Research Working Paper Series

Is Australia’s ‘Twin Peaks’ System of Financial Regulation a Model for China?

Andrew Godwin
Melbourne Law School
The University of Melbourne

Guo Li
Peking University Law School
Peking University

Ian Ramsay
Melbourne Law School
The University of Melbourne

APRIL 2016
WORKING PAPER NO.102/2016 / Project E018

This research was supported by the Centre for International Finance and Regulation, which is a Centre of Excellence for research and education in the financial sector, funded by the Commonwealth and NSW Governments www.cifr.edu.au.
Is Australia’s ‘Twin Peaks’ System of Financial Regulation a Model for China?

Andrew Godwin,* Guo Li** and Ian Ramsay***

As China’s financial system has become more complex and integrated, calls have intensified for structural reform. In particular, many commentators have called for China to move towards the twin peaks model of financial regulation along the lines of the experience in Australia. This paper explores the insights that China might glean from the experience in Australia and other twin peaks jurisdictions and suggests certain choices that China might make if it decided to adopt the twin peaks model. Although such a decision is by no means certain and other options are perhaps more likely, at least in the short term, it is of critical importance to ensure that each option is fully understood before it is either ruled in or ruled out. This paper sets out to contribute to a broader understanding of the twin peaks model and Australia’s experience for this purpose.

CONTENTS

I Introduction .......................................................................................................................... 3
II Regulatory Models – An Overview .................................................................................... 5
  A The dominant models of financial regulation ................................................................. 5
  B The perceived advantages and disadvantages of the twin peaks model ................. 6
III China’s System of Financial Regulation – Challenges and Reform Proposals ........ 7
  A Challenges ...................................................................................................................... 8
    1 Potential conflict between regulatory and economic objectives ............................... 8
    2 Regulatory overlap .................................................................................................... 10
    3 Regulatory coordination ............................................................................................ 11
        (a) The history of regulatory coordination in China .................................................. 11
        (b) The 2013 Joint Ministerial Conference ................................................................. 13
        (c) Coordination Memorandum ................................................................................. 14
        (d) Experience of regulatory coordination in China to date .................................... 15
  B Reform Proposals ......................................................................................................... 16
    1 Twin peaks .................................................................................................................. 17
    2 Functional regulation ................................................................................................ 17
    3 Integrated model ........................................................................................................ 18
    4 Enhancing the status quo ............................................................................................ 20
    5 Analysis of proposals ................................................................................................ 21
IV Australia’s Experience and the Twin Peaks Model ......................................................... 22
  A Background to Twin Peaks in Australia .................................................................... 22
  B Responsibilities and objectives ..................................................................................... 25
    1 The Legislative Framework ....................................................................................... 25
    2 Regulatory Overlap .................................................................................................... 27

* Senior Lecturer, Melbourne Law School, The University of Melbourne.
** Professor of Law, Peking University Law School, Peking University.
*** Harold Ford Professor of Commercial Law, Melbourne Law School, The University of Melbourne.

This article is part of a research project funded by Melbourne Law School and the Centre for International Finance and Regulation entitled ‘Financial System Regulation – is Australia’s “Twins Peaks” Approach a Model for China?’ (see http://www.cifr.edu.au). The authors would like to thank Amy Feng, Chenjie Ma and Timothy Howse for their research assistance.
PROJECT OUTPUTS

- Godwin, A., Kourabas, S. and Ramsay, I., ‘Creating the Infrastructure for Macroprudential Regulation’ [in draft]
- Godwin, A., Gilligan G. and Howse, T., Submission to Treasury on the Proposed Industry Funding Model for the Australian Securities and Investment Commission
The Global Financial Crisis and its fallout have tested the integrity and resilience of financial systems and have led to significant reforms to regulatory models around the world. Over the last two decades, one model has attracted a high degree of attention since its inception in 1998. The ‘twin peaks’ model of financial regulation was pioneered in Australia and sees regulation split into two broad functions: market conduct regulation and prudential regulation. The model has since been adopted by the Netherlands, Belgium, New Zealand (NZ) and the United Kingdom (UK). South Africa is currently in the process of changing to this model,¹ and it has also been considered by the US.²

As China’s financial system has become more complex and integrated in respect of financial services and products, calls have intensified for structural reform. In particular, many commentators have called for China to move towards the twin peaks model of financial regulation. This paper identifies various challenges associated with China’s current financial regulatory system and considers the insights that the experience of Australia and other twin peaks jurisdictions might offer as China contemplates reform.³ Although China’s move towards a twin peaks model is by no means certain, particularly in view of the different reform proposals that have been advocated and the divergent voices within the current debate, it is important to be clear about what a twin peaks model might look like as there is no archetypal twin peaks model and various choices need to be made before it can be implemented.⁴

This paper is structured as follows: Part II provides an overview of the main models of financial regulation and outlines the perceived advantages and disadvantages of the twin peaks model. Part III examines the challenges in China under its current regulatory model and the various reform proposals that have been advocated. Part IV considers Australia’s experience by reference to two features that are critical to the effective implementation of the twin peaks model - clarity in terms of regulatory objectives and effective regulatory coordination - and compares the approach in Australia with that in other twin peaks jurisdictions. Part V explores insights that the experience in Australia and other twin peaks jurisdictions offers and which version of the twin peaks model might be appropriate for China. Part VI concludes.

³ The focus of this paper is on the financial system in mainland China and does not include the financial system in the Hong Kong Special Administrative Region or the Macao Special Administrative Region.
II REGULATORY MODELS – AN OVERVIEW

A The dominant models of financial regulation

The main models of financial regulation, which broadly speaking refers to the rules governing financial institutions, financial products and financial services, fall into three broad categories; the ‘institutional model’, the ‘integrated’ or ‘super-regulator’ model, and the functional model as reflected in ‘twin peaks’. The experience of the jurisdictions surveyed reveals that some countries have frequently changed models, particularly in response to financial collapse. Significantly, however, no country has yet changed from a twin peaks model to another model.

The ‘institutional approach’ focuses on the form of the regulated institution (e.g. a bank, insurer or a securities firm) and establishes a separate specialist regulator for that institution. Under this approach, the relevant regulator supervises all activities undertaken by the institution that fall within the scope of financial regulation, irrespective of the market or sector in which the activities take place, and the institution is normally regulated by one regulator alone. The institutional approach is often referred to as an offshoot of the broader sectoral or ‘operational’ approach, under which institutions are regulated by reference to the sector in which they operate or the products or business in which they engage. For example, where a financial institution offers banking products and life insurance, it might be regulated by both the banking regulator and the insurance regulator.

As early as 1996, Taylor argued that ‘a regulatory system which presupposes a clear separation between banking, securities and insurance is no longer the best way to regulate a financial system in which these distinctions are increasingly irrelevant.’ The sectoral or operational model, like the institutional model, becomes increasingly difficult to operate as the complexity of financial products increases as well as the complexity of financial institutions, as reflected in the emergence of financial conglomerates or financial holding companies. This potentially causes coordination problems and regulatory overlap between the relevant regulators, both of which are challenges that China is increasingly facing as its financial system becomes more complex and integrated in respect of financial services and products.

---


6 Some commentators exclude the ‘super-regulator’ model as a distinct model: Llewellyn (n 4).

7 Some commentators refer to the sectoral or operational model as a functional approach, under which each type of business is ‘ overseen by a separate, “functional” regulator’: Group of Thirty, The Structure of Financial Supervision – Approaches and Challenges in a Global Marketplace (6 October 2008).

The ‘integrated’ or ‘super-regulator’ model attempts to address the problems experienced by the institutional and sectoral approaches by creating a single regulator to monitor both the conduct of market participants and also the prudential soundness of financial institutions. This model was championed by the UK prior to its move to twin peaks. One of the perceived problems with this model, however, is that ‘[p]ruudential and conduct of business... regulation require[s] fundamentally different approaches and cultures and there may be doubt about whether a single regulator would, in practice, be able to effectively encompass these to the necessary degree.’9 Another issue with the unified approach is that a single regulator ‘might not have a clear focus on the different objectives and rationales of regulation and supervision, and might not make the necessary differentiations between different types of institution and business.’10

The third approach, and the focus of this paper, is the ‘twin peaks’ model. Twin peaks regulates the market in accordance with two broad regulatory functions: first, market conduct integrity and consumer protection; secondly, prudential regulation and financial system stability. Each objective is pursued by a separate regulator, thus lending the name ‘twin peaks’ to the model.

B The perceived advantages and disadvantages of the twin peaks model

The twin peaks model is considered to have a number of advantages. First, the two peak regulators are more likely to have ‘dedicated objectives and clear mandates to which they are exclusively committed.’11 Secondly, there is minimal danger that one aspect of regulation – such as prudential regulation – will come to dominate the regulatory landscape.12 Regulatory culture, which encompasses the attitudes, policies and practices adopted by regulators in fulfilling their objectives, can be fostered depending on the function of the regulator and the culture that it needs to perform its role effectively.13 This avoids the issue of having multiple ‘cultures’ under the one roof, as might be the case with a super-regulator where different cultures arise as a result of the different regulatory objectives.14 Thirdly, the model may be better adapted towards keeping pace with the growing complexity of financial markets and the continuing rise of financial conglomerates. Finally, the twin peaks model may avoid an inherent conflict of interest in having a super-regulator. As was noted by the UK Joint Committee on the draft Financial Services Bill (JCFSB):

[T]he evidence of the recent financial crisis suggests that mixing functions can contribute to a lack of focus on rising macro-prudential risk and difficulties in moving to a ‘war footing’ when that risk becomes substantial. In addition, the incentives are different. For example consumer protection can be well served by keeping a bank open, while stability is well served by closing it.15

There are also a number of perceived disadvantages of the twin peaks model. First, twin peaks may create regulatory overlap with dual-regulated entities. The twin peaks model means that it is ‘inevitable that two separate regulators would have two separate rule books and two separate

---

9 Llewellyn (n 5) 25.
10 ibid 25.
11 ibid 27-8.
12 ibid 27-8.
13 ibid 27-8.
15 Joint Committee on the draft Financial Services Bill (JCFSB), Draft Financial Services Bill – Report, together with formal minutes and appendices (HL 2010-12, 236, HC 2010-12, 1447) 73 [83].
systems.' In the UK, it was noted in 2013 that ‘approximately 2,000 firms [would] be subject to dual regulation.' If not carefully managed, this could place a ‘considerable burden’ on regulated entities and lead to poor information-sharing and coordination.

Secondly, there is a general risk that cooperation and coordination between the regulators will not be sufficient with potentially serious consequences. While these risks can be managed through robust coordination and liaison channels, it nevertheless remains a key concern for jurisdictions that have adopted the model.

Finally, and depending on how the twin peaks model is implemented, there may be a conflict of interest within the central bank. This can arise if the central bank is responsible for both prudential regulation and monetary policy, as is the case in NZ. Llewellyn has suggested that ‘a central bank with responsibility for preventing systemic risk is more likely to loosen monetary policy on occasions of difficulty.’ At the same time, this aspect may also be viewed as creating a synergy ‘arising from [the central bank’s] knowledge of monetary policy and financial market developments.’

III CHINA’S SYSTEM OF FINANCIAL REGULATION – CHALLENGES AND REFORM PROPOSALS

To date, the regulatory approach in China has been close to the traditional approach in the United States - the regulatory authorities have been established along institutional or sector-based lines and separate authorities have been established to regulate the banking sector, the insurance sector and the securities sector: the China Banking Regulatory Commission (CBRC), the China Insurance Regulatory Commission (CIRC) and the China Securities Regulatory Commission (CSRC). The nature of China’s regulatory approach is encapsulated in Article 6 of the PRC Securities Law, which provides that ‘[s]eparate operation and separate management is adopted in respect of the securities, banking, trust and insurance sectors; securities companies and the business entities of banks, trust and insurance are established separately, unless otherwise provided by the state’. In addition, China still maintains a structural separation between commercial banking activities and investment banking

16 ibid para 286.
18 JCFSB, above n 15, para 285.
19 This was considered in the New Zealand context: The New Zealand Institute of Chartered Accountants, Submission to the Commerce Select Committee, Financial Markets (Regulators and Kiwisaver) Bill, November 2010, para 32.
20 This was a serious concern in the HIH Report, as discussed in Part IV below: see generally Commonwealth, The HIH Royal Commission, The failure of HIH insurance: A corporate collapse and its lessons (April 2003).
22 Llewellyn, above n 5, 29.
23 Hengel and others, above n 14, 186.
activities along the lines of the approach adopted in the United States under the Gramm-Leach-Bliley Act of 1999.\(^{24}\)

Over the past decade or so, China has experienced huge growth in financial products and services and also increased integration in the financial services industry. Further, as the impact of financial innovation and financial conglomerates has increased, the weaknesses of the current structure have become evident, particularly in the area of regulatory overlap and regulatory coordination, two challenges that are outlined below.\(^{25}\)

### A Challenges

#### 1 Potential conflict between regulatory and economic objectives

The regulatory objectives of each of the Chinese financial regulators are clearly expressed by law and broadly consistent with international standards. In the case of the banking sector, the Law of the People’s Republic of China on Regulation of and Supervision over the Banking Industry provides in Article 3 that ‘[t]he objectives of regulation of and supervision over the banking industry are to promote the lawful, sound and steady operation of the banking industry and preserve public trust in the industry.’\(^{26}\) In the case of the insurance sector, Article 134 of the PRC Insurance Law provides that ‘[t]he CIRC shall supervise and regulate the insurance industry, safeguard the order of the insurance market, and protect the lawful rights and interests of the proposers, the insured, and the beneficiaries.’ In the case of the securities sector, Article 178 of the PRC Securities Law provides that ‘[the CSRC] shall regulate the securities market according to law, maintain order of the securities market and ensure its lawful operation.’

