CHAPTER -VIII
UNIFIED OR MULTIPLE REGULATORY STRUCTURE

The gaps that come up in Regulatory Structure that were discussed in the last chapter, invariably takes one to the view whether Unified model of regulatory structure for the country will help close the gaps. The available data and the practices in other jurisdictions indicate that each model whether unified or multiple has its own advantages and disadvantages. What should be the ideal structure of regulatory framework for a jurisdiction is the subject matter of great debate world over which is far from over. There appears to be no perfect model that can be prescribed for any country. The same is dependent on plethora of factors ranging from geo political, social to economical reasons. This Chapter, most critical to the central theme of this thesis, examines in detail the unified or multiple models, their advantages and disadvantages of each structure.

The main issue that comes to the fore is the choice between a Unified Regulatory Structure and Multiple structures that would be suited to a financial market in a jurisdiction. Though a very big debate is raging on the pros and cons of a unified regulator, ultimately the choice of a particular type of a regulatory structure is dependent upon the risks perception of each jurisdiction, its political environment, its value system, public policy etc. As such there can be no prescribed structure for regulatory system that can be recommended to a financial market in any country. It may differ from country to country depending upon their political, financial, institutional and economic set ups. An unified regulator is one which has regulatory oversight over all the financial activities. There is no guarantee that by mere change from one form of regulation to another would ensure effective supervision. Changing the structure of regulation might appear to respond to “be seen to be doing something” especially in the wake of crisis. But such a change may not address the root cause of weakness of supervision that may have contributed to the crisis in the first place. Hence,
strengthening regulatory capability requires urgent attention than the change in the model.

An Unified regulator is structured either on a functional or a silos matrix depending upon local conditions and the objectives of a regulation. Where departments of a regulatory agency, such as the legal, Licensing, Supervision and Investment Policy Departments, deal with different financial services and products across the financial sector without segregating these services and products on the basis of the type of business activity or the type of institution offering them, the regulator is said to be organized along functional lines. By contrast, in a silos matrix, a particular organizational unit would deal exclusively with the regulation and supervision of insurance, another with pension funds and so on. Here, although all supervisory functions are undertaken by the regulator as a whole, insurance businesses are licensed and supervised separately from securities firms or banks. The competing interests of various stakeholders can also have a bearing on the organizational structure of a unified regulator.

Another important distinction is that unification may be partial or full. Normally, where only two segments of the financial sector are supervised by a single regulator, as are pension funds and insurance companies in Zambia, the regulator is said to be partially unified. A fully unified regulator will normally supervise all business activities in the financial sector, as it happened in the case of Financial Services Authority (FSA) in U.K. Unified financial sector supervision in which banking, insurances and securities regulation are combined appears relatively rare in the world.

**Preconditions for effective Supervision:**

Maintenance and continuous enhancement of supervisory capacity must be the guiding principle of any form of regulatory structure. Accordingly, the development of regulatory capacity should be given predominance over the issue of regulatory structure and the latter is only a matter of fundamental

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94 Id
concern to the extent that it can assist in achieving this overarching objective. The following is an indicative list of key features that constitute an effective supervisory structure:

1. Clear objectives: A regulatory agency should have clear objectives that assist the management of the regulatory agency to take appropriate decisions and which will enable it to determine suitably policy framework to respond to a given problem. Clear objectives enable it to identify the problems on time and rectify the same.

2. Independence and Accountability: A regulatory agency must be able to take independent decisions in respect of the sphere of activities which fall under its purview free from interferences from politicians or bureaucrats. This can be ensured through measures such as protection to senior management from arbitrary removal, budgetary autonomy etc. But at the same time the independence should be balanced by accountability of the agency of its actions. The accountability of the regulatory agency should suitably be fixed to the Parliament.

3. Adequate Resources should be made available to the regulatory agency for carrying out their tasks effectively. The regulator should have sufficient financial resources to retained the skilled manpower, creation of necessary implementation mechanism as also to ensure timely and effective data collection and processing.

