 [3.122] ('*Inquiry into Financial Products and Services*'). A class action, alleging negligence and misfeasance in public office brought by Storm investors against ASIC in 2014 was ultimately struck out by the Federal Court in 2016: *Lock v Australian Securities and Investments Commission* (2016) 248 FCR 547.

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10 *ASIC Inquiry*, above n 3, xviii.

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11 Ibid xvii.

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12 Ibid 455 [28.10].

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13 Ibid 278 [17.47].

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14 Commonwealth, Financial System Inquiry, *Final Report* (2014) (‘*Financial System Inquiry*’).

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15 Michael E Levine, ‘Regulatory Capture’ in Peter Newman (ed), *The New Palgrave Dictionary of Economics and the Law* (Palgrave McMillan, 1998) 267, 267. ‘Regulatory capture’ is often used more narrowly. See, eg, Richard Posner, ‘The Concept of Regulatory Capture: A Short, Inglorious History’ in Daniel Carpenter and David A Moss (eds), *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (Cambridge University Press, 2014) 49, 49: ‘The term regulatory capture, as I use it, refers to the subversion of regulatory agencies by the firms they regulate. This is to be distinguished from regulation that is intended by the legislative body that enacts it to serve the private interests of the regulated firms, for example by shielding them from new entry. Capture implies conflict, and regulatory capture implies that the regulated firms have, as it were, made war on the regulatory agency and won the war, turning the agency into their vassal’.

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16 See Daniel Carpenter, ‘Detecting and Measuring Capture’ in Daniel Carpenter and David A Moss (eds), *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (Cambridge University Press, 2014) 57, 59–60. Agency capture may be present in conjunction with legislative capture (often, it is claimed, as a result of the legislature’s ability to control the regulatory agency), or it may appear in isolation.

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17 Samuel P Huntington, ‘The Marasmus of the ICC: The Commission, the Railroads, and the Public Interest’ (1952) 61 *Yale Law Journal* 467.

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18 Marver H Bernstein, *Regulating Business by Independent Commission* (Greenwood Press, 1955).

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19 Huntington’s focus had been the Interstate Commerce Commission. Bernstein’s study also included the Federal Trade Commission, Federal Power Commission, Civil Aeronautics Board, Federal Communications Commission, National Labor Relations Board and the Securities and Exchange Commission.

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20 Bernstein, above n 18, 80.

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21 Ibid 88.

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22 Ibid 87.

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23 Ibid.

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24 Ibid 88.

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25 Ibid 91–5.

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26 Ibid 293.

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27 See George J Stigler, ‘The Theory of Economic Regulation’ (1971) 2 *Bell Journal of Economics and Management Science* 3.

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28 The novelty of public choice theory lay in the application of economic analysis (hitherto used to explain only the operation of private markets) to political decision-making. The theory posits that, as rational wealth-maximisers, ‘public choosers’—politicians, voters and bureaucrats—are motivated by the same self-interest as actors in private markets. See James M Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (University of Michigan Press, 1962); Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press, 1965). There is debate as to whether Olson should be considered a member of the Virginia School. Some consider Olson’s approach sufficiently distinct to merit the label ‘Maryland School’: see Jac C Heckelman and Dennis Coates, ‘On the Shoulders of a Giant: The Legacy of Mancur Olson’ in Jac C Heckelman and Dennis Coates (eds), *Collective Choice: Essays in Honor of Mancur Olson* (Springer, 2003) 1, 6–8. Although Stigler’s economic theory of regulation incorporated many of the insights of these public choice theorists, it made no express reference to their work.

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29 Arthur Pigou is generally considered the founder of public interest theories: see Arthur Pigou, *The Economics of Welfare* (Macmillan, 1920).

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30 Stigler, above n 27, 3.

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31 George J Stigler, ‘Old and New Theories of Regulation’ in George J Stigler (ed), *The Citizen and the State: Economic Regulation* (University of Chicago Press, 1975) 137–140.

State: Essays on Regulation (University of Chicago Press, 1975) 137, 140.

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32 Richard A Posner, 'Theories of Economic Regulation' (1974) 5 *Bell Journal of Economics and Management Science* 335, 344.

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33 According to Stigler, 'The Theory of Economic Regulation' above n 27, the four regulatory products for sale were subsidies, control over entry to a market by new rivals, the regulation of product substitutes and complements, and price-fixing.

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34 Typically money, for example in the form of campaign contributions, which could purchase votes indirectly.

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35 Stigler, 'Old and New Theories of Regulation', above n 31, 140.

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36 See, eg, Ann Bartel and Lacy Glenn Thomas, 'Predation through Regulation' (1987) 30 *Journal of Law and Economics* 239; Lacy Glenn Thomas, 'Regulation and Firm Size: FDA Impacts on Innovation' (1990) 21 *RAND Journal of Economics* 497; W Kip Viscusi, *Fatal Tradeoffs* (Oxford University Press, 1992) 177.

