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978-1-107-18642-2 — The Cambridge Handbook of Twin Peaks Financial Regulation
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THE CAMBRIDGE HANDBOOK OF TWIN PEAKS FINANCIAL REGULATION

First proposed in 1994, the Twin Peaks model of financial system regulation employs two specialist peak regulators: one charged with the maintenance of financial system stability and the other with market conduct and consumer protection. This volume, with contributions from more than thirty scholars and senior regulators, provides an in-depth analysis of the similarities and differences in the Twin Peaks regimes that have been adopted around the world. Chapters examine the strengths and weaknesses of the model, provide lessons from Australia (the first to adopt the model) and offer a comparative look at the potential suitability of the model in leading non-Twin Peaks jurisdictions. A key resource for central bankers, public policy analysts, lawyers, economists, politicians, academics and students, this work provides readers with a comprehensive understanding of the Twin Peaks model and a roadmap for countries considering its adoption.

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The Cambridge Handbook of Twin Peaks Financial Regulation

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University Printing House, Cambridge CB2 8BS, United Kingdom

One Liberty Plaza, 20th Floor, New York, NY 10006, USA

477 Williamstown Road, Port Melbourne, VIC 3207, Australia

314–321, 3rd Floor, Plot 3, Splendor Forum, Jasola District Centre, New Delhi – 110025, India

79 Anson Road, #06–04/06, Singapore 079906

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www.cambridge.org
Information on this title: www.cambridge.org/9781107186422
DOI: 10.1017/9781316890592

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First published 2021

A catalogue record for this publication is available from the British Library.

Library of Congress Cataloging-in-Publication Data
NAMES: Godwin, Andrew, editor. | Schmulow, Andrew, 1970– editor.
TITLE: The Cambridge handbook of Twin Peaks financial regulation / edited by Andrew Godwin, Melbourne Law School; Andrew Schmulow, University of Western Australia School of Law.
DESCRIPTION: Cambridge, United Kingdom ; New York, NY : Cambridge University Press, 2021. | Series: Cambridge law handbooks | Includes bibliographical references.
IDENTIFIERS: LCCN 2020042870 (print) | LCCN 2020042871 (ebook) | ISBN 9781107186422 (hardback) | ISBN 9781316890592 (epub)
SUBJECTS: LCSH: International finance–Law and legislation. | Financial institutions, International–Law and legislation. | Banks and banking, International–Law and legislation.
CLASSIFICATION: LCC K4444 .C36 2021 (print) | LCC K4444 (ebook) | DDC 343/.03–dc23
LC record available at https://lccn.loc.gov/2020042870
LC ebook record available at https://lccn.loc.gov/2020042871

ISBN 978-1-107-18642-2 Hardback

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Foreword

Howell E. Jackson[*]

Scholarship on financial regulation tends to focus on legal standards for safeguarding the solvency of financial institutions or protecting the public from misconduct in financial transactions. When it comes to regulatory design, the most commonly studied topic is the development of regulatory networks that have emerged in recent decades to create an international financial architecture. Much less attention has been focused on the evolution of the organisational structure of supervisory agencies at the national level, even though that is where the lion's share of regulation is done. Work of this sort is immensely challenging, as it is inherently comparative and requires expertise and experience across a host of jurisdictions. In this volume, Andrew Godwin and Andrew Schmulow fill that gap by offering the first comprehensive examination of one of the most significant organisational innovations in financial regulation of the past quarter-century: the emergence of the Twin Peaks regulatory structure.

During the final decades of the twentieth century, as the boundaries between the traditional financial sectors of banking, securities and insurance began to merge and financial firms increasingly operated in multiple sectors, policymakers were led to explore new regulatory structures that also move beyond traditional sectoral boundaries. While some jurisdictions, such as Japan and several northern European countries, took the fairly straightforward step of combining sectoral agencies like banking departments and securities commissions into a single consolidated body, others chose the more innovative Twin Peaks approach, which deconstructs sectoral agencies and reassembles the resources into a pair of industry-wide bodies: one focused on market conduct requirements that protect customers and market structures, and a second targeted at the prudential regulations that ensure the safety and soundness of financial firms. In addition to breaking down entrenched supervisory silos, Twin Peaks reforms allow for both regulatory specialisation and the reduction of persistent conflicts between consumer protection mandates – which tend to reduce firm profitability – and solvency concerns – which lead supervisors to favour strong firm earnings.

While the theory underlying Twin Peaks oversight is elegant and compelling, the actual manner in which the Twin Peaks regimes have been implemented has varied considerably across jurisdictions and now, after more than two decades of experience, the time is ripe to investigate how the Twin Peaks model works in practice, and where the challenges lie. Originally the brainchild of former Bank of England official and volume contributor Michael Taylor, Twin Peaks had its first and most fulsome implementation with the Australian Securities

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and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA). As this volume so nicely documents, the model has been taken up in an increasing number of jurisdictions over the years, from the Netherlands to New Zealand, eventually even finding its way back to Albion shores in the post-financial crisis reforms of the past decade. Interestingly, the Twin Peaks approach has now also been adopted in South Africa, perhaps heralding a trend towards Twin Peaks structures in the developing world. While the United States remains, as always, an outlier, Professor Schooner's chapter documents the extent to which one can even see glimmers of Twin Peaks arrangements in America's Byzantine regulatory structure.

