Structuring the Banking Regulators and Supervisors: Developed Country Experiences and Their Possible Implications for Latin America and Other Developing Countries

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Structuring the Banking Regulators and Supervisors:
Developed Country Experiences and Their Possible Implications for Latin America and Other Developing Countries.

Professor Joseph J. Norton*

I. Introduction.

The 1997 Second High Level Meeting on the Reform of Latin American and Caribbean Financial Systems (SELA) and its related Proceedings1 address a number of important issues in relation to the reform of Latin American and Caribbean financial systems. This chapter focuses on the specific issue of the appropriate basic structure(s) for bank regulators and supervisors.

Various chapters in this compilation consider, in general terms, the structure of a number of different financial systems, both from Latin America and from developed countries such as Spain and the United States. While the needs of developed and developing systems are indeed different, comparative analysis can provide lessons for the further development of both.

Other chapters touch upon the increasingly important question of regional integration of banking markets and harmonization of legal and regulatory regimes. While obviously the European Union is the farthest along in this process to date,2 convergence deve-
Developments in both Mercosur and the NAFTA countries are also progressing. In terms of the Mercosur countries, the experiences of the EU are especially instructive and in many ways may provide a rough blueprint for the way forward.

By way of brief digression, the following should be kept in mind with respect to the regional integration and regulatory harmonization processes in the banking area in Latin America:

(a) these processes should fit within and contribute to the broader regional economic integration objectives of greater liberalization in cross border trade in services and direct investments. As such, there is an inherent tension that must be reconciled ultimately between the goal of liberalization and the goal of maintaining safe and sound banking and other financial systems;

(b) these banking reform processes are highly complex, involving and intersecting with various national, bilateral, subregional, regional, and hemispheric economic regimes;

(c) whether concerning the banking reform or the broad economic integration processes, what is involved is not a series of ends, but a series of broad objectives to play out over time through "ongoing processes." Yet, in the same context, "time is of the essence," as modern technology and market realities have an increasingly accelerating impact on these processes and as integration and reform windows tend to be open only for limited periods;

(d) the reform and integration processes occurring within Latin America today are not tools in any North-South conflict, but are part of a dynamic and interactive framework involving constructive North-South and South-South sustainable economic development; and


4. See the contribution of Dr. Eva Holz, 1997 Sela Caracas Conference Proceedings, supra note 1 (on the Mercosur process).


9. See id.

10. For example, even though some commentators refer to the European Union integration as an evolving area over nearly half a century, the reality has been that true integration advancements have occurred during selective time windows (e.g., 1956-63, 1969-72, and 1986-92).

(e) the reform and integration processes are not simply about the creation of substantive rules, but of creating an environment of deeper and wider regional transparency within the financial market places and the relevant governmental decision-making processes.12

Still other chapters in this compilation have turned to the question of supervisory activity. For example, these Proceedings have looked at the question of dealing with distressed banks. Unfortunately, for many countries, including those of Latin America as well as the United States, this is a question of continuing importance and moreover, is likely to remain so. As discussed at a recent conference in London on the topic of banking failures and bank insolvency law in emerging and transitioning economies, individual bank failures will never and should (perhaps) never be eliminated completely.13

In addition, international trends in the area of banking supervision have been discussed. At the moment, we are seeing a wide variety of international and regional organizations producing various principles and agreements in the area of financial supervision.14 These developments are significant in that they provide not only an internationally agreed framework of best practices, but they also create the possibility of further harmonization and stability for all participants.15 Regardless, however, of the significance of these achievements, countries around the world, both developed and developing, are faced with the most difficult aspect: implementation of these principles in their own banking systems.16

It is within the above-referenced contexts that the topic of this chapter can be elaborated upon; i.e., the question of the basic structure(s) for banking regulators and supervisors. As such, this chapter will attempt to lay out what appears to be the basic issues in relation to the structuring of a banking supervisor/regulator in developed and developing economies. Unfortunately, this is an area where there are no clear answers; however, hopefully the problems involved can be made a bit clearer. Also, perhaps a few suggestions can be extended that could be taken into account in any country's individual decision-making process in regard to the structure of its regulatory authorities.

In terms of basic structural issues, there are three that appear to be of the most significance. Each of these will be discussed in turn—placing them in the context of the recent Basle Committee Core Principles for Effective Banking Supervision.17 First, decision-makers need to address the question of whether banking supervision should be placed under the ambit of the central bank. Second, given the increasing trend internationally towards uni-

14. For example, the International Organization of Securities Commissions (IOSCO) and the International Accounting Standards Committee have emerged as increasingly important multilateral agencies in relation to reconciling and harmonizing the various regulatory regimes existing alongside one another in today's global financial marketplace.
17. BASLE COMMITTEE ON BANKING SUPERVISION, CORE Principles FOR EFFECTIVE BANKING SUPERVISION 4 (Sept. 1997) [hereinafter BASLE CORE PRINCIPLES].
universal banking, the question is whether regulation of banks should be taken from an institutional or a functional basis. Third, there are issues that arise from the increasing prominence of financial conglomerates and from the regulatory structural questions that emerge as a result—namely whether a single financial regulatory scheme is a logical step in an evolution of regulatory approaches.

After looking at these issues, primarily in the context of developed country experiences, this chapter will then turn to the implications of each for developing countries. In this regard, despite the differences in needs between developed and developing countries, the experiences of the developed countries can be instructive. Further, as these experiences are today being set down in various principles of best practice, the chapter will look at what some of these may mean for the structure of regulatory and supervisory practices in developing countries. Finally, this chapter will draw from all of this a few suggestions and themes that may be of some use to those involved in financial restructuring in Latin America.

II. The Basle Core Principles for Effective Banking Supervision.

The Basle Core Principles present the basic outline for effective banking supervision and are intended to serve as a basic reference for supervisory and other public authorities around the world. Essentially, the Basle Committee has prepared a list of twenty-five basic principles that should underlie banking supervisory policies and structures. These principles are then enumerated in a Compendium of existing Basle Committee documents that are cross-referenced in the Core Principles and are intended to expand upon them and explain their application. These principles are to be updated periodically, as additional documents are released.18

In terms of the twenty-five Core Principles themselves, they are divided into seven sections: preconditions for effective banking supervision,19 licensing and structure,20 prudential regulations and requirements,21 methods of ongoing banking supervision,22 information requirements,23 formal powers of supervisors,24 and cross-border banking.25 While these Principles are very instructive in terms of coverage and issues, they nonetheless must be implemented by domestic authorities on an individual basis.

