International developments in the organizational structure of financial services supervision*

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* A paper presented at a seminar hosted by the World Bank Financial Sector Vice-Presidency on September 20th, 2001 (World Bank: Washington DC). The views expressed in this paper are entirely those of the authors. They do not represent the views of the World Bank, its Executive Directors, or the countries they represent.
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# TABLE OF CONTENTS

## I. DEVELOPMENTS AROUND THE WORLD ON FINANCIAL SERVICES SUPERVISION ............................................................................................................................. 1

## II. CASE STUDIES ...................................................................................................................... 6

CASE STUDY I – THE SCANDINAVIAN COUNTRIES’ EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION ................................................................. 8

CASE STUDY II – THE UK’S EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION …… 10

   - Overview and the organizational structure of financial services supervision …… 10
   - Recent developments in the UK on the regulatory framework ……………………………. 13

CASE STUDY III – CANADA’S EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION …… 14

   - Overview and the organizational structure of financial services supervision …… 14
   - OSFI’s authorization and supervision of financial institutions …………………………… 21
   - Accounting standards ……………………………………………………………………………… 22
   - The skills-mix of supervisors in OSFI …………………………………………………………… 22

CASE STUDY IV – HUNGARY’S EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION… 24

   - Overview and the organizational structure of financial services supervision …… 24
   - The era after the 1996/97 reforms in Hungary ………………………………………………… 25
   - The Hungarian Financial Supervisory Authority …………………………………………… 27
   - Some problems associated with universal banking in Hungary ……………………………. 28

CASE STUDY V – ICELAND’S EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION….. 29

   - Overview and the organizational structure of financial services supervision …… 29
   - The dynamics of institutional re-structuring ……………………………………………………. 30
   - The Board of Directors of FSA ……………………………………………………………………. 32
   - Supervision of financial institutions and the role of the Central Bank of Iceland …… 32
   - Efficacy of the legal framework: some salient features ………………………………………… 32

## III. CONCLUSION .................................................................................................................... 33

## APPENDIX .................................................................................................................................. 34
Introduction

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. As the literature review shows at the end of this paper, a number of papers and commentaries have been written on the subject of unified financial services supervision. This paper builds on this work to take stock of various developments relating to the organizational structure of financial services supervisory agencies. It seeks to provide a comparative perspective on the structural issues confronting financial services supervision around the world and, further, to set out an updated bibliography of work pertaining to this subject.

The paper consists of three main parts. Part I sets out the background, highlighting developments relating to financial services supervision worldwide. It also identifies the various countries that have either adopted or are in the process of adopting or considering the merits of some form of unified financial services supervision. In almost all the countries studied, the introduction and implementation of unified financial services supervision has varied in terms of the structural form and institutional arrangements adopted. Differences have also been seen in the management of both institutional change and the dynamics of corporate culture. In the third section of this paper, the type of institutional and structural differences that often arise when moving from a ‘specialist and separatist’ model to a ‘unified’ model are examined. In that section of the paper, a number of case studies are examined, specifically: (a) Scandinavian countries; (b) the UK; (c) Canada; (d) Hungary; and (e) Iceland. Part III provides a brief conclusion.

At the outset it is important to stress 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.

I. DEVELOPMENTS AROUND THE WORLD ON FINANCIAL SERVICES SUPERVISION

In the last few years, a number of countries have moved to integrate different supervisory functions into a single agency. Even so, in approximately half the countries examined in a July 2000 study, the regulatory structures were still based on specialist agencies, with the banking,

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insurance, and securities sectors each supervised by a dedicated agency,\(^3\) as described in the table below. The other half of the countries surveyed had combined elements of supervision in partially unified or fully unified supervisory agencies.

Table 1. The Regulatory Structures in Selected Countries as of July 2000

<table>
<thead>
<tr>
<th>Supervisory Structure</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Separate agencies for each main sector</td>
<td>35</td>
</tr>
<tr>
<td>Combined securities and insurance regulators</td>
<td>3</td>
</tr>
<tr>
<td>Combined banking and securities regulators</td>
<td>9</td>
</tr>
<tr>
<td>Combined banking and insurance regulators</td>
<td>13</td>
</tr>
<tr>
<td>Unified supervision (in central bank)</td>
<td>3</td>
</tr>
<tr>
<td>Unified supervision (outside central bank)</td>
<td>10</td>
</tr>
</tbody>
</table>


Although in a number of countries where separate supervisory agencies existed the banking supervisor was the central bank, this was not always the case.\(^4\) In the cases of South Africa and the Slovak Republic, for instance, the securities and insurance sectors had a common regulator, while banks were regulated by a specialist agency.\(^5\) Given the foregoing, it has been argued that:

“... the unified model is not as common as the recent attention it has received seem to suggest. The ten countries classified as having adopted this organizational form are Australia, Canada, Denmark, Iceland, Japan, Norway, the Republic of Korea, Singapore, Sweden, and the United Kingdom. However, in at least two cases – Australia and Canada – the regulatory structure is not fully unified as securities regulation is conducted separately from banking and insurance regulation. Moreover, in Singapore’s case, regulation has been unified within the central bank. This leaves only seven countries that have fully unified regulatory agencies separate from the central bank. Over half of these are in the Nordic countries. This observation may suggest that unified supervision has, to date, been a response to country-specific factors, and as such may not be universally applicable.”\(^6\)

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What is clear is that a number of countries are beginning to re-examine the organizational structure of their financial supervision. While these observations are quite valid there is some danger of viewing the cup as half-empty, when it might equally be considered to be half full. Increased importance is being placed on the design of efficient and effective organizational structures to support financial services supervision and in some cases this is lending to partial or full unification. The table below shows some countries that have, to date, adopted or are in the process of either adopting or considering to move towards one or other form of unified financial services supervision. These include a number of transition economies.  

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7 See M. Taylor and A. Fleming, Integrated Financial Supervision: Lessons from Northern European Experience, op. cit., p. 1. See also L. Sundararajan, A. Petersen, and G Sensenbrenner, Central Bank Reform in the Transition Economies, (Washington DC: IMF, 1997), which not only identifies some of the priorities for deepening of banking reforms in the transition economies, but also illustrates that since 1992 the central Banks of the Baltic states and the Commonwealth of Independent States have undertaken comprehensive reform of their monetary and exchange arrangements in support of their stabilization efforts, with extensive technical assistance provided by the IMF and twenty-three central banks.
Table 2. Table showing countries (as at June 2001) that have either moved towards unified supervision or are considering moving towards such a model.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Unified supervision that includes supervision of the banking sector (partially or fully)</th>
<th>Considering or mooting the idea of a unified regulator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Austria</td>
<td>X</td>
<td></td>
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<tr>
<td>Bulgaria</td>
<td>X</td>
<td></td>
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<tr>
<td>Canada</td>
<td>X</td>
<td></td>
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<tr>
<td>Colombia</td>
<td>X</td>
<td></td>
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<tr>
<td>Denmark</td>
<td>X</td>
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<tr>
<td>Ecuador</td>
<td>X</td>
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<tr>
<td>El Salvador</td>
<td>X</td>
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<tr>
<td>Estonia</td>
<td>X</td>
<td></td>
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<tr>
<td>Germany</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Guatemala</td>
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<tr>
<td>Hungary</td>
<td>X</td>
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<tr>
<td>Iceland</td>
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<tr>
<td>Ireland</td>
<td></td>
<td>X</td>
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<tr>
<td>Jamaica</td>
<td>X</td>
<td></td>
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<tr>
<td>Japan</td>
<td>X</td>
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<tr>
<td>Kazakhstan</td>
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<td>X</td>
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<tr>
<td>Korea</td>
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<tr>
<td>Latvia</td>
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<td>X</td>
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<tr>
<td>Malaysia</td>
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<tr>
<td>Malta</td>
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<tr>
<td>Mauritius</td>
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<td>X</td>
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<tr>
<td>Netherlands Antilles</td>
<td>X</td>
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<td>Nigeria</td>
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<td>Norway</td>
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<td>Pakistan</td>
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<td>Paraguay</td>
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<td>Peru</td>
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<td>Poland</td>
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<td>X</td>
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<td>Singapore</td>
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<td>Slovakia</td>
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<td>X</td>
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<td>Slovenia</td>
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<td>X</td>
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<tr>
<td>South Africa</td>
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<td>X</td>
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<tr>
<td>Sweden</td>
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<tr>
<td>Trinidad and Tobago</td>
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<tr>
<td>Turkey</td>
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<tr>
<td>Ukraine</td>
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<td>X</td>
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<tr>
<td>United Kingdom</td>
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<tr>
<td>Uruguay</td>
<td></td>
<td></td>
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<tr>
<td>Venezuela</td>
<td></td>
<td></td>
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<tr>
<td>Zambia</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>30 countries</strong></td>
<td><strong>11 countries</strong></td>
</tr>
</tbody>
</table>

Source: Compiled by the authors, with the assistance of Mr. Jeffrey Carmichael, Chairman of the Australian Prudential Regulation Authority, June 7th 2001.
In the year or so since table 1 was prepared, a number of other countries—including Germany and the Republic of Ireland—have decided on a wholesale restructuring of their financial regulatory structures. Table 2 provides a broad overview of the state of play.

