Unified Financial Services Regulation

The Unfolding Debate

By Dr. Kenneth K. Mwenda

The main thrust of the academic debate concerning unified financial services supervision was started in the UK. More recently, international organizations have taken an interest in the subject. Some of the issues, on unified financial services supervision, confronting countries the world-over are whether to adopt unified supervision and, if so, how to structure the institutional and regulatory framework for unified agencies. At the outset, it must be pointed out that issues of regulatory organization are essentially second order issues. Far more important-and the first order issue-is the implementation of financial regulation, in particular supervisory capacity and its quality and the soundness of the legal framework underlying the regulatory process.

Over the years financial regulation and supervision in many countries has been organized around specialist agencies that have distinct and separate responsibilities for banking, securities and insurance sectors. But there has been an apparent trend towards restructuring the financial supervisory function in many countries in recent years, and in particular unified regulatory agencies-that is, agencies that supervise two or more of these areas.

This article provides an exploratory study of some of the more recent contributions to the debate on unified financial services supervision. The article shows that unified financial services supervision has been adopted differently in many countries and that its application has varied from country to country. There is, indeed, no single right way of introducing or implementing unified models of financial services supervision. In Africa, for example, Mauritius has legislation which provides for the establishment of that country's unified financial services regulatory agency. South Africa, too, has a model of [partially] unified financial services supervision. In the case of South Africa, the securities and insurance sectors have a common regulator, while banks are regulated by a specialist agency. In Nigeria, the regulation of pension funds and banking business is undertaken within the same regulatory agency, while the regulation of securities and insurance business is done by separate agencies. Zambia is another

African country that has a partially unified supervisory system. While the Central Bank of Zambia regulates financial institutions such as banks, building societies and bureau de change, the Zambia Securities and Exchange Commission is responsible for securities regulation. The experience of Africa, hitherto, shows that a good number of African countries are leaning towards partial unification.

Worldwide, experience shows that in order for a country to manage effectively the transition to a unified supervisory agency, one of the factors to consider includes the effective and efficient co-ordination of information sharing among the major stakeholders in the unified supervisory system, namely, the Ministry of Finance, the central bank, and the unified supervisory agency. Also, if there is an independent deposit insurance agency and an independent payments and settlements clearing agency, they, too, must be consulted. Co-ordination and consultation here provides for efficient means of sharing information between the various stakeholders.

Indeed, different countries have approached the introduction and implementation of unified financial services supervision differently. In those countries where segments of the financial sector are quite inter-connected, a good case of moving towards unified supervision exists. In these countries, the nature of banking and financial services business is often developing and encompasses more complex and multi-functional operations. However, until there is a longer track record of experience with unified agencies, it is difficult to come to firm conclusions about the restructuring process itself, and the optimal internal structure of such agencies.

A network of unified supervisors, comprising mainly supervisors from developed countries and transition economies, has now been set up. Members of this network have been meeting in various parts of the world to share, among other things, some lessons on unified financial services supervision. In July 2001, a meeting held in Tallinn, Estonia, organized by the supervisory agency of Estonia-in collaboration with the World Bank-also brought together a group of practitioners from unified agencies. A number of papers presented at this conference provided more up to date discussions on apparent trends in unified supervision world-wide.

Mwenda and Fleming (2001), taking stock of the various contributions by scholars and practitioners prior to 2001, examine the institutional and structural issues facing unified financial services agencies in the United Kingdom, Canada, Hungary, Iceland and Scandinavian countries. The learned authors argue that, although a good case of moving towards unified supervision exists in countries where segments of the financial sector are quite inter-connected, until there is a longer track record of experience with unified agencies, it is difficult to come to firm conclusions about the restructuring process itself and the optimal internal structure of such agencies.

Kawai (2001) observes that the international body responsible for setting international standards on banking supervision differs from the international bodies responsible for setting international standards on insurance and securities regulation, respectively. He argues that while the Basle Committee for Banking Supervision is responsible for banking supervision standards, the International Association of Insurance Supervisors (IAIS) is responsible for insurance standards and the International Organization of securities Commissions (IOSCO) for securities regulatory standards. Kawai argues that while insurance supervisors, for example, focus more on techniques for assessing 'risk', securities regulators are pre-occupied with 'information disclosure' requirements. However, to promote economies of scope here there is need to coordinate risk management by pulling together the efforts of all these three bodies.

Trink (2001:3) observes that it is not the institutional structure of the regulator that creates effective and efficient supervision. The institutional structure serves only as a prerequisite for effective and efficient financial services supervision. In Estonia, as part of the preparations for setting up a unified regulator, it was argued that (see Trink 2001:4) 'in a small economy, the unified agency should first, be better able to supervise large financial groups, since the Estonian financial sector is very much dominated by a few universal banks active in all seg-

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Worldwide, experience shows that in order for a country to manage effectively the transition to a unified supervisory agency, one of the factors to consider includes the effective and efficient coordination of information sharing among the major stakeholders in the unified supervisory system.

With the setting up of an integrated supervisory authority in Estonia (see Kraft 2001:8), the Bank of Estonia will now be working closely with this new agency. The Bank of Estonia will, however, retain the responsibility of regulating the banking sector. Kraft (2001:10) argues that since the pan-European consolidation of the banking industry in Europe has resulted in rapid increase of cross-border ownership of banks, the question of co-operation between central banks and supervisors is now a key factor in maintaining sound financial systems.