On the one hand, the Core Principles are intended to serve as a “basic reference,” and as such, national adaptations and variations in the implementation of the principles are

18. Basle Committee on Banking Supervisions, Compendium of Documents Produced by the Basle Committee on Banking Supervision (April 1997) (updated) (as referred to in Basle Core Principles, supra note 17, at 1).
19. See Basle Core Principles, supra note 17, Principle 1, at 4.
22. Id. Principles 16-20, at 6.
23. Id. Principle 21, at 6-7.
contemplated. However, on the other hand, the Principles are “minimum requirements” for “supervisory and other public authorities in all countries and internationally.” In addition, it must be kept in mind that these Core Principles are not the work product of the exclusive Basle Committee “club” of selective industrialized nations, but they represent the joint effort of the Basle Committee and non-G-10 supervisory authorities, including key Latin American authorities.

Moreover, it is expected that the Principles will be endorsed by supervisory authorities throughout the world. For example, in 1998 the Principles will be submitted to the Association of Banking Supervisory Authorities of Latin America and the Caribbean Bank Supervisors for their formal endorsement. Further, the Principles must be taken most seriously by all countries because they “have been designed to be verifiable by supervisors, regional supervisory groups, and the market at large.” In fact, “it is suggested that the I[nternational] M[onetary] F[und], the World Bank and other interested organizations use the Principles in assisting individual countries to strengthen their supervisory arrangements with work aimed at promoting overall macroeconomic and financial stability.” Also, in all likelihood, substantial compliance with the Principles will be factored into decisions of private rating agencies, private investors, and financial markets themselves.

III. The Role of the Central Bank in Regulation and Supervision of Banks.

According to the above-mentioned Basle Core Principles, a precondition for effective banking supervision is, “an effective system of banking supervision that will have clear responsibilities and objectives for each agency involved in the supervision of banking organizations.” This Principle 1, however, does not afford any meaningful insight into the question of the structure of the relationship between the central bank and the banking supervisory authorities. In many countries around the world, the functions of the central bank include banking regulation and supervision; however, many countries separate the two with equal effectiveness. This section will look at the arguments for and against the separation of the central bank and the banking supervisory authorities.

26. Id. at 2, para. 6.
27. Id. at 2, paras. 5 & 6.
28. Id. at 1-2, para. 3 (outlining the 16 participating non-G-10 supervisory authorities (including Mexico, Argentina, and Brazil)).
29. Id. at 3, para. 7.
30. See oral remarks by Dr. Edgardo Mimica Miranda, Executive Secretary of the Association, at the SELA Conference upon which these Proceedings are based.
31. See Basle Core Principles, supra note 17, at 2, para. 6.
32. See id.
33. See id. Principle 1, at 4.
A. ARGUMENTS FOR SEPARATION.

In terms of arguments for the separation of banking supervision from the central bank, three primary points emerge.

First, there may be a conflict of interest between supervision and monetary policy objectives. The danger is that in the context of supervising and perhaps supporting the banking system through, for example, lender of last resort functions, the central bank will jeopardize its commitment to monetary policy objectives—especially price stability. More to the point, a central bank that is responsible for (and is subject to public criticism on account of) banking supervisory activities might have a bias towards injecting extra capital into the banking system to avert or contain a bank failure. Without delving into the economics of monetary policy objectives, it seems an increasing trend internationally is to place greater (and often sole) emphasis on central bank commitment to monetary objectives, namely price stability, within a framework of independence from political processes. Including banking supervision within the central bank’s catalogue of responsibilities would run counter to this objective. An area where this can be most clearly seen is in the situations in developing countries, such as Mexico and Thailand, where the central bank has actually been forced to abandon stability in the face of threats to the banking system.

Second, if price stability is indeed the prime (or sole) objective of the central bank, then in order to assure credibility for its actions in that regard, it must jealously guard its reputation in the marketplace. Credibility is seen as vital for effective central bank support for price stability. The examples of Germany and the United Kingdom are instructive in the reputational risk that banking supervisory activities may pose to a central bank’s credibility. The German Bundesbank has no formal supervisory authority and has escaped criticism over its role in banking crises in Germany. In the United Kingdom (where central bank and supervisory roles have historically been combined) the Bank of England’s handling of BCCI and Barings has impacted its supervisory reputation adversely. The current U.K. Labor Government is now proposing the separation of supervisory powers from the Bank, though the Government has conceded the Bank’s formal monetary independence.

Third, it is argued that the increasingly diverse nature of financial institutions prevents the central bank from administering adequate supervision. The expertise of the central bank, of course, will relate to the areas of finance and economics in banking. As more
and more banks begin to venture out into other areas of the financial market (e.g., securities investment and insurance), the scope of the central bank’s expertise begins to become relatively inadequate. The argument here is that a multi-faceted banking industry needs to be mirrored by a multi-faceted banking regulator.

Note, however, that in developing countries, with their lack of experienced financial personnel and typically small financial systems, this argument may in fact cut the other way. There may be certain synergies to be gained by placing banking supervision under the central bank’s responsibility in these countries where the scarcity of qualified economists and financial experts justifies it. Central banks may be able to attract recruits of a higher quality, if for no other reason than salaries and other benefits that tend to be better for central bankers than for other public officials. Furthermore, in many developing countries, the research department of the central bank is often the best (if not the only) policy research group in the country.41

B. ARGUMENTS AGAINST SEPARATION.

There are essentially three fundamental categories of arguments against the separation of the central bank from banking supervision activities: (i) those relating to the central bank’s lender of last resort function; (ii) those involving the payment systems; and (iii) those advancing the need for consistency between monetary policy and banking supervision.

First, the central bank is traditionally the lender of last resort in any country’s banking system. In essence, this role involves the provision by the central bank of short-term liquidity at penalty rates of interest to sound banks facing immediate liquidity problems. The rationale is that the collapse of an otherwise sound bank due to a short-term liquidity crisis may present a threat of contagious risk to other banks and the financial system as a whole through a failure of confidence inducing systemic bank runs, potentially resulting in systemic financial collapse. While the merits of all of the various assumptions and theories that have just been mentioned are of some contention among economists,42 it is nonetheless widely accepted that the central bank plays a vital role in ensuring the liquidity and stability of the financial system in its role as lender of last resort.

The separation of the central bank from the banking supervisory functions is an effective separation of the lender of last resort from the information it needs to exercise its duties. Moreover, the agency placed in charge of banking supervision will inevitably lack the level of funding needed to effectively avert a problem. Given that lender of last resort situations develop quickly and must be attended to with as much immediacy as is possible, this very obviously could pose a problem of considerable importance for both developed and developing countries alike.43

Overall, the experiences of Germany are very instructive in this regard. In Germany, as stated previously, banking supervision is undertaken by an agency external to the

42. See Goodhart and Schoenmaker, supra note 34, at 18, referencing, inter alia, Thomas M. Humphrey and Robert E. Keleher, The Lender of Last Resort: A Historical Perspective, 4 CATO J., 275-318 (Spring / Summer 1984).
Bundesbank, the German central bank. However, in the German system, all supervisory information passes through the Bundesbank before going to the supervisory authority, which is conveniently located in the same building (supervision is actually undertaken by a system of external auditors who report to both the supervisors and the central bank, although actual supervisory functions are not undertaken by the Bundesbank).44

The German system has two implications for supervisory structures. First, regardless of whether a formal separation exists between the central bank and the supervisory authorities, a system must exist whereby the central bank has immediate access to all supervisory information in order to allow it to perform its role as lender of last resort. Second, in a universal banking system such as Germany's where most financial assets do in fact flow through the banking system, information is much more readily available to the central bank in regard to both its monetary policy and its lender of last resort roles.

