Regulators: Accountable to Stakeholders or a Law unto Themselves?

Joanna Bird*

'We are governed more and more by people we never elected, and who can't be turned out of office by our votes and who want more power than they ever have.'[1]

In this paper I will look at:

- What is accountability?
- Why should regulators be accountable?
- What should they be accountable for?
- What are the challenges involved in holding regulators to account?
- What are the existing accountability mechanisms for Australian regulators? I will focus on the accountability mechanisms for the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA).
- Are Australian regulators sufficiently accountable? Do we need more, fewer or different accountability mechanisms? This issue will largely be left to the panel discussion but I will offer some preliminary thoughts.

1. What is accountability?

There are constant calls for regulators to be more accountable.[2] But what does this mean? What do people actually want when they call for regulators to be more accountable?

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* Associate Professor, Sydney Law School, University of Sydney. This paper has been prepared solely for the 28th Annual Banking & Financial Services Law Conference, 2011. It should not be reproduced in whole or part without the permission of the author.

[1] Ronald Reagan, quoted in Steven F. Hayward, 'Reagan and the Historians', *Claremont Review of Books*, vol. 7, no. 4, Fall 2007, as quoted in Berg, Chris, *The Growth of Australia's Regulatory State* (2008, the Institute of Public Affairs), p.81.

[2] For recent examples see Commonwealth of Australia, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (June 2003) (Uhrig Report) pp.52 – 53; Berg, Chris, *The Growth of Australia's Regulatory State* (2008, the Institute of Public Affairs); Hyland, Margaret 'Is ASIC sufficiently accountable for its administrative decisions? A question of review' (2010) 28 *Company & Securities* LJ 32. As early as 1937 the Brownlow Commission in the United States of America warned about regulatory commissions being unaccountable: Lodge, Martin and Stirton, Lindsay 'Accountability in the Regulatory State', Ch 15 in Baldwin, Robert, Cave, Martin and Lodge, Martin (eds) *The Oxford Handbook of Regulation* (2010), p353. See also references listed in Baldwin, Robert and Cave Martin, *Understanding Regulation* (1999), fn.2, p. 286-7. Colin Scott points out that public lawyers almost universally regard accountability mechanisms as inadequate: Scott, Colin, 'Accountability in the Regulatory State' (2000) 27 *Jnl of Law & Society* 38, 42.

Definitions of 'accountability' generally focus on the idea of giving account of one's actions to some other person or body. [3] Under these definitions a regulator is accountable if it is required to explain or justify its actions to another person or body.

However, I suspect that at least some advocates for the increased accountability of regulators want more than explanation and justification. They want some response to the regulator's explanation or justification (above the non-binding recommendations or negative publicity that may follow the explaining and justifying). That response may be reversing the regulator's decision if it does not meet the required standard. Alternatively, it may be some sort of penalty if the regulator's actions do not meet the required standard, such as, removal from office in much the same way that directors may be removed from office, or not re-elected, if their performance does not meet the standard required by the company's members or that members of parliament may lose their seats if they or their parliamentary party fails to perform to the electorate's liking. The penalty may even be some form of civil or criminal sanction if the regulator's behaviour fails to meet the required standard, in much the same way that directors of a company may be liable if they fail to meet the standard of care of a reasonable director[4] or fail to act for a proper purpose in the interests of the company.[5]

I will call accountability mechanisms that merely require regulators to explain and justify their actions 'weak' accountability mechanisms and those that involve some sort of response if the regulator does not meet the required performance standard 'strong' accountability mechanisms.

2. Why should regulators be accountable?

Regulators are agents; they act on behalf of the government and, ultimately, on behalf of the public.[6] In acting on the government's and public's behalf they exercise fairly extraordinary powers. They exercise governmental or public powers, that is, they make laws or regulations; they compel compliance with their demands;[7] and, they impose penalties. Further, they receive a substantial amount of public money.[8]

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[3] The Oxford English Dictionary defines 'accountability' as 'the quality of being accountable; liability to give account of, and answer for, discharge of duties or conduct; responsibility, amenableness.' See also Scott, Colin, 'Accountability in the Regulatory State' (2000) 27 *Jnl of Law & Society* 38, 40 and Lodge, Martin and Stirton, Lindsay 'Accountability in the Regulatory State', Ch 15 in Baldwin, Robert, Cave, Martin and Lodge, Martin (eds) *The Oxford Handbook of Regulation* (2010, Oxford University Press), p349.
[4] Section 180 *Corporations Act 2001* (Cth).
[5] Sections 181 and 184, *Corporations Act 2001* (Cth).
[6] Ogus, Anthony I, *Regulation: Legal Form and Economic Theory* (2004, Hart Publishing), p. 111.
[7] For example, ASIC can require a person to give reasonable assistance in connection with its investigations and to appear for examination on oath (s 19 *Australian Securities and Investments Commission Act 2001* (Cth)), inspect books (s29 *Australian Securities and Investments Commission Act 2001* (Cth)), and require the

Agents should be accountable to their principals for the manner in which they exercise the powers and discretions given to them by their principals and for the way in which they expend the principal's resources. Therefore, regulators should be accountable to the government and, ultimately, to the public.

Accountability is linked to legitimacy.[9] In democracies we tend to believe that the legitimacy of governmental or public power principally derives from accountability to the electorate.[10] As I said regulators exercise government or public powers and yet they are not directly elected; they do not have democratic legitimacy. Therefore, we need to find other ways to make regulators accountable to the public and, therefore, legitimate.

3. What should they be accountable for?

As stated above, regulators should be accountable for the way in which they exercise their powers and discretions and for the way in which they expend their resources. That is, they should be accountable for everything they do. Ogus talks of three types of accountability: financial accountability, procedural accountability and substantive accountability.[11] Regulators should satisfy high standards of financial management because they are spending public money. Regulators' procedures should be fair, impartial and comply with administrative law principles because they are exercising public power.[12] Finally, regulators should be accountable for their substantive decisions. They should be accountable for the policies and regulations they make. They should be accountable for their administration of the regulatory regime, for example, the way they conduct licensing processes, the approvals they give, and the way they maintain public records and registers. They should be responsible for their compliance and enforcement decisions. Finally, and perhaps most importantly, regulators should be responsible for their overall management of their regulatory regime, that is, the priorities they set and how they allocate their resources. All these substantive decisions should achieve the public interest goals of the regulatory regime that the regulator administers.

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production of books and documents (ss 30, 31, 32A and 33 *Australian Securities and Investments Commission Act 2001* (Cth).

[8] For example, ASIC is largely funded by allocation in the Federal budget. APRA is largely funded by levy on the industries it regulates: s 50 *Australian Prudential Regulation Authority Act 1998* (Cth) and *Financial Institutions Supervisory Levies Collection Act 1998* (Cth).

[9] Morgan, Bronwen and Yeung, Karen *An Introduction to Law and Regulation: Text and Materials* (2007, Cambridge University Press), p.221. Morgan and Yeung quote Jody Freeman who defines legitimacy as 'when the public accepts decisions without having to be coerced (Freeman 1999)': p.221.

[10] Berg, Chris, *The Growth of Australia's Regulatory State* (2008, Institute of Public Affairs), p. 58.

[11] Ogus, Anthony I. *Regulation: Legal Form and Economic Theory* (2004, Hart Publishing), p. 111.

[12] Administrative Review Council, *Administrative Accountability in Business Areas subject to Complex and Specific Regulation* (2008).

4. What are the challenges?

So far it all sounds very simple: regulators should be accountable for everything they do. Unfortunately, like most things in regulation, it is not so simple. There are two significant challenges facing those who wish to call regulators to account, especially those who wish to impose strong accountability mechanisms.

- First, for regulators at least, accountability is not an absolute good. We do not want endless quantities of it because in general it undermines other desirable attributes of a regulator, namely, independence, expertise and efficiency.
- Secondly, the accountability of regulators is hampered by the difficulty of effectively measuring and assessing their performance. It is very difficult to hold someone to account if you cannot actually determine when they have performed well and when they have performed badly.

Trade-off between accountability and independence, expertise and efficiency

Governments create independent regulatory bodies primarily[13] to ensure that various decisions are made by those with expertise, [14] and independence.[15]

Governments have decided that it is in the public interest if certain decisions are made by those who possess specialist expertise. The complex and technical nature of the modern world means that no one group is in a position to develop the expertise to successfully govern all aspects of modern society. Parliamentarians, as a group, are unlikely to develop the expertise necessary, for example, to determine the appropriate capital adequacy and liquidity standards for Australian Authorised Deposit-taking Institutions[16] one day and to determine whether to authorise the operation of a nuclear facility[17] the next.

Arguably, groups of public servants within government departments could develop this expertise and provide advice to their Ministers. However, governments have also decided that it is in the public interest for certain decisions to be made by those who are more

[13] See text at fn. 20 for a third reason. Regulators also allow the combination of different functions (eg regulation-making and enforcement) in a way that is not often possible in other institutions: Baldwin, Robert and Cave Martin, *Understanding Regulation* (1999, Oxford University Press), p. 70.

