



**AUSTRALIAN BANKERS' ASSOCIATION INC.**

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Mr Chris Sayers  
Assistant Commissioner  
Regulation Benchmarking Study, Productivity Commission  
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Dear Mr Sayers,

**Performance Benchmarking of Australian Business Regulation**

Thank you for the opportunity to make a submission to the Productivity Commission's study into *Performance Benchmarking of Australian Business Regulation*. The purpose of the study is to assist the Council of Australian Governments (COAG) implement an in-principle agreement to adopt a common framework for benchmarking regulatory regimes across all levels of government.

The Australian Bankers' Association (ABA) strongly supports the Commission's inquiry to:

- Develop a range of feasible quantitative and qualitative indicators and reporting framework options for ongoing assessment and comparison of the burden of regulation;
- Provide information on the availability of data and approximate costs of data collection, collation, indicator estimation and assessment; and
- Present these options for the consideration of COAG.

As part of its membership of the Finance Industry Council of Australia (FICA)<sup>1</sup>, the ABA has commissioned Access Economics to prepare a report on the Terms of Reference for this study – see *Enclosure 1* (FICA Report). The FICA Report builds on an extensive review of regulation in the financial services sector by CRA International, which was produced as part of the banking and financial services sector response to the Federal Government's review into reducing the regulatory burden on business ('Regulation Taskforce').

The ABA commends the initial FICA Report entitled *Review of Financial Sector Regulation in Australia* for its excellent analysis and representation of the impact of regulation on the financial services sector, although we do not support all its recommendations. We would be pleased to provide the Commission with a copy of the initial FICA Report.

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<sup>1</sup> FICA comprises: Australian Bankers' Association (ABA), Australian Finance Conference (AFC), Australian Financial Markets Association (AFMA), AFMA Services, Investment and Financial Services Association (IFSA), and Insurance Council of Australia (ICA).

In the ABA's submissions to the Regulation Taskforce we highlighted the need for more comprehensive and consistent assessment of business regulation and regular monitoring of regulatory costs. We would be pleased to provide the Commission with copies of our submissions.

As such, we strongly endorse a number of the recommendations of the Regulation Taskforce, including:

- Regulators should develop a wider range of performance indicators for annual reporting (Rec 7.16)
- There should be provision for merit review of any administrative decisions that can significantly affect the interests of individuals or enterprises (Rec 7.18)
- Unless there are exceptional circumstances, a regulatory proposal with material business impacts should not proceed to Cabinet or other decision-maker unless it has complied with the Government's Regulatory Impact Statement (RIS) requirements (Rec 7.9)<sup>2</sup>
- Rigorous cost-benefit analysis be employed in regulation making, such as analysis should be used to compare different regulatory options, and should incorporate adequate risk analysis (Rec 7.2)

## 1. General observations

Regulatory burden and compliance costs have risen significantly in the banking and financial services sector, particularly over the past 5 to 10 years.

ABA members indicate that:

- Compliance expenditure has risen sharply over the past 5 years, often more than doubling with substantially more staff resources dedicated to compliance activities, including compliance with FSR (CLERP 6), CLERP 9, IFRS, Basel II, AML and Sarbanes-Oxley.
- Banks report direct compliance costs for FSR implementation of \$3-\$40 million per bank, representing 0.5%-5% of operating income. (Total direct compliance costs for FSR implementation across the banking sector exceeded \$200 million). Banks have also incurred additional direct compliance costs due to refinements to FSR, including implementing new procedures, retraining staff, rewriting disclosure documents, seeking legal advice, etc, which are additional but not ongoing costs. In addition, banks have incurred substantial indirect compliance costs.
- The major banks report ongoing direct compliance costs of \$30-\$40 million per year, representing 0.5%-1.5% of operating income (excluding costs associated with major reforms).
- Compliance is accounting for between 5-20% of senior management time and around 25% of board time.

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<sup>2</sup> Grounds for a RIS to be deemed 'inadequate' should include: failure to document relevant existing regulations at all levels of government and explain why they do not suffice; inadequate cost-benefit analysis of regulatory options; failure to quantify compliance costs of options; inadequate risk analysis and assessment; and failure to document directly relevant international standards and, where a proposed regulation differs from them, to identify the implications and fully justify this variation. (Rec 7.8)

Regulatory burden and compliance costs are also borne by consumers, with the range of financial services being restricted in some cases and choice of financial products being retracted in other cases to facilitate compliance with some regulations. Some relationships between banks and their customers have been adversely impacted, particularly with the amount of written disclosures now required, with costs being passed on to customers through higher product fees.

