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RIA Benchmarking Study
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

By email: ria.benchmarking@pc.gov.au

Dear Mr Bogaards

Regulatory Impact Analysis: Benchmarking

1. Introduction

The Australian Financial Markets Association (AFMA) welcomes the opportunity to provide comments to the Productivity Commission in relation to the benchmarking of regulatory impact analysis in Australia.

AFMA is a member organisation with over 130 members that represents the interests of participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign banks, stockbrokers and investment banks, fund managers, energy traders and other specialised markets and industry service providers.

Our members report that the regulatory burden placed on them has increased significantly over the past decade, both in absolute terms and as a proportion of operating income. This is a result of a range of reforms in taxation, financial services regulation, anti-money laundering and accounting, and the global response to the Financial Crisis amongst other things. Our members understand that the financial sector must be well-regulated and accept they will incur significant compliance costs. However, not all of the regulatory reforms undertaken in recent years have been sufficiently well-defined or effectively targeted and, consequently, some are affecting the efficiency of the system and the regulatory burden is influencing decisions about where and how to conduct business.

Against this backdrop, we welcome the Government's initiative to benchmark the efficiency and quality of Commonwealth, State and Territory and Council of Australian Governments (COAG) Regulatory Impact Analysis (RIA) processes.

Australian Financial Markets Association
ABN 69 793 968 987
Level 3, Plaza Building, 95 Pitt Street GPO Box 3655 Sydney NSW 2001
Tel: +612 9776 7955 Fax: +61 2 9776 4488
Email: info@afma.com.au Web: www.afma.com.au

2. Industry Experience of Federal RIA Processes

AFMA believes that RIA, by making agencies that are responsible for policy development also responsible for assessing the impact of what they propose, should improve regulatory outcomes and contributes to more disciplined policy creation processes and so reduces unnecessary burdens on industry. Our concern is that the level of confidence in the industry about the effectiveness of RIA processes in practice in promoting high quality policy and regulatory decisions appears to be low.

The extent to which RIA can assist in improving regulatory outcomes is dependent on a number of factors including the quality of the RIA process itself, the resourcing and importance attached to it in a particular instance and the political discipline that ensures that RIA does not become a post process add-on and its disciplines over-ridden.

Benchmarking the RIA processes themselves, to ensure they are of high quality is therefore an important second-order review towards ensuring that they can make their maximum contribution to quality regulatory outcomes.

2.1. Political Commitment

In general, AFMA believes from its experiences with Federal Government practices that the existing framework for RIA processes is sound. However, and consistent with the OECD experiences noted in the consultation paper, there are concerns that there is not always sufficient commitment politically and at the agency level to following the principles embedded in the RIA approach in good faith.

This is evidenced by some regulatory outcomes that are not consistent with good regulatory practice and are poorly supported by the relevant agency. In these cases the RIA, and in some cases the accompanying consultation processes, show signs of being pro-forma exercises.

While RIA can never override Parliamentary sovereignty, it can assist legislators in making clear when proper, coherent policy development governance processes are being followed and when they have been put to one side for extraneous reasons.

For this to occur there needs to be a more effective accountability process for agencies that have produced poorly formed, inadequate or flawed RIA processes as assessed by the oversight body and informed by a survey of significant stakeholders.

Currently when a RIA is of poor quality there is no consequence for policy development unless that RIA leaves the department in breach of their RIS requirements. Even then, the sanction of a post-implementation review is often too little, too late, to prevent poor policy and regulation and avoid associated and often significant implementation costs being borne by industry.

While we must acknowledge the overriding prerogative of Parliament to shape the final form of legislation drawing on the presented explanatory memorandum with its

Regulatory Impact Statement (RIS), greater pre-vetting of the quality of a RIA would be a good governance measure.

In the event that it is deemed appropriate to proceed with a flawed or qualified RIS, as judged by the oversight authority, the exemption should be taken by the responsible Minister in a formal and standardised process with an explanation to the Parliament accompanying the Regulation on why it has been necessary to curtail the process. If a deficient RIS is found after a regulation is made, this same process should be followed to ensure Parliament is aware that the best-practice processes have not been followed and the reasons why it was necessary in this instance.

This requirement would, while recognising the proper relation of Ministerial authority to the regulatory process, impose an additional self-discipline on governments and their Ministers that would raise the importance of full engagement with the RIA process for agencies.