4. Effective enforcement Powers should be invested with the regulatory agency to initiate necessary corrective punitive actions wherever required against the errant or to prevent any major default or crisis that may take place in the system. To effectively carry out their responsibilities, the staff of the regulatory agency should also have suitable immunity from legal actions for actions taken in discharge of their duties.
5. Comprehensive Regulation as far as possible in a regulatory structure would ensure that there could be no scope for any regulatory gaps. As far as possible almost all financial entities must be brought under the purview of its regulatory framework. Whenever an innovation takes place in the market place, the regulator should quickly respond by coming out with suitable rule for the same.

6. Regulations should be cost efficient. As there is always costs, both direct and indirect costs, of compliance, this requires utmost attention of the policy makers while formulating regulations. Overall, regulatory structure with lesser cost would be preferred to one which imposes higher costs.

The above criteria and its effectiveness will play a critical role in structuring an Unified or multiple regulatory Model. The starting point for deciding whether to opt for unified or not would depend upon the possibility of merging the three core financial sector supervision namely, banking, insurance and securities sector. Similarly, it is essential to find out the implications of such merger and the role the Central Bank will have in such merger.

**A Case for Unified Structure**:95

Financial Conglomerates:

An increasing trend of arguments in favour of unified structure of regulation have been advanced throughout the world, one most important being achieving economy of scale. The other arguments appear to be that on account of increasing financial conglomerates that operate diverse groups of financial institutions, both within and outside the country as also to ensure competitive neutrality in view of the thinning line of difference of groups of financial

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95 Id
institutions, it is felt that Unification could be a solution. As fragmented regulation could have problems in detecting the risks that these entities pose to the system, unified approach is felt as a better solution. Further, in the event of financial or systemic crises, invariably there are issues in exchange of information amongst the sectoral regulators or delay in acting on such information which could lead to serious implications for the market. In an unified model, all information are concentrated with one agency which is able to act on time to prevent a crisis.

Competitive Neutrality: Another important factor in favour of unified approach is that due to the increasing trend world over of thinning of lines of demarcation of the products as also the entities which undertake those activities, regulatory arbitrage has increased. There could be situations where the financial entities offering similar products may be supervised by different regulators. All regulators may not have uniform or strict regulations, some strict and some light regulations. This gives rise to regulatory arbitrage. This may lead to the financial entities to design products in such a way that they can benefit out of such regulatory arbitrage. This could, in the long run, lead to serious systemic risks. This can be avoided if unified form of regulation is in place, who as a single regulator could effectively ward off all such arbitrage anomalies.

Regulatory Flexibility is cited as another advantage that an unified regulator could have as compared to sectoral regulators. While there are possibilities of either turf war or passing the buck, in the event of any crisis, amongst the regulators, such a scenario may be non-existent in an unified approach. Furthermore, the legislations governing such regulators may not arm them fully to react to all such situations whereas in case of an unified approach, the regulator may have such legislative backing. Such regulatory flexibility is also said to be more tilted in favour of unified approach when regulators are expected to react appropriately to ever innovative spirit of the market forces, whenever the market comes out with innovative financial products.
Large economies of Scale is achieved in a single regulatory organization which enables it to save huge costs on infrastructure, large specialized staff compliment, more intensive utilization of inputs, including the data collection and dissemination. At the same time, having multiple regulatory structures tend to impose huge costs of maintenance of those bodies, staff, infrastructure etc., Several economic scholars have advanced arguments for the advantages of a unified model. The arguments relate to such factors as the 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 ease with which the unified regulator can resolve efficiently and effectively the conflicts that inevitably merge between the different objectives of regulation; the avoidance of unjustifiable differences in supervisory approaches and the competitive inequalities imposed on regulated firms when multiple specialist regulators have inconsistent rules; and, where a unified regulator is given a clear set of responsibilities, the possibility of increased supervisory transparency and accountability.

