

The Rationale for a Single National Financial Services Regulator

Clive Briault

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THE RATIONALE FOR A SINGLE NATIONAL FINANCIAL SERVICES REGULATOR

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FSA Occasional Paper

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BIOGRAPHICAL NOTE

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Introduction

The single statutory regulator for financial services which is being established in the UK (the Financial Services Authority, "FSA") will be the broadest financial regulator in the world, combining prudential, conduct of business and market conduct regulation across the full range of financial services, including banking, securities, investment management and insurance. A few other countries already have single financial services regulators, but the FSA will be the first in a major international financial centre.

This paper considers the rationale for establishing a single national financial services regulator. The institutional structure of financial services regulation is important because of the impact of the efficiency and effectiveness of this regulation on the direct and indirect costs of regulation and on the success of regulation in meeting its statutory objectives. To what extent should the structure of financial regulation be driven by the functions which financial services firms undertake, reflecting market developments in the financial services industry? Is there a first-best institutional arrangement which is independent of these market developments, arising perhaps from economies of scale and scope in undertaking financial regulation, or from some underlying logic linking the structure of regulation with the objectives of regulation or with the institutional arrangements for monetary policy and for addressing systemic risk? Are there also implications here for the structure of regulation internationally, not just within national borders?

Although the structure of financial regulation must depend in part on what is being regulated and why it is being regulated, this paper takes as given the rationale for financial services regulation as set out in Davies (1998a), Goodhart et al (1998) and Llewellyn (1999). This is not to deny the crucial importance of determining the rationale for intervention – and indeed the key interrelationships between this rationale and the choice of the tools of supervision – but this is too large a subject to cover within this paper.

The paper is structured as follows. Section 1 explains the formation of the FSA in the UK and Section 2 describes similar developments in a number of other countries. Section 3 discusses market developments in the financial services industry and their implications for the structure of financial regulation, both domestically and internationally, while Section 4 considers other factors, including economies

of scale and scope, the efficient allocation of regulatory resources, the resolution of conflicts, accountability, the possible over-concentration of power in a single regulator and the potential importance of basing the structure of regulation on the objectives of regulation. Section 5 discusses the relationship between regulation and central banking and Section 6 concludes.

1 Institutional arrangements in the UK

The Chancellor of the Exchequer, Gordon Brown, announced in May 1997 that the responsibilities for financial services regulation in the UK would be merged into a single entity. This would entail the bringing together of nine regulatory bodies¹, including those responsible for banking, securities and insurance business, and for markets and exchanges. The rationale for their consolidation was that:

“The existing arrangements for financial regulation involve a large number of regulators, each responsible for different parts of the industry. In recent years there has been a blurring of the distinctions between different kinds of financial services business: banks, building societies, investment firms, insurance companies and others. This has added further to the complexity of financial regulation. The Government believes the current system is costly, inefficient and confusing for both regulated firms and their customers. It is not delivering a standard of supervision and investor protection that the public has a right to expect. We are therefore establishing a single, statutory regulator for the UK financial services industry with clearly defined

1 The Securities and Investments Board, the Personal Investment Authority, the Investment Management Regulatory Organisation, the Securities and Futures Authority, the Supervision and Surveillance Division of the Bank of England, the Building Societies Commission, the Insurance Directorate of the Department of Trade and Industry, the Friendly Societies Commission, and the Registrar of Friendly Societies.

regulatory objectives and a single set of coherent functions and powers." (HM Treasury, 1998a, page 8).

The establishment of the FSA is well under way. The former Securities and Investment Board was renamed the Financial Services Authority in October 1997, and the supervisory responsibilities of the Bank of England were transferred to the FSA in June 1998.² The next stage in this reform was the publication for public consultation by the Government in July 1998 of a draft Financial Services and Markets Bill (HM Treasury, 1998b), which will give the FSA the powers to act as a single financial services regulator. The Bill is now being debated, scrutinised and amended by Parliament, and, if passed by Parliament, will come into force as the Financial Services and Markets Act.³

Meanwhile, although still operating under existing legislation until the new Act is passed (which will probably be during 2000), the FSA has co-located all of its staff in a single building and has introduced a single management and organisational structure. The FSA is therefore operating in effect as a single financial services regulator, even before the new legislation is enacted, supplying regulatory services back to the boards or commissions of those regulators who retain statutory responsibility until the legislation comes into force (Davies, 1999).

Two aspects of the new arrangements in the UK are of crucial relevance to the discussion in Section 4 of this paper and are therefore discussed in some detail here. These are the statutory objectives of the FSA and the accountability of the FSA. Both of these will be underpinned by a single piece of flexible legislation through which the objectives, roles and responsibilities of the FSA will be subject to the will of a democratically elected parliament; regulatory inconsistencies, overlaps and duplication can be removed; and flexibility will enable regulatory requirements to reflect market developments.

2 Under the Bank of England Act 1998, which also gave the Bank of England independence in the setting of key short-term interest rates.

3 The new Act will replace the Insurance Companies Act 1982, the Financial Services Act 1986 and the Banking Act 1987, together with those parts of the Building Societies Act 1986 and the Friendly Societies Act 1992 which deal with the regulation of financial services business.

The statutory objectives of the FSA

The draft Financial Services and Markets Bill sets four objectives for the FSA:

- (a) maintaining confidence in the financial system;
- (b) promoting public understanding of the financial system, including promoting awareness of the benefits and risks associated with different kinds of investment or other financial dealing;
- (c) securing the appropriate degree of protection for consumers, having regard to the differing degrees of risk involved in different kinds of investment or other transaction, the differing degrees of experience and expertise which different consumers may have in relation to different kinds of regulated activity, and the general principle that consumers should take responsibility for their decisions; and
- (d) reducing the extent to which it is possible for a business carried on by a regulated person to be used for a purpose connected with financial crime, with particular regard to the desirability of regulated persons being aware of the risk of their businesses being used in connection with the commission of financial crime and taking adequate measures to prevent, facilitate the detection, and monitor the incidence of financial crime.⁴

In addition, in discharging its general functions the FSA must have regard to: the need to use its resources in the most efficient and economic way; the responsibilities of those who manage the affairs of authorised persons; the principle that a burden or restriction that is placed on a person, or on the carrying on of a regulated activity, should be proportionate to the benefit the provision is generally intended to confer; the desirability of facilitating innovation in connection with regulated activities; the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom; and the principle that competition between authorised persons should not be impeded or distorted unnecessarily.⁵