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37 Stigler, 'The Theory of Economic Regulation', above n 27, 17, observing that to criticise the Interstate Commerce Commission ('ICC') for its pro-railroad policies was 'exactly as appropriate as a criticism of the Great Atlantic and Pacific Tea Company for selling groceries, or as a criticism of a politician for currying favour'.

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38 Steven P Croley, *Regulation and Public Interests: The Possibility of Good Regulatory Government* (Princeton University Press, 2007) 19–20.

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39 For elaboration on this point, see Posner, above n 32, 337–9.

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40 For subsequent contributions of the Chicago School, see Sam Peltzman, 'Toward a More General Theory of Regulation' (1976) 19 *Journal of Law and Economics* 211; Sam Peltzman, 'The Economic Theory of Regulation after a Decade of Deregulation' [1989] *Brookings Papers in Macroeconomics* 1; Gary Becker. 'A Theory of Competition among Pressure Groups for Political Influence' (1983) 98 *Quarterly Journal of Economics* 371. Jessica Light, 'Public Choice: A Critical Reassessment' in Edward Balleisen and David Moss (eds), *Government and Markets: Toward a New Theory of Regulation* (Cambridge University Press, 2010) 213. On the differences between the Chicago and Virginia strands of public choice theory, see: Neil Gunningham, 'Public Choice: The Economic Analysis of Public Law' (1992) 21 *Federal Law Review* 117, 120–31; William C Mitchell, 'The Old and New Public Choice: Chicago versus Virginia' in William F Shughart II and Laura Razzolini (eds), *The Elgar Companion to Public Choice* (Edward Elgar, 2001).

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41 See, eg, George W Hilton, 'The Basic Behavior of Regulatory Commissions' (1972) 62 *The American Economic Review* 47, 48 for an early revolving-door argument: 'Since employment in the regulated industry is one of the most obvious opportunities after a regulator's term in office, alienating members of the regulated industry may prove very costly to a member of a commission'. This is the incentive most commonly discussed in relation to agency capture. However, it has also been claimed that fears of potential reputational and career damage from firms making complaints or spreading negative rumours about the employee-regulator's competence, might induce them to keep firms happy. For an overview of these claims, see Ernesto dal Bó, 'Regulatory Capture: A Review' (2006) 22 *Oxford Review of Economic Policy* 203, 212.

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42 Croley, above n 38, 27.

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43 See Light, above n 40, describing the public choice theory of regulation as the dominant view.

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44 In this respect, the public choice theory was a victim of its own success. As Kahn has observed, 'After all, why should the logic of deregulation differ from the logic which explains regulation? Why, then, do deregulatory movements succeed, if special interest groups oppose them? Either the successes of the deregulatory movement indicate that some public-regarding political outcomes succeed for reasons not explained by the model, or that the political environment must have changed so that *deregulation* now serves the same private interests which once sought regulation. And if this is so, self-serving behavior on occasion coincides with the public interest. The success of the deregulatory movement demonstrates the limits of the model in prescribing policy': Peter L Kahn, 'The Politics of Unregulation: Public Choice and Limits on Government' (1990) 75 *Cornell Law Review* 280, 286–7.

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45 See James M Buchanan's comments on the neglect of public choice theory in the United Kingdom in 'From Private Preferences to Public Philosophy: The Development of Public Choice' in James M Buchanan et al (eds), *The Economics of Politics* (Institute of Economic Affairs, 1978) 1, 4. On the reception of public choice theory in the UK, see Noel Thompson, 'Hollowing Out the State: Public Choice Theory and the Critique of Keynesian Social Democracy' (2008) 22 *Contemporary British History* 355, 369–74.

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46 From the late 1970s onwards, the Institute commissioned basic introductions to public choice theory for UK readers from leading American scholars, often with additional commentary explaining the theory's relevance in the UK context. Examples include Gordon Tullock, 'The Vote Motive' (Hobart Paperback no 9, Institute of Economic Affairs, 1976), with a British commentary by Morris Perlman; H Geoffrey Brennan and James M Buchanan, 'Monopoly in Money and Inflation' (Hobart Paper no 8, Institute of Economic Affairs, 1981); William C Mitchell, 'Government As It Is' (Hobart Paper no 109, Institute of Economic Affairs, 1988) with a Commentary on the British Scene by David G Green.