There are now about 30 countries in the world that have introduced unified or partially unified financial services supervision. And the degree of unification varies widely between countries. While some of these countries have moved towards financial services integration, others—about 11 in total—are in the process of either doing so or have done so partially, or are mooting the idea.

In Africa, Mauritius has been preparing legislation which provides that the banking sector will not be included—at least, in the initial two years—in that country’s model of unified financial services supervision. South Africa, too, as noted earlier, has a model of partially unified financial services supervision. Also, Nigeria has a model of partially unified supervision. 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.

In the Pacific, Australia has a ‘twin peaks’ model of unified financial services supervision. In central Asia and the far East, Japan, Korea, Malaysia, Pakistan and Singapore are some of the countries that have introduced models of unified supervision.

Most South American countries have prudential and market conduct regulation under one roof. In countries such as Guatemala, Venezuela, Ecuador, El Salvador and Peru the regulators operate out of organizational silos with very little integration in practice. In the Caribbean, Jamaica’s unified regulator is now operational, while Trinidad and Tobago seem to be developing along similar lines.

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8 E-mail received by the authors from Mr. Jeffrey Carmichael, Chairman of the Australian Prudential Regulation Authority, June 3, 2001.
10 E-mail received by the authors from Mr. Jeffrey Carmichael, op. cit.
11 Ibid.
12 Ibid.
In Western Europe, Germany has announced its intention to form a unified regulator.\textsuperscript{13} And the respective unified regulatory agencies of the UK, Iceland, and Malta are now fully functional. These agencies regulate all financial institutions and markets. In Eastern Europe, Hungary’s unified regulatory agency has been operating for a few years now and like its Icelandic, Maltese and UK counterparts, it regulates all financial institutions and markets. Estonia and Latvia are also advanced in establishing unified agencies.\textsuperscript{14}

Other countries from Europe and Central Asia considering the possibility of moving towards some form of unified financial services supervision include Slovakia, Turkey (considering combining banking and securities dealers), Slovenia, Kazakhstan and Poland.\textsuperscript{15} But most of these countries are just beginning to go through the initial phases of discussing the feasibility of introducing such a model. Some of these countries are looking at prospects of introducing unified financial services supervision in the aftermath of financial restructuring.

Given the above developments, why are so many countries restructuring their regulatory organization? Perhaps the most potent reason has been the move to financial conglomerates—that combine banking, insurance, and securities business. Conglomeration has been taking place among international financial groups as well as among institutions within specific countries. Countries are therefore seeking more effective modes for effective supervision of financial conglomerates. There is also some evidence to suggest that the smaller countries, in particular, are seeking to yield the fruits of economies of scale in regulation through improved management of regulatory resources (especially staff) and infrastructure support.

\section{II. CASE STUDIES}

Countries contemplating a reorganization of their financial regulatory structure are confronted by two fundamental questions:

(a) Should some model of unified financial services supervision be followed?
(b) And if unified financial services supervision were to be introduced, how should that be done?

\textsuperscript{13} \textit{Ibid.}
\textsuperscript{14} However, a unique regulatory system where the central bank—and not a separate regulatory agency—regulates banks, securities firms and insurance companies is found in Netherlands Antilles, Singapore and Uruguay. See D.T. Llewellyn, ‘Introduction: The Institutional Structure of Regulatory Agencies,’ \textit{op. cit.}, p. xvii.
\textsuperscript{15} E-mail received by the authors from Mr. Jeffrey Carmichael, \textit{op. cit.}
It is important that countries address these questions with reference to their own economic, institutional and political frameworks. In some instances reorganization of regulatory structure may be ill-advised. For example, in some countries there are more pressing financial and economic issues than the introduction of a model of unified financial services supervision. There is a question, for instance, as to whether countries facing major imminent challenges in their financial sector—those perhaps facing insolvencies among major banks—should be contemplating wholesale reorganization of the regulatory function which might deflect attention away from the problems at hand. In other countries, there is very limited interconnectedness between the various segments of the financial sector (i.e. the insurance, securities, pensions and banking sectors and hence maintaining the status quo would be more appropriate in the short-term). And, further still, some countries may not have enough financial resources and well trained human capital to deal with the implementation of unified financial services supervision.

Assuming a country chooses to initiate a restructuring of its regulatory organization what does country experience tell us about the way unified financial services supervision should be introduced? The five quite different case studies set out below shed light on these questions.


17 Addressing some of the recent developments in bank regulation, Llewellyn draws an analogy and argues (D.T. Llewellyn, “Some lessons for bank regulation from recent cases,” a paper presented at the conference on Regulation and Stability in the Banking Sector, at De Nederlandsche Bank, Amsterdam, 3-5 Nov. 1999, abstract page): “The causes of systemic bank distress are complex and multi-dimensional involving economic, financial, regulatory and structural weaknesses. This also means that regulatory approaches also need to be multi-dimensional... an optimum ‘regulatory regime’ needs to incorporate seven key components: regulation (the rules imposed by official agencies), official supervision, incentive structures within banks, market discipline, intervention arrangements in the event of distress, corporate governance arrangements with banks, and the accountability of regulatory agencies. All are necessary but none alone are sufficient for systemic stability. As there are trade-offs between the components, regulatory strategy needs to focus on the overall impact of the regime rather than only the regulation component.”
CASE STUDY I – THE SCANDINAVIAN COUNTRIES’ EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION

Among the Scandinavian countries, Norway was the first to move towards a model for unified financial supervision.\(^\text{18}\) In 1986, after a long process of consolidating its regulatory system, Norway merged its Banking and Insurance Inspectorates.\(^\text{19}\) This development followed an experience of:

“... having been influenced by broadly similar considerations in making the move towards an integrated approach to regulation and having reaped many of the same benefits from this approach. Chief among these benefits has been obtaining economies of scale in the use of scarce regulatory resources in comparatively small, highly concentrated financial systems in which financial conglomerate groups predominate.\(^\text{20}\) ... Its Bank Inspectorate could trace its history back to the end of the last century, when it was established for the supervision of savings banks. The supervision of the commercial banks was added to its responsibilities in the 1920’s. Banking supervision has thus never been formally part of the responsibilities of the Norwegian central bank, and hence the creation of a unified regulatory authority did not involve any significant dilution of the central bank’s range of powers. Indeed, a proposal in 1974 for the merger of the bank inspectorate with the central bank was defeated in parliament. In 1983 the Banking Inspectorate further acquired some of the functions of the securities bureau of the Ministry of Finance.”\(^\text{21}\)

On the one hand, while the Ministry of Finance continued to be responsible for regulating the Oslo Stock Exchange,\(^\text{22}\) on the other hand, the Banking Inspectorate was entrusted with powers to undertake prudential supervision of specialist securities firms and investment management firms.\(^\text{23}\) And given that the Norwegian banks were already the most active participants in the securities markets, placing the supervision of non-bank securities firms under the Bank Inspectorate was simply a natural extension of its role in overseeing activities of securities firms.\(^\text{24}\) Indeed, since 1986 Norway’s single regulatory agency, the Kredittilsynet, has performed the regulation of banks, non-bank investment firms, and insurance companies, primarily in respect of their solvency.\(^\text{25}\) However, although the Norwegian regulatory agency is also responsible for the regulation of real estate brokers and auditing firms, it had, by November

\(^{19}\) Ibid., p. 113.
\(^{20}\) An integrated model represents a significant concentration of power, ensuring that its powers are not used to serve political rather than administrative purposes.
\(^{22}\) The only organised financial market in Norway.
\(^{24}\) Ibid., p. 5.
\(^{25}\) Ibid., p. 5.
1999, still not been granted the formal authority and responsibility to supervise the Oslo Stock Exchange.\footnote{See \textit{Ibid.}, p. 5.} The transfer of these powers to the agency from the Ministry of Finance was, however, expected any time after November 1999.\footnote{\textit{Ibid.}, p. 5.}

In Sweden, the Finans Inspektionen, which is the institution charged with the responsibility of undertaking unified financial supervision, was set up in 1991.\footnote{\textit{Ibid.}, p. 7.} Its counterpart in Denmark, the Danish Finanstilsynet, was established pursuant to a merger of that body’s banking and insurance regulatory agencies in 1988.\footnote{\textit{Ibid.}, p. 6.} Both the Swedish and Danish regulatory bodies have responsibilities akin to those of the Norwegian Kredittilsynet. In Denmark, as in the case of Norway, the banking supervisory authority had enjoyed a long history as an agency outside the central bank and it had also combined the prudential supervision of non-bank securities firms as part of its responsibilities prior to the creation of a fully unified agency.\footnote{See \textit{Ibid.}, p. 6.} However, the creation of the Danish framework for unified financial supervision was ‘largely an administrative arrangement, and there was no fundamental review of legislation governing its supervisory activities at the time of the merger.’\footnote{\textit{Ibid.}, p. 6.} As such, it is argued that the Danish unified regulatory body operates under a number of different statutes inherited from predecessor organizations.\footnote{\textit{Ibid.}, p. 6.} Indeed, ‘the sector legislation has been adjusted and harmonized successively during the nineties. Similarly, its governance arrangements have not been fully unified.’\footnote{\textit{Ibid.}, p. 6.}