One challenge that has been identified by the International Monetary Fund (IMF) and the International Organization of Securities Commissions (IOSCO) in their assessments of China is the impact of national economic policies and the state-owned economy on the realisation of regulatory objectives. In respect of the CBRC, for example, the IMF has noted that ‘[t]he potential conflict between safety and soundness objectives and other objectives exists in many countries but can be more acute in China because of the predominant use of the banking system, much of which is state owned, to achieve economic and social goals.’\(^{27}\) Further, the IMF has suggested that ‘[a]s with other supervisors, the CBRC will need to find ways to reinforce understanding among policy makers and

---


\(^{25}\) Operational independence has also been identified as a significant challenge, one that is exacerbated by three factors: the nature of the relationship between the financial regulators and the State Council, which is the executive arm of government and supervises the PBOC and the financial regulators; the so-called ‘revolving door’ phenomenon; and regulatory capture. Although operational independence is an issue of critical importance in China, it is a challenge that all regulatory models face and is not explored in this paper. For literature on this issue, see Robin Hui Huang, Securities and Capital Markets law in China (2014, Oxford University Press), 35-38.

\(^{26}\) Article 3 goes on to provide that ‘[t]he banking industry shall be regulated and supervised in such a way as to protect fair competition in the industry and increase the competitiveness of the industry.’

\(^{27}\) This is likely to be based on provisions such as Article 34 of the Commercial Banking Law, which provides that ‘[c]ommercial banks must conduct their business of lending in accordance with the needs of the national economic and social development and under the guidance of the industrial policies of the State.’
the general public that its safety and soundness mandate contributes to general economic and social goals."^{28}

In respect of the CIRC, the IMF has also noted the potential conflict between its supervisory objectives and its commercial and social objectives that relate to the development of the insurance market.\textsuperscript{29} Although not expressly stated, it is likely that the IMF’s concerns arise out of provisions such as Article 1(1) of the Circular of the General Office of the State Council on Issuing the Regulations on the Main Functions, Interior Institutions and Staffing of the China Insurance Regulatory Commission (7 July 2003), which provides that the main functions of the CIRC include ‘drafting guidelines and policies on the development of the insurance industry’ and ‘formulating development strategies for the industry’, and Article 4(1) of the Regulations on Supervision and Administration Responsibilities of Local Offices of the China Insurance Regulatory Commission (30 June 2004), which provides that the responsibilities of local offices include ‘researching, formulating and organising the implementation of the development plans of the insurance industry in the areas under their jurisdiction and guiding and promoting the overall, coordinated and sustainable development of the insurance industry.’

In respect of the CSRC, IOSCO has noted that ‘[t]he CSRC performs centralized and unified supervision and regulation of the nation’s securities and futures markets, with the aim both of promoting soundness in the markets and promoting market development. This dual aim necessarily involves balance and compromise, especially with respect to financial innovation. There may be times when the two mandates conflict.’\textsuperscript{30}

Although it appears that the concern about the potential conflict between the regulatory and economic objectives is more theoretical than practical in nature and its validity has been queried by the regulators themselves,\textsuperscript{31} it remains an issue that needs to be taken into account in terms of the regulatory design of China’s financial system, as discussed further in Part V below.

\textsuperscript{28} People’s Republic of China: Detailed Assessment Report: Basel Core Principles for Effective Banking Supervision, April 5, 2012, 27. As an example of this potential conflict, the IMF has noted that ‘[t]he CBRC has participated, under the overall national development strategy of the State Council, and in concert with the PBC and other agencies, in various measures to enhance credit provision to various sectors such as SMEs or to promote development and access to financial services in under-served regions and rural areas.’ The response from the Chinese authorities, as reported by the IMF, is that ‘there need not necessarily be a conflict between national development goals and prudent bank practices’ and ‘they do not see an issue in CBRC endorsing (public) goals for banks having their small business lending grow at least as fast as the average for the bank’s overall lending.’

\textsuperscript{29} People’s Republic of China: Detailed Assessment Report: IAIS Insurance Core Principles, April 5, 2012, 8-9. Noting that ‘[t]he regulatory and commercial objectives each require very distinct mindsets and skills’, the IMF recommended that ‘the two mandates be separated and a suitable agency be identified to take ownership of the developmental, commercial and social objectives. This would help to ensure the supervisor has a clear objective and is able to undertake its role without conflict. This would help the government and the industry to understand better the risks to safety and soundness of actions taken.’ The IMF further suggested that such an agency ‘could ensure a closer alignment of development in the banking, securities and insurance areas while also looking to the specific needs of each sector.’


\textsuperscript{31} See, for example, the views of the CBRC as reported by the IMF, above n 28, 24: “CBRC experience is that there need not necessarily be a conflict between national development goals and prudent bank practices. CBRC has participated in various high-level policy discussions, including at the State Council level, and has
Regulatory overlap

By comparison with the above challenge, overlap between the regulatory objectives of the financial regulators in China appears to be a more critical issue in a practical sense. Regulatory overlap refers to the situation where products, transactions and other activities undertaken in the financial services sector are subject to the regulation of two or more regulators, giving rise to potential conflicts and difficulties in compliance. This is a challenge that involves all three regulators. In terms of the CBRC and the CIRC, IOSCO has noted that ‘[w]here banking or insurance companies engage in securities type activities, such as establishing and distributing wealth management products, the CBRC and CIRC have corresponding regulatory authority’ and has suggested that ‘[i]n the interests of avoiding regulatory arbitrage, products performing a similar function should be regulated in a similar way, and the authorities should pay particular attention to wealth management products in this regard.’

In terms of the CSRC, IOSCO has noted the following:

[t]he CSRC imposes regulation on [collective investment schemes] of securities investment companies and securities companies, while the CBRC and CIRC impose regulation on investment products provided by banks and investment-linked insurance products offered by insurance companies. The latter has grown to very considerable proportions in recent years, to a little over one quarter of the value of securities investment funds registered by the CSRC, but is not subject to similar disclosure or sales practice requirements. A review of the requirements across the banking, insurance and securities sectors with respect to wealth management products should therefore be conducted to ensure consistent regulatory approaches and avoid any unjustified differential treatment.

Regulatory overlap also arises between the CBRC and China’s central bank, the People’s Bank of China (PBOC). The functions and responsibilities of the PBOC reflect those that are common among central banks, including formulating and implementing monetary policies, issuing Rennminbi and monitoring its circulation; supervising and administering the inter-bank lending market and the inter-bank bond market; and maintaining the payment and settlement system. However, the responsibilities of the PBOC also include ‘planning financial industry reform and development strategies’, ‘promoting the coordinated and healthy development of the financial industry’, ‘promoting the orderly opening up of the financial industry’ and ‘formulating rules on regulation of financial holding companies together with other financial regulatory authorities and monitoring financial holding companies and cross-sector financial products’. As a result, there is significant potential for overlap between the functions of the PBOC and those of the CBRC. This overlap has been noted by commentators, particularly as a result of the extent to which the PBOC continues to be responsible for the macro-supervision of banks and certain aspects of micro-supervision.

 issu cred guidance, to ensure that prudential goals are taken into account in implementing economic policies. What is important is that banks and CBRC react quickly to check imprudent practices that may result in certain cases. There are recent examples of CBRC acting, both in advance to ensure prudential goals were met in implementing national economic policies, and when it subsequently became clear that the appropriate balance might not be achieved.’


33 Ibid.

34 Ibid, 28.


36 See, for example,樊荣超[Fan Rongchao], 中央银行和银监会的法律层面冲突 [‘The Legal Conflicts between PBOC & CBRC’]中国科技论文在线 Chinese Science Paper Online (2005), 1.
3 Regulatory coordination

(a) The history of regulatory coordination in China

The first attempt to achieve regulatory coordination in China occurred in 2000, when the PBOC, along with the CSRC and the CIRC jointly agreed to hold joint conferences from time to time to coordinate financial regulation (the ‘2000 Conference’). Mo Fei has suggested that the 2000 Conference was of limited impact because the three members did not have equal power and, at the time, there were not enough cross-sector financial activities to require a sophisticated and coordinated regulatory approach. However, as cross-sector financial activities increased, challenges associated with regulatory overlap and vacuum began to emerge. It has been suggested that some of these challenges were attributable to organisational self-interest.

The 2000 Conference largely remained inactive until September 2003, when the CBRC replaced the PBOC in the 2000 Conference and the members of the joint conference held a meeting for the first time and signed a memorandum of understanding clarifying the working mechanism of the 2000 Conference (the ‘Coordination Memorandum’). Although the Coordination Memorandum required the regulators to meet every quarter, after its first meeting in September 2003, the regulators did not hold another meeting until March the following year and it appears that no further meetings were held until the 2013 Joint Ministerial Conference was instituted.

Commentators have argued that this mechanism has not worked well to achieve coordination between the three regulators. For example, in early 2004, the CBRC issued orders to stop banks from lending to security companies in order to quarantine banks from risks in the securities market because it was unable to effectively supervise the funds that were flowing from banks to security

37 田俊荣 [Tian Junrong], 三大金融监管部门建立联席会议制 [‘Three Main Financial Regulators Establish Joint Conference Mechanism’] 人民日报 People’s Daily (Beijing), 5 Sep 2000, 2.
39 In late 2003, for example, the PBOC and the CSRC had a difference of opinion over the regulation of money market funds (货币基金) because the central bank thought that money market fell within its jurisdiction and the CSRC thought fund products was a form of security investment and therefore it should be the regulator. Ibid.
40 安起雷 [An Qilei], 完善我国金融监管协调机制的方案设计及模式选择 [‘Design to Optimise China’s Financial Supervision Coordination and Mode Selection’] (2012) 3 中国发展观察 China Development Observation, 47-51, 48.
42 Coordination Memorandum, Article 15.
companies.\textsuperscript{44} In addition, the collapse of Delong International highlighted the ineffectiveness of the 2000 Conference in managing cross-sector financial activities.\textsuperscript{45} Associate Director of the Institute of Financial Research of the Centre for Developmental Research of the State Council, Ba Shusong, was reported as saying that a key shortcoming of the 2000 Conference was its lack of real power and its inability to issue binding regulations. Further, the 2000 Conference operated on an \textit{ad hoc} basis and there was no overarching coordination plan.\textsuperscript{46} An adviser at the PBOC also noted that the need for the three sector-based regulators to ask the State Council for instructions every time there was a deadlock, as required by the Coordination Memorandum, further exacerbated regulatory inefficiency.\textsuperscript{47}

The second attempt to coordinate financial regulation came amidst the global financial crisis. In August 2008, the State Council issued the Regulation on People’s Bank of China’s Main Responsibilities, Internal Departments and Personnel Arrangements (the ‘2008 Regulation’), expanding the responsibility of the PBOC to include ‘taking charge to coordinate financial regulators to formulate regulatory rules for financial holding companies and standards and norms for cross-sector financial activities, and to supervise financial holding companies and cross-sector financial instruments’.\textsuperscript{48} In addition, the 2008 Regulation expressly established a Joint Ministerial Conference Mechanism led by the State Council with the PBOC, the CBRC, the CSRC and the CIRC as the members (the ‘2008 Conference’).\textsuperscript{49}

The purpose of the 2008 Conference was to ‘strengthen coordination between monetary policy and regulatory policies and between regulatory policies and legislation’ and to ‘establish a financial information-sharing mechanism’, with ‘important problems’ to be submitted to the State Council for decision.\textsuperscript{50} However, the arrangements remained high-level in nature and it appears that no meeting was held under the 2008 Conference.\textsuperscript{51} Consequently, the second attempt to achieve effective coordination between the financial regulators suffered from the same problems that its predecessor had experienced; namely, unclear delineation of responsibilities, lack of real power to issue binding documents, a weak information-sharing mechanism and an \textit{ad hoc} approach to problem-solving.\textsuperscript{52} In

\textsuperscript{44} Мо Фей [Mo Fei], above n 38.

