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DOES OBJECTIVES-BASED FINANCIAL REGULATION IMPLY A RETHINK OF LEGISLATIVELY MANDATED ECONOMIC REGULATION? A LITERATURE REVIEW

Bryane Michael, Say-Hak Goo**, and Svitlana Osaulenko****

Objectives-based legislation—or laws that focus on achieving particular and concrete outcomes—has become a new and important tool that financial sector regulators use to tackle large and varied financial system risks. Yet, objectives-based legislation—and the frequent principles-based regulation underpinned by such legislation—represents a stark departure from traditional ways of legislating. In this paper, we describe the problems and prospects of implementing objectives-based financial regulation—in the form of a Twin Peaks regulatory structure. A focus on the objectives of achieving financial market stability and proper market conduct would require a different approach to legislating and regulating in most other countries.

INTRODUCTION

A revolution has been occurring in all kinds of government contracting since the mid-1980s. Government bodies have been increasing use of performance-based contracts, results-based budgeting, and outcomes-based performance management as ways to focus on regulatory outcomes rather than processes. Nowhere has the trend toward outcomes-based regulation been more pronounced than in financial sector regulation. Bank regulators (like the U.K.'s Prudential Regulation Authority) focus on risks to the U.K.'s financial markets, whether they come from banks, broker-dealers, or insurance companies. The U.K.'s Financial Services Act of 2012 looks very different from previous acts in other countries. The Act defines general *objectives* of the Authority—rather than describing the mechanics of how such an Authority would work. Such a legislative approach represents a watershed change in legislative drafting. Imagine if the Crime Act legislatively required a murder rate below 5 per 1000, and set up law enforcement agencies using statutory instruments which only defined broad objectives? Such an example shows the important—and controversial—nature of such objectives-based legislation.

In this paper, we review the literature and data about how objectives-based legislation provides a new paradigm for thinking about the way governments create and organize regulatory agencies.[1] An objectives-based approach to legislation

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would challenge the fundamentals of legislative and administrative jurisprudence. Part I reviews what we know about objectives (or results-based) legislative drafting. We describe theories for thinking about the division, and sharing, of competencies between regulatory agencies with the aim of tackling particularly large and complex regulatory challenges. Part II describes Twin Peaks regulation as an objectives-based regulatory approach—giving examples of such regulation for readers not particularly well-versed on financial sector regulation. This Part also describes the objectives and circumstances under which a jurisdiction may choose a Twin Peaks model. Finally, Part III will conclude with a brief discussion of the appropriateness of objectives-based legislation more generally.

I. GROPING TOWARD OBJECTIVES-BASED LEGISLATION: A LITERATURE REVIEW

A. LEGISLATING GOVERNMENT BODIES FOCUSING ON PARTICULAR OUTCOMES

To what extent *should* legislation define public policy objectives? Traditionally, legislative acts have focused on defining rights and obligations of various persons and providing the legal basis for the government bodies that police the enforcement of these rights and obligations.[2] Public policy defines goals, while legislation and regulation outline the way the government helps achieve these (often changing) policies.[3] Legislation—and regulation based on that legislation—represents the method of putting policy priorities into practice.[4] Traditionally, legislation designates one administrative body to deal with a specific social problem—the police deal with local law enforcement, the health ministry deals with hospitals, and so forth. Yet, many scholars have noticed a significant rethink of the traditional role of legislation. Increasingly complex social problems have required

[1] This paper provides the background for a larger study looking at the appropriateness of objective-based Twin Peaks financial regulation in and for Hong Kong. For that larger study, *see* Bryane Michael et al., *Does Objectives-Based Financial Regulation Imply a Rethink of Legislatively Mandated Economic Regulation?*, 15 CAP. MKTS. L.J. 115 (2020) (for the first half), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2523346.

[2] We do not have the space to describe the extent to which legislative drafters define the intent of a particular bill from the text of the document itself or the way that legislators choose the ambiguity or specificity of particular black letter statutory provisions. The "canonical" view of legislation focuses on law as transmitting legislators' desire for some outcome into the creation of rights and obligations and instructions to executive agencies for enforcing/supervising those rights and obligations. For a recent discussion of the issues, *see generally* John Manning, *Textualism and Legislative Intent*, 91 VA. L. REV. 419 (2005).

[3] The process, of course, is far more complex than this. In practice, administrative agencies have great latitude in determining legislative intent—and administrative and other courts have latitude in questioning a regulator's interpretation of a statute's objectives. For a recent discussion of some of these issues, *see generally* Daniel Gifford, *The Emerging Outlines of a Revised Chevron Doctrine: Congressional Intent, Judicial Judgment, and Administrative Autonomy*, 59 ADMIN. L. REV. 783 (2007).

[4] The line between legislation and regulation has become increasingly blurry—with administrative agencies often given extremely wide latitude to make laws. *See generally* Peter Shane, *Separation of Powers in American Constitutionalism: The Twenty-Eighth Annual Federalist Society National Student Symposium on Law and Public Policy—2009: IV. The Administrative State and the Constitution: Legislative Delegation, the Unitary Executive, and the Legitimacy of the Administrative State*, 33 HARV. J. L. & PUB. POL'Y 103 (2010).

organizational structures that involve overlapping competencies, inter-agency cooperation, and a focus on the outcomes (rather than process) of executive action.[5]

New approaches to public agency organizational design focus on methods of inter-agency cooperation and outcomes rather than processes. Figure 1 shows the major research areas that have grappled with these issues in recent years. The "quality of legislation school" focuses on the mechanics of writing laws—arguing that the clarity of drafting and public participation in such drafting can affect implementation (and thus the laws' effectiveness).[6] According to this mechanistic approach to assigning agency competencies, large social problems can be tackled by allocating competencies rationally among existing agencies or by creating a new agency. According to this approach, if a regulatory agency does not deal adequately with complex issues (like financial crises), better legal drafting can solve the problem. The "administrative discretion school" might argue that, with loosely defined legislation and regulation, administrative agencies can adopt their own rules to respond to complex social issues.[7] Unlike the "quality of legislation school", this school of authors argues that murkier (less clear) legal drafting provides the best way of allowing regulatory agencies to deal with complex social issues. Because public policy objectives change over time, regulatory discretion provides executive agencies with the latitude they need to respond to an increasingly complex regulatory environment.[8] Regulatory interpretation is an ongoing process of matching regulations with agency needs to address the problems of society.[9] For both these schools, sufficiently clearly (or unclearly) legislation and rulemaking can resolve any problems in assigning competencies between agencies.

[5] A variety of scholars have argued that increasingly complex social risks and challenges require a rethink of the traditional structure of government. For a recent take on this long-standing debate, *see* Donald Kettl, *Managing Boundaries in American Administration: The Collaboration Imperative*, 66 PUB. ADMIN. REV. 10, 12–14 (2006).

[6] For a recent example, *see* Wim Voermans, *Concern about the Quality Of EU Legislation: What Kind Of Problem, By What Kind Of Standards?*, 2 ERASMUS L. REV. 1, (2010). *See also* Helen Xanthaki, *The Problem of Quality in EU Legislation: What on Earth is Really Wrong?*, 38 COMMON MARKET L. REV. 651 (2001). *See also* ANN SEIDMAN, ROBERT SEIDMAN, & NALIN ABEYESEKERE, LEGISLATIVE DRAFTING FOR DEMOCRATIC SOCIAL CHANGE: A MANUAL FOR DRAFTERS (2000).

[7] Like with all the "schools" we describe, our caricature descriptions cannot hope to describe all the complexity of the views espoused by the various authors whose work we cite. For a recent discussion of some of these issues, *see* William West, *Administrative Rulemaking: An Old and Emerging Literature*, 65 PUB. ADMIN. REV. 655, 655–58 (2005). For a legal angle, *see* Cass Sunstein & Adrian Vermeule, *Interpretation and Institutions*, 101 MICH. L. REV. 885 (2003).

[8] Such an approach has gained proponents among scholars like Stack, who argue that a "purposive approach, not a textualist one, best suits the distinctive legal character of regulations." *See* Kevin Stack, *Interpreting Regulations*, 111 MICH. L. REV. 355, 355 (2012). Even though rule makers originally wrote very specific regulations, new social and administrative values require new interpretations of even specific regulations. Given the need to adapt to ever-changing values and needs, the reader might ask, why not just adopt a more objectives-based approach to interpretation? *See id.* at 399–400.

[9] Andromachi Georgosouli, *Regulatory Interpretation: Conversational or Constructive?*, 30 OXF. J. OF LEG. STUD. 1, 2 (2010).

Figure 1: How to Deal With Complex Social Problems (like Financial Crises)? A Perspective from Several Branches of Literature

Research area	Description	Critiques
Quality of legislation (drafting) school	Focuses on the mechanics of drafting legislation, focusing on clarity and consultation.	Does not deal with the goal of legislative drafting. Putting same words in different legal system can have adverse consequences.
Administrative discretion school	Either *de jure* or *de facto* administrative discretion encourages focus on important objectives	Does not define which objectives and subject to abuse (capacious and arbitrary regulatory behaviour).
Inter-agency Administrative Networks in a Multi-layered Public Administrative School	New, complex challenges—combined with IT technologies—allow for greater scope of inter-agency collaboration.	Often based on models and jargon instead of hard data. Challenges to inter-agency coordination often shown to be greater than benefits of such collaboration. Why not just make agencies that focus on objectives rather than processes?
Inter-agency Administrative Law School	Focuses on the legal rationale for dividing competencies among agencies. Also focuses on the politics behind such a partition. Ignores analysis of the actual problems these agencies try to solve.	
"Public Policy Implementation" School	Focuses on organisational conditions for successfully implementing policies.	Assumes "implementation" of legislative objectives, despite most not defined in law.
Performance-Based Budgeting	Agencies receive resources to the extent they achieve particular objectives. Thus, their existence and size depends on extent they achieve objectives.	Objectives can change and reflect the political priorities of the day.
Financial Regulatory Reform	Objectives allow agencies to organize themselves in order to deal with multi-disciplinary risks.	Encourages extreme administrative discretion and reduces legal certainty.

The figure summarises some of the recent literature dealing with the size and scope of executive agencies. We focus on literature dealing with the way that structure follows strategy—mapping organization to policy challenges.