The ABA acknowledges that a sound and safe banking and financial services sector supported by a robust regulatory system is crucial to the success of market economies. Indeed the objectives of financial services law are to promote market efficiency and consumer protection. However, it needs to be recognised that the success of market economies is built on their ability to respond flexibly to changing circumstances.

Rigid regulations can harm innovation and competition. Regulation includes not just primary and delegated legislation, but also quasi-regulation, such as codes of conduct and advisory or relief instruments, as well as policy statements, guidance notes and practice guides. Regulation should be effective, efficient and above all necessary. It is important for regulators to consider effectiveness, efficiency and what may be the best means of addressing an identified problem. Therefore, regulation should only intervene where there is a clear need and when it done in ways that are proven to be effective and capable of delivering results while minimising cost and other market distortions.

In determining whether regulation is effective, efficient and necessary, government and regulators should assess the potential impacts of regulation on business, the community and the wider economy throughout the regulation making process. Assessing the costs and benefits of regulation should take place before a decision is taken as to whether regulation is necessary. Furthermore, governments and regulators need to be prepared to respond and fine tune legislation and regulation during the development phase so to avoid a situation where more complex regulatory fixes are required later.

Benchmarking regulatory burden and compliance cost of existing regulation is essential to ensure that poor regulation can be addressed. However, benchmarking existing regulation will not reduce the creation of inefficient and inappropriate regulation. Identifying a framework for benchmarking regulatory process and design is crucial to ensuring systemic improvements to regulation making can be implemented.

Benchmarking regulatory burden should include:

- Establishing a clear need or market failure that needs to be addressed;
- Tracking of compliance costs over time (by jurisdiction if relevant);
- Relating compliance costs to regulatory benefits and objectives (ensuring assessment of regulatory options and their relative costs and benefits takes place in the formative stages of regulation making);
- Benchmarking of the process of regulatory development and review against best practice principles (including ensuring harmonisation is a fundamental consideration in the process);
- Benchmarking the design of regulation against best practice principles (including ensuring adequate and effective consultation in the design); and
- Tracking the performance of regulatory authorities against the intent of the objectives.

## 2. Specific comments

### 2.1 Purpose of benchmarking

The ABA believes that a framework for benchmarking regulation would be useful in identifying best practices that measure performance of regulation over time, including regulation across jurisdictions if relevant.

Benchmarking and monitoring performance of regulation has a number of benefits:

- Improving efficiency and effectiveness of regulation;
- Ensuring consistency of regulation across jurisdictions (Commonwealth and state laws and international obligations applicable to Australian businesses);
- Improving transparency of regulation decision making and accountability of regulators; and
- Ensuring regulation delivers 'net benefits'<sup>3</sup>.

However, it is important to take into account that regulation can import irregular costs overtime; for example, initial set up costs and ongoing maintenance costs can impose different costs at different times. With principles-based legislation, initial costs may be significantly less than ongoing costs due to evolving interpretation of requirements.

It is also important to measure instances where regulation has been introduced instead of an alternative response; for example, assessing the impacts of self-regulation as an alternative to legislation or regulation.

The objectives of the law and benefits of regulation need to be demonstrated and measured against the regulatory burden, whether that be quantitative or qualitative costs. Benchmarking regulatory design and process is as important as identifying the costs of regulation or measuring the performance of regulatory authorities in administering the law.

The ABA supports:

- FICA recommendation 1: The development of performance benchmarks of business regulation and the process of developing and reviewing regulations are endorsed as important elements of improving the design of regulations and implementation by regulators.
- FICA recommendation 2: The Commission's attempt to focus on instances where the regulatory burden is 'unnecessary' (or above that required to achieve the legislative objectives) is endorsed.
- FICA recommendation 3: The benchmarks that are developed will be partial in nature. It is important that the evidence on regulatory burden is assessed against the benefits of regulations, and that information gaps are explicitly highlighted. The information needs to be presented in context with clear guidance for readers on its appropriate use.

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<sup>3</sup> 'Net benefit' of regulation is derived by summarising and comparing the aggregate costs to the overall benefits of the proposed regulations (and the alternative regulatory options); evaluating the overall impacts of the proposed regulations; and discussing other matters underlying the cost-benefit analysis which influence the merits of the proposed regulations.

- FICA recommendation 4: It is reasonable to expect that the exercise will evolve over a number of years and take time to deliver benefits. In part, the benefits will be derived from sustained measurement and reporting over time. It is, therefore, crucial to view the exercise as a long term investment.

## 2.2 Coverage of benchmarking

The ABA believes that benchmarking should be applied at a number of levels:

- Regulation that affects all businesses, such as corporations regulation and tax law; and
- Regulation that affects a specific industry sector, such as banking regulation and financial services regulation.

Whilst benchmarking of specific regulatory areas should be undertaken on a case-by-case basis, it is important to recognise that some sectors, such as banking and financial services, have a greater impact on, and contribution to, the Australian economy.

The banking and financial services sector contributes 8% to GDP<sup>4</sup>. Furthermore, the financial sector (excluding property) represents 27% of the market capitalisation of the S&P/ASX200 (as at December 2005). Australian retail banks market capitalisation represents 77% of the financial sector (excluding property)<sup>5</sup>.

The ABA considers that corporations regulation, banking regulation and financial services regulation should be given a high priority in the regulatory benchmarking process because:

- Banks and other financial services providers must deal with an extremely high level of regulation, with many entities subject to multiple regulations and regulators.
- A competitive, innovative and efficient financial system is critical to the performance of the entire economy.

It is important for regulation to facilitate greater competition and efficiency in the financial sector as well as to secure the integrity and stability of its operations<sup>6</sup>.

It is also important to recognise that businesses differ in scale and complexity. Regulatory impact on business should take account of small and large businesses.

Regulations on specific industry sectors deemed to make a significant contribution to the economy should be acknowledged as broadly having a 'material' impact on business, thereby subject to thorough benchmarking and regulation impact assessment.

The ABA supports:

- FICA recommendation 5: The initial selection of regulatory areas and sectors of the economy to be benchmarked should be based on an assessment of their importance to the economy; the extent of the regulatory burden relative to the likely benefits; the likely costs of compiling the data; and whether the benchmarking approach in any particular area can be used as a template for reporting other areas in future.

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<sup>4</sup> <http://www.abs.gov.au/>

<sup>5</sup> <http://www.standardandpoors.com.au/>

<sup>6</sup> Financial System Inquiry Final Report. p1. <http://fsi.treasury.gov.au/content/FinalReport.asp>

- FICA recommendation 6: Given both the relative importance of the financial sector to the Australian economy and the extent of the regulatory burden it faces, the benchmarking exercise should be designed to enable the potential identification of unnecessary regulatory burdens on the Sector (including broader corporations legislation).

### 2.3 Measuring regulatory burden

The ABA believes that measuring regulatory burden should adopt a multi-dimensional approach taking into account the process for developing regulation; its design, implementation and enforcement; and harmonisation across regulatory authorities. Benchmarking regulatory burden must give consideration to costs and benefits of regulation, with respect to regulatory options and the relative costs and benefits of an alternative response to regulation.

It is the ABA's view that there are a number of key elements in assessing the costs of regulation, including:

1. Issue identification: Identifying the problem that needs to be addressed.
2. Issue analysis: Evaluating the objective and the impact of the objective in terms of establishing priorities.
3. Strategy assessment: Developing options (regulatory and non-regulatory) that may achieve the desired objective and assessing these options in terms of the costs and benefits on government, regulators, industry and consumers.
4. Implementation and communication: Identifying the preferred strategy and communicating the objectives.
5. Evaluation: Analysing the results and reviewing the preferred strategy.

It is important to recognise that the relevant benchmark, whether that is state or national, will depend on the particular regulatory problem being addressed. In some instances, the compliance cost is magnified due to the cumulative effect of regulation. Therefore, benchmarking should take into account the broad regulatory framework applicable to the specific industry sector, including originating from Commonwealth or state law as well as international obligations.

There will be limitations in measuring costs; for example, it may be far easier to describe the cost qualitatively rather than measure the cost quantitatively. Limitations for measuring potential compliance costs include: data limitations (where information may not be available); measurement limitations (where measuring incremental costs against an unknown is not possible); and comparability limitations (where regulations are designed to meet different objectives or where changes have no precedent to derive estimated costs).

In our experience, collection of data on compliance costs for existing regulation is more difficult, thereby imposing limitations on the ability to measure regulatory burden as distinct from the overall cost of operating a business. For example, an IT system may have been developed to generate regulatory reports that can now be used to also generate commercial information for the business.

Furthermore, in our experience, collection of data on compliance costs for new regulation is difficult to capture unless specific business impacts are identified so that financial institutions can understand how changes may impact on current systems and processes and make assessments of potential impacts<sup>7</sup>.

Whilst we acknowledge that measuring costs can be difficult, some broad indicators should be contained within a common framework for benchmarking regulation. At a high level, some compliance cost areas relevant to the banking and financial services sector include direct operating costs (e.g. staff training, customer communications), internal costs (e.g. IT systems), external costs (e.g. legal advice, consultancy services) and indirect costs (e.g. management time and resources spent on compliance rather than pursuing business opportunities).

At a practical level, the ABA suggests that further consideration needs to be given to identifying indicators relevant to measuring the cost of banking and financial services regulation. However, we acknowledge the Office of Small Business' *Business Cost Calculator* as a potentially useful tool to use in the context of regulatory impact assessment and this tool, as a general basis, should enable governments to conduct better cost-benefit analysis of potential business regulation.

Fundamental to measuring performance of regulation is to identify any inefficiencies which create unnecessary regulatory burden and compliance costs or impede opportunities for innovation for businesses. However, in some instances, it may not be possible to obtain reliable estimates of direct costs resulting in inefficiencies or lost opportunities, and therefore the only source of data is indirect costs.

The ABA notes that measuring the benefits of regulation can be difficult. However, rigorous assessment of benefits is crucial to benchmarking regulation. Some indicators could include complaints (such as a reduction in the number of complaints related to particular compliance matter), enforcement matters (such as a reduction in enforcement action required to be taken by regulators) and administrative efficiencies (such as a reduction in legal costs related to compliance matters).

We also recognise that some costs may be costs incurred by business in order to maintain consumer confidence and business reputation regardless of regulation.

Overall, the ABA believes that it is possible to consider a range of indicators to capture the design, implementation and enforcement of regulation, thereby measuring the efficiency of the regulatory process and the costs of regulation on business. Compliance costs can be measured in terms of the cumulative burden over time as well as the specific components of compliance cost, whether these are direct or indirect indicators.

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<sup>7</sup> In the past, there have been instances where government and regulators have consulted with the banking and financial services industry on major reforms requesting comments on compliance costs on the basis of incomplete legislative packages. Although, while we do assist government and regulators during their reform processes and produce cost estimates, in some cases, the reform process has been rushed and without a thorough regulation impact assessment. In the absence of information about the intent, benefits and potential business impacts, this compromises the ability to collect data on compliance costs. While we acknowledge that it is preferable to be consulted early in the regulatory decision making process (and indeed any planned legislation or regulation should be subject to business impact and cost-benefit analysis before issuance of consultation or discussion papers, let alone draft legislation or regulations), it must be recognised that substantive data on compliance costs may not be available so early in the process. However, this should not be interpreted as there will not be substantive business impact or cost consequences (quite the contrary); rather it implies that it is necessary for further consultation between government and industry to enable industry the time to adequately analyse potential impacts.

The ABA supports:

- FICA recommendation 7: National and state/territory-based regulatory benchmarks should be used, where possible, to measure performance of regulation across jurisdictions.
- FICA recommendation 8: The Commission work with FICA to develop benchmarks for the regulatory burden on the financial sector in a cost-effective manner.

## **2.4 Feasibility of performance and reporting options**

### **2.4.1 Quantitative and qualitative indicators**

The ABA believes it is feasible to obtain quantitative data and qualitative information on aspects of regulatory burden and compliance costs specific to banks and other financial services providers.

Importantly, it should be recognised that in most instances collection of data will require input from individual banks, which in itself will generate a cost. For example, member banks were recently requested to provide information on a proposal that could change processing across the payments system. While the government was seeking feedback on potential technical implications and compliance costs of the proposal, to conduct a thorough assessment would incur a cost of between \$50-\$60,000 for a major bank, just for the assessment, excluding use of resources and staff and managerial time.

It will be important for industry to have confidence in the benchmarking process, and that measuring the performance of regulation will ultimately lead to more efficient and cost-effective regulation.

### **2.4.2 Composite indicators**

The ABA believes that indicators of relative performance of jurisdictions in minimising regulatory burden on business can be a useful way to benchmark efficiency of regulation. For example, credit regulation is based in State law; however, much banking and financial services regulation is based in Commonwealth law.

The ABA also believes that international comparisons may be useful to benchmark performance of business regulation.

### **2.4.3 Raw indicators**

The ABA believes benchmarking regulatory objectives can give some insight into the scale of regulation and whether there is an imbalance with the intended objectives and benefits and the actual regulatory burden and compliance costs borne by government, regulators, industry and consumers.

### **2.4.4 Source indicators**

The ABA believes that benchmarking regulation making processes is vital to measuring the performance of regulation. Lack of early consultation; deficiencies in administrative coordination; insufficient cost benefit analysis and assessment of regulatory options; inadequate time to commencement date (transition period); unnecessary level of prescriptiveness or alternatively inadequate certainty, depending on the regulation; inconsistent or opaque enforcement and so on can result in sub-optimal results for government, regulators, industry and consumers.



It is essential that all regulation meets its underlying intent. Regulation making must be transparent, adequate consultation with those affected by the decision to regulate must take place prior to issuance of draft regulation, and decision makers must be accountable for the quality of regulation making.

#### **2.4.5 Indirect indicators**

It is important to recognise that estimating costs due to inefficiencies and lost opportunities will generally be difficult to achieve in a reliable manner; although this will not always be the case.

In practice, it may be difficult to develop a comprehensive set of performance indicators that can be applied across regulation broadly; however, with the caveat that some performance indicators or cost categories are not always relevant, it should be possible to gather data and aggregate to provide a view across industry.

Regulators should utilise industry representatives, such as through consultation groups or business roundtables, to assess existing indicators and/or identify alternative indicators, including indirect indicators that may be relevant.

The ABA supports:

- FICA recommendation 9: In key identified sectors, the aggregate regulatory burden needs to be monitored over time at a national level.
- FICA recommendation 10: For cross jurisdictional comparisons, benchmarking should be performed within narrow and comparable areas of regulation that are for the most part targeting the same objectives (such as OH&S or consumer protection).
- FICA recommendation 11: Benchmarking against the regulatory benefits (or objectives) should be a core element of the exercise. The Australian Bureau of Statistics should be responsible for the design and operation of surveys of consumers where appropriate.
- FICA recommendation 12: Criteria should be developed by which the process of developing new regulations and reviewing existing regulations can be benchmarked.
- FICA recommendation 13: There should be a presumption on State and Territory governments to establish consistent regulations. Where a jurisdiction is considering departing from this objective, it should undertake to consult first and publicise the costs and benefits of their decision. Accordingly, the benchmarking exercise should aim to identify the costs associated with lack of harmonisation and to identify where these issues are most problematic. The Commission should explore establishing a mechanism which business groups can use to nominate regulatory areas where inconsistency is a source of unnecessary compliance costs.
- FICA recommendation 14: Criteria should be developed by which the process of designing and implementing new regulation can be benchmarked.

#### **2.5 Selection of reporting indicators**

The ABA believes that a range of reporting indicators could be used to benchmark performance of business regulation. However, identifying reporting indicators is not straightforward, and as previously stated, further consultation should be undertaken on the form of indicators that might be feasible and useful for an assessment of the regulatory burden generated by regulation specific to the banking and financial services sector.

The ABA notes the selection criteria to evaluate and select reporting indicators, including significance and relevance; comparability; data availability and cost; acceptability and ease of interpretation; timeliness; and robustness, as identified in the Issues Paper, provides a useful and sensible way to think about selecting business and specific industry sector indicators.

Importantly, the ABA believes that reporting indicators should enable performance benchmarking of business regulation over time.

The ABA supports:

- FICA recommendation 15: An important priority for the benchmarking exercise will be to measure the cumulative burden of regulation — not just the quantum of regulation but the way it is implemented and administered over time. The corresponding information available to regulators and those they regulate will allow monitoring of the impact of the regulatory approach adopted which is a significant component of compliance costs.

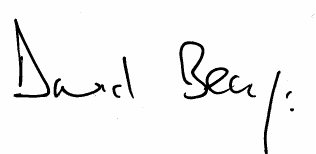
### 3. Concluding remarks

The ABA believes that it is possible to combine a range of indicators to capture the efficiency of the regulatory system for banking and financial services by measuring performance against best practices for effective regulation and estimating compliance costs to business.

Transparent benchmarking and assessment of regulation will enable objective decision making in relation as to whether regulation, quasi-regulation or self-regulation delivers net economic and social benefits. The benefits of regulation to the community should outweigh the costs to government, regulators, industry and consumers and it should be determined that the objective can be achieved only by regulation.

We look forward to the next stage of the Commission's study. If you have any queries regarding the issues raised in this letter, please contact me or the ABA's Director, Corporate & Consumer Policy, Diane Tate on (02) 8298 0410: [dtate@bankers.asn.au](mailto:dtate@bankers.asn.au).

Yours sincerely



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