\textsuperscript{45} 高慧斌 [Gao Huibing], 如何完善金融监管协调机制 ['How to Optimise the Financial Regulatory Coordination Mechanism'] 辽宁日报 \textit{Liaoning Daily} (Liaoning), 15 Nov 2006, 3.

\textsuperscript{46} Ibid.

\textsuperscript{47} 陆媛 [Lu Yuan], 金融监管协调机制有待完善 ['Financial Regulatory Coordination Mechanism Needs Improvement'] 第一财经日报 \textit{China Business News} (Shanghai), 15 Mar 2007, B01; See also 余靓 [Yu Liang], 我国银行监管协调机制亟待法制化 ['China’s Banking Regulation Urgently Needs Legislation'] 中国证券报 \textit{China Securities Journal} (Shanghai), 17 April 2008, A07.


\textsuperscript{49} Ibid, point 5(4).

\textsuperscript{50} Ibid.

\textsuperscript{51} 史进峰 [Shi Jinfeng], 央行牵头，金融监管协调联席会议制度化 ['Central Bank Takes the Lead, Financial Regulatory Coordination Mechanism Solidifies'] 21 世纪经济报道 21 \textit{Century Business Herald} (Guangzhou), 21 August 2013, 9.

\textsuperscript{52} 蔡军龙 [Cai Junlong], 论混业经营趋势下我国金融监管协调机制的完善 ['Consummation of Financial Regulatory Coordination Mechanism Under the Trend of Mixed Management'] 《经济法论丛》 2012 年 12 第 23 卷 \textit{Economic Law Forum}, Volume 23, December 2012, 97-127, 110; see also, 安起雷 [An Qilei], above n 40.
fact, an empirical study found that despite the existence of the 2000 and 2008 Conferences, the degree of coordination in the area of financial regulation remained very low.53

(b) The 2013 Joint Ministerial Conference

The third and most recent attempt to achieve regulatory coordination was initiated in 2013, by which time the PBOC reported that market conditions had changed greatly and financial product innovation had reached an unprecedented level.54 Like the 2008 Conference, the 2013 Conference is led by the PBOC with the three sector-based regulators as members and the State Administration of Foreign Exchange (SAFE) as an additional member. In addition, the 2013 Conference permits the National Development and Reform Commission and the Ministry of Finance and other relevant agencies to be invited to its meetings where necessary.

As was the case under the 2008 Conference, the 2013 Conference is required to submit ‘important problems’ to the State Council for instructions. Unlike the 2000 Conference, however, it does not, provide how often meetings should be held. The objectives of the 2013 Conference are much the same as those of the 2008 Conference; namely, to coordinate monetary policy and regulatory policies, to coordinate financial regulatory policies and legislation as well as to facilitate financial information-sharing and to maintain financial stability. Significantly, the State Council’s approval expressly states that the 2013 Conference ‘does not change the current mechanism of financial regulation, nor substitute or weaken the current division of responsibilities of relevant government agencies’, and that it also ‘does not act as a substitute for the decisions of the State Council’.55 This leaves the structure of the 2013 Conference essentially the same as that of the previous two Conferences.

With the exception of a few details, the 2013 Conference is very similar to its predecessors. What is different, however, is that it has led to eight meetings in the two years since its inception in August 2013,56 despite reports of disharmony between the regulators.57 Nevertheless, no detailed procedural rules for the conduct of the 2013 Conference have been issued. As a result, some have

noted that the effectiveness of the 2013 Conference is unpredictable and that the inability of the 2013 Conference to issue formal documents further adds to its uncertain effectiveness.

A member of the Standing Committee, Wu Xiaoling has noted that several issues need to be addressed for the 2013 Conference to work effectively. Firstly, the definition of ‘important problems’ that need to be reported to the State Council must be clarified so that responsibility can be clearly delineated; secondly, accountability mechanisms must be established so that the 2013 Conference has the incentive to ensure implementation of the regulations passed as a result of its efforts.59

(c) Coordination Memorandum

The Coordination Memorandum, which was signed on 28 June 2004, provides that its objective is to clarify the responsibilities of the three regulators – CBRC, CSRC and CIRC – in the area of financial regulation, achieve coordination and cooperation between them, avoid regulatory vacuum and regulatory duplication, increase regulatory efficiency and encourage financial innovation in order to achieve continuously effective regulation of all financial institutions and the financial business in which they are involved and ensure the stable operation of the finance industry and its healthy development.60

The Coordination Memorandum is expressed to be based on five principles: (1) separation of regulation; (2) clarity of responsibilities; (3) orderly cooperation; (4) transparency of rules; and (5) pursuing practical results.61 In addition to setting out the allocation of responsibilities between the three regulators,62 the Coordination Memorandum provides in Article 8 that financial holding companies will continue to be regulated in accordance with the principle of separate operation and separate management, their group companies will be regulated by the relevant regulator based on their main business and their internal departments will be regulated separately based on the nature of their business.

Similar to regulatory memoranda of understanding in other jurisdictions, the Coordination Memorandum provides that if any regulator requires information from entities that are regulated by another regulator, it may engage the other regulator to collect the relevant information.63 It also provides that the three regulators must cooperate closely with the Ministry of Finance and the PBOC and jointly preserve the stability of the financial system and confidence in the financial markets.64 Further, it contains provisions on information-collection.65

59 Wu Xiaoling, n 58 above.
60 Article 2.
61 Article 3.
62 Articles 4 – 6.
63 Article 7.
64 Article 10
65 Article 11.
Articles 15 sets out the working mechanism of the ‘regulatory coordination meeting system’, under which the regulatory coordination meeting is constituted by the chairpersons of each regulator (or their delegates) and meets once each quarter ‘to discuss and coordinate major issues concerning financial regulation, the market response to, and evaluation of, policies that have been released and other matters on which the regulators should consult, report and exchange views’. The Coordination Memorandum provides that the meeting should only discuss major issues concerning the three regulators and that the original allocation of functions between the three regulators and the mechanisms for their daily work should not change. The meeting notes must be reported to the State Council for approval before any decisions are implemented.

Article 16 provides that if a regulator makes a change to major policies or matters in its area of regulation or a major change in its regulatory action would have a significant effect on the activities of entities regulated by another regulator, it must inform the other regulators in a timely manner. If a policy change involves the regulatory responsibilities of another regulator and its regulated entities, the views of the other regulator must be sought and its counter-signature must be obtained before the policy is adjusted.

An important feature of the Coordination Memorandum is the ‘countersign’ mechanism, which requires the other two of the three financial regulators to countersign when one of the regulators plans a ‘major change’ in policy affecting the other sectors. Some commentators have expressed doubt over this mechanism on the basis that it does not have binding force and is simply a notice mechanism.

The following discussion examines the experience of regulatory coordination in China to date and the impact of the Coordination Memorandum.

(d) Experience of regulatory coordination in China to date

As noted above, since the first attempt to achieve regulatory coordination, the financial regulators in China have encountered various challenges. The literature suggests that these challenges can be divided into the following categories: (1) challenges associated with regulatory vacuum and regulatory arbitrage; (2) the challenges of regulating financial conglomerates or financial holding companies; and (3) regulatory overlap and differences of opinion between the regulators.

The first category involves uncertainty over which regulators are responsible, which regulator should take the lead and how actions by the regulators should be coordinated. An example of this is Nanfang Securities. Established in December 1992, Nanfang Securities was one of China’s oldest national securities firms. Following allegations of insider trading and manipulation of stock prices, the CSRC issued a penalty decision on 11 October 1999, which involved confiscation of illegal proceeds and fines. Although there had been reports of non-compliance with key disclosure...
requirements in July 2002, the authorities took a long time to act, reportedly because the Treasury, the PBOC, the CBRC and the CSRC had serious differences of opinions as to how the issue should be resolved. Nanfang Securities was ultimately ordered to close and was liquidated in May 2005.

The second category is exemplified by the issues concerning the collapse of the Delong Group, which has been described as a ‘quasi-financial conglomerate, or an industrial-commercial group with financial elements.’ According to Fan Liao:

The Delong story fully demonstrates the insufficiencies of the existing legal and regulatory framework with respect to financial conglomerates: key rules had not been put in place in terms of division of regulatory responsibilities, qualification and licence for market admission, limitation on the affiliation between financial and industrial-commercial enterprises, and control over intra-group affiliated transactions, thus providing inadequate guidance for regulatory practice and leaving loopholes for market participants. Furthermore, the absence of information-sharing and emergency coordination mechanisms prevented group risks from being timely identified, assessed and addressed, resulting in further losses.

The third category is exemplified by the reported tension in 2014 between the PBOC and the CBRC in relation to the regulation of off-balance sheet activities in the banking sector and financial innovation, including so-called shadow banking activities, much of which increased after stimulus measures taken by the PBOC after the global financial crisis. The tensions are particularly acute between the PBOC and the CBRC as a result of their overlapping objectives. Fan Rongchao has identified the following areas of potential conflict: incompatible information-sharing systems (particularly as a result of limited resources) and inconsistent systems for assessing risk on the part of banking institutions and managing financial risks. This, Fan suggests, increases the difficulties in terms of reaching agreement. The difficulties are compounded by the fact that major matters must be determined by the State Council and it is the State Council that must coordinate differences of opinion between the two regulators.

B Reform Proposals

The calls for reform of China’s financial regulatory model can be divided into four categories: (1) the call for China to move towards a twin peaks model along similar lines to the Australian model; (2) the call for China to move towards functional regulation along similar lines to the US model; (3) the call for China to move towards an integrated model along similar lines to the previous model in the

72 Ibid.  
73 The reported turf war between the CBRC and the PBOC in 2014 was reportedly triggered by differences of opinion over how to deal with domestic bond defaults and concerns about off-balance sheet activity of the state-controlled banking system, shadow banking and the risks of financial innovation. See Jamil Anderlini, ‘China bank regulators caught in turf war’, above n 57; Jamil Anderlini, ‘Fear of crisis intensifies China’s political battles’, above n 57; David Keohane, ‘Shadow banking in China: custody battle edition’ Financial Times (15 January 2014).  
74 Fan, above n 36, 4-5.
UK; and (4) the call to enhance the status quo (i.e. the existing Chinese model) by strengthening coordination and the independence of the agencies. Each of these proposals is outlined below.

1  **Twin peaks**

Most commentators who favour a move towards twin peaks advocate that China should adopt a staged approach, under which the twin peaks model should be adopted in the mid-to-long term.\(^75\) Some argue that in the short-term, China should move towards the US approach of regulation along functional business lines with strengthened coordination. For example, Ba et al propose that in the near term, the PBOC should be authorised to regulate financial conglomerates to minimise systemic risk and the focus should be placed on systemically important institutions. Further, based on the current institutional regulatory model, an agency similar to the US Financial Stability Oversight Council should be established to coordinate the regulators and strengthen information-sharing. In the mid to long term, as the financial market structure becomes more developed, China’s regulatory system should pay more attention to macro-prudential supervision of systemic risk in the financial markets. During this stage, Australia’s ‘Twin Peaks’ model or the UK’s previous sole regulator model should serve as a reference.\(^76\)

In terms of the mechanism by which the twin peaks model should be adopted, Yu proposes that prudential regulation should be vested in the CBRC and the function of regulating market conduct, fair competition and financial products and services should be vested in the CSRC. Outside the twin peaks, the PBOC and the Ministry of Finance should be responsible for macro-prudential regulation and coordination.\(^77\)

Dong and Zhan propose that in the first phase, coordination should be strengthened through the establishment of a Joint Financial Regulatory Committee. In addition, the regulatory functions of the PBOC should be reduced so that it only retains the power to maintain financial stability and to set monetary policy. In the long-term, after the Joint Financial Regulatory Committee has obtained regulatory experience and the relevant personnel, it should be split into two bodies: a financial regulatory bureau to perform the function of prudential regulation and a market conduct and consumer protection regulator along the lines of the ‘twin peaks’ model.\(^78\)

2  **Functional regulation**

Those who favour a move towards functional regulation tend to advocate an expanded role for the PBOC as the lead coordinator. This is similar to the ‘umbrella’ form of regulation as established by the Gramm-Leach-Bliley Act, under which the central bank is designated ‘as the overall regulator, or

---


umbrella regulator, for [financial holding companies]’ and ‘the various financial subsidiaries are subject to regulation by the corresponding functional regulators.’ On this basis, the central bank would act as the ‘overarching supervisor’ or umbrella supervisor and be responsible for leading the permanent coordination mechanism.79

The supporters of a move towards functional regulation argue that China is not well prepared for a move towards an integrated model and that regulation along functional business lines with the central bank as the lead coordinator would be a better choice.80 The reasons for rejecting the integrated model include China’s limited experience in financial market regulation, the extent of government involvement in the financial markets and the extent to which the umbrella model is adaptive and achieves a balance between market safety and efficiency.81