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47 See the warning of McAuslan in 1988 that: 'Public choice is influencing public policy, both in substance and…design. The intellectual community is in danger of being left behind; dismissive of public choice a few years back, it now runs the risk of being dismissed by public choicists—perhaps even literally—as having little to offer either public debate or policies on the future direction and shape

of the British polity': Patrick McAuslan, 'Public Law and Public Choice' (1988) 51 *Modern Law Review* 681, 684. A notable exception was Patrick Dunleavy, 'Explaining the Privatisation Boom: Public Choice Versus Radical Approaches' (1986) 64 *Public Administration* 13.

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48 See Thompson, above n 45, 371, noting echoes of public choice theory in Thatcher's speeches, references to public choice literature in the bibliographies accompanying edited editions of her speeches, and suggesting that it was through her closest advisor, Keith Joseph, that she acquired an awareness of public choice literature.

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49 For a rare early account of public choice theory in the Australian literature, see Gunningham above n 40.

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50 See, eg, Jonathan Pincus, 'Public Choice Theory had Negligible Effect on Australian Microeconomic Policy, 1970s to 2000s' (2014) 59 *History of Economics Review* 82, arguing that public choice theory played a negligible role, at most, in the pro-competitive shift that occurred from the mid-1960s onwards in Australia.

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51 For a recent critical account, see Light, above n 40, 230–8.

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52 See the evaluation of Gunningham, n 40, 134.

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53 See Daniel Carpenter and David A Moss 'Introduction' in Daniel Carpenter and David A Moss (eds), *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (Cambridge University Press, 2014) 1, 7.

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54 See Croley, above n 38, ch 3.

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55 See, eg, Robert Weisman and James Donohue, 'Sold Out: How Wall Street and Washington Betrayed America' (Essential Information Report, Consumer Education Foundation, March 2009); Andrew Baker, 'Restraining Regulatory Capture? Anglo-America, Crisis Politics and Trajectories of Change in Global Financial Governance (2010) 86 *International Affairs* 647; Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown* (Pantheon, 2010); James R Barth, Gerard Caprio and Ross Levine, *Guardians of Finance: Making Regulators Work for Us* (MIT Press, 2012).

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56 See Carpenter and Moss, above n 53, 16–17.

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57 Ibid. Corrosive capture is defined as that which 'occurs if organized firms render regulation less robust than intended or than what the public interest would recommend. By less robust we mean that the regulation is, in its formulation, application, or enforcement, rendered less stringent or less costly for regulated firms (again, relative to a world in which the public interest would be served by the regulation in question)'. As Carpenter and Moss note, most of the more recent work on regulatory capture has been concerned with the corrosive variety.

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58 James Kwak, 'Cultural Capture and the Financial Crisis' in Daniel Carpenter and David A Moss, *Preventing Regulatory Capture: Special Interest Influence, and How to Limit It* (Cambridge University Press, 2014) 71.

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59 See Willem H Buiter, 'Central Banks and Financial Crises' (Financial Markets Group Discussion Paper no 619, London School of Economics, September 2008) 39, talking in terms of 'cognitive regulatory capture' whereby regulators internalised 'as if by osmosis, the objectives, interests and perception of reality of the vested interest they are meant to regulate'. See also the comments of Lord Adair Turner, former Chairman of the United Kingdom's Financial Services Authority, acknowledging the concept of

former Chairman of the United Kingdom's Financial Services Authority, acknowledging the concept of 'cognitive capture' and the difficulties regulators have in resisting it in an interview with the Financial Crisis Inquiry Commission (November 30, 2010) <http://fcic.law.stanford.edu/interviews/view/102>.

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60 See, eg, The Warwick Commission, *Warwick Commission on International Financial Reform: In Praise of Unlevel Playing Fields*, The Report of the Second Warwick Commission (The University of Warwick, 2016) 7, 28.

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61 On the evidence of deep capture in the US financial regulatory system, see Lawrence G Baxter, 'Capture in Financial Regulation: Can We Channel It Toward the Common Good?' (2011) 21 *Cornell Journal of Law and Public Policy* 175, 184–6. On the concept of deep capture generally, see Jon Hanson and David Yosifon, 'The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture' (2003) 152 *University of Pennsylvania Law Review* 129, 202–84.

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62 Johnson and Kwak, above n 55, 93.

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63 See, eg, Carol A Needham, 'Listening to Cassandra: The Difficulty of Recognising Risks and Taking Action' (2010) 78 *Fordham Law Review* 2329, 2347–55, discussing the role cognitive biases played in the Federal Reserve Bank's January 1998 decision that it would neither conduct routine consumer compliance of, nor investigate consumer complaints about, non-bank mortgage originators (and its subsequent refusal to depart from that decision in the face of the widespread abusive lending practices during the housing bubble).

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64 See, eg, Wendy Wagner, 'Administrative Law, Filter Failure, and Information Capture' (2010) 59 *Duke Law Journal* 1321, describing the phenomenon of 'information capture', which involves inundating an agency with complex information with a view to achieving the desired regulatory outcomes.