In Sweden, the creation of the Finans Inspektionen was prompted by the banking crisis that hit Sweden in 1990-91.\footnote{\textit{Ibid.}, p. 7.} There was also a political desire by Sweden to keep up with developments in other Scandinavian countries which had already established a framework for unified financial supervision.\footnote{See \textit{M. Taylor and A. Fleming, Integrated Financial Supervision: Lessons from Northern European Experience, op. cit.}, p. 7.} In addition, and apart from the fact that Sweden, unlike Norway and Denmark, is a member of the Basle Committee on Banking Supervision and, thus, most likely to be attracted to achieving economies of scale and enhancing its international presence, there is also a long history of enhanced links between the banking and insurance sectors in Sweden.\footnote{See \textit{Ibid.}, p. 7.}

By contrast, Finland has opted not to adopt a fully unified approach to financial supervision. However, for some time the Finish regulatory framework mirrored that of Norway,

\begin{itemize}
\item See \textit{Ibid.}, p. 5.
\item \textit{Ibid.}, p. 5.
\item \textit{Ibid.}, p. 7.
\item \textit{Ibid.}, p. 6.
\item See \textit{Ibid.}, p. 6.
\item \textit{Ibid.}, p. 6.
\item \textit{Ibid.}, p. 6.
\item \textit{Ibid.}, p. 6.
\item \textit{Ibid.}, p. 7. See also generally B. Drees and C. Pazarbasioglu, \textit{The Nordic Banking Crisis: Pitfalls in Financial Liberalisation?}, Occasional Paper 161, (Washington DC: IMF, April 1998), where it is argued that although the banking crises in Norway, Sweden and Finland in the early 1990’s followed a similar pattern, and appear to have had similar causes, their impact on the structure of regulation differed significantly between Norway and Sweden, on the one hand, and Finland, on the other.
\item See \textit{Ibid.}, p. 7.
\end{itemize}
Denmark and Sweden until the late 1980s.\(^3^7\) A number of institutional changes were introduced to the Finish system and these focused mainly on enhancing the link between banking supervisors and the Bank of Finland.\(^3^8\) It is against this background that the Finish Financial Supervision Authority was established. Although administratively connected to the Bank of Finland, the Finish FSA is independent in its decision-making.\(^3^9\) Contrasting the model for unified financial supervision in many Scandinavian countries and from that found in the UK, it can be argued:

“For different reasons, the United Kingdom’s adoption of unified regulation stands out as something of an exception among northern European countries. Unlike the Scandinavian countries, the UK is home to an international financial centre and its domestic financial services industry is much larger, more diverse and less concentrated than in Scandinavia. Furthermore, the UK’s Financial Services Authority is responsible for both prudential and conduct of business regulation, unlike its counterparts in Scandinavia which have focused on prudential regulation only... Finally, the formation of the UK Financial Services Authority has been undertaken as a radical, ‘Big Bang’ measure, bringing together nine existing regulatory bodies. By contrast, the Scandinavian integrated regulators were the product of a long process of agency consolidation, and were formed primarily from the merger of banking and insurance inspectorates... the growth of bancassurance business - i.e. financial conglomerate groups combining both banking and insurance activities - was regarded as a powerful reason for adopting an integrated approach to supervision (i.e. in most Scandinavian countries)... None of the three Scandinavian integrated regulatory bodies (i.e. the Swedish, Norwegian and Danish bodies) was created by removing the banking supervision function from the central bank: in each case the regulation of commercial banks had long been conducted by a specialist banking supervisory body.”\(^4^0\)

**CASE STUDY II – THE UK’S EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION**

**Overview and the organizational structure of financial services supervision**

In the UK, the Bank of England Act 1998 now transfers from the Bank of England to the Financial Services Authority the Bank’s former banking supervision functions.\(^4^1\) Prior to the enactment of this piece of legislation, the legal pedigree for powers of the Bank to conduct financial services supervision rested not only in provisions of the Banking Act 1987, but also in section 101(4) of the Building Societies Act 1986 and in provisions of the Banking Coordination (Second Council Directive) Regulations 1992. Under these laws, the core purposes and strategy of the Bank of England included monetary stability, monetary analysis, monetary operations, banking activities, financial stability, supervision and surveillance. The Financial Services

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\(^{40}\) See *Ibid.*, pp. 9, 17.

Authority has now acquired the powers to supervise banks, listed money market institutions (as defined in the Financial Services Act 1986, section 43) and related clearing houses (as defined in the Companies Act 1989, section 171). The current structure under the Bank of England Act 1998 endeavors, among other things, to place a balance between the role of the Bank and that of the Treasury. As Blair observes:

“This aspect is the one that has attracted the greatest amount of public attention. So far as the law is concerned, section 10 removes from the Treasury the power to give directions to the Bank in relation to monetary policy. That said, the Treasury have... important powers to condition the general strategy in relation to monetary policy. Critically, section 12 enables the Treasury to specify what price stability is to be taken to consist of, and what the government’s economic policy is to be taken to be. These are the two elements, and the only two elements, of the Bank’s statutory objectives in relation to monetary policy, though the second of them contains a subsidiary reference to objectives for growth and employment.”

In general, the areas which are expected to be influenced in the aftermath of the enactment of the Bank of England Act 1998 include the overall stability of the financial system as a whole, and in particular; the stability of the monetary system; the financial system infrastructure, especially payments systems; the broad overview of the (financial) system as a whole; the ability to conduct what loosely may be described as official support operations; and the efficiency and effectiveness of the financial sector, with particular regard to international competitiveness.

Further arguments on advantages of a unified model have been advanced by scholars such as Briault. These arguments relate to issues such as economies of scale and scope that arise because a single regulator can take advantage of a single set of central support services, increased efficiency in allocation of regulatory resources across both regulated firms and types of regulated activities, the case with which the unified regulator can resolve efficiently and effectively the conflicts that inevitably emerge between the different objectives of regulation, the avoidance of unjustifiable differences in supervisory approaches and the competitive inequalities imposed on regulated firms through inconsistent rules which have arisen across multiple...
specialist regulators, and, if a unified regulator is given a clear set of responsibilities then it should be possible to increase supervisory transparency and accountability.\textsuperscript{46}

It was strongly believed that the system that existed prior to the introduction of the Financial Services Authority in the UK lacked transparency and adequate accountability partly due to its fragmented regulatory structure.\textsuperscript{47} By contrast, consolidated prudential supervision of multi-functional financial groups, it was argued, provided for an efficient way of managing risks related to different financial activities (e.g. traditional retail banking and securities trading).\textsuperscript{48} Also, a unified model for financial supervision was expected to be more publicly accountable and transparent.\textsuperscript{49} Today, the Financial Services Authority is expected to carry out prudential financial supervision in accordance with a number of EU directives in the area of financial services, all of which have been implemented in the UK. As Bartolini observes, ‘most recently, the EU’s Capital Adequacy Directive (CAD) and CAD II (implemented in the UK on January 1, 1996, and on September 30, 1998, respectively) have extended the UK supervisory picture to cover market risk and have provided scope for internal value-at-risk (VaR) models to determine risk capital.’\textsuperscript{50} It is, however, argued that the UK regulators do retain significant flexibility with respect to these directives and other internationally agreed standards.\textsuperscript{51} An example often cited is that the UK typically sets capital ratios above the Basle Accord guideline of a minimum of 8 per cent.\textsuperscript{52} Another example is that of the UK setting required capital ratios in firm-specific fashion, taking into account credit and market risk factors specific to a firm’s business, and applying them on a consolidated basis to all financial firms within a group.\textsuperscript{53} Furthermore, the prudential requirements applicable to authorized firms place limits on maximum exposure toward single (or

\textsuperscript{46} See generally C. Briault, “The Rationale for a Single National Financial Services Regulator,” Occasional Paper Series No. 2 (London: Financial Services Authority, May 1999). In another paper, Briault (see generally C. Briault, “A Single Regulator for the UK Financial Services Industry,” Financial Stability Review, (November 1998)), observes that the benefits of a unified regulator include the harmonization, consolidation and rationalization of the principles, rules and guidance issued by the existing regulators or embedded within existing legislation, while recognizing that what is appropriate for one type of business, market or customer may not be appropriate for another; a single process for the authorization of firms and for the approval of some of their employees, using standard processes and a single database; a more consistent and coherent approach to risk-based supervision across the financial services industry, enabling supervisory resources and the burdens placed on regulated firms to be allocated more effectively and efficiently on the basis of the risks facing consumers of financial services; a more consistent and coherent approach to enforcement and discipline, while recognizing the need for appropriate differentiation; and, in addition to a single regulator, single schemes for handling consumer complaints and compensation, and a single independent appeals tribunal. Further readings, see also M. Taylor and A. Fleming, Integrated Financial Supervision: Lessons from Northern European Experience, op. cit., p. 11.


\textsuperscript{48} See \textit{Ibid.}, p. 31.

\textsuperscript{49} See \textit{Ibid.}, p. 32.