[14] In his 1938 book *The Administrative Process*, James Landis (one of the inaugural Commissioners of the Securities Exchange Commission) justified the creation of regulators substantially on the basis of expertise, arguing that the technical nature of their tasks meant specialisation and expertise were necessary: see McCraw, Thomas, K *Prophets of Regulation* (1984, Belknap Press), p. 213. See also Ogus, Anthony I. *Regulation: Legal Form and Economic Theory* (2004, Hart Publishing), p. 105.

[15] Ogus, Anthony I. *Regulation: Legal Form and Economic Theory* (2004, Hart Publishing), pp. 105 – 106; Baldwin, Robert and Cave Martin, *Understanding Regulation* (1999, Oxford University Press), p. 70.

[16] This is the responsibility of APRA.

[17] This is the responsibility of the Australian Radiation Protection and Nuclear Safety Authority.

independent of the political process.[18] That is, government has decided that the public interest will be better served if certain regulatory and administrative decisions are made by people who are separated from the political process. Such persons do not have to appeal to populism or appease vocal lobby groups to ensure re-election or re-appointment. They have the luxury of taking a long-term and expert view of the public interest, whereas the electoral cycle means that politicians, and those directly answerable to them such as government departments, have strong incentives to take a short-term view.

Therefore, the very purpose of regulators is undermined when they are held to account, especially using strong accountability mechanisms which lead to responses imposed by those who do not possess the same level of expertise and independence. This is the accountability dilemma:

> 'Particular institutions may be designated as regulators because their expertise and independence from political influence maximize the prospects of their fulfilling public interest goals. Those prospects are reduced if their judgments may be overridden by other bodies which do not combine the same degree of expertise and political independence.'[19]

I should add that the cynics may also add an additional reason for the creation of regulators, beyond expertise and independence. Governments and parliaments may create regulators out of a desire to distance themselves from potentially unpopular decisions.[20] For example, from a political perspective is it preferable for an independent body to decide to raise interest rates. Of course, if this is the reason for the creation of a regulator neither the government nor the parliament will have an interest in ensuring strong accountability mechanisms; the imposition of a strong accountability mechanism will involve some assumption of responsibility for assessing and perhaps changing the decision of the regulator. So even from the cynic's perspective there is a trade-off between accountability and the *raison d'etre* of the regulator.

Another trade-off is between accountability and efficiency. Accountability may significantly undermine efficiency. For example, every minute regulators spend explaining or justifying themselves to another party, such as a parliamentary committee, is a minute that the regulator is not performing its core functions. Consultation with stakeholders slows down a regulator's

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[18] Lodge, Martin and Stirton, Lindsay, 'Accountability in the Regulatory State', Chap 15 in Baldwin, Robert, Cave, Martin and Lodge, Martin *The Oxford Handbook of Regulation* (2010, Oxford, Oxford University Press), p. 350.

[19] Ogus, Anthony I. *Regulation: Legal Form and Economic Theory* (2004, Hart Publishing), p.117. See also Lodge, Martin and Stirton, Lindsay, 'Accountability in the Regulatory State', Chap 15 in Baldwin, Robert, Cave, Martin and Lodge, Martin *The Oxford Handbook of Regulation* (2010, Oxford, Oxford University Press), p. 350.

[20] Berg, Chris, *The Growth of Australia's Regulatory State* (2008, Instiute of Public Affairs), p. 58

response to regulatory issues,[21] as do requirements to produce and publish regulatory impact analyses.

This is not an argument that regulators should not be required to explain and justify their actions, consult or conduct regulatory impact analyses. In fact, the regulator's knowledge that it may be called on to explain and justify its actions creates strong incentives to ensure that its actions are, in fact, explicable and justifiable. Likewise consultation and regulatory impact analysis generally leads to improved regulatory decision-making. So in this way appropriate accountability mechanisms will significantly improve performance of the core functions of regulators.

Nevertheless, it must be acknowledged that accountability involves trade-offs; it distracts regulators from their core functions, slows down their responses and, as stated above, undermines their expertise and independence. It, therefore, has to be balanced against efficiency, expertise and independence. We must understand the costs of accountability and accept that the gains from accountability will eventually be off-set by losses. Baldwin and Cave summarise the challenge facing those who are devising accountability mechanisms:

> 'it would be a mistake to assume that any improvement in accountability that can be devised will always be in the public interest. As is usually the case in regulation, trade-offs are at issue. The abilities of regulators to develop and apply their expertise, to operate efficiently in pursuit of their mandate, and to function in a transparent and accessible manner, may all be prejudiced by ill-judged moves to increase accountability. Where, for instance, review procedures allow other institutions (be they ministers, courts, or specialist review bodies) to second-guess regulators, there may be a holding to account but there may also be: decisions by officials who are less expert than the specialist regulators being reviewed; duplications and confusion of policy; delays in processes; and the removal of real decision-making power to bodies less transparent and accessible in their operations than those under review.'[22]

When devising accountability mechanisms we have to find an uneasy balance between accountability and these other desirable attributes. Alternatively, we could try to find the Holy Grail of an accountability mechanism that does not negatively affect these other desirable attributes. (I will come back to this Holy Grail at the end of this paper.)

Difficulty of measuring and assessing regulatory performance

Another significant challenge confronting those calling for increased accountability of regulators stems from the difficulty of measuring and assessing substantive regulatory

[21] Lodge, Martin and Stirton, Lindsay, 'Accountability in the Regulatory State', Chap 15 in Baldwin, Robert, Cave, Martin and Lodge, Martin *The Oxford Handbook of Regulation* (2010, Oxford, Oxford University Press), p. 365.

[22] Baldwin, Robert and Cave Martin, *Understanding Regulation* (1999, Oxford University Press), p. .313.

performance. Given the complex nature of many regulatory mandates it is notoriously difficult to set meaningful performance measures or standards for regulators and to actually measure their substantive, as opposed to procedural or financial, performance.[23]

ASIC, for example, has a statutory mandate that involves both business facilitation and consumer protection.[24] Accordingly, it is constantly required to balance somewhat inconsistent goals. It also has an incredibly broad area of responsibility. It regulates corporations, consumer credit, financial markets and financial services. This brings with it responsibility for 1.77 million companies, 4,874 Australian financial services licensees, 16 licensed financial markets, 5 licensed clearing and settlement facilities, 5270 company auditors, 664 registered liquidators, and 4339 registered managed investment scheme[25] and now ASIC is also responsible for credit licensees. ASIC must decide on priorities amongst these areas of responsibility and allocate resources accordingly. It would be unrealistic to expect it to supervise each and every one of these entities, to prevent every breach of the law by these entities or to even respond to every breach of the law of which it becomes aware. In this complex environment how should one measure the performance of ASIC?

It is possible to count things, such as, the number of enforcement actions per year, the percentage of successful enforcement actions, and the average number of days taken to process a licence application. ASIC, in fact, does all of these things in its annual report.[26] However, all of these performance measures are ambiguous. Does a record number of enforcement actions mean that ASIC has been particularly effective or does it mean that ASIC has failed to create a compliant regulated population by educating and persuading that population as encouraged by advocates of responsive regulation?[27] Does a high percentage of successful enforcement actions mean that ASIC is a successful litigant, making the best use of its limited enforcement budget, or does it mean that ASIC is targeting only easy cases and letting the more complex cases go? Does speed in dealing with licence applications indicate that ASIC is efficient or does it indicate that ASIC's licensing process is not rigorous? Another measure used by ASIC, and other regulators,[28] is satisfaction of key stakeholders measured by way of stakeholder surveys.[29] However, this too is a highly ambiguous measure. Is an industry stakeholder's satisfaction with the performance of ASIC

[23] Stern, Jon, 'The Evaluation of Regulatory Agencies' in Robert Baldwin, Martin Cave and Martin Lodge (eds), *The Oxford Handbook of Regulation* (2010, Oxford University Press) and Sparrow, Malcolm, *The Regulatory Craft* (2000, The Brookings Institution), pp. 113 – 117.
[24] Section 1(2) *Australian Securities and Investments Commission Act 2001* (Cth).
[25] All figures are from *AISC Annual Report 2009-2010*, p. 80.
[26] *ASIC Annual Report 2009-2010*, pp. 16 and 42. ASIC reports on the percentage of licence applications and variations completed within 28 days of receipt of a complete application.
[27] Ayres, Ian and Braithwaite, John *Responsive Regulation* (1992, Oxford University Press).
[28] Sparrow, Malcolm, *The Regulatory Craft* (2000, The Brookings Institution), p. 118.
[29] ASIC last did a stakeholder survey in 2010. The previous stakeholder survey was done in 2008: http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC+stakeholder+survey?openDocument (accessed 6 June 2011)

a sign that ASIC is doing a good job or that ASIC has been completely captured by the industry stakeholder and is doing its bidding? Given ASIC's mandate to facilitate business and to protect consumers, how should one balance industry satisfaction against consumer satisfaction?