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65 Kwak, above n 58, 77–8. For a sceptical view, see David Freeman Engstrom, ‘Corralling Capture’ (2013) 36 *Harvard Journal of Law and Public Policy* 33, arguing that this ‘non-materialist account of capture begins to resemble, upon further examination, the marketplace of ideas. Some ideas win out; some do not’ and that it ‘suggests that, when deploying the concept of capture, it is quite easy to lose focus to the point where we are not talking about much at all’.

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66 Daniel Carpenter, David Moss and Melanie Wachtell-Stinnett, ‘Lessons for the Financial Sector’ from ‘Preventing Regulatory Capture: Special Interest Influence, and How to Limit it’, 71 in Stefano Pagliari (ed), *Making Good Financial Regulation: Towards a Policy Response to Regulatory Capture* (Grosvenor House Publishing, 2012) 70.

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67 In 2010, the Tobin Project launched its research project, ‘Preventing Regulatory Capture’, see The Tobin Project, *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (2017) <http://tobinproject.org/research-inquiry/government-markets/featured-inquiry-preventing-capture>. See also similar work in the UK context under the auspices of the International Centre for Financial Regulation (2009–12): Stefano Pagliari (ed), *Making Good Financial Regulation: Towards a Policy Response to Regulatory Capture* (Grosvenor House, 2012).

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68 ‘Strong’ capture has been defined as capture that ‘violates the public interest to such an extent that the public would be better served by either (a) no regulation of the activity in question—because the benefits of regulation are outweighed by the costs of capture, or (b) comprehensive replacement of the policy and agency in question: Carpenter and Moss, above n 53, 11.

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69 ‘Weak’ capture is said to occur ‘when special interest influence compromises the capacity of regulation to enhance the public interest, but the public is still being served by regulation, relative to the baseline of no regulation’: ibid 12.

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70 Ibid.

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71 Ibid 18.

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72 For an interesting review of *Preventing Regulatory Capture*, describing the history of capture scholarship as an example of 'the authority of social science research being forged into rhetorical weaponry suitable for political battle', see Philip Wallach, 'What Is Regulatory Capture, Review of Preventing Regulatory Capture: Special Interest Influence and How to Limit It' by Daniel Carpenter and David A Moss http://newramblerreview.com/book-reviews/political-science/what-is-regulatory-capture, last accessed 8 July 2017.

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73 See Lawrence G Baxter, 'Capture Nuances in Financial Regulation' (2012) 47 *Wake Forrest Law Review* 537, 551–7.

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78 See dal Bó, n 41, 214–15. For examination of the revolving door phenomenon, with particular reference to the financial crisis, see Organisation for Economic Co-Operation and Development, *Revolving Doors, Accountability and Transparency: Emerging Regulatory Concerns and Policy Solutions in the Financial Crisis* GOV/PGC/ETH(2009)2, (OECD, 2009).

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79 See Organisation for Economic Cooperation and Development, *Post-Public Employment: Good Practices for Preventing Conflict of Interest* GOV/PGC(2008)20 (OECD, 2008) 16–17.There is a long-standing debate on whether firms hire ex-regulators to obtain preferential regulatory treatment (the ‘quid pro quo’ hypothesis) or for their expertise (the ‘regulatory schooling’ hypothesis). For a recent discussion, see David Lucca, Amit Seru and Francesco Trebbi, ‘The Revolving Door and Worker Flows in Banking Regulation’ Staff Reports no 678 (Federal Reserve Bank of New York, 2014); Sophie A Shive and Margaret M Forster, ‘The Revolving Door for Financial Regulators’ (2017) 21 *Review of Finance* 1445.

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80 Baxter, ‘Capture in Financial Regulation: Can We Channel It Toward the Common Good?’, above n 61, 187.

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81 For example, the Federal Reserve Bank of New York located teams of examiners (including ‘relationship managers’) on-site in offices within the large banks they regulate on a full-time basis. In 2016, it took the decision to move most of these employees back to Federal Reserve premises after an investigation into regulatory capture was launched by the Government Accountability Office.

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82 Baxter, ‘Capture in Financial Regulation: Can We Channel It Toward the Common Good?’, above n 61, 187.

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83 OECD, above n 78, [66]–[69]. There was a particularly strong incidence of previous employment with one law firm with a long association with the banking sector. Of 34 senior employees identified in the report, only six had no revolving-door connections. Eleven had formerly worked for corporate law firms, seven for banks or other financial institutions, six as accountants or auditors in corporate auditing firms, two in finance lobby groups, two in other corporate sectors and just one had worked in a 'public interest' law centre.

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84 Australian Securities and Investments Commission, *ASIC Senior Executives* (21 September 2018) <http://asic.gov.au/about-asic/what-we-do/our-structure/asic-senior-executives/>.