3 Integrated model

Those who favour a move towards the integrated model, either under the PBOC or under another body (i.e. similar to the previous FSA model in the UK), tend to advocate that the need for integrated regulation is driven by financial innovation and that China should establish a single integrated regulatory system when the conditions are mature.82 Some argue that ‘even a unified supervision system is unable to effectively regulate [the integration of industry and finance] and cross-industry management’ and that it is necessary ‘to establish “the super supervision system” in which the Central Bank is a leader, [supported] by the financial supervision institutions and anti-monopoly organization.’83

In terms of the mechanism by which an integrated model should be adopted, Qian proposes that this could be achieved in one of two ways. The first option would see the establishment of a Central

---

79 Liao, above n 71, 302-305.
80 For Liao’s arguments against the adoption of an integrated model in China, see Liao, above n 71, 306-309.
81 The author argues that ‘what is needed now in China is not a hasty integration of financial regulators, but rather the establishment and operation of an official regulatory cooperation and coordination mechanism led by the People’s Bank, with the necessary “teeth” such as a dispute resolution mechanism.’ (313) See also Ge Jianguo, Wang Xuesong and Zhang Xiaolei, ‘China’s Financial Regulatory Reform in Post-WTO Period’ (2008) 23(9) Journal of International Banking Law and Regulation 480-488. See also 陈巍 [Chen Wei] 中国分业经营向混业经营转变过程中的金融监管研究 [Financial Regulation in the Transition from Institutional Operation to Mixed Operation] 中国商贸，2013 年 6 月 China Business and Trade, June 2013. Chen argues that a completely unified regulatory system should replace the institutional model and that a central regulator with highly concentrated regulatory powers should be established, namely the China National Financial Regulation and Administration Bureau, to undertake comprehensive regulatory functions in relation to banking, insurance and securities business. The Bureau should be directly managed by the central government and should be free of interference by local governments. In addition, a uniform legislative framework should be adopted to reduce government interference in financial regulation; self-regulation by professional bodies should be strengthened and the independence and professionalism of the financial regulators should be increased. See also 张锋 [Zhang Feng] 关于完善中国宏观审慎层面金融监管协调机制的探讨 [Improving China’s Macro Financial Regulation Mechanism] 经济研究导刊，2013年第 33 期 Economic Research Guide, Issue 33, 2013. Improving China’s Macro Financial Regulation Mechanism
Financial Supervisory Commission under the State Council to act as a coordinating body between the financial regulators along the lines of the Council of Financial Regulators in Australia.\textsuperscript{84} Under the second option, a Chinese Financial Supervisory Commission would be established to consolidate the regulation of banking, trust, securities, and insurance business and would take charge of both establishing and implementing financial regulation policies.\textsuperscript{85}

Lu and Wang suggest that the move towards the integrated model could be undertaken through three transitional phases: in the short-term, a Financial Supervisory Commission should be established above the CBRC, the CSRC and the CIRC to coordinate financial supervision; in the mid-term, the three regulators should be combined, their common functions should be consolidated and appropriate adjustments should be made to the specialist regulatory departments; in the long-term, regulation should be undertaken according to the different regulatory functions: market stability, prudential supervision, and market conduct aimed at consumer protection. Under this system, the PBOC would take responsibility for implementing monetary policy and maintaining market stability; prudential regulation and market conduct regulation would be undertaken by the Financial Supervisory Commission.\textsuperscript{86}

Along similar lines, Cao Fengqi has suggested that reform should be carried out in three stages. In the first stage, coordination should be strengthened between regulators, institutional supervision should transition towards functional supervision, and a legal framework should be established to regulate financial holding companies. In the second stage, a financial regulatory coordination commission should be established under the State Council. The PBOC should act as the lead regulator of financial holding companies and the CBRC, the CSRC, and the CIRC should regulate subsidiaries of financial holding companies and other financial institutions based on their functions. In the final stage, a China Financial Supervisory and Regulatory Commission (“FSRC”) should be established under the State Council and alongside the PBOC. The banking, securities, and insurance regulators should be established as bureaus under the FSRC, with the FSRC directly regulating the parent companies of financial conglomerates.\textsuperscript{87} Cao subsequently changed his recommended design of the FSRC, proposing that three sub-commissions with different regulatory objectives should be interposed between the FSRC and the banking, securities, and insurance regulatory bureaus: a Financial Prudential Regulatory Commission, an Investor Protection Commission, and a Financial Stability Commission.\textsuperscript{88}

\textsuperscript{84} 钱小安 [Qian Xiao'an], 建立中国统一的金融监管体制的构想 [‘A Panorama of An Integrated Financial Administrative and Supervisory System in China’] 《财经科学》2002 年第 1 期 Finance & Economics, Issue 1, 2002.

\textsuperscript{85} Ibid.


\textsuperscript{87} 曹凤岐 [Cao Fengqi], 改革和完善中国金融监管体系 [‘Reforming and Improving the Chinese Financial Regulation System’] 北京大学学报（哲学社会科学版）第 46 卷第 4 期, 2009 年 7 月 Journal of Peking University (Philosophy & Social Science) Volume 46, Issue 4, July 2009.

\textsuperscript{88} Cao, 2013 [cite]. A similar structure has been advocated by 张燕 [Zhang Yan], 我国金融监管体系改革的趋势分析研究 [Analysis on the Trend of China’s Financial Regulation Reform] 财经界, 2014 年第 13 期 Financial Circle, Volume 13, 2014. Zhang suggests that a Financial Service Regulatory Commission should be established under a China Financial Supervisory System Reform Law and that the three bureaus should operate below the Commission. The Commission would directly supervise financial holding companies.
Those who favour enhancing the status quo argue that the solution lies in strengthening information-sharing and coordination between the regulators through the establishment of an umbrella coordination body. Some have also called for the establishment of a macroprudential financial regulatory coordination framework at the central and local government levels.

Cai argues in favour of the establishment of a Financial Regulatory Coordination Commission under the leadership of the State Council as a permanent body to coordinate the policies and operations of the regulators and to overcome challenges in information-sharing. An Qilei argues that a coordination body under the State Council would result in inefficiencies and a situation where the individual regulators do not take responsibility and that it would be better for the State Council to authorise the People’s Bank of China to take the lead in the establishment of a Financial Regulatory Coordination and Cooperation Commission, of which the members would be the CBRC, the CSRC and the CIRC and, where necessary, bodies such as the Ministry of Finance would attend as alternate members.

Other commentators have suggested that China should learn from the experience of other countries in strengthening coordination between the financial regulators. Zheng has noted the extent to which China can learn from the Australian experience concerning regulatory coordination in terms of (1) including the central bank and Treasury as part of the coordination mechanism; (2) having the Council of Financial Regulators led by Treasury and chaired by the Reserve Bank of Australia to coordinate between the regulators and ensure that the regulatory memoranda of understanding (MOUs) do not just have a formal function; (3) having bilateral MOUs between the regulators to achieve regular information-exchange and work cooperation; and (4) establishing coordination committees between the regulators to update information and to ensure that there is effective communication and exchange of views. In Zheng’s view, the experience in Australia suggests the

---

89 See Kuan-Chun Chang, ‘From Zero to Something: The necessity of Establishing a Regulatory System of Financial Conglomerates in China’ (2010) 11 Asian-Pac. L. & Pol’y J. 1. Chang further argues that it is important for financial supervisors to be independent from undue pressure and influence imposed by politicians and industries.’ (49). ‘So long as a proper coordination mechanism among supervisors is available, and the independence of supervisors can be enhanced, the structural change of supervisors is not imminent.’ (50). See also Cai, above n 51; 刘天琦 [Liu Tianqi] 金融混业经营背景下我国金融监管体系的构建 [Financial Regulation in the Backdrop of Mixed Financial Groups] 财政金融，2013 年第 15 期 Finance & Banking, 2013, Issue 15; 高田甜，陈晨 [Gao Tiantian, Chen Chen] 金融监管体制：国际比较、发展趋势与中国选择 ['Financial Regulatory System: the International Comparison, Development Trend and China’s Choice'] 上海金融 2013 年第 10 期 Shanghai Finance, 2013, Issue 10, 67. Gao and Chen argue that the inherent conflict between prudential regulation and consumer protection needs to be solved to avoid regulators focusing too much on protecting the interests of financial institutions and ignoring the protection of consumers. Even though each of the financial regulators has a financial consumer protection unit, it is structurally part of the prudential regulators’ internal organs and lacks independence. In the short-term, the consumer protection unit needs coordination to achieve better information-sharing and cooperation. In the long term, a financial industry-wide consumer protection agency independent of the prudential regulators should be established (72-73). Further, the legislative framework governing consumer protection should be improved.


91 Cai, above n 52, 125.

92 An Qilei, above n 40, 49.
following: first, a financial regulatory coordination commission should be established at both the State Council level and the institutional regulators level. At the State Council level, the commission should take the form of the Financial Stability Commission, assisted by the relevant State Council departments, the National Development and Reform Commission, and the Minister of Commerce. At the institutional regulators level, the PBOC should take the lead in the coordination commission, which should consist of the three institutional regulators, the PBOC, and the Ministry of Finance. As a reflection of the leading role of the PBOC, the PBOC should have the casting vote in the event of a deadlock. Secondly, bilateral MOUs should replace the current inefficient tripartite MOU, as the allocation of duties and responsibilities would be clearer this way. Thirdly, coordination committees should be established between the regulators to ensure that there is regular communication and information-exchange.93

5 Analysis of reform proposals

On a scale that measures the extent of reform that would be required for their implementation and the level of disruption that this might involve, the first and third options are at the higher end and the second and fourth options are at the lower end. There is a natural correlation between the options in each of these two groupings as the first option (i.e. a move towards twin peaks) may well be achieved through a transitional move towards the third option (i.e. the integrated model). In addition, the move towards the second option (i.e. functional regulation) may well be achieved through a transitional move towards the fourth option (i.e. enhancing the status quo).

This paper suggests that the fourth option, even with the establishment of an umbrella coordination body, is unlikely to accommodate China’s needs in the mid-to-long term as a result of the increasing integration of the financial sector and the deficiencies that are inherent in an institutional model. In particular, these deficiencies are exacerbated by the degree of regulatory overlap between the PBOC and the CBRC. As a result, the second option (i.e. functional regulation under the PBOC as the umbrella regulator) is likely to be the easiest and least disruptive of the first three options. The benefit of the second option is that it maintains the current role of the PBOC but expands it to include coordination. However, this option is unlikely to be fully effective without reforms to increase the operational independence of both the PBOC and each of the financial regulators.

The PBOC China Financial Stability Report 2015 overviews and compares the different financial regulatory models in western and Asian countries, including Australia’s ‘twin peaks’ model. It observes that China’s regulatory model is generally performing well and is suitable for the current economic conditions. However, as the financial industry continues to develop and innovate, there is an increasing number of issues such as regulatory arbitrage and lack of regulation in some areas. The Report concludes that reforms to China’s regulatory system should include establishing a macroprudential regulatory framework, strengthening the role of the 2013 Joint Ministerial Conference, and promoting the interaction of institutional regulation and functional regulation.94 This suggests that from the perspective of the PBOC at least, the preference would be to move in the direction of a combination of the second and fourth options.

IV Australia’s Experience and the Twin Peaks Model

In the research and commentaries as outlined in Part III above, the system of financial regulation as implemented in Australia is often considered to be synonymous with the archetypal twin peaks model and is cited as providing insights and experience on which China should draw for the purpose of examining its own reform proposals. The analysis in this part examines Australia’s experience and the twin peaks model that it has adopted, and provides the context for a consideration of the insights that Australia’s experience might offer for China in Part V. The purpose of the analysis is two-fold. First, it argues that although Australia’s experience may be relevant in various areas such as the mechanisms for achieving effective regulatory coordination, the design of its twin peaks model is somewhat idiosyncratic when compared with other twin peaks models. Accordingly, if China decides to move towards the twin peaks model, there are aspects of Australia’s version of twin peaks that may not be suitable for China. Secondly, the analysis offers insights into relevant aspects of Australia’s experience that might be instructive to China generally in determining whether the twin peaks model should be considered as an option for reform to its own system of financial regulation.