\textsuperscript{50} \textit{Ibid.}, p. 27.

\textsuperscript{51} See \textit{Ibid.}, p. 27.

\textsuperscript{52} See for example, \textit{Ibid.}, p. 27.

\textsuperscript{53} See \textit{Ibid.}, p. 27.
related groups of counter-parties. This entails that liquidity requirements emphasize two major areas; that is, securing an institution’s access to enough cash and high-quality near-cash assets to meets its obligations, and provisioning for bad and doubtful debts.

As experience has shown, some of the shortcomings of a unified model for financial supervision are as follows:

“...advocates of a narrow role for central banks argue that if the central bank (or whichever institution performs the role of the LOLR) must provide liquidity assistance to avert a financial crisis, then it should do so only by providing liquidity to the market at large, e.g., through open market operations, leaving to the market the task of allocating liquidity to worthy borrowers. This conduct would minimise moral hazard, both for potential beneficiaries of liquidity rescues (which would have fewer incentives to assume socially excessive risks) and for other banks (who would need to step up peer monitoring and associated market discipline.) Expanding the role of a central bank to include supervisory responsibilities may also significantly raise the cost of a supervisory failure, which would damage the central bank’s reputation and the credibility of its monetary policy. Furthermore, the mandates of banking supervision and of price stability are subject to a potential conflict of interest: a central bank responsible for supervision could lean towards lax monetary policy if this was perceived to avert bank failures... A widely held view among advocates of an active LOLR mandate is that central banks (or whoever performs the function of LOLR) may deter the banks’ tendency to assume excessive risk by keeping details of the LOLR practices ‘constructively’ ambiguous, i.e., by retaining discretion as to whether, when, and what conditions, emergency liquidity support will be provided.”

Recent developments in the UK on the regulatory framework

There has been a proposal in the UK to establish a new single Financial Services Ombudsman that would receive and handle consumer complaints. This effort is being pursued so that the UK Financial Services Authority can accomplish its tasks, which include supervising wholesale markets in over-the-counter derivatives. As the IMF observes:

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54 See Ibid., p. 28.
56 The IMF argues that while countries such as Germany, Japan and - recently - Australia have established separate functions of banking supervision and Lendor-of-last-resort (LOLR), the US, Italy and (to some extent) France have opted for a broad central bank role, combining both monetary policy/LOLR and banking supervision. For a detailed discussion, see L. Bartolini, “The Financial Services Authority: Structure, Mandate, and Policy Issues,” in H. Samiei, J K. Martijn, Z. Kontolemis, and L. Bartolini, International Monetary Fund: United Kingdom, Selected Issues, Ibid., pp. 36-37.
58 Ibid., p. 29.
59 Ibid., p. 29.
“... the FSA’s goal is to promote ‘awareness of the benefits and risks associated with different kinds of investment or other financial dealing’ while safeguarding ‘the general principle that consumers should take responsibility for their decisions’ (Financial Services and Markets Bill, Clauses 4(2)(a) and 5(2)(c)). In practice, the FSA plans to protect consumers of financial services by intervening at several stages: 1) by vetting firms at entry, to ensure that only those found to be ‘fit and proper’ are permitted to conduct financial business; 2) by setting and enforcing prudential standards; 3) by using its powers of investigation, enforcement, and restitution against firms that fail to meet expected standards; 4) by setting a ‘one-stop’ arrangement for resolving disputes between consumers and authorised firms - the single ‘Financial Services Ombudsman Scheme’; 5) by overseeing the compensation of investors when an authorised firm is unable to meet its liabilities... Unsurprisingly, the approach taken by the FSA to balance consumer protection with the preservation of strong elements of caveat emptor - consumers must take significant responsibility for their own financial decisions - has spurred a lively debate in the UK.”

Under the new system, which introduces the FSA, the existing five compensation schemes are to be merged into a single compensation scheme, the UK Financial Services and Markets Compensation Scheme (FSMC). One of the notable aims of FSMC is to safeguard, partially, consumers of financial services against failure of authorized institutions to deliver on their obligations.

CASE STUDY III – CANADA’S EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION

Overview and the organizational structure of financial services supervision

Canada’s main agency for unified financial services supervision, the Office of the Superintendent for Financial Institutions (OSFI), was established in 1987. The agency is an autonomous entity—legally, speaking—although it reports to the Minister of Finance. OSFI deals with unified supervision of banks, insurance companies, pensions funds, and trusts and loans companies that are federally incorporated.

A justification for having a model of unified financial services supervision in Canada is that the country has a highly concentrated financial sector. This view falls in line with our submission at the start of this paper that in countries where segments of the financial sector are quite inter-connected - as is the case in many small and emerging economies - there is often a good case for moving towards unified financial services supervision. In these countries, the

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60 Bartolini (see Ibid., p. 26) argues that one of the main innovations the regulatory reform has introduced into UK financial system is the separation of the functions of banking supervision (now undertaken by the Financial Services Authority) from the provision of emergency liquidity (or the Lender-of-last-Resort, for which the Bank of England will continue to be responsible).


62 Ibid., p. 30.

63 Ibid., p. 30.
nature of banking business continues to evolve, encompassing more complex and multi-functional operations. Change is, therefore, market-driven and rarely imposed politically.\(^{64}\)

In Canada, unified financial services supervision is expected also to reduce layers of over-regulation and bureaucracy. And market players generally appear satisfied with the present framework for unified financial services supervision. However, in countries that do not have sufficient resources to move towards unified financial services supervision, it might be a bit too far-fetched for them to adopt a model such as Canada’s. Again, this view reinforces the argument that although unified financial services supervision has been adopted differently in many countries, its application has varied from country to country and that there is no single right way of introducing or implementing unified financial services supervision.

Prior to the establishment of OSFI, Canada had a structure of supervision that provided for two different federal supervisory agencies: an agency for banking supervision; and an agency for supervising insurance companies, pension funds, and trusts and loan companies. While the business of insurance, pensions funds, and loans and trusts companies was supervised by the Department of Insurance, the business of banking was supervised by the Inspector-General of Banks. Both these supervisory agencies were independent of the Bank of Canada. In Canada, the function of banking supervision and that of supervision of insurance companies, pension funds, and loans and trust companies has historically been undertaken outside the Bank of Canada. The Bank of Canada has never had supervisory powers over banks, insurance companies, pension funds, and loans and trusts companies. Thus, when the Bank of Canada was set up in 1933 there was really no need to transfer functions of banking supervision from the Inspector-General of Banks to the Bank of Canada.

The Bank of Canada has, however, had some role in providing regulatory advice and arranging for the auctioning of debt instruments. Indeed, the central bank is also tasked - under a 1996 piece of legislation - with the responsibility of handling the payments and clearing system. In Canada, the Canadian Payments Association previously dealt with the payments and settlement system, whereas the Bank of Canada served only as a member of the Association. Having been a member of the Association for some time, the Bank of Canada had little difficulty in adjusting to and taking over the payments and clearing system. Also, the central bank’s interest to take over the payments and clearing system was prompted by its role as a lender-of-last-resort. Today, the Bank of Canada is viewed by many as being in a better position to deal with risk containment in cases relating to payments and settlements. Indeed, the Bank of Canada now oversees securities clearing and settlements, and any large volume of payments that can cause systemic risk. But, presently, there is a bill before parliament to grant the Minister vast powers of oversight on all payment systems.

**The Estey Commission and developments afterwards:** In the mid 1980’s, a commission of inquiry, the Estey Commission, was set up to look at the failure of two major banks in Canada. The failure of these banks occurred after several years of no bank failures in Canada.

\[^{64}\] Although political (government) support of market-driven change is very important in order to provide the right incentives and institutional support for a successful change management programme.
Prior to the two bank failures in 1984/85, the last bank failure in Canada was around 1933. Therefore, when the two bank failures occurred in 1984/85 the Canadian Government decided to set up a commission of inquiry to look into these developments. The Estey commission was tasked to look into, *inter alia*, ways of improving the safety and soundness of the banking sector. Such a task inevitably entailed the consideration of prospects for some institutional reforms to the Canadian financial services industry. At that time, there were a number of financial institutions in Canada that engaged in business that crossed-over from banking business to insurance and securities investment. The Estey Commission took two years to complete its inquiry. And the Commission’s findings were published in 1987.

As part of its recommendations, the Estey Commission established that the function of banking supervision should be moved to the Bank of Canada because the Inspector-General of Banks lacked ‘the will to act’. The Bank of Canada, on the other hand, hesitated to take on this role. One of the reasons advanced by the Bank of Canada was that its main role was confined to addressing monetary policy. Further, the Bank of Canada was not sure of how it would deal with the supervision of non-banking institutions that carried on the activity of banking in addition to other financial services. For example, in the case of merchant banks that provided securities brokerage services there was a fear that conflict of interests would arise between banking supervision done at the federal level and securities regulation conducted at the provincial level. Further, the Bank of Canada feared that there was a general perception by many that banking supervisors are there to prevent the failure of banks. Thus, if the Bank of Canada were to take on the responsibility of banking supervision, and some banks went under, the Bank of Canada could risk losing its reputation. In addition, the Bank of Canada was reluctant to take on the role of financial services supervision, arguing instead that it was in transition moving away from monetary policy to inflation targeting. To buttress this view, the Bank of Canada saw potential conflict of interests between pursuing goals of monetary policy and managing responsibilities of banking supervision. The Bank of Canada, being an autonomous institution, did not want to get entangled in all sorts of political pressure—say, on the Minister closing down a bank or withdrawing a banking license—if it had to take on the role of banking supervision. Inevitably, it became clear that the best thing for the Bank of Canada was to decline the invitation to act as the supervisor of banks.