Related to the problem of lender of last resort functions, central banks also traditionally provide emergency support to the payments system within a country.45 This is due to what is typically referred to as Herstatt risk, following the failure of Bankhaus Herstatt in 1974.46 Essentially, the problem is that in any system without a real-time payment system, if a major bank fails before it pays on all matched contracts with other financial institutions, the financial system faces the threat of systemic collapse due to a chain of payments failure to other financial institutions within the system. As with lender of last resort functions, a supervisory agency separate from the central bank will not have sufficient funds to provide the necessary support until the chain of payments problem is resolved, and this situation requires action on very short notice and must be dealt with through provision of constant information to the central bank.

The final argument against the separation of the central bank from banking supervisory functions is that there is a need for consistency between monetary policy and banking supervision. The argument posits that those devising monetary policy must have a comprehensive and intimate understanding of the workings of the banking system, and that the optimal method of gaining such an understanding is through a direct supervisory role over the banking sector.47

C. COMPARATIVE STRUCTURES.

Essentially three traditions exist internationally in regard to the issue of separation of central banking and banking supervision: non-separation, separation, and non-rule-based, which are reflected in the United States, Germany, and the United Kingdom respectively.

Ironically, in the United States, the Federal Reserve Board historically was to act as a decentralized central bank with limited bank supervisory powers. The Board retained residually direct supervision over only state-chartered banks that were members of the Federal Reserve System; the Office of the Comptroller of the Currency was to be the pri-

44. See generally Baums and Gruson, supra note 38.
45. See Goodhart and Schoenmaker, supra note 34, at 12.
47. R. Lastra, supra note 41, at 149.
mary supervisor for the national banks. However, with the granting to the Board in 1956 of direct supervisory powers over bank holding companies (which now is the primary structure for banking organizations) and with the solidification in 1991 of supervisory powers over foreign banks operating in the United States, the Board has become (in reality) a dominant "bank" supervisor in the United States. Thus, in the United States, monetary responsibility has become "grafted onto" and intimately related to the process of banking supervision and the insurance of a safe and sound financial system. In many ways, this can be seen as the result of the multiple and disparate objectives legislatively given to the Federal Reserve by the U.S. Congress (e.g., also supervision over Federal Reserve System functions and over consumer-related financial matters, as well as supervision over bank holding companies and foreign banks).

In Germany, the central bank and the banking supervisory agency are formally separated; although de facto, the two are very closely connected. Nonetheless, the central bank has no direct powers of supervision or enforcement. This is based on the idea that price stability is the sole goal of the central bank, and that supervision should neither detract from that goal nor potentially impair the credibility of the central bank in its pursuit of price stability. Once again, in many ways this can be seen as the result of the Bundesbank's singular mandate to pursue price stability, a mandate that is not diluted by the requirement to seek other objectives within the financial system.

As to a non-rule-based system, in the United Kingdom, historically, there was no legal basis for the activities of the Bank of England, either in regard to central bank functions or supervisory issues. Rather, the English banking system was managed as a small gentlemen's club of bankers through the practice of "moral suasion." In many ways, this can be seen as a system that was largely sui generis to the peculiarities of the London financial markets (although a similar system was in effect in Hong Kong for most of its existence under British rule) that have now ceased to exist. The historical English system represented essentially a laissez faire, free market system, based on the Bank's practical powers of "moral suasion." Significant changes in the institutional composition of the London financial markets, the development of the EC single market, and certain financial scandals have led to the restructuring and greater legal formalization of this historical system.

51. See Norton & Whitley, supra note 48.
52. See Baums and Gruson, supra note 38, at 121.
Where does that leave one then? Overall, the issues involved in the question of separation between the central bank and banking supervision are not capable of simple solution. Nonetheless, both the separation and the non-separation models seem valid, if they are properly structured. However, the indistinct model practiced traditionally in the United Kingdom and in Japan does not seem to be a workable solution, especially in the context of an emerging economy, as discussed later. As stated in Core Principle 1, clear responsibilities, objectives, operational independence, and adequate resources are the essential qualities to be sought.

IV. “Functional” versus “Institutional” Regulation.

For more than a decade, traditional banking practice has been undergoing a dramatic change: large non-bank institutions (including securities firms and finance companies) and insurance companies have become major players in the area of traditional banking activities, forcing banks to expand their range of financial activities into the other previously segmented industries. In the interests of competition, in the 1990s international banks have significantly expanded the scope of their activities into areas that directly impact and/or reallocate credit risk and expose them to differentiating types of risk not previously within the supervisory “crosshairs” of financial regulators. The end result is that particular types of risk are no longer confined to specific institutional categories.

Regarding, for instance, the securities activities of international banks, the securities markets have undergone tremendous changes, accelerated by increasingly sophisticated trading and risk management systems, and by derivative products that serve to unbundle and to redistribute risks from instruments or transactions. International banks are becoming involved to a heightened extent (as both dealers and proprietary traders) in the international swaps and over-the-counter (OTC) derivatives markets. In turn, derivative instruments are inducing modifications to the regulation of international bank exposure to credit risk. For example, the 1988 Capital Accord has been amended to accommodate bilateral netting arrangements for off-balance sheet (OBS) activities into capital adequacy requirements. In April 1995, the Basle Committee issued a final report that both amended the 1988 Capital Accord and revised a previous July 1994 report to facilitate the regulatory acceptance of bilateral netting arrangements for the purpose of reducing credit risk among counterparties and further recognizing such arrangements for purposes of credit risk-based capital requirements in OBS items.

55. Basle Core Principles, supra note 17, Principle 1, at 4.
57. Id. at 232.
58. See Basle Committee, Basle Capital Accord: Treatment of Potential Exposure for Off-Balance Sheet Items (Apr. 1995) [hereinafter the “Capital Accord Amendment”]. Legal recognition of netting arrangements is crucial because the credit exposure of a bank trading in derivatives is mitigated through bilateral netting with counterparties, and incorporation of netting arrangements into the credit risk-based capital standards facilitates the desire of banks to engage in such arrangements.
With the expansion of activities of international banks beyond the confines of what could be termed "traditional," countries have begun to consider whether their financial regulatory structures, which were formulated in a seemingly outdated era, are still adequate (if not relevant) in today's financial marketplace. Modern debates in the United States over the reform of the Glass-Steagall Act have more often than not involved a discussion over "functional" versus "institutional" regulation. Without delving into a discussion on the comprehensiveness of the functional/institutional dichotomy, a preliminary analysis can serve as a good springboard for a discussion of financial regulatory reform.

