Single FinancialRegulator

Growth and Transparency?

Come 2010 and Qatar will see the Financial Regulatory Authority (FRA), the proposed single financial regulator, take reins of the country's burgeoning financial sector. A big decision, a huge stride, and one that will necessarily not be without implementation hiccups.

Since it not only means a new financial regime but also realignment of a lot of the existing – all this while the overall financial machinery moves in a seamless fashion.

"The initial work of the new regulator will comprise two major components," says Philip Thorpe, Chairman and CEO, Qatar Financial Centre Regulatory Authority.

"First the practical matter of establishing a single regulator. That will involve both bringing in new legislation and operational elements, including bringing the various existing regulatory staff together, finding common premises, developing common procedures and the like.

"Secondly, we will need to produce a single regulatory regime, in the form of rules and regulations, for all of the financial institutions currently operating in the State of Qatar and for any new institutions wishing to establish in the country."

While these tasks are complex, and bold given the fact there is no regional precedence, it certainly has not deterred those in charge in taking slow, yet steady steps in the direction of the unification, news of which has been doing the rounds for over a year now.

Growth and Transparency?

BY APARAJITA MUKHERJEE

THERE is enough international precedence and case studies that Qatar can fall back on, with the US, the UK, Japan, South Korea, Germany, Australia, Canada and the Netherlands, following one model or the other of regulatory unification. (See box on pg 61, for details).

FRA will oversee all banking, insurance, securities, asset management and other financial services.

As for the current status, Thorpe elaborates, "Since the announcement by HE Yousef Hussein Kamal in 2007, work has been underway amongst the regulatory bodies in preparation for the single regulator coming into existence.

"As you might imagine, the task of developing appropriate legislation, and analysing the changes needed to existing legislation, has been very time consuming, but a lot of progress has been made on this front. There has also been progress in terms of identifying the steps needed to achieve operational change. In this regard, we have been able to gain an understanding of the various existing regulatory regimes and I am sure this will provide a sold foundation for the transitions that will follow.

"We are looking forward to more concrete, and public, moves toward integration in the near future, and I know that the staffs of the QFCRA are very excited about the prospects of this more active 'second stage' of the integration."

Qatar Today presents four perspectives: that of the bankers, the academic and the legal, in addition to what QFCRA, one of the main implementers, has to say on how the work towards establishing the FRA is progressing.

"The unification of the regulator will not be done overnight, there will be a transition phase."

HE Yousef Hussain Kamal, Minister of Finance

Managing the transition

Minister of Finance, HE Yousef Hussain Kamal, last year said, "The unification of the regulator will not be done overnight, there will be a transition phase."

The transition model and its incumbent processes must be under the hammer for bankers who are driving the steps at the micro level. Foreign banks like HSBC which operate in multiple regulatory regimes seem more confident than local/regional banks.

"HSBC is used to working in multiple regulatory jurisdictions around the world as one group.

"Any movement towards a world class regulatory standard is going to be beneficial towards providers and users of financial services if it promotes better risk management, innovation and deepening of the financial markets in Qatar," says Charles L Moncrieff, Chief Executive Officer, HSBC-Qatar.

"We have been working with the Central Bank on a range of issues to reflect the transition from one regulator to another, and are confident that it will be a smooth handover," says Bassel Gamal Aly, CEO, Ahli Bank.

The new body: impact on QCB

The FRA will bring together the staff resources currently dispersed amongst the Qatar Central Bank's (QCB) Department of Banking Supervision and its Banking Consumer services Unit, the Qatar Financial Markets Authority and the QFCRA.

On the government decision to set up the FRA, HE Abdullah bin Saud Al Thani, Governor of Qatar Central Bank, recently commented at a reporters' meet that the government has decided to integrate the responsibilities of all the financial sector regulators and have a unified regime in order to harmonise licensing and other criteria.

"The unified regulator will be a combination of the QFCRA, the Department of Banking Supervision at the QCB, Qatar Financial Markets Authority and the insurance sector under the Ministry of Economy & Commerce. The unified regulatory body will have a wide range of powers including authorisation and prudential supervision of all regulated financial institutions, firms and individuals."

While this comment certainly makes the structure of FRA clear, it does not elaborate on what impact it will have on the regulatory role of the QCB.