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85 Ben Butler, EXCLUSIVE, How Big Banks Managed to Massage ASIC Message', *The Australian*, 19 April 2017.

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90 International Monetary Fund, ‘Australia: Financial System Stability Assessment’ (IMF Country Report No 12/308, Washington DC, 2012) 25–6.

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91 See the submissions cited in *ASIC Inquiry,* above n 3, [25.6]–[25.7].

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92 Commonwealth, Financial System Inquiry, above n 14, 247.

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93 See *ASIC Inquiry*, above n 3, [17.13]–[17.16].

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94 See, for example, Ian Ramsay and Miranda Webster, ‘ASIC Enforcement Outcomes: Trends and Analysis’ (2017) 35(5) *Company and Securities Law Journal* 289.

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95 Former Chairman of the Trade Practices Commission.

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96 Robert Baxt, Submission No 189 to Senate Standing Committee on Economics, Parliament of Australia, *Inquiry into the Performance of the Australian Securities and Investments Commission*, 28 October 2013, 6–7.

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97 Rather it flatly denied any reluctance to take action against big businesses: see Greg Medcraft, 'Senate Inquiry into the Performance of ASIC: Opening Statement February 2014' (Speech delivered at the Senate Inquiry into the Performance of ASIC, 10 April 2014) <https://asic.gov.au/about-asic/media-centre/speeches/senate-inquiry-into-the-performance-of-asic-opening-statement-february-2014/> claiming that 'we act without fear or favour irrespective of the size of the organisation' and 'ASIC action occurs across the spectrum regardless of entity size'.

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98 *ASIC Inquiry*, above n 3, [17.33].

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99 Senior Executive Leader, Strategy Group.

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100 Thus the files would have to be reconstructed.

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101 *ASIC Inquiry,* above n 3, [11.47].

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102 *ASIC Inquiry*, above n 3, 166.

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103 A new 'user-pays' industry funding model for ASIC came into effect in July 2017: see *ASIC Supervisory Cost Recovery Levy Act 2017* (Cth). However, a $26 million cut of its permanent Government funding was announced in the May 2018 budget. It was expected that staffing levels would be reduced by 2 per cent, or about 30 positions: see Eryk Bagshaw, 'Banking Regulator ASIC Hit by $26 m Funding

Cut', *The Age* (Melbourne), 11 May 2018, 7.

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104 A review of ASIC's enforcement regime was initiated in 2016. The ASIC Enforcement Review Taskforce reported in December 2017: Treasury, Commonwealth of Australia, *ASIC Enforcement Review Taskforce Report* (2017). The Government responded to the Report in April 2018, but is awaiting the findings of the Royal Commission before reaching final conclusions on a number of the Taskforce's recommendations.

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105 Andrew Sheng, 'Regulatory Capture: A Former Regulator's Perspective' in Stefano Pagliari (ed), *Making Good Financial Regulation: Towards a Policy Response to Regulatory Capture* (Grosvenor House Publishing, 2012) 158. Mr Sheng is former Chairman of the Hong Kong Securities and Futures Commission.

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106 *ASIC Inquiry*, above n 3; *Inquiry into Financial Products and Services*, above n 9; *Financial System Inquiry*, above n 14, 193–232; 233–60 233 ff.

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107 Adele Ferguson, 'Hearing into ASIC's failure to investigate CBA's Financial Wisdom', *Sydney Morning Herald* (online), 3 June 2014 <http://www.smh.com.au/business/hearing-into-asics-failure-to-investigate-cbas-financial-wisdom-20140602-39ept.html>; *Banking Bad* (Australian Broadcasting Corporation, 2014); Adele Ferguson, 'Sweating on every word—how ASIC massaged the banking message', *Sydney Morning Herald* (online), 21 April 2017 <http://www.smh.com.au/business/banking-and-finance/sweating-on-every-word--how-asic-massaged-the-banking-message-20170421-gvp9%20qt.html>; Pat McConnell, 'ASIC's Fashion Faux-Pas', *The Conversation* (online), 13 July 2015 <https://theconversation.com/asics-fashion-faux-pas-44590>; Andrew Schmulow, 'Time for Abbott Government and ASIC to get serious about Australian banksters', *Independent Australia* (online), 10 August 2015 <https://independentaustralia.net/business/business-display/time-for-asic-and-other-regulators-to-get-serious-about-australian-banksters,8036>.

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108 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services

Industry, <https://financialservices.royalcommission.gov.au/Pages/default.aspx>

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109 Royal Commission—Banks and Financial Services, 30 November 2017, Office of the Prime Minister of Australia, <http://sjm.ministers.treasury.gov.au/media-release/124-2017/>.