Authors writing in "inter-agency public administration school" argue that cross-agency collaborations sometimes represent the best approach to tackling large, complex regulatory challenges. Often more positive than normative, authors writing in this school explain why inter-agency collaboration has increased—and if such inter-agency collaboration represents the best public sector organizational form for dealing with complex social problems. For example, in Hall and O'Toole's study of U.S. legislation between 1965-66 and 1993-94, it was found that inter-agency work increased over time.[10] Roughly eighty-four percent of programs in the sixties required multi-agency support. By the 1990s, that proportion rose to ninety percent. Most studies in this school find that "networked" or "joined up" policy implementation must occur—because the objectives of legislation span beyond the institutional silos inherited from decades (or centuries) of use.[11] Public sector managers can overcome the inherent difficulties and ambiguities of inter-agency relationships by "managing for results."[12] Such a solution begs the question—why not structure administrative agencies around desired outcomes in the first place?[13]

Rather pointlessly, authors in the "interagency administrative law school" have looked at legal issues surrounding the design and operation of inter-agency collaboration. Most authors in this school describe small issues in administrative law, usually arguing why particular administrative decisions may (or may not) represent the best outcome for the development of administrative law in general.[14] A "shared regulatory space" (usually some form of collective action problem between agencies) requires action by multiple agencies.[15] Some authors argue that the "best" agency design may not be achievable—as political processes often

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[10] *See* Thad Hall & Laurence O'Toole, *Structures for Policy Implementation: An Analysis of National Legislation, 1965-1966 and 1993-1994*, 31 ADMIN. & SOC. 667, 682–84 (2000).

[11] *See* Robyn Keast et al., *Network Structures: Working Differently and Changing Expectations*, 64 PUB. ADMIN. REV. 363, 364 (2004). *See also* Bob Hudson et al., *In Pursuit of Inter-Agency Collaboration in the Public Sector: What is the Contribution of Theory and Research?*, 1 PUB. MAN REV., 235 (1999). *See also* Christopher Pollitt, *Joined-up Government: A Survey*, 1 POL. STUD. REV. 34, 46–47 (2003).

[12] The term 'managing for results' represented an important, if vacuous, nostrum—encouraging administrators to follow the rules, but also achieve results. *See* Stephen Page, *Measuring Accountability for Results in Interagency Collaboratives*, 64 PUB. ADMIN. REV. 591, 591–95 (2004); *see also* John Bryson, Barbara Crosby & Melissa Stone, *The Design and Implementation of Cross-Sector Collaborations: Propositions from the Literature*, 66 PUB. ADMIN. REV. 44, 48 (2006).

[13] Indeed, failures in inter-agency cooperation related to the fight against terrorism and other aspects of law enforcement have led to a broader disenchantment with inter-agency collaboration. *See* Ashton Carter, *The Architecture of Government in the Face of Terrorism*, 26 INT'L SEC. 5, 7–11 (2002). The failure of inter-agency cooperation to prevent and quickly resolve the 2007-08 financial crisis further cast doubts about inter-agency cooperation as an effective method of dealing with large and serious social risks.

[14] For an overview of many of the issues and authors, *see generally* Jason Marisam, *Interagency Administration*, 45 ARIZ. ST. L.J. 183 (2013).

[15] For a recent take on inter-agency coordination, *see* Jim Rossi & Jody Freeman, *Agency Coordination in Shared Regulatory Space*, 125 HARV. L. REV. 1131, 1161-73 (2012).

determine the structure of agencies and regulators.[16] In general, legal schools have completely failed to write about how objectives help shape law and the development of administrative traditions.[17]

Two seemingly unrelated schools of thought have struggled with ways of improving the performance of executive agencies when they work in combination on complex social problems. Unique to public administration, authors in the "public policy implementation school" look at the extent to which various types of executive agency design help promote certain policy outcomes.[18] Many commentators point to stupidity (for lack of a better word) by policymakers at all levels to change government agencies and their processes in order to improve policy implementation.[19] Cooperation between government agencies—and the outcomes of such collaboration—may improve only when agencies tackle complex tasks.[20] Yet, such collaboration needs deliberate design. The "performance-based budgeting school" argues that rule-makers and executive agency creators need not worry too much about organizational design—as long as they provide cross-agency incentives for executive agencies to maximize performance. Budgets should allocate resources based on social needs, not based on past or requested budgets. For example, a performance-based budget for tackling HIV/AIDS might allocate funds to the Ministry of Education, Interior Ministry, local governments, and even Ministry for Foreign Affairs (if relevant) to the extent their activities can help achieve a set decrease in new infections.[21] Such a strategy basically represents an objectives-based approach to executive agency design. Budgets set objectives—and agencies must work in collaboration in order to receive budget line-item funding. However, such budgeting in such a way does not allow for unpredictability and resource overruns.[22] Moreover, like with inter-agency collaboration, performance-based budgeting has not necessarily resulted in significant improvements in multiple agencies' ability to solve certain social problems.[23]

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[16] Elizabeth Magill & Adrian Vermeule, *Allocating Power Within Agencies*, 120 YALE L.J. 1032, 1057–58 (2011).

[17] Authors writing in the New Comparative Economics perspective represent a refreshing (yet brief) look at how economic objectives and incentives shape the development of administrative law and agency design. For one of the first comprehensive discussions about how incentives drive legal development, *see* Simeon Djankov et al., *The New Comparative Economics*, 34 J. COMP. ECON. 1, 4 (2003).

[18] *See* Jill Schofield, *Time for a revival? Public policy implementation: a review of the literature and an agenda for future research*, 3 INT'L J. OF MAN. REV. 245, 246–47 (2001); *see also* Harald Saetren, *Facts and Myths about Research on Public Policy Implementation: Out-of-Fashion, Allegedly Dead, But Still Very Much Alive and Relevant*, 33 POL'Y. STUD. J. 559 (2005).

[19] For an-oldie-but-goodie taking on this issue, *see* Benjamin Crosby, *Policy Implementation: The Organizational Challenge*, 24 WORLD DEV. 9 (1996).

[20] *See* Martin Lundin, *When Does Cooperation Improve Public Policy Implementation?*, 35 POL. STUD. J. 629, 629 (2007).

[21] *See* Matthew Andrews, *Performance-Based Budgeting Reform*, ANWAR SHAH, FISCAL MANAGEMENT (2005).

[22] *See* Matthew Andrews, *Authority, Acceptance, Ability and Performance-Based Budgeting Reforms*, 17 INT'L J. PUB. SEC. MANAGE. 332, 334 (2004).

[23] *See generally* Jack Yun-Jie Lee & Xiao-Hu Wang, *Assessing the Impact of Performance-Based Budgeting: A Comparative Analysis across the United States, Taiwan, and China*, 69 PUB. ADMIN. REV. 60 (2009). For a more general review, *see* Marc Robinson & James Brumby, *Does Performance Budgeting*

Nowhere has the discussion about organizing public administrative agencies gone further than discussion by the "financial regulatory reform school."[24] The 2008 financial crisis led to wide-spread acceptance that previous regulatory structures failed to manage risks inherent in the New Financial Architecture of the 2000s.[25] The lack of regulatory supervision over the financial sector, and regulators' *ad hoc* response to the crisis showed that existing financial regulatory agencies either lacked the authority or ability to engage in necessary financial supervision.[26] Naturally, policymakers and academics called for a restructuring of financial regulators in many financially developed jurisdictions. Both the U.K. and U.S. came out with Blueprints for reforming financial regulators like the Financial Services Authority ("FSA") and the Securities and Exchange Commission ("SEC"), respectively.[27] Both Blueprints came out in favour of objectives-based regulation focusing on macro-prudential surveillance and rulemaking, and monitoring of market conduct.[28] Academics reached pretty much the same conclusion.[29] Because the U.K. approach to implementing a Twin Peaks approach to financial regulation centred around objectives-based legislation, the discussion about Twin Peaks regulation and objectives-based regulation often go hand-in-hand.

B. TWIN PEAKS REGULATORY SYSTEMS AND OBJECTIVES-BASED LEGISLATION

Work?: An Analytical Review of the Empirical Literature 17–30 (Int'l Monetary Fund Working Paper 05/210, 2005).

[24] For a discussion, *see* Saule Omarova & Adam Feibelman, *Risks, Rules, and Institutions: A Process for Reforming Financial Regulation*, 39 U. MEM. L. REV. 881 (2009).

[25] The New Financial Architecture refers to the "globally integrated system of giant bank conglomerates and the so-called 'shadow banking system' of investment banks, hedge funds and bank-created Special Investment Vehicles" that emerged after financial sector deregulation of the 2000s in the US and EU. *See* James Crotty, *Structural Causes of the Global Financial Crisis: A Critical Assessment of the 'New Financial Architecture'*, 33 CAMB. J. ECON. 563, 564 (2009).

[26] Instead of a proper system of supervision and resolution (saving or winding-up financial institutions in times of crisis), US authorities had to engage in "regulation by deals" in order to put in place micro and macro-prudential measures. *See* Steven Davidoff & David Zaring, *Regulation By Deal: The Government's Response To The Financial Crisis*, 61 ADMIN. L. REV. 463, 464 (2009).

[27] *See generally* HM TREASURY, A NEW APPROACH TO FINANCIAL REGULATION: DRAFT SECONDARY LEGISLATION (2012), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191571/condoc_fin_regulation_draft_secondary_leg.pdf; DEP'T OF TREASURY, THE DEPARTMENT OF THE TREASURY BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE (2008), http://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf.

[28] To take one example, the "Treasury believes that a regulatory structure centered on an objectives-based regulatory framework should represent the optimal structure." DEP'T OF TREASURY, *supra* note 27, at 143.

[29] Authors like Levine argued for objectives-based legislation creating "an informed, expertly staffed, and independent institution that evaluates financial regulation from the public's perspective." Ross Levine, *The Governance of Financial Regulation: Reform Lessons from the Recent Crisis*, 12 INT'L REV. OF FIN. 1, 12 (2010). Eddy Wymeersch, after considering the range of institutional structures present across Europe, noted that consolidation of regulators seems to be the trend—with objectives-based approaches often preferred. *See* Eddy Wymeersch, *The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors*, 8 EURO. BUS. ORG. L. REV. 2 (2007).

Creating and organizing regulators to achieve specific objectives represents one (relatively new) way of regulating a financial sector. Figure 2 shows the major approaches to financial regulation—broadly describing each approach and showing several countries following that approach.[30] Traditionally, regulators have taken an institutional or functional approach to financial sector regulation. Banking laws tended to place the authority to oversee banks with the central bank or a separate banking regulator. Securities acts world-wide tended to put a securities regulator in charge of capital markets surveillance.[31] By the early 2000s, both policymakers and academics alike asked if integrating financial sector supervisors could provide higher risk-adjusted returns to the national financial sector as a whole.[32] The trend toward unifying regulators increased—with more countries merging financial regulators from sectoral to more integrated structures. Yet, by the time of the 2007-08 financial crisis, many countries' lawmakers realized that a single, integrated regulator probably would not provide the best level of regulatory oversight.[33] The global financial crisis also led to intense debate around objectives-based (rather than institutions or services-based) regulators. Inspired by both policymaker and academic support for Twin Peaks financial sector regulation, more countries are drafting objectives-based legislation putting a Twin Peaks regulatory framework in place.[34]

[30] *See* GROUP OF THIRTY, THE STRUCTURE OF FINANCIAL SUPERVISION: APPROACHES AND CHALLENGES IN A GLOBAL MARKETPLACE 13 (2008), https://group30.org/publications/detail/138.

