

Council of Financial Supervisors

The Chairman of the Council of Financial Supervisors, Reserve Bank Governor, Mr B. W. Fraser, recently released the Council's 1995 Annual Report. The following passages draw on Chapter 1 of the Report, copies of which are available from the Reserve Bank.

The Council and its Aims

The Council of Financial Supervisors is a coordinating body which brings together the heads of Australia's main financial supervisory agencies. Its members are the Reserve Bank of Australia (RBA), which chairs the Council; the Insurance and Superannuation Commission (ISC); the Australian Securities Commission (ASC); and the Australian Financial Institutions Commission (AFIC).

The Council aims to enhance the quality of financial supervision and regulation in Australia by:

- facilitating exchanges of information bearing on the efficiency and health of the financial system;
- assisting each supervisory agency to be aware of, and to understand, developments in parts of the financial system outside its particular area of responsibility;
- identifying important issues and trends in the development of the financial system as a whole; and

- avoiding unintended gaps, duplication or inconsistencies in regulation.

The Council encourages the harmonisation of regulatory requirements where the interests of agencies overlap. It does not, however, promote the application of identical standards to all financial institutions or products. Approaches to the protection of depositors and investors vary from one part of the financial system to another depending on a range of factors, including the nature of the products in question and the degree of risk attaching to them; the numbers and characteristics of the institutions and investors involved; and the statutory responsibilities and community expectations of supervisors.

Through its Annual Reports, the first of which was released in 1993, the Council aims to provide the public with an overview of regulatory and other trends in the financial system, together with commentary on particular issues affecting its members. Annual Reports of the individual members of Council contain further details about their responsibilities and activities.

Council Activities in 1995

Supervisory issues raised by financial conglomerates remain a major focus of the Council, and it has kept a close watch on

international work in this area. In July, the report of a Tripartite Group on supervision of financial conglomerates was released under the auspices of the Basle Committee on Banking Supervision, the International Organisation of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS). This combination of the main regulatory groups indicates the importance they attach to this issue. While the recommendations in the report have no formal status at this stage, a successor to the Tripartite Group will be formed with the aim of developing a set of principles and practices upon which the supervision of financial conglomerates could be based internationally.

Fundamentally, the Group's recommendations point to the need for close cooperation between supervisors, including the exchange of information about entities within financial conglomerates. This is consistent with the Council's own guidelines agreed in 1993 for the effective supervision of these groups. In 1995, Council members have pursued legislative changes to remove impediments to information sharing, both among Council members, and with other regulatory agencies in Australia and overseas. Amendments to banking and insurance legislation are expected to be introduced next year. Alongside these initiatives, Council members have been establishing bilateral arrangements on information exchange and for the supervision of particular institutions or groups.

An important aspect of financial conglomerates relates to the transparency of their corporate structure. The Tripartite Group recommended that supervisors have powers to prohibit structures which impair adequate supervision. For its part, the Council has been reviewing issues relating to holding company structures in financial conglomerates – in particular, to 'special purpose' or non-operating holding companies. A key question is what kind of regulation or supervision, if any, should apply to these companies.

This work has focused attention on the need for supervisors to complement their supervision of individual entities with an assessment of the 'financial health' of a financial conglomerate as a whole. An issue for the Council's future attention is how best to go about this, including the vexed issue of appraising the overall capital adequacy of conglomerates, particularly those which combine banking and insurance.

Aside from conglomerates, the Council is overseeing a review of unintended overlaps and inconsistencies in the regimes regulating sales and advice practices for similar products from different kinds of institutions.

Other developments to attract the attention of the Council over the past year include:

- progress towards the establishment of uniform national supervisory schemes for State-regulated financial institutions, such as friendly societies and trustee companies;
- the regulation of derivatives, where Council is providing a forum to help avoid inconsistencies and overlaps in regulations which might be proposed as a result of various studies of derivatives markets. Council members have also agreed to the formation of a joint working party to review the problems of 'undisclosed counterparties' to transactions in derivatives markets and how they might be addressed from a system point of view;
- regulatory responses to the Barings collapse, where the Council's interest lies not only in proposals specifically related to derivatives, but also in improved regulatory cooperation generally, including in emergencies and across international borders; and
- financial sector complaints schemes designed to deal with consumer complaints quickly, informally, equitably and cheaply. With the recent proliferation of these schemes, Council is supportive of moves to achieve broad consistency in approaches. It has endorsed the efforts of the ISC, which is involved in several schemes, to greater harmonisation.

More generally, the Council members are monitoring – and, where appropriate, discussing with fellow members – developments in overseas regulation/supervision, including through their close involvement in, or relationships with, the main international bodies (Basle Committee, IOSCO, IAIS). With an eye to minimising compliance costs in the financial sector, Council members – often in conjunction with the Australian Bureau of Statistics – are also reviewing proposals for new or revised statistical collections.

The Evolving Framework of Supervision and Regulation

In the aftermath of deregulation of the 1970s and 1980s, supervisors and regulators have faced a common dilemma: damned if they do (‘reregulate’), and damned if they don’t. Arguments against reregulation or intrusive supervision are based on the costs of interfering unnecessarily with market forces, including the stifling of innovation, resulting in inefficiencies which ultimately impact on shareholders and consumers – and perhaps driving financial activity to avenues which are not supervised at all. The arguments for are based on concerns about the consequences of unfettered markets, including the potential for crises or at least the failure of individual institutions, to the detriment of consumers or shareholders alike. There is clearly a fine balance to be struck here, which is complicated further by the continued rapid evolution of financial markets and institutions – confronting supervisors and regulators with something of a moving target.

Calls for more or better regulation often follow hard on the heels of actual crises in individual markets or institutions. Reactions to the collapse of Barings Plc, and some highly

publicised losses by both financial and commercial entities in derivatives markets, are recent illustrations. Regulators need to avoid knee-jerk responses to problems which no reasonable supervisory regime might be able to avoid, and to weigh carefully the costs and benefits of radical changes to existing requirements. They need to coordinate their responses carefully where issues cross boundaries of responsibilities. This raises many questions such as ‘level playing fields’, ‘functional’ as opposed to ‘institutional’ approaches to regulation, and ‘mega-regulation’. Not surprisingly, interest in these matters has intensified with the spread of financial conglomerates.

That no consensus has been reached on many of these issues is reflected in the diversity of regulatory frameworks around the world. This is despite general agreement on the need for more vigilant supervision, and the trend in practice for supervisors to place greater emphasis on assessing the adequacy of the management systems of financial institutions, and on improving disclosure standards to assist the functioning of the market. While special factors are tending to meld the frameworks of some countries (e.g., in the European Union), and international bodies are increasingly laying down a framework of principles and guidelines in key areas, regulatory arrangements in individual countries continue to reflect their own cultural and economic histories: there is no unique model which is applicable to all countries.

In Australia, the Council’s relatively informal, cooperative approach is proving helpful in dealing with current challenges. It affords a degree of flexibility which is appropriate in a period of rapid change in the Australian financial system and which should be conducive to Council members adjusting their regulatory frameworks as this becomes necessary.