4 HM Treasury, 1998b, pages 2-3.

5 HM Treasury, 1998b, page 2.

The key point here is that unless the legislative process introduces radical changes to the draft Bill, the new legislation will give the FSA a clear set of statutory objectives and a clear steer on the factors it should take into account in performing its functions, while beneath this the FSA will have considerable discretion and flexibility in how it pursues its responsibilities.⁶ Indeed, it is this discretion and flexibility which makes the accountability of the FSA so important. There are strong similarities here with the distinction drawn by Fischer (1994) between “goal” independence and “instrument” independence in the context of the respective roles of governments and central banks in the setting of targets for monetary policy and in the setting of instruments (usually short-term interest rates) in order to attain these targets.⁷

Accountability

The draft Financial Services and Markets Bill published in 1998 contained a range of accountability provisions. These included that the FSA Chairman and Board would be appointed and removable by the Treasury; that in exercising its rule-making powers and setting its policies the FSA should act in a way which is compatible with the regulatory objectives set out in the legislation and which is most appropriate for meeting those objectives; that the FSA should make an annual report upon the discharge of its functions, and the extent to which it has met its regulatory objectives; that the Treasury and the FSA are likely to be asked to give periodic evidence to the Treasury Committee; that a committee of the non-executive members of the Board should keep under review whether the FSA is undertaking its functions in an economic and efficient way, review the adequacy of the FSA's internal financial controls, and report on these matters in the FSA's annual report; that the Treasury will have powers to commission inquiries into regulatory matters of public concern, and to direct the FSA to change its rules, procedures or practices in response to an adverse competition report from the Director General of Fair Trading; and that the FSA would be subject to the decisions of an independent

6 Financial Services Authority (1998c) describes in detail how the FSA intends to meet its statutory objectives, set out in the draft Bill, and to do so with due regard to the considerations listed in the draft Bill; to use effectively and fairly the powers which the new legislation will grant to the FSA; to operate as a single regulator, with a consistent – but not necessarily identical – approach to its functions across the financial services sector; and to develop its regulatory approach further through a series of consultations.

7 See also Briault, Haldane and King (1997) for a discussion of the relationship between independence and accountability.

financial services tribunal. Rights of access to the tribunal would arise whenever the FSA proposes to exercise its disciplinary or intervention powers.

Moreover, following the responses to the public consultation on the draft Bill, which focused in particular on the enforcement powers available to the FSA and on accountability mechanisms, the Government proposes to strengthen the FSA's accountability through introducing a number of additional provisions, including giving the Treasury the power to commission independent reports, at periodic intervals, into the efficiency and economy of the FSA's operations; requiring a majority of the FSA Board members to be non-executives; requiring the FSA to maintain consumer and practitioner panels which will have a role in assessing the performance of the FSA against its statutory objectives⁸; and requiring the FSA to hold an annual public meeting to discuss its annual report, and to consult upon its arrangements for the independent investigation of complaints made against it (see HM Treasury, 1999, pages 8-11).

A further important aspect of accountability is that there must be a clear allocation of responsibilities between the Treasury, the Bank of England and the FSA. A Memorandum of Understanding between these three bodies was published in October 1997 (Financial Services Authority, 1997). This set out the responsibilities of the Treasury for the overall institutional structure of regulation, and for the legislation which governs it; of the Bank for the overall stability of the financial system, including the stability of the monetary system, for the financial system infrastructure (in particular payment systems), for being able "in exceptional circumstances" and subject to the agreement of the Treasury to undertake official financial support operations, and for the efficiency and effectiveness of the financial sector; and of the FSA for the authorisation and supervision of financial services firms, for the supervision of financial markets and of clearing and settlement systems, for the conduct of market-based support operations which do not involve official finance in response to problem cases affecting firms, markets and clearing and settlements systems within its responsibilities, and for regulatory policy on all of these areas.

In addition, the Memorandum of Understanding sets out a framework for close co-operation between the three bodies in terms of information gathering; information exchange; consultation on policy changes; the establishment of a Standing

8 The FSA had already established a Practitioner Forum and a Consumer Panel on a non-statutory basis.

Committee (which has been meeting since April 1998) to meet monthly to discuss individual cases of significance and other developments relevant to financial stability; and arrangements governing the implementation of support operations.

The International Monetary Fund has reported favourably on these new arrangements in the UK, judging the creation of a unified financial supervisory authority to be “an appropriate response to the uneven quality of supervision and consumer protection across various financial sectors and to the increasing importance of large financial institutions operating across traditional lines of business” (International Monetary Fund, 1999), while observing that it will be important to maintain the close collaboration between the FSA and the Bank of England.

2 Developments in other countries

The UK was not the first country to introduce a single financial services regulator. The Finansinspektionen was created in Sweden in July 1991 in response to actual and prospective market developments, including increasing integration both among different types of financial institutions and across borders. These developments led in turn to a concern that a fragmented regulatory structure might generate inconsistencies in approach, insufficient communication or an inadequate overview of regulated firms as more financial conglomerates emerged (see Norgren 1998). Similarly, the Finanstilsynet in Denmark (established in 1988) and the Kredittilsynet in Norway (established in 1986) supervise the banking, securities and insurance sectors.

Meanwhile, there has been a reconsideration of regulatory structures in some other countries as a result of factors such as greater integration among financial services firms, financial sector fragility in the form of the failure of financial institutions or other financial market disruptions, a change in central bank responsibilities (including, within members of European Monetary Union, the creation of the European Central Bank), potential economies of scale and scope, and the interest shown elsewhere in the creation of the FSA in the UK and the earlier moves by Norway, Denmark and Sweden.

Japan introduced a single regulator (the Financial Supervisory Authority) covering banking, securities and insurance in June 1998, as did Korea in April 1998 with the new Financial Supervisory Service, which was modelled explicitly on the UK's FSA, and Iceland (the Fjármálaesfirlit) in January 1999. Australia has chosen to introduce (in July 1998) two cross-sectoral bodies, one for the prudential supervision of banks, insurance companies and pension funds (the Australian Prudential Regulation Authority) and one for the supervision of securities firms and conduct of business requirements (the Australian Securities and Investments Commission), with a single overarching council above them, while in 1987 the Canadian authorities merged banking and insurance regulation in the Office of the Superintendent of Financial Institutions (OSFI).

Luxembourg introduced a single regulator for banking and securities business (but not yet insurance) in January 1999; consultation is underway in Ireland on government proposals to form a single financial services regulator, possibly by the end of 1999; and Israel, Mexico and South Africa are among several countries considering moves towards a single regulator.