In the simplest of terms, institutional regulation places the supervision of certain institutions under the charge of a specified regulator or regulators. For instance, under this theory banks would be regulated by a specified banking agency, securities firms would be regulated by a specified securities agency, and insurance companies would be regulated by a specified insurance agency. This has been the historic method of financial regulation. A simple and straightforward approach, this theory fails to comport with modern realities that involve, as mentioned, banks engaging in securities and insurance activities. A prime example of the discrepancies in regulation that occur with institutional-based supervision was highlighted by SEC Chairman Arthur Levitt during his testimony in 1994 before the U.S. Congress in the Securities Regulatory Equality Hearings. Chairman Levitt cited as a justification for the implementation of a more functional regulatory approach the prevailing law that generally excluded the securities brokerage or advisory activities of banks from the federal securities laws. Because of this provision, there was an inconsistency between the regulation of unregistered banks and securities firms, with investors receiving disparate standards of protection depending upon which institution with which they did their securities business.

Functional regulation has been seen as an alternative approach. This theory separates regulatory responsibilities among agencies according to common activities or products, "so that financial products, services and markets delivering similar benefits and risks can be subjected to substantially equivalent regulation and so that economic competition, rather than jurisdictional barriers or differences in supervision, can determine which products, services and markets succeed in the marketplace." In other words, functional regulation postulates that similar functions should be regulated similarly. Accordingly, banking activities would be regulated by a banking agency, securities activities would be regulated by a securities agency, and insurance activities would be regulated by an insur-

62. Chicago Mercantile Exchange, MODEL FOR FEDERAL FINANCIAL REGULATION 2 (1993). In the proposal by the Chicago Mercantile Exchange (CME) for the restructuring of the federal financial regulation regime, a consolidation was proposed that would envelop the Securities and Exchange Commission, the Commodities Futures Trading Commission, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the Securities Investor Protection Corporation (SIPC), in addition to parts of the Department of Labor and the Federal Reserve Board. See John C. Coffee, Jr., Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation, 50 BUS. LAW. 447, 451 (1995).
ance regulator. The advantages of this approach to regulation have long been recognized. For instance, the 1984 Report of the Task Group on Regulation of Financial Services (chaired by then Vice-President George Bush) stated:

> [F]unctional regulation can serve the public interest by reducing duplication among different government agencies and by promoting equal regulation of competing activities by different types of financial firms. By making regulation "transparent" as to the type of firm involved, functional regulation helps promote the availability of the widest possible range of financial products for the public at the lowest possible cost, with different firms prospering or failing to the greatest degree possible on their efficiency and merits rather than because of arbitrary differences in government regulation.63

Even though functional regulation promises to promote, *inter alia*, reduced duplication among regulators and increased fairness for regulated activities, it harbors serious shortcomings that render it problematic and prevent it from being incorporated wholesale as a *modus operandi* of financial marketplace supervision. First, Federal Reserve Chairman Alan Greenspan has argued that functions, much like institutions, are becoming increasingly difficult to distinguish.64 As the business of finance becomes ever more intertwined, the meshing of functional distinctions could make functional regulation as obsolete as strict institutional regulation seems to have become. Furthermore, in relation to financial conglomerates, functional regulation would have the effect of (i) subjecting these institutions to multiple regulators, thereby increasing their cost of compliance and (ii) preventing any single regulator from gaining a "full picture" of the institution and its operations, which would have the potential effect of allowing certain regulatory issues to "fall between the cracks." As a result, functional regulation cannot exclusively provide an adequate, efficient or even feasible method of supervision for these entities.65

Once again, the Basle *Core Principles* do not provide essential guidance in this area, but in terms of prudential regulations and requirements, they lay down the traditional Basle focus on capital adequacy, with the proviso that "such requirements should reflect the risks that banks undertake."66 Accordingly, what is needed is a method that would allow a fusion of the two regulatory approaches (i.e., institutional and functional). In other words, effective regulation of today's financial marketplace may require a combined approach that would allow the benefits of each respective approach to merge. It is within this context that the concept of a single financial services regulator gains importance, as discussed below.

Within this overall debate of institutional versus functional regulation lies the issue as to what role "private actors" should play in the overall regulatory process.67 Key here is the future

65. See Karmel, *supra* note 60, at 12.
66. See Basle *Core Principles*, *supra* note 17, Principle 6, at 5.
role of the banking and financial services industries themselves in devising, implementing, and monitoring effective internal risk management systems\(^\text{68}\) and the role of independent auditors in providing oversight and greater accountability in the supervisory processes.\(^\text{69}\)


The recent history of the financial marketplace is marked by a revolution of sorts in the manner in which financial services are being provided. Regulatory deregulation and technological innovation have ushered in a transformation that has resulted in the relative destruction of the traditional strict demarcation between commercial and investment banking business.\(^\text{70}\) Exemplary of this shift is the emergence of the financial conglomerate.

As defined by the Tripartite Group of banking, securities, and insurance regulators, a financial conglomerate can be defined as "any group of companies under common control whose exclusive or predominant activities consist of providing significant services in at least two different financial sectors (banking, securities, insurance)."\(^\text{71}\) This definition easily lends itself to the realization that a traditional regulatory approach based on an institutional basis will not suffice for the purposes of proper prudential supervision.

Perhaps it is appropriate to examine why such financial conglomerates have emerged. If for nothing else, this explanation is necessary to discover the answer to what could be a primary question, namely: should we allow such business amalgamations to form in the first place? The financial conglomerate structure is important because it allows significant improvements in terms of operational efficiency and effectiveness. These benefits are driven by economies of scope and scale, which generate lower costs, reduced prices, and improved product and service innovation. The general competitiveness of the business can also be heightened through sector synergies. By diversifying revenues and risks, the separate business components, as well as the conglomerate as a whole, can also be improved. Finally, by promoting product variety and innovation, the conglomerate structure can achieve increased customer loyalty as well as market penetration and market development.\(^\text{72}\)

Additionally, one must consider the impact of globalization on the provision of financial services. Under the universal banking theory, whose most well-known disciple is probably Germany, there are no Glass-Steagall-type distinctions between commercial and investment banking businesses.\(^\text{73}\) Further, in those states with traditional, formal separation between banking and securities activities (e.g., the United States and Japan), such divisions are breaking down with remarkable speed.\(^\text{74}\) As the global marketplace develops, regulatory edicts

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\(^{72}\) Walker, *supra* note 70 at 63.

