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Transparency in the Regulatory Process

21. Transparency in the Regulatory Process,
Speech by Mr. Alan Cameron

Former Chairman, Australian Securities and Investments Commission Consultant, Arthur Andersen Legal; Director, Sydney Futures Exchange, Australia

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It is difficult to decide how to approach such a broad topic, and one which carries a connotation of universal support. How can one be heard to say one is opposed to transparency? It sounds like motherhood. But the obvious retort is that it all depends on the context. Frosted glass was invented for a reason. Cabinet secrecy in the Westminster system has survived the introduction of freedom of information legislation, everywhere so far as I know.

I am looking forward to a vigorous debate in the panel session. I will in this paper, simply share some reflections on transparency and regulation in general terms, mention the application of freedom of information laws, and respond to the recent paper by the US Securities Industry Association (Promoting Fair and Transparent Regulation - August 31, 2000). I will inevitably refer from time to time to the Australian Securities and Investments Commission; this presentation, now more than ever, is my responsibility, not their's.

(I thought I should add credibility to my own thoughts on this subject by seeking some stimulus for my own approach, or simply an appropriate quotation to start this paper, from a website. I chose the OECD site, www.oecd.org. I searched for the word "transparency", and found 1733 documents. The first 7 came up with the notation "The access of (sic) this document is reserved.")

The regulatory context

Regulators gathered at this meeting perform different kinds of regulatory work, both from time to time in their own organisations, and as between themselves. Those who are purely securities regulators have at least two broad kinds of work. On the one hand, they are facilitators: making rules, granting licences, or recommending the grant of licences, granting exemptions from rules and modifying the operation of rules, usually for particular market participants or classes of market participants. Most also have enforcement roles: investigating apparent breaches of the rules, and either prosecuting those cases or recommending them for prosecution, and occasionally accepting submissions that no action should be taken. Other regulators may be market operators, formerly known as self-regulators. Still others will be prudential regulators, interested in the health of institutions, the adequacy of their capital and the solvency of their assets.

As is implicit in that description, there is a multitude of different interests to which regulators must have regard when they are performing those different roles. The description of the roles which I have adopted above suggests the different nature of those interests. Let me draw some of those out.

When a regulator is deciding whether to grant or recommend the granting of a licence, there is the interest of the applicant to be considered primarily, but also the interests of others who might be affected by the granting of the licence. A recent case in point was the application by Australian Derivatives Exchange Limited for a licence to operate a futures market in Australia. Such licences are granted by the Minister, but on the recommendation of the statutory regulator, the Australian Securities and Investments Commission. Clearly the existing futures market, the Sydney Futures Exchange (of which I an now a director) had an interest in the granting of that licence, but the details of the application, which would have included commercially sensitive information, were not published. Instead, a summary of the application together with a description of the issues upon which ASIC sought public comment, was issued by ASIC, thereby enabling both the SFE and any other market players who wish to do so, to comment to ASIC prior to ASIC giving its advice to the Minister. Some may criticise that process, as less than fully transparent. Most people would, I think, regard that as a transparent process, notwithstanding that the full terms of the application were not published.

Take then the enforcement situation. Regulators with an enforcement role frequently receive submissions from those who have been subjected to investigative action, making a case as to why they should not prosecuted or have any other enforcement action taken against them. Following the good example of the United States Securities and Exchange Commission, ASIC publishes a policy on how it will deal with such applications. Like all other ASIC policies, this policy statement is itself published and readily available (PS 108, contained in Volume 2 of the ASIC Digest at PS 1/257). However, paragraph 28 of the policy statement is in the following terms:

> ASIC will generally publish no-action letters or details of particular no-action letters. Firstly, no-action letters are case specific and are not precedents which may be quoted as the basis for further applications. Secondly, publicising particular no-action letters may

> inhibit persons with bona fide cases from applying to ASIC for them. However, ASIC reserves the right to do so…

The reference to ASIC reserving the right to do so is a reference to the fact that the policy statement also makes it clear that ASIC is more likely to issue a no-action letter if the applicant acknowledges ASIC's freedom to make a public announcement. How therefore does one characterise this process: as *transparent*, because the policy statement is published and makes it clear that the no-action letters will not normally be published; or as *non-transparent*, because such letters are in fact hardly ever publicised.