This will be a critical determinant of how flawless the new system will be, at the first instance.

R Seetharaman, Group CEO, Doha Bank points out that any supervisory regime will have to provide a link between the new single regulator and the QCB, given the potential relationships between monetary stability and financial stability.

"In general, unification with QCB may be beneficial on account of its independence and technical expertise, information-related synergies between prudential supervision and core banking functions and focus on systematic risk."

"The QCB is also the manager of the monetary policy in addition to being a regulator of banks and we envisage that the regulation of the monetary policy (in the context of a single currency) will remain a relevant activity for the QCB," says Bassel Gamal.

"QCB will continue to be responsible for the country's monetary policies and issues such as money supply. Only the Banking Supervision Department in the QCB is sought to be

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HE Abdullah bin Saud Al Thani, Governor of Qatar Central Bank

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REGULATORS' TRAINING

As part of this preparation, a training team from the UK's Financial Services Authority (FSA) were in Doha to deliver their Arrow - the Advanced Risk Responsive Operating framework – training to regulators from the QFC Regulatory Authority, the Qatar Central Bank and the Qatar Financial Markets Authority.

Arrow is the framework used by the FSA to assess risks to the FSA's statutory objectives (of maintaining market confidence, promoting public awareness, protecting consumers and reducing financial crime) and to assist the FSA to determine regulatory priorities and the allocation of resources.

Generally regarded as one of the most comprehensive and sophisticated risk assessment models being used today, FSA's experience in designing and operating the Arrow model offers many valuable lessons for financial regulators.

The training course is part of a QFC Regulatory Authority initiative to encourage coordination and collaboration amongst Qatar's current financial regulators ahead of the much anticipated launch of a single financial regulator.

Welcoming the participation of Qatar's regulatory community, QFC Regulatory Authority Chairman and CEO Phillip Thorpe said, "In addition to hearing first hand about the practices and experiences of a leading international regulator, this training event has allowed us to share that opportunity with our future colleagues from the Central Bank and Market Authority.

"It is clear that Qatar's financial regulators share very similar goals and objectives. We are very keen to expand our collaborative efforts through joint training and other initiatives. It is important that we take every opportunity to foster co-operation and understanding between the existing regulatory bodies, as we move closer to the establishment of a single integrated financial regulator."

placed under the single unified regulator," says Abdul Basit Al Shaibei, CEO, International Islamic Bank.

The model: Best international practices

Bankers are not in sync on the model that the FRA will be moulded on, though on the face of it, it appears that of the three models – functional (like in the US), unitary (like in the UK, Denmark, Hungary, Iceland, Japan, Norway, Sweden, South Korea, among others) and twin peaks structure (like in Australia, Canada, the Netherlands) – Qatar seems to have opted for the second, aiming as it is towards a single operating body to oversee the entire sector.

"In 2005, the Government of Qatar mandated that the QFC regulatory structure should follow best international practices and with that in mind the initial work in creating the QFCRA focused on major jurisdictions where international practices were in evidence.

As a practical matter, this drew us to the UK model, where the Financial Services Authority (FSA) represents probably the most developed of the single integrated regulators and is often regarded as setting the benchmark for such institutions," says Thorpe (see interview below).

"That said, while we have utilised much of the FSA model in respect of the QFCRA, we have also taken advantage of the experience of a number of other jurisdictions where world-class standards are the norm. For instance we have looked at the experiences in the US, Hong Kong, and Singapore in respect of particular markets or products. As for the new single regulator, I am sure it will draw upon those experiences too, though we must also be sure we achieve an outcome that is appropriate to the circumstances of Qatar, and which builds upon and maximises the work of all of the existing regulatory bodies."

"UK and Singapore are the closest models that would apply well to the Qatari market and our understanding is that the authorities are looking at these carefully," attests Kapil Chadda, Head of Investment Banking, HSBC, Qatar.

> "Any supervisory regime will have to provide a link between the FRA and QCB, given the relationships between monetary and financial stability."
>
> *R Seetharaman, CEO, Doha Bank Group*

Micro planning

At the individual level, each bank has chalked out its strategy in preparing for the impending unification.