The Estey Commission also made a recommendation for a merger between the Inspector-General of Banks and the Agency for the authorization of deposit-taking. Added to that was a recommendation that the Bank of Canada, the Canada Deposit Insurance Corporation (CDIC), the Inspector-General of Banks and the Ministry of Finance should co-ordinate over the sharing of information relating to supervision of the financial services industry.

**The birth of OSFI and OSFI’s supervisory role:** In 1987, when OSFI was formed, as a specialized agency for unified financial services supervision, the supervisory functions of the Department of Insurance and the Inspector-General of Banks were transferred to OSFI. Following below is an outline of what the organizational structure of OSFI looked like in 1988.

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65 Also, given that the Department of Insurance supervised loans and trusts companies, in addition to insurance companies and pensions funds, and that loans and trust companies operated somewhat like quasi-banks, there was a good case to integrate the supervisory functions.
Fig. 1.2.1

From the beginning, the supervision of deposit-taking institutions and that of insurance companies and pension funds were kept separately. OSFI also maintained a Policy Unit that prepared prudential regulations and co-ordinated supervision. Policies that were promulgated by this Unit fed into legislation and regulations, while the Services Unit of OSFI managed the day-to-day administrative functions.

In 1992, there was a revision of financial services legislation in Canada. This review was designed to address some of the problems faced by the regulatory framework. Thus, the present structure of OSFI appears as in the diagram below.

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66 Deposit-taking institutions in Canada include banks, trusts and loan companies.
While OSFI is the primary regulator of federally chartered financial institutions, such as [some] insurance companies, pension funds, trusts and loans companies, the regulation of securities on Canadian stock exchanges is left to provincial agencies for securities regulation. This bi-cameral regulatory structure developed in line with provisions of the British-North American Act 1867 (the Canadian Constitution), which required all banks, federally incorporated insurance companies, pension funds, and trusts and loan companies to be licensed and regulated at the federal level. Thus, OSFI regulates mainly institutions licensed at the federal level. By law,

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By virtue of the British-North American Act 1867 (the Canadian Constitution), OSFI’s mission is to safeguard policy holders, depositors and pension plan members from undue loss. OSFI supervises and regulates all banks, and all federally incorporated or registered trust and loan companies, insurance companies, cooperative credit associations, fraternal benefit societies and pension plans. As explained on OSFI’s web-site (http://www.osfi-bsif.gc.ca/eng/default.asp?ref=home), visited on April 4, 2001: “OSFI is committed to providing professional, high-quality and cost-effective service. This is achieved by advancing and administering a regulatory framework that contributes to public confidence in the financial services industry. At the same time, OSFI ensures the regulatory system does not preclude institutions from competing effectively.”
all banks are required to be incorporated and regulated at the federal level,\textsuperscript{68} while some insurance companies, trusts and loan companies are provincially chartered and thus licensed and regulated at the provincial level.\textsuperscript{69} In the case of securities firms, they are incorporated at the provincial level and are, like other financial institutions chartered at the provincial level, subject to the laws and licensing requirements of a particular province where incorporation and licensing has taken place. The cardinal point to note here is that unified financial services supervision applies principally to institutions regulated at the federal level, and not to institutions regulated at the provincial level. Thus, whereas all banks and federally chartered insurance companies, pension funds, and trusts and loan companies are regulated at the federal level, securities on the Canadian stock exchanges are regulated at the provincial level. This model is unique to Canada, showing that every country has country-specific conditions which necessitate a different way of introducing and implementing unified financial services supervision. In Canada’s case, unless the British-North America Act 1867 is amended to give OSFI powers to conduct securities regulation at the federal level, the powers of securities regulation will remain in the hands of the provincial regulators. There have been efforts in the past to try and set up a Canadian nationwide based securities regulator, akin to the US Securities and Exchange Commission. Such efforts have not yielded much results, mainly due to the unwillingness of the various provinces to give up regulatory powers. Thus, although some commentators and observers might want to argue that Canada could benefit more from a model of supervisory unification such as that found in the UK, the historical and constitutional background to Canada’s regulatory framework poses some interesting challenges. To overcome some of the constitutional challenges posed by the British-North America Act 1867 (on prospects for full unification of the supervisory functions in Canada), the Hockin-Kwinter Accord provides for a special information-sharing framework to regulate securities firms owned by banks. Under the Hockin-Kwinter Accord, there are special procedures of how federal regulators can gain access to information on securities firms that are owned by banks.

In Canada, where a bank, in addition to undertaking its normal banking business, provides investment advice or deals in securities, it must also obtain authorization from the competent authority for securities regulation at the provincial level. Similarly, collective investment schemes, such as mutual funds or unit trusts, involved in securities trade and investment require authorization at the provincial level. The structure of securities regulation in Canada evolved historically, and, also, as provided for in the federal and provincial laws of Canada. There were only two major stock exchanges in Canada, the Toronto and Montreal Stock Exchanges. These stock exchanges continued to dominate and a provincial structure of regulating securities investment business, therefore, evolved. There is, indeed, no institution in Canada with federal-wide powers to supervise stock exchanges. And there is now a growing fear that because of such provincially-biased mode of regulation in the area of stock markets, Canada’s stock exchanges might not succeed quickly in harmonizing listing rules and other

\textsuperscript{68} See generally the British-North American Act 1867 (the Canadian Constitution).

\textsuperscript{69} In Canada, a notable feature of provincial-level licensing is that a financial institution chartered at the provincial level will require to be licensed in each and every province where it decides to conduct financial services business, whereas banks and other financial institutions licensed (and regulated) at the federal level are under no obligation to seek provincial licensing if ever they decide to undertake financial services business in any province.
disclosure requirements. This feature presents itself as a major constraint to Canada’s framework for securities regulation.

**On-site and off-site supervision by OSFI:** Generally, OSFI conducts its supervisory functions mainly through its offices in Toronto, Vancouver, Ottawa and Montreal. In Canada, unlike in many other countries, both on-site and off-site activities are performed by the same group of supervisors. This approach is called the ‘relationship-manager’ concept. The relationship-manager concept follows the same principle that is used by major international banks in dealing with its clients. Some of the notable advantages of the relationship-manager concept are as follows:70

(i) It allows for a more efficient and better off-site monitoring process as the people who are performing the off-site supervision have been to the institution and do understand the institution’s business plan;

(ii) Since the supervisors who conduct off-site supervision have been to the institution as on-site supervisors, they know the staff of that institution well and there is a higher likelihood that there would be better and effective communication with staff of that host institution;

(iii) The supervised institutions will often find this approach better because they have to deal with someone who understands their business activities and someone who they know already;

(iv) There is more accountability within the supervisory agency as it reduces the possibility of something falling through the crack (this allows for more rigorous supervision since if something were to fall through the crack, responsibilities of supervision would be diffused amongst several groups); and

(v) The flow of information to senior management of the supervisory agency is much faster and efficient, as all information concerning the supervised institution resides within the same group of supervisors (thus, senior management do not have to go to several different groups of regulators/supervisors to find out pertinent information on a particular financial institution).

At the time of restructuring OSFI in 1992, the issue of whether off-site and on-site supervision of banks should be conducted by the same group of supervisors within OSFI was discussed. Although the supervision of deposit-taking institutions, such as banks, was done on both on-site and off-site bases, there was slight inclination towards more off-site supervision. For insurance companies and pension funds, off-site and on-site supervision was done by separate groups of supervisors within OSFI. Today, both on-site and off-site supervision of insurance companies and pension funds is done by the same group in OSFI. Similarly, both on-site and off-site supervision of banks is done by the same group. And a regulatory framework dealing with the supervision of insurance companies and pension funds, on the one hand, and the supervision of banks, on the other, is now in place. This framework focuses mainly on the risks associated with the particular business and institution being supervised.

70 As argued in an e-mail note to this author, from and by R.Y. Liu, Adviser, Banking and Financial Restructuring Unit, FSE-VP, the World Bank, Washington DC, USA, 25th September, 2001.
Further, OSFI works closely with provincial agencies supervising stock exchanges in Canada. There are a number of Canadian banks that have ownership interests in securities firms. Overall, banks have an estimated 80% of ownership interests in securities firms. Therefore, the close relationship between OSFI and the provincial agencies for securities regulation is very important. This link provides for an efficient mechanism through which regulatory agencies can share vital information that affects the supervision of the relevant financial institutions.