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110 Banking and Financial Services Commission of Inquiry Bill 2017 (Cth).

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111 Matthew Burgess and Jason Scott, ‘Turnbull’s Win May Lift Ailing Government After Tough 2017’, Bloomberg (online), 18 December 2017 <https://www.bloomberg.com/news/articles/2017-12-17/turnbull-s-win-may-kick-start-ailing-government-after-tough-2017>.

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114 Joanna Mather and James Eyers, ‘APRA delivers banks $1b windfall: Productivity Commission’, *Australian Financial Review* (online), 7 February 2018 <http://www.afr.com/business/banking-and-finance/financial-services/apra-delivers-banks-1b-windfall-productivity-commission-20180206-h0ulfe>.

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115 Peter Harris, Julie Abramson and Stephen King, ‘Competition in the Australian Financial System, Draft Report’, Government of Australia, Productivity Commission (2018).

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117 Mather and Eyers, above n 114.

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118 Harris, Abramson and King, above n 115, 465–516 469ff; 479 ff.

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119 The Interim Report, Residential Mortgage Price Inquiry, was issued in March 2018. Australian Competition and Consumer Commission, *Residential Mortgage Price Inquiry—Interim Report*, Commonwealth of Australia (2018).

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128 Peter Ryan, 'APRA launches scathing criticism of Commonwealth Bank, Scott Morrison puts boards on notice', *ABC News* (online), 1 May 2018 <http://www.abc.net.au/news/2018-05-01/cba-forced-to-put-aside-a-billion-dollars-extra-by-apra/9713646>.

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130 Anthony Klan, ‘APRA “captured by major banks”’, *The Australian* (online), 23 July 2017, 1

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131 Michael Roddan, ‘ACCC in parallel rate-rigging probe’, *The Australian* (online) 2 March 2018, 22.

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132 See for example, Pat McConnell, ‘ASIC finally pulls the BBSW trigger on ANZ’, *The Conversation* (online), 4 March 2016 <https://theconversation.com/asic-finally-pulls-the-bbsw-trigger-on-anz-55766>; Andrew Schmulow, ‘To clean up the financial system we need to watch the watchers’, *The Conversation* (online), 4 March 2015 <http://theconversation.com/to-clean-up-the-financial-system-we-need-to-watch-the-watchers-38359>; Andrew Schmulow, ‘Why rigging of the bank bill swap rate hurts everyone’, *The Conversation* (online), 9 March 2016 <https://theconversation.com/why-rigging-of-the-bank-bill-swap-rate-hurts-everyone-55826>; Andrew Schmulow, ‘Fancy dress financial regulators ASIC and APRA must go’, *The Age* (online), 31 May 2016 <http://www.theage.com.au/business/banking-and-finance/fancy-dress-financial-regulators-asic-and-apra-must-go-20160531-gp89dp.html>.

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138 See also, Ian Ramsay and Miranda Webster, 'ASIC Enforcement Outcomes: Trends and Analysis' (2017) 35(5) *Company and Securities Law Journal* 289, particularly graph 12, 304, which demonstrates ASIC's overwhelming predilection for bringing criminal sanctions only against small businesses. Indeed the same research indicates that in the case of the financial services industry, ASIC relies almost entirely upon 'administrative remedies' followed by 'enforceable undertakings/negotiated outcomes'.

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139 James R Barth, Gerard Caprio and Ross Levine, above n 55, 203–32. Barth et al acknowledge the precursor to this idea, put forward by Adams in a series of articles (see, eg, Adams, Jr., Charles Francis, 'Boston' [1] (1868) 106 (218) 1), and discussed in McCraw (Thomas K McCraw, *Prophets of Regulation: Charles Francis Adams; Louis D. Brandeis; James M. Landis; Alfred E. Kahn* (Harvard University Press, 1986) 15), of a 'Sunshine Commission': 'a commission that would shed the cleansing light of disclosure on the hitherto secret affairs of business corporations'. What Marshall J Breger et al refer to as '[A]n impartial body of experts that would investigate, examine, and report on railroad activities but would not have enforcement power'. Marshall J Breger and Gary J Edles, *Independent Agencies in the United States: Law, Structure, and Politics* (Oxford University Press, 2015) 27. See above n 77, 1–49, 4, for a proposal along similar lines for an 'Expert Review Panel'.

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141 Ibid 203.

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151 Ibid 213.

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158 *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, above n 108.