\(^{73}\) On universal banking, see, for example (Anthony Saunders & Ingo Walter eds., 1996) *Universal Banking: Financial System Design Reconsidered*.

\(^{74}\) See Norton and Olive, *supra* note 56.
demanding the maintenance of such distinctions are becoming increasingly obsolete, with the end result being that some form of reformation has been necessary to allow the financial institutions in countries with such regulatory approaches to compete on an even footing with those institutions who are constituents of a universal banking regulatory regime.

Accordingly, it is argued that the benefits of the financial conglomerate structure (e.g., financial sector efficiency, innovation, and customer satisfaction) demand that it represents a development that at the very least should not be discouraged. With this said, regulators must also come to terms with the new, nontraditional risks that are accompanying financial conglomerates into the marketplace.

In its report on the supervision of financial conglomerates, the Tripartite Group of banking, securities, and insurance regulators addressed certain issues of concern characteristic of the conglomerate structure. Though the Group discussed concerns revolving around, inter alia, transparency, managerial fitness, and conflicts of interest, perhaps the most important issues addressed related to contagion and additional financial exposures engendered by this business form. Without delving into detail, there is a question whether traditional regulatory techniques can adequately address the combinations of separate market risks involved with banking, securities, and insurance activities and the dependencies created among these activities when they are combined in a conglomerate structure, as well as whether the existing regulatory structures can prevent inter-activity or inter-market contagion (actual or psychological) within these modern conglomerate purveyors of the financial marketplace.

In addition to the increased (or different) risks to the financial system posed by conglomerates, regulators must also ask themselves whether these institutions can be supervised fairly and effectively under their existing regulatory regimes. More to the point, traditional regulatory theories, formulated when banks engaged exclusively in "banking" business, securities firms practiced only "securities" business, and insurance companies were the sole providers of private insurance, simply may not be able to accommodate these conglomerates that house men and women wearing the hats of all of these different professions. In short, it is time to ponder whether the structure of financial regulation should evolve to reflect the conglomerate form of financial services providers.

In very general terms, under a single financial regulator scheme the individual regulators of banks, securities firms, and insurance companies would be combined into a single "mega" regulator that would have the sole responsibility for supervising the entirety of the financial marketplace. The concept is by no means novel, as several countries, notably in Scandinavia, have implemented such a scheme. As with any other regulatory approach, the regulation by a single umbrella agency has its advantages and disadvantages. The umbrella approach is also being pushed actively in the United States by the Federal Reserve.

75. The Tripartite Report, supra note 71.

76. As defined by The Tripartite Report, "psychological contagion" is "where problems in one part of a group are transferred to other parts by market reluctance to deal with a tainted group." The Tripartite Report, supra note 71, at 18.

77. See e.g., recent speech by W.J. McDonough, President of the Federal Reserve Bank of New York, to the Institute of International Bankers (Sept. 19, 1997). His views echo those expressed earlier in the year before the Congressional Banking Committee by Mr. Alan Greenspan, Chairman of the Federal Reserve Board. Alan Greenspan, Statement Before the Committee on Banking and Financial Services, U.S. House of Representatives (Mar. 19, 1997).
In a recent publication, Professor Charles Goodhart of the London School of Economics listed the arguments for and against such an approach. For the purposes of this chapter, the following subsections will proceed along the lines of Professor Goodhart's analysis, with elaboration by this author.78

A. THE ADVANTAGES OF A SINGLE REGULATOR.

1. Economies of Scale and Scope.

As with the financial conglomerates themselves, there might be economies of scale to be realized from the combination of regulatory efforts. Notably, a single financial regulator may be able to make more efficient use of resources, personnel, and expertise than various individual regulators by pooling all the efforts into one. Likewise, a single regulator might be able to employ synergies amongst the various functional regulators to achieve some sort of economy of scope.

Perhaps the best area in which to view these gains in efficiency is with enforcement. Rather than having multiple enforcement agents pursuing the same individual or group of individuals on different, but related offenses committed across the spectrum of financial activities, the efforts could be consolidated, with a single enforcement agency pursuing the violator(s) without a duplication of effort and with more of a sense of coherence or fluidity.

2. Simplicity of Regulatory Structure.

Any confusion that arises due to a multitude of regulators would be alleviated by appointing a single agency to be in charge of supervising the whole of the financial marketplace. This has special importance in relation to financial conglomerates, who, with a single regulator in place, would have little trouble in discerning who to report to regardless of the activity in which it was engaged.

3. Reduced Costs of Compliance.

Related to the point above, a single regulator scheme would limit the costs of compliance for those institutions that were active across the financial services spectrum. Financial conglomerates with banking, securities, and/or insurance businesses would no longer have to bear the expense of dealing with a multitude of different regulators.


To the extent that financial institutions have, for lack of a better word, "evolved" into conglomerate structures offering products and services in a number of different areas, there may be some advantages to be realized from reformulating the regulatory structure to mirror these changes. By growing into an umbrella regulator, this agency may be able to better monitor the activities of financial conglomerates vis-à-vis its one-on-one type of relationship with those it regulates.

78. See generally C. Goodhart et al., FINANCIAL REGULATION, ch. 8 (forthcoming 1998).
As recognized by Michael Taylor, banks are no longer the only institutions to be regarded as systemically important:

[1] In contrast to securities houses' traditional investments, derivatives contracts are not highly liquid and may be difficult to unwind in an insolvency. Thus the failure of a securities house which is a major player in these markets may itself be the cause of systemic risk through disruption of the payments system.... Insurance companies are now also moving into the OTC ["over the counter"] derivatives markets—with similar potential for systemic disruption resulting from the failure of a company which has become a major player in these markets.79

5. Creation of a More Sound Net of Regulation.

A single regulatory agency would seemingly cure problems inherent in a system with multiple regulators, which could give rise to incomplete or unequal treatment of regulated entities. Examples of such problems include: (i) inconsistent regulation; (ii) over- and underlay of regulatory coverage where the lines of supervisory responsibility are not clearly demarcated; and (iii) competition among regulators, which could lead to the classic "race to the bottom" scenario and/or regulatory arbitrage.


By limiting the number of different regulators and concentrating the regulatory focus, there may be advantages in markets in which there is a dearth of regulatory expertise.

7. Accountability.

With a single regulator in place, accountability for regulatory actions would be in little doubt as the question of the responsible agency would never seriously come into play.

B. DISADVANTAGES OF A SINGLE REGULATOR.

The adoption of a single regulator scheme is not without certain problems, which may or may not outweigh the advantages such a structure would offer.

1. Failure to Appreciate Remaining Differences Among Institutions.

Despite the blurring of the distinctions between banking, securities, and insurance businesses, and the increased proclivity for financial institutions to dabble in activities across the financial services spectrum, major differences still exist among financial institutions. For example, even though a bank is conducting some securities business, its core business will continue to be banking. If ever, it will be some time before there is an institution which places an equal importance upon its different financial activities. The point here is that differences will continue to remain between the risks inherent in the businesses of what have traditionally been termed "banks," "securities firms," and "insurance companies," thereby justifying a differentiated approach to prudential regulation.