No-one has very good answers to any of these questions; no-one can confidently assess ASIC's performance. The same analysis can be conducted in relation to the activities of many regulators. Essentially, no-one has come up with the perfect Key Performance Indicators for regulators. This is a significant impediment to effective accountability. Strong accountability mechanisms, in particular, require measuring the quality of a regulator's performance; we cannot respond if the regulator fails to meet the required standard unless we know what the required standard is and we can measure whether the regulator has meet it. Even weak accountability mechanisms are not particularly meaningful if those receiving the justification or explanation cannot discriminate between convincing and unconvincing justifications or explanations.

5. What are the existing accountability mechanisms?

Against this background, I will now look at the existing accountability mechanisms for Australian regulators. I will concentrate on accountability mechanisms for ASIC and APRA. There is, in fact, a broad array of accountability mechanisms and for ease of exposition I have grouped them by reference to the body to which the regulator is accountable. The key accountability mechanisms are also shown in Table 1.

Courts and tribunals

Australian regulators are accountable to courts and tribunals as part of the administrative law regime. In general, persons with standing can challenge the lawfulness of regulators' decisions by way of judicial or administrative law review in the courts.[30] Decisions can only be reviewed on the basis of *ultra vires* (misuse of power) or lack of procedural fairness. Further, the outcome of the review will generally be that the decision is remitted to the regulator to be made according to law. However, there is a stronger form of administrative law accountability available through independent tribunals such as the Administrative Appeals Tribunal (AAT).[31] A person whose interests are affected[32] by a regulator's decision can seek merits review of the decision through the AAT. In this review the AAT stands in

[30] Note that there are limitations on administrative law review. For example, under the *Administrative Decisions (Judicial Review) Act 1977* (Cth) a decision can only be reviewed if it is made under an enactment.
[31] There are also specialist Federal Tribunals, such as, the Takeovers Panel (which has the power to review decisions of the ASIC regarding whether to grant exemptions or modifications to Ch 6 or 6C during the life of a takeover: s 656A *Corporations Act 2001* (Cth)), the Social Security Appeals Tribunal and the Refugee Review Tribunal. There are also tribunals at the State level, such as the NSW Administrative Decisions Tribunal.
[32] Section 27 *Administrative Appeals Tribunal Act 1975* (Cth).

the place of the regulator and re-makes the decision.[33] Merits review through the AAT is only available where the legislation under which the regulator's decision is made provides a right of review to the AAT. The bulk of the decisions made by ASIC and APRA are subject to merits review by the AAT.[34] Under the *Administrative Appeals Tribunal Act 1975* (Cth) a person affected by a decision also has a right to apply for a written statement of the reasons for the decision.[35]

Administrative law accountability is strong accountability in that it involves a response to the regulator's failure to meet the required standards. However, judicial challenges on the basis of *ultra vires* or lack of procedural fairness are at the weaker end of the range of responses as the decision is simply remitted to the regulator to be made in accordance with law. The plaintiff is likely to feel that it has had a pyrrhic victory if the regulator makes the same decision, but according to law, the second time around. Review of decisions by a court on these bases is, on the other hand, not vulnerable to attack on the basis of lack of expertise. Judicial officers can be assumed to be experts on the requirements of procedural fairness and natural justice. Moreover, there is generally no difficulty measuring whether the regulator has actually complied with the standards of procedural fairness and natural justice.

The AAT delivers a much stronger response; the AAT can re-make the impugned decision. However, the AAT is slightly more vulnerable to criticism on the basis of expertise. The AAT tries to deal with this criticism by the creation of panels of experts. However, these panels may not have quite the same expertise as the regulator. Further, the AAT adjudicates the individual matter brought before it and will often have difficulty putting that individual matter into the broader context. Regulators make individual decisions about, for example, refusing a license or banning an individual, in the broad context of the market and its work in relation to that market. An individual decision will not just be designed to have an impact on the behaviour of the individual who it directly affects; it will also be designed to have a broader impact on the market. There is room to question whether the AAT is able to understand and take into account this broader context. There is, in fact, room to debate whether it should. The short point, however, is that if it is not able to do this its decisions might undermine the regulator's attempt to achieve its statutory mandate.

Finally, it should be acknowledged that administrative law review will undermine efficiency. Decisions that are supposed to be made quickly, such as, decisions banning an individual from participating in a certain industry in order to protect the general public, will be delayed

[33] Section 43 *Administrative Appeals Tribunal Act 1975* (Cth).

[34] See ss 1317A – 1317C, *Corporations Act 2000* (Cth), s 51A – 51D, *Banking Act 1959* (Cth), s 63 *Insurance Act 1973* (Cth) and s 334 *Superannuation Industry (Supervision) Act 1993* (Cth).

[35] Section 28.

by the review process. Moreover, both the individual seeking review and the regulator will expend resources in the review process.

Civil or criminal liability can create a strong form of accountability. It can ensure a penalty or remedy is imposed if behaviour falls short of a legal standard. For example, as stated above, directors of a company may be liable if they fail to meet the standard of care of a reasonable director or fail to act for a proper purpose in the interests of the company. Regulatory officers can be criminally liable for misuse of public funds. The *Financial Management and Accountability Act 1997* (Cth), which applies to both ASIC and APRA, imposes on regulatory officers[36] criminal penalties of up to 7 years imprisonment for improper use or handling of public money or property and other related offences, as well as liability for lost amounts.[37] However, compared to most, regulatory officers are insulated from civil liability. In general, they have immunity from liability for damages for an act or omission in performance of their functions, except in cases of bad faith.[38] There is a tort of misfeasance in public office which imposes liability on regulatory officers who cause loss or damage, but only where the regulatory officers act in bad faith.[39] To establish bad faith a plaintiff needs to establish either that:

- the officer was motivated by a purpose foreign to that for which the power or duty was bestowed and that the officer's conduct was undertaken with the intention of harming the plaintiff; or
- the officer's acts or omissions were undertaken in the knowledge that they were beyond power and were likely to harm the plaintiff.[40]

Given this high threshold, this action is rarely made out.[41]

Regulators' qualified immunity from civil liability supports the regulator's independence and, to a lesser extent, efficiency. As stated by Harlan J of the United States Supreme Court:

> 'It has been thought important that officials of government should be free to exercise their duties unembarrassed by the fear of damage suits in respect of acts done in the course of those duties – suits which would consume time and energies which would

[36] Liability is imposed on 'officers', that is, a person who is in or part of an agency covered by the Act: s 5.
[37] See ss 10 – 16, 26, 40 – 43, 60 and 61.
[38] See for example s 246 *Australian Securities and Investments Commission Act 2001* (Cth) and s 58 *Australian Prudential Regulation Authority Act* 1998 (Cth).
[39] Balkin, RP and Davis JLR, *Law of Torts* (4th ed, 2009, LexisNexis Butterworths, Australia), pp. 705 – 710.
[40] Balkin, RP and Davis JLR, *Law of Torts* (4th ed, 2009, LexisNexis Butterworths, Australia), p. 708.
[41] It was made out in *Rowan v Cornwall (No 5)* (2002) 82 SASR 152; on appeal *Cornwall v Rowan* (2004) 90 SASR 269. Without admission of liability, the Federal Government settled an action brought by Pan Pharmaceuticals and its former Chief Executive in relation to the Therapeutic Goods Authority actions against Pan Pharmaceuticals for $50 million plus legal costs: Therapeutic Goods Authority, *Media Statement: Commonwealth Government settlement with Pan Pharmaceuticals and its former Chief Executive* (14 August 2008).

> otherwise be devoted to governmental service and the threat of which might appreciably inhibit the fearless, vigorous, and effective administration of policies of government.' [42]

In other words, in this instance accountability is sacrificed to independence and efficiency.

Parliament

In Australia, regulators are accountable to parliament through the parliamentary committee system. The parliamentary committee system allows parliamentarians to directly question regulators (and other members of the executive government) about the broad range of their activities. Questions can be about anything, ranging from financial management, staffing, regulation or policy-making, administration of the law (such as licensing) and enforcement policy. (Although in practice specific questions about potential or individual enforcement actions may be 'batted away' by the regulator on the basis that the regulator does not want to prejudice its enforcement action.)

Parliamentary committees are generally specialised and this allows them to look at matters in detail and be directed and informed in their scrutiny. ASIC appears before Estimates but also has its own parliamentary committee, the Parliamentary Joint Committee on Corporations and Financial Services, which is responsible for oversight of its activities.[43] This Committee holds inquiries into specific policy matters relevant to ASIC's jurisdiction, such as the 2009 Inquiry into Financial Products and Services in Australia, which has lead to the Future of Financial Advice Reforms. It also holds 'oversight hearings' about ASIC's performance in general and examines ASIC's annual report. It then reports to both Houses of Parliament on the results of its inquiries. In 2009-2010 ASIC appeared before parliamentary committees on 11 occasions and the Parliamentary Joint Committee on Corporations and Financial Services tabled 3 statutory oversight reports.[44] This process would have consumed a considerable amount of senior resources at ASIC.