3 Market developments

The financial services sectors of most countries have long been much influenced by market developments. These include the removal or weakening of barriers to entry and of restrictions on diversification and on various types of ownership structure; innovation and technological progress (which has had a dramatic impact on the cost of entering some markets for financial services); greater competition; and internationalisation. These developments are interrelated and mutually reinforcing. The result has been a blurring within the financial services sector of the traditional distinctions which used to apply across types of firm, types of product and types of distribution channel, albeit to different extents and in different ways across different countries.

For financial services firms, this has been manifested as an increase in the number of institutions which cut across traditional sectoral boundaries. This growth in

financial conglomerates (usually defined as a group which undertakes at least two major financial services activities) has resulted in part from the impact of mergers and acquisitions (perhaps most frequently between banks and securities firms and between banks and insurance companies, but also involving purchases of fund managers by banks and by insurance companies).⁹ But it also reflects the result of financial services firms extending through internal growth into new areas (for example, insurance companies setting up banks and vice-versa, insurance companies selling investment products, and banks setting up securities and fund management operations), and of new entrants to the financial services sector (such as retailers, including Marks & Spencer, Safeway, Sainsbury, Tesco and Virgin in the UK, and commercial firms, including General Electric in the United States) choosing to offer a range of financial services (extending from banking to pensions, and from general insurance to fund management) to their customers. In all of these cases the resulting mix of functions undertaken by the firm has been determined primarily by anticipated profits and the scope for cross-selling products to customers, rather than by any traditional linkages between, or separations across, products.

In the absence of reliable time series data (because even the pre-FSA regulatory structure in the UK is comparatively recent and shifted significantly during the first half of the 1990s), a snapshot of the incidence of financial conglomerates in the UK is revealing. Data for early 1998, collected as the FSA was taking organisational shape, show a large number of firms with multiple authorisations from the (then) separate UK regulators. Eight firms (including HSBC, Halifax, Abbey National and the Royal Bank of Scotland) were authorised to conduct all five of the main regulated activities (deposit-taking, insurance, securities and corporate finance, fund management, and advising on or selling investment products to retail customers). A further 13 firms were authorised to conduct four of these activities, and more than 50 other firms were authorised for three of these five functions. Twenty years ago, even the largest UK financial institutions were typically confined to just one, or at most two, of these five activities.

This increase in the number of financial conglomerates has been accompanied by a blurring of the boundaries between products. The securitisation of traditional forms of credit (including mortgages, credit card outstandings and commercial loans)

⁹ See for example, *The Economist*, 13 March 1999, pages 61-63, for a survey of the rapid domestic, and less frequent cross-border, consolidation of the financial services sector in Europe, including significant cross-sectoral mergers and acquisitions.

and, with the growth of options, increasingly elaborate ways of unbundling, repackaging and trading risks, have weakened the distinction between equity, debt and loans, and even between banking and insurance business (where, for example, credit derivatives bear many of the characteristics of an insurance product and insurance companies offer short-term deposit-like products).

Equally, channels of distribution are no longer as specialised as they once were. Banks and building societies have used their branches as a sales point for an increasing range of products (even non-financial products), while many of the new entrants to (and a few incumbents in) parts of the financial services sector have introduced new sales methods – such as telephone and internet channels – to a wide range of products which had previously been available only through more traditional channels.

What does all this imply for the structure of financial services regulation? The disappearance of a neat conjunction between a particular type of firm and a limited range of products being supplied by that firm means that it is difficult to regulate on a functional basis, since the traditional functional approach no longer matches the structure of either firms or markets. The “emergence of financial conglomerates has challenged traditional demarcations between regulatory agencies” (Goodhart et al, 1998, page 143) and the “boundaries between regulators simply no longer reflect the economic reality of the industry” (Taylor, 1996, page 4).

There is a clear need for regulatory oversight of a financial conglomerate as a whole, since there may be “risks arising within the group ... that are not adequately addressed by any of the specialist prudential supervisory agencies that undertake their work on a solo basis” (Goodhart et al, 1998, page 148). Many of the threats to the solvency of the institution can be assessed adequately only on a group-wide basis. This includes the assessment not only of whether the group as a whole has adequate capital, but also of the quality of its systems and controls for managing risks, and the calibre of its senior management. Indeed, the importance of systems and controls and of senior management to the standards of compliance achieved by a firm against both the prudential and the conduct of business standards and requirements set by financial services regulators means that it is not possible to draw a clear dividing line between prudential and conduct of business regulation, since, in this respect, both types of regulation have an interest in the same aspects of a firm's business. Moreover, there needs to be an effective exchange of information and a co-ordination of regulatory requirements across the regulators responsi-

ble for different parts of a conglomerate's business, as well as mechanisms for co-ordinated action when problems arise in a conglomerate (Goodhart et al, 1998, page 149).

But even if there is a strong case for an institution-wide overview of a financial conglomerate, is it necessary for this to be undertaken by a single regulator? Or could it be undertaken by a "lead" regulator (or "co-ordinator") appointed from among the "solo" regulators responsible for specialised aspects of the institution? This lead regulator would be responsible for taking a consolidated view of the capital adequacy and liquidity of the institution as a whole; taking a similarly group-wide view of more qualitative factors such as the calibre of senior management and the high-level systems and controls of the financial conglomerate; and co-ordinating and encouraging the exchange of information among the relevant regulatory bodies, both routinely and in the event of an emergency (see, for example, Goodhart et al, 1998, pages 147-150 and Joint Forum 1999).

Most countries still follow the lead regulator approach. But, equally, those countries who have shifted to a single national financial services regulator – or at least consolidated their regulatory bodies into just two or three regulators – have generally done so in part because, with the growth in the number of multiple-function firms, the need for communication, co-ordination, co-operation and consistency across specialist regulatory bodies had become increasingly acute and increasingly difficult to manage efficiently. The question is therefore less one of whether lead regulation can work – it clearly does so in many cases – and more one of the efficiency of such an approach when market developments make the problems of communication, co-ordination, co-operation and consistency the norm rather than the exception.

So does the same argument apply internationally? Lead regulation also needs to be – and frequently is – undertaken on a cross-border basis for the supervision of institutions with operations in more than one country (where the institution need not even be a conglomerate, since an internationally active institution will have multiple (national) regulators even if its operations are confined to a single line of business). However, although this suggests that there might be a case for moving towards some form of single regulator on a cross-border basis, the argument is less strong here for three main reasons.