**OSFI’s authorization and supervision of financial institutions**

Generally, banking licenses in Canada are granted by the Minister of Finance in line with the advice of OSFI. Financial institutions engaged in deposit-taking are also required to obtain deposit-insurance licenses from CDIC. CDIC is the agency responsible for the authorization of deposit-taking in Canada. In essence, institutions such as banks, once seen to be engaging in deposit-taking, need to show that they have already obtained prior licensing from both CDIC and the Minister. However, a fear has been expressed that there is potential for an overlap of powers between OSFI and CDIC. Today, Canada has in place two information sharing-committees. These committees are known as the Financial Institutions Supervisory Committee (‘FISC’) and the Senior Advisory Committee (‘SAC’). Both committees have the same members. The distinction, however, is that the Chairman of FISC is the Superintendent of OSFI. FISC deals mainly with issues of a non-policy nature, focusing more on bank failures and other systemic risks. On the other hand, SAC deals mainly with policy issues affecting the government and the Deputy-Minister of Finance is the Chairman of SAC. It is important to stress here that both FISC and SAC are co-ordinated at the federal level and that they do not deal with provincial matters. These committees allow for sharing of information among the various stakeholders. In the main, they each comprise the Governor of the Bank of Canada, the Chairman of the Deposit Insurance Corporation, the Deputy-Minister of Finance, and the Superintendent of OSFI. An important point to make here is that supervisors of stock markets are not represented in FISC and SAC. To some observers, this feature presents itself as a notable shortcoming.

In general, OSFI, the main regulatory body at the federal level, is responsible for screening and approving applications for a banking license before the Minister can grant such license. First, OSFI examines the business plan accompanying the application before making a recommendation to the Minister that a banking license should be granted. OSFI also has powers

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71 And FISC is supported by its own sub-working groups.
72 Since the central bank is lender-of-last resort and oversees the payments systems.
73 Since some financial institutions are required to register with the CDIC, as already noted above.
74 Who helps to articulate government policy on matters pertaining to the financial sector.
75 Since OSFI is the unified regulator in Canada.
76 When FISC was set up—as noted by some interviewees during the collection of data for this paper—there was a delay in realizing FISC’s benefits. The delay, it was pointed out, was exacerbated partly by the attitude of the then head of OSFI who thought that FISC was simply ‘second-guessing’ his work. By contrast, OSFI disagrees and places some reservations to this view. OSFI believes that the problems encountered by FISC were not a direct result of the attitude of the head of OSFI, but that what actually transpired was that it took OSFI a while to adjust and learn how best to get the FISC mechanism going. Today, both OSFI and the rest of the interviewees agree that FISC has performed well so far and that it has had a good record of efficiency in sharing information.
to stop a bank from undertaking banking business if OSFI is satisfied that the bank is engaging in ‘unsafe and unsound’ practices.\textsuperscript{77} The supervisory mandate of OSFI covers mainly issues relating to ‘safe and sound’ practices. OSFI employees, when acting in good faith, enjoy immunity from judicial proceedings regarding their discharge of official functions.

The Minister may also, in accordance with the advice of OSFI, revoke a license of a financial institution. Although the superintendent of OSFI is appointed by the Minister, he or she is expected to act independently and impartially. The superintendent can, however, be removed from office by the Minister for ‘cause’ only and the Minister is required by law to explain such cause to parliament. The superintendent is appointed to serve for a term of 7 years.

**Accounting standards**

Canada, like many other developed countries, has its own accounting standards known as the General Accepted Accounting Principles (GAAP). Under the Canadian GAAP, as noted by some interviewees, unlike in many other countries, disclosure obligations are principally geared at providing information to shareholders, and not to regulators. Some interviewees feared that this feature might pose potential problems in the regulatory framework by denying regulators the necessary information. OSFI, however, disagrees and points out that since OSFI itself has some residual powers to provide for additional guidelines on disclosure requirements and accounting standards, the regulators would not be denied any vital information. OSFI argues that, in essence, this residual power is an important strength of the Canadian unified supervision model because it provides, among other things, for the flexibility to deal with an unforeseen shortcoming in requirements for information disclosure.

Further, there is a general feeling among regulators that Canada has to address and resolve the differences in accounting standards that apply to insurance and banking institutions on bad debts and assets, and also on the definition of ‘capital.’

**The skills-mix of supervisors in OSFI**

In Canada, the setting up of OSFI involved the transfer of all members of staff in the Department of Insurance and in the unit under the Inspector-General of Banks to one Agency - OSFI. This approach was unlike the case of the United Kingdom were the re-deployment of only a certain number of staff members from the Bank of England to the Financial Services Authority caused some problems.

In general, however, it was observed that most of the banking supervisors in Canada come from a professional banking background. Economists are rarely hired as banking supervisors. Canada has usually hired banking supervisors from the banking sector itself. And Canada is less legalistic, when compared with the USA, in that it hardly places emphasis on the

\textsuperscript{77} In some countries, such as Zambia, banking legislation does not define the term ‘unsafe and unsound practices’. However, it is not the purpose of this work to delve into such intricacies of juridical interpretation.
use of lawyers in ‘prudential’ banking supervision. Certainly, there are more accountants than lawyers and economists serving as bank supervisors in Canada.

Some of the practical constraints and successes experienced by Canada, with regard to the unified model of financial services supervision, include the following:

• OSFI is constantly faced with the challenge of competing for highly skilled personnel - often a time, such skilled personnel are attracted to the well-paying jobs in private sector institutions
• There is need for Canada to address some aspects of her accounting standards, as already noted above
• OSFI has not instituted Chinese Walls within its sectoral departments, although there could be possibilities of conflict of interests—particularly that competing interests between banks and insurance companies might require OSFI to attend carefully to the protection of depositors, on the one hand, and to the protection of policy-holders, other the other
• The absence of OSFI’s “federal” presence at the provincial level, with regard to securities regulation, leaves the prospect of harmonizing the different disclosure requirements in Canada hanging in the balance  
• Although some interviewees observe that it is not easy to understand why the Minister has the final word on the de-licensing of banks when OSFI is supposed to be the main (and independent) regulator, OSFI counter-argues that the Minister only has the final word if his or her intervention is justified as being in the ‘public interest’
• A view has been expressed by some commentators that it would serve well if OSFI were to be more independent from the Minister than it is today  
• And in terms of the skills mix of the supervisors, there is a fear by some insurance supervisors that their role might suffer from lack of ‘visibility’ and that they may end up being over-shadowed by banking supervisors.

78 There is, however, a ‘Joint Forum’ at the provincial level which covers securities regulation on Canadian stock exchanges and regulatory issues affecting insurance companies, pension funds, and other financial institutions registered at the federal level. It is at this Forum that OSFI has an ‘observer’ status. This position gives OSFI some nominal presence at the provincial level of regulation.
79 It was pointed out, however, by interviewees at the Bank of Canada that lately OSFI has acquired some powers to close down a bank even without getting the approval of the Minister.
80 OSFI is a government department and it reports to the Minister. In some circles, it has been argued that it would serve well if OSFI, like the Bank of Canada, were to report to parliament. A view was also expressed that, overall, due to the transparent nature of its operation, OSFI has succeeded in shielding itself away from unnecessary political pressure and interference.
CASE STUDY IV – HUNGARY’S EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION

Overview and the organizational structure of financial services supervision

In the late 1980s, Hungary began to restructure its banking system. A two-tier system of banking was introduced in 1987. While the system permitted the central bank to operate like a commercial bank, it also provided for two major state banks to cater for the housing and retail industries respectively. These two major banking institutions, in turn, held accounts at the central bank. There were no other commercial banks in Hungary.

With the coming into force of the 1987 changes, the central bank concentrated on addressing monetary policy. Two supervisory agencies that worked in close liaison with the Ministry of Finance were set up and assigned the responsibility of issuing banking licenses and insurance licenses, respectively. The Central Bank of Hungary and the Ministry of Finance coordinated on the monitoring and supervision of banks. Banks were supervised, on-site, every two years. New commercial banks, controlled by private investors, began to spring up. Insurance companies, on the other hand, were supervised every five years by the insurance supervisors.

In 1990, the Hungarian Securities and Exchange Commission was set up. A law providing for the establishment of the Securities and Exchange Commission was enacted. Later, another piece of legislation was passed and this statute addressed the establishment of a banking supervisory agency. The banking supervision agency was set up in 1991.

Insurance business remained under the supervision of the state supervisory agency for insurance companies, an institution which operated closely, albeit at arms-length, with the Ministry of Finance. While the chief executive of the insurance supervisory agency was appointed by the Minister of Finance, the insurance supervisory agency raised its own finances from supervision taxes levied on insurance companies. The Securities and Exchange Commission and the post-1991 banking supervisory agency also raised their finances in a similar manner. They levied taxes for supervisory functions in the industry.

In general, the regulatory framework for insurance supervision provided for appeals by a person dissatisfied with the decision of the insurance supervisory body. The appeal had to be lodged with the Minister of Finance. By contrast, appeals against the post-1991 banking supervision agency and the Securities and Exchange Commission were to be made before a competent court of law.