Accountability to parliament is reinforced by the requirement that regulators' annual reports be tabled in parliament. Both ASIC and APRA are required to report annually to the Commonwealth Parliament, through their Ministers and legislation sets out mandatory content for those reports.[45]

A regulator's knowledge that its actions will be subject to intense and public scrutiny through the Committee system acts as a powerful motivator to ensure that its actions are justifiable

[42] *Barr v Matteo* 360 US 564 (1959), at 571.

[43] The duties of the Parliamentary Joint Committee on Corporations and Financial Services are set out in s 243 *Australian Securities and Investments Commission Act 2000* (Cth).

[44] *ASIC Annual Report 2009-2010*, p. 71.

[45] Section 136 *Australian Securities and Investments Commission Act 2001* (Cth) and s 59 *Australian Prudential Regulation Authority Act 1998* (Cth).

and explicable. Additionally, parliamentary scrutiny is one of the few mechanisms that looks at whether the regulator is achieving its statutory mandate as a whole. Parliamentary committees can question regulators on priority setting and resource allocation, rather than just ensuring accountability for individual decisions and acts. Annual reports should also concentrate on and explain these priorities and allocations.

However, these parliamentary reporting requirements are weak accountability mechanisms; they may lead to a significant amount of information being made public, but they do not lead to a response, other than political pressure, embarrassment or non-binding recommendations. Further, although parliamentary committees tend to be specialised and, therefore, able to develop a level of expertise, they are rarely able to develop the same level of expertise as the regulator itself. Finally, of course, excessive accountability to parliament and responsiveness to parliamentary pressure will undermine the independence of regulators and their efficiency. Ogus summarises the situation neatly:

> 'Accountability to Parliament may force disclosure of information which would not otherwise be available, and may facilitate public debate, but it is not clear that it provides a good medium for ensuring that regulators satisfy the three criteria which we have identified [financial accountability; procedural accountability; and substantive accountability]. Politicians rarely have the time and expertise to absorb the data and make detailed judgments on the financial management of regulatory bodies. They may provide a valuable, generalized overview of procedural fairness, but investigation of particular grievances normally requires a specialist institution. Nor are they well placed to monitor adherence to public interest goals, since they are vulnerable to the influence of private interest lobbying. More generally, increased parliamentary scrutiny may encourage greater governmental interference, which itself may attempt to capture short-term political gains.'[46]

One of the things that regulators do is make laws or regulations. Most of these laws or regulations will be legislative instruments[47] and therefore subject to parliamentary scrutiny under the *Legislative Instruments Act 2003* (Cth). The *Legislative Instrument Act* requires that, except in limited circumstances, the regulator conduct the consultation that it considers appropriate and reasonably practicable.[48] It also provides for parliamentary scrutiny of

[46] Ogus, Anthony I. *Regulation: Legal Form and Economic Theory* (Hart Publishing, 2004), p. 113.
[47] 'Legislative instrument' is defined in ss 5 – 9, *Legislative Instruments Act 2003* (Cth). In essence, a legislative instrument is an instrument in writing that is made in the exercise of a power delegated by Parliament and is of legislative character (ie determines the law or alters the content of the law, rather than applies the law in a particular case and has the effect of affecting a privilege or interest, imposing an obligation, creating a right, or varying or removing an obligation or right).
[48] Sections 17 – 18, *Legislative Instruments Act 2003* (Cth).

legislative instruments.[49] Essentially legislative instruments, and their explanatory statements, are tabled in both Houses of the Parliament.[50] Either House can pass a resolution disallowing the instrument.[51] The disallowance power is used, but not frequently: in 2010 there were two disallowances, in 2009 there were eight and in 2008 there were five.[52] None of these disallowances related to legislative instruments made by ASIC or APRA.

This strong accountability mechanism is vulnerable to the criticism that it undermines the independence and expertise of the regulators' regulation-making. However, the history of its use shows that it is not over-used or abused. Further, the fact that it is limited to the most parliamentary of the regulator's roles – regulation-making – means that it is an acceptable incursion into the independence of the regulator. Here, I would suggest the uneasy balance between accountability and independence is maintained. Further, the process is designed so as not to undermine efficiency unnecessarily. Legislative instruments are valid until disallowed and the disallowance must occur within a relatively short time-frame. The instrument must be tabled before both Houses of the Parliament within six parliamentary sitting days of its registration.[53] The motion to disallow must be given within 15 sitting days of the tabling and the fate of the instrument is then determined within a further 15 sitting days.[54]

Executive Government and Government Agencies

Regulators are generally[55] accountable to the executive government through a Minister.[56] In fact, the relevant Minister can often give a direction to the regulator.[57] Section 12 of both the

[49] Under s 46B, *Act Interpretation Act 1901* (Cth), certain non-legislative instruments are also subject to disallowance under the *Legislative Instruments Act 1901* (Cth). They will be subject to disallowance if they are expressly declared by the enabling provision or by legislation or legislative instrument under which they are made to be disallowable instruments for the purposes of s 46B.

[50] Sections 38 – 39 *Legislative Instruments Act 2003* (Cth).

[51] Section 42 *Legislative Instruments Act 2003* (Cth).

[52] Export Inspection (Establishment Registration Charges) Amendment Regulations 2009 (No. 1); Export Inspection (Quantity Charge) Amendment Regulations 2009 (No. 1); Health Insurance (Cataract Surgery) Determination 2009; Health Insurance (Dental Services) Amendment and Repeal Determination 2008; Higher Education Support Act 2003 - Amendment No. 2 to the Commonwealth Grant Scheme Guidelines No. 1 (23/02/2008); National Health Act 1953 - Amendment determination under subsections 85AB(1) and 85AC(1) - drugs on F1 and drugs in Part A of F2 (No. PB 2 of 2010); Road User Charge Determination 2008 (No. 1); Threat Abatement Plan for Disease in Natural Ecosystems caused by Phytophthora Cinnamomi (2009); Workplace Relations (Registration and Accountability of Organisations) Amendment Regulations 2007 (No. 1) Workplace Relations Amendment Regulations 2007 (No. 4). See http://www.comlaw.gov.au/Browse/ByTitle/LegislativeInstruments/Disallowed/0/0/ (accessed 14 June 2011).

[53] Section 38 *Legislative Instruments Act 2003* (Cth).

[54] Section 42 *Legislative Instruments Act 2003* (Cth).

[55] The Auditor-General is directly accountable to Parliament: s 8 *Auditor-General Act 1997* (Cth).

[56] Ministerial responsibilities are allocated in the Administrative Arrangements Order made by the Governor-General, on advice from the Federal Executive Council. This reporting relationship is reinforced by provisions such s 44A *Financial Management and Accountability Act 1997* (Cth) (which provides that the head of an Agency covered by the Act, such as ASIC and APRA, must give the Minister responsible for the Agency such reports, documents and information in relation to the operations of the Agency as that Minister requires and such reports, documents and information in relation to the financial affairs of the Agency as that Minister

Australian Securities and Investments Commission Act 2001 (Cth) and the *Australian Prudential Regulation Authority Act 1998* (Cth) allows the Minister to give a direction in writing to ASIC or APRA 'about policies it should pursue, or priorities it should follow.'[58] The Minister cannot give a direction about a particular case.[59] However, the Minister can direct that a particular matter be investigated by ASIC.[60] A direction (other than a direction that ASIC must investigate a particular case) must be published in the Gazette and laid before both Houses of Parliament.[61]

The International Monetary Fund commented negatively on this directions power in its 2006 Financial Sector Assessment of Australia.[62] It is an extremely strong accountability mechanism, which potentially severely impinges on the regulator's expertise and, in particular, independence from the political process. The giving of a direction to a regulator puts the regulator firmly in the political process. On one view this accountability mechanism is so strong it is very rarely used.[63] On this view, this power, and its limited use, are evidence of the uneasy, but positive, balance between accountability and independence that is achieved in practice. The power to give directions ensures accountability to government, but the value placed on the independence of regulators means that it would be politically unacceptable to use the power except in the most extraordinary cases.[64]

Having said this it is possible that, behind the scenes, the directions power could lead to significant actual Ministerial interference in the regulatory process. The mere threat of a direction could encourage a regulator to follow the wishes of the Minister because few regulators would want to be on the receiving end of a direction. In fact, s12 of the *Australian Securities and Investments Commission Act 2001* (Cth) and the *Australian Prudential*

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requires) and s 136 *Australian Securities and Investments Commission Act 2001* (Cth) and s 59 *Australian Prudential Regulation Authority Act 1998* (Cth) (which require ASIC and APRA to provide annual reports, covering certain matters, to their responsible Minister). See, generally ,Commonwealth of Australia, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (June 2003) (Uhrig Report) pp. 33-34.

[57] Commonwealth of Australia, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (June 2003) (Uhrig Report) p.38 and p.62.

[58] Section 12(1).

[59] Section 12(3).

[60] Section 14 *Australian Securities and Investments Commission Act 2001* (Cth).