In Norway, one of the reasons for establishing an integrated supervisory authority (Halvorsen 2001:4) was to strengthen the supervision of insurers. In Ireland, by contrast, a number of factors made the reform of the Irish regulatory system a political imperative. In Ireland's case, as McDowell (2001:4) observes, first, the increasing pace of integration, on an international and European level, of banking and insurance services, and, secondly - and not wholly unrelated - the establishment in Dublin of the International Financial Services Centre (IFSC) were both factors that provided an impetus for the unification of financial services supervision. A third factor was a public perception in Ireland that financial regulation was being conducted by the central bank and by the insurance regulatory mechanism with a primary focus on solvency and prudential matters and

debate on the introduction of a unified regulator in each country inevitably reflects country-specific factors and the currently prevailing institutional structure. He points out arguments which have influenced countries to set up unified regulators, and these include the emergence of financial innovation and structural change in the financial system; the emergence of financial conglomerates; the occurrence of financial failures; the complexity and extensiveness of objectives behind regulation in some countries; the emergence of new financial markets; and the increasing internationalization of financial operations. In setting up the institutional structure of a regulatory system, Llewellyn (2001:4) observes, a country should consider issues such as the appropriate number of regulatory agencies; the appropriate structure of regulatory agencies (that is, which firms and functions are to be allocated to which agencies, and how the objectives for each agency are to be defined); the degree of co-ordination, co-operation and information sharing between different agencies; the effect of the institutional structure on the cost of regulation; the role of competition authorities in the regulatory process; the role to be given to self-regulation and mechanisms for practitioner in-put; the institutional mechanisms for facilitating efficiently the international co-ordination and co-operation of national regulatory agencies; and the independence and accountability of the regulatory agencies.

Llewellyn (2001:7-8) proceeds to advance reasons in support of the introduction of a unified regulator. On the one hand, he argues in favor of prospects for: (a) the introduction of economies of scale within the regulatory agency (most especially with respect to skill requirement); (b) the introduction of economies of scope (or synergies) to be reaped between different functional areas of regulation; (c) the introduction of a simplified single regulator whose system of operation is user-friendly to firms being regulated and to consumers as well; (d) the introduction of a regulatory structure which mirrors the business of regulated institutions; (e) the avoidance of problems of competitive inequality, inconsistencies, duplication, overlap, and gaps which can arise with a regime based upon several agencies; (f) the rational utilization of scarce human resources and expertise; (g) more effective accountability under a single (and simplified) regulatory agency; and (h) the reduction of costs imposed upon regulated firms to the extent that these firms would need to deal with only a single regulator.

On the other hand, Llewellyn is quick to point out some of the possible shortcomings of a unified regulator. He observes (2001:9-10) that such shortcomings include the views that there can be: (a) erosion of traditional functional distinctions between financial institutions; (b) the lack of clear focus on the objectives and rationale of regulation (that is, not making the necessary differentiations between different types of institutions and businesses, e.g. the distinction between wholesale and retail business); (c) possibilities of cultural conflict in the unified agency since regulators come from different sectoral backgrounds; (d) possibilities of creating an overly bureaucratic single regulator that has excessive and over-concentrated power; (e) possibilities of creating a moral hazard that portrays a picture that the risk spectrum among financial institutions has disappeared or become blurred; and (f) possibilities of actually watering down the concept of 'economies of scale' by creating an inefficient and monopolistic single regulator.

Briault (2001:4) observes that in the case of the UK (a detailed study of the UK position has been provided already in this paper) the four statutory objectives of UK's newly created unified regulator, the Financial Services Authority, are as follows:
(a) to maintain confidence in the financial system;
(b) to promote public understanding of the financial system, including the awareness of the benefits and risks associated with different kinds of investment or other financial dealing;
(c) to secure the appropriate degree of protection for consumers, having regard to the degrees of risk in different kinds of investment or other transaction, the differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity, the

needs consumers may have for advice and accurate information, and the general principle that consumers should take responsibility for their decisions; and
(d) to reduce the extent to which it is possible for a financial services firm to be used for a purpose connected with financial crime.

While unified supervisory agencies in countries such as Denmark are not closely linked to operations of the central bank (see Bjerre-Nielsen 2001:11), the UK Financial Services Authority co-operates closely, and exchanges information, with the Bank of England and the Treasury. A Memorandum of Understanding, agreed and published in 1997, provides a framework for co-ordination of functions involving the UK Financial Services Authority, the Bank of England and the Treasury. A similar arrangement is present in countries such as Hungary.

Nigeria has a partial unification model. The Nigerian Federal Reserve Bank supervises, in addition to banks, pension funds. Mauritius, too, has recently gone that route, creating a unified regulatory agency. Zambia has a partial unification system; established through its focus on pension funds and insurance business supervisory agencies only. South Africa is considering a similar course of action.

It might be too early for anyone to draw firm conclusions on the experiences of the aforementioned African countries with unified financial services supervision given that this concept is relatively new to many developing countries and, in particular, to many on the continent of Africa. Regarding the continent as a whole, it is, at this time, difficult to adequately discuss the unification of financial services due to the problem of limited availability of data. Moreover, the concept of unified financial services remains a new concept in many parts of Africa and the world, including Europe.

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