First, a transnational regulator would have to operate across very different legal and cultural structures. The Joint Forum (1999) report on the role of a “co-ordinator” stressed the importance of taking account of these factors in defining the role and responsibilities of a co-ordinator, including the different legal frameworks of the countries in which the conglomerate operates, the different statutory responsibilities and powers of the individual regulators concerned, and the varying abilities of these regulators to share information across sectors and across borders. Second, market developments do not yet suggest the need for a transnational financial services regulator. Even within the European Union the amount of cross-border business in financial services is relatively small and a genuinely single market in this area – especially in retail financial services – has still not emerged. Third, a transnational regulator could be very distant (both literally in terms of geography and in terms of its approach) from most of the firms it regulates (especially the great majority in numerical terms which still operate wholly or predominantly in a single country).

Thus, at least at present, the growth of internationally active financial services firms (whether single or multiple function) has been met by a combination of increasing international co-operation and co-ordination, including through the introduction of lead regulator arrangements, and agreements on common minimum standards to be applied by all countries – especially in prudential standards and in guidelines for high-level systems and controls.¹⁰ Meanwhile, in the European Union the incorporation of common standards in Directives has formed the basis for “passporting” arrangements under which the home state regulator takes full responsibility for assessing some (essentially prudential) aspects of the business of firms who have branched into other EU countries, while the principle of subsidiarity is reflected in the nationally-based responsibilities for financial services regulation.

The recently established Financial Stability Forum (G7, 1999) is in part intended to move international regulatory co-operation forward from the setting of such common standards to a greater emphasis on the effective implementation of these standards, including possibly through a process of peer review and the IMF’s regular Article IV surveillance of its member countries. The Forum is also intended to

10 For example, the Basle Committee for Banking Supervision Core Principles for Effective Supervision and Capital Accord, the International Organisation of Securities Commissions Objectives and Principles of Securities Regulation, and the International Association of Insurance Supervisors Principles, Standards and Guidance papers.

improve co-operation and co-ordination among the key international financial services regulatory bodies (the Basle Committee on Banking Supervision, the International Organisation of Securities Commissions and the International Association of Insurance Supervisors), finance ministries, central banks, the leading national regulatory authorities and the international organisations with responsibilities for international financial stability (the International Monetary Fund, the World Bank, the Bank for International Settlements and the Organisation for Economic Co-operation and Development). Thus the forum will be well positioned to cover both cross-border and cross-sectoral issues.

Padoa-Schioppa (1999) argues from a narrower perspective that co-operation and co-ordination among national banking supervisors should increase in line with the development of a single banking market in Europe; and he suggests in addition that this could eventually turn naturally into a pan-European banking supervision authority, responsible at least for pan-European banks. But it should also be acknowledged that financial institutions may become sectorally integrated (across banking, securities, insurance etc.) at least as rapidly as the development of their cross-border activities, thus generating in addition the need for greater co-ordination and co-operation across both borders and sectors. This might, in turn, eventually generate a stronger argument for any pan-European or other transnational financial regulator to have a broad scope across a wide range of financial services activities.

4 Regulatory efficiency and effectiveness

There can be little doubt that a single national financial services regulator offers scope for significant efficiencies. In theory, at least, a single regulator ought to be able to generate a number of efficiency gains. Equally, however, it may be difficult for a single regulator to deliver these in practice.

Economies of scale and scope

Economies of scale and scope should arise because a single regulator can take advantage of a single set of central support services (human resources, information services, financial control, premises etc); introduce a unified statistical reporting system for regulated firms; operate a single database for the authorisation of firms and the approval/registration of individuals; avoid unnecessary duplication or underlap across multiple specialised regulators; introduce a consolidated set of rules and guidance; tackle problems of co-ordination, co-operation and communication more effectively within a single entity and under a unified management structure than might be possible across separate specialist entities; offer a single point of contact to both regulated firms and to consumers (through a single complaints handling regime and a single compensation scheme); and adopt a more effective and focused approach to areas of common interest to most regulated financial activities (for example, handling Year 2000 issues and turbulence in international financial markets).

In the UK, the Financial Services Authority has already established single authorisation, supervision, investigation and discipline, training and competence, consumer relations and central services functions, and is working towards the construction of a single handbook of rules and guidance, a single complaints handling regime and a single compensation scheme.¹¹ In addition, the FSA's statu-

11 Financial Services Authority (1998c) and Briault (1998) set out how the FSA will approach the harmonisation, consolidation and rationalisation of the principles, rules and guidance issued by the existing regulators or embedded within existing legislation, while recognising that what is appropriate for one type of business, market or customer may not be appropriate for another; will introduce a single process for the authorisation of firms and for the approval of some of their employees, using standard processes and a single database; will move to a more consistent and

tory objective to promote public understanding of financial services is probably best undertaken on a centralised basis (Davies, 1998b).

Moreover, these economies of scale and scope have been reflected in the costs of the FSA as a single regulator, which are budgeted to be lower in real terms in 1999/2000 than the sum of its component parts in either of the previous two years (see Financial Services Authority, 1999), with the prospect of further savings to come once the new legislation is in force (Davies, 1998b), despite the FSA having a slightly wider scope than that of the nine regulatory bodies being brought together. Moreover, the consolidation of rules and guidance, the unification of reporting requirements and the removal of duplication and overlap across specialist regulators should reduce the costs (other than the costs of the regulator itself) imposed by regulation on regulated firms, which is of particular importance because studies have found that these “indirect” (additional compliance) costs of regulation are a multiple of the “direct” costs of paying for the regulator(s) itself (see Franks et al, 1998; Goodhart, 1988; and Lomax, 1987).

The principle of a single regulator has been welcomed in the UK: “There was almost unanimous support from consultees for the proposal to have a single statutory regulator, in order to tackle overlaps, gaps and inconsistencies in regulation and to improve accountability and clarity of purpose.” (HM Treasury, 1999, page 7), and financial conglomerates have supported the move away from regulatory overlap and a plethora of reporting requirements (Davies, 1999).

As Goodhart et al (1998) point out, a single regulator need not necessarily deliver these advantages. Specialist divisions/areas will exist even within a single agency, thus creating potential problems in communication, information sharing, co-ordination and consistency. However, it is difficult to see how these problems could be more acute within a single regulator with a unified management structure and an effective internal decision-making process than across multiple specialist regulators each with their own individual and largely independent cultures and decision-making structures.

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; will adopt a more consistent and coherent approach to enforcement and discipline, while recognising the need for appropriate differentiation; and will introduce single schemes for handling consumer complaints and compensation, and a single independent appeals tribunal.