Depending on the size of the bank, the sophistication of its products and the vision of those steering the institution, we seem to see the path that each has laid out for the bank.

Says Seetharaman, "The GCC market in general and Qatar market in particular is going through a face of paradigm shift in the banking and financial services industry with the emergence of financial conglomerates and growing securitisation both in the conventional and Islamic side.

"It is indeed a very positive development that unified financial regulator has been planned as the single supervisor regime seems to

(continued on page 64)

> "FRA is going to be an extension, rather than a replacement, of existing regime."
>
> *Bassel Gamal Aly, CEO, Ahli Bank*

'UNIFICATION WILL ACHIEVE LEVEL PLAYING FIELD'

QATAR Financial Centre Regulatory Authority, Chairman & CEO, Philip Thorpe illustrates the functional scope of the proposed FRA, the model on which it is shaping itself and the how the FRA will impact the present tenants of QFC.

|q| How do you see Financial Regulatory Authority's (FRA) scope of work once unification is underway?

|a| The intention in creating the FRA is to provide Qatar with a regulator that will oversee all financial services activity in the country. This means a "one-stop shop" for regulation in respect of banking, insurance, securities, asset management and all related activities. This is a significant task that will draw upon the existing resources of the QFCRA, the banking supervision staff of the Qatar Central Bank (QCB), and the Qatar Financial Markets Authority (QFMA), which currently oversees the Doha Securities Market.

"One aim in creating a single unified regulator is to ensure that all institutions in Qatar are operating to the same high standards – that we have in effect a regulatory "level playing field."

The initial work of the new regulator will comprise two major components: first the practical matter of establishing a single regulator. That will involve both bringing in new legislation and operational elements, including bringing the various existing regulatory staff together, finding common premises, developing common procedures and the like. Secondly we will need to produce a single regulatory regime, in the form of rules and regulations, for all of the financial institutions currently operating in the State of Qatar and for any new institutions wishing to establish in the country.

The expectation is that both these sets of tasks will be complex and will »

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»

take time to complete. In respect of the organizational matters, it is clearly desirable to try and press ahead with these as quickly as possible, to ensure that there is no loss of operational capability during the transition phase, and to ensure that maximum benefit can be extracted from the unification of the regulators at the earliest opportunity. In respect of the move to a single regulatory platform for financial institutions, this will inevitably be affected by the ability of those institutions to meet the requirements of the new regulator. We expect that abilities will vary, and the timeline for this part of the exercise will need to accommodate that fact. However, our hope is that the majority of firms will go through this transition process relatively quickly, though elements of the transition could extend into late 2009 and 2010.

|q| With regard to the unified financial regulator, which country's model would Qatar follow since there are quite a few European (UK, Germany, Scandinavian countries) and East Asian (Korea, Singapore) countries that have a unified regulator?

|a| As the question identifies, there are now a number of jurisdictions that have moved to the single regulator model and indeed recent turmoil in the markets has caused others, including the United States, to reflect upon the value of unifying or simplifying existing regulatory structures.

In 2005 the Government of Qatar mandated that the QFCRA should follow best international practices and with that in mind the initial work in creating the QFCRA focused on major jurisdictions where international practices were in evidence. As a practical matter, this drew us to the UK model,

where the Financial Services Authority represents probably the most developed of the single integrated regulators and is often regarded as setting the benchmark for such institutions.

That said, while we have utilised much of the FSA model in respect of the QFCRA, we have also taken advantage of the experience of a number of other jurisdictions where world class standards are the norm. For instance we have looked at the experiences in the US, Hong Kong, and Singapore in respect of particular markets or products.

"I am sure it (FRA) will draw upon those (international) experiences too, though we must also be sure we achieve an outcome that is appropriate to the circumstances of Qatar, and which builds upon and maximises the work of all of the existing regulatory bodies."

As for the new single regulator, I am sure it will draw upon those experiences too, though we must also be sure we achieve an outcome that is appropriate to the circumstances of Qatar, and which builds upon and maximizes the work of all of the existing regulatory bodies.

|q| How will unification affect present QFC firms?

|a| One aim in creating a single unified regulator is to ensure that all institutions in Qatar are operating to the same high standards – that we have in effect a regulatory "level playing field". This will mean that for some institutions change will be necessary, as they transition to new standards.