[31] For a historical cross-country overview of countries' financial sector regulatory choices (including the extent of integration between these regulators), *see* Jose de Luna-Martinez and Thomas Rose, *International Survey of Integrated Financial Sector Supervision* (The World Bank Fin. Sector Operations and Policy Dep't, Working Paper No. 3096, 2003), http://core.kmi.open.ac.uk/download/pdf/6522027.pdf. We describe their data in detail in a subsequent section. *See infra* Part II.

[32] *See* Martin Cihak & Richard Podpiera, *Is One Watchdog Better Than Three? International Experience with Integrated Financial Sector Supervision* (IMF, Working Paper 06/57, 2006), http://www.imf.org/external/pubs/ft/wp/2006/wp0657.pdf.

[33] Many countries' changes in financial regulation had the U.K.'s experience well in mind. The failure of the U.K.'s integrated FSA, which inspired other countries to adopt such an approach, led to a groping around for "something better." Joseph J. Norton, *Global Financial Sector Reform: The Single Financial Regulator Model Based on the United Kingdom FSA Experience—A Critical Reevaluation*, 39 INT'L L. 15 (2005). Some might argue that the U.K.'s Twin Peaks approach came about from the need to dismantle the FSA-approach, more than from its intrinsic qualities. *See* Michael W. Taylor, *The Road from "Twin Peaks"—And the Way Back*, 16 CONN. INS. L.J. 61 (2010).

[34] Two recent prominent analyses of the suitability of a Twin Peaks regulatory structure concern Canada and South Africa. Pan's misnamed article essentially assesses the positive features of a financial sector regulatory structure, looks at various regulatory structures, and decides on a Twin Peaks model for Canada. *See* Eric Pan, *Structural Reform of Financial Regulation*, 19 TRANSNAT'L L. & CONTEMP. PROBS. 796 (2011). The South African study basically cajoles the public into adopting a Twin Peaks approach. *See* SOUTH AFRICA FIN. REGULATORY REFORM STEERING COMM., IMPLEMENTING A TWIN PEAKS MODEL OF FINANCIAL REGULATION IN SOUTH AFRICA (2013), http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%203%20Roadmap.pdf.

Figure 2: Major Approaches to Financial Sector Regulation

Approach	Description	Country Examples
Institutional Approach	A firm's legal status (for example a bank, broker-dealer, or insurance company) determines which regulator oversees its activity.	China, Mexico, **Hong Kong**
Functional Approach	The type of business conducted determines which regulator oversees that transaction. For example, a bank selling securities and insurance products may have three different regulators overseeing its operations.	Brazil, France, Italy, Spain.
Integrated Approach	One single regulator oversees all financial sector actors.	Canada, Germany, Japan, Qatar, Singapore.
Twin Peaks Approach	**Separates regulators by objective** – such that one regulator oversees the safety and soundness of the financial system and the other focuses on the conduct of business.	Australia, UK, Netherlands (possibly South Africa in the future?)

Source: summarized from Group of 30 (2008)[35]. The Country Examples may not reflect changes made after 2008.

Twin Peaks financial regulation—and specifically such regulation based in objectives-based legislation—provides an interesting development for scholars of legislative drafting and jurisprudence for three reasons. First, most legislation regulation does not "put it on the line" by defining specific objectives—and therefore outcomes. Central banks often have had particular objectives (like inflation control, encouraging economic growth and regulating banks).[36] Securities

[35] *Supra* note 30.

[36] Congress only added the U.S. Federal Reserve Bank's objectives to the 1913 Federal Reserve Act in 1977. *See* Federal Reserve Act of 1913, 12 U.S.C. § 226 (1913). That objective requires the Federal Reserve to "maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production." *Id.* § 226. Banking regulation does not appear as a primary objective. Article 127(6) of the Treaty on the Functioning of the European Union appears to give the Central European Bank regulatory authority to supervise banks almost as an after-thought, as "the [European] Council . . . may . . . confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings." Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26/10/2012, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:12012E/TXT. Such a conferral requires a

regulators also had specific objectives enshrined in legislation.[37] However, legislation—whether financial or otherwise—has rarely, if ever, explicitly stated risks targeted and objectives of legislative action. Second, legislatively defined objectives create objective yardsticks by which to measure executive agencies' success. A specific objective allows independent analysts to assess versus outcomes.[38] Such a structure also focuses democratic accountability on executive agencies for achieving these clearly-defined legislative objectives.[39] Third, less prescriptive legislation allows for less prescriptive regulation. In other words, because legislation defines broad objectives (like financial stability), financial regulators and other executive agencies can engage more freely in risk-based and principles-based regulation.[40] Principles-based regulation (as a system—including the agency-level rules that focus on risk) clearly represent a new form of governance.[41] Despite its detractors, principles-based regulation—and the objectives-based legislation that underpins such regulation—still represents one of the best ways of dealing with complex social and economic problems.[42] To the extent that a country's first objectives-based legislation represents a "framework law," that law clearly and unambiguously represents a completely different approach to legislation.[43] Legislation-by-objectives (even in the form of a financial markets act) can create a precedent for future lawmaking-by-objectives.[44]

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special legislative procedure, must be adopted unanimously, and must offer after consulting the European Parliament and the European Central Bank itself. *Id.*

[37] The original U.S. Securities and Exchange Commission Act had a section titled Necessity for Regulation. However, the section does not provide explicit objectives *per se*. The European Securities and Markets Authority probably represents best-in-practice, having a clear statement of objectives to "protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses." *See* Securities Exchange Act of 1934, 15 U.S.C. § 78a (1934). The objective includes regulatory and supervisory objectives, objectives for ensuring the integrity, transparency, efficiency and orderly functioning of financial markets, proper regulation and supervision of the taking of regulatory risks, and enhancing customer protection. *Id.*; *see also* Establishing a European Supervisory Authority Regulation, OJ L 331 Reg. 1095/2010 (2010), available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32010R1095.

[38] Such a legislative approach in some ways enshrined the same principles that the U.K. introduced at the regulatory level through its Citizens Charter policy. As a Prime Ministerial policy, the U.K.'s Citizens Charter policy required U.K. public agencies to agree on service performance targets and report on these. *See* Bruce Doern, *The U.K. Citizen's Charter: Origins and Implementation in Three Agencies*, 21 POL. & POLITICS 1 (1993). For the problems that the initiative encountered, *see also* Mary Bowerman, *Auditing Performance Indicators: The Role of the Audit Commission in the Citizen's Charter Initiative*, 11 FIN. ACCOUNTABILITY & MGMT. 2 (1995).

[39] For a discussion on the case of prudential regulation, *see* Julia Black, *Managing Regulatory Risks and Defining the Parameters of Blame: A Focus on the Australian Prudential Regulation Authority*, 28 L. & POLICY 1 (2006).

[40] Legislation which defines very specific obligations on regulators and financial institutions leaves very little room for such regulators and institutions to develop their own methods of addressing the risk the statute targets. *See* Cristie L. Ford, *Principles-Based Securities Regulation in the Wake of the Global Financial Crisis*, MCGILL L. J. 55, (2010), http://works.bepress.com/cristie_ford/2/.

[41] *See* Cristie L. Ford, *New Governance, Compliance, and Principles-Based Securities Regulation*, 45 AMER. BUS. L. J. 1 (2008).

[42] For a review of the issues (including the arguments against), *see* Julia Black, *The Rise, Fall and Fate of Principles Based Regulation*, (LSE LAW, SOCIETY AND ECONOMY WORKING PAPER 17/2010, 2010), http://works.bepress.com/cristie_ford/2/.

[43] Scholars have recently described laws that change the way the legislature makes laws, "framework laws." Such framework laws impose obligations on future legislative members to pass laws in particular

Yet, such objectives-based financial sector legislation and regulation is not without its critics. Jones, for example, might argue that lawmakers should not design financial regulators around financial market risks, institutions, and actors.[45] To make the argument less abstract (and to paraphrase Jones to the breaking point), the United States SEC should not just sit back and figure out how to apply rules to JP Morgan, Goldman Sachs, AIG, and other financial sector actors as they are. The SEC, Federal Reserve, and other regulators should not react to financial markets. They should shape them—requiring Goldman Sachs to break up, for example, at their pleasure. Government should drive markets—not the other way around. Yet, Von Nessen, almost as if responding to the Jonesian challenge, argues that government *diktat* has caused large difficulties in the adoption of Australia's Twin Peaks legislation.[46] Australian financial firms have had large difficulties accepting and adapting their rules and compliance systems to Twin Peaks regulators requirements down under. White warns that integrated regulatory approaches—like Twin Peaks—provide financial regulators and central banks with too much discretionary authority.[47] For his part, Pan argues that the approach adopted for financial sector regulation (and the organisational structure of financial regulators) does not matter very much.[48] Instead, the resources available and grant of legal authorities to engage in effective regulation represents the most important part of successful financial sector regulation. Even if regulatory approaches—like the U.K.'s integrated model or its subsequent Twin Peaks model—represent the best model for the U.K., nothing guarantees that such an approach will work when exported.[49]

Yet, who could deny that Twin Peaks regulation based on objectives-centered legislation (for better or worse) represents a new approach to lawmaking? Proponents like Bakir mistakenly claim that Twin Peaks regulation serves as a way of creating inter-agency collaboration through "steering and coordinating policy networks . . . [and] governance through hierarchy in the financial services."[50] These proponents argue that inter-agency collaboration still represents a challenge.[51]

formats. *See* Elizabeth Garrett, *The Purposes of Framework Legislation* (USC Law School, USC Pub. Policy Research Paper No. 04-3, 2004).

[44] Why does most U.K. financial law focus so heavily on objectives, whereas other countries do not? Some may argue in the U.K. that mental legislative entrenchment has affected such objectives-based thinking. Once legislatures start thinking and using new concepts (like cost-benefit analysis, impact assessment, objectives-based-legislation and so forth) later bills reflect these trends. *See* Oona Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601 (2003).

[45] *See* Renee Jones, *Back to Basics: Why Financial Regulatory Overhaul is Overrated*, 4 ENTREPRENEURIAL BUS. L.J. 391 (2010).

[46] *See* Paul Von Nessen, *Financial Services Reform: What Can be Learned from the Australian Experience*, J. S. AFR. L. 64 (2006).

[47] *See* Lawrence White, *The Rule of Law or the Rule of Central Bankers?*, 30 CATO J. 3 (2010).

[48] *See* Eric Pan, *Four Challenges to Financial Regulatory Reform*, 55 VILL. L. REV. 743 (2010).

[49] *See* Joseph J. Norton, *Global Financial Sector Reform: The Single Financial Regulator Model Based on the United Kingdom FSA Experience—A Critical Reevaluation*, 39 INT'L LAWYER 1 (2005).

[50] Canir Bakir, *The Governance of Financial Regulatory Reform: The Australian Experience*, 87 PUB. ADMIN. 4 (2009).