An interesting recent example of this in the UK has been the regulatory response to the announcement by the Government in 1998 of the introduction (from April 1999) of Individual Savings Accounts (ISAs). These will provide individuals with tax relief on a limited amount of deposits, investments with an element of life assurance, and various types of bond and equity investments. Providers of these products will be encouraged to meet voluntary "benchmark" standards relating to charges, access and other terms and conditions (although these standards are not a condition for eligibility for tax relief). The FSA was given the responsibility of ensuring that the selling and marketing of these products is fair (in particular in the sense of the disclosure of relevant information, including accurate information on whether a product is eligible for inclusion within an ISA and whether it meets the benchmark standards) and that financial advisers give proper advice on the suitability of these products for investors. This has necessitated an amendment to the rulebooks (which continue in existence until the Financial Services and Markets Act comes into force) of the Personal Investment Authority, the Securities and Futures Authority and the Investment Management Regulatory Organisation. Although most of the work on this was undertaken in the first half of 1998, in the early days of the FSA's existence, the move towards a single financial services regulator created an environment in which the various regulators co-operated closely with each other to ensure a co-ordinated and coherent regulatory response to the Government's initiative, which might not otherwise have been achieved as readily or speedily.

Resource allocation

In addition to pure scale economies, a single regulator ought to be more efficient in the allocation of regulatory resources across both regulated firms and types of regulated activities. One crucial element of this is the development of a single system of risk-based supervision under which regulatory resources are devoted to those firms and those areas of business which pose the greatest risk when judged against the objectives of protecting consumers, maintaining market confidence (including the reduction in systemic risk) and reducing financial crime. It is not an easy task to assess and to compare the "apples and pears" risks across different regulated firms and regulated activities, but it is necessary to undertake this task in order to allocate resources effectively within a single regulator - or indeed across multiple specialist regulators. The explicit nature of this task and the organisational and managerial ability to reallocate resources within a single regulator

means that the end result should be more efficient and effective than the outcome of the more historical and arbitrary allocation of regulatory resources across separate specialist regulators (see Financial Services Authority, 1998c; and Foot, 1999).

In addition, a single regulator might be able to retain and to utilise expertise more effectively (for example in the assessment of market risk models and other complex internal risk control systems used by regulated firms), especially when this expertise is in short supply (Taylor, 1995), and to offer more extensive professional development and career prospects to its staff (Davies, 1999).

Conflict resolution

A single regulator ought to be best placed to resolve efficiently and effectively the conflicts which inevitably emerge between the different objectives of regulation. This is because a single management structure should be better able to identify, to decide upon and to implement a collectively agreed resolution in response to conflicts which arise.

Goodhart et al (1998) and Taylor (1995) argue that it may be either easier or more appropriate to resolve conflicts of interest (between different objectives or responsibilities, or between different regulators) at a political level rather than within a single regulator. At one level it is difficult to argue against this essentially democratic approach, but it must also be recognised that in practice governments have been slow and ineffective in resolving these types of conflict¹²; that some of the conflicts of interest between multiple specialist regulators arise because they either do not have clear objectives and responsibilities or because these were set at different times and are inconsistent with each other; and that a single regulator can be given clear and consistent objectives and responsibilities, which should generate fewer conflicts in the first place, and can operate within a clear system of accountability. Thus even if all specialist regulators are focused effectively on delivering their own specific mandates, the sum of the parts need not add up to a coherent and consistent overall outcome.

12 Governments may lack the necessary information and experience to take decisions here, and may also be reluctant to do so if it brought them too close to the regulation of individual financial institutions.

Appropriate differentiation

A single regulator ought to be able to avoid the unjustifiable differences in supervisory approaches and the competitive inequalities imposed on regulated firms through inconsistent rules which have arisen across multiple specialist regulators (Norgren, 1998). However, this does not mean that a single regulator has to adopt a “one size fits all” approach, which might offset the internal economies available to a single regulator through the imposition of higher “indirect” costs on the industry. Different objectives and approaches can be internalised within a single regulator. This is reflected starkly in the UK government’s commentary on the new legislation (HM Treasury, 1998a and 1999). And it is clear from all of the material published by the UK Financial Services Authority that the issue of appropriate differentiation is central to its approach (Financial Services Authority, 1998c and 1998d). Plans for the development of the FSA’s proposed single handbook of rules and guidance stress both the need to harmonise, consolidate and rationalise the various principles, rules and guidance in the regulatory material issued by the former specialist regulators – so that similar risks are treated similarly irrespective of where they arise – and the need to create and to preserve appropriate differentiation to reflect the different degrees of protection required by different types of consumer (Financial Services Authority, 1998a, 1998c and 1998e). Accountability and review mechanisms should also help to reduce the possibility of insufficient differentiation.¹³

Accountability

If a single regulator is given a clear set of responsibilities then it ought to be possible to increase the transparency and accountability of the single regulator (Taylor 1995, Goodhart et al 1998), not least in terms of its accountability for performance against its statutory objectives, for the regulatory regime, for the costs of regulation, for its disciplinary policies, and for regulatory failures (Davies, 1998b and 1999).

13 And in the UK the FSA has for example continued with the Bank of England’s flexible approach to the setting of firm-specific required capital ratios for banks, sometimes considerably above the Basle Accord of a minimum of 8%.

Although Taylor (1995 and 1996) recognises the arguments in favour of moving toward a single financial services regulator – placing particular emphasis on the emergence of financial conglomerates, the excessive fragmentation of specialist regulatory bodies, the lack of accountability across these multiple regulators and a lack of clarity in their objectives – he stops short of recommending a single national financial services regulator. This is in part because of a concern that a single regulator “could potentially become an over-mighty bully, a bureaucratic leviathan divorced from the industry it regulates” (Taylor, 1995, page 15). Similar concerns were expressed by some of the respondents to the draft Financial Services and Markets Bill in the UK (HM Treasury, 1999, pages 10-11 and 21). What is to prevent a monopolistic regulator from operating in an ever more intrusive manner?

There is no simple way of constructing a single regulator so as to remove these concerns, but in the UK the Government has addressed them most recently by strengthening the statutory accountability mechanisms in the draft legislation (as described in Section 1 above)¹⁴, and by improving the provisions in the draft legislation which govern the investigation and discipline powers of the Financial Services Authority, including a requirement on the FSA to establish and publish procedures on taking disciplinary action and to act in accordance with them (HM Treasury, 1999, page 20). Meanwhile, the FSA has itself published a considerable amount of material setting out how it intends to meet its responsibilities under the proposed legislation (Financial Services Authority, 1998c); how it will consult widely and openly with interested parties in determining its overall approach and in formulating its standards and requirements (Financial Services Authority, 1998b), including the use of published cost-benefit analysis (Alfon and Andrews, 1999); and how it will establish the internal procedures necessary to ensure that its enforcement processes are used fairly and are seen to be fair, including a clear internal separation of functions between the staff who investigate a case and those who take the decision to proceed with enforcement action (Financial Services Authority, 1998e).