2.2. Incremental Management and Public Release of RIAs

To address the risk that RIAs are sometimes done after the fact at a time when gaps in reasoning cannot be addressed by relevant industry stakeholders, and the process has progressed too far for fundamental re-thinks to be readily contemplated by agencies, we propose that the RIS publication process be restructured, such that defined stages in the RIS are released with interim departmental sign off (from department or agency) incrementally throughout the process. This would be in keeping with the practices that should be adopted for 'Better Regulation'.

As a starting point the Commission should propose that RIAs are managed in the following stages:

I. *Issue identification*: public engagement with this process would bring greater discipline and empirical rigor to sometimes nebulous agency reasoning and justification. There is often nothing sensitive at this stage in release of an agency's reasons and data around concerns but it is a critical part of the process. Publication and targeted consultation at this point should include the test for continuation and commencement that will be described later in this submission;

II. *Identification of options*: while agencies may be reluctant to publicly discuss the range of alternatives contemplated to address an identified issue, where there is scope for publication of options this should be pursued to improve accountability. It may also inform an informal consultation process;

III. *Assessment of impacts*: often impacts are considered too narrowly and without properly weighted consideration of big picture strategy. Exposure of these types of flaws before proceeding to final design can only assist outcomes; and

IV. *Public transparency*: full publication of the RIA rationale, evidence and conclusions following Government policy decision.

Incremental release of the RIA would also give assurance to industry that proper process was being followed during what can be a period of little information from the agency. It

would allow timely response before the process had progressed too far down the wrong path.

2.3. Administrative Change or Substantive Policy Measure

Industry experience has been that substantive policy changes that should be brought forward by the Government under Parliamentary control are often characterised as administrative measures suitable for delegated decision making by agencies. The result is that significant public policy is sometimes in practice generated at the administrative level and in effect undermines the authority of the Parliament.

Agencies should be required as part of the identification of options to confirm whether they view a particular option as a substantive policy change or merely a matter of administrative implementation. These categorisations should be signed off individually by department heads and be included in the RIS to ultimately be tabled.

If a policy change is proposed to be made by an administrative agency the case for the deviation from the standard policy creation process, which would see such changes driven by the policy agency, should also be made in the RIA.

2.4. Scope of Assessment Criteria

AFMA believes that ultimate high-level national objectives are often not given sufficient weight in agency considerations if at all. For example, the ultimate competitive disadvantage that a particular regulation may place on the domestic market in comparison to our regional competitors often should be a key consideration but is generally overlooked.

These high-level concerns can be difficult or impossible to quantify but they go to the heart of the issues that need to be considered when driving technical regulatory change. For example, a change in a Market Integrity Rule by ASIC that changes the exchange market microstructure may put Australia as a jurisdiction at a disadvantage to Singapore in a yet to be fully developed market - such as carbon. While the impact to existing business may be nil and any future impact may be impossible to quantify, such an impact needs to be fully acknowledged and its significance explored.

Currently there is a tendency to focus too narrowly and with too much primacy on domestic and technical concerns and to lose track of this bigger picture. Impacts that are difficult or impossible to quantify with precision are routinely discounted.

The Federal Government has an objective to support Australia as a regional financial hub or centre and yet business continues to be lost to Hong Kong and Singapore. It is important that comparisons by regulators are primarily with these regional financial hubs, who are Australia's real competitors, rather than Europe and North America, which are certainly out of context and uncompetitive in the Asia-Pacific region.

2.5. Addressing Cost Empirical Data Gaps

A weakness in current processes is where costs are not detailed by industry due to difficulty of assessment on a firm-by-firm basis, and these costs are often dismissed by agencies. Industry can be reluctant to do detailed and costly work to determine costs for a variety of reasons including competitive pressures.

It should be incumbent on agencies to produce some guide to costs in these instances in order that these costs are not ignored. One approach to detailing industry sentiment where actual costs are difficult to quantify is to recommend a scale system where industry participants are invited to register their estimate of the order of costs associated on a scale of one to ten.

2.6. Evolving Sunset Clauses

Sunset clauses, while a welcome addition to ensure regular review of regulation, are a fairly primitive approach to ongoing assessment of regulatory relevance. In practice when regulations reach their sunset timing they are reintroduced sometimes without sufficient re-assessment.

AFMA views that the sunset clause approach should be evolved to include more defined and more empirical assessment criteria. These criteria would require departmental sign-off as still relevant by a public process and would promote more ongoing monitoring of regulatory outcomes. This approach may be more effective than a simple re-making of regulations.

By defining the testing conditions for a successful regulatory outcome before developing the regulation, RIA can draw on developments in software quality assurance such as Test Driven Development. In this programming paradigm the test is always designed first and the proposed algorithms (analogous here to policy) must pass the established tests.