[61] Section 12(5) *Australian Securities and Investments Commission Act 2001* (Cth).

[62] International Monetary Fund, *Australia: Financial Sector Assessment Program – Detailed Assessment of Observance of Standards and Codes: IMF Country Report 06/415* (2006), at pp 41, 85 and 125.

[63] In September 1992 the then Attorney-General gave a direction to ASIC's predecessor body, the Australian Securities Commission, to require increased cooperative arrangements between the Director of Public Prosecutions and the Australian Securities Commission. No other direction appears to have been given to ASIC or APRA.

[64] The Statement of Expectations (SOE) from the Treasurer to ASIC's Chairman and the SOE from the Treasurer to APRA's Chairman, both dated 20 February 2007, state that the Minister would only use the directions power in 'rare and exceptional circumstances': http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC_Statement_of_Expectations.pdf/$file/ASIC_Statement_of_Expectations.pdf and http://www.apra.gov.au/AboutAPRA/upload/Statement-of-Expectations-from-Treasurer-20-Feb-07.pdf.

Regulation Authority Act 1998 (Cth) seems to facilitate such intentional or unintentional Ministerial or political influence. It provides that before giving a direction the Minister must notify ASIC or APRA that it is 'considering giving the direction'. It is impossible to know how often this has been done or how often a Minister has more informally indicated that he or she is inclined to give a direction if something does not happen. We do know that there are situations in which the Minister has informally requested that ASIC does certain work.[65] This may suggest that the uneasy balance is a bit off kilter and in practice there is too much accountability to the executive government and too little independence.

Another mechanism designed to enhance accountability to the Minister is the Ministerial Statement of Expectations (SOE) and the regulator's Statement of Intent (SOI). The SOE and SOI owe their birth to the 2003 *Uhrig Report*.[66] Recognising Ministers' reluctance to use directions powers,[67] Uhrig recommended[68] that Ministers should communicate government's expectations of statutory authorities, such as regulators, in a public, written SOE. According to Uhrig, this would ensure 'individuals responsible for the performance of statutory authorities clearly understand the expectations of government including the outcomes for which they would be held accountable.'[69] Uhrig did recognise the need for the SOE to be carefully drafted so as not to undermine the independence of the statutory authority.[70] Uhrig recommended that the statutory authority respond to the SOE in a public, written SOI which outlines how the authority will meet the government's expectations and which identifies Key Performance Indicators (KPIs) against which the authority's performance can be measured.

In practice the SOE and SOI mechanism has enhanced neither transparency nor accountability. The then Treasurer provided SOEs to the Chairmen of ASIC and APRA on 20 February 2007. The APRA Chairman provided an SOI in response on 18 May 2007 and the ASIC Chairman provided ASIC's SOI on 27 June 2007. Neither APRA's nor ASIC's SOI actually contain KPIs. Both regulators express an intention to develop new KPIs but also note the difficulty of devising meaningful measures. The SOEs and SOIs are still

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[65] For example, the Hon Nick Sherry, then Minister for Superannuation and Corporate Law, asked ASIC to facilitate the use of forecasts of superannuation end benefits: Speech to the Institute of Actuaries Financial Services Forum 2008, Melbourne, 19 May 2008 http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2008/013.htm&pageID=005&min=njs&Year=&DocType=1. Interestingly, ASIC has still not finished this work.

[66] Commonwealth of Australia, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (June 2003) (Uhrig Report)

[67] Commonwealth of Australia, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (June 2003) (Uhrig Report), p. 38.

[68] Commonwealth of Australia, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (June 2003) (Uhrig Report), pp. 59 – 61.

[69] Commonwealth of Australia, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (June 2003) (Uhrig Report), p. 60

[70] Commonwealth of Australia, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (June 2003) (Uhrig Report), p.60.

available on the websites of the respective regulators[71] but appear to have little, if any, ongoing relevance. Given their vague and platitudinous content, they are certainly unlikely to provide any concrete guidance on the government's expectations or on how the regulators intend to give effect to the government's expectations. Uhrig stated that the SOE and SOI should be reviewed at least annually and more regularly if circumstances, such as a new Minister or Head of Department, required.[72] A measure of the lack of relevance or importance of the SOEs and SOIs is the fact that they have not been updated since their original issue in spite of a change in government and a number of changes in Minister.

The regulatory impact analysis (RIA) requirements imposed by the executive government on government departments and agencies, such as regulators, create a form of accountability in relation to regulation making. RIA is 'the process of examining the likely impacts of a proposed regulation and a range of alternative options which could meet the government's policy objectives.'[73] There are different RIA requirements for federal government regulatory proposals[74] and Council of Australian Government (COAG) regulatory proposals.[75] There are also different RIA requirements at State and Territory level.[76] I will concentrate on the standard federal government requirements that apply to ASIC and APRA.

The federal government's requirements are administered by the Office of Best Practice Regulation (OBPR), which is a division of the Department of Finance and Deregulation. While these requirements apply to regulation making activities only, regulation is defined broadly as '[a]ny 'rule' endorsed by government where there is an expectation of compliance.'[77] The key component of the RIA requirements is the obligation to prepare a Regulatory Impact Statement (RIS). A RIS is a document that 'formalises and provides evidence of the key steps taken during the development of the regulation and the costs and benefits of each option' available to address the particular regulatory problem.[78] A RIS is required for all decisions made by the government and its agencies that are likely to have a regulatory impact (positive or negative) on business or the not-for-profit sector, unless that

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[71] See http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC_Statement_of_Expectations.pdf/$file/ASIC_Statement_of_Expectations.pdf and http://www.apra.gov.au/AboutAPRA/upload/Statement-of-Expectations-from-Treasurer-20-Feb-07.pdf.

[72] Commonwealth of Australia, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (June 2003) (Uhrig Report), p. 60.

[73] Australian Government, *Best Practice Regulation Handbook* (June 2010 edition), p. 7, para 2.1. http://www.finance.gov.au/obpr/proposal/handbook/docs/Best-Practice-Regulation-Handbook.pdf

[74] See Australian Government, *Best Practice Regulation Handbook* (June 2010 edition).

[75] See *Best Practice Regulation: A Guide for Ministerial Councils and National Standard Setting Bodies* (COAG 2007).

[76] For details about the RIA requirements at State level: see Office of Best Practice Regulation 2010*, Best Practice Regulation Report 2009-10*, Department of Finance and Deregulation, Canberra, Appendix B, pp. 68 – 87.

[77] Australian Government, *Best Practice Regulation Handbook* (June 2010 edition), p. 9, para 2.10.

[78] Australian Government, *Best Practice Regulation Handbook* (June 2010 edition), p. 7, para 2.3.

impact is of a minor or machinery nature[79] and does not substantially alter existing arrangements.

The process of developing a RIS has four stages:[80]

- *Notifying the OBPR* – Once an agency makes a decision that regulation may be necessary it is required to inform the OBPR. The OBPR will decide, based on information provided by the agency, whether a RIS is required.
- *Preparing the RIS* – If a RIS is required it is prepared by the agency. The OBPR does not mandate a format for the RIS but states that generally it should set out:

  ‘1. the problem or issues that give rise to the need for action
  2. the desired objectives
  3. a range of options (regulatory and non-regulatory, as applicable) that may constitute feasible means for achieving the desired objectives
  4. an assessment of the impact (costs, benefits and, where relevant, levels of risk) of a range of feasible options for consumers, business, government and the community
  5. a consultation statement
  6. a conclusion and recommended option, and
  7. a strategy to implement and review the preferred option.’[81]

  The RIS requirements are scalable: the more significant the impacts of the regulatory proposal the more detailed the analysis in the RIS must be. The RIS must be certified by the relevant agency head or deputy head. The adequacy of the RIS is then assessed by the OBPR. The regulatory agency must also prepare a one-page summary of the RIS which must be approved by the OBPR as a fair, balanced and accurate summary of the RIS.[82]
- *The decision-making stage* – The RIS, the OBPR’s assessment of its adequacy and the one-page summary are then presented to the decision-maker prior to the decision

[79] ‘”Minor” changes refer to those changes that do not substantially alter the existing regulatory arrangements for businesses or not-for-profit organisations, such as where there would be a very small initial one-off cost to business and no ongoing costs. “Machinery” changes refer to consequential changes in regulation that are required as a result of a substantive regulatory decision, and for which there is limited discretion available to the decision maker’: Australian Government, *Best Practice Regulation Handbook* (June 2010 edition), p. 10, para 2.14.

[80] See Australian Government, *Best Practice Regulation Handbook* (June 2010 edition), pp. 10 – 20.

[81] Australian Government, *Best Practice Regulation Handbook* (June 2010 edition), p. 14, para 2.24. If a regulatory proposal restricts competition the RIS must also demonstrate that the preferred option generates a net benefit to the community as a whole and that the only way to achieve the relevant objective is to restrict competition: p .61

[82] The one-page summary requirement was introduced in the June 2010 edition of the *Best Practice Regulation Handbook.* It seems to be an acknowledgement that the decision-makers do not always have time to read the complete RIS and, in the past, frequently did not.

being made. The RIS is supposed to assist the decision-maker reach an informed decision.

