

The secret to successful self-regulation

In rapidly evolving, complex industries (particularly those with network characteristics, like payments), successful self-regulation is better than good public regulation.

Successful self-regulation, compared with direct government regulation, offers a means of addressing public policy objectives, that:

- a. is a better balance between public policy concerns and industry interests;
- b. is more flexible, responsive to changing participant needs and innovation;
- c. creates lower compliance costs; and
- d. is more certain because participants control its evolution.

How then can public policy self-regulation be organised to maximise its chances of success? This article examines the roles of, and levels of engagement between, the two parties most interested in self-regulatory solutions to public policy objectives: the government regulator (for the Australian payments system, the Reserve Bank of Australia) and the industry.

Successful public policy self-regulation

Successful self-regulation addresses public policy objectives to the satisfaction of the government regulator and the industry. This means that:

1. The regulator must be satisfied that its public policy objectives are being met (otherwise direct regulation will result); and
2. The industry needs to be satisfied that, notwithstanding the need to meet public policy objectives, a self-regulatory solution is better than direct regulation because it delivers benefits such as those described above.

The critical question is, then, what allocation of responsibilities between the regulator and industry and what level of engagement between these two parties maximises the chances of achieving the above dual objectives of successful self-regulation.

For example, in order to maximise the chances of a successful self-regulatory regime to effect ATM reform, what issues should be the responsibility of the Reserve Bank (RBA), the payments industry, and both the RBA and the payments industry, and what

How do we organise government/industry co-regulation so as to promote payment system efficiency and innovation in the long term?

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levels of engagement between the RBA and the payments industry are required on these different issues.

Overview

The role of the regulator and the industry, and the level of engagement required to achieve successful self-regulation, varies depending upon the type of issue under consideration. Figure 1 (right) shows that:

1. Any self-regulatory issue (in respect of public policy objectives) is somewhere between:
 - a. *what* are the public policy objectives that the regime is trying to achieve; and
 - b. *how* the requirements of those objectives are implemented;

This 'continuum' is represented by the blue lines.

2. The regulator has the greatest responsibility for the *what* and least for the *how* and that the industry has the greatest responsibility for the *how* and least for the *what*; and
3. The level of engagement between the regulator and the industry should increase for the issues for which both the regulator and industry are responsible.

This article argues that Figure 1 represents the allocation of responsibilities and level of engagement that is most likely to deliver successful self-regulatory solutions to public policy objectives.

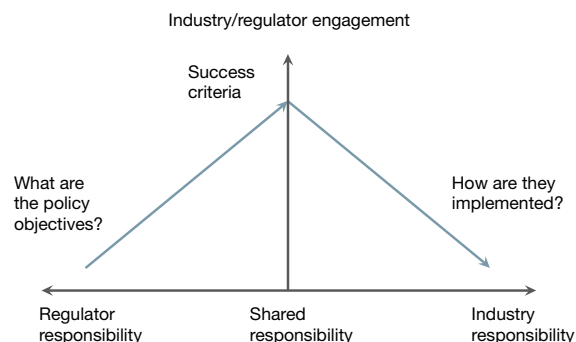


Figure 1 – Regulator/industry responsibilities and engagement

What are the public policy objectives?

Fundamental to any regulatory regime are the public policy objectives that it is seeking to further or achieve. This is where the regulator (and/or government) must have primacy.

Industry participants will generally act to advance their commercial interest (indeed most participants are legally obliged to act in the best interests of their shareholders). As such, the industry can only have minimal responsibility for the development of public policy objectives. Moreover there is little need for regulator / industry engagement in this area. (Note the difference between public policy objectives and success criteria – see next page.)

This does not mean that the industry cannot, or should not, make representations to the regulator as to public policy objectives. Indeed in many cases it is likely to be good practice for the regulator to seek views on its public policy objectives. The point is that it is the regulator that must have the responsibility for setting these objectives.

Thus the highest level public policy objectives will often, and should, be set outside of a self-regulatory regime. For example, the definition of the public interest by the *Payments System Regulation Act* as the desirability of payment systems:

- a. *being:*
 - i. *financially safe for use by participants; and*
 - ii. *efficient; and*
 - iii. *competitive; and*
- b. *not materially causing or contributing to increased risk to the financial system.*

Of course, self-regulatory regimes may also have industry objectives, to the extent that they do not impinge upon the public policy objectives. However, inconsistency or confusion around public policy and industry objectives is likely to retard successful self-regulation.

Success criteria

Clear and objective success criteria are fundamental to a successful self-regulatory regime.

Success criteria are what we use to determine whether public policy objectives, such as safety, efficiency and competition, are being met. In a self-regulatory regime they let the industry know whether they are meeting the first of the dual objectives of successful self-regulation: the regulator being satisfied that its public policy objectives are being met.

Figure 1 puts the development of success criteria at the mid-point between the *what* and *how*. This means that the regulator and the industry have equal responsibility for their development (and review) and that there should be maximum engagement between the regulator and industry. This is because:

1. the regulator needs to ensure that the success criteria are an accurate measure of the relevant public policy objective(s);
2. the industry best understands the fundamentals of what is actually happening in the relevant markets, what is likely to happen in the future and therefore what changes will signify achievement or movement towards the relevant public policy objectives; and
3. dual responsibility and maximum engagement increase confidence of the industry and other stakeholders in the self-regulatory regime and is more likely to foster the right levels of regulator/industry co-operation.

For example, for the Australian payments system both the RBA and the payments industry should be responsible for developing the success criteria in respect of the public policy objectives in the *Payments System Regulation Act*. These success criteria, which could differ across payment systems, should (ideally) provide an objective and clear basis to determine whether payment systems are financially safe for use by participants, efficient and competitive and do not materially cause or contribute to increased risk to the financial system.

How are they implemented?

Implementation of rules to create the conditions that meet the success criteria is where the industry must have primacy.

If self-regulation is to be successful it must also meet a second objective: delivery of a solution that is better than direct regulation because it delivers benefits such as greater flexibility, lower compliance costs and a better balance between industry interest and public policy.

Only the industry itself can develop these solutions because it is only the industry that knows and is able to assess (in detail) how different rules will affect its flexibility, compliance costs (etc) and, for example, result in other unintended consequences.

Further, if clear and objective success criteria have been developed by the regulator and industry, then the regulator can be confident that a clear means of assessing whether the implemented rules are achieving the public policy objectives exists. It can thus leave the industry to develop and enforce rules to achieve the success criteria.

Temogen Hield

Head of Self-Regulation