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A Review of the Financial Regulatory Framework of Barbados

Abstract

It is well established in the literature that the financial system plays a pivotal role in the development process. Thus, it is incumbent on governments to have strong and effective regulatory regimes in place to protect investors, ensure orderly functioning of financial institutions and markets, and maintain confidence and stability in the financial system. An area of regulation receiving renewed attention in recent times is the institutional structure of financial regulation; specifically, whether the existing institutional arrangements for regulation are resulting in comprehensive and effective regulation of the financial system. These discussions have been driven to a large extent by changes in the structure of the financial services industry globally and the disruption to financial systems in many countries.

While the type of institutional structure may not be the main determinant of regulatory effectiveness, an inappropriate or outmoded structure can impede the attainment of regulatory and supervisory goals. The aim of this paper is to examine the adequacy of the financial regulatory framework in Barbados. Specifically, the paper seeks to determine whether the current architecture of financial regulation provides suitable coverage of all areas of regulation, and whether the

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Central Bank's responsibility for prudential regulation and monetary policy is appropriate and in keeping with best practice. Data were obtained via an interview survey with managerial personnel of the regulators (Central Bank of Barbados, Financial Services Commission and Fair Trading Commission) and selected financial institutions during the period July to September 2014. The research findings reveal that though an integrated regulator would benefit the Barbadian financial system, it is not necessary as the current system is adequate. However, the lines of responsibility for certain aspects of regulation by the three agencies should be better delineated. Also, the Central Bank should maintain responsibility for monetary policy and prudential regulation.

Keywords: Barbados, central bank, Fair Trading Commission, Financial Services Commission, financial regulation, financial system, regulatory framework.

JEL classification: G10, G18, G28.

1. INTRODUCTION

It is well established in the literature that the financial system plays a pivotal role in the development process. In the course of financial activity, the savings of the economy are increased and rendered highly mobile, and the risk facing savers are reduced through diversification. Also, the financial system contributes to economic growth by enhancing the volume and productivity of investment activities. By assessing which managers and which projects are likely to be the most profitable and monitoring the behavior of borrowers, financial intermediaries ensure that resources are used efficiently (Wood, 2012).

Given the critical role of the financial system in a country's development, it is incumbent on governments to have strong and effective regulatory regimes in place to protect investors, ensure orderly functioning of financial institutions and markets, and maintain confidence and stability in the financial system. This imperative was once again brought into sharp focus by the latest financial crisis which had devastating consequences for companies and governments worldwide. In a crisis situation confidence in the financial system is undermined and there is a reduction of credit to firms and individuals which in turn leads to a contraction in economic activity.

An area of regulation receiving renewed attention in recent times is the institutional structure of financial regulation; specifically, whether the existing institutional arrangements for regulation are resulting in comprehensive and effective regulation of the financial system. These discussions have been driven to a large extent by changes in the structure of the financial services industry globally and the disruption to financial systems in many countries. Notable examples are the financial crisis originating in the United States of America in the late 2007 which, through contagion, affected several countries and financial systems across the globe, and in the Caribbean the failure of Colonial Life Insurance Company Group which had disastrous consequences for investors, policyholders and governments in the region. In many jurisdictions the traditional distinction between the activities of different types of financial institutions has faded. Hence, the previous division of regulators based predominantly on institution type is now being relooked. Indeed, some countries have established a single regulator for the entire system while others have opted for a regime with regulators based on the regulatory objectives they seek to achieve.

While the type of institutional structure may not be the main determinant of regulatory effectiveness, an inappropriate or outmoded structure can impede the attainment of regulatory and supervisory goals. Institutional structure may have an impact on the overall effectiveness of regulation and supervision because of the expertise, experience and culture that develop within particular regulatory agencies and the approaches they adopt (Llewellyn, 2004). The aim of this paper is to examine the adequacy of the financial regulatory framework in Barbados. Specifically, the paper seeks to determine whether the current architecture of financial regulation provides suitable coverage of all areas of regulation and whether the Central Bank's responsibility for prudential regulation and monetary policy is appropriate and in keeping with best practice. The paper extends the Caribbean literature on financial regulation which focuses mainly on describing the regulatory frameworks (Williams, 1988; Feracho and Samuel, 1997; Nicholls and Seerattan, 2004).

Data were obtained via an interview survey with managerial personnel of the regulators (Central Bank of Barbados, Financial Services Commission and Fair Trading Commission) and selected regulated financial institutions during the period of July to September 2014.