[51] *See* Adriane Fresh and Martin Baily, *What does international experience tell us about regulatory consolidation?* (Pew Fin. Reform Project, Briefing Paper 6, 2009),

Other analysts put Twin Peaks regulation—sometimes with or sometimes without objectives-based regulation—head-to-head with other regulatory models in a menu fashion.[52] Regardless of whether Twin Peaks regulation represents a new regulatory model or not, objectives-based regulation does. Objectives-based legislation—and the objectives-based regulation that give it force—represents a new way of thinking about all kinds of legislation, not just in the financial sector.

II. WHAT DO WE KNOW ABOUT TWIN PEAKS FINANCIAL REGULATION AND THE OBJECTIVES-BASED LEGISLATION THAT PUTS IT IN PLACE?

A. TWIN PEAKS AS THE NEXT STEP OF REGULATORY INTEGRATION?

Financial regulators worldwide have struggled to find a regulatory structure which fulfils the objectives of promoting financial stability and protecting customers.[53] Such a search has resulted in changes (sometimes several) to financial sector regulatory structure since the 2000s. Figure 3 shows the number of financially sophisticated countries who changed their financial regulatory structure in the 2000s (and the number of changes).[54] The impetus for financial sector regulatory reform began well before the 2007-08 crisis—with regulators recognizing that previous structures did not adequately generate macro and micro-prudential regulation nor protect customers adequately—while still encouraging financial sector innovation and growth. Except for a jump in 2002, both the number of countries adopting changes and the number of reforms, have remained relatively constant throughout the decade. However, we cannot judge from this data the extent to which these reforms focus on aligning regulations with particular objectives.

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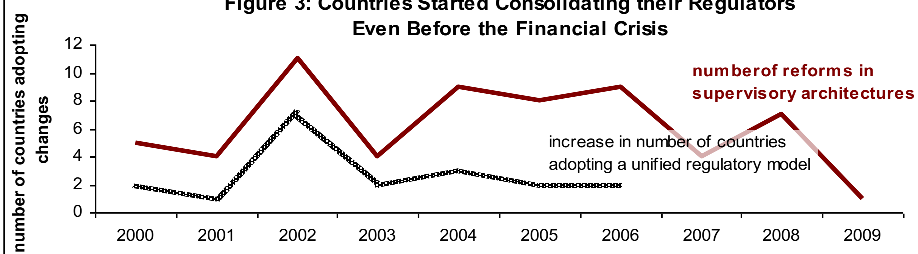
http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0CCcQFjAA&url=http%3A%2F%2Fwww.brookings.edu%2Fresearch%2Freports%2F2009%2F09%2F21-consolidation-baily&ei=pPxsU_iLNaiKywPKhoCoAw&usg=AFQjCNEvMCt2AuJfDpTRDZxe_d9iPlaIxg&bvm=bv.

[52] Taylor represents one of the many authors who compares Twin Peaks side-by-side with other approaches. To his unending credit, he represents one of the only authors to actually classify "regulation by objective" as a separate system. *See* CHARLES TAYLOR, CHOOSING FINANCIAL REGULATORY AGENCY MANDATES, PEW FIN. REF. PROJ. WORKING PAPER 6 (2009), https://www.pewtrusts.org/-/media/assets/2009/07/20/0013.pdf.

[53] Financial sector regulators' objective may vary from country to country, yet they all agree on the basics of stable financial markets and protecting customers. For a fuller description of how various Twin Peaks regulatory model objectives converge on these ultimate outcomes, *see* Jeroen Kremers and Dirk Schoenmaker, *Twin Peaks: Experiences in the Netherlands* (LSE FIN. MKTS. GRP., WORKING PAPER 196, 2010), http://www.lse.ac.uk/fmg/assets/documents/papers/special-papers/SP196.pdf.

[54] *See* Richard Herring & Jacopo Carmassi, *The Structure of Cross-Sector Financial Supervision*, 17 FIN. MKT., INST. & INSTRUMENTS 56, 58 (2008); Donato Masciandaro & Marc Quintyn. *Regulating the Regulators: The Changing Face of Financial Supervision Architectures Before and After the Crisis*, *in* HANDBOOK OF CENTRAL BANKING, FINANCIAL REGULATION AND SUPERVISION AFTER THE FINANCIAL CRISIS (2009).

Figure 3: Countries Started Consolidating their Regulators Even Before the Financial Crisis



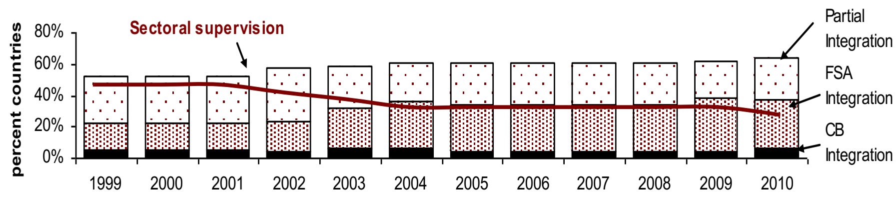
The figure show s the number of countries adopting changes in their financial regulatory architecture per year. Sources: Herring and Carmassi (2008) for increase in the number of countries adopting a unified regulatory model and Masciandaro and Quintyn (2009) for data on number of reforms in supervisory architecture.

Yet, the trend toward integrating financial regulators suggests a regulatory focus on objectives rather than financial institutions themselves. Figures 4a and 4b show the nature of changes in financial sector regulation among a range of countries.[55] As shown in Figure 4a, sectoral supervision—the kind Hong Kong has used—decreased dramatically over the decade from forty-five percent of the countries Melecky and Podpiera studied—to thirty-four percent.[56] Financial legislation worldwide has integrated competencies for prudential supervision over the decade—mostly with a central bank (or to a lesser extent, a financial services authority). Integration of prudential supervisory functions in central banks, like Hong Kong's Monetary Authority, has not necessarily been the preferred method for a variety of countries. Furthermore, as shown in Figure 4b, the trend toward integrating business (market) conduct competencies has also increased. Only a handful of countries have adopted Twin Peaks style integration (assigning market conduct to a separate agency). Yet, the trend toward looking at business conduct at all has surged—from fifty percent of countries putting in place such a system of oversight—to sixty-two percent by 2010.

[55] Martin Melecky & Anca Podpiera, INSTITUTIONAL STRUCTURES OF FINANCIAL SECTOR SUPERVISION, THEIR DRIVERS AND EMERGING BENCHMARK MODELS, at 33–-35 (MPRA, 2012), https://mpra.ub.uni-muenchen.de/37059/1/MPRA_paper_37059.pdf.

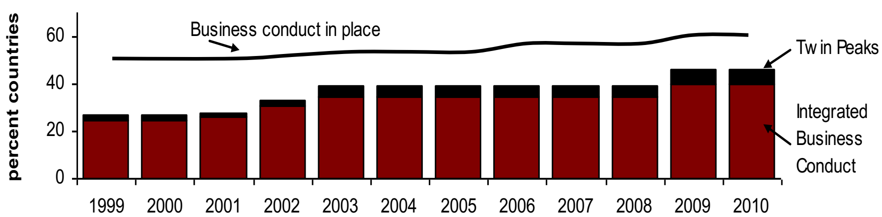
[56] Hong Kong follows a functional approach in the Group of 30 and other academics' taxonomy. Using the Melecky and Podpiera taxonomy, Hong Kong employs a sectorally-based system of financial regulation. While the words differ, the underlying concept remains the same. Hong Kong regulates financial institutions according to their legal form and (to a limited extent) the services they provide.

Figure 4a: Integrated Macroprudential Regulators The Norm -- with Countries Using Sectoral Supervisors on the Fall



The figure shows organisational arrangements for the prudential supervision of financial institutions in a range of "high financial depth" economies studied by the authors from 1999 to 2010. Please see the original source for the definitions of each type of regulatory structure and criteria for assigning changes in prudential regulatory supervisory structures.
Source: Melecky and Podpiera (2012).

Figure 4b: Integrated Business Conduct Regulatory Structures Continued to Gain Popularity throughout the 2000s



The figure shows organisational arrangements for the prudential supervision of financial institutions in a range of "high financial depth" economies studied by the authors from 1999 to 2010. Please see the original source for the definitions of each type of regulatory structure and criteria for assigning changes in prudential regulatory supervisory structures.
Source: Melecky and Podpiera (2012).

Unsurprisingly, integration among regulated entities has encouraged integration of their regulators. A number of factors contribute to the benefits of integration exceeding the costs among financial regulators, including: more cross-border financial transactions, economies of scale in regulation, computerization, and conglomeration of financial organizations.[57] Bureaucratic politics can also play an

[57] Luna-Martinez and Rose provide one of the first thorough analyses of such factors. In their comprehensive econometric study of factors influencing the extent of financial regulator integration, Melecky and Podpiera find that GDP per capita, population trade-to-GDP ratios, central bank autonomy, number of previous economic crises, stock market capitalization and private credit to deposit ratios have statistically significant relationships with the integration of prudential supervision. Business conduct integration is statistically significant in correlation to GDP per capita, trade-to-GDP ratios, credit-to-GDP ratios, and banks' net interest margins. JOSE DE LUNA-MARTINEZ & THOMAS ROSE, FIN. SECTOR OPERATIONS AND POLICY DEP'T, INTERNATIONAL SURVEY OF INTEGRATED FINANCIAL SECTOR SUPERVISION (2003), https://core.ac.uk/download/pdf/6522027.pdf; MELECKY & PODPIERA, *supra* note 55.

important role.[58] Relative "bargaining power" between regulators and the regulated can also play a role.[59] Kremers and co-authors in particular have argued that the presence of financial conglomerates in the Netherlands has militated for an integrated regulatory structure.[60] Figure 5 illustrates the forces encouraging the integration of financial regulators and the need for objectives-based regulation. In the U.S., acquisitions by financial firms outside of their sub-sector constituted about eighteen percent of the value of all transactions. In the EU, such acquisitions (by value) came to about twenty-five percent of all mergers and acquisitions between 1990 and 2006. Many financial service providers offer banking, insurance, and securities simultaneously. In such a market environment, dividing regulators by function makes less and less sense.

Figure 5: Increased Financial Integration Militates for Integrated Regulators

		Target					
			US			EU-27	
		banks	insurance	securities	banks	insurance	securities
acquirer	banks	**52%**	<1%	7%	**54%**	1%	5%
	insurance	2%	**12%**	<1%	<1%	**13%**	<1%
	securities	5%	3%	**18%**	14%	3%	**8%**

The figure shows the value of mergers and acquisitions in the U.S. and EU financial services sectors from 1990-2006. Acquisitions outside of each sector came to about 18% for the U.S. and 25% for the EU.