An important angle to the multi-structure set up is that there is an involvement of various agencies regulating different financial activities. A strong view point that has emerged over a period of time that a unified regulatory structure is a good model due to its inherent advantages over a multiple structure of regulatory system.

**Preconditions for establishing a Unified Regulator:**

In order to ensure the success of a Unified Regulator, the following are the decisive factors:

1. Sound and sustainable macroeconomic policies
2. The necessary political will among stakeholders
3. Cooperation and sharing of information among financial services regulators as a country moves towards a single unified regulator
4. Skilled human capital to support establishment and operation of the unified regulator
5. Financial resources to support establishment and operation of the unified regulator
6. Conglomerates and cross-ownership of groups of companies that pose risk of contagion during a financial crisis and are thus a good case for a unified regulator.
7. The practice of universal banking, also a good case for a unified regulator
8. The interconnectedness of segments of the financial sector, assuming it has reached a minimum level of sophistication.
9. The emergence of new financial instruments and services from many segments of the financial sector
10. The internationalization of best practices for unified financial services regulation
11. A well-developed public infrastructure to support the establishment of a unified regulator
12. Effective market discipline to provide similar support.

Generally, where there are sustainable macroeconomic policies and effective market discipline, the presence of a well-structured framework for financial services supervision is likely to provide incentives to stimulate conduct desired of market participants. Such a framework must be supported by sufficient operational and financial resources. Also, there must be effective enforcement of laws and regulation, avoiding at all costs politically motivated regulatory forbearance.

Often, the establishment of a unified regulator is supported by the political will of major stakeholders. It is difficult to think of a buoyant and sound regulator that does not enjoy the support of its major stakeholders. If that were the case, even the enforcement of the law would be affected adversely; the lack of political will
would undermine the legitimacy of the regulatory system, and enforcement of the law by demotivated policing parties would be lax.\(^3\)

The advantages of a Unified Regulator are:

1. There is no need for different administrative/infrastructural set up to be created as the same regulator may be common governing authority. Also there is a huge saving of costs achieved as the scarce specialized human resources can be better utilized in an unified environment and cost of creation of different infrastructure are avoided.

2. There is better appreciation of the systemic risks when activities are under the same regulator and it would be possible to intervene on timely basis whenever a crisis occurs. From the perspective of containment of risks in the financial sector, an unified regulator would be better placed as all information are available with them for taking prompt timely and corrective actions in the event of a financial crisis.

3. Having multiple layer of regulatory structure could lead to conflicting regulations being prescribed especially where the regulated entities are the same. The entities may have difficulty in complying with the different regulators’ requirements. Instead, under a unified regulator, there is a greater degree of clarity that would be established resulting in quicker resolutions of the problems.

4. Another major advantage of having unified regulator is increased accountability which may be difficult to achieve in a multiple layer of regulatory regime.

5. The usual exchange of information which takes place amongst various regulators in a multiple regulatory regime especially in a stressed situation or to prevent any systemic risks is done away with under the Unified Regulatory framework.

Though there appears to be a strong shift towards unified regulator, there are equally strong arguments against unified regulator.
Firstly, the concentration of all the activities under the same regulatory roof may lead to monopolistic situation giving rise in the process to avoidable stiffness and rigidity in the system including resistance to change management as and when innovations take place.

Another problem of having a single regulator may be that it might counteract in mitigating the risks in the system in the sense that the appreciation of risks perspective for various markets/financial products may be difficult inasmuch it may require specialized skills and experience for that purpose and hence it may not be appropriate to concentrate all activities under one regulator. The argument that can always be advanced is that it is better to have various wings of specialized skill sets under the same umbrella set up for regulating different functions. In reality, it may not be that easy as it presupposes that the controlling authority at the top would be having at least reasonable perspective of these areas of functions if not expertise in all those functions. Not necessarily so in all scenarios. Lastly, it may lead to development of huge bureaucratic set ups within the single regulatory regime promoting vested interests and sense of “knowing everything” or a sense of “déjà vu” and ultimately becoming a power centre.