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159 Joanna Mather, 'Banking royal commission: APRA hasn't taken court action over super law breaches', *Australian Financial Review* (online), 17 August 2018 <https://www.afr.com/personal-finance/superannuation-and-smsfs/banking-royal-commission-apra-hasnt-taken-court-action-over-super-law-breaches-20180817-h143yv>; James Thomson, 'Banking royal commission: Hayne shows APRA is no tough cop', *Australian Financial Review* (online), 17 August 2018 <https://www.afr.com/personal-finance/superannuation-and-smsfs/banking-royal-commission-hayne-shows-apra-is-no-tough-cop-20180817-h144b8>; Chanticleer, 'Productivity Commission right to question focus on "unquestionably strong"', *Australian Financial Review* (online), 3 August 2018 <https://www.afr.com/brand/chanticleer/productivity-commission-right-to-question-focus-on-unquestionably-strong-20180803-h13iwt>.

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161 Australia's 'Twin Peaks' regulatory model for the financial system comprises one regulator responsible for maintaining financial system stability, and another for ensuring good market conduct and consumer protection. The former is the Australian Prudential Regulation Authority (APRA), and the latter is the Australian Securities and Investments Commission (ASIC). For more on the role, mandate, functions and the underlying philosophy of the jurisdictions afforded to both peaks, see Taylor's remarks circa 1995, in which he first set-forth his proposal for 'Twin Peaks'. Michael W. Taylor, *'Twin Peaks': A regulatory structure for the new century* (Centre for the Study of Financial Innovation, 1995). See also Michael W. Taylor, *Peak Practice: How to reform the UK's regulatory system* (Centre for the Study of

Financial Innovation, 1996) 2ff; Michael W. Taylor, *'Twin Peaks' Revisited…a second chance for regulatory reform* (Centre for the Study of Financial Innovation, 2009) 4ff; Michael W. Taylor, 'Welcome to Twin Peaks' (2010) 21(1) *Central Banking Journal*; Heidi Mandanis Schooner and Michael W. Taylor, 'United Kingdom and United States Reponses to the Regulatory Challenges of Modern Financial Markets' (2003) 38(2) *Texas International Law Journal* 317, 336ff; A. D. Schmulow, 'Twin Peaks: A Theoretical Analysis' (Working Paper No. 064, Centre For International Finance and Regulation, 2015) 4ff; A. D. Schmulow, 'Financial Regulatory Governance In South Africa: The Move Towards Twin Peaks' (2017) 25(3) *African Journal of International and Comparative Law* 393, 395 ff.

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162 Financial System Inquiry, above n 14, 239. Recommendation 27 states 'Create a new Financial Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates. Provide clearer guidance to regulators in Statements of Expectation and increase the use of performance indicators for regulator performance'.

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163 Ibid. See also Barth, Caprio and Levine, above n 55, 217. A similar ambit of responsibility—the provision of annual reports and nothing more—was proposed for the 'Sentinel', precisely to prevent a blurring of the boundaries of accountability.

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164 Financial System Inquiry, above n 14, 239.

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166 Ibid 237.

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protection in a crisis? (4 March 2015) FINSIA <https://finsia.com/insights/news/news-article/2015/03/04/twin-peaks-sufficient-protection-in-a-crisis>: 'The CFR coordinates activity across the Reserve Bank of Australia (RBA), APRA, ASIC and the Treasury, leading North to describe it as the

"conductor of the regulatory orchestra." He believes it gives rise to "significant potential for group think."'

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175 Financial System Inquiry, above n 14, 239.

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177 Ibid 240.

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181 Financial Systems Inquiry, above n 14, 243.

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182 Ibid.

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183 Ibid 245.

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184 Ibid 243.

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185 Ibid.

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186 Ibid 243–4. For more on reciprocal oversight, see also Pagliari, ‘How Can We Mitigate Capture in Financial Regulation’, above n 77, 4.

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187 Senate Economics References Committee, Parliament of Australia, *Performance of The Australian Securities and Investments Commission* (2014) 433, Recommendation 55.

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192 Australian Government, *Improving Australia's Financial System, Government response to the Financial System Inquiry* (2015) 23. The regulators, ASIC and APRA, possibly fearing that a board of oversight would uncover the kinds of collusion between regulators and regulatees that has been uncovered through the Royal Commission, argued strenuously against the establishment of such a Board. See: Australian Prudential Regulation Authority, Submission to Financial System Inquiry, Parliament of Australia, *Financial System Inquiry,* 31 March 2014.

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199 See, eg, Ben Butler, 'D'Aloisio shelved CBA inquiry', *The Australian*, 8 January 2018, 14.

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201 Details of the litany of scandals that have bedevilled the financial services industry are not within the scope of this article. For details, see Andrew Schmulow, 'Retail Market Conduct Reforms in South Africa Under Twin Peaks' (2018) 12(1) *Law and Financial Markets Review* 1, 163–73, Fn 103, 104.

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202 Productivity Commission, *Competition in the Australian Financial System Productivity Commission Inquiry Report,* Report No 89 (2018) 38, Finding 3.2.