However for a large number of existing institutions, particularly the QFC institutions, the change will be relatively minor. I should emphasise, the new single regulator, and its rules and regulations, will be specific to that regulator – they will not be the rules and regulations of any of the existing regulators.

It should also be remembered that international best practices and standards are now well established and known to many of the existing domestic financial institutions in Qatar. We are not expecting that the new regulator's rules and regulations will present unreasonable challenges to the majority of firms, and for those firms that do need assistance to meet those standards, we are expecting to work closely with them to ensure as smooth and as rapid a transition as possible.

|q| What role will the FRA have in the event of a monetary union of the GCC?

|a| Monetary union is clearly a matter for the Government of Qatar and the other Governments of the GCC. When this occurs, I am sure the Government will consider how it wishes the new regulator to play a role.

If one looks at the experiences in the European Union, the arrival of the Euro as a common currency, and the establishment of a common European Central Bank have not lead to material changes for domestic financial regulators.

The important lessons from the EU experience have been related to the value of close and continuous coordination between those domestic regulatory bodies and I am sure that GCC monetary union will also give us the opportunity to reflect on whether further coordination can occur between GCC financial regulators. In addition to ensuring a strong flow of information between regulators, it is also important that we are able share experiences, and aspire to common high standards. This should be beneficial to all users of financial services in the GCC, provided we can all agree on the high standards that we should aspire to.

|q| How is the integration work going?

|a| Since the announcement by HE Yousef Hussein Kamal in 2007, work has been underway amongst the regulatory bodies in preparation for the single regulator coming into existence. As you might imagine, the task of developing appropriate legislation, and analyzing the changes needed to existing legislation, has been very time consuming, but a lot of progress has been made on this front. There has also been progress in terms of identifying the steps needed to achieve operational change. In this regard, we have been able to gain an understanding of the various existing regulatory regimes and I am sure this will provide a sold foundation for the transitions that will follow.

We are looking forward to more concrete, and public, moves toward integration in the near future, and I know that the staff of the QFCRA is very excited about the prospects of this more active "second stage" of the integration.

|q| How well, in your view, is the country positioned to migrate into the regime of an unified financial regulator?

|a| The analysis we have undertaken over the last few months indicates that there is a real appetite for change in financial services regulation. Clearly those institutions that have established under the auspices of the QFCRA have shown a strong commitment to the prospects in Qatar and a willingness to meet the types of standards required by us.

We expect those institutions to be natural supporters of the move to a single regulator, as it yet further simplifies the regulatory regime in Qatar and opens up new opportunities for institutions to work with their counterparts in the country.

It has also been pleasing to find that there is an increasing volume of Qatari firms who view the QFC as a great opportunity for building on and expanding their businesses, and who also view the QFC regulatory standards as of value to them in their expansion plans, particularly where they wish to develop their capacity for entering overseas markets. To me this speaks clearly of the enthusiasm that exists for an integrated regulatory solution for the country, and while no one is underestimating the effort that will be needed to achieve this change, there is genuine acceptance of the importance of high standards for financial services businesses.

It is worth remembering the reason we seek to impose high standards is to ensure that firms are best placed to manage their risks, serve their customers well, and most importantly, to ensure that the reputation of Qatar, as a good place to do business, is protected and upheld. The market turmoil of late has illustrated very clearly the importance for firms and customers of knowing and managing risks. It is undoubtedly the case that the new integrated regulator will help raise that ability.

I am also pleased to note that the move to a single regulator has strong political support, and for a number of reasons; because of the importance to Qatar of having a strong and reliable financial sector to support growth in the economy, because of Qatar's commitment and enthusiasm for operating to high standards, and because a simplified and strengthened regulatory system will have the capacity to both reduce costs, while offering businesses and individuals in Qatar better quality and better choice in financial services.

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be the 'natural' and best answer to the challenges posed by financial market integration. We are a diversified financial services group having ambitious plans to grow in the future organically both in the region and across the globe. Further, we also want to improve across various business lines. "For this purpose we intend to work in a robust regulatory environment which will be beneficial to our business plans and strategies. We expect the unified regulator will enable us to do this and also achieve our mission of most innovative, competent, profitable and sustainable one-stop financial service organization."