A Background to Twin Peaks in Australia

The reforms that introduced the twin peaks model in Australia were driven by the Wallis Inquiry, which was established in 1996 to review the financial system.\(^6\) The Wallis Inquiry made a number of important recommendations. First, it recommended that a single agency be established for the regulation of companies, market conduct and consumer protection.\(^7\) Noting that conduct and disclosure regulation in Australia had previously ‘been provided through a variety of agencies, with arrangements governed by the institutional form of the service provider’, the Wallis Inquiry considered that ‘such arrangements [were] inconsistent with the emerging structure of markets’ and ‘resulted in inefficiencies, inconsistencies and regulatory gaps and [were] not conducive to effective competition in financial markets.’\(^8\) The reforms pursuant to the Wallis Inquiry resulted in the conversion of the Australian Securities Commission into the Australian Securities and Investments

---

96 For the recommendations of the Wallis Inquiry, see <http://fsi.treasury.gov.au/content/downloads/FinalReport/overview.pdf>. See also Anthony Jensen and Michael Kingston, ‘The Australian ‘Twin Peaks’ framework of financial system regulation: Australia and UK compare’ (2010) Journal of International Banking and Financial Law, 548, 549: ‘The concept of separate prudential and disclosure/conduct regulators, forming a ‘Twin Peaks’ regulatory structure, emerging from the Wallis Inquiry, owes at least some debt to the influential work of Michael Taylor who in 1995 wrote an article entitled ‘“Twin Peaks”: A regulatory structure for the new century’ ...In a UK regulatory context, the article advocated functionally based regulation and the consolidation of the existing multiplicity of regulatory bodies into two commissions, one responsible for the financial soundness of all systemically important financial institutions and the other responsible for consumer protection’.
97 Recommendation 1.
98 Financial System Inquiry (‘Wallis Report’), ‘Overview – The Financial System: Towards 2010’ (Commonwealth of Australia, 1997) 17. According to the Wallis Report, 17-8 ‘[r]egulation for the integrity of market conduct, consumer protection and the regulation of companies have significant synergies. These functions should therefore be combined.’
Commission (ASIC) with expanded responsibilities for consumer protection in areas such as superannuation and insurance. ASIC is governed by the Australian Securities and Investments Commission Act 2010 (Cth).

Secondly, the Wallis Inquiry recommended that a single prudential regulator be established to carry out prudential regulation in the financial system.99 It considered that ‘[c]ombining prudential regulation in a single regulator [would] better accommodate the emergence of wide ranging financial conglomerates100 and enable a more flexible approach over time to changes in the focus of prudential regulation.’ Further, ‘[s]uch an entity [would] be better placed to reduce the intensity of regulation, and so lower its cost, in the likely event that new technologies or other developments facilitate a reduction in systemic risks.’101 The reforms resulted in the creation of the Australian Prudential Regulation Authority (APRA), which is governed by the Australian Prudential Regulation Authority Act 1998 (Cth).

Both ASIC and APRA cooperate with the Reserve Bank of Australia (RBA)102 and the Department of the Treasury in relation to financial regulation and the coordination of regulatory functions.103

Thirdly, the Wallis Inquiry recommended that the prudential regulator ‘should be separate from, but cooperate closely with, the Reserve Bank of Australia’ and that ‘strong mechanisms should be established to ensure appropriate coordination and cooperation between the two agencies.’104 When compared with other twin peaks jurisdictions, Australia stands alone in terms of housing prudential regulation in an entity that is independent of the central bank. As noted above, APRA is established under its own legislation and operates outside of the RBA. By contrast, the UK operates a unique model where the Prudential Regulation Authority is a subsidiary of the Bank of England (BoE). In the Netherlands, Belgium and New Zealand, the prudential regulator is a part of the central bank.

Finally, for our purposes, the Wallis Inquiry recognised the need for information sharing and co-ordination between the key regulators105 and recommended that the Council of Financial Regulators coordinate a broad range of activities ‘with the aims of facilitating the cooperation of its three

99 Wallis Report, Recommendation 31. This would involve transferring all prudentially regulated financial corporations from state jurisdiction to Commonwealth jurisdiction in a move away from the state-based regulation as is still much the case in the United States.
100 When the legislative framework for twin peaks in Australia was implemented, the concentration of prudential supervision in APRA was seen as enabling APRA ‘to provide flexible, efficient, coordinated and consistent regulation across the financial sector, particularly for financial service conglomerates.’ Commonwealth, Parliamentary Debates, House of Representatives, 26 March 1998, 1650 (Peter Costello).
102 The Reserve Bank of Australia is the central bank of Australia and is required to carry on business as a central bank: Reserve Bank Act 1959 (Cth) s 26.
103 See further in section C below for a discussion of regulatory coordination.
104 See Recommendation 32. Coordination and cooperation were to be achieved by making provision for ‘full information exchange between the RBA and [APRA]’ and for ‘RBA participation in [APRA] inspection teams’. Further, ‘[a] bilateral operational coordination committee, chaired by an RBA deputy governor, should be established to coordinate information exchange, reporting arrangements on financial system developments, and other ongoing operational cooperation between the RBA and [APRA], including cooperation in establishing clear procedures for the management of regulated entities which experience financial difficulties’: Wallis Report, ‘Overview’, above n 98, 11-2.
105 See Jensen and Kingston, above n 96, 549.
members (the RBA, [APRA] and [ASIC]) across the full range of regulatory functions, and the attainment of regulatory objectives with the minimum of agency and compliance costs.\textsuperscript{106}

The Wallis Inquiry identified several factors justifying a move towards a twin peaks model of financial regulation, all of which resonate with the challenges in China today. These included innovation in product design and distribution, which had ‘blurred the boundaries between financial instruments and institutions,’ intensifying competition from new competitors ‘emerging from outside the financial system and from overseas’ and conglomeration, which was occurring within financial services institutions. The Wallis Inquiry noted that ‘[t]he ideal regulatory scheme [required] a balance between preventing market failure and allowing financial markets to perform efficiently the functions for which they were designed.’\textsuperscript{107}

An analysis of the regulatory framework and experience in Australia suggests that two features stand out as being of critical importance to the effective operation of the twin peaks model. The first is clarity in terms of the responsibilities and objectives of each regulator, which requires a clear demarcation between the roles of the regulators and the minimisation of regulatory overlap. The second, which is closely related to the first, is a framework of coordination that encourages both regulators to share information proactively and to cooperate in the performance of their supervisory and enforcement functions.\textsuperscript{108}

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.\textsuperscript{109} This is because a market participant may be regulated by both regulators. Further, to ensure that comprehensive supervision is achieved and that issues do not fall between the cracks, it is necessary to achieve effective coordination between the regulators. This requires consultation, information-sharing and mutual cooperation in areas such as supervision and enforcement action.\textsuperscript{110}

The following section discusses the responsibilities and objectives of ASIC and APRA. The discussion is timely in terms of the recent Financial System Inquiry of 2014 (the ‘FSI’), which reviewed Australia’s financial system and examined many issues that are relevant to the ways in which the twin peaks model works in Australia.\textsuperscript{111}

\textsuperscript{106} See Wallis Report, Recommendation 112.
\textsuperscript{108} Andrew Godwin and Ian Ramsay, above n 95.
\textsuperscript{109} See Wymeersch, above n 5, 258.
\textsuperscript{110} Godwin and Ramsay, above n 95.
\textsuperscript{111} The FSI issued its interim report on 15 July 2014 (‘FSI Interim Report’) and its final report on 7 December 2014 (‘FSI Final Report’). The FSI was ‘charged with examining how the financial system could be positioned to best meet Australia’s evolving needs and support Australia’s economic growth’. See The Hon Joe Hockey MP, Treasurer of the Commonwealth of Australia, ‘Financial System Inquiry’ (Media Release, 20 December 2013) <http://jbh.ministers.treasury.gov.au/media-release/037-2013/>. Submissions were invited from the public and were made in two rounds: one prior to the FSI Interim Report and the other prior to the FSI Final Report. It was the first comprehensive review of developments in the Australian financial system since the 1997 Financial System Inquiry, known as the ‘Wallis Inquiry’, and since the global financial crisis. Included within the terms of the FSI was a review of Australia’s regulatory architecture and ‘the role, objectives, funding and performance of financial regulators, including an international comparison’. For an outline of the recommendations of the FSI Final Report as it relates to the regulatory architecture of Australia’s financial system, see Andrew Godwin,
**Responsibilities and objectives**

1. **The Legislative Framework**

The necessity of regulators having clear responsibilities and objectives is reflected in the Basel ‘Core Principles for Effective Banking Supervision’\(^{112}\) and the ‘Insurance Core Principles’.\(^{113}\)

In relation to APRA, subsection 8(2) of the APRA Act provides that in ‘performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia.’ APRA thus has an express mandate to promote financial system stability.\(^{114}\)

The concept of ‘competitive neutrality’ reflects the desire that smaller institutions ‘be held to standards comparable with large institutions, in order to maintain competitive neutrality’,\(^{115}\) that APRA’s ‘prudential requirements [be] applied in a competitively neutral manner’ and that APRA ‘not place unreasonable expectations on smaller regulated institutions.’\(^{116}\) The concept of contestability is aimed at making it possible for market entrants to enter the market and compete effectively with existing participants.\(^{117}\)

In relation to ASIC, subsection 1(1) of the ASIC Act sets out the objects of the Act and refers to the functions and powers of ASIC:

1. The objects of this Act are:
   
   a. to provide for the Australian Securities and Investments Commission (ASIC) which will administer such laws of the Commonwealth, a State or a Territory as confer functions and powers under those laws on ASIC; and
   
   b. to provide for ASIC’s functions, powers and business;

   ...

\(^{112}\) Basel Committee on Banking Supervision, ‘Core Principles for Effective Banking Supervision’ (September 2012) 21.
\(^{113}\) International Association of Insurance Supervisors, ‘Insurance Core Principles’ (October 2011) 1. See also IOSCO, ‘Objectives and Principles of Securities Regulation’ (June 2010), Principle 1: ‘The responsibilities of the Regulator should be clear and objectively stated.’
\(^{115}\) Australian Prudential Regulation Authority, Submission, Financial System Inquiry, 31 March 2014, 16.
\(^{116}\) Ibid. In its FSI submission, APRA elaborated by saying ‘APRA acknowledges that the prudential regime can affect the relative position of competitors by imposing differential costs. For that reason, APRA aims to ensure that its prudential requirements are applied in a competitively neutral manner. All ADIs [authorised deposit-taking institutions], for example, are subject to the same set of behavioural requirements and minimum capital requirements; so too are general and life insurers. However, APRA also aims to ensure that its prudential requirements and supervisory approach are proportionate to risks. APRA works actively to ensure that it does not place unreasonable expectations on smaller regulated institutions. For example, in areas such as data management and analysis, capital planning and stress testing, APRA sets proportionately higher expectations for large ADIs and insurance companies than for smaller institutions, commensurate with their structure, resourcing and size and complexity of risks’: Ibid 25-6.
\(^{117}\) See ibid 27: ‘Contestability is strengthened when new entrants to a market have the potential to challenge the incumbents.’

---

25
Subsection 1(2) of the ASIC Act provides that ‘in performing its functions and exercising its powers, ASIC must strive to:

(a) maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and

(b) promote the confident and informed participation of investors and consumers in the financial system;

..."}

Detailed reference to the functions and powers of ASIC are contained in sections 11 and 12A. Section 12A (2) provides that ‘ASIC has the function of monitoring and promoting market integrity and consumer protection in relation to the Australian financial system.’

It is relevant to note that ASIC does not have an express mandate to promote financial system stability as in the case of APRA. Instead, the focus is on market conduct and investor/consumer protection. Nor is there a reference to competition, as in the case of APRA. In its submission to the recent FSI, ASIC suggested that this was anomalous and was supportive of a formal requirement ‘to consider the effect of its decision making on competition’. This, it submitted, ‘would drive a greater focus on the long-term benefits for the end users of the financial system’ and ‘help ensure that ASIC’s approach to regulation considered market-wide effects more explicitly.’ The effect of including a formal competition objective would be that ASIC would ‘select the most “competition-friendly” option from a range of potential regulatory responses, provided that this option was also capable of achieving ASIC’s other regulatory objectives.’ This was accepted in the recommendations of the FSI in its Final Report, which recommended that ASIC ‘be given an explicit competition mandate’ and that ‘periodic reviews of the state of competition should be conducted.’

As outlined above, APRA’s focus is 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. As the ‘legal’ regulator, ASIC should be relatively blind to institutional failure. APRA, on the other hand, acts as an ‘economic’ regulator, the focus of which is on protecting customers of prudentially regulated institutions, such as bank depositors and insurance policy-holders, from institutional failure. It is conceivable that action undertaken by APRA in the interests of financial stability, particularly in a time of crisis, would run counter to the interests of consumers or consumer protection laws.