In 1993, a pensions supervisory agency was set up. The Hungarian agency for pensions supervision dealt mainly with the supervision of voluntary mutual pension funds. There were three types of pension funds in Hungary; that is, social security funds, mandatory pension funds, and voluntary mutual pension funds. The Hungarian pensions supervisory agency was funded partly by the state from national budget allocations. Also, this agency raised its own finances by levying supervision taxes on pension funds. In 1997, a second pillar to the development of the pension funds supervisory framework was introduced. This pillar dealt with the supervision of
mandatory pension funds. Prior to the introduction of the 1993 and 1997 pillars, all social funds, such as the social security funds and the health insurance funds, were supervised by a pensions directorate at the Ministry of Social Welfare. Only private pension funds were supervised by a separate agency. But the said agency worked closely with the Ministry of Finance. It is important to point out here that this twin-system of supervision of private pension funds and social funds reflected Hungary’s inherent ideology to deal with both aspects of socialist and capitalist tenets of development at the time.

In 1996 and 1997, legislation was enacted in Hungary to address developments relating to securities regulation and banking supervision. In 1997, the Securities and Exchange Commission and the post-1991 banking supervisory agency were merged.

The era after the 1996/97 reforms in Hungary

The Central Bank of Hungary is responsible mainly for liquidity of financial markets, issuing bonds, administering monetary policy and exchange control. The central bank acts as ‘lender of last resort’. A formal agreement between the central bank and the unified agency for financial services supervision has now been reached. Under this detailed agreement, the central bank’s role is confined to supervising matters relating to payment systems. If the central bank detects something wrong in the operations or business of a bank, the central bank can only make recommendations to the unified supervisory agency for further action. Thus, the central bank’s supervision of credit institutions, such as banks, relates mainly to supervision of payment systems, in general, and that of payment services by banks. Be that as it may, insurance companies and securities firms do not fall under the supervisory wing of the central bank. It is therefore not clear what the position is with regard to the supervision of settlement of payments relating to securities trade. The central bank, in undertaking its limited supervisory role, coordinates mainly with the unified supervisory agency. And on-site examination of banks is sometimes undertaken jointly by the central bank and the unified supervisory agency.

The Hungarian supervisory agency is now responsible for the supervision of securities markets, insurance companies, pension funds and credit institutions. The agency began operations with two deputy presidents. Each deputy-president represented a silo that followed the business of his or her previous agency; that is, as noted above, there used to be an agency for banking supervision and another for supervision of securities markets. Later, as the unified model of financial services supervision began to take root, the ‘silos’ approach was abandoned. The silos approach is said to have caused some operational problems since the departments that dealt with banking supervision and securities regulation stood in isolation from other departments such as those that dealt with insurance companies and pension funds. However, by April 2000, the unified supervisory agency had moved from two vice-presidents to one vice-president under its newly adopted ‘functional’ organizational structure. Thus, the agency is no longer organized along the lines of ‘sectoral’ departments since such an approach follows the use of silos. The agency is now structured along the lines of organizational functions, with departments representing various functions such as licensing and legal enforcement, and information technology. This is in contrast to the previous set-up that focused on silos, addressing separately the banking sector, the insurance and pension funds sector and the
securities markets. The adoption of the functional organizational structure has, indeed, helped the agency to smoothen out the flow of information across its departments. The following is the organizational structure of the agency today.

Figure 2.1

**Hungarian Financial Supervisory Authority**

- **PRESIDENT**
- **Deputy President**

Source: Provided by the Hungarian Financial Supervisory Authority on 23rd April, 2001, Budapest, Hungary.

In Hungary, one of the reasons that led to the introduction of a model for unified financial services supervision is that the financial industry was growing in size. Also, new products on the market, some of which were of a complex and multi-faceted nature, started to spring up, with the businesses of banking, insurance, pensions and securities investment becoming more interconnected. The share-holding structure in a number of these financial service institutions showed a high degree of interconnectedness. Overall, banks in Hungary have about 50 percent shareholding interests in investment companies and securities firms. And although banks do not have much equity ownership in insurance companies, most insurance companies are controlled by foreign investors. Foreign investors, in turn, hold major controlling rights in banks. There are about 43 banks, 50 investment companies and 22 insurance companies in Hungary. In a sense, this development was one of the reasons that led to the emergence of what is often referred to as ‘universal banking’. Hungary now has a universal banking system in place.
The emergence of the universal banking system in Hungary now calls for the need to address some of the changes that have taken place since the notion of unified supervision of financial services began. These changes include developments relating to information flow. Further, there is need to address the harmonization of supervisory functions within the unified agency since the various supervisory agencies that existed before the present unified agency was set up have now come under one umbrella.

**The Hungarian Financial Supervisory Authority**

The President of the unified supervisory agency in Hungary is, first, nominated by the Prime Minister and, then, elected to office by parliament. The term of office for the President is six years. Hungarian legislation is, however, silent on whether or not the President can be re-elected for more than one term. A view has been expressed by the agency that although the institution is still in its early years of existence, there is likely to be no objection to the re-election of the President.

The President of the agency can only be removed from office by parliament. The fundamental idea here is that both the President and the unified agency should be provided with operational independence. The granting of such independence serves to augment provisions of the Basle Committee Core Principles for Effective Banking Supervision. However, when removing the President from office, parliament is under a statutory obligation to explain publicly why the President is being removed. The explanation here must be in accordance with powers granted to parliament by legislation.

In Hungary, a view has been expressed that there is now need for Hungary to build consumer protection into its legislation and regulatory framework. The challenge, however, is that it is not easy to come up with market driven regulations since the unified agency has no powers to enact subsidiary legislation or make regulations. Such rules can only be made by the Minister of Finance. Further, in Hungary, judicial review of decisions of the unified agency is only permitted on matters such as whether the correct procedures and regulations were followed. There is no judicial review on matters relating to substantive arguments, merits or facts of a case. Indeed, while the supervisory agency can withdraw the license of an insurance company, pension fund, and stock exchange, the license of a credit institution such as a bank can only be withdrawn by the agency with the approval of the Minister of Finance and the Central Bank of Hungary. If the Minister or the central bank does not agree with the decision of the agency to revoke a license, the Minister or the central bank, whichever of the two is dissenting, must spell out measures for rescuing the financially distressed credit institution. A common example here is the case of banks which are seen to be ‘too big to fail.’

In general, however, the agency is funded mainly from its own revenues. About ninety-three percent of funds of the agency constitute such portfolio. The agency generates its own revenues by requiring the supervised institutions, whose rating is dependent on the evaluation

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81 Such banks can, at times, be ‘too big to rescue’.
made by the agency, to pay for the cost of supervision, evaluation and rating. Only about seven percent of the funding comes from the state. However, from 2002 onwards, the agency will be expected to raise its entire finances.

**Some problems associated with universal banking in Hungary**

With the growth of universal banking, a number of parent banks have now turned securities firms that were once their subsidiaries into their bank departments. Given this development, it is now not easy for banks in Hungary to set up Chinese Walls or Fire Walls effectively. In general, however, it must be stressed that Hungary has made good efforts at complying with Basle Committee Core Principles for Effective Banking Supervision. Regulations to curb insider lending—a practice that seemed to be quite rampant at some point in Hungary—have now been developed and promulgated.

Initially, when the unified supervisory agency was set up, some cynicism was expressed by staff of the former supervisory agencies that were in charge of pension funds and insurance companies. Fears were expressed that too much prominence was given to banking supervision and securities regulation. Further, it was argued that this feature would undermine and overshadow the importance of promoting the supervision of other financial services. However, as the unified supervision model began to take root, confidence amongst the stake-holders started to increase. One of the advantages of moving towards unified financial services supervision, as cited by the unified agency of Hungary, is that integration has facilitated cross-fertilization of ideas and methods of supervision. Also, the supervised institutions are rated by the unified agency in order to promote investor protection and investor confidence in the market. The methods of rating used, say, for banks are different from that used in the case of insurance companies and pension funds. However, cross-fertilization of ideas helps to maintain a harmonized and coherent structure for ratings and supervision.

Given the differences in the salary structures of professionals and practitioners across the financial sector, it was not easy for the Hungarian unified supervisory agency to provide prospective employees with appropriate incentives that would attract them away from other employers. With time, however, the agency has managed to retain a number of employees that served under the various units that were responsible for supervising insurance companies, pension funds, banks and securities firms. Today, the agency is certainly well financed and it attracts bright individuals to work for it. However, the agency observes that one of the constraints before it is that its offices are not in one central location and staff are therefore located all over the place. There are proposals now that by the end of 2002 all employees of the agency should come under one roof. Generally, in Hungary, there is a flexible skills mix, in terms of professionals and practitioners serving as financial services supervisors. The Hungarian supervisory agency has in its ranks lawyers, accountants, bankers, economists, business administrators and many other qualified individuals.
CASE STUDY V – ICELAND’S EXPERIENCE WITH UNIFIED FINANCIAL SERVICES SUPERVISION

Overview and the organizational structure of financial services supervision

Iceland was the fourth Nordic country to adopt a model of unified financial services supervision. As noted earlier, the first Nordic country to introduce unified financial services supervision was Norway (in 1986). Other Nordic countries that have also followed this route include Denmark and Sweden. The decision to set up the Financial Services Authority in Iceland (hereinafter referred to as ‘FSA’) coincided with the setting up of the Financial Services Authority in the United Kingdom.