A further and even starker example of the issue in the enforcement context concerns a decision not to prosecute. I am aware of cases where, after a very lengthy and very public investigation, a regulator decides that there will be no prosecution. Because the investigation has become public knowledge, and perhaps in some cases even notorious, there is clearly in my view an obligation on the regulator to announce the outcome. This is necessary as a matter of fairness to those who are regarded at least by the public, as the targets of the investigation, but it is difficult to publicise all of the reasons as to why the prosecution is not to proceed, without effectively blackening the reputation of the "targets". Again, I suggest this demonstrates that an understandable desire for transparency of process still needs to be balanced against the competing interest, in this case of the entitlement of the "target" to the preservation of the good reputation which they are deemed, as a matter of law, to possess.

Perhaps the foregoing discussion takes too much for granted as common ground. Let me spell out my philosophy on transparency for regulatory policy making in particular, expressly.

1. Regulations, and regulatory actions, will be better if they are the subject of wide consultation in advance, because they will be more likely to address relevant issues, and less likely to have unintended consequences. ASIC has developed and uses a format for consultation on its policies which is designed to encourage submissions and comments in a way structured to make it easier for comments to be grouped, compared, and considered when policy is finally settled.[1] It involves an explanation of the issue, an outline of the approach ASIC intends to take, and questions which can be answered. It is intended to

[1] See the asic website, www.asic.gov.au, under financial services reform, for the form of Policy Proposal Paper used in that context. I do not suggest it is unique, or ideal, rather it is a model for consideration.

be, or regarded by the market as, a straitjacket to prevent fundamental concerns from being raised.

2 Regulators should signal their intentions clearly to the marketplace, and should be prepared to modify their intended actions if persuaded that this would produce better outcomes. There are two points which in turn derive from that

- Regulators are not de-powering themselves by doing so. They still retain the same freedom to accede to, or overrule, the representations of those who claim to be affected, as they would have had without first consulting; in fact, more, because they have added moral authority when it comes time to enforce or act on the policy. I did find those who assumed that when ASIC announced some proposal as a draft, or for consultation, it was not to be taken at face value; that ASIC had made up its mind. I would not actually change a policy simply to persuade them that we had always had an open mind, but I was tempted!
- Respondents on proposed policy will almost by definition have a particular axe to grind, their own special interest. We all know that. The completely altruistic commenter is either a mythical figure, or someone whose interest is simply too well hidden. So it must be the quality of the comment, not the identity or forcefulness of expression, which matters.

3 Regulators should publish as much of their policies in advance as they can. ASIC does so at least in part because its staff are scattered across a large continent and need guidance to ensure consistent decision making; they rely on the ASIC Digest; so can the market place.

Freedom of information

Questions of transparency can also be looked at in terms of the administrative law context in which many regulators operate. I am familiar with an environment in which the regulators are themselves subject both to freedom of information and to privacy legislation. These, of course, also seem at first blush to be in conflict one with the other, and to some extent they are. (I speak as one who in a former professional role, administered the Australian Freedom of Information legislation, in my capacity as Australian Ombudsman). Such legislation is usually enacted by well intentioned legislators seeking to protect individuals from the overweening powers of the

sate, but in my experience are frequently most useful to well resources corporations, but that is another subject. It creates some difficulties for regulators, despite (or as can be seen from) the long series of sections in the Australian legislation providing for certain documents or classes of documents to be exempt. Exemptions which might be relevant to regulators include exemptions for

- internal working documents,
- documents affecting the enforcement of law and protection of public safety,
- documents to which secrecy provision of enactments apply,
- documents concerning operations of agencies,
- documents affecting personal privacy,
- documents subject to legal professional privilege,
- documents affecting the national economy, documents containing material obtained in confidence, and even
- certain documents arising out of companies and securities legislation. This paper would be even longer and more tedious if I were to go into any more detail about the exact nature of the exemptions; my point for present purposes is simply that the common characterisation of freedom of information legislation as freedom *from* information, might be thought to have some substance.