By way of example, a proposal to protect price discovery put forward by ASIC in Consultation Paper 168 may have as its continuation tests:

- a continuing legitimate concern based on evidence that price discovery is at risk (that has not been countered by the weight of academic research); and
- a quantitative measure of success in maintaining current average spreads within 5 bps of current levels.

By designing the tests for commencement and continuation first before any options are considered all options can be benchmarked against the relevant tests and this can feed into the decision making process.

2.7. Case Studies

2.7.1. Future of Financial Advice Reforms to the Corporations Act

In the case of the Future of Financial Advice (FOFA) reforms, the RIAs, which were based on early policy positions in the development of the legislation and could not be said to be directly referable to the impact of the legislation in its final form, were found to be

defective by the Office of Best Practice Review. This was not addressed by Treasury through the preparation of revised RISs. Instead, it was decided that the operation of the legislation will be reviewed within 2 years of its commencement. This was an entirely inadequate outcome and effectively sidelined the RIA process. The costs in implementation of the reforms that will have been expended by industry by the time of the review will be substantial and there will likely be resistance to further change even if it would result in a more optimal outcome as a result. This should only have occurred after the granting of a Ministerial exemption.

2.7.2. Treasury-Run Cost Recovery Consultation for ASIC

The Treasury-run cost recovery consultation for ASIC's market supervision costs showed signs of being a post-decision formality. While a consultation paper was issued the strong industry response was comprehensively ignored even when its main request was completely revenue neutral and identified significant distortionary effects of the proposed apportionment method. In particular estimates of industry revenue were at odds with industry estimates.

A stakeholder consultation panel also appears to be a formality as strong and repeated industry representations at the panel had no impact on subsequent Government decision making. The RIA controls appear to have been ineffective in this instance.

2.7.3. ASIC Price Improvement Requirement

ASIC are responsible for market supervision and administering the Corporations Act in relation to the exchange markets. ASIC proposes to introduce a requirement to provide 'price improvement' for stock crossing (where a single broker executes both the buy and sell for a trade) for all stocks in the Australian market. The consultation paper's justification for this measure consisted of three linked potential concerns unsupported by evidence:

> This [*existing practice*] has the effect of enabling dark orders to step ahead of pre-trade transparent orders at the same price, and **may** discourage investors from displaying orders if they believe it is likely that such orders will be bypassed.
>
> This **may** lead to a reduction in the level of displayed depth in the order book. It **may** also potentially reduce investor confidence if an investor observes that their order remains unfilled while other, non-displayed orders are being executed at the same price.[1] [Emphasis added]

The industry responded to overwhelmingly oppose the change except where empirical analysis suggested it may be beneficial, noting that the proposal was poorly supported in the consultation paper. The industry also supplied quantitative analysis to suggest where intervention may be appropriate.

Further, the industry argued that the substantive policy change to discourage dark liquidity was not an appropriate decision for an administrative body such as ASIC to be

[1] Page 107, ASIC Consultation Paper 168.

making. Similar decisions in the EU have been taken at the highest levels as directives of the European Council.

As there is no incremental release of the RIS, industry cannot be sure that the RIA is playing any role in the assessment process for this proposal, and at least from the outside does not appear to be effectively preventing poor policy.

3. Responses to Specific Questions in the Consultation Paper

What existing information can be used to indicate the impact of RIA processes on decision making and regulatory outcomes? What additional information could feasibly be collected in the future to improve the evidentiary base on the contribution of RIA?

Comparative studies of RIS structures form the main existing information that can suggest RIA contributions to regulatory outcomes.

AFMA holds that stakeholder surveys of regulatory outcomes and RIS quality are an undervalued tool of analysis in terms of additional information, particularly where the same stakeholders assess many RIS processes and regulatory outcomes over time and there is scope for normalising data.

What specific examples could help illustrate the extent to which RIA has influenced the policy development process and decision making? For example:

- ***not proceeding with regulatory action — by demonstrating that a non-regulatory option or the status quo is a better solution to the problem***
- ***where regulation is found to be justified — by identifying more effective and efficient design elements that were subsequently built into the regulation***
- ***building stakeholder support for proposals — through effective consultation processes and/or by allaying fears of adverse regulatory impacts***
- ***altering the objective to be achieved — by raising warning signs and suggesting further analysis and verification***
- ***over time, evidence that departments and agencies are implementing improved regulatory development processes.***

It is difficult from outside Government, when RIA is published following the final decision making, to understand what role RIA has played in regulation construction.