There could be resistance to change on account of the unpredictability of the change process. This has different dimensions. In such move to unify, the political groups and bureaucracy could come out with designs to build power centres within the Government or through the Unified authority and assume excess of additional powers. In addition to this, there could be vested interest groups within government or individuals, having their own pet theories and ideas and would like to demonstrate that they have achieved the change management or interest groups which would be part of the Unified model, might push the reforms more aggressively so that they could gain in terms of powers. This could lead to serious problems in the design of the regulatory model itself as it could be full of mistakes and loopholes as the same would not have been objectively
and impartially thought through. As a result, the Unified model instead of becoming a blessing may become a curse.

Another risk could be the loss of specialised staff strength on account of change in model. On account of uncertainty of the change to Unified model, highly experienced staff who are critical and were part of the regulators could look out for employment or taking retirement. This could lead to loss of expertise in the new setup.

Such a change management could also place a very heavy demand on the scarce resources which are already in short supply. Further, the priorities of the Government may be more on creation of infrastructure, if it happens to be an emerging economy and in such a case any such major shift towards Unified model could be a very costly exercise.

One more major area of concern in such a change to Unified model could be the legislative process. The possibility of the interest group capturing the legislative process through which Unified regulator will be created is highly likely; the legislation may not comprehend objectively all scenarios. In other words, what has become settled law in terms of judicial pronouncements or legislations of the specialised regulations may be opened up creating chaos in the markets.

Specialisation will suffer in the Unified approach. It must be noted that each financial market has a different objective with which it should be regulated. The focus and methodology of regulation of each market is different. For example, in case of banks the regulators will see the risks from the assets side whereas in case of insurance, their regulators would see the risk from liability side. The risks profile of each of this market is different. This, in an unified approach, may be difficult to accomplish.

Finally, the problem of moral hazard is the most important limiting factor in case of Unified approach. There will be a general presumption by the public that in the event of crisis, the Unified regulator will bail out all the stakeholders or customers which may not be the case. For instance, in the event of bank failure,
the depositors may be bailed out up to a limit depending on the legislative sanction. But other creditors or customers of other segments of entities governed under the same regulator may not be protected on the same lines. Ultimately, Central bank may also come to the rescue of banking institutions as lender of last resort.\textsuperscript{96}

\textbf{Role of Central Bank:}

The role that the Central Bank, as monetary authority of the Country would play in an Unified Regulatory system, would determine its success or failure. In most of the countries, the need to create unification will involve separation of banking supervision from Central bank as it is generally felt world over that the bank supervision is required to be separated from Central bank as it is required to function only as monetary authority of the country. It is felt that there is apparent conflict of interest between the role as monetary authority and supervisor of the banks. Firstly, it may mistake, as bank supervisor, when it decides or takes decision for safeguarding monetary interests. Also as the financial system is increasingly becoming more non-bank centred of late, the moral hazard issue becomes very important. Finally, if the bank failures occur, the supervisor would be blamed. Since Central Bank is bank supervisor, its credibility will suffer as monetary authority.

Notwithstanding the above, there are strong arguments in favour of combination of banking supervision and monetary function in Central Bank. Firstly, it is through banks that interest rates are transmitted into the financial system and hence Central Bank needs to constantly monitor their financial health to have an effective monetary policy. The Central Bank needs to prudently regulate the banks for their solvency and those data are essential for Central Bank to act as lender of last resort.

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Further the independence of the Central bank from the political interferences ensures its fair and impartial supervision of the banks free of any such interferences from policy makers or parliamentarians.

That leads then one to another option as to whether Central bank itself can act as Unified Regulator. This will work effectively when it is a small economy and the size of insurance, securities markets are also small and the cost of creation of additional regulatory structures could be expensive. It will also work well where the financial system is fully led by banking entities and also in cases where the independence of the Central Bank is also very strong. In Singapore, the Monetary Authority of Singapore acts as Central bank as well as a Super regulator.