14 Although even these additional measures would not satisfy all of the critics of the FSA's accountability mechanisms (see, for example, Laslett and Taylor, 1998).

Objectives of regulation

Goodhart et al (1998) and Taylor (1995, 1996) both propose models of regulatory structure based primarily upon the objectives of regulation, albeit fine-tuned to take account of market developments and of the need for accountability and efficiency. Thus Taylor (1995, 1996) proposes a “twin peaks” model - as indeed did Goodhart (1996) – which “institutionalises the distinction between the systemic protection and consumer protection objectives” and which reflects the “profound differences between the style and techniques appropriate to prudential and conduct of business regulation” (Taylor, 1995, page 15). In this model, a Financial Stability Commission would be responsible for the prudential supervision of most financial institutions, including all banks, building societies, insurance companies, securities firms and institutional fund managers, while a Consumer Protection Commission would be responsible for the conduct of business between financial institutions and retail consumers (Taylor, 1996, page 6). There might also need to be a “third peak” in the form of a Market Surveillance Agency, with responsibility for detecting and prosecuting various types of market abuse in wholesale markets (Taylor, 1995, page 14).

However, as discussed briefly in Section 3 above, the distinction between prudential and conduct of business regulation is not in practice as neat and simple as Taylor’s twin peaks model might imply. Even without the emergence of financial conglomerates, a large number of financial services firms would need to be regulated by both of his proposed Commissions because their business would require both prudential and conduct of business regulation. This would certainly include life insurance companies, securities firms and institutional fund managers, and in practice would also include the many banks and building societies who combine deposit-taking with various forms of investment business. This in turn would generate inefficiencies (firms having to be authorised and supervised by more than one regulator) and the possibility of the communication, co-operation and consistency problems discussed earlier.

Moreover, there is a considerable overlap – both conceptually and in practice – between prudential and conduct of business regulation. Both have a close and legitimate interest in the senior management of any financial institution subject to both of these types of regulation, in particular because of the crucial roles of senior management in setting the “compliance culture” of a firm, in ensuring that management responsibilities are properly allocated and cover comprehensively the business of the firm, and in ensuring that other internal systems and controls are

in place. The detail of some of these systems and controls may indeed be specific to either prudential or conduct of business considerations, but many of them will be more general.

Indeed, one of the criticisms from the industry of the earlier fragmented structure of supervision in the UK was the frequency with which different regulators wanted to discuss with the senior management of a firm with multiple authorisations how its business was structured and operated. Furthermore, the move in the UK and elsewhere to a risk-based approach to supervision (Foot, 1999), under which regulatory resources and the tools of supervision are directed towards those firms (and those areas of their business) which are judged by the regulator to carry the greatest risk to consumers and to the stability of the financial system, can only be undertaken effectively if it embraces all the regulated activities of each financial services firm. Of course, these risks will differ both within and between the different aspects of prudential and conduct of business regulation, but this does not mean that they cannot be assessed and compared. Indeed, it may be necessary for any regulatory structure to address these issues because of the potential trade-off between conduct of business and prudential objectives (since undesirable business conduct, such as overcharging consumers, could reduce the risk of a financial institution becoming insolvent).

Goodhart et al criticise the “twin peaks” model from a different perspective, claiming that the model is “too all embracing and does not recognise the significant differences between institutions and types of business with respect to both prudential and conduct of business regulation” (1998, page 159). They note that most financial institutions are not conglomerates and that

“There remain, and will remain for the foreseeable future, major differences between banks, securities firms and insurance companies in the nature of their business, the type of contracts they issue, and hence the nature and form of asset transformation. Firms in all subsectors have diversified, but almost invariably their core business remains dominant. The natures of the risks are sufficiently different to warrant a differentiated approach to prudential regulation.” (1998, page 153).

This, and the arguments discussed earlier in this section, lead Goodhart et al to propose that the structure of regulation should be based on the different objectives

of regulation. They suggest no fewer than six separate regulators, covering systemic risk (banks, building societies and credit unions); non-systemic prudential regulation (insurance companies); retail conduct of business; wholesale conduct of business; financial exchanges; and a competition authority (1998, pages 159-168). The rationale for this approach (or for other possible objective-based models with more than one regulator) is superficially attractive – giving regulators clear mandates and ensuring appropriate differentiation in the regulation of different types of activity. But it does not address convincingly the risk that it would be subject to all of the problems discussed above in the context of multiple functional regulators (since the objective-based structure proposed by Goodhart et al looks very similar in practice to a functional-based structure), in particular because many firms would be subject to regulation by more than one of the proposed regulators (and some by all of them). And the inefficiencies and complications inherent in a multiple regulator structure can only increase as financial conglomerates become more prevalent, thus potentially outweighing the advantages of an objectives-based structure.

Moral hazard

Goodhart et al ask whether, under a single regulator, a “potential moral hazard would result from a public perception that the risk spectrum among financial institutions had disappeared or become blurred” (1998, page 154). In practice, the public’s understanding of the regulatory system is – regrettably – likely to be so low that this type of moral hazard should not arise. And although the public may become more aware of the unified nature of complaints handling and compensation schemes, there will also be scope – and in the UK there is a specific statutory objective for the Financial Services Authority – for a single regulator to raise public awareness of the risks, costs and benefits of different financial services, and to make clear the limitations of what regulation can deliver, thus reducing the potential moral hazard.

5 Regulation and central banking

One effect of creating a single financial services regulator has, as in the UK, generally been to move banking regulation away from the central bank. There is a debate about whether a central bank which is responsible for monetary policy gains from undertaking the regulation of individual institutions, or whether combining these two responsibilities can lead to conflicts of interest. Also, irrespective of whether a central bank is responsible for monetary policy, does its role as a lender of last resort provide a rationale for its undertaking the regulation of those financial institutions which are deemed to give rise potentially to systemic risk?