The remainder of the paper is organized in the following way: Section 2 reviews the relevant literature on financial regulation; Section 3 provides an overview of the Barbadian financial regulatory framework; the methodology is discussed in Section 4; the findings are presented in Section 5 while the discussion of the findings is the focus of Section 6; and a concluding summary is provided in the final section.

2. LITERATURE REVIEW

2.1 Why Financial Regulation?

The idea of mandatory regulating something suggests a need to control it, have it conform to standardized norms and comply with rules within a particular framework. Financial regulation involves government intervention in the financial system through the passage of rules and laws, and the establishment of institutional arrangements to deal with enforcement, monitoring and supervision. It is generally acknowledged that the financial system is more heavily regulated than other areas of the economy. This situation arises from the special nature of the activities undertaken by financial institutions and the vital role of the financial system in the development process.

Wood (2012) discusses the important functions performed by the financial system. First, through economies of scale in the collection of information and portfolio management, financial intermediaries transmutate the financial claims flowing from borrowers to lenders in order to satisfy simultaneously the portfolio preferences of both economic agents (Gurley and Shaw, 1956, 1960). Through the intermediation process transaction costs are reduced and there is greater diversification of risk than is achievable under direct finance. Thus, financial intermediaries contribute significantly to an increase in investment activities and, hence, growth. Second, financial intermediaries may serve as leading agents in development by identifying entrepreneurs with the potentially most profitable ideas and products, and supplying finance to these projects (King and Levine, 1993; Drzeniek-Hanouz et al., 2009). Third, financial intermediaries facilitate a more efficient allocation of resources through their ability to overcome informational problems in financial markets (Diamond, 1984; Mayer, 1988). Fourth, financial institutions may serve as a disciplinary device on management, thereby incentivizing managers to pursue policies to improve the financial performance of firms (Jensen, 1986 and 1988; Sheard, 1989; Aoki and Patrick, 1994). Further, financial intermediaries may play an important role in the reallocation of assets through corporate restructurings. Fifth, the financial system facilitates trade through the provision of credit and guaranteeing payments. Finally, financial institutions provide specialized services, for example, brokerage, insurance, property management, underwriting and other financial services.

In the performance of these important functions, financial institutions are open to varying types of risk (for example, credit risk, default risk, interest rate risk, market risk, liquidity risk, operational risk, reputational risk) which, if not efficiently managed, could be detrimental to the financial health of the institutions and could undermine confidence and stability in the entire financial system. Also, because of the inextricable link between finance and real development, other sectors within the economy are affected when financial institutions fail. As noted by the Warwick Commission (2009, p. 9) "when financial markets malfunction, the real economy takes a nose-dive."

Given the crucial role of the financial system in the growth process and the risks inherent in the intermediation process, governments have consistently intervened to regulate and control the activities of financial institutions. The standard rationale for government intervention in the financial sector is the problem of market failure, that is, the market would produce a suboptimal outcome if left to itself. Several reasons have been identified for market failure in the financial sector including asymmetric information or information inadequacies, moral hazard and externalities of financial disruptions. Asymmetric information relates to the situation where investors have limited information about the products sold by financial institutions and as a result can be disadvantaged by financial institutions at the time of purchase. Moral hazard relates to the situation where management of the financial institution takes on riskier than normal activities once the investor purchases the product. The moral hazard problem may be exacerbated with a deposit insurance scheme which guarantees investors recovery of some percentage of their funds should the financial institution experience difficulty. Externalties of financial disruptions or social externalities relate to the situation where the failure of a financial institution (or subset of institutions) has a negative effect on other financial institutions and, in severe cases, may lead to a collapse of the financial system. Also, because of the nexus between finance and real development, problems in the financial sector are likely to have devastating consequences on the entire economy.

The above discussion indicates that the major objectives of government intervention in the financial sector are the protection of investors, ensuring orderly functioning of financial institutions and promoting financial stability. Other reasons identified by Pilbeam (1998, p. 368) are to promote fair and healthy competition to ensure competitive prices for consumers and the government's desire to exert some degree of control over the level of economic activity, particularly in relation to monetary policy.

2.2 Types of Regulatory Measures

Financial systems worldwide are subject to several types of regulatory measures which vary by levels of complexity and scope depending on the state of development of the country's financial system and the differing cultural, economic and political systems.

The literature identifies the following types or categories of financial regulation: Structural, monetary, prudential, code-of-conduct/consumer protection and competition. Structural regulation sets the general parameters for the financial institutions; it refers to the types of activities, products and geographical boundaries within which financial institutions can operate. Monetary regulation, sometimes termed macro-monetary regulation, refers to the use of monetary policy tools to bring about predetermined macroeconomic outcomes. Traditional instruments of monetary policy include open-market operations, cash reserve requirements, interest rate controls and discount rate.