Source: Herring and Carmassi (2008).[61]

What does the data say about the effectiveness of financial regulator integration in achieving particular objectives like encouraging compliance with macroprudential regulation and protecting customers? At first glance, such integration produces mixed results (to say the least). Figure 6 provides some of the first evidence about the effectiveness of regulator integration on compliance with prudential and market conduct standards established by the International Monetary Fund ("IMF").[62] Integrated supervision has a statistically significant correlation with compliance with Basel Core Principles.[63] However, it doesn't correlate with

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[58] *See, e.g.,* Donato Masciandaro, *Divide et Impera: Financial Supervision Unification and Central Bank Fragmentation Effect*, 23 EURO. J. OF POL. ECON. 2 (2007).

[59] *See generally,* Donato Masciandaro, *Politicians and Financial Supervision Unification Outside the Central Bank: Why Do They Do It?*, 5 J. OF FIN. STABILITY. 2 (2009).

[60] Jeroen Kremers et al., *Cross-Sector Supervision: Which Model?*, *in*.BROOKINGS-WHARTON PAPER ON FIN. SERV.: 2003, 225, 230-31 (2002).

[61] *Supra* note 54.

[62] Martin Cihak & Richard Podpiera, IS ONE WATCHDOG BETTER THAN THREE? INTERNATIONAL EXPERIENCE WITH INTEGRATED FINANCIAL SECTOR SUPERVISION, (IMF, 2006), https://www.imf.org/external/pubs/ft/wp/2006/wp0657.pdf.

[63] The Basel Core Principles represent advice promulgated to regulators in 2012, dealing with reducing bank and banking system risk. *See* BASEL COMMITTEE ON BANKING SUPERVISION, CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION, (2012), https://www.bis.org/publ/bcbs230.pdf.

much else. Instead, factors like overall regulatory environment and level of economic development matter far more. Interestingly, the extent of integration does not affect the number of regulatory staff monitoring financial institutions.

Figure 6: At First Glance, Data on Integrated Financial Supervision Mixed at Best

Effect of Integrated Supervision on...	Effect?	Reason	Reference
Compliance with Basel Core Principles	Yes	A higher proportion of countries with integrated supervisors had higher levels of compliance with the Basel Principles	Figure 3
Regulatory governance in banking and securities markets?	No	Regression analysis shows no statistically significant effect for having an integrated regulator.	Table 6
Prudential frameworks in banking and securities markets?	No	Same	Table 6
Regulatory PRACTICES in banking and securities markets?	No	Same	Table 6
Financial integrity and safety nets in banking and securities markets?	No	Same	Table 6
Compliance with International Standards	No	Same	Table 7
Does the overall regulatory environment matter?	Yes	Having an integrated regulator matters far less for Basel Principle compliance when taking regulatory environment into account	Table 4
Does level of economic matter?	Yes	Having an integrated regulator matters far	Table 4

		less for Basel Principle compliance when taking GDP per capita into account	
Number of regulatory staff in government	No	Regression analysis shows no statistically significant effect for having an integrated regulator.	Table 8

Source: Cihak and Podpiera (2006).

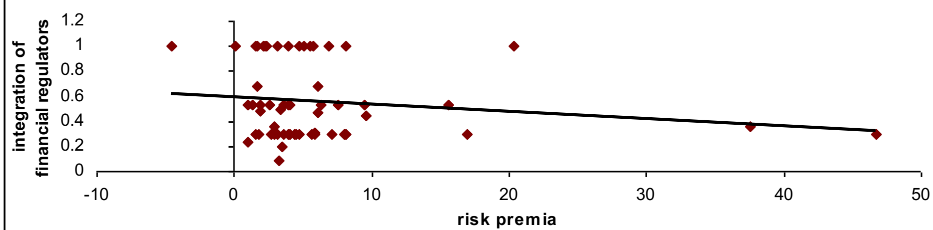
Some trends in the data suggest that regulator integration may lead to better macro-prudential policymaking and market conduct. The data needs far more analysis than the illustrative graphs we have put together. However, these illustrative graphs (shown as Figures 7a and 7b) suggest that regulator integration may help financial regulators achieve their objectives.[64] Figure 7a shows a positive relationship between integration of financial regulators and decreases in risk premia associated with a country's investments.[65] Figure 7b shows a positive relationship between integration of a country's financial regulators and rule of law (as a possible proxy for the extent to which financial firms engage in illegal activity).[66] These relationships do not control for macroeconomic factors or even control for potential outliers. However, further analysis could confirm that integration among countries' financial regulators has positive macro-prudential regulatory and market conduct impacts—such results would provide support for further integration worldwide. A Twin Peaks regulatory structure would certainly represent one of the more integrated regulatory models considered by lawmakers in these countries.

[64] The reader should see these graphs as only illustrative. We compared the organization of financial sector supervision with the banking crises internationally. We found that countries which changed their prudential supervision organizational structures had a forty-three percent average output loss as a result of banking crises (with our results unadjusted for country size). In contrast, countries without any change in their prudential supervisory structures had an unweighted output loss as a result of banking crisis of only thirty-two percent. To repeat our analysis, *see generally* MARTIN MELECKY & ANCA PODPIERA, ORGANIZATION OF FINANCIAL SECTOR SUPERVISION DATASET (2012); *see also,* LUC LAEVEN AND FABIAN VALENCIA, SYSTEMIC BANKING CRISES DATABASE: AN UPDATE (IMF, 2012), https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Systemic-Banking-Crises-Database-An-Update-26015.

[65] *See* Donato Masciandaro, Marc Quintyn & Michael Taylor, *Inside and Outside the Central Bank: Independence and Accountability in Financial Supervision*, 24 EURO. J. POL. ECON. 4 (2008). WORLD BANK, DATABANK, https://data.worldbank.org/indicator/FR.INR.RISK?end=2014&start=1960&view=chart.

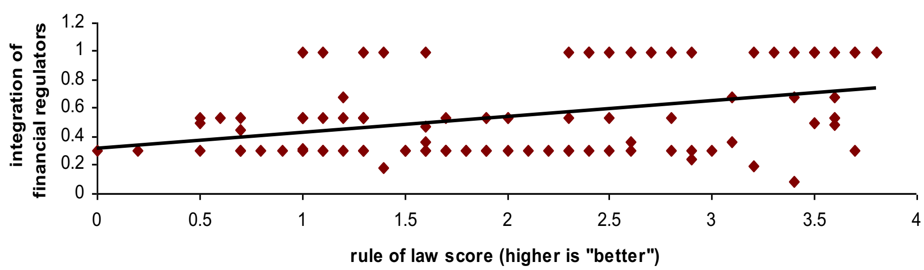
[66] *See* WORLD BANK, WORLDWIDE GOVERNANCE INDICATORS (2014), http://info.worldbank.org/governance/wgi/#home. For Masciandaro and co-authors, *see supra* note 65.

Figure 7a: Countries with Integrated Regulators Have Lower Risk Premia -- Suggesting Better Macroprudential Policies



The figure show s the relationship betw een the degree of integration of financial regulators compared w ith risk premia in various countries' financial markets (compared w ith the local lending rates minus T-bill rates) in a range of countries. Level of economic development does not cause omitted variable bias in this figure. See original for definition of concentration of financial regulators.
Sources: Masciandaro and Quintyn (2009) for data on financial regulator concentration and World Bank (2014) for data on risk premia.

Figure 7b: Integrated Regulators Promote Better Market Conduct?



The figure show s the relationship betw een the degree of integration of financial regulators compared w ith rule of law scores (as one of the World Bank's Worldw ide Governance Indicators) in a range of countries. The level of economic development does not cause omitted variable bias in this figure. See originals for definitions of concentration of financial regulators and rule of law . The extent to w hich rule of law proxies market misconduct is very much an open question.
Sources: Masciandaro and Quintyn (2009) for data on financial regulator concentration and World Bank (2014) for data on rule of law .

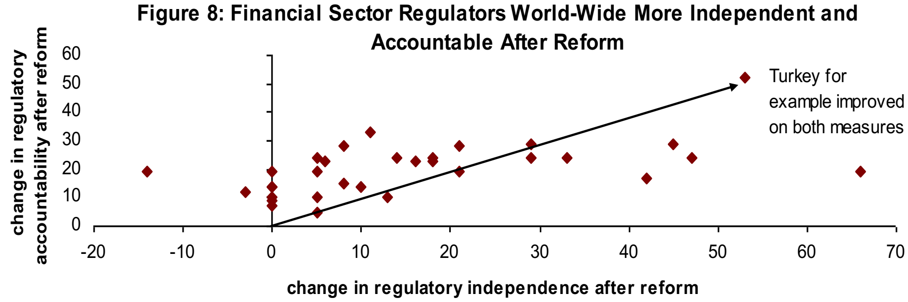
Financial regulator integration also seems to improve these regulators' independence and accountability—making them more likely to achieve their objectives. Figure 8 shows the change in scores of financial regulators' independence and accountability after a change in regulatory structure.[67] Bird—talking specifically about the accountability of Australia's Twin Peaks regulators—finds the accountability arrangements covering the country's Prudential Regulatory Authority and Securities and Investments Commission adequate.[68] Masciandaro

[67] *See* MARC QUINTYN et al., THE FEAR OF FREEDOM: POLITICIANS AND THE INDEPENDENCE AND ACCOUNTABILITY OF FINANCIAL SECTOR SUPERVISORS 42 (IMF, 2007), https://www.imf.org/en/Publications/WP/Issues/2016/12/31/The-Fear-of-Freedom-Politicians-and-the-Independence-and-Accountability-of-Financial-Sector-20155.

[68] Joanna Bird, *Regulating the Regulators: Accountability of Australian Regulators*, 35 MELB. U.L. REV. 739, 755 (2011).

and co-authors find this effect increases when the prudential regulator sits outside of the central bank.[69] Integration, particularly outside the central bank, correlates with greater financial stability (namely fewer systemic banking crises).[70]

Figure 8: Financial Sector Regulators World-Wide More Independent and Accountable After Reform



The figure shows the extent to which accountability and independence of various countries' financial regulators changes after financial regulatory reform expressed as a percent of a benchmark given by the authors -- according to survey data. Countries like Turkey and Mexico improved the most. Japan and Estonia backpeddled.
Source: Quintyn and co-authors (2007)

Many authors have reviewed the pros and cons of using a principles-based financial sector regulatory approach as opposed to a rules-based financial sector regulatory approach.[71] These authors miss the point. Legislators should not simply balance pros and cons of principles versus rules from a priori principles. Instead, they should match regulatory structure to regulatory environment. In other terms, structure should follow strategy.[72] Melecky and Podpiera, among others, find a strong relationship between the structure of financial sector regulators and various macroeconomic and financial sector variables. As we have previously mentioned, some of these factors include GDP per capita, population trade-to-GDP ratios, extent of central bank autonomy, number of previous banking crises, stock market capitalization, credit-to-GDP ratios, and banks' net interest margins.[73] The question isn't whether countries like Hong Kong should have a sectoral basis of financial

[69] Such a finding holds particular relevance for jurisdictions like Hong Kong, where the central bank has always played a pivotal and undisputed role in establishing macro-prudential regulations. *See* Donato Masciandaro, Marc Quintyn & Michael Taylor, *Inside and Outside the Central Bank: Independence and Accountability in Financial Supervision*, 24 EURO. J. POL. ECON. 4 (2008).