2. Excessive Power and/or Bureaucracy.

There is a possibility that a regulator with complete oversight of the financial marketplace could become a bullying, bureaucratic monolith with considerable power at its disposal. In a speech on March 22, 1997, Federal Reserve Chairman Alan Greenspan noted the dichotomy between effective supervision and systemic protection on the one hand and the latitude for banks to conduct essential risk-taking on the other. In Chairman Greenspan's view, there is a level of "optimal risk-taking" that must be allowed to take place in the marketplace in order for there to be the innovation necessary to maintain a healthy and expanding financial sector. Overbearing supervision of the sector would have a stifling effect on the freedom of institutions to take risks and perhaps, fail. In his words:

The key to protecting against overzealousness in regulation is for banks to have a choice of more than one federal regulator. With two or more federal regulators, a bank can choose to change its charter thereby choosing to be supervised by another federal regulator. That possibility has served as a constraint on arbitrary and capricious policies at the federal level. True, it is possible that two or more federal agencies can engage in a competition in laxity—but I worry considerably more about the possibility that a single federal regulator would become inevitably rigid and insensitive to the needs of the marketplace. So long as the existence of a federal guarantee of deposits and other elements of the safety net call for federal regulation of banks, regulation should entail a choice of federal regulator in order to ensure the critical competitiveness of our banks.80

This statement by Chairman Greenspan highlights not only the problem of an "overzealous regulator," but also the merit in having a competitive regulatory environment.

3. Loss of Regulatory Competition.

Related to the point above, by combining the financial regulators into a single agency, there is a risk that there will be a loss of diversity and competitive spirit that will lead to a stagnation of the regulatory environment. In other words, with a unilateral approach towards financial supervision, regulators would be unable to learn from the lessons of other regulators—other than from a historical perspective.

An easy example is the introduction of money market accounts by brokerage firms in the early 1970s in the United States. With the maximum interest rates chargeable by commercial and savings banks limited by Regulation Q, the brokerage firms were able to carve out a niche of the deposit market for themselves—at the expense of the banks. The argument is that a single mega regulator could have banned such brokerage firm accounts because they constituted a threat to the banking industry, thereby hindering the innovation and competitiveness of the marketplace.81

81. See Coffee, supra note 62, at 456.

Even though regulators would all be under one roof, it is not a foregone conclusion that the supervisors responsible for the different functional areas of regulation would communicate any better or coordinate their activities to any greater extent.

5. Likelihood of Cultural Conflicts Arising Within the Single Regulator.

If a single agency was given the responsibility for all aspects of regulation (systemic, prudential, and conduct of business), it is likely that it would result in an unmanageable aggregation of interests. At the very least, it would seem that such an agency would have some difficulty in focusing, with its objectives being so diffuse.

Michael Taylor has identified two main public policy objectives in the regulation of financial services, namely:

(i) ensuring the stability and soundness of the financial system (systemic protection), and

(ii) protecting individual depositors, investors, and policy holders to the extent that they cannot be reasonably expected to protect themselves (consumer protection).82 Interestingly, Taylor posits that it is unacceptable to have conflicts between these objectives internalized within a super-regulatory structure, as resolutions of such conflicts are inherently of a public policy nature, and therefore, should be taken at a political level.83


The public could become confused with which functions of the financial institutions are insured and those that are not. Specifically, the public could come to assume that the single financial regulator extends its umbrella of deposit protection over the entirety of the financial services it supervises.

7. Question as to Whether Economies of Scale Are Attainable.

It cannot be taken as a truth that the bigger size of the single regulator would translate into more efficiency in its operations. This agency would be existing as a regulatory monopoly, and it is possible that X-inefficiencies or diseconomies of scale could arise.

C. The Role of the Central Bank Within a Single Regulator Structure.

A question that needs to be addressed in relation to the adoption of a single financial regulator scheme is what to do with the central bank. In many countries the central bank has been traditionally responsible for bank supervision, in addition to its quintessential role as monetary authority. Upon the restructuring of a financial regulation scheme into a single agency, it must be decided whether to incorporate the central bank into the structure. Importantly, recent restructuring efforts in Australia and the United Kingdom have notably excluded the central bank from their conceptions of a single financial services regulator.

82. Taylor, supra note 79, at 2.
83. Id. at 15.
A number of issues present themselves in relation to the role of the central bank within the single regulator structure. None, however, is more important than the issue of how the central bank’s role as lender of last resort is integrated into a single regulator structure in which it has no supervisory powers. This issue is framed in relation to the discussion of the separation of the central bank from the responsibilities of banking supervision, as discussed in the first part of this paper.84

Outlined by the Wallis Committee Report in Australia85 and the Labour Government’s plans in the United Kingdom,86 the intention is to detach the central bank from the single financial supervisory structure. Though the respective central banks will retain the responsibility for financial system stability generally, including a lender of last resort role, neither will be involved in the supervision and regulation of the financial intermediaries within the system. As a result, these central banks will no longer have direct access to the information provided through supervision regarding the health of the individual banks, as well as the system as a whole, while having to reach (and fund) the decisions of whether and how to implement necessary rescue operations. The obvious question is: how is a central bank supposed to make, in the relative sliver of time that such emergency situations dictate, such conclusions that could very well be of heightened systemic importance? The answer must be that the central bank is afforded a direct and comprehensive line of communication with the single regulator.

The German model, as briefly discussed earlier, could serve as a viable example of how such information could be provided, whereby all information that is gathered via supervisory examinations is filtered through the Bundesbank—even though it lacks any explicit supervisory powers. This model illuminates an interesting point. Many of the arguments against the separation of the central bank from the supervisory functions hinge on the interrelation of the supervisory powers and the central bank’s monetary and prudential role.

This author advances that it is not the supervisory powers themselves that the central bank is in need of, but rather, the information which such powers yield. If a proper mechanism is established that will allow the central bank to distill the information from the supervision conducted by another entity, then the argument that the central bank cannot properly function without supervisory powers seems to lose much of its thrust—as does the argument against a single financial regulator detached from the corpus of the central bank. With that said, it is essential that there are lines of timely communication set up between the central bank and the single financial regulator to allow the central bank to adequately discharge its duties as general overseer of the financial system—including its lender of last resort function.

84. See supra notes 33-47 and accompanying text.
86. See UK SECURITIES AND INVESTMENTS BOARD, REPORT TO THE CHANCELLOR OF THE EXCHEQUER ON THE REFORM OF THE FINANCIAL REGULATORY SYSTEM (July 1997) [hereinafter REPORT TO THE CHANCELLOR].
D. RECENT FINANCIAL REGULATORY REFORM IN THE UNITED KINGDOM NEWRO: THE CASE FOR A SINGLE FINANCIAL REGULATOR.