Prudential regulation focuses on the safety and soundness of financial institutions. This type of regulation emphasizes the control of risk through mainly capital requirements, limits on customer concentration and risk-based portfolio assessment (Williams, 1996). Prudential regulation is further divided into micro and macroprudential regulation. Microprudential regulation focuses on the health of individual institutions whereas macroprudential regulation refers to the use of prudential tools with the explicit objective of promoting the stability of the financial system as a whole. Macroprudential regulation may therefore be considered systemic regulation where the focus is on the externalities from financial disruptions.

Immediately after the financial crisis, a widespread consensus emerged among policymakers and academics that a new macro approach to prudential regulation aimed at containing externalities was needed to stabilize the economy going forward (Glavan and Anghel, 2013). Specifically, the regulatory measures should address issues relating to the underestimation of risk during economic booms and overestimation during economic recessions, the procyclicality phenomenon discussed by the Warwick Commission (2009) and Mishkin and Eakins (2012), among others. This would ensure that financial institutions, mainly banks, invest more capital than they would generally consider necessary in boom periods so they can support credit during crash periods by releasing this capital. Such activities would narrow the gap between economic boom and crash periods and, hence, achieve greater economic stabilization.

Consumer protection regulation is focused on conduct-of-business arrangements designed to protect the consumer from factors such as incomplete information, bad practices by financial firms and unfair practices (Llewellyn, 2004). This type of regulation requires setting and enforcing the appropriate rules under a transparent legal framework. It is not the simplest task for the ordinary consumer to understand the details of financial products and, hence, can be disadvantaged in their transactions with financial institutions. Woolward (2013) notes that many financial firms add layers of complexity via impenetrable jargon, pages of terms and conditions, bizarre exclusions in the reams of small print, and products launched and withdrawn with often bewildering frequency. However, regulations that consider the interest of consumers, with regards to making financial terms more customer-friendly and having the financial institutions being more transparent, fair and accountable for their actions, will help to ensure that customers are protected against discriminatory and unfair practices by the institutions (Jordan, 2015).

Competition regulation is designed to ensure that there is an appropriate degree of competition in the financial system and that anticompetitive practices by financial firms are eliminated. This type of regulation is necessary to prevent ineffective competition from leading to poor outcomes for consumers. Competition regulation involves analyzing markets from all angles and seeking to understand the interactions between both demand and supply-side competition weaknesses. The regulator then uses his powers to improve the effectiveness of competition.

2.3 Regulatory Structures

The Group of Thirty (2008) and Fresh and Baily (2009) identify four main types of structures: The *twin peaks model*, the *functional approach*, the *institutional approach* and the *integrated approach*.

The Twin Peaks Model

The twin peaks model relies on two types of regulators: A prudential regulator and a conduct-of-business (consumer protection) regulator. Although defined as separate entities, these two regulators generally employ a high level of coordination since they are each responsible for overseeing the operations of different aspects of the same institutions. The twin peaks model is generally considered, like the integrated approach, to offer the type of flexibility needed to deal with rapid innovation in the financial sector and the blurring of lines between what were once considered the traditional actors in finance.

The Functional Approach

The functional approach seeks to regulate financial institutions based on the type of business they undertake, with disregard for how a given institution is defined legally. Therefore, various branches of the same institution could be under the purview of different regulators as a result of the business that they conduct. For example, a bank, which as part of its business model also offers securities services, would have to report to two regulators, the banking regulator and the securities regulator. For the functional approach to operate most effectively, a great deal of coordination is required among the various functional regulators to ensure that no branch of a given institution escapes oversight.

The Institutional Approach

Under an institutional approach, the legal status of an institution determines its regulatory supervision. In this case, once an institution is licensed as a bank, it is regulated by the banking supervisor though it may also be lawfully conducting securities business. The institutional approach is one of the least flexible, proving difficult to adapt to the blurring lines between types of financial institutions. Despite a given legal status, many financial institutions have engaged in increasingly broad operations outside of the relatively narrowly-defined confines of that status. Furthermore, shifting their legal status allows institutions to engage in regulatory arbitrage.

The Integrated Approach

In an integrated approach, a single regulator oversees all types of financial institutions and provides both prudential regulation as well as conduct-of-business (consumer protection) regulation. Llewellyn (2004) does not, however, consider the mix of conduct-of-business regulation and prudential regulation as the integrated approach; he considers this a mega regulator, a more drastic level of integration.

Few countries have