- *Publication* – The RIS then has to be published, on a central online public register of all RISs and, where appropriate, as an attachment to the explanatory memorandum or explanatory statement. This is where the process breaks down. The RIS approved by the OBPR will recommend an option. However, the decision-maker is presumably entitled to prefer an alternative option. If that were not the case the actual regulatory decision would be made by those preparing the RIS and the decision-maker would be a rubber stamp. However, if the decision-maker does not follow the option approved in the RIS, the publication of the RIS would be highly embarrassing to the agency.[83] There is a significant tension between the RIS's role as a decision-making tool and its role as a transparency measure, documenting, explaining and justifying the regulatory decision. The attempt to use the document to achieve both ends means that neither may be achieved. In practice there is a temptation to ensure that the RIS actually documents the decision already endorsed by the decision-maker. Further, if that is not achieved, and the decision-maker reaches a decision that is inconsistent with the approved RIS, generally, the RIS is subsequently amended, with the approval of the OBPR. The *Best Practice Regulation Handbook* (June 2010 edition) does not clearly acknowledge this. It does, however, note that:

> '2.38 There is scope for RISs to be modified after the decision maker's consideration but prior to publication:
>
> - where a draft RIS refers to commercial-in-confidence or national security information, or
> - to include analysis of the option adopted where that option was not considered in the original RIS.
>
> 2.39 While it may be possible to add further information to give greater context to the decision, as a general principle information on the options considered will not be able to be removed. Any changes to the RIS intended for publication need to be approved by the OBPR.'[84]

The use of the RIS as a transparency document means that it frequently becomes a document that merely justifies a decision already made.

The strength of the federal government's RIA requirements, as an accountability measure, is that they are mandatory and compliance with them is assessed, and reported on, by the

[83] This problem is also recognised by the OECD: *OECD Reviews of Regulatory Reform: Australia 2010 Towards a Seamless National Economy* (OECD 2010), p. 106 which suggests the original RIS should be published but acknowledges this can create 'some confusion'.
[84] Australian Government, *Best Practice Regulation Handbook* (June 2010 edition), p. 20.

OBPR. That is, whenever a government department or agency makes regulation they are required to comply with the RIA requirements and the OBPR makes the judgment about both whether those requirements are triggered and whether they are complied with. However, the requirements are mandatory by Executive order, not as a matter of law. The government has agreed that, in the absence of exceptional circumstances as agreed by the Prime Minister, a regulatory proposal that requires a RIS cannot go to Cabinet or other decision maker, such as the Commission of ASIC or APRA's executive group, unless RIA requirements have been complied with. However, the only sanction for failure to comply is negative publicity. In this sense the RIA requirements are a weak accountability mechanism. As evidence that governments and regulators are not perfect when it comes to complying with regulatory requirements imposed on them, compliance rates are dropping. Compliance rates have fallen, from 90 per cent in 2007-08 to 84 per cent in 2009-10; there were 12 non-complying regulations last year.[85] However, ASIC and APRA are fully compliant.[86]

Most advanced countries have similar RIA processes. Australia's process is highly ranked. The OECD has described it as 'among the most rigorous and comprehensive in the OECD'.[87] The Australian RIA requirements do have much to recommend themselves. They impose a disciplined and systematic approach to regulation making on regulation-makers. However, it is important to keep some scepticism about the process and to understand the impact that it has on efficiency. There are incredible implementation challenges. The RIS requires assessment of costs and benefits but certain things are very difficult to assess, especially *ex ante*. In particular, benefits are hard to measure; future benefits are almost impossible to measure, identify and sensibly analyse. In practice, so many assumptions have to be made that the analysis becomes incredibly tenuous. As noted above, the insistence that the RIS is both a transparency document and a decision-making tool mean that it is challenging to prevent the drafting of the RIS becoming a time-consuming and expensive process of justifying decisions already made. I suspect those who are actually involved in the RIA process have some scepticism about it, privately doubting whether it would itself, in all cases, survive a rigorous cost-benefit analysis.[88]

Apart from the OBPR there are a number of other bodies which effectively regulate the regulators. For example, Auditors-General, Ombudsmen, and specialist bodies such as the

[85] Office of Best Practice Regulation 2010*, Best Practice Regulation Report 2009-10*, Department of Finance and Deregulation, Canberra, p. 15.

[86] See *Annual Compliance Reports* from 2005 to 2010 available at http://www.finance.gov.au/obpr/reporting-publications/publications.html#annual_compliance (accessed 14 June 2011).

[87] *OECD Reviews of Regulatory Reform: Australia 2010 Towards a Seamless National Economy* (OECD 2010), pp. 15 – 16.

[88] Lave concludes that cost-benefit analysis is so costly to perform that 'it ought not be applied to every problem or applied lightly. Few issues are worthy of a formal benefit-cost analysis': Lave, Lester B, 'Benefit-Cost Analysis: Do the Benefits Exceed the Costs?', Chap 6 in Ogus, Anthony I (ed) *Economics and the Law* (2001, Elgar Publishing). p. 466.

Inspector-General of Taxation all play a role in ensuring the accountability of regulators.[89] In general, these regulators of the regulators provide weak accountability in that they cannot impose any response; they only make recommendations, generally to the Minister or the regulator concerned.

The Auditor-General, supported by the Australian National Audit Office, audits the financial statements of Commonwealth agencies, such as ASIC and APRA.[90] The Auditor-General must report to the agency's responsible Minister about whether the financial statements have been prepared in accordance with the Finance Minister's Orders and give a true and fair view of the matters required by those Orders. The audit report has to be included in an agency's annual report which is tabled in Parliament.[91] The Auditor-General also conducts performance audits of agencies, such as ASIC and APRA.[92] Performance audits conducted by the Auditor-General include:

- ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the Corporations Act 2001 (January 2007);
- ASIC's Implementation of Financial Services Licences (January 2006);
- Bank Prudential Supervision (July 2005);
- APRA's Prudential Supervision of Superannuation Entities (September 2003); and
- Bank Prudential Supervision (May 2001).

The Auditor-General can also conduct a review or examination of a particular aspect of the operations of the whole or part of the Commonwealth public sector.[93]

In Australia, there are Ombudsmen at the State and Territory and Federal level.[94] They have broad powers to investigate potential maladministration by regulators. The Commonwealth Ombudsman, for example, can investigate either following a complaint, or of its own motion, action by a regulator that relates to 'a matter of administration'.[95] When investigating complaints the Ombudsman seeks explanation and justification from the relevant regulator. The Commonwealth Ombudsman receives complaints about ASIC and APRA.[96] Most complaints about ASIC relate to the imposition of late fees (although these complaints have

[89] This list could be further extended. For example, the Office of the Australian Information Commissioner monitors, investigates and reports on compliance by agencies with the *Freedom of Information Act 1982* (Cth) and privacy requirements and the Productivity Commission's regular reviews of regulatory burden could be characterised as an accountability mechanism.
[90] Sections 12 *Auditor-General Act 1997* (Cth) and s 57 *Financial Management and Accountability Act 1997* (Cth)
[91] Section 57 *Financial Management and Accountability Act 1997* (Cth).
[92] Sections 15 *Auditor-General Act 1997* (Cth).
[93] Section 18 *Auditor-General Act 1997* (Cth).
[94] See generally Head, Michael *Administrative Law: Context and Critique* (2nd ed, 2008, Federation Press), pp. 71 – 77.
[95] Section 5 *Ombudsman Act 1976* (Cth).
[96] See , for example, *Commonwealth Ombudsman Annual Report 2009-2010*, pp. 124 – 126.

recently reduced) and its failure to investigate or take action in relation to alleged misconduct. Most complaints about APRA relate to the processing of applications for early release of superannuation benefits.