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203 Mather and Eyers, above n 114.

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204 Productivity Commission, above n 202, Finding 3.2.

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209 Barth, Caprio and Levine, above n 55, 216–17.

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210 Australian Prudential Regulation Authority, above n 192, 62.

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211 Ibid. Barth, Caprio and Levine, above n 55, 217, refute this when they state: ‘Sentinel demands for information must trump the desires of regulatory agencies for secrecy…From regulatory failures

contributing to oil spills and nuclear fuel leakages to those involving finance, the problem seems to be too much secrecy, not too much transparency’.

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212 Australian Prudential Regulation Authority, above n 192, 63.

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213 Productivity Commission, above n 202, 38.

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214 See Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry above, n 89 and n 200.

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215 For details on the ‘probability and impact rating system’ (PAIRS) and the ‘supervisory oversight and response system’ (SOARS) used by APRA, and attendant critique, see: Schmulow, ‘Financial Regulatory Reform In South Africa: The Move Towards Twin Peaks’, above n 161, 398–400.

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216 See Charles Wyplosz, ‘Globalised Financial Markets and Financial Crises’ in Jan Joost Teunissen (ed), *Regulatory and Supervisory Challenges in a New Era of Global Finance* (Forum on Debt and Development, 1998) 72, 77–9.

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217 So-called ‘Black Swan’ events, a theory developed by Nassim Taleb (Nassim Nicholas Taleb, *The Black Swan: The Impact of the Highly Improbable* (Random House, 2007)) to describe an event that comes as a surprise, is of significant impact, and is often inappropriately rationalised with the benefit of hindsight. For citing of the concept, see, eg, David Lewis, ‘Risk-Based Supervision: How Can We Do

Better? An Australian Supervisory Perspective' (Speech delivered at Toronto Centre Program on Supervisory Experiences in Implementing Global Banking Reforms, Toronto, 19 June 2013) <https://www.apra.gov.au/media-centre/speeches/risk-based-supervision-how-can-we-do-better-australian-supervisory-perspective>; Joint Committee on the Draft Financial Services Bill Report, House of Lords, London, 16 December 2011, 1026. But see Julia Black, 'Learning from Regulatory Disasters' (Working Paper No 24, London School of Economics Law, Society and Economy, 2014) 4, where Black points out, however that: 'Nonetheless, the inquiries that often follow a disaster, even if it is a 'black swan' event, often reveal systemic problems within the regime which have hence far gone unnoticed by regulators, or unheeded by key policy actors'. It is precisely the kind of recursive review that would be conducted by a Financial Regulator Assessment Board (FRAB) that would be most suited to teasing-out these problems. See also Phillip Swagel, 'The Financial Crisis: An Inside View' (2009) 1 *Brookings Papers on Economic Activity* 1, 65.

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218 Cristie Ford, 'Macro- and Micro-Level Effects on Responsive Financial Regulation' (2011) 44(3) *University of British Columbia Law Review* 589, 589.

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219 Pat McConnell, 'War on banking's rotten culture must include regulators', *The Conversation* (online), 4 June 2015 <http://theconversation.com/war-on-bankings-rotten-culture-must-include-regulators-42767>. See also Julie May, 'Regulatory board to beef up watchdog accountability', *Financial Observer* (online), 10 December 2014 <http://www.financialobserver.com.au/articles/regulatory-board-to-beef-up-watchdog-accountability>; Williams, *Twin Peaks: sufficient protection in a crisis?,* above n 174; Schmulow, 'To clean up the financial system we need to watch the watchers', above n 132; Ruth Williams, 'Merit in oversight board for ASIC, but only if it's got teeth', *Sydney Morning Herald* (online), 27 January 2015 <http://www.smh.com.au/business/merit-in-oversight-board-for-asic-but-only-if-its-got-teeth-20150127-12z7zy.html>; Barth, Caprio and Levine, above n 55, 211; Pat McConnell, 'Reckless endangerment: The failure of HBOS' (2014) 7(2) *Journal of Risk Management in Financial Institutions* 202, 202.

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220 Pat McConnell, *War on banking's rotten culture must include regulators*, above n 219.

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221 Llewellyn, above n 198, 41.

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222 Geoffrey P. Miller and Gerald Rosenfeld, 'Intellectual Hazard: How Conceptual Biases in Complex Organizations Contributed to the Crisis of 2008' (2010) 33(2) *Harvard Journal of Law and Public Policy* 807, 838–9 [83]–[84].

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223 See Bernstein, above n 18.

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224 McCraw, above n 139, 44.

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225 Ibid 44.

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226 Erick F. Gerding, 'Subprime Crisis and the Link between Consumer Financial Protection and Systemic Risk' (2009) 4(2) *Florida International University Law Review* 435, 435.

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