But this is also not without problems as the moral hazard problem could get heightened if all regulations are centred in the Central Bank as the public expectation may be that it will come to everyone’s rescue in the event of a problem or crisis. Secondly, in an unified framework under Central bank, if crisis hits any one segment it may affect the reputation of the Central Bank as monetary authority.

Given the above pros and cons of full Unification as outlined above, it may be practicable to adopt a middle path:

1. To retain the status quo of sectoral regulators and create a Common legislation which lay down principles of governance across the financial markets under which a Governing Board could be created with the Head of Central bank as its Chairperson and Chairpersons of other regulators as its members. This Governing Board could be empowered by that law to sort out all cross jurisdictional issues amongst the regulators, sharing of information amongst them to face any financial risks in an united
manner and lay down common rules of discipline, code to regulate the markets.

2. Another option is to maintain the existing structures, but locate them in the same building where all the resources, staff and other infrastructures could be commonly shared. This sharing of management could be more of administrative convenience than a legislative prudence. This will also promote informal sharing of information amongst the regulators that may be critical during a crisis. In this approach, what could not be achieved legally may be possible through sharing of resources and the end result may be the unified approach.

3. Last option would be to share the resources with the Central bank of the country. Finland has adopted this approach. It helps realise the economies of scale and it also helps flow of information between the Central bank and other regulators who share premises, IT systems and other infrastructure.

From the above, it is safe to conclude that the type of regulatory approach Unified or multiple is required to be decided based on the synergies that could flow from such integration. For instance, in countries where insurance and banks are interlinked the same should be combined or in a country where universal banking is present, securities and banking could be combined or in a country where each of this sector is large and catering to a large population, it makes sense to retain the current structure. Furthermore, before choosing a model, unified or multiple, the advantages and disadvantages discussed above are required to be balanced and an appropriate decision is taken. Last but not the least, the independence of the regulator is the most important determining factor in choosing the model. If it is prone to interference from political class, no

\[97 Id\]
amount of effective policy making will help transform regulatory structure into one which could be said to be the most efficient model.

There are many aspects of financial regulation - e.g., information requirements, entry limitations, facilities limitations - where more choice and competition will often be beneficial. An exception may be prudential (safety-and-soundness) standards for banks, insurance companies, and some forms of pension plans, which should be tough, because national governments almost always will bear the losses in the event of failures of these types of financial institutions. Even here, multiple agencies can lead to beneficial innovations that can reduce the regulatory burden on institutions while maintaining effective levels of safety.  

In the US there are three national agencies that regulate commercial banks, one that regulates savings institutions, one that regulates credit unions, one that regulates securities markets, one that regulates commodity and financial options/futures markets, and two that regulate pension funds. In addition, the 50 American states each have separate bank regulators (with overlapping jurisdictions with the national regulators), most have savings bank regulators, all have credit union regulators, all have insurance regulators (which is solely a state responsibility), and all have securities regulators.

It does have the problem of duplicated efforts. But the system works. In fact, it works pretty well, though mistakes do occur (as they do in any regulatory system).

Most important, this multiple agency structure ensures regulatory competition - each agency generally wants to expand its domain of chartering and jurisdiction - that is generally beneficial for the financial system.

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99 Id.

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Far fewer will suffice for most countries. There is another side to that coin: where are the safety valves? Where are the alternatives? What about errors? How will innovation occur? In government (as well as in the private sector) a golden rule is that more competition and less monopoly are likely to be beneficial.

In India, for instance, the Financial Sector Legislative Reforms Commission has neither recommended a full unified structure nor a multiple structure but a middle path; where RBI will have regulatory authority over banking and payment system, the Unified Regulator will have all other existing financial activities.

From the above, it can safely be concluded that both models that is unified and multiple regulatory structures have merits and demerits and the solution in choosing the right model appears to lie in identification of the correct factors that may be suitable to each country based on its experience with the existing model as also the country specific conditions such as economic, social cultural and political etc.