Rasheed Mohammed Al Maraj: Bahrain’s experience as single regulator

Presentation by His Excellency Rasheed Mohammed Al Maraj, Governor of the Bahrain Monetary Agency, at the Arab Central Bank Governors' Meeting “Bahrain's Experience as a Single Regulator”, Algiers, 4 September 2006.

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Fellow Governors, Excellencies:

My remarks today will focus on Bahrain’s experience with the single regulator model. I will briefly outline the main arguments supporting the single regulator model, as well as some of the arguments made against it. I will then describe Bahrain’s own experience in creating a single regulator, and draw some conclusions from this.

First, what are some of the arguments typically encountered in the debate on financial regulatory structures, when considering the single regulator model?

In principle, regulatory structures can be categorized according to two basic types – those that are essentially focused on a class of financial institution or sector - such as insurance brokers or banks - and those that are based around specific regulatory functions or objectives – such as investor protection or the prudential soundness of financial sector firms.

Historically, many jurisdictions have operated multiple regulators, reflecting the way financial sector regulation has evolved in the industrialized world. This evolution typically saw banking supervision become the first to develop in a formal manner, usually as an extension of the mandate of central banks (because a stable banking system is important to running effective payment systems and monetary policy).

Insurance and securities supervision typically developed separately, usually at a later stage. Securities regulators, furthermore, have tended to focus more on investor protection than on wider issues of systemic stability: many could be categorized as functional rather than sectoral regulators, as in many cases their responsibilities have cut across different classes of institutions.

From the late 1980s onwards, however, various jurisdictions started implementing new regulatory structures by merging their regulators, often into a single body. North European countries such as Norway (1986), Denmark (1988) and Sweden (1991) led the way. But it was moves in the UK and Japan (both in 1998) that gave a major impetus to this trend. Since then, there has been a steady stream of countries changing to a single regulator model.

Three main arguments are usually advanced to support the creation of integrated regulators. The first is that sector-based regulators no longer reflect the reality of evolving financial markets and players, which has blurred the boundaries between financial sectors and seen the growth in ‘cross-sectoral’ groups, or conglomerates.

As groups develop across different sectors or product types, they face the problem of having to deal with a growing number of regulators, ostensibly focusing on different aspects of their operations, but raising the risks of duplication or regulatory underlap. Even where the activities of an institution or group remain limited to a single sector, they may potentially face multiple functional regulators. In short, traditional regulatory structures are viewed as increasingly ill-adapted to a rapidly evolving financial services industry, increasing both regulatory costs for the industry and heightening the risk of supervisory failures.

The second argument is that integrated regulators can operate more efficiently as a single body – in other words, that they can achieve economies of scale. Thus, a single regulator can reduce its own costs by moving to a single set of support services, a unified management structure, and a unified approach to rule making and supervision.

Third, it is argued that single regulators can achieve economies of scope. In other words, they can address cross-sector issues more effectively as a single body, rather than as multiple regulators – whether this be in terms of developing rules of cross-sector applicability (such as on corporate governance or anti-money laundering), or in addressing supervisory concerns (e.g. the impact of falling asset prices on financial sector firms). A single regulator should be better at reaching a comprehensive view of risks facing a financial sector, and responding accordingly – for instance, by moving staff to supervise sectors where risks are increasing.

What are some of the arguments against the single regulator model? Some people have argued that there are fundamental differences between prudential supervision – i.e. ensuring that an institution does not fail – and conduct of business regulation – i.e. ensuring that an institution treats its customers fairly and in accordance with good market practice or applicable regulations.

The former has tended to be less rules-based and less confrontational – indeed, prudential supervisors often don't want to publicize their actions, for fear of further undermining confidence in an institution. The latter has tended to be more legalistic in approach, focused simply on whether compliance with the rules has been achieved, and ensuring compliance through tough enforcement and publicity – fines, 'naming and shaming', and so on. – Combining these functions in a single entity is thus problematic, or so the argument goes.

In my view, these differences can be over-emphasised; in many jurisdictions, furthermore, there has in recent years been an evolution in supervisory approaches, which has further reduced the differences between these different types of regulation. To the extent that differences remain, it can also be argued that it is better to internalize these and resolve them within a single institution.