The Cambridge Handbook of Twin Peaks Financial Regulation does an admirable job of reconstructing the history of the Twin Peaks revolution, with contributions from those who were present at the founding, as well as expert commentators on all of the major jurisdictions that have adopted the Twin Peaks regime, along with several others from jurisdictions likely headed in that direction in the near future. With this volume, the readers will find a richly documented education of the paths that Twin Peaks reforms have followed, as well as the most promising steps forward. One of the virtues of this collection is that it includes chapters exploring the implications and potential value of Twin Peaks reforms for countries such as Israel or China that maintain more traditional regulatory structures. The influence of Twin Peaks reforms extends well beyond the model's formal adoptions. The collection also illustrates, with admirable clarity, the principal difficulties of implementing an effective system of Twin Peaks oversight.

A recurring theme in the volume is the importance of coordination across Twin Peaks regimes, which necessarily involves overlapping supervision of many firms by both the market conduct authority and the prudential regulatory authority. Complete separation of regulatory objectives is impractical and so the principal operating units in a Twin Peaks regime need to find ways to work in harmony. In certain respects, this problem of coordination is similar to the one that national authorities face in cross-border supervision, and the various mechanisms documented in the volume employ a number of familiar instruments, including memoranda of understanding and documentation of shared principles. While the need for coordination may strike some readers as a weakness of the Twin Peaks approach, one must recognise that similar, if not more confounding, issues of coordination are faced in sectoral models of regulation, where financial conglomerates are also subject to overlapping jurisdictions. Even within consolidated regulatory bodies, coordination must be imposed across operational divisions, so the question is not whether supervisory coordination is required, but rather whether the coordination is more easily and efficiently accomplished through Twin Peaks models, as opposed to organisational alternatives.

A second question about Twins Peaks regimes, touched upon in multiple chapters, is whether financial regulation can really be divided into just two peaks or whether, in fact, macroprudential regulation focusing on systemic risk represents a third peak, and perhaps financial crime/anti-money laundering constitutes at least another foothill. Throughout the volume this tension plays out most clearly in discussions of the appropriate relationship between the central bank/monetary authority and the prudential regulatory authority. As the chapters explore, a variety of approaches are possible, including embedding the prudential authority within the central bank (as is done in the United Kingdom) or imposing structural distance (as is true in Australia). Weaknesses in prudential restraints, as well as widespread market misconduct of the sort preceding the Global Financial Crisis, can pose systemic risks, thus arguing in favour of a tight connection between central bank officials and Twin Peaks agencies. On the other hand, regulatory focus is one of the key virtues of Twin Peaks reforms and blurring the lines between

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monetary authorities and supervisory agencies can muddle matters. Moreover, especially in times of economic stress, there are advantages in separation, as conflicts can emerge with macroprudential concerns focused on avoiding pro-cyclical policies, and the prudential authority's responsibilities for ensuring the solvency of individual firms. There is no consensus on this issue, but proper integration of Twin Peaks agencies with the third peak of macroprudential oversight is an important design consideration.

Beyond the question of how closely Twin Peaks agencies should be anchored to monetary authorities, there is a separate design issue of how far out into the real economy the regulatory perimeters of regulatory agencies should extend. While sectoral agencies are naturally bound to specific institutional structures, like banks or insurance companies or securities firms, Twin Peaks supervisors are grounded in regulatory objectives: firm solvency and market misconduct. As several chapters explore, one of the advantages of Twin Peaks systems is that they are better suited to reach beyond traditional sectors to areas such as finance companies (New Zealand) or Fintech innovations (Hong Kong). With the rise of big tech and the ever-rising importance of various flavours of shadow banking, the comparative advantages of Twin Peaks structures should continue to grow. Objectives-based supervision may just be a better fit for the twenty-first-century economy.

For scholars, students, policymakers and practitioners, *The Handbook* provides both an invaluable history and a stimulating window into what the future might hold.

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Cambridge University Press
978-1-107-18642-2 — The Cambridge Handbook of Twin Peaks Financial Regulation
Edited by Andrew Godwin , Andrew Schmulow
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Acknowledgements

This book has been as much a journey for us as it has been a destination and there are many people to whom we owe irredeemable debts of gratitude. First, our sincere thanks go to Michael Taylor for his pioneering inspiration and generous suggestions as to who might be able to join us on our trek. We are also grateful to our research colleagues who have supported us throughout the process of researching Twin Peaks: Timothy Howse, Malcolm Anderson, Chenjie Ma, Amy Feng, Tom Monotti, Timothy Tabalujan and James Occleshaw. We are indebted to our employer institutions – the University of Melbourne and the University of Wollongong – for their support and for providing us with the time and funds to pursue this research project. We are also indebted to the University of Pretoria and, in particular, Corlia van Heerden and her colleagues in the Department of Mercantile Law for inviting us to the Twin Peaks Colloquium in 2017 and for providing us with access and insights into South Africa's transition towards Twin Peaks, and to colleagues in the South African National Treasury, and in particular Roy Havemann, for inviting us to participate in the design and implementation of the Twin Peaks model in South Africa.

We are immensely grateful to Matt Gallaway and the team at Cambridge University Press for their invitation to us to publish such a book and for their patience and support in what has been a much longer trek than we had originally anticipated.

Last, but certainly not least, we are grateful to the contributors and to other fellow travellers who have encouraged us along the journey towards Twin Peaks, including Eddy Wymeersch, Howell Jackson, Emilios Avgouleas, Parker Hood, Yuan Kang and Kevin Davis.

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