Prior to the establishment of the FSA in Iceland, banking supervision and securities regulation were conducted by the Central Bank of Iceland. There were two directorates within the central bank that dealt with banking supervision and securities regulation, respectively. The directorate dealing with banking supervision also dealt with supervision of pension funds. Then there was a separate institution responsible for supervising insurance companies, the Insurance Supervisory Authority. The Insurance Supervisory Authority was a state agency independent of the central bank.

In Iceland, a committee was set up in 1996, by the Minister of Commerce, to look at prospects of moving towards unified financial services supervision. This committee comprised members drawn from the following institutions and sectors: the Central Bank of Iceland, insurance companies, banks, and the Ministries of Finance and Commerce. Initially, the Committee was not sure of how to proceed since the supervision of insurance sector was isolated from that of the banking sector. Later, one of the biggest banks in Iceland acquired 51 percent shareholding interests in an insurance company. Also, a number of banks started issuing products that were akin to products found under a system of universal banking. These two factors strongly supported the case for unified financial services supervision. Further, financial institutions such banks began to diversify their operations. Some even started setting up subsidiary banks abroad, while others started setting up investment firms. In Iceland, banks remain the biggest players on the securities markets, investing in securities either directly or through subsidiaries. Therefore, the main advantage of unified financial services supervision is that a better utilization of human resources relating to financial services supervision can be realized.

Another reason supporting the case for unified financial services supervision in Iceland is that the Icelandic Government has been selling its shares in many banks where it has ownership interests. To facilitate a smooth transition for state disinvestment, the Icelandic Government has been encouraging a policy of bank mergers in the country. The mergers of most of the credit institutions in Iceland did lead to the emergence of a universal banking practice. And this feature, in turn, called for the need to address prospects for introducing unified financial services supervision. Thus, the Committee on reform of the regulatory framework for the financial sector recommended that Iceland should move towards unified financial services supervision. However, only one member on the Committee – the central bank official – voted against the introduction of unified financial services supervision in Iceland. The reason behind the sole dissenting view was
grounded mainly in some fears expressed by the central bank that it would lose its supervisory powers over most financial institutions, especially credit institutions.

In 1999, Iceland’s unified supervisory agency, the Financial Services Authority, was set up. Practically, all staff that were in the directorates of securities regulation and banking and pensions supervision at the central bank, plus staff at the Insurance Supervisory Authority, moved to the FSA. While in the previous setting only insurance companies would pay to the Insurance Supervisory Authority for the supervisory role that it played, in the present set-up all financial institutions are now required to pay the FSA for the supervisory function that the FSA performs over the entire financial sector. Indeed, the levying of supervisory ‘taxes’ provides the FSA with a source of revenue. The FSA raises its own finance and, thus, the levying of supervisory ‘taxes’ is an important source of income. Further, this self-financing arrangement for the FSA serves to promote its independence from the state.

**The dynamics of institutional re-structuring**

Overall, although there has been an increase in the number of qualified individuals within the financial sector that keep moving from one financial institution to another, partly due to the expansion of the economy, the FSA feels that it has succeeded in attracting and retaining well qualified individuals. And although the financial and private sectors of Iceland are growing rapidly, a number of personnel serving in the employ of the FSA have not been lured by the competitive employment packages offered by the private sector. The greatest challenge, however, according to the FSA, is that Iceland does not have a big pool of experts from which to recruit.

In general, the organizational structure of Iceland’s FSA, like that of Hungary’s unified supervisory agency now, is arranged along ‘functional’ lines. The following illustrates the structure of Iceland’s FSA.
Fig. 2.1

Board of Directors

Directors General & Deputy Director General

Secretariat

Development of Regulations etc.

Supervision of all functions

Collection of

Insurance market

Pension funds

Credit institutions

Securities market

Source: Adopted from the Annual Report 2000 of the Financial Services Authority of Iceland, p. 4.
The organizational structure of the FSA in Iceland provides for a flexible mechanism that permits staff with expertise in the supervision of particular types of financial institutions to render cross-support to other units within the FSA; that is, those units dealing with matters pertaining to such expertise.

The Board of Directors of FSA

The Board of Directors of FSA has three members. One of the members is nominated by the Central Bank of Iceland. However, all members of the board are appointed by the Minister of Commerce. Customarily, the nominee of the central bank will be one of the three governors of the central bank. Board members hold office for a period of four years. But, the law is silent on the powers of the Minister to fire a member of the board. In practice, however, it is not easy for the Minister to fire a board member, unless he or she can show that there is a genuine case, say, of gross criminal behavior.

The majority of supervisors in the employ of Iceland’s FSA are economists. The next largest group is that of individuals with qualifications in business administration. Following after that is a team of lawyers, and then individuals specialized in information technology. FSA has only one accountant.

Supervision of financial institutions and the role of the Central Bank of Iceland

Like the case of Hungary, Iceland has in place a formal agreement between the Central Bank of Iceland and the FSA. This agreement regulates and harmonizes the supervisory powers of both institutions. In addition, to ensure that there is no conflict of interests, one of the three governors of the central bank serves on the board of the FSA. So, what, then, is the role of the Central Bank of Iceland in regard to the supervision of financial institutions? While the central bank is in charge of administering the payments system, the FSA is responsible for supervising financial services institutions. In spite of the division of labor here, a recent joint IMF-Bank Financial Sector Assessment Program observed that the Central Bank of Iceland and Iceland’s FSA should work closely on over-seeing the payments system in the country. However, the primary responsibility of over-seeing the payments system, as was observed, remained with the central bank.

Efficacy of the legal framework: some salient features

The law in Iceland does not provide employees of the FSA with judicial immunity from legal proceedings on matters relating to acts or omissions of the employees in the course of their business. This shortcoming is seen by the FSA as a failure to meet one of the principles of the Basle Committee’s Core Principles for Effective Banking Supervision. That said, the FSA observes that it is unlikely that there would be any lawsuits given that Iceland is not an aggressively litigious society.
The law in Iceland also provides for an Appeals Committee. The Appeals Committee comprises three members. The members are nominated by the Supreme Court and the Minister then appoints them. It is not clear, however, what would happen in the event that the Minister is not happy with one, or two, or all of the nominees. The law in Iceland, however, provides for judicial review of decisions of the Appeals Committee. This review concentrates mainly on finding out if the right procedures were followed. Indeed, the court will not re-open the case to look at the merits of the case all over again.

III. CONCLUSION

Over the years financial regulation and supervision has, in most countries, been organized around specialist agencies that have distinct and separate responsibilities for banking, securities and insurance sectors. It now appears that there is a growing trend towards restructuring the financial supervisory function in many countries, and in particular moving to unified regulatory agencies—that is, agencies that supervise two or more of these areas. This paper has sought to provide a comparative perspective on the structural issues confronting financial services supervision around the world.

Although unified financial services supervision has been adopted differently in many countries, its application has varied from country to country and there is no single right way of introducing or implementing unified models of financial services supervision. However, experience so far seems to suggest that in order for a country to manage effectively the transition to a unified supervisory agency, one of the factors to consider include 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, as noted in almost all the case studies examined in the report, provides for efficient means of sharing information between the various stakeholders.

In making its case that the application of models of unified financial services supervision has varied from country to country and that there is no single right way of introducing or implementing such models, the paper provided case studies which highlighted the differences, say, in the skills-mix of financial services regulators across different countries. Also, the functional matrix of organizational structure, in contrast to the sectoral approach, showed that 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.

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.
APPENDIX

Literature Review

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. A network of unified supervisors, comprising mainly supervisors from developed countries and transition economies, has 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. These papers are reviewed hereunder.

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 segments of the financial sector; second, be better placed to attract qualified staff and other resources to guarantee an equal level of supervision in banking, securities and insurance sectors; third, have more authority and independence to be more effective in carrying out supervision; and fourth, be better placed to prevent regulatory arbitrage.’

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 with very little emphasis on the interests of consumers of the services provided. There was a perception in Ireland, according to McDowell (2001:6), that value for money and consumer rights had been subordinated unduly to the interests of stability and solvency. Taking into account all these factors, McDowell (2001:9) argues that smaller states, by necessity, cannot afford to have very complex or costly regulatory institutions and systems. In financial terms, the burden of regulation has to be kept under control. Even so, the experience of Ireland (see McDowell 2001:6) shows that there is no single stereotype model for the regulation of the financial services industry. Llewellyn (2001:4) adds:

“A review of international experience indicates a wide variety of institutional structures for financial regulation (see Goodhart, et al, 1998). Some countries (e.g. Sweden, Canada, Denmark, Korea, Iceland) have reduced the number of regulatory agencies and in some cases (UK, Iceland, Korea, Finland, Sweden) created a single mega agency. Other countries have opted for multiple agencies. Differences reflect a multitude of factors: historical evolution, the structure of the financial system, political structures and traditions, and the size of the country and financial sector. With respect to the last mentioned, for instance, if there are economies of scale in regulation, a single agency might be especially appropriate for small countries.”

Llewellyn (2001:2) observes that the 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 input; 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, as noted in this paper, is available in countries such as Hungary.
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