[70] *See generally* BARRY EICHENGREEN & NERGIZ DINCER, NAT'L BUREAU OF ECON. RESEARCH, WHO SHOULD SUPERVISE? THE STRUCTURE OF BANK SUPERVISION AND THE PERFORMANCE OF THE FINANCIAL SYSTEM (2011), https://www.nber.org/papers/w17401.

[71] For a recent description in the financial regulation context, *see* John Coffee & Hillary Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea*, 95 VA. L. REV. 707 (2009); *see also* Richard Abrams & Michael Taylor, ISSUES IN THE UNIFICATION OF FINANCIAL SECTOR SUPERVISION (IMF, 2000).

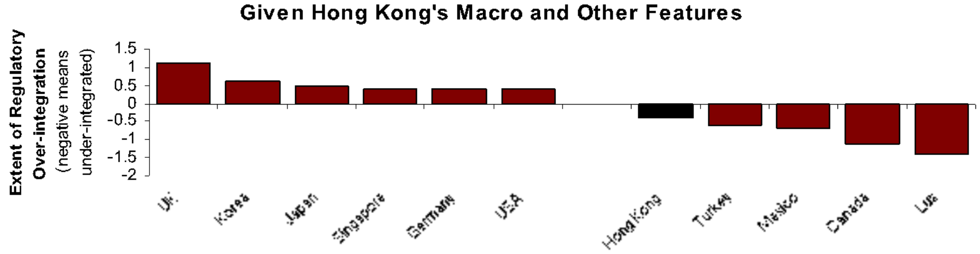
[72] The question about whether public sector organizational design adapts to the broader organizational environment remains an open one. For an empirical analysis of the extent to which government agency size and specialization (structure) responds to the macroeconomic environment, *see* BRYANE MICHAEL & MAJA POPOV, PUB. ORG. REVIEW, THE SIZE AND STRUCTURE OF GOVERNMENT (2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1740842.

[73] *See* Melecky, *supra* note 55 and accompanying text.

regulation as opposed to a Twin Peaks one. *Instead, countries like Hong Kong should choose the regulatory approach most appropriate for their financial markets (as measured by a range of macroeconomic and other variables).*

As the economic crisis already illustrated, some countries' lawmakers can make incorrect decisions about the structure of the country's financial regulators. Figures 9a and 9b show the extent of the over or under integration of several countries' financial regulators.[74] Some prudential regulators—like the U.K.'s and Korea's—have over-integrated (compared with other countries with similar levels of GDP-per-capita and other factors). Other countries' prudential regulators—like Hong Kong's, Canada's, and Mexico's—have under-integrated. Similarly, regulators focusing on financial sector business conduct have over-integrated in Singapore and Germany. Such regulators have under-integrated in Hong Kong and Switzerland.

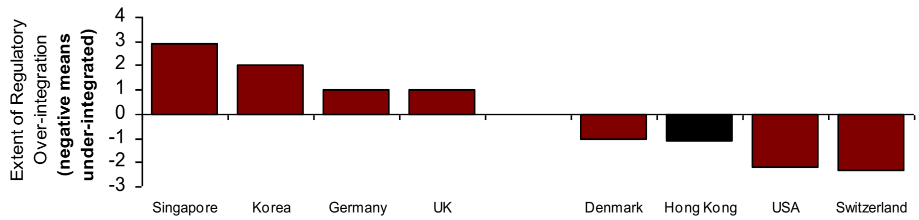
Figure 9a: Hong Kong's Macro-Prudential Regulators Under-Consolidated Given Hong Kong's Macro and Other Features



The figure show s the degree of over-integration of each country's MACROPRUDENTIAL financial regulators - as predicted by a range of factors w hich should determine the optimal extent of regulator integration. We subtracted actual integration scores w ith fitted values (predicted by regression analysis) and assumed that differences betw een actuals and predicted scores represent over-regulator (if the resulting difference is positive) or under-regulation (if the regulating difference is negative). Source: Melecky and Podpiera (2012)

[74] The authors ran regression analysis on the extent of financial sector regulatory integration and a range of variables for most of the world's economies. Such regression would show which countries have higher (or lower) levels of regulator integration compared with other countries that have similar levels of GDP-per-capita and other factors. Any judgment about over or under integration would thus assume that the average or normal level of integration for any chosen level of GDP-per-capita (and other factors) represents the right level. Naturally, such value judgments should be taken with scepticism. For figures' source, *see supra* note 55.

Figure 9b: Hong Kong's Financial Sector Regulators Monitoring Business Conduct Also Under-Integrated



The figure shows the degree of over-integration of each country's BUSINESS CONDUCT financial regulators - as predicted by a range of factors which should determine the optimal extent of regulator integration. We subtracted actual integration scores with fitted values (predicted by regression analysis) and assumed that differences between actuals and predicted scores represent over-regulator (if the resulting difference is positive) or under-regulation (if the regulating difference is negative).
Source: Melecky and Podpiera (2012)

Financial sector regulatory integration does not need to correlate with objectives-based financial legislation. However, the two trends have coincided over the years. Larger financial regulators need to define objectives (outcomes) rather than specific activities to regulate. Regulator size provides economies of scope and scale in overseeing a range of financial sector activities.[75] Larger financial sector risks have also militated a focus on specific types of risks—rather than simply focusing on processes of regulated entities. With increasing leverage, larger sizes, and more international exposure, financial entities pose systemic risks unknown even twenty years ago.[76] Thus, larger and more integrated financial regulators would usually do well to focus on objectives.

B. LEGISLATING TWIN PEAKS REGULATORY STRUCTURES THROUGH OBJECTIVES-BASED LEGISLATION

A number of jurisdictions have adopted a twin-peaks regulatory structure (or other similar structure). In the U.K., a review of regulators' response to the financial crisis has led the Government to adopt a Twin Peaks structure.[77] According to recent surveys, "79% of firms believe the changes to the regulatory system will result in improved effectiveness, which can be expected to contribute to promoting the UK as a global hub for the financial sector."[78] Regarding Australia's

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[75] *See* Abrams, *supra* note 71.

[76] We do not have space to describe these risks in this paper. Interestingly, authors like Allen and Gale note that inappropriate financial regulation may have actually contributed to systemic and other risks (like counterparty risks). *See* Franklin Allen & Douglas Gale, *Systemic Risk and Regulation*, THE RISKS OF FINANCIAL INSTITUTIONS 341 (University of Chicago Press, 2007).

[77] *See* Alison Lui, *Single or Twin? The UK Financial Regulatory Landscape After the Financial Crisis of 2007–2009*, 13 J. OF BANK. REG. 24 (2012).

[78] Michelle Carrol & Michael McKee, BDO & DLA PIPER, THE NEW TWIN PEAKS MODEL 8 (2012), https://www.bdo.co.uk/getattachment/bb4e11fe-2767-40b2-b548-cfed3f40a4ee/attachment.aspx.

twin peaks system, Professor Brown echoes the many voices in the literature that have argued that Australia's twin peaks regulatory model helped it during the crisis.[79] "The evidence from this examination suggests that Australia was able to avoid many of the problems that arose in the United States and the United Kingdom … partly due to its twin peaks regulatory structure."[80] The Dutch experience with Twin Peaks regulation shows that such a regulatory structure helped the Netherlands weather the global financial crisis.[81] South Africa's consultation on its upcoming Twin Peaks reforms also points to the promise of such regulation.[82] Given its promise, the EU is considering adopting a twin-peaks approach in its Union-wide surveillance and monitoring actions.[83] As previously mentioned, the US Treasury and General Accountability Office have already come out in favour of an objectives-based Twin Peaks approach for the USA.[84]

A Twin Peaks approach to financial sector regulation does not strictly require objectives-based legislation. Indeed, the legislation setting up Australia's Twin Peaks approach to financial sector regulation focuses on setting up the organizations sitting on each of the Peaks and defining their activities. The Australian 1998 Prudential Regulation Authority Act provides no objectives at all.[85] The Act notes that "the [Australian Prudential Regulation Authority] exists . . . [for] regulating bodies in the financial sector in accordance with other laws of the Commonwealth that provide for prudential regulation or for retirement income standards, administering the financial claims schemes . . . and developing the administrative practices and procedures to be applied in performing that regulatory role and

[79] *See* Elizabeth Brown, *A Comparison of the Handling of the Financial Crisis in the United States, the United Kingdom, and Australia*, 55 VILLANOVA L. REV. 509 (2010).

[80] Elizabeth Brown, *A Comparison of the Handling of the Financial Crisis in the United States, the United Kingdom, and Australia*, 55 VILLANOVA L. REV. 509 (2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1864898.

[81] Like with all regulatory approaches, the Netherlands's Twin Peaks model had good as well as bad aspects. For an illuminating discussion of the Dutch experience (and succinct recommendations for improving the Dutch version), *see* MONETARY AND CAPITAL MKT. DEP'T., TECHNICAL NOTE ON FINANCIAL SECTOR SUPERVISION: THE TWIN PEAKS MODEL, (IMF, 2011), https://www.imf.org/external/pubs/ft/scr/2011/cr11208.pdf.

[82] The Financial Sector Regulation Bill looks a lot like the UK's implementing legislation—with a focus on objectives. *See* NAT'L TREASURY, FINANCIAL SECTOR REGULATION BILL (2013), http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%201%20Financial%20Sector%20Regulation%20Bill.pdf.

[83] The EU currently follows a sectoral approach for Union-wide surveillance. However, several politicians and senior advisors have started militating for a Twin Peaks approach. For an overview of the EU system of financial regulation, *see* Eddy Wymeersch, *The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors*, 8 EURO. BUS. ORG. L. REV. 2, (2007). For one example of a senior EU legislator arguing for a Twin Peaks approach, *see* Pervenche Beres, *First Step Towards 'Twin Peaks' Model of Financial Supervision*, BANKING TODAY, Mar.–Apr. 2014, https://www.euractiv.com/euro-finance/step-twin-peaks-model-financial-analysis-496770.

[84] We have previously discussed Treasury's Blueprint. Interestingly, the GAO was looking at reform of the U.S. financial regulatory structure well before the global crisis. *See* GAO, FINANCIAL REGULATION: INDUSTRY CHANGES PROMPT NEED TO RECONSIDER U.S. REGULATORY STRUCTURE (2004), https://www.gao.gov/products/GAO-05-61.