Other arguments against the single regulator model tend to focus more on institutional factors, many specific to particular jurisdictions. It has been said that single regulators are too powerful – although the answer here is better accountability mechanisms. In some countries, creating single national regulators is difficult, either because of institutional rivalries, with existing bodies able to resist a loss of responsibility, or because of regional issues. (Each of the USA's 52 states, for instance, retains their own insurance regulator.) Though powerful obstacles, these arguments don't so much call into question the rationale for a single regulator; rather, they highlight that specific political or institutional obstacles may make such a move difficult, within a particular jurisdiction.

Until a few years ago, regulatory structures in the Gulf were essentially sectoral in nature, and Bahrain was no exception. Banks tended to dominate the financial sector, and the primary focus of regulation was therefore on the banking sector. In all cases, responsibility for regulating and supervising the banking sector rested with central banks.

The regulatory mandates of central banks in the region also extended beyond banks, in most cases, to cover certain types of non-bank institutions (such as money changers and sometimes investment firms); but insurance supervision was separately regulated by Commerce Ministries, and the stock market (and its broking members) were run as self-regulatory organizations.

In May 2002, the Government of Bahrain announced the transfer of regulatory responsibility for the insurance sector and capital markets from, respectively, the Ministry of Commerce and the Bahrain Stock Exchange, to the BMA. This was a far-reaching reform, creating the first integrated regulator in the region, and bringing together under one roof both prudential and conduct of business regulation for the whole financial sector. In addition, the BMA retained its responsibilities as a central bank for systemic stability (including oversight of the payments system and monetary policy), as well as other central bank functions such as currency issue, reserves management and provider of banking services to government departments. In short, the scope of the BMA's responsibilities is similar to those of the Monetary Authority of Singapore, but is otherwise unique for a single institution in the Gulf region.

What were the reasons for the above reforms? The key advantages for Bahrain in moving to a single regulator lie mainly in the economies of scale and scope that could be achieved. For a relatively small country such as ours, the impact of these economies is significant.

Not only have we been able to save on some of our own costs, but we have also reduced costs to the industry by creating a simple and easily understood regulatory framework, which minimizes the risk of regulatory duplication. We have been able to utilize scarce specialist resources, previously available only in one regulator, across the difference sectors; and we have been able to apply the more extensive supervisory experience available in the banking regulator across the other sectors as well.

The net result of the move has been to upgrade the quality of regulation and supervision applied to non-banking sectors, at a time when insurance and capital markets activities are fast developing.

Achieving this, however, takes time. Combining different regulatory organizations, each with their own corporate cultures and way of doing things, means that much management attention is required to create a new organization. Staff need to be motivated and retained, to counter the unsettling nature of change. New systems and processes need to be put in place.

Also, as with most other jurisdictions that have undertaken such reforms, new laws need to be put in place. In Bahrain's case, pending the passage of a single financial services law, we were able to make progress by the simple expedient of initially issuing short amendments to the existing sector laws, such as our 1987 Insurance Act – the only change being to transfer regulatory responsibility to the BMA.

This allowed us to make a start on integrating the different regulatory organizations early on, even though we continue to operate under different laws for banking, insurance and capital markets. The process of drafting a new, integrated financial services law, and securing its passage through parliament was only recently completed, so without such an approach, implementation of a single regulator would have been delayed several years.

Let me finish by drawing together some conclusions from Bahrain's experience. First, there is no doubt in my mind that the single regulator model is the right approach for a country like Bahrain. I believe it has allowed us to build a more effective and efficient regulatory system; and has allowed us to spread regulatory best practice across the whole financial sector. Separate regulators would simply be sub-optimal in size, in our case.

That is not to say that the single regulator is the right model for all countries. Industry specific, institutional or other factors may mean that different approaches would work better in other jurisdictions.

Second, I would caution against expecting instant results. It takes time to put in place new laws, and to create a truly integrated organization, with a common understanding as to regulatory approaches and processes. Four years on, we have made significant progress in this direction, but I would be the first to admit that we are still working on these issues.

Finally, I would underline the management challenges involved in creating a new regulator. On-going supervisory work of course remains, whilst the additional work of building a new regulator is undertaken – maintaining a 'business as usual' approach requires significant commitment from staff.

These brief remarks only touch on the surface of the issues surrounding the single regulator debate. Nonetheless, I hope that they provide some helpful pointers for discussion, and perhaps encourage some of you to consider whether your own jurisdictions might also benefit from moving to such a model.

Thank you for your attention.