Uhrig recommended the creation of a new regulator of regulators, an Inspector-General of Regulation. He modelled his proposed Inspector-General of Regulation on the Inspector-General of Taxation. The Inspector-General of Taxation can identify systemic problems with the administration of the tax laws[97] and, therefore, operates one of the few accountability mechanisms that examines the overall regulatory approach of a regulator. The Inspector-General reviews and reports on the systems established by the Australian Taxation Office to administer the tax laws, and the systems established by tax laws.[98] The Minister may direct that the Inspector-General conduct a review and the Minister, the Commissioner of Taxation, the Parliament or a Parliamentary Committee may all request a review.[99] The Inspector-General of Taxation can also conduct a review on his or her own initiative following, for example, complaints by individual tax payers, tax professionals or the Ombudsman.[100] After conducting a review, the Inspector-General gives a written report, which may include recommendations, to the Minister and the report is made public.[101] When conducting a review the Inspector-General may invite submissions from the public and has broad powers to request or require information, documents and evidence from tax officials.[102]

Urhig envisaged that the Inspector-General of Regulation would 'investigate systems and procedures used by regulatory statutory authorities to administer regulation and to recommend improvements where appropriate'[103] and 'would provide the community with a mechanism to ensure that the regulators are being held to account for the way in which they exercise their powers.'[104] Uhrig saw the Ombudsman as providing an avenue to ensure accountability in relation to services or administration, whereas the Inspector-General of Regulation would provide an avenue for complaint about systemic regulatory issues. He stated:

> 'Where statutory authorities provide services, dissatisfied individuals are able to seek redress through the Ombudsman. Where a pattern of complaints emerges, the Ombudsman has the power to undertake investigations into systemic issues. However,

[97] Section 3 *Inspector-General of Taxation Act 2003* (Cth).
[98] Section 7 *Inspector-General of Taxation Act 2003* (Cth).
[99] Section 8(2) and (3) *Inspector-General of Taxation Act 2003* (Cth).
[100] Section 8(1) *Inspector-General of Taxation Act 2003* (Cth).
[101] Sections 10 and 11 *Inspector-General of Taxation Act 2003* (Cth).
[102] Sections 12 – 21 *Inspector-General of Taxation Act 2003* (Cth).
[103] Commonwealth of Australia, Review of the Corporate Governance of Statutory Authorities and Office Holders (June 2003) (Uhrig Report), p. 90.
[104] Commonwealth of Australia, Review of the Corporate Governance of Statutory Authorities and Office Holders (June 2003) (Uhrig Report), p. 68.

in the case of systemic regulatory issues, it is the opinion of the review that the business community will be more inclined to seek an investigation of issues through an Inspector-General of Regulation.'[105]

The government did not accept Uhrig's recommendation to create an Inspector-General of Regulation.[106]

The ultimate response to failure to meet a required standard of performance is removal from office by the person to whom you are accountable. This is a strong and effective accountability mechanism. For example, under Australian law members' power to remove directors from office[107] significantly enhances the accountability of directors to members. Senior officials at regulators can generally be removed from office by the executive government but only in limited circumstances. In order to reinforce their independence from the political process, senior officials at regulators are generally given a form of tenure.[108] For example, the Governor-General, who would, of course, act on the advice of the executive government, may terminate the appointment of an ASIC Commissioner only on the grounds of misbehaviour, physical or mental incapacity, certain absences from duty, breach of legislative requirements relating to disclosure of conflicts of interests, bankruptcy, and paid employment outside the duties of his or her office without consent of the Minister.[109] The requirements in relation to APRA are almost identical, although there is a specific provision stating that the appointment of a member of APRA is immediately terminated if the member becomes a director, officer or employee of a body regulated by APRA and another provision stating that the member may be removed from office if the member is or becomes a director, officer or employee of a body operating in the financial sector, other than a body regulated by APRA, and the Minister considers that the person is, will be, or could be, prevented from the proper performance of the functions of his or her office because of resulting conflicts of interest. [110]

The purpose of this limitation on removal from office is clearly to ensure the independence of regulators. It ensures that a regulatory official cannot be removed from office merely

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[105] Commonwealth of Australia, Review of the Corporate Governance of Statutory Authorities and Office Holders (June 2003) (Uhrig Report), p. 68.

[106] Senator Nick Minchin Media Release 57/04 Australian Government Response to Uhrig Report (12 August 2004) http://parlinfo.aph.gov.au/parlInfo/download/media/pressrel/Y8GD6/upload_binary/y8gd62.pdf;fileType%3Dapplication%2Fpdf (accessed 14 June 2011).

[107] Public company directors can be removed by resolution of the members, regardless of anything in the company's constitution, and any contractual agreement between the company and the director or the members and the director: s203D *Corporations Act 2001* (Cth). For proprietary companies the power to remove directors by resolution is a replaceable rule: s203C *Corporations Act 2001* (Cth).

[108] See also s 13 *Competition and Consumer Act* 1974 (Cth).

[109] Section 111 *Australian Securities and Investments Commission Act 2001* (Cth).

[110] Section 25 *Australian Prudential Regulation Authority 1998* (Cth).

because he or she has made a decision that is unpopular with the executive government or parliament. However, this of course does limit the accountability of regulators when compared to other agents. The limitation on the right to dismiss regulatory officials is an example where, in the trade-off between independence and accountability, independence won.

Finally, before moving onto accountability to the general public, I should note the role of funding in accountability. Posner argued that American regulators are subject to market accountability because they compete for funding:

> 'the agency's head is answerable to both the legislative and (if he desires promotion or reappointment) to the executive branches. Legislative oversight of agencies is too little emphasized. Unlike business firms, government agencies must go to *their* capital markets – the legislative appropriations committees – every year. There is competition among agencies for the largest possible slice of the appropriations pie, and the agency that has a reputation for economy and hard work enjoys an advantage in the competition, for only in the exceptional case will it be to the legislators' advantage that the agency's personnel be lining *their* pockets (whether with pecuniary income or with non-pecuniary incomes such as leisure).'[111]

I think there is little evidence of this competition for funding in Australia. In fact, poor, rather than good, performance tends to be rewarded by more money from the government because it is often assumed or argued that poor performance by regulators is caused by lack of resources. However, in Australia the executive government can, and does, use tied funding to exert control over the resource allocation of regulators and ensure that regulators deliver projects that the government considers to be important, such as certain high profile enforcement actions. Over the years the federal government has allocated significant funds to ASIC for specific projects.[112] As noted by the International Monetary Fund, this has the potential to impede the independence of ASIC.[113]

The public

Direct accountability to the general public is limited. As a general proposition, accountability to the general public is achieved indirectly through accountability to the government and, in particular, the parliament which represents the general public. There are, however, some direct accountability mechanisms.

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[111] Posner, Richard, 'Theories of Economic Regulation', (1974) 5 *The Bell Jnl of Economics and Management Science'*, 335, 338 – 9.

[112] See, for example, Media Release No 34 from the Treasurer *Increased Budget Funding for ASIC* (9 May 2006), which indicates about $146 million of funds allocated to ASIC over a four year period will be tied to certain activities.

[113] International Monetary Fund, *Australia: Financial Sector Assessment Program – Detailed Assessment of Observance of Standards and Codes: IMF Country Report 06/415* (2006), at pp. 98 and 125.

As noted above, administrative law mechanisms provide a mechanism for individual members of the public affected by regulators' decisions to seek review of those decisions through courts or tribunals. Additionally, individuals or entities who suffer loss because of a regulator's conduct have a very limited right to sue for damages, where there is bad faith. The regulatory impact analysis requirements referred to above mean that regulators have to consult with members of the public who are affected by their regulatory proposals and the RIS must note how the regulator has responded to this consultation. This too creates a form of accountability to the public. The Ombudsman process is specifically designed to provide an avenue for members of the public to complain about the administration of government, including the administration of regulators.

Freedom of Information legislation[114] also supports direct accountability to the public. Subject to limited exceptions, Freedom of Information legislation gives members of the public the right to access information held by regulators. This information will explain why regulators have acted as they have. This is a weak accountability mechanism but it is a useful way to ensure information about the broad range of regulators' activities is made public, generally via the intervention of the media. However, it should not be thought that this accountability mechanism has no downsides. Studies indicate that transparency measures, such as Freedom of Information legislation, can merely encourage regulators 'to hide away from being held to account' by ensuring that real decision-making is not recorded in a way that could be made public.[115] Moreover, Freedom of Information legislation imposes a significant financial and time burden on regulators.[116] Finally, it should be noted that in Australia regulators also tend to voluntarily make a significant amount of information public.[117]

The Rule of Law Institute of Australia has argued that Senate Estimates Committees should take evidence and potential questions directly from the public.[118] In practice interest or lobby groups and other members of the public already feed evidence and questions to parliamentary

[114] There is freedom of information legislation at the Federal and State and Territory level. At the Federal level see *Freedom of Information Act 1982* (Cth).
[115] See Lodge, Martin and Stirton, Lindsay 'Accountability in the Regulatory State', Ch 15 in Baldwin, Robert, Cave, Martin and Lodge, Martin (eds) *The Oxford Handbook of Regulation* (2010), p. 364.
[116] Fung, Archon, Graham, Mary and Weil, David *Full disclosure : the perils and promise of transparency* (2007, Cambridge University Press), pp. 27 – 8.
[117] Australian regulators make a significant amount of information available, largely through their websites. Regulators also publish specific documents explaining their regulatory approach. For example, ASIC's Regulatory Guides explain when and how ASIC will exercise specific powers under legislation, explain how ASIC interprets the law, describe the principles underlying ASIC's approach and give practical guidance (for example, describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations). It should also be noted that recent amendments to the *Freedom of Information Act 1982* (Cth) require agencies, including Federal regulators, to proactively publish information, including information in documents to which the agency routinely gives access in response to freedom of information requests: see Part II *Freedom of Information Act 1982* (Cth).
[118] Rule of Law Institute of Australia, *ROLIA Senate Estimates Survey No. 2* (August 2010), p.22. http://www.ruleoflawaustralia.com.au/Downloads/Senate_Estimates_Survey_2.pdf (accessed 14 June 2011).

committees. However, the Rule of Law Institute of Australia's proposal would formalise this process and may make it easier for ordinary members of the public, as opposed to lobby groups, to have input into the process.