Unlike other twin peaks jurisdictions, the legislative framework in Australia does not distinguish between the functions and objectives of ASIC based on whether they are ‘main’ or ‘strategic’. Other

---

119 Ibid 18-9. ASIC noted that the Australian Competition and Consumer Commission (ACCC) would remain the competition regulator. The call for a competition mandate was also made in the submission to the FSI by Minter Ellison: Minter Ellison, Submission, Financial System Inquiry, March 2014.
121 See Gail Pearson, Financial Services Law and Compliance in Australia (Cambridge University Press, 2009) 56. The distinction between APRA as the prudential regulator and ASIC as the conduct regulator was also noted by the IMF in ‘Australia: IOSCO Objectives and Principles of Securities Regulation—Detailed Assessment of Implementation’ (IMF Country Report No. 12/314, November 2012) 41.
jurisdictions, such as New Zealand, the UK and the Netherlands, identify ‘main’ or ‘strategic’ objectives. Use of the word ‘main’ suggests that in the event there is a conflict between objectives, the main objective will prevail. The use of the word ‘strategic’ suggests that the regulator must generally act in a way that is compatible with the strategic objective and that the operational objectives must be informed by the strategic objective.

In terms of the functions and objectives of the prudential regulator, Australia is broadly in line with other twin peaks jurisdictions. It is interesting to note that the UK Treasurer has the power to provide for new objectives with respect to the Prudential Regulation Authority (PRA). Where the Treasurer decides to exercise this power, it is subject to a Parliamentary approval procedure. In addition, the UK is unique in terms of giving the PRA the power to prevent the Financial Conduct Authority (FCA) from acting in limited circumstances. This is effectively a veto power, and will be used where ‘an action to be taken by the FCA... is likely to threaten the stability of the UK financial system...’ In 2011 the IMF raised concerns about the veto power, and stated that ‘without appropriate safeguards, this arrangement [had] the potential to limit FCA independence and also to cause uncertainty in decision making.’ Other jurisdictions do not recognise an equivalent regulator veto power.

2 Regulatory Overlap

A consistent theme in many of the submissions to the FSI was the need to reduce regulatory overlap and inconsistency between ASIC and APRA in circumstances involving jointly supervised or dual-regulated entities. According to several submissions, this was particularly relevant with respect to superannuation funds and superannuation regulations administered by APRA and ASIC. In its FSI

---

122 The NZ Financial Markets Authority Act 2011 (FMA Act), s 8, provides for the ‘main objective’ of ‘promoting and facilitat[ing] the development of fair, efficient, and transparent financial markets.’
123 In line with its objectives-based approach to regulation, the UK’s FCA provides for two types of high level objective: a ‘strategic’ objective of ensuring that ‘the relevant markets function well’ under the Financial Services Act 2012 (FS Act), Part 2 amendments to the FMA Act, s 1B(2) and the ‘operational’ objective of consumer protection, integrity and competition under s 1B(3). In addition to these objectives, the UK recognises a diverse range of ‘regulatory principles to be applied by both regulators.’ These relate to notions of efficiency, placing the onus of responsibility on consumers, and transparency. FS Act, Part 2 amendments to the FMA Act, s 3B.
125 See the UK House of Commons Treasury Committee, ‘Financial Conduct Authority’ (Twenty-sixth Report of Session 2010-12, 2012) 11.
126 FS Act, Part 2 amendments to the FMA Act, s 2D.
127 FS Act, Part 2B amendments to the FMA Act, s 9.
128 Explanatory Note, FS Act, para 10. The details provision is set out in FS Act, Part 2 amendments to the FMA Act, s 31.
submission, Treasury suggested that there was a ‘[n]eed to draw clearer demarcations with the responsibilities attributable to ASIC and APRA’.\textsuperscript{131}

In addition, Treasury noted that although the regulatory framework determined the prudential/non-prudential boundary based on the ‘intensity of promises’,\textsuperscript{132} it was difficult for investors, particularly retail investors, to distinguish between, on the one hand, institutions subject to prudential regulation by APRA and, on the other hand, institutions registered with ASIC and subject to the conduct and disclosure regime, and that this invited regulatory arbitrage.\textsuperscript{133} However, according to Treasury, ‘[i]mproving the ability to distinguish between entities regulated in different ways is likely to present the lowest cost option for dealing with this issue.\textsuperscript{134} The alternative, expanding the prudential perimeter to cover a larger range of businesses, [was] likely to invite regulatory arbitrage, and involve significant industry compliance and opportunity costs.\textsuperscript{135}

One submission noted the possibility of reducing regulatory overlap by adopting a system where an institution would have a primary regulator depending on the sector to which it belonged whilst all of the regulators would regulate in their respective areas of responsibility. However, the direct compliance and enforcement responsibilities would rest with the primary regulator. Such a model, it was suggested, ‘would ensure a consistent and coordinated approach for regulated entities informed by a regulator who understands the business of their regulated entities and...ensure that any regulation is enforced in a manner that promotes innovation, efficiency and competition in the particular sector.’\textsuperscript{136} Although a logical solution to regulatory overlap, the ‘primary regulator’ or ‘lead supervisor’ approach has been said to ‘[create] problems in terms of coordinating supervisory action, information flows and, ultimately, crisis intervention’\textsuperscript{137} and was not recommended in the FSI Final Report.\textsuperscript{138}

The following section discusses the issue of regulatory coordination between ASIC and APRA.

\section*{C Regulatory Coordination – The Legislative and Policy Frameworks}

\subsection*{1 The Legislative Framework}

As noted above, an analysis of the regulatory framework and experience in Australia suggests that coordination is critical for the twin peaks model to operate effectively because a market participant

\begin{footnotesize}
\begin{enumerate}
\item[132] The ‘intensity of promises’ approach posits that the intensity of prudential regulation should be greatest where the intensity of financial promises (and the risks of market failure) are greatest.
\item[133] Treasury, ‘Submission’, above n 131, 29. Regulatory arbitrage may arise where financial products are structured to avoid being subject to prudential regulation.
\item[134] This, Treasury suggested, was ‘not a trivial task, and it [underlined] the role for financial advisers in assisting unsophisticated investors to navigate the financial system and potential benefits of the new tools for consumer empowerment’: Ibid 31.
\item[135] Ibid 26. Treasury noted that the opportunity costs included ‘the opportunity cost associated with locking capital in low-risk assets (Australia already has a very high proportion of financial assets in prudentially regulated institutions, reflecting the dominance of banking and APRA-regulated funds)’: Ibid 30.
\item[136] Minter Ellison, ‘Submission’, above n 119. Minter Ellison noted that it did not expect that the primary regulator regime would apply to all regimes (e.g. the investigation and enforcements powers of the Australian Taxation Office in relation to the taxation of financial institutions).
\item[137] Wymeersch, above n 5, 262.
\item[138] Such an approach was also initially trialled but subsequently rejected in the draft legislation in South Africa.
\end{enumerate}
\end{footnotesize}
may be regulated by both regulators. Effective coordination requires consultation, information-sharing (within an appropriate confidentiality framework) and mutual cooperation in areas such as supervision and enforcement action.

As noted by the IMF, in Australia ‘[c]oordination among the agencies is effective in a largely informal arrangement.’\textsuperscript{139} In fact, there is only one provision that expressly refers to coordination; namely, section 10A of the APRA Act, which was inserted following recommendations made by the HIH Royal Commission, which was established to examine issues arising out of the collapse of the general insurer, HIH Insurance Limited, in 2001 and which reported in 2003.\textsuperscript{140}

10A Cooperation with other agencies

(1) The Parliament intends that APRA should, in performing and exercising its functions and powers, have regard to the desirability of APRA cooperating with other financial sector supervisory agencies, and with other agencies specified in regulations for the purposes of this subsection.

(2) This section does not override any restrictions that would otherwise apply to APRA or confer any powers on APRA that it would not otherwise have.

Note: For example, APRA’s ability to provide information to another agency remains subject to section 56.\textsuperscript{141}

There is no equivalent provision to section 10A above in the ASIC Act or the Reserve Bank Act.

2 The Policy Framework

It has been noted that ‘[c]oordination can be formal or informal. It can be long or short-term, and frequent or occasional. Coordination can be voluntary and cooperative, or mandated by legislative or executive action.’\textsuperscript{142} Adopting the categorisation by Camacho and Glicksman, regulatory coordination in Australia is primarily informal, long-term, frequent, voluntary and cooperative in nature.

The extent to which coordination in Australia is based on policy and informal arrangements, as distinct from statutory prescription, can be contrasted with the approach in jurisdictions such as the UK, where the legislation prescribes the nature of coordination between the regulators and imposes a statutory duty on the regulators to cooperate or coordinate their activities.\textsuperscript{143} Unlike the position in other twin peaks jurisdictions, where regulatory memoranda of understand (MOUs) do not have any formal significance, many of the MOUs in the UK have statutory backing, and the Bank of England considers that ‘these are documents through which the Bank expects to be held to account by Parliament, through the Treasury Select Committee.’\textsuperscript{144}

\textsuperscript{140} For details of the HIH Royal Commission and the HIH Report, see <http://www.hihroyalcom.gov.au/>.
\textsuperscript{141} Section 56 deals with confidentiality. See further in section (2) below in relation to confidentiality.
\textsuperscript{143} See section 3D of the Financial Services Act 2012 (UK).
\textsuperscript{144} Bank of England, Memoranda of Understanding <http://www.bankofengland.co.uk/about/Pages/mous/default.aspx> accessed 7 June 2015.
The UK is not the only jurisdiction that recognises a statutory duty to cooperate. In the Netherlands, both regulators are under general statutory duties to cooperate. They are also required to cooperate in specific areas.\textsuperscript{145} One translation of the general duty reads ‘the supervisor shall collaborate closely with a view to laying down generally binding regulations and policy rules, in order to ensure that these are equivalent wherever possible insofar as they relate to matters that are both subject to prudential supervision and supervision of conduct.’\textsuperscript{146}

The Belgian Law of 2 August 2002 states that ‘the FSMA [Financial Services and Markets Authority] and the Bank may agree terms of cooperation in areas which they shall determine.’\textsuperscript{147} The National Bank of Belgium has noted that the regulators ‘conclude[d] a protocol in order to lay down the practical arrangements\textsuperscript{148} necessary for coordination. The Belgian ‘protocol’ was concluded on 14 March 2013 and has the same legal status as a Memorandum of Understanding. Interestingly, in Belgium it is only the FSMA that is under a duty to cooperate with other Belgian authorities.\textsuperscript{149}

We suggest that there are four aspects to the policy framework supporting coordination that are critical to the approach in Australia, all of which are interrelated: (i) proactive information-sharing between the regulators; (ii) consultation and mutual assistance between the regulators; (iii) practical measures to encourage and facilitate coordination; and (iv) a coordination body. The discussion below examines each of these aspects by reference to the MOUs between the regulatory bodies and between each regulatory body and the RBA, and also the published statements and policy documents issued by the regulatory bodies.

In Australia, the MOUs between the regulators and between each regulator and the RBA are not legally binding. Empirical evidence suggests that the experience in Australia is that the MOUs have limited practical effect or utility in terms of achieving the relevant outcomes, and that neither ASIC nor APRA relies strictly on the letter of the memoranda of understanding. Instead, the main value of the MOUs is in signalling to the public how the regulators intend to achieve effective co-ordination, and also in reviewing and confirming the arrangements from time to time.\textsuperscript{150}

The discussion below considers each of these four aspects.

(a) Proactive information-sharing

The legislation governing each of ASIC and APRA makes provision for each body to share information with the other. Information-sharing is underpinned by the confidentiality provisions in the relevant


\textsuperscript{146} Act on Financial Supervision 2006 (AFS Act) [unofficial translation], s 1:46(1).

\textsuperscript{147} Article 45bis.


\textsuperscript{149} Law of 22 February 1998 Establishing the Organic Statute of the NBB (unofficial translation March 2015) art 77bis § 1(1°). Available at <https://www.nbb.be/doc/ts/enterprise/juridisch/e/organic_act.pdf>. The IMF picked up on this idiosyncrasy, and suggested ‘consideration should be given to introducing [an equivalent] provision to supplement other cooperation.’ This would ensure that the FSMA was ‘aware of failures or weaknesses in an institution’s capital, liquidity or governance structure.’ IMF, ‘Financial Sector Assessment Program Update — Technical Note — Securities Markets Regulation and Supervision’ (Report, May 2013) 19.

\textsuperscript{150} Interviews conducted with the regulators by the authors (July 2014).
legislation, which allow confidential information to be shared between the regulators to assist the regulators to perform their functions or exercise their powers. It is further supported by provisions in the MOUs that relate to information-sharing.

As noted by a representative of one of the regulators in Australia, information-sharing is important at all levels, including policy and enforcement. However, it may give rise to tensions given the different regulatory objectives and the different philosophical propositions about how to regulate; in particular, whereas the prudential regulator must control information tightly in order to maintain confidence on the part of the regulated entities, the emphasis of the market conduct regulator is on disclosure.\(^{151}\)

**(b) Consultation and mutual assistance**

The second aspect to the policy framework supporting coordination in Australia is consultation and mutual assistance between the regulators in those areas in which action by one regulator may have an impact on the regulatory responsibilities of the other. As reflected in the MOUs, this is supported by regular meetings, consultation, proactive dialogue and liaison between the regulators.