"In many regards, the new regulator is going to be an extension, rather than a replacement, of the existing regime. The fundamentals of bank supervision are not likely to change significantly. Additionally, being a part of Ahli United Bank and with presence in seven countries, has added further depth to our regulatory compliance," says Bassel Gamal.

"At QIIB we have been consistently upgrading the skills of our personnel, processes and technologies. We have invested quite a lot on these. This is absolutely essential for us because we have correspondent banking relationship with over 70 international banks besides the local and regional banks. We are also expanding rapidly in the region. QIIB has also fully complied with the QCB and international re-

THREE MODELS OF FINANCIAL REGULATION

- The first is functional regulation, whereby separate regulators oversee different types of financial companies. Most countries have moved away from that model, on the solid grounds that financial markets themselves have become more interlinked and companies more promiscuous. The US is a prominent exception. Americans have remained committed to a highly complex form of functional regulation.
- The second model is unitary regulation, with a single institution covering most if not all of the financial sector. Although this model is often associated with London and the Financial Services Authority, the Scandinavians started the trend on the back of the banking crises there in the early 1990s. Following the UK switch a number of other countries, including Japan, South Korea and Germany, did the same. Now more than 50 countries operate something similar, although no two models are precisely the same.
- The third scheme is known in the trade as Twin Peaks - whereby two regulators are established: one for prudence, focusing on capital soundness, and one to monitor the general conduct of business standards. So far very few countries have followed this prescription, originally devised by UK academics: Australia, Canada and the Netherlands. They have done so in subtly but importantly different ways, with various permutations and combinations available. In Amsterdam the central bank is the prudential regulator. In Sydney there is a separate authority, leaving the Reserve Bank with scrutiny of the payments system and responsibility for financial stability.

"QCB will continue to be responsible for the country's monetary policies and issues such as money supply. Only the Banking Supervision Department in the QCB is sought to be placed under the single unified regulator."

Abdul Basit Al Shaibei, CEO, Qatar International Islamic Bank

quirements on combating money laundering. We have also complied with the Basel-II Accord. The purpose of Basel II is to create an international standard that banking regulators can use when creating regulations about how much capital banks need to put aside to guard against the types of financial and operational risks banks face," says Al Shaibei.

Operational differences

That the regime of the proposed unified regulator is expected to be picture perfect, without hampering the rhythm in which the sector moves, comes across from what the bankers have told us, though they do not rule out the fact that the transition will have to be managed by all players concerned. "The general focus of bank supervision is on systemic stability and sensible risk management practices. We don't anticipate this changing dramatically. Furthermore, there will be a transitional period for all institutions operating under the single regulator to adjust," says Bassel Gamal.

"Having a seamless regulatory body on a standard akin to the FSA from the UK will allow banks to function more efficiently, especially if they are compliant with Basel II regulations on the application of capital and the management of risk. It will also allow the regulator to regulate rather than supervise at an intimate level each activity of the bank. Operationally this will mean that the checks and balances and need for a high compliance standard in a bank will be essential for banks to be allowed to conduct a wide array of activities without hindrance," says Chadda.

Seetharaman is more specific when he says, "We can expect enhancement of an already effective regulatory system; a harmonised, consistent and/or more integrated approach to regulation among different sectors; strengthening the financial industry and financial systems, thereby enhancing economic stability and growth; and increase Qatar's standing as a financial centre as cross-border financial activities increase globally."

GCC monetary union

One crucial role of the proposed single financial regulator would be its functions in the wake of the GCC monetary union, which has become a more concrete eventuality with the recent decision taken at Jeddah in which the finance chiefs of the Gulf States approved proposals to set up a monetary council and a draft charter for a monetary union. "The single financial regulator will regulate the financial services. If you follow the EU model, there will be greater level of cooperation between the regulators of each GCC country contemplating monetary union. This will allow better management of financial market in the region. We would like to think that if the single financial regulator is a reality in the time frame proposed, it will allow itself to take a leading position in developing a world-class standard for regulators in the region to emulate," asserts Moncrieff.

Some others see a functional division between the QCB and the single regulator.