[85] *See* Australian Prudential Regulation Authority Act 1998 No. 50 (1998), https://www.legislation.gov.au/Details/C2014C00106/Html/Text#_Toc381004899.

administration."[86] This is hardly an inspiring vision statement for the Authority. The Act contains what looks like an objectives-based requirement to "balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, . . . promote financial system stability in Australia."[87] Yet, the existence of these abstract and multiple regulatory objectives would make derived rulemaking (based on article 8(2)) extremely difficult. In other words, one could hardly imagine the Authority promulgating a rule about the central clearance of derivative transactions based on the authority of the singular and concrete mandate derived from article 8(2). Yet, if we must point to one article in the Act as the objectives-based legislative mandate for the Authority's function, article 8(2) of the Prudential Regulation Authority Act would provide the natural candidate.[88]

The UK's Financial Services Act could not provide a starker contrast to the way legislation defines objectives, rather than organizations and their processes. Figure 10 shows the objectives defined in various parts of the UK 2009 Banking Act.[89] Objectives appear scattered across various parts of the Act. In the case of special resolution regimes, the Act outlines the objectives—leaving the Treasury to issue a Code of Practice.[90] In the case of bank insolvency, the Act provides liquidators with general powers, which they use to achieve their objectives.[91] With regard to bank administration, the Act makes plain that "a bank administrator may do anything necessary or expedient for the pursuit of the Objectives."[92]

Figure 10: The UK's Legislative Design of Objectives-Based Twin Peaks Regulatory Structure: The Financial Conduct Authority

<table>
<tr><th>Part I: Special Resolution Regime</th><th>Objectives and Code</th><th>4. Special Resolution Objectives</th></tr>
<tr><td colspan="3">The Act provides the UK's Treasury, Financial Services Authority, and Bank of England with stabilisation powers, use of bank insolvency procedures, or bank administration procedures to (in no particular order):
• Protect and enhance the stability of the UK's financial systems (objective 1)
• Protect and enhance public confidence in the stability of the banking systems of the United Kingdom (objective 2)
• Protect depositors (objective 3)
• Protect public funds (objective 4) and</td></tr>
</table>

[86] *Id*. at 8(1) (alteration in original).

[87] *Id*. at 8(2).

[88] We could have done the same analysis for the Australian Securities and Investments Commission Act. In order to keep our paper at a readable length, we will focus our discussion mostly on prudential regulatory legislative provisions rather than business conduct ones. *See* Australian Securities and Investments Commission Act 2001 No. 51 (2001), https://www.legislation.gov.au/Details/C2013C00002.

[89] *See* Banking Act c.1 (2009), http://www.legislation.gov.uk/ukpga/2009/1/contents.

[90] *Id*. at 5.

[91] *Id*. at 75–76.

[92] *Id*. at 108.

• Avoid interfering with property rights in contravention of a Human Rights Act convention right (objective 5). The order in which the objectives are listed in this section is not significant; they are to be balanced as appropriate in each case.		
Part II: Bank Insolvency	Process of Bank Liquidation	99. Objectives
Bank liquidators should pursue two objectives (with objective 1 taking precedence over objective 2): • Work with the Financial Services Compensation Scheme to ensure that eligible depositors either have their accounts moved to another financial institution or receive payment from the Scheme (objective 1) • Wind up the bank's affairs for the greatest benefit of the bank's creditors (objective 2).		
Part 3 Bank Administration	Introduction	137-140. Objectives
The Act provides bank administrators with two objectives (with the first objective taking priority), • Provide support for commercial purchaser or bridge bank (objective 1), and • Provide "normal" administration (objective 2). If the purchaser or "normal" administration is no longer required, these objectives cease to exist.		
Part 5 Inter-Bank Payment Systems	Regulation	188. Principles
The Bank of England may publish–after receiving the Treasury's okay–any principles it deems appropriate.		

The figure provides a plain English explanation of the legislation, omitting original formatting. *See* original for exact measures and specific language.

Source: UK 2009 Banking Act

The organic provisions governing the UK's Twin Peaks regulators also revolve around defining objectives—leaving the new organizations to define their own rules. Figure 11 shows an example of legislation creating the UK's Financial Conduct Authority (though we could have presented the Prudential Regulatory Authority without any change in the tenor of our analysis).[93] As shown, the Act outlines three objectives (sections 1C-1E). The Act further devolves rulemaking authority to the Financial Conduct Authority (in section 1K). Rather than defining the Authority's powers and processes in a detailed manner, the Act authorizes a number of panels to oversee the Authority's work (sections 1N-1Q). The Act thus

[93] *See* Financial Services Act 2012 c.21, Part 2, at 6 (amending sections 1 to 18 of the Financial Services and Markets Act 2000 as part 1A Chapter 1), http://www.legislation.gov.uk/ukpga/2012/21/part/2/crossheading/financial-conduct-authority-and-prudential-regulation-authority/enacted.

uses ex-post evaluation—rather than ex-ante rulemaking—as the main way of regulating the regulator.

Figure 11: The UK's Legislative Design of Objectives-Based Twin Peaks Regulatory Structure: The Financial Conduct Authority

Provision	Location
Overview 1. defines overall objective "ensuring that the relevant markets function well" 2. provides requirement to uphold the "strategic objectives" defined in the Act 3. gives authority to engage in rulemaking needed to ensure fulfilment of objective	1B
Consumer Protection Objective Defines an 8 part list of **principles** which the Authority should keep in mind when regulating)	1C
Integrity Objective Defines 5 part inclusive list of characteristics defining integrity of the "UK financial system"	1D
Competition Objective sets out a 5 part **criteria** for assessing "effective competition in the interests of "financial consumers"	1E
Definitions which define Authority's jurisdiction	1F-1I
Power to Amend Objectives Treasury may amend	1J
Rulemaking authority	1K
Duty to engage in supervision	1L
Duty to Consult	1M
Authority Oversight Defines a group of panels that oversee the Authority's work	1N-Q
Right to Conduct Market Review	1S
Authority to Obtain Documents Needed for Reviews	1T

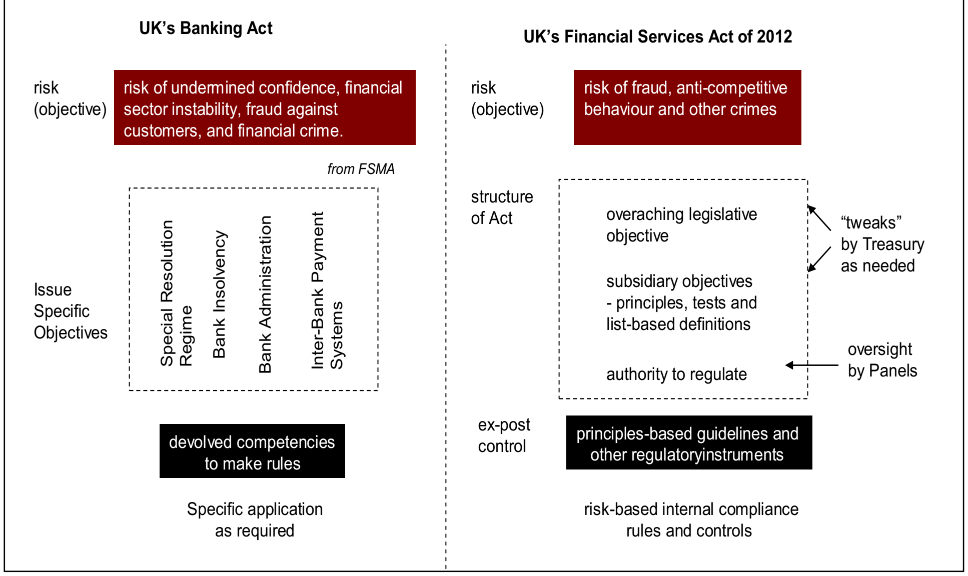
The figure provides a paraphrasing of the provisions of the relevant sections of the 2012 Financial Services Act (Part 2 amending the Financial Services and Markets Act of 2000). The reader should consult the original text for authoritative text.

Objectives-based legislation thus sets general objectives (tied to risks) and allows regulators to adopt rules which achieve those objectives.[94] As if to belabour

[94] Omarova and Feibelman represent perhaps some of the most avid proponents of designing a financial sector regulatory structure around objectives. At the risk of over-interpreting their proposal, they suggest starting from a clean slate–first deciding on regulatory objectives and then designing regulatory agencies

the point, Figure 12 summarizes our presentation of several pieces of the UK's objectives-based financial sector legislation in graphical form. The legislation focuses on risks identified by regulators and the public during the legislative process.[95] Besides initial identification of risks by government agencies, like Treasury, business and civil society groups have their say on the risks and objectives targeted by the Twin Peaks legislation.[96] In the Banking Act, various policy areas have their own objectives (defined in different parts of the Act). In the case of the Financial Services Act, the section outlining the Financial Conduct Authority places all the objectives up front. In each case, the relevant executive (or public sector) agencies charged with obtaining the objectives receive authority to engage in delegated legislation. As we will see in the upcoming sections, administrative agencies often further devolve rulemaking—in the form of risk-based or principles-based regulation—on financial institutions directly.

Figure 12: A Schematic Depiction of the UK's Objectives-Based Financial Regulation



around those objectives. *See* Saule Omarova & Adam Feibelman, *Risks, Rules, and Institutions: A Process for Reforming Financial Regulation*, 39 U. MEM. L. REV. 881 (2009).

[95] Some of these can be seen in preliminary documents leading up to the passage of the Financial Services Act. *See* UK TREASURY, TREASURY - TWENTY-SIXTH REPORT, FINANCIAL CONDUCT AUTHORITY (2012), https://publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1574/157402.htm. *See also* TREASURY, TREASURY - TWENTY-EIGHTH REPORT: FINANCIAL CONDUCT AUTHORITY: REPORT ON THE GOVERNMENT RESPONSE (2012), https://publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1857/185702.htm.

[96] In the case of the establishment of the Financial Conduct Authority, the House of Commons heard testimony from almost seventy persons and organizations–including names like the City of London Corporation, AXA UK, Financial Services Practitioner Panel, Aviva, and others.

One attraction of objectives-based legislation lay in the ability to devolve responsibility for achieving the objectives to industry in the form of principles-based regulation.[97] Objectives-based legislation would obviously provide the objectives for use in principles-based regulation.[98] Figure 13 shows how objectives (as enshrined in the UK's principles-based regulation) translate into outcomes—and how financial institutions—like Lloyds Banking Group ("Lloyds")—translate these outcomes into their own principles.[99] In this particular example, the Financial Services Authority's *Business Principles* led to the publication of a guidance document for use by UK financial institutions.[100] This provides further guidance for the general objectives set out by the regulator. Each financial institution responds to the regulators' objectives and principles in their own internal policies. We show the five "pillars" (or objectives) that Lloyds used to translate national regulatory objectives into its own specific objectives (and specific policies, which we do not show in the figure).[101] Objectives "cascade" from national regulator to financial institution.

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[97] Authors like Ford have argued principles-based regulation represents a new governance paradigm. Indeed, objectives-based legislation may represent the same new governance paradigm at the legislative level that principles-based regulation provides at the rulemaking level. *See* Cristie Ford, *New Governance, Compliance, and Principles-Based Securities Regulation*, 45 AM. BUS. L. J. 1 (2008), http://www.cccucuta.org.co/uploads_descarga/desc_725679340f90dc19a918613be1317850.pdf.