Monetary policy and supervision

There is a large literature but few clear conclusions on the question of whether central banks should regulate individual financial institutions. The arguments against combining these functions include

- (i) that there might be a conflict of interest which tempts a central bank to loosen its monetary policy stance (or to delay a monetary tightening) – and thus to impart an upward bias to inflation – because of concerns about the financial health of the firms (typically banks) which it regulates¹⁵;
- (ii) that losses of credibility arising from perceived regulatory “failings” could contaminate its monetary policy role; and
- (iii) that the wider the role of a central bank¹⁶ the greater the risk that its functions will be subject to political pressures or political control, thus poten-

15 This is usually presented as a “one-off” argument which applies during a period of financial instability. There is also an argument that continuing (modest) inflation could reduce the risk of bank insolvencies if higher inflation (and thus higher nominal interest rates) raised banks’ profit margins on non-interest (or low interest) bearing deposits.

16 Which might include widening regulatory responsibilities as a result of the emergence of financial conglomerates, or indeed making the central bank a single regulator for the entire range of financial services.

tially undermining the independence of its monetary policy (and indeed regulatory) responsibilities (see, for example, Cukierman, 1992, Chapter 7; Goodhart and Schoenmaker, 1995a and 1995b; and Bruni, 1997).

Goodhart and Schoenmaker (1995a) do indeed find some positive cross-country correlations between the rate of inflation and the combination of monetary and supervisory functions, but in the absence of any firm theoretical underpinning it is difficult to interpret this result as suggesting any causal link. Moreover, as in other simple cross-country comparisons of this type, the result may be reflecting the influence of other factors, such as positive correlations between central bank independence and both lower rates of inflation and a separation of supervisory functions from the central bank (for example, Goodhart and Schoenmaker, 1995b, note that less independent central banks tend to combine monetary policy and regulatory functions¹⁷). Similarly, Briault (1997) found no evidence of any impact of either the BCCI or Barings bank failures on the credibility of UK monetary policy (as measured by the term structure of inflation expectations), although this does not preclude the possibility that there was some damage to the prestige of the Bank of England. There is also no firm empirical evidence of the monetary authorities (whether independent central banks or governments) loosening monetary conditions simply in order to support banks or other financial institutions,¹⁸ with the possible exception of the United States in the 1980s. (See, for example, Goodhart and Schoenmaker 1995a and 1995b.)

Turning to the potential advantages of combining monetary policy and regulatory responsibilities in a single institution, Goodhart (1995) observes that the monetary authorities usually make the opposite mistake of taking too little account of conditions in the financial sector when setting monetary policy. For example, the credit channel literature¹⁹ provides one explanation of why monetary policy may need to be relaxed following an adverse shock to the banking industry's credit creation process. Moreover, Peek et al (1999) find evidence that confidential super-

17 But some central banks may have so little independence in the setting of monetary policy that they cannot be described as the "monetary authority" at all, since both the goals and the instruments of monetary policy are set by the government. So, in this case, a central bank's regulatory responsibilities cannot be in conflict with its (non-existent) monetary policy responsibilities.

18 A loosening of monetary policy would anyway not be an efficient way of assisting just one (or a small number of) financial institution.

19 See, for example, Bernanke and Gertler (1995) for a survey and discussion of this literature.

visory information on the financial condition of US banks could be used to improve the accuracy of forecasts of US inflation and unemployment, and indeed that such information has been used by members of the Federal Open Market Committee in the setting of US monetary policy.

A central bank which combined monetary policy and regulatory responsibilities – or at least had access to regulatory information – could therefore potentially improve its ability to undertake monetary policy through understanding better both conditions in the financial services industry and the transmission mechanism of monetary policy through the financial sector, not least in periods of particularly rapid credit expansion or asset price increases, or in periods of “credit crunch” or falling asset prices. As expressed by the Governor of the Bank of England:

“Monetary and financial stability are inter-related. It is inconceivable that the monetary authorities could quietly pursue their stability-oriented monetary policy objectives if the financial system through which policy is carried on – and which provides the link with the real economy – were collapsing around their ears. The liabilities of banks in particular are money, and you cannot be concerned with preserving the value of money without being concerned also with preserving public confidence in money in this broader sense. Equally though, the financial system is much less likely to be collapsing around the ears of the monetary authorities in an environment of macro-economic stability than in one of exaggerated boom and bust and volatile asset values. This inter-relationship means that, whatever the precise institutional arrangements for financial regulation and supervision, central banks necessarily have a vital interest in the soundness of the financial system.” (George, 1994)

So although there need to be close links and a proper flow of information between the relevant regulator and the monetary authorities, this does not imply that the two functions have to be combined within the same institution. In many countries they are not. As noted recently by Padoa-Schioppa (1999), the central bank is the sole authority responsible for banking supervision in only two of the twelve countries represented on the Basle Committee on Banking Supervision (Italy and the Netherlands), while the creation of the European Central Bank has separated financial regulation and monetary policy across the eurozone, leaving some of these

central banks with responsibility for banking supervision but not for monetary policy, and some with responsibility for neither function (except for the shared responsibility for monetary policy with other members of the eurozone, and in some cases a shared involvement in banking supervision with the relevant national regulatory authority).

Systemic risk

The other relevant aspect of the relationship between central banks and the structure of regulation is the question of whether banks are “special”. The argument runs as follows (and is discussed in more detail in George, 1997, Goodhart et al, 1998 and Llewellyn, 1999). Banks generally issue short maturity and capital certain deposits, while much of their lending is illiquid and non-marketable. They specialise in loans whose value depends on customer-specific information which is not generally available to other lenders. The combination of these liability and asset characteristics leaves banks²⁰ prone to deposit runs if their depositors (retail or wholesale) perceive a risk of insolvency, or even of illiquidity.

There is also the potential for contagion here if the perceived problem is believed to apply to more than one bank,²¹ or if it is believed that the failure of one bank could cause other banks to become insolvent or illiquid, for example because of their exposures to it through the payments system. Moreover, a run on an otherwise solvent bank might cause it to become insolvent through the forced sale of its illiquid assets, where the asymmetry of information about the bank’s borrowers may make it difficult for potential buyers of these assets to price them accurately. This means that

- (i) a bank failure might be damaging to the economy as a whole because of an adverse impact on its borrowers, who are unable readily to find alternative sources of credit, and on the smooth functioning of the payments system;

20 Albeit not necessarily all banks; and some non-banks may also share similar characteristics.

21 It may be difficult for bank depositors to distinguish between institution-specific shocks affecting a single bank and more general shocks affecting the position of more than one bank.

- (ii) this effect would be reinforced by any contagion; and
- (iii) it may be rational for depositors to join a “run” even if they had previously perceived their bank to be financially sound, because of the possible adverse impact of illiquidity on the bank’s solvency if other depositors are seeking to withdraw their funds (or even if they are just expected to do so).