"We expect the single regulator to continue its prudential regulatory review in relation to monetary union, but QCB will control decisions in relation to inflation, interest rates, foreign reserves and fiscal criteria for Qatar which are necessary for implementing the GCC monetary Union," says Seetheraman ■

The interview with Charles L Moncrieff was done shortly before his sad demise.

"... if the single financial regulator is a reality in the time frame proposed, it will allow itself to take a leading position in developing a world class standard for regulators in the region to emulate."

Charles L Moncrieff, CEO, HSBC, Qatar

Unification will enhance Qatar's reputation

BY KHAWAR QURESHI

QATAR'S economy is one of the fastest growing in the world. With increasing liquidity comes greater demand for financial products and services. Put simply, people want their money to make money, and for their investments to be as safe as possible.

In this article we explore the historical development of Financial Services Regulation, with some reference to developments in the US/UK.

It seems all too often the case that money and greed unfortunately and increasingly go hand in hand.

This means that a State needs to consider very carefully how it will enable financial products and services to be offered within its jurisdiction, not least so as to protect those who may otherwise be taken advantage of.

Indeed, the need for a State to effectively regulate financial products and services is vital, given the potential impact of these activities upon the very reputation of the State and the well-being of its economy – witness what has been happening in the US/UK in recent weeks (with suggestions that the US' AAA credit rating was under threat for a while).

State Regulation: the US and UK experience

For many years, the UK authorities adopted a "hands-off" approach to regulation of the financial services sector.

Apart from the need for licensing, and some supervision from the Bank of England, financial institutions were more or less left to regulate themselves upon the basis of voluntarily adopted codes of good practice.

The rationale for this was that the "City" (as the financial services sector is generally termed) fully understood that the State would intervene and regulate heavily if the City did not voluntarily adhere to prudential practices.

This is in contrast to the USA Securities and Exchange Commission/Department of Justice based system of tighter and more forceful regulation, which was brought into place after the great depression of the 1930's.

In the UK, the first real effort to bring about systematic regulation came with the Financial Services Act 1986, in the aftermath of serious financial scandals which led to many people losing their savings to fraudsters.

That piece of UK legislation created a statutory system of regulation for different types of financial products and institutions.

It imposed a requirement for licensing and designated a number of super-

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visory regulatory bodies which had the power to intervene, close down and impose penalties upon financial service providers who broke the rules.

However, the underlying sentiment was that there should be a "light touch" to regulation, so as to let the City get on with what it did best – making money.

The 1986 Act was riddled with problems. The rules were vague, and there were too many regulators for different types of activities (with names such as the SIB/IMRO/FIMBRA) leading to confusion, lack of co-ordination and "turf wars".

In addition, the regulators lacked effective resources and institutional experience. The recession of the early 1990's led to a re-think and produced the Financial Services and Markets Act 2000. This comprehensive piece of legislation makes the Financial Services Authority ("the FSA") the key Financial Services Regulator in the UK.

Accordingly, the need for any State to adopt a unified Financial Service Regulatory system appears compelling. Not only are the mistakes of the UK 1986 Act to be learnt from, but also, in an age of Globalisation, the statement that "When New York sneezes the rest of the World catches a cold" is powerfully apparent.

The recent financial disasters in the US (such as the collapses of AIG and Lehmann Brothers) have sent shock waves throughout the world, and are likely to signal the beginning of a global recession.

A dynamic, sound and unified regulatory approach is vital to respond to rapidly developing domestic opportunities and international challenges.

In many jurisdictions, the need for more effective regulation is seen by some experts as all too apparent. Recent reports of high-profile arrests and investigations suggest that the Dubai authorities are beginning to tackle problems in the property and financial services sector which are seen by some commentators as likely to be the result of ineffective State regulation.

What this means for a State such as Qatar when considering regulation in the Financial Services Sector is as follows: What are the lessons to be learnt from the recent UK/US disasters, and how should the Qatar Financial Regulation system operate?

This article is not the place to elaborate upon what the Qatar Unified Regulator can learn from recent events. However, some of the dangers might be addressed by imposing stronger prudential norms, tougher licensing requirements/enforcement powers, clearer capital to risk requirements, enhanced Accounting Standards (to seal off loopholes such as "off balance sheet") and greater scrutiny of "exotic" financial products.