**(c) Practical measures to encourage and facilitate coordination**

The third aspect to the policy framework supporting coordination in Australia is the availability of practical measures to encourage and facilitate coordination between the regulators. These practical measures include informal communications and secondments, as noted in a speech by Greg Medcraft, Chairman, Australian Securities and Investments Commission on 30 June 2011:

I believe there is now a habit and practice of:

- engaging with the other regulator before regulatory actions are taken;
- notifying, discussing and jointly planning supervisory activities;
- discussing which regulator is the most appropriate to investigate certain matters or take particular action;
- if necessary, modifying original timetables to accommodate the other regulator; and
- coordinating day-to-day operations, especially in special circumstances.

I think the GFC has increased the level of cooperation between ASIC and APRA and I will be encouraging the co-operation to continue.\(^{152}\)

These practical measures were also outlined in the APRA 2013 – 2014 Annual Report.\(^ {153} \)

**(d) A coordination body**

The fourth aspect to the policy framework supporting coordination in Australia is a coordination framework. This is achieved through a coordinating body for the relevant regulatory agencies; namely, the Council of Financial Regulators (CFR).

---

\(^{151}\) Interviews with regulators (July 2014).


The CFR has no statutory basis in Australia and ‘has no legal functions or powers separate from those of its individual member agencies.’\(^\text{154}\) As outlined by the RBA in its submission to the FSI, its membership comprises APRA, ASIC, the RBA and the Treasury; meetings are chaired by the Reserve Bank Governor and are ‘typically held four times per year but can occur more frequently if required’. Further, ‘[m]uch of the input into CFR meetings is undertaken by interagency working groups, which has the additional benefit of promoting productive working relationships and an appreciation of cross-agency issues at the staff level’. Noting that the CFR has worked well since its establishment, the RBA submitted that the ‘experience since its establishment, and especially during the crisis, [had] highlighted the benefits of the existing non-statutory basis of the CFR.’\(^\text{155}\)

Two questions are relevant in terms of the substantive powers and functions that such a body should have: (1) should the CFR have substantive powers and functions that go beyond its consultative and co-ordinating role?; and (2) how should accountability and transparency be ensured?

Both of these questions have been the subject of current debate in Australia. In submissions to the FSI, various stakeholders suggested that the role and functions of the CFR should be enshrined in statute. For example, KPMG submitted that the CFR’s ‘role, transparency and accountability would be strengthened if it were given statutory recognition.’\(^\text{156}\) In addition, the National Australia Bank recommended that ‘the Council of Financial Regulators (CFR) should be given a more formal structure and be tasked by the Treasurer to coordinate the implementation of regulatory change by APRA and ASIC.’\(^\text{157}\)

One concern in having a statutory-based inter-agency co-ordinating body is that it might be treated as the only channel through which inter-agency co-ordination can be achieved. A further concern, which was expressed by the RBA in its submission to the FSI, is that ‘formalising the CFR with explicit responsibilities and policy tools would involve transferring agency constituent powers to the CFR, with the risk of blurring lines of responsibility that to date have worked well.’\(^\text{158}\) In other words, conferring explicit powers and responsibilities on the CFR that go beyond its consultative and co-ordinating role might cut across the powers and responsibilities of the member agencies. A better approach, the FSI suggested, was for the CFR to be ‘seen as the collaborative dimension of the regulatory agencies’ activities, rather than as a separate body with its own ability to make the regulatory agencies cooperate.’\(^\text{159}\) This is consistent with the attitude of one of the regulators, expressed during interviews conducted by the authors, that giving formal co-ordination powers to the CFR may confuse accountability and require a more intrusive infrastructure, and that the system in Australia works well without one body directing the process. Further, what is critical to regulatory

\(^{154}\) The Council of Financial Regulators, *About the CFR* (11 May 2015) <http://www.cfr.gov.au/about-cfr/index.html>. See also International Monetary Fund, ‘Australia: Basel Core Principles for Effective Banking Supervision—Detailed Assessment of Observance’ ([IMF Country Report No. 12/313, November 2012](https)): ‘The CFR does not have a legal personality, nor does it have powers separate from its member agencies. Its members share information and views and advise the Government on Australia’s financial system architecture. APRA and the RBA both have mandates for financial stability and have legal gateways to share institution-level data that is needed for them to carry out their respective duties.’


\(^{158}\) RBA, ‘Submission’, above n 155, 67.

co-ordination is, at a formal level, the regular meetings of the CFR and its working committees and, at an informal level, the relationship between the people involved.\textsuperscript{160}

In its submission, the RBA noted that although formal structures for co-ordination between agencies might assist to mediate resolution of differences between regulatory agencies and enforce outcomes, ‘it is unclear how reassigning part of a regulatory agency’s constituent powers to an overarching body will influence coordination and effectiveness of regulatory policies. Similarly, it remains to be seen if formality is the feature of institutional arrangements that ensures better outcomes.’ The RBA further noted that cooperation without formal arrangements appeared to be working well in Australia.\textsuperscript{161}

Underlying this reservation, it is suggested, is a concern that formalising the role of the CFR and the inter-agency co-ordinating arrangements might distract from the flexibility and robustness required to make co-ordination work; namely, it might result in a situation where the regulators involved are more concerned about complying – and being seen to comply – with the formal requirements than they are about regulatory performance and achieving the desired outcomes.

One area in which there has been some development in Australia in relation to the CFR, albeit somewhat limited, is increased transparency in the form of a webpage for the CFR on the website of the Australian Commonwealth Treasury.\textsuperscript{162} The webpage contains information about the CFR, media releases, publications and other resources. To date, however, the minutes of the meetings of the CFR have not been published.

D \textit{Coordination – The Experience in Practice}

1 \textit{The use of soft law and a culture of coordination}

Much has been written about soft law in the context of regulation, and its relative merits, as compared with hard law. For example, it has been said that regulators turn to soft law in financial regulation because soft law is ‘quuter, cheaper and more flexible’ and also its non-binding nature, which ‘appeals to fast-moving regulators who need to try things out’.\textsuperscript{163} Soft law is often embodied in memoranda of understanding between the regulatory agencies. As Ferran and Alexander state:

Hard law ordinarily gives rise to enforceable obligations and therefore has to be reasonably certain and predictable so that people can determine what is expected of them. Soft law, not being directly enforceable, can be more open-textured.\textsuperscript{164}

\textsuperscript{160} Interviews conducted with the regulators by the authors (July 2014).

\textsuperscript{161} See RBA, ‘Submission’, above n 155, 53: ‘Some other jurisdictions, including the United States, United Kingdom, the European Union (EU), Sweden and Norway have formalised arrangements in the last few years to delineate their respective financial stability mandates, powers and tools….It is too early to judge the performance of these more formal structures for coordination between agencies.’


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, where the legislative framework is more facilitative, or enabling, than prescriptive. Overseeing the process is the CFR, which ‘operates as a high-level forum for co-operation and collaboration among its members.’\(^{166}\) The soft law approach in Australia is reflected in the fact that neither the CFR nor the form or content of the regulatory MOUs is prescribed by statute.

The soft law approach was underscored in the Interim Report of the FSI, which drew on the submission of the RBA in stating that ‘[l]egislation cannot be relied on to promote a culture of cooperation, trust and mutual support between domestic regulatory agencies. These have been highlighted as essential elements of an effective financial stability framework, especially during a crisis.’\(^{166}\) Of greater importance to the regulators in Australia, the RBA has suggested, is cultivating a culture of co-ordination, under which the main focus is on regulatory performance rather than regulatory structure. The Assistant Governor (Financial) of the RBA has attributed the effective coordination between the regulators in Australia to a culture:

> where we regard cooperation with the other agencies as an important part of our job, and there is a strong expectation from the public and the government that we will continue to do so…Key aspects [of coordination] include an effective flow of information across staff in the market operations and macroeconomic departments of a central bank and those working in the areas of financial stability and bank supervision. Regular meetings among these groups to focus on risks and vulnerabilities and to highlight warning signs can be very valuable. A culture of coordination among these areas is very important in a crisis because, in many instances, a stress situation is first evident in liquidity strains visible to the central bank, and the first responses may be calls on central bank liquidity.\(^{167}\)

2  **The perspectives of the regulators and Treasury**\(^{168}\)

As reflected in their submissions to the FSI and interviews conducted by the authors, the regulators and the Treasury hold the view that the framework of coordination in Australia is working well and does not need to be redesigned or radically overhauled. The following were identified as key factors in the success of the framework of coordination to date:

- **A focus on process as well as outcomes** – under which coordination is considered to be an end in itself and not just a means to an end.
- **The strength of relationships** – which involves a good working relationship between the senior executives, many of whom have known each other for years, and regular meetings of

---


\(^{166}\) FSI, ‘Interim Report’, above n 159, 3-119.

\(^{167}\) Malcom Edey, ‘Macropriudential Supervision and the Role of Central Banks’ (Regional Policy Forum on Financial Stability and Macropriudential Supervision Hosted by the Financial Stability Institute and the China Banking Regulatory Commission, 28 September, 2012).

\(^{168}\) The following discussion is based on interviews conducted with ASIC, APRA, the Reserve Bank of Australia and The Treasury in July 2014 on an anonymous basis.
the CFR and other fora. In particular, the APRA knows the RBA well as the first three APRA chairs came from the RBA. This results in robust dialogue at the CFR. As one interviewee noted, better interaction produces better regulatory outcomes. Relationship-building is also supported at the lower levels through secondments and mutual briefings.

- **The twin peaks model itself** - which means that the regulators need to develop a high level of mutual trust and, because of their complementary roles, have a collective interest in making coordination work. This underscores the importance for each regulator to avoid getting in the way of the other regulators and to stay out of each other’s area of responsibility.

- **Effective consultation and information-sharing** – under which there is regular consultation, particularly with ASIC and APRA by the Treasury.

- **The framework of coordination itself** – which is facilitative, informal and not prescriptive and involves a flexible approach to coordination that can adapt to the circumstances. As one interviewee noted, ‘it is not possible to rely on legislation to enforce regulatory coordination….over-prescription or formalisation can stifle coordination.’ For example, the approach was able to adjust quickly to accommodate the specific needs during the Global Financial Crisis and also the 2010 Sovereign Debt Crisis in Europe. In addition, it was suggested that the flexible and informal nature of the framework of coordination has given rise to a ‘culture of coordination’ in which there is informal ‘give and take’ between the regulators and an intuitive sense as to which agency should be the lead agency in certain areas. This reduces the risk of turf warfare or territory-grabbing.

At the same time, it was acknowledged by two of the interviewees that greater public transparency would be good to overcome the criticism that CFR was invisible, ‘to demonstrate that the Council of Financial Regulators was thinking about the right things and doing the right things in the right order’ and to provide the ‘outward appearance of coordination and accountability.’ To this end, one interviewee suggested, it would be useful for CFR to produce minutes and possibly a document that outlines the sequence of regulatory actions to enable industry to plan change and determine the cumulative impact of change.

**V INSIGHTS FOR CHINA**

There is no archetypal twin peaks model. If China decides to move towards a twin peaks model, it is important to consider which version would be appropriate. Our research on the experience in Australia and other jurisdictions that have adopted the twin peaks model suggests that three questions are fundamental to the design of the twin peaks model and to the selection of the appropriate version: (1) where should the prudential regulator be housed?; (2) how should the functions and objectives of the regulators be expressed?; and (3) how should effective coordination

---

169 One of the interviewees noted that ‘the Trio collapse had hammered this home’. The strength of the relationship is also enhanced as a result of long-standing personnel at ASIC and APRA (there is greater turnover at Treasury).

170 It was acknowledged, however, that there had sometimes been some shifting of responsibility from one agency to the other.
be achieved? An examination of each of these questions appears below, together with suggestions as to how the experience in Australia and other twin peaks jurisdictions provides insights for China.

A Where should the prudential regulator be housed?

One of the key considerations in implementing a twin peaks model is deciding where the prudential regulator should be housed. The analysis of twin peaks jurisdictions reveals three options:

1. The prudential regulator is a separate entity that sits outside of the central bank.
2. The prudential regulator is a subsidiary of the central bank.
3. The prudential regulator exists within the central bank.