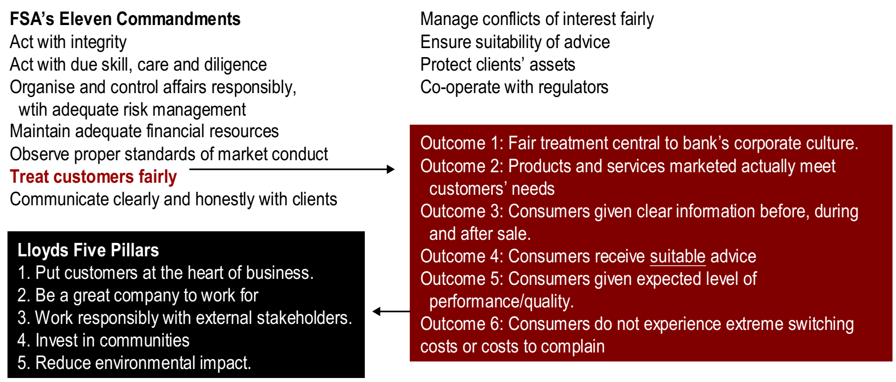
[98] Professor Di Lorenzo argues that regulations must have "legislative congruence" in order to comply with the statute's dictates while achieving the objectives that legislators sought in the first place. Naturally, any system that just "passes on" objectives from legislators' podiums to regulators desks (or directly passes objectives from the statute to the rulebook) achieves such congruence more efficiently. *See* Vincent Di Lorenzo, *Principles-Based Regulation and Legislative Congruence*, 15 N.Y.U. J. LEGIS. & PUB. POL'Y 45 (2012).

[99] Unsurprisingly, the simple illustration we provide grossly simplifies the way regulations (and particularly principles-based regulations) promulgate through the financial system. Black discusses the various channels used while Cunningham even questions the use of the term "principles-based" as a valid description. *See* Julia Black, *The Rise, Fall and Fate of Principles Based Regulation*, LSE LEG. STUD. WORKING PAPERS 17/2010 (2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1712862; Lawrence Cunningham, *Prescription to Retire the Rhetoric of Principles-Based Systems in Corporate Law, Securities Regulation, and Accounting*, 60 VAND. L. REV. 1409 (2007).

[100] *See* FSA, PRINCIPLES-BASED REGULATION: FOCUSING ON THE OUTCOMES THAT MATTER (2007), https://www.fca.org.uk/old-fsa-website; FSA, TREATING CUSTOMERS FAIRLY – TOWARDS FAIR OUTCOMES FOR CONSUMERS (2006), https://www.fca.org.uk/publication/archive/fsa-tcf-towards.pdf. We refer to FSA rulemaking, as the Financial Services Authority did not just disappear overnight when the UK's Twin Peaks regulators appeared.

[101] *See* Lloyds Banking Group, *Code of Personal Responsibility* (2013), https://www.lloydsbankinggroup.com/globalassets/documents/our-group/responsibility/policies-and-codes/code_of_personal_responsibility.pdf.

Figure 13: From Principal to Outcome in the Defunct Financial Services Authority Regulatory Regime



Source: paraphrased from FSA (2007), FSA (2006) and Lloyds Banking Group (2013).

Principles-based financial sector regulator has its proponents and detractors. Many authors note that principles-based regulation (if supported better by regulatory enforcement) could have mitigated some of the worst parts of the 2007–08 crisis. Ford, in her analysis of the UK's principles-based regulation, argues that inadequate enforcement—rather than the nature of principles-based regulation in itself—led to inadequate regulator responses to the crisis.[102] Yet others note that the UK's controversial experience with principles-based financial sector regulation provides some lessons for other countries—like Hong Kong. The biggest criticism of principles-based regulation comes from the uncertain responses companies had in implementing the new rules.[103] An equally valid critique has been that principles-based regulation has coincided with "light touch" regulation.[104] To sum up the prevailing view from the literature, *principles-based regulation thus trades regulatory simplicity for decreased certainty about what the regulator will accept ex-post as financial institutions' response to regulation*.[105]

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[102] Cristie Ford, *Principles-Based Securities Regulation in the Wake of the Global Financial Crisis*, MCGILL L. J. 55 (2010), https://works.bepress.com/cristie_ford/2/.

[103] Authors like Conceicao and Gray warned that companies might have difficulty drafting internal rules based on abstract principles. They were right. *See* Carlos Conceicao and Rosalind Gray, *Problems of Uncertainty - The FSA Cannot Underestimate the Risk of Fewer Rules Creating More Fear and Less Innovation*, 26 INT'L FIN. L. REV. 42 (2007).

[104] *See* Julia Black, *Forms and Paradoxes of Principles-Based Regulation*, 3 CAP. MAR. L. J. 4 (2008). For the media's analysis of the confusion between principled-based and light-touch regulation, *see* Harry Wilson, *Hector Sants Calls Time on FSA's 'Light Touch' Regulation*, TELEGRAPH (Mar. 12, 2010), https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/7431645/Hector-Sants-calls-time-on-FSAs-light-touch-regulation.html.

[105] To continue with our example from Lloyds Banking Group, the recent fines for treating customers unfairly shows how banks can see and implement regulators' controls, but misjudge whether they have reacted

The literature suggests two things about the way that objectives-based financial sector legislation would translate into regulations and thus financial institutions' internal policies. First, objectives-based legislation—and attendant principles-based regulation—could allow for a greater regulatory focus on risks. Clearly, more and tighter regulations should govern areas of financial sector activity with higher risks—leaving less risky areas relatively under-regulated.[106] By focusing on objectives rather than on processes, financial institutions can spend more time and energy drafting complex internal regulations controlling complex risks—leaving less risky areas with fewer (lighter) rules. Second, such policies would shift competencies for financial section regulation directly onto financial institutions—increasing costs as well as risks.[107] Allowing banks and broker-dealers to regulate themselves (self-regulation) seems counterproductive. However, as shown in Figure 14, the cost and benefits of such an approach will depend on a number of variables. Depending on the values of the variables described in the figure, either a rules-based or principles-based approach will work better. The best system depends on the country in question.

Figure 14: Factors affecting whether an objectives-based financial sector legislation and regulation would outperform a rules-based approach

variable	way variable affects objectives-based legislation
Number of government regulators needed	As the number of regulators rises, their cost increases, making the country's regulatory regime more expensive. Moreover, the taxes raised to pay their salaries may reduce financial sector and overall economic growth.
Relative efficiency of government versus banks' legal departments and economics department staff	Nothing requires regulators to have superior abilities to draft regulations based on legislation and analyse regulatory impacts better than in-house counsel and economists. Bank-based analysts (if they have long time-horizons) have stronger personal financial incentives to strike the right balance between prudence and profit.

correctly. Lloyds put in place incentive schemes designed to increase sales which the FCA thought, "led to a serious risk that sales staff were put under pressure to hit targets to get a bonus or avoid being demoted, rather than focus on what consumers may need or want." *See* FCA, *FCA Fines Lloyds Banking Group Firms a Total of £28,038,800 for Serious Sales Incentive Failings* (Dec. 11, 2013), https://www.fca.org.uk/news/press-releases/fca-fines-lloyds-banking-group-firms-total-£28038800-serious-sales-incentive.

[106] For a review of the promises of risk-based regulation (and a review from several jurisdictions), *see* Julia Black, *The Development of Risk Based Regulation in Financial Services: Canada, the UK and Australia* (2004), http://www.lse.ac.uk/collections/law/staff publications full text/black/risk based regulation in financial services.pdf.

[107] Regulators using financial institutions to regulate for them represents a way to leverage public resources—which in the private sector context is called "leveraging off the client." Authors like Omarova see strong incentives for financial firms to create optimal self-regulation that minimises systemic risks. *See* Saule Omarova, *Wall Street as Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411 (2011). Authors like Helm are not convinced. *See* Dieter Helm, *Regulatory Reform, Capture, and the Regulatory Burden*, 22 OXF. REV. ECON. POL. 2 (2013).

Cooperation between compliance departments	Cooperation—through a national banking association for example—can ensure financial institutions' in-house counsel and economists do not create institution-specific rules from scratch. By communicating, they can agree on fundamental provisions in all financial institutions' policies. Naturally, free-riding and collective action problems may make the costs of such cooperation exceed the benefits.
Relative asymmetry of shocks between financial institutions	To the extent that financial institutions require differing responses to shocks (for example one bank will suffer more than others from a change in interest rates), delegated rule-making may allow them to better tailor a response.
Reduction in profits from rules	McKinsey estimates that return on equity from banks will fall from 20% to 7% due to lower profits and quantities traded from new financial sector regulations.[108] The more firms can tailor their own rules, the less this damage from excess rulemaking.
Marginal change in financial institutions' staff time dealing with compliance rather than policy writing	Financial institutions will need to adjust their policies, no matter which regulatory approach used. If these institutions need about the same amount of time to create substantive rules as to simple adopt policies to comply with prescriptive rules, then companies should just write these substantive rules for themselves.
Relative effectiveness of self-written rules on reducing the probability of financial distress	The benefits of regulator-written rules versus industry (or company) written rules depends on whose rules provide better protection against systemic and other risks (while offering the possibility of profit). If financial institutions write better rules, then clearly they should have self-regulatory powers.
Relative monitoring and punishment costs under principles-based vs. rules-based regime	Rules control risks only if financial institutions follow them. If financial institutions can ignore regulators' rules (due to low detection probabilities or penalties), self-regulation of a principles-based system could provide superior results.

[108] Markus Böhme, et al., *Day of Reckoning? New Regulation and its Impact on Capital-markets Businesses*, MCKINSEY WORKING PAPERS ON RISK, NUMBER 29 (2011), https://www.mckinsey.com/~/media/mckinsey/dotcom/client_service/Risk/Working%20papers/29_Day_of_reckoning.ashx.

The figure shows the factors that would determine whether the costs and benefits of a government regulator promulgating specific financial sector rules would exceed those of a decentralized approach (with firms deciding specific policies that comply with general objectives). We do not show the actual equation(s) in order to keep the paper readable for a general audience. We do not show concrete results (using simulation or regression analysis) due to lack of data. We assume that government regulators and professionals working in financial firms earn the same salaries.

III. CONCLUSION

In this paper, we argued that objectives-based legislation may help solve some difficult executive agency organizational problems which have stumped legal, public administration, and economics scholars. Objectives-based regulation could change the way lawmakers and regulators see the role of law in implementing government policies. When tackling complex risks (like security or financial stability), lawmakers passed a range of legislation with competencies and obligations assigned to a range of government agencies. Recent legal scholarship around the objectives-based Twin Peaks financial regulation challenges the usual view of legislating. Such legislating sets out social (financial) risks, defines particular statutory objectives and creates executive agencies to achieve those objectives. Such an approach promises to reduce the complex and sometimes ineffective inter-agency collaborations which bedevil public administration.