While AFMA generally views the quality of regulatory outcomes as very good and sees RIA as a substantial contributor to these outcomes, incremental publication of RIA during the process would make clearer the extent to which RIA is a factor.

Is there evidence that the quality of regulation has been improving? To what extent are any improvements due to RIA processes? Do differences in RIA systems help explain differences in regulatory outcomes within and across jurisdictions?

Putting to one side regulatory outcomes that are strongly driven outside of good processes we see regulatory quality improving substantially over the last ten years.

What are some of the key factors that influence the costs of RIS preparation and other costs of RIA processes? How can the cost effectiveness of RIA be improved?

From the perspective of industry participants, in many cases relative measures (as against a scale of one to ten for example) would be a more efficient way of ensuring high cost proposals are flagged.

It should be remembered that with the multiplicity of consultations, industry participants are constantly being asked difficult and costly to answer questions around what a particular theoretical measure would cost them.

Are there specific strategies that should be considered to reduce the review costs associated with the prospective large volume of sunsetting regulation?

As discussed, we view the sunsetting approach as in need of evolution.

A public process that re-assesses regulation against its pre-determined commencement and continuation test may be more effective than going through the motions of re-making regulation.

What is the appropriate scope of RIA requirements, including in relation to:

- ***types of regulatory instrument?***
- ***reviews of existing regulation, including sunsetting regulation?***
- ***government bodies involved in the development and making of regulations?***

Are threshold triggers/significance tests for RIA requirements appropriate and are they defined clearly? Are such triggers successful in ensuring RIA processes are appropriately targeted to improve cost effectiveness, while at the same time ensuring all significant proposals are subject to adequate analysis? If not, what changes should be considered?

We do not note any concerns in this area.

Are oversight bodies consistent in their advice and interpretation with respect to when a RIS is required? Should oversight bodies have the final say as to whether a RIS is required in any particular instance?

Yes, and greater Parliamentary scrutiny.

Are the processes for granting exemptions from RIA appropriate? To what extent are significant proposals avoiding timely and rigorous scrutiny through the granting of exemptions?

Where exemptions are granted, are there requirements for subsequent RIA or post-implementation reviews? Are these requirements appropriate? Are they being satisfied? How could these requirements be improved?

We do not have any comments in regard to these questions but again note the need for improved procedures where a RIS has been found defective including Ministerial exemption.

What evidence is there that RIA has been effectively integrated into policy-making processes? Has there been necessary cultural change in regulation development?

How and when in the decision making cycle are Ministers, or other decision makers, engaging with RISs?

In general, AFMA sees the RIA as a positive influence on policy making; however, we note interim publication of each stage of the RIS would assist with making it a more active part of the process.

Is RIA being undertaken early enough in the policy development process to enable consideration of all feasible alternatives, including regulatory and non-regulatory options? To what extent is the preparation of a RIS still being treated as an 'add on' task — after a course of action has already been agreed?

While we are aware of instances of RIS still being treated as an 'add on' task, in general we see it as a worthwhile exercise.

What have been some of the major challenges in achieving desirable cultural change within agencies?

Good governance in respect of RIAs and the culture of any organisation is a 'top down' exercise. Where deficiencies may exist, the leadership within the organisation should lead the response.

How might RIA processes be best refined or streamlined to improve their integration into policy development?

Do agencies responsible for preparing RISs generally have the necessary skills and expertise? If not, why not?

In some cases it would be unreasonable to expect personnel in a government agency to have an intimate or acceptable complete understanding of the economic and commercial drivers of a business or the associated industry practices. In this situation, it is important to have effective engagement and dialogue with industry participants and bodies to obtain the information required to enable a proper assessment to be made. Success in this regard depends on the existence of an open and trust based relationship.

What arrangements are in place to ensure institutional learning and knowledge transfer (between and within departments), to build on the knowledge/experience gained when completing RISs?

How can consultants and others with specialist expertise best be utilised to improve the quality of RISs? What are the implications of their involvement for the development of agency capacities and achieving cultural change?

External experts can be useful to assist agencies in making technical assessments. However, in our experience, great care needs to be taken in the selection of independent experts to ensure that they have both the independence and industry knowledge, in addition to a willingness to engage with industry, to provide the objective and technically accurate information sought. We believe there would be benefit in the Commission making recommendations in relation to the appropriate appointment process for independent experts and the conduct of their work in a manner that is consistent with the objectives of the RIA process.