As noted above, Australia stands alone in housing its prudential regulator completely outside of its central bank. By contrast, the UK uses a ‘subsidiary’ model, the Netherlands and Belgium rely on their central bank which has diminished responsibility for monetary policy as a result of their membership of the European Union, while NZ sees the central bank having complete responsibility for monetary policy and prudential regulation. There are two observations that emerge from these decisions. The first is that achieving synergies is considered by some jurisdictions to be important. The second is that there appears to be a trend towards giving greater powers to the central bank. This resonates with the calls of some in China for the PBOC to be given an expanded role.171

The notion of achieving synergies is reflected in the view that the central bank – with its highly specialised set of skills, processes and experience – is best situated to undertake the task of prudential supervision. There is logic in this argument, particularly given the interconnected nature of monetary policy and prudential regulation. The counter-argument is that this in itself creates a conflict because the priorities of prudential supervision and monetary policy are at times contradictory. The experience in the Netherlands, Belgium, NZ and the UK suggests that synergies are desirable. On the other hand, the experience of APRA in Australia demonstrates that it is possible to conduct effective prudential supervision in an entity that is separate from the central bank.172

The trend towards giving the central bank more power is significant because it contradicts previous thinking that a central bank conducting prudential supervision was the touchstone of a developing country, as compared to an ‘industrial’ one. As Llewellyn has noted:

It is... the case that a higher proportion of central banks in developing countries are responsible for bank supervision than is the case with industrial countries where, until last year, the proportion has been falling (e.g. bank supervision has recently been taken away from the central bank in the UK, Austria and Australia) as more countries have adopted the integrated agency but have chosen for this not to be the central bank. This general trend has recently been reversed as some countries have extended the remit of the central bank to include the supervision of more than banks. The Netherlands is a notable example.173

171 See above, Part III.
172 In this regard, it is relevant to note that APRA was originally staffed with people who came across from the RBA.
This trend has now been reversed in the UK, Belgium and NZ in addition to the Netherlands. In fact, the legislative frameworks in these countries have been continuously reinforced to expand the powers of the central bank. This suggests that there is a trend towards enhancing the power of the central bank in developed countries as well as developing countries.

In 2010 the European Central Bank, after conducting a survey of various EU jurisdictions, made reference to this apparent trend. It noted:

[T]he survey confirms the departure from the sectoral model and highlights a clear tendency towards further enhancing the role of central banks in supervisory activities. The latter development is underpinned by the experience during the financial crisis, which highlighted the information-related synergies between the central banking and the prudential supervisory function. This rationale may explain another important finding of the survey, namely that the involvement of the central bank in financial supervision seems to be increasingly strengthened through the adoption of the “twin peaks” model.174

There are various concerns about housing the prudential regulator within the central bank. In addition to the potential conflicts of interest created by this arrangement as noted above, there is the risk that monetary policy might be prioritised over prudential regulation. If it is accepted that prudential regulation requires a fundamentally different approach175 from market conduct regulation, it may also be the case that monetary policy and prudential regulation require different approaches. Even if there are complementary or synergistic functions between prudential regulation and monetary policy formulation, there is nevertheless the risk that all staff and personnel of the bank end up thinking in exactly the same way about regulatory issues. This may mean that prudential regulation is downplayed or underemphasised. This concern was captured by Dr Edey, the Assistant Governor of the RBA, when he gave evidence at the JCFSB:

The disadvantage of [housing prudential regulation within the central bank] is that prudential supervision is a very big job. When we had bank supervision inside the central bank we found that for most of the time outside a period of crisis nothing was happening in the regulatory sphere, so central banks tend to focus most of their energies at the very senior level on the monetary policy function. I think there can be a case for separating out and specialising the institution that does regulation so it is more focused just on that task, but if you are to do that you need good co-ordination mechanisms between the two.176

If it is accepted that there is some level of risk in merging the functions together, it is necessary to consider how these concerns might be mitigated. It is relevant to note that this risk is largely avoided by central banks that have relinquished their exclusive control over monetary policy; for example, the Netherlands and Belgium. NZ and the UK, on the other hand, show two different ways of approaching the issue. With the former, prudential regulation is carried out by a department of the

---

174 European Central Bank, ‘Recent Developments in Supervisory Structures in the EU Member States’ (2007-10) 5.
175 Llewellyn, above n 5, 25.
176 Dr Edey (Assistant Governor of the Reserve Bank of Australia), ‘Evidence presented to the Joint Committee on the draft Financial Services Bill’ (Published 16 December 2011) 435.
Reserve Bank of New Zealand. With the latter, it is carried out by a subsidiary of the Bank of England.177

Interestingly, the proposed Prudential Authority in South Africa will not be a subsidiary but, instead, a juristic person under the administration of the South African Reserve Bank. This appears to be a variation of the UK model, where the Prudential Regulation Authority operates as a subsidiary of the Bank of England. It is possible that the thinking behind this was that housing the prudential regulator within the independent central bank would offer the regulator an added layer of protection and shield it from political interference and influence. This is consistent with the belief that central banks in emerging markets are better placed to undertake banking supervision and distance themselves from political interference and regulatory capture.178

The above analysis suggests that if China were to move towards a twin peaks model, a decision to house the prudential regulator within the PBOC might be better than a decision to establish a separate prudential regulator, particularly if concerns exist about the lack of independence of a stand-alone prudential regulator and the associated risk of regulatory capture.

**B How should the functions and objectives of the regulators be expressed?**

As noted above, all twin peaks jurisdictions except Australia distinguish between strategic or main objectives and operational objectives or functions. Arguably, the breadth of functions within a market conduct regulator, together with the co-existence of high-level objectives with detailed operational functions, favours such an approach. In China, such an approach would appear sensible, particularly in terms of resolving potential conflicts between the prudential and development goals as discussed in Part III above.

Distinguishing between strategic or main objectives and operations objectives or functions would also appear sensible in view of the extent to which market conduct regulators are increasingly being expected to play a role in supporting and maintaining systemic stability. The experience in Australia to date suggests that there has been some ambiguity over the role of the market conduct regulator in this regard and that clarity in terms of ASIC’s main or strategic objectives would assist in resolving this ambiguity.179

---

177 It is clear in the UK that the BoE exercises considerable influence over the PRA, largely in the form of cross-representation. However, the PRA retains an existence independent of the BoE, and does not have the primary purpose of furthering monetary policy objectives. NZ does not give its Prudential Supervision Department – which for all intents and purposes is the Reserve Bank of New Zealand – the same level of protection from being overwhelmed with monetary policy considerations. It does not have specialist directors appointed with a prudential regulation mandate.


179 For a discussion about the ambiguity over ASIC’s role, see Andrew Godwin, Steve Kourabas and Ian Ramsay, ‘Twin Peaks: The Challenges of Increasing Regulatory Overlap and Expanding Responsibilities’ (2016) The International Lawyer [forthcoming]. There has also been debate over the regulatory tools that ASIC should possess and whether they should include prudential tools such as capital requirements.
C How should effective coordination be achieved?

As noted above, some jurisdictions establish a formal, statute-based regime for coordination, whereas Australia views ‘coordination among the agencies [as]...a largely informal arrangement.’

In particular, an area where there is considerable divergence between jurisdictions is whether there should be a statutory duty to cooperate. As noted above, both ‘hard law’ and ‘soft law’ approaches can be made to work. In terms of choosing between the two approaches, it is worth asking whether the imposition of a statutory duty to cooperate actually results in more effective cooperation. While it would clearly give the regulators an incentive to be seen to be cooperating, the mere appearance of cooperation probably does little to secure actual, operational cooperation. Australia is a good example of a jurisdiction that relies on a predominantly soft law approach with apparent relative success.

Where a hard law approach is determined to be the most appropriate and a statutory duty is imposed, thought needs to be given to whether the duty to cooperate is general or specific. The key issue with a general duty to cooperate is that it lacks substance and does not give clear direction as to how cooperation should be achieved. A specific duty to cooperate, on the other hand, arguably leaves less guesswork to be done on behalf of the regulators, at least in terms of what the duty entails and how it should be discharged in a mechanical or procedural sense. The disadvantage of this, however, is that it might encourage a shallow approach to cooperation – namely, restricting cooperation to the specific instances where it is required and encouraging a box-ticking approach to regulatory coordination.

Arguably, what is more important is not whether there is such a duty, but whether the duty is complemented by other processes and forums for dialogue to ensure that effective cooperation is achieved. Of the twin peaks jurisdictions, Australia, NZ and the Netherlands sit at the ‘soft law’ end of the spectrum and are largely informal. Belgium contains a mixture of ‘formal and... informal’ procedures for coordination. The UK, on the other hand, reflects a ‘hard law’ approach to cooperation. It establishes its coordinating body under statute, imposes multiple and overlapping duties to cooperate, creates a procedure for the government to define the lead regulator, and sets out a detailed process to enable the prudential regulator to veto the market conduct regulator.

Another important area to consider is whether or not there should be an MOU that addresses coordination between the regulators, and if so, the role that the MOU will play. At one end of the spectrum are Australia, NZ and the Netherlands, none of which imposes a duty to create an MOU nor makes the MOU binding. The UK, on the other hand, places a duty on the regulators to bring an MOU into existence, and makes compliance with that MOU subject to parliamentary oversight. A related question is the purpose that the MOU should serve. Is the MOU simply going to be used to indicate how the regulators intend to cooperate, or is the MOU supposed to represent how the regulators will actually cooperate?

---

181 See Part IV above.
Ultimately, whether an approach is successful may depend more on the culture of the regulators than on the specific mechanism through which they cooperate. It may also depend on the regulatory practice in the relevant jurisdiction and whether a prescriptive approach is favoured over an informal, soft law approach. The experience of regulatory practice in China to date suggests that a more prescriptive, statute-based approach would be better than the approach in Australia.

Finally, a question arises as to whether a coordination body should be established to facilitate coordination between the regulators. All twin peak jurisdictions have some form of coordination body. The UK stands alone in constituting its Financial Policy Committee as a statutory subcommittee of the Bank of England. Belgium has two coordination bodies – one concerned with implementing the MOU, the other taking on a role akin to Australia’s Council of Financial Regulators.

A preliminary consideration in designing a coordination body is who should be its members. The obvious choices are the peak regulators, and the central bank where it is not one of the peak regulators. Beyond these initial members, there are a range of potential candidates. The government appears to have a seat in all twin peaks jurisdictions’ coordination bodies, with the exception of Belgium.

Treasury or the Ministry of Finance is the most obvious choice to sit on the body, as it is likely to be informed about fiscal and economic policy. It is also a good conduit to relay information to the government. In addition to the Treasury, NZ includes the Ministry of Business and Employment in its CFR. In the Australian context, the Commonwealth Bank recommended extending the membership of the CFR to include the Privacy Commissioner, the Australian Tax Office, the Australian Transaction Reports and Analysis Centre and the Australian Competition and Consumer Commission.¹⁸² This recommendation was not accepted by the FSI Final Report.

Another important consideration is whether the body should have its existence formalised in statute or whether it should be a largely informal mechanism. Once again, the experience of regulatory practice in China to date suggests that a statute-based coordinating body would be more appropriate.

VI CONCLUSION

Two features stand out as being of critical importance to the effective operation of the twin peaks model. The first is clarity in terms of the responsibilities and objectives of each regulator, which requires a clear demarcation between the roles of the regulators and the minimisation of regulatory overlap. The second, which is closely related to the first, is a framework of coordination that encourages both regulators to share information proactively and to cooperate in the performance of their supervisory and enforcement functions.

It is perhaps in this respect – namely, the existence of two independent regulators that 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 the other models. When compared with the institutional model, the twin peaks model is less susceptible to functional overlap.

and the resulting territorial conflicts. 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.

An interesting point of distinction in relation to Australia’s system, when compared with other twin peaks jurisdictions, is that regulatory coordination is primarily informal, voluntary and cooperative in nature, relying more on soft law than prescriptive legislation. As suggested by interviews with the regulators in Australia, the framework is facilitative and involves a flexible approach to coordination that can adapt to the circumstances. Underpinning the framework is said to be a culture where mutual trust exists between the regulators, who have a collective interest in making coordination work and allowing each other to perform its role effectively. Permeating such a culture is the reality that because both regulators may find themselves regulating the same institutions and market participants, they need to rely on each other to share information and to cooperate in the performance of their functions. In such circumstances, their roles, responsibilities and effectiveness are inextricably inter-connected.

As previously noted, there is no archetypal twin peaks model. The variations in the regulatory design of the model reveal that the model is inherently flexible, and can and should be modified to suit local conditions and the local regulatory culture. If China were to move towards a twin peaks model, it would need to consider fundamental questions as to which version of the twin peaks model would be appropriate. These questions include where the prudential regulator should be housed, how the functions and objectives of the regulators should be expressed and how effective regulatory coordination should be achieved.

This paper has explored the insights that China might glean from the experience in Australia and other twin peaks jurisdictions and has suggested the choices that China might make if it decided to adopt the twin peaks model. Although such a decision is by no means certain and other options are perhaps more likely, at least in the short term, it is of critical importance to ensure that each option is fully understood before it is either ruled in or ruled out. This paper has set out to contribute to a broader understanding of the twin peaks model and Australia’s experience for this purpose.

*********************************