What does this imply for regulation? If the failure of a financial institution would impose negative externalities on others, and if – as seems likely – these externalities are not factored into the risk appetite of that institution, then there is a case for official intervention. This could take the form of regulation of the financial institution to limit the risks it takes, to demand that it holds more capital than it otherwise would choose to do as protection against failure, and/or to insist that it holds more liquid assets. Alternatively, or in addition, the authorities could provide deposit insurance to reduce, but not entirely eliminate, the incentive for “runs” and could provide financial support in the event of a “systemic” financial institution running into difficulties. Such support might be provided not only to firms which were illiquid – in order to prevent insolvency and/or contagion – but also to firms which were insolvent, if it was judged that the cost of support would be less than the benefits (ie preventing the negative externalities from crystallising). In turn, both deposit insurance and the possibility of support operations are themselves arguments for the regulation of the firms covered by them, in order to offset the impact of the moral hazards which such insurance generates, unless this insurance can be properly priced.

But this case for “systemic” regulation does not imply any unambiguous conclusions for the structure of regulation. The difficulty in determining which financial institutions might generate a significant negative impact on financial stability if they failed makes it difficult to draw a dividing line around which firms should be regulated by a separate “systemic” regulator.²² Taylor (1995, 1996) deliberately argued for a wide-ranging prudential regulator to avoid this difficulty since “a wide

22 George (1997) and Goodhart et al (1998) recognise that under some circumstances securities firms and other non-banks may pose systemic threats. A recent example was provided by a hedge fund, Long Term Capital Management, whose possible collapse was judged by the US authorities to have potentially systemic risks at a time of general financial fragility, although no public funds were involved in the support provided by some of LTCM’s major creditors.

range of firms can now create potentially systemic problems" (1995, page 4). And if a narrower set of financial institutions is deemed to be of systemic importance (as, for example by Goodhart et al, 1998), then there must be a risk that creating a separate regulator with a specific "systemic risk" mandate would increase the moral hazard problem by creating the impression that the financial institutions authorised and supervised by such a regulator would be likely to be protected and supported in the event of problems arising. This in turn could create serious competitive distortions in the financial services sector, since depositors might be unfairly attracted to those financial institutions perceived to be "protected" in this way.

Meanwhile, the inability of retail customers in particular to monitor the financial soundness of firms who take deposits, or where the value of an investment or insurance policy depends on the continuing financial health of the product provider, generates a consumer protection case for prudential supervision (and indeed also for deposit insurance and for investment and policy-holder compensation schemes).²³ Although there might in theory be a difference between the type or intensity of regulation introduced for systemic reasons and that imposed for consumer protection reasons, there is almost no discussion in the academic literature of what form any such distinction might take, and no practical experience of regulators explicitly introducing such a distinction. Both the macro-economic aspects of financial stability and the micro-economic aspects of the value of deposits, investments and insurance policies may be threatened by much the same set of events, namely those which imperil the solvency of the relevant financial institutions. Similarly, regulatory standards and requirements designed to protect the solvency of these institutions will benefit both financial stability and individual customers. So it may not make much sense to establish a structure of regulation based on a supposed distinction between the systemic risk and consumer protection bases for prudential regulation. And, as discussed earlier in a more general context, even if such differences could be identified, there is no reason why any appropriate differentiation in approach could not be applied by a single regulator, who might also be best placed to manage efficiently and effectively the considerable overlaps in approach which would remain.

23 Indeed, in the UK micro-prudential supervision of banks and deposit insurance were introduced in 1979 "with the distinct social purpose of providing individual small depositors with a degree of protection against the sudden loss of their principal liquid asset holdings" (George, 1997).

Finally, does the case for regulation in response to systemic risk provide an argument in favour of the central bank undertaking regulation? Probably not, although it will be essential to preserve a flow of information between the regulator(s) and the central bank. The role of central banks at the heart of the payments system and their ability to utilise their own balance sheets means that liquidity support and other forms of intervention can most efficiently be provided to financial institutions through, or with the assistance of, a central bank. Nevertheless, it is important to recognise (as in Goodhart & Schoenmaker, 1995b; Goodhart et al, 1998; and Padoa-Schioppa, 1999) that because an illiquid financial institution might turn out to be insolvent, because some official support operations are anyway directed explicitly at insolvent financial institutions, and because the increasing diversity and competition among commercial banks make it more difficult to arrange a private sector rescue package, the decision to provide official support will more often than not involve the government rather than just the central bank. And, as is anyway the case in many countries, the institution-specific information available to regulators can be given rapidly to the central bank and to the fiscal authorities once problems arise. Moreover, the increasing prevalence of financial conglomerates means that a multiple regulator structure might make it more difficult to assemble and to assess the available regulatory information at times of emergency, than would be the case with a single financial services regulator. The synergies arising from a single regulator may outweigh those arising from undertaking the regulation of a sub-set of financial institutions within a central bank.

The conclusion of this section is therefore that the multi-faceted relationship between regulation and central banking does not have strong implications for the optimal structure of regulation, although it does certainly make it essential for there to be close co-operation and an extensive flow of information between the central bank and the regulator(s), including routinely for those aspects of financial stability in which the central bank has an interest for the setting of monetary policy, and in exceptional circumstances for more specific and detailed information relating to the position of financial institutions for whom support operations are being considered (where the fiscal authority is also likely to have a close interest). The UK Memorandum of Understanding, described in Section 1 above, provides an important underpinning to the necessary exchange of such information under the new arrangements in the UK.

6 Conclusions

The UK has not been alone in establishing a single national financial services regulator. This international trend has reflected in particular the increasing number of institutions undertaking a range of different financial activities, the potential economies of scale and scope from combining regulatory responsibilities within one or two financial regulatory bodies, and a reappraisal in some countries of the allocation of – and the accountability for – monetary stability, financial stability and micro-regulatory responsibilities.

This paper has set out the theoretical advantages of a single national financial services regulator and the way in which, in the UK in particular, these advantages can be delivered in practice, while minimising as far as possible any potential downsides from such an approach. Goodhart et al (1998, page 181) may well be correct in stating that “there is no universal ideal model”, not least because financial markets have developed – and will continue to develop – differently in different countries. But, overall, a single national financial services regulator, covering a broad range of financial services activities and spanning both prudential and conduct of business regulation, is likely to be well placed to deliver effective, efficient and properly differentiated regulation in today’s financial environment.

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