"A dynamic, sound and unified regulatory approach is vital to respond to rapidly developing domestic opportunities and international challenges."

Whatever the eventual substance of financial services regulation in Qatar, the case for a unified regulator seems compelling. For example, the UK Northern Rock Bank disaster is seen by some as having occurred because the jurisdiction of at least two regulators (the Bank of England and the FSA) overlapped and a speedier response may have averted the collapse of that Bank.

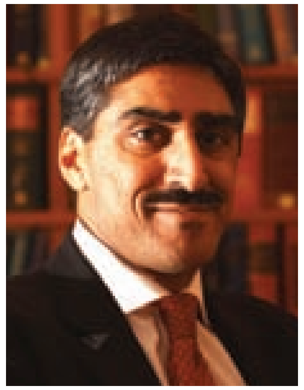
Qatar's Unified Regulator

Qatar intends to adopt a single, integrated financial regulatory body that will supervise all banking, insurance, securities, asset management and other financial services. Press reports indicate that an interim Board for the new regulator will be established later this year. It is intended that the Board will develop a common set of rules to be implemented by 2010. The rationale

for the changes was explained by His Excellency Yousef Hussein Kamal as follows, "This initiative, aimed at creating a best-practice legal and regulatory environment for Qatar's entire financial sector, illustrates the government's commitment to the development of a thriving financial services industry."

It is clear that the vision expressed by the Finance Minister reflects an intention for Qatar to become the preeminent regional financial services hub. The positive pace of change thus far in Qatar indicates that this goal is seriously achievable. Qatar Financial Centre (QFC), created in 2005, has drawn in major global financial institutions.

The Qatar Financial Markets Authority was established in 2006 to regulate the securities sector. Staff from the Financial Markets Authority, along with those from the Qatar Central Bank's Department of Banking Supervision and its consumer services unit, will be combined together with the QFC Regulatory Authority to create a single new organization. The decision of the authorities in Qatar to establish a unified Financial Services regulator comes at a time when experienced regulators in the US/UK are coming under increasing pressure to be more effective, given the disasters which have recently taken place. Qatar's unified regulator will come into existence at a time when the World's Financial Markets are volatile. The creation of a strong, dynamic and knowledge-based Unified Regulator in Qatar is likely to enhance Qatar's position as a financial services hub significantly.



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Challenges aplenty for new regulator

BY PROF MOHAMMAD K NAJDAWI

Creating a single financial services regulator in Qatar will result in moving banking regulation and supervision away from the central bank. As a result, potential monetary policy issues and banking regulation issues will accompany such a decision.

Monetary policy issues are focused on the costs and benefits of combining the monetary policy function and the banking regulation responsibility within the central bank. In general, even when it is not possible to provide an unambiguous cost-benefit result, in the case of the Qatar, and possibly the GCC countries, the costs probably outweigh the benefits of combining monetary policy with the financial regulator role in a single institution, i.e., the central bank. In addition, the central bank role as lender of last resort does not generally provide a rationale for making it the financial sector regulator of those financial institutions that are deemed to give rise to systemic risk.

The lender of last resort function (like the benefits of combining monetary policy and banking regulation) only provide support for close links and a proper flow of information between the relevant banking regulator and the monetary authorities, but has no unambiguous implications for the structure of regulation.

Monetary policies different

There is enough evidence that confidential supervisory information on the financial conditions of US banks has been successfully used in setting US monetary policy. However, this finding is of limited relevance for the economy of Qatar and other GCC countries because the nature of monetary policies is different. A big central bank, like the US Federal Reserve System, can engage in a truly independent monetary policy that sets interest rate targets. However, only a few of the central banks of the region are in a position to engage in that kind of policy.

In an environment of high international capital mobility, the scope for that type of policy is limited by the degree of substitution of domestic and foreign bonds. The problem with the argument posed above when applied to Qatar is that the scope for an independent monetary policy, like the one pursued by 'big' central banks, is itself severely limited in the first place. Therefore, the case made in favour of merging the conduct of monetary policy and financial regulator functions within the central bank is not particularly strong. However, this does not mean that, in general, there will be no need for close links (and a proper flow of information) between the monetary authority and the financial sector regulator. This becomes particularly relevant during periods of financial distress when the core objective of financial stability could potentially be in jeopardy.