6. Are Australian regulators sufficiently accountable?

As stated above the issue of whether Australian regulators are sufficiently accountable will largely be left to the panel discussion but I will offer a few thoughts.

Australian regulators are not perfectly accountable. However, I think that, on balance, they are probably sufficiently accountable. This is all that can be hoped for and, in fact, all that we should strive to achieve given the need to balance accountability against other important attributes, namely, independence, expertise and efficiency.[119]

There is a web of accountability mechanisms which is, perhaps, more comprehensive than those calling for increased accountability recognise. Given the breadth of the existing accountability mechanisms and the competing public interests, the real challenge for those calling for more accountability is to explain:

- exactly what additional accountability mechanism they would impose
- how it would ensure accountability,
- why that mechanism would not merely duplicate existing accountability mechanisms; and
- how that mechanism would not unacceptably undermine independence, expertise and efficiency.

I will tentatively suggest two mechanisms that might survive this challenge. However, first I want to stress that my general conclusion that Australian regulators are probably sufficiently accountable should not be mistaken for an argument that Australian regulators are perfect. Of course, like most organisations, they could always do a better job. For regulators doing a better job means that they can improve in terms of:

- effectiveness (that is, achieving their regulatory mandate),
- efficiency (achieving their mandate in the most cost efficient way), and
- respect for non-instrumental values (such as, procedural fairness, proportionality, predictability and transparency).[120]

[119] See Lodge, Martin and Stirton, Lindsay 'Accountability in the Regulatory State', Ch 15 in Baldwin, Robert, Cave, Martin and Lodge, Martin (eds) *The Oxford Handbook of Regulation* (2010), p. 367
[120] Freiberg, Arie *The Tools of Regulation* (2010, The Federation Press), pp. 258 – 268.

However, subject to the two possible mechanisms discussed below, I think that increased accountability mechanisms are highly unlikely to help Australian regulators do a better job along any of these dimensions.

Tentative suggestions: additional accountability mechanisms

My first suggestion is more a substitution than an addition. As Table 1 shows, Australian regulators are subject to oversight by a number of other regulators. Just as regulatory overlap, duplication and complexity is inefficient for the business community, so is it inefficient for Australian regulators. There must be some scope to bring together the roles of the government authorities that oversee and ensure the accountability of regulators, into a Super-regulator of Regulators. The case seems compelling in relation to those bodies, such as the OBPR, Ombudsman and the Auditor-General that only have roles in relation to other government authorities. Rationalisation of the accountability of regulators would not just improve efficiency for regulators. Currently there are so many 'regulators of regulators' and such a complex array of accountability mechanisms that certain things may 'fall through the cracks'.

My second suggestion relates to governance. The governance arrangements of ASIC and APRA are very different from those of the Australian companies they regulate.[121] They are also very different from those of some key comparable foreign regulatory authorities which have governing boards with a majority of non-executive directors and separate Chairs and Chief Executive Officers (CEOs).[122] Both ASIC and APRA have governing bodies that are comprised of full time executives.[123] Further, there is no separation of the role of Chair and Chief Executive Office. In both organisations, the Chairman is effectively the Chief Executive Officer and the Chair of the governing body.

The use of a board, comprising of executive and non-executive directors, to govern Australian regulators has been firmly rejected in Australia. The HIH Royal Commission rejected this typical public company governance structure largely because the board of a

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[121] They are inconsistent with *ASX Corporate Governance Principles and Recommendations* (2007, 2nd ed). See Recommendation 2.1 (a majority of the board should be independent directors), Recommendation 2.2 (the chair should be an independent director) and Recommendation 2.3 (the roles of chair and chief executive officer should not be exercised by the same individual.)

[122] For example, the United Kingdom Financial Services Authority has a board, the majority of members of which are non-executive. The Deputy Governor (Financial Stability) of the Bank of England, is an ex officio director. One of the non-executive members is Deputy Chairman and 'lead' non-executive. The Hong Kong Securities and Futures Commission has a Commission consisting of full-time executive officers and part-time non-executive officers and the role of Chairman and Chief Executive Officer are separate.

[123] Note the *Australian Securities and Investments Commission Act 2001* (Cth) does allow the appointment of part-time Commissioners: s 9(3). However, there has never been an appointment of a part-time Commissioner. Under s 16 *Australian Prudential Regulation Authority Act 1998* APRA must have between 3 and 5 members and three must be full-time. APRA has had full-time members only following the Government's acceptance of the HIH Royal Commission recommendation in relation to the governance of APRA: recommendation 18. Prior to this APRA had non-executive directors.

government regulator could not appoint the CEO. Owen J said, in relation to the then governing board of APRA which consisted of a majority of part-time directors:

> The imposition of a governance board between the chief executive and the Treasurer has the potential to cloud the line of accountability, especially as it is the board and not the Treasurer that sets the duties of the chief executive.
>
> The chief executive is answerable to the board—although it does not appoint him or her—as well as to the Treasurer. At the same time, the board carries responsibility for the performance of APRA but does not appoint the person who runs the organisation on its behalf.
>
> While individuals of the kind who are appointed to APRA's board would no doubt be able to play a valuable advisory role—including acting as a commercial sounding board—there is a question as to the utility of non-executive board input into how a regulatory body such as APRA carries out its statutory role.[124]

The *Uhrig Report* also firmly rejected the use of public company type boards for regulators for similar reasons. Uhrig argued that the power of the board is significantly 'derived from the ability to appoint and remove the CEO, appoint the chairman and new directors, finalise and approve strategy, define the values and culture, 'say no' to management and give final approval to the sale and purchase of significant assets.'[125] When these powers are diluted or modified, as they inevitably are in a regulator, a board of directors is, according to Uhrig, rendered useless. It has no ability to ensure effective oversight of the performance of management. Moreover, the presence of a board dilutes the accountability of the CEO and management to the Minister, as the CEO and management may effectively play the board and the Minister off against each other.[126]

Yet the public company governance system seems to work in foreign regulators, such as the Hong Kong Securities and Futures Commission and the United Kingdom Financial Services Authority. Further, there is an argument that this is the way to ensure accountability without undermining independence and expertise. The non-executive directors can ensure that the regulator is aware of and responsive to the needs of the ultimate stakeholders, the public, just as a key role of non-executive directors in a public company is to ensure accountability to

[124] *The HIH Royal Commission Report* (2003) at section 8.5.1

[125] Commonwealth of Australia, Review of the Corporate Governance of Statutory Authorities and Office Holders (June 2003) (Uhrig Report), p. 65.

[126] Commonwealth of Australia, Review of the Corporate Governance of Statutory Authorities and Office Holders (June 2003) (Uhrig Report), pp. 66 – 67.

members of the company.[127] However, the presence of non-executive directors on the board of a regulator does not undermine the independence of the regulator.[128] In other words the use of a public company style board is the holy grail of accountability mechanisms for regulators – a mechanism that ensures accountability without undermining independence or expertise.

Both these suggestions are very tentative for two reasons: first, I think that on balance Australian regulators are sufficiently accountable, and secondly, further work would need to be done to ensure the viability of either of these mechanisms. The arguments against the use of independent, non-executive directors in the *HIH Royal Commission Report* and the *Uhrig Report* are strong but, nevertheless, there is scope for more research on the most effective and efficient corporate governance mechanisms for regulators.

[127] ASX Corporate Governance Council, Corporate Governance Principles and Recommendations with 2010 Amendments (2nd Edn, 2010), p.3 and Petra, Steven T., 'Do outside independent directors strengthen corporate boards?' (2005) 5(1) *Corporate Governance* 55

[128] See the discussion in Enriques, Luca, 'Regulators' Response to the Current Crisis and the Upcoming reregulation of Financial Markets: One Reluctant Regulator's View' (2008-20090 30 U. Pa. J. Int'l Law 1147, at pp. 1149 – 1151.

Table 1: Key accountability mechanisms

	COURTS AND TRIBUNALS		PARLIAMENT		EXECUTIVE and GOVERNMENT AGENCIES		PUBLIC
	Judicial review	**Merits review**	**Parliamentary Committees**	**Parliament: Legislative Instruments Act**	**Ministerial direction**	**Other monitoring bodies**	**Freedom of Information**
Financial accountability						Auditor-General	
Procedural accountability				Legislative instruments		OBPR Auditor -General	
Substantive - regulation				Legislative instruments			
Substantive – administration of the law		Decision re-made, *de novo*				Ombudsman Auditor -General	
Substantive – enforcement					Cannot give a direction about a specific case	Ombudsman	
Substantive – overall management							

Strong accountability ie accountability mechanism that leads to a response where the regulator has failed to meet the required standards

Weak accountability ie accountability mechanism that merely involves the regulator giving an account of its actions. It does not lead to a response (other than perhaps non-binding recommendations or negative publicity)