The viability (if not favorability) of a single financial regulator scheme is becoming increasingly more accepted in markets across the globe. The Scandinavian countries of Denmark, Norway, and Sweden have in place a combined banking, securities, and insurance regulator. Furthermore, as mentioned above, Australia and the United Kingdom have indicated their plans to place their respective financial regulatory schemes under the supervision of a single umbrella regulator. Both of the latter cases could be instructive for countries (developed and developing alike) considering a restructuring of their financial regulatory system. For the purposes of this subsection, the author will briefly address the changes that are underway in the United Kingdom.

The financial market in the United Kingdom (i.e., London) is undoubtedly one of the world's biggest and most important. Long on experience and steeped in history, this market currently employs 600,000 persons in various capacities. To have such a venerable institution subjected to the changes that single agency regulation will usher in is important in and of itself. Indeed, the fact that the new Labor Government felt that such a change was needed to maintain the United Kingdom's market position of importance is perhaps telling of the shape that financial regulation is to take in the future.

In May 1997, soon after the Labor Party assumed control of the government, it announced that the financial regulation regime in the United Kingdom was to be restructured. Traditionally fragmented into operational areas, financial regulation in the United Kingdom will undergo a consolidation, with a new single regulatory agency supervising the whole of the British financial market. In the Report to the Chancellor on the Reform of the Financial Regulatory System, the basic framework of the changes was laid out. The following discussion will proceed on the assumption that the government will proceed, at least generally, along the lines of this report.

When finally implemented (in all likelihood not before the turn of the millennium), financial regulation in the United Kingdom will be conducted under the auspices of a single statutory agency. Referred to in the Report as "NewRO" (and elsewhere as the "Super SIB"), this single regulator will incorporate the regulatory functions of nine different bodies, namely:

1. Building Societies Commission (BSC);
2. Friendly Societies Commission (FSC);
3. Insurance Directorate of the Department of Trade and Industry (DTI);
4. Investment Management Regulatory Organization (IMRO);

87. Michael Cassidy, Declaration of Interest, FIN. TIMES, Feb. 19, 1997, at 22. "Financial services produce GBP 20bn a year in net overseas earnings and are as important to the UK economy as manufacturing." Id.
89. REPORT TO THE CHANCELLOR, supra note 86.
90. On October 28, 1997 (subsequent to the drafting of this chapter), the Labour Government announced the name for the new financial regulator will be The Financial Services Authority (FSA). However, for the purposes of this chapter, references to the new regulator will be to "NewRO."
(5) Personal Investment Authority (PIA);
(6) Registry of Friendly Societies (RFS);
(7) Securities and Futures Authority (SFA);
(8) Securities and Investment Board (SIB); and

By combining these individual regulators into a single agency, the United Kingdom hopes to realize the benefits of (i) more coordinated and consistent regulation; (ii) simplified access for those who need to deal with it; (iii) simpler and clearer lines of regulatory accountability; and (iv) greater efficiency of operations, including economies of scale. In addition, appreciating that there may be potential disadvantages to regulating its financial markets through a single agency, the United Kingdom will implement measures to compensate. For example, arrangements are to be made to allow for a "flexible and differentiated" regulatory approach that will better accommodate the varying needs of consumers of different financial products. Moreover, realizing that a key to the successful operation of such a single regulator is the maintenance of clear and open lines of communication, NewRO plans to incorporate formal mechanisms to promote open internal communications, as well as non-structural mechanisms, including cross-functional staff training and rotations.

The regulatory functions to be undertaken by NewRO are categorized under five broad headings:

(i) policy formation and review;
(ii) authorization of firms and vetting and registration of individuals;
(iii) investigations, enforcement, and discipline;
(iv) relations with consumers and the public; and
(v) supervision.

The organization of NewRO will largely mirror these five functional areas, though supervision will be divided into units according to types of business. These individual supervision units will be responsible for both prudential supervision and conduct of business regulation. The idea is that combining these two duties will enhance efficiency and effectiveness, since some aspects of supervision (namely, reviews of the quality of the management and of systems and controls) has relevance to both prudential and conduct of business risks.

A point of interest is the manner in which NewRO plans to handle the supervision of financial conglomerates. The intention is to build upon the "lead supervisor" concept already used to a certain extent. Accordingly, individual lines of business will be supervised by function, but a lead supervisor will be named to set the supervisory program and to coordinate the relationships among members of the group—and with international regulatory bodies as well. In situations where the financial conglomerate has a dominant type of business, the lead supervisor will simply be the unit covering that area. However, the choice of the lead supervisor will have to be made on a case-by-case basis where the business activities of the conglomerate are more complex.

91. REPORT TO THE CHANCELLOR, supra note 86, at para. 1.
92. Id. at para. 3.
93. Id. at para. 21.
94. Id. at para. 5.
95. Id. at para. 17.
The investigative and enforcement functions of NewRO are to be delegated to a single unit that will handle cases from all the various areas of supervision.\textsuperscript{96} As mentioned above, it is in this area where regulatory economies of scale can be most important, and it seems that the organization of NewRO appreciates the efficiencies that can be realized in this respect.

Finally, NewRO, though it will exist as a separate agency accountable only to the government and Parliament, will have a working external relationship with the Bank of England. Evidencing this relationship will be a Memorandum of Understanding, drawn up by the Treasury, NewRO, and the Bank outlining the respective responsibilities among the organizations.\textsuperscript{97}

VI. The \textit{Core Principles} and the Basic Pillars of a Regulatory and Supervisory System.

Once policy-makers have determined the basic shape of the regulatory authority, i.e., who will regulate (the central banks or a separate authority or authorities) and what will be regulated (anything on the range from only banking to all financial activities of financial institutions), the focus must then turn to how such regulation and supervision will be achieved. In this regard, the Basle \textit{Principles} and their explications within the \textit{Compendium} are of considerable usefulness, at least in the setting of broad standards and methodologies. The basic pillars of an effective regulatory and supervisory system can be seen on five levels: adequate entry requirements, minimum prudential regulations, effective ongoing supervision, adequate enforcement mechanisms, and channels for international cooperation.

At an initial level, there must be an adequate licensing process. Licensing allows the regulatory authority to control and define the number and types of institutions that it is responsible for. Permissible activities of institutions and the licensing requirements need to be clearly defined.\textsuperscript{98} Further, the licensing authority must have the right to set criteria and reject applications, assessing at a minimum, ownership structure, qualifications of directors and management, operating plans and controls, and projected capital base.\textsuperscript{99} In addition, in case of an application from a foreign financial institution, approval should be sought from the home regulatory authority.