Monetary and financial stability are inter-related. It is inconceivable that the monetary authorities could quietly pursue their stability-oriented monetary policy objectives if the financial system through which policy is carried on, and which provides the link with the real economy, were collapsing around them This inter-relationship means that, whatever the precise institutional arrangements for financial regulation and supervision, central banks necessarily will have a vital interest in the soundness of the financial system.

A good example of institutional reform that separated banking regulation and monetary policy, while keeping close links between the banking regulators and the monetary authorities, is the creation of the European Central Bank (ECB). That institution has separated financial regulation and monetary policy functions across the euro area, leaving some central banks with responsibility for banking supervision, but not for monetary policy, and some with responsibility for neither function.

Lender of last resort

The fact that some (prominent) central banks in a position to implement independent monetary policies have recently decided to separate the banking regulatory and supervisory functions from monetary policy suggests that there are indeed some costs associated with the merger of both functions under the same authority. These costs include, the potential conflict of interest that tempts the central bank to loosen monetary policy because of concerns about the financial health of the banks it regulates. As a consequence, there would be an upward bias in the rate of inflation.

> "The problem could be especially serious in the case of liquidity assistance credits to ex-post insolvent commercial banks."

The problem could be especially serious in the case of liquidity assistance credits to ex-post insolvent commercial banks. A second important cost stems from the fact that a wider central bank role increases the risk that its functions will be subject to political pressures or political control. This argument seems particularly relevant in the case of some of the GCC countries.

As far as the issue of the lender of last resort is concerned, there is a rationale for financial regulation in response to

systemic liquidity risk. However, this does not provide an argument in favour of the central bank undertaking banking regulation. The decision to provide official support will, more often, involve the government rather than just the central bank. In a serious banking crisis, like the one that involved some US banks recently, the rescue schemes involved the participation of the fiscal authority, the central bank, the banking regulator, and the deposit insurance corporation. That does not mean, however, that there is a rationale for all these parties for undertaking banking regulation. Moreover, as is the case in many countries, the institution-specific information available to regulators can be transmitted rapidly to the central bank and to the fiscal authorities once problems arise.

There are benefits and costs that the banking regulator could derive from the merger of monetary policy. From the benefits side, it can be argued that merging monetary policy with banking regulation functions reduces the coordination problems, facilitates the access to relevant information, and diminishes the risk of the deteriorating quality of human resources. However, the benefits of the merger should be big enough to outweigh the costs stemming from conflicts of interest.

Increased information

An additional advantage of the merger of functions from the standpoint of the banking regulator is related to the increased amount of information (regarding monetary conditions) and of the number of instruments that the banking regulator could have available. However, the concern among some banking regulators of the danger of the deterioration of the quality of human resources is not always true.

In some countries, the quality of human capital in a central bank typically tends to be high. If it happens to be higher than the average quality prevailing in the other specialised financial regulators, the creation of a single financial authority that moves banking regulation outside of the central bank could lead to a reduction in the quality of both banking regulation and supervision. This could even lead to a reduction in the quality of financial regulation across financial products and firms in the industry. In particular, in so far as the potential economies of scope and scale that exists in financial regulation can successfully materialise, an upgrade in the quality of human capital in financial regulation and supervision would be possible

There are several arguments in favour of integration including, economies of scale and scope, the prevalence of financial conglomerates, competitive neutrality, and transparency and accountability. The integrated approach is also preferable regarding the efficacy and efficiency to achieve the objective of promoting efficiency in the financial system. The issues that are important regarding efficacy of the integrated approach include, moral hazard problems affecting consumer protection, separation of the banking regulation from the central bank that could potentially affect systemic stability, and competitive neutrality.

One final important issue is related to the enforcement of rules. In environments with weak legal enforcement, as is the case in several developing countries, one could argue that there is no guarantee that the new, clearer and more transparent legal framework will indeed be enforced. However, the argument in favour of the integrated approach can still be perceived as presenting a unique opportunity to introduce a more transparent, effective and efficient regulatory framework for financial services activities ■

Author's note: This article draws on a study by Demaestri and Guerrero on financial regulation in Latin America.

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