

Finance leaders caution on over-reactive regulation

A group of leading financial academics and researchers from New Zealand and Australia are cautioning their governments against over-reacting in regulating suppliers of riskier investment products.

The Australia-New Zealand Shadow Financial Regulatory Committee have just met in Melbourne and discussed the financial turmoil affecting markets across the world. In a statement issued in Australia on Tuesday (25 November) the group said: "Failure of financial institutions and the attendant losses must be expected as part of the normal operation of efficient and innovative financial systems. "Risk taking, risk transformation and risk management are core parts of the business of financial intermediation. By its very nature, risk involves the prospect of loss as well as gain, and losses must occasionally occur. When investors knowingly accept exposure to high-risk financial assets in the expectation of improving their returns, they should bear the consequences of failure."

The group said that if governments were to protect investors from the adverse consequences of their informed decisions, moral hazard can arise to distort the efficient working of the financial system.

The ANZSFRC's third statement also:

emphasised that the prudential safety net should be limited in extent. This means that regulatory proposals such as those being considered to protect investors in financial products need to take care not to blur the boundary line of the safety net.

Repeated its December 2006 call to the Australian and New Zealand authorities to speedily finalise and implement their proposals regarding failure management arrangements, which would help to clearly delineate the safety net boundary.

Recommends that proposals for new disclosure requirements should be "road tested" with consumers as part of the required regulatory impact assessment.

Suggested that regulators review whether increasing (or retaining) the role of mandatory trustees for debenture or deposit-like securities is appropriate, given the availability of alternative, possibly superior, approaches to fulfilling their current investor protection role.

Argued that the authorities should promote the development of secondary markets for such securities as a complement to other measures which have been proposed for improving information (and exit mechanisms) for retail investors.

Questioned whether the application of an "If Not Why Not" approach to disclosing whether benchmark financial indicators have been met, as proposed by the Australian Securities and Investments Commission (ASIC), is effectively equivalent to compulsion, and calls for more detailed consideration of the benchmarks proposed.

The ANZSFRC meets twice every year in one of the major cities in Australia or New Zealand. The 'shadow' function of the ANZSFRC is related to the Committee's purpose of following and analysing critically the existing and evolving regulatory framework for financial institutions and markets. The ANZSFRC is part of an emerging worldwide network of Shadow Financial Regulatory Committees that meet to discuss a theme of common interest, resulting in a joint policy statement.

Members on the ANZSFRC include Co-chair Professor Glenn Boyle, Victoria University, Professor Lawrence Rose, Massey University, Professor Steven Cahan, Auckland University and Professor Alireza Tourani Rad from AUT University as well as representatives from the University of New South Wales, Macquarie Graduate School of Management, the University of Melbourne, Sydney University, Melbourne Business School and Griffith University.