Beyond initial entry requirements, the authorities must be able to monitor and reject transfers of ownership or major acquisitions.\textsuperscript{100} Such controls are essential to maintaining the initial level of standards set for entry and to maintain an accurate picture of the institutional population. Despite this basic level of control, however, financial innovation is vital to economic success and should not be unduly deterred through bureaucratic impediments.

At a second level, prudential regulations and requirements are necessary as a precursor to successful ongoing supervision. Today, financial regulation is turning increasingly to a process of risk based supervision and therefore the authority must establish requirements appropriate to the risks that banks are likely to face in their ongoing operations. It is

\begin{itemize}
  \item \textsuperscript{96} \textit{Id.} at para. 12.
  \item \textsuperscript{97} \textit{Id.} at para. 30.
  \item \textsuperscript{98} \textit{Basle Core Principles, supra} note 17, Principle 2, at 4.
  \item \textsuperscript{99} \textit{Id.} Principle 3, at 4.
  \item \textsuperscript{100} \textit{Id.} Principles 4 and 5, at 4.
  \item \textsuperscript{101} \textit{See Norton, supra} note 15.
\end{itemize}
at this level that the Basle Committee has historically been very accurate and, arguably, effective in establishing standards and methodologies.\textsuperscript{101}

Within the context of supervision, prudent minimum capital adequacy requirements are essential,\textsuperscript{102} not only from a regulatory viewpoint, but more importantly from the standpoint of international investors. Beyond minimum capital requirements, supervisors need to be able to evaluate policies, practices, and procedures related to the granting of loans, the making of investments, and the ongoing management of both (the process of monitoring credit risk).\textsuperscript{103} While obviously supervisors cannot and should not subject each individual decision to scrutiny, they should make sure that banks have in place prudent written policies for such activities and internal information capabilities, as well as follow concentration limits to single borrowers and prohibitions against connected lending.\textsuperscript{104} In addition, banks must establish and implement policies and procedures for asset quality maintenance and provisioning.\textsuperscript{105}

In addition to credit risk, supervisors must ensure that banks have adequate policies and procedures to deal with country risk,\textsuperscript{106} market risk,\textsuperscript{107} and other risks such as interest rate and liquidity risk.\textsuperscript{108} Finally, banks must establish procedures and policies to deal with operational risks, such as fraud, corruption, and money-laundering, including internal controls and “know-your-customer” rules.\textsuperscript{109}

At a third level, once prudential requirements are established, supervisors must have clear and effective methodologies for ongoing supervisory efforts. Such a system should include both on-site and off-site supervision,\textsuperscript{110} along with regular contact with bank management and understanding of each institution’s operations\textsuperscript{111} as part of a comprehensive means of gathering and analyzing information from institutions on both a solo and a consolidated basis.\textsuperscript{112} Beyond information gathering and monitoring, supervisors must have a means of independent validation of information, either through on-site examination or the use of effective and accountable external auditors.\textsuperscript{113} Finally, if financial groups are allowed, supervisors must be able to supervise such banking groups on a consolidated basis.\textsuperscript{114} As one significant aspect of this process, banks must maintain and publish fair and accurate financial statements in accordance with consistent accounting policies.\textsuperscript{115}

At a fourth level, banking supervisors must be able to enforce prudential regulations and cause banks to undertake appropriate corrective action, up to and including de-autho-

\textsuperscript{101} Basle Core Principles, supra note 17, Principle 6, at 5.
\textsuperscript{102} Id. Principle 7, at 5.
\textsuperscript{103} Id. Principle 8, at 5.
\textsuperscript{104} Id. Principles 9 and 10, at 5.
\textsuperscript{105} Id. Principle 11, at 5.
\textsuperscript{106} Id. Principle 12, at 5.
\textsuperscript{107} Id. Principle 13, at 5-6.
\textsuperscript{108} Id. Principles 14 and 15, at 6.
\textsuperscript{109} Id. Principle 16, at 6.
\textsuperscript{110} Id. Principle 17, at 6.
\textsuperscript{111} Id. Principle 18, at 6.
\textsuperscript{112} Id. Principle 19, at 6.
\textsuperscript{113} Id. Principle 20, at 6.
\textsuperscript{114} Id. Principles 21, at 6-7.
Internationally, there is an increasing focus on varying levels of supervision for institutions based on their financial health under the doctrine of "prompt corrective action" developed in the United States following the S&L crisis in the 1980s. If a supervisory authority is not given powers to implement its authority, then its effectiveness is effectively eliminated. Further, these powers should be clear and non-discretionary to the extent possible.

Finally, banking supervisors must be able to operate in the international arena for financial institutions that continues to develop worldwide. Home supervisors of internationally active financial institutions should practice global consolidated supervision, at a minimum establishing contact and information exchanges with other relevant foreign supervisory authorities. In terms of foreign banks operating domestically, such institutions must follow the same standards required for domestic institutions, and supervisors must be able to share information with the institutions’ home supervisors in order to ensure effective supervision.

VII. Conclusions: Implications for Banking Regulation and Supervision in Emerging Markets.

Admittedly, this chapter has revolved around the experiences of developed countries in struggling with the issues concerning financial regulatory structure—in terms of both developed countries individually and speaking as a group through the Basle Core Principles. Developing countries, however, can learn from the experiences (and mistakes) of developed countries, and, accordingly, the relevance of this chapter transcends any such distinction. With that said, the author would like to address briefly certain issues that could be particular to developing countries.

First, developing countries are likely to lack the abundance of resources and/or expertise that their developed brethren possess. As mentioned earlier, this factor could, for example, play a part in a decision of whether to separate the central bank from bank supervisory functions.

Second, the level of development of the financial markets and/or institutions in developing countries could be different than their counterparts in developed countries. As a result, the “functional versus institutional” debate may be premature if the financial institutions in these countries still abide to a large degree on their traditional definitions. Furthermore, in countries with relatively small financial markets, the chances for a large and powerful financial regulatory bureaucracy, which will jealously protect its regulatory "turf," may be less—and, as a result, the chances for real and quick restructuring could be better.

117. See NORTON & WHITLEY, supra note 48, §§ 3.11[8], 5.08[3][a] (1996).
118. See contribution of R. Helfert, former U.S. Federal Deposit Insurance Corporation (FDIC) Chairman, for the 1997 SELA Caracas Conference Proceedings, supra note 1.
120. Id. Principle 25, at 7.
121. Id.
Lastly, I would like to conclude by saying that there is no "right" regulatory structure for financial services. Different histories, cultures, capabilities, etc., will dictate the shape and character that a regulatory structure must necessarily take. A framework that has been proven to be effective in one country might have disastrous results if attempted to be adopted wholesale in another country.

The recent experience in the United Kingdom demonstrates that there is always room for improvement and/or innovation, and that financial regulation, similar to the financial markets for which the financial regulators/supervisors have oversight responsibilities, can never be considered to be a static endeavor.