

Working paper summary

Twin Peaks - the legal and regulatory anatomy of

Australia's system of financial regulation

Andrew Godwin; Ian Ramsay
The University of Melbourne

Australia adopts a functionally-based twin peaks model under which regulatory responsibility is divided primarily between two regulators. The Australian Securities and Investments Commission (ASIC) is responsible for the regulation of companies, market conduct and consumer protection. The Australian Prudential Regulation Authority (APRA) is responsible for prudential regulation.

This paper examines the anatomy of the Australian twin peaks model from a legal and regulatory perspective. It also reflects on the work of the Financial System Inquiry (FSI) of 2014, which reviewed Australia's financial system and examined issues that are relevant to the operation of the twin peaks model.

The relevance of the twin peaks model is becoming greater as an increasing number of jurisdictions have adopted, or are considering, this model.

The purpose and content of short-form disclosure

Under the twin peaks model, it is necessary to ensure that the objectives of each regulator and the boundaries, or regulatory perimeters, between them are clearly defined. This is because market participants may be overseen by both regulators. Further, to ensure comprehensive supervision, it is necessary to achieve effective coordination between the regulators.

The experience from the collapse of HIH Insurance and Trio Capital highlights the critical importance of information-sharing between APRA and ASIC, particularly at the operational level. It also shows the importance of ensuring that regulators are able to respond in a timely and effective manner to problems experienced by regulated entities. Furthermore, there is a need for coordination between both regulators in the performance of their respective functions and responsibilities.

APRA focuses on promoting financial system stability, whereas ASIC's focus is on promoting the confident and informed participation of investors and consumers in the financial system. There is an inherent potential for conflicting priorities between these regulatory objectives, as action taken by one regulator may conflict with or undermine the objectives of the other. Accordingly, coordination is critical for the twin peaks model to operate effectively. Effective coordination requires consultation, information-sharing and mutual cooperation in areas such as supervision and enforcement action.

The view within regulatory and official circles is that the framework of coordination in Australia is working well and does not need to be redesigned or radically overhauled. The following are identified as key factors in the success of the framework of coordination:

- **A focus on process as well as outcomes** – this ensures that coordination is considered to be an end in itself and not just a means to an end.
- **The strength of relationships** – at both the senior and lower levels of the respective organisations.
- **The twin peaks system itself** - because of their complementary roles, regulators have a collective interest in making coordination work.
- **Effective consultation and information-sharing** – this is particularly important at the operational levels of the respective regulators.
- **The framework of coordination itself** – which is facilitative, informal and involves a flexible approach to coordination that can adapt to the circumstances.

In Australia, the legislative framework for regulatory co-ordination is high-level and outcomes-focused. This framework relies substantially on ‘soft law’ mechanisms in the form of memoranda of understanding and informal protocols between the regulators, with such mechanisms being facilitative and enabling, rather than prescriptive.

It is perhaps in this respect, namely the existence of two independent regulators who have different functions but nonetheless must achieve effective coordination in order to make the system work for both, that the twin peaks model might claim an advantage over other models. When compared with the institutional model, the twin peaks model is less susceptible to functional overlap and territorial conflicts. Also, when compared with the integrated, or super-regulator, approach, the twin peaks model is less susceptible to the internal conflicts of interest that arise as a result of the concentration of regulatory functions in one regulator.

The FSI Final Report found that the twin peaks model in Australia does not need major change, reflecting the conclusions previously reached by international agencies that ‘Australia’s financial system is sound, resilient and well-managed’, and that ‘the financial regulatory and supervisory framework exhibits a high degree of compliance with international standards.’

Instead of recommending structural changes to the model, the FSI focussed on ways in which certain aspects, such as coordination and regulatory overlap, could be strengthened and improved. Interestingly, the most significant recommendations of the FSI related to those aspects that were common to all models, namely the objectives of the regulators, the accountability framework governing financial sector regulators, funding arrangements and regulatory tools such as enforcement powers.