Australian regulators are therefore subject to a form of compulsory transparency brought about by freedom of information legislation. But their decisions are often subjected to other administrative review, including review on the merits by the Administrative Appeals Tribunal, by the Ombudsman in the case of unfair process or mishandling, and to judicial review where the decision is claimed to be tainted by illegality. There is explicit provision too for applicants to be able to demand formal reasons for decisions.

It is because of this wide-ranging capacity for review of decision making, that I have previously argued that statutory regulators in an Australian context, are not well-placed to be direct supervisors of markets. It is the wide-ranging obligations to afford complete fairness of process, including transparency, which makes it difficult for those who are subjected to such obligations to be effective as direct supervisors of markets. Direct supervisors of markets require a speed of decision making and a commercial approach to issues which is difficult to reconcile with

elaborate structures of governmental decision making. While attempts have been made to require governmental standards of administrative decision making by self regulators in Australia, none has succeeded to date. But there is left open the question of to what extent it is reasonable to expect even market operators to be transparent in their decision making and policy setting; good customer relations should dictate that as a basic approach, even when it is not formally required.

The Australian Accounting Standards Board is now adopting a high level of transparency which might be a useful model for regulators when they are engaged in rule making. That board is going even further than the US Financial Accounting Standards Board, by not only having its meetings in public, but also putting the key board papers up on the web site. They are also following the FASB practice in putting project summaries on the web site for public scrutiny. I do not know how many securities regulators follow the US SEC practice, and law, which requires all meetings to be in public; the accounting standard setters, and interpreters like interpretations groups, are ahead in that respect.

SIA Discussion Paper - Promoting Fair and Transparent Regulation[2]

What has struck me about the SIA paper in the context of this conference session is the extent to which the paper focuses on matters of fairness which do *not* in themselves involve transparency. Clearly there is a concern that regulators are making decisions on grounds which are not *legitimate*, however that might be defined or assessed. When IOSCO included in its Objectives and Principles of Securities Regulation in September 1998, references to regulators adopting processes and regulations that were:

- consistently applied;
- comprehensible;
- transparent to the public; and
- fair and equitable,

I suspect the reaction of many was that the first two and the last were requirements which were useful to spell out, but not likely to require substantive attention. We recognised that the

[2] Available at http://www.sia.com/international/pdf/fair_transparent_regulation.pdf

reference to transparency, was not as straightforward a concept as the others, for the reasons set out above. The SIA paper has the strong flavour that a large sector of the industry believes

- that regulators are *not* "treating foreign and domestic licensed market participants fairly and equitably";
- that regulatory actions are *not* being taken "only for the purpose of achieving legitimate public policy objectives that are expressly identified", and
- that regulation is *not* presently "enforced in a fair and non-discriminatory manner… having regard to the nationality or jurisdiction of establishment of a market participant".

For my part, I have a great deal of sympathy for the proposition that these should be minimal requirements. If some greater commitment to transparency by regulators is needed in order to overcome the impression that regulatory decision making may have been tainted in those ways, then I would recommend that IOSCO should recommit itself to the style of regulatory decision making which its own principles espouse.

Indeed there are some interesting examples in the regulatory arena of different approaches to transparency. I have already mentioned above, the way in which ASIC has dealt with a sensitive market licence application. The SIA paper refers specifically to criteria governing licensing of firms being in writing and accessible, and being the basis on which decisions are made - the latter being another example of a comment which seems so obvious, it is troubling that it needed to be made at all.

Effectiveness and Efficiency

Management theory has long distinguished these two concepts. Effectiveness is the extent to which objectives are achieved, and efficiency is the measure of the use of resources to achieve the outcomes. I venture to suggest that transparency tends to improve effectiveness, by leading to more relevant and more useful outcomes; but tends to impede efficiency, by slowing down decision making. In the spirit of Lord Acton's famous dictum about corruption, frequently misquoted,[3] I have been careful to include the word "tends". But I strongly support regulatory transparency, without denying that there are other values, including aspects of fairness, which mean that transparency always rules.

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[3] Power tends to corrupt, and absolute power tends to corrupt absolutely. (Frequently misquoted as, Power corrupts, and absolute power corrupts absolutely)