How can RIA training and guidance material — both in-house and provided by oversight bodies — be improved?

Apart from training and guidance material, what other strategies should be employed by governments to develop and maintain agency RIA capacities and foster cultural change in regulation making?

We do not have specific comments in regard to these questions.

What are some of the common weaknesses in RIS analysis and how can the quality of analysis be improved?

As noted, significant costs to industry can be overlooked as they have not elicited a specific dollar cost response for any number of reasons. These costs should be better understood through the use of a scale response (for example one to ten).

As publication of the RIS occurs only after government decision making has occurred, poor RIS justification is not viewed at present as an effective barrier to poor regulation as it could be with incremental publication.

Does RIS analysis undertaken for national regulation include an appropriate level of detail on specific impacts in individual states and territories?

We do not have a comment on this question.

Are the implications for national markets given adequate consideration when new or amended regulation is proposed and/or proposals to remake sunsetting regulation are being considered?

No. We do not view particularly the impacts on the competitiveness of national markets as receiving sufficient consideration when a new regulation is proposed.

Where regulation includes a built in requirement for review (for example, sunset clauses), should specific guidance also be provided on the nature of the impact analysis to be undertaken, including evaluation of the case for maintaining the regulation?

Yes. We believe the test for continuation and commencement should be clearly established before any proposals are considered. When a built-in requirement for review occurs these should be used to assess the need for continuation of the regulation within a public process.

Does the requirement that a RIS demonstrate that the recommended option is the one that would generate the 'greatest net benefit' contribute to better regulatory decisions? What is the rationale for the lower 'net benefit' test used in some jurisdictions?

We do not have comments on these questions.

To what extent have data constraints been an issue affecting the quality and/or timing of RISs? Has proper use been made of existing information? What efforts have been made to bridge identified data gaps and what other measures could be taken to improve the quality and accessibility of data?

We do not believe sufficient use is made of stakeholder feedback in this regard. Stakeholder feedback particularly when accumulated over time from the same respondents can contribute much more to identifying regulations and RIS processes of concern. A combination of quantitative and qualitative surveys of stakeholders by oversight bodies should be particularly productive.

Are there adequate mechanisms in place to ensure accountability and compliance with RIA processes?

AFMA holds that more use should be made of stakeholder feedback to assess compliance with RIA processes.

How can RIA processes be better insulated from political expediency? How can systems avoid the abandoning or bypassing of RIA processes when there are pressing political demands?

RIA processes must respect their place in the political system which is completely subordinate to Parliamentary sovereignty.

We believe the right balance can be achieved by Governments requiring Ministerial exemption for inadequate or defective RISs to be presented to Parliament.

What are the appropriate functions for a regulatory oversight body and which aspects of their operations are the most significant determinants of their effectiveness? Does the degree of independence matter?

Are the sanctions for non-compliance with RIA requirements adequate?

Yes. However we note that poor quality RISs should require Ministerial exemption and an explanation to Parliament.

Should RIA processes include the power to stop regulatory proposals without an adequate RIS proceeding to the decision maker? If so, should this power be vested in the oversight body or another body?

No. This may be seen as frustrating the operation of agencies and would not be the proper function of an oversight body. Particularly if the decision maker has requested information from their agency, interference in this process is not appropriate.

Direction of agencies properly lies with the Minister responsible. Oversight bodies' proper role is to adjudicate on whether RIA processes have been properly followed to a good standard.

To what extent do agencies conduct reviews of the accuracy of their ex ante RIS estimates? Should such reviews be undertaken routinely?

To what extent is there independent scrutiny and performance monitoring of RIA processes? Should government auditors or other external bodies conduct assessments of RIA, including the quality of RISs, assessments by oversight bodies and exemptions granted?

How effective are existing mechanisms for enhancing transparency, such as: consultation processes; publication of draft/final RISs; and publication of compliance information? How can RIA transparency be improved?

As noted, transparency can be improved by incremental publication of RISs.

Is consultation and, where relevant, release of the consultation RIS occurring early enough in the policy development process?

No.

Would publication of the oversight body's assessment of the adequacy of each RIS create a stronger incentive for agencies to undertake RIA of an appropriate standard?

Yes and this should occur with incremental publication.

4. Conclusion

Thank you for the opportunity to contribute to the Commission's Regulatory Impact Analysis: Benchmarking study. If you would like further clarification on any of the points raised please contact me directly on (02) 9776 7993 or at djeffree@afma.com.au.

Yours sincerely

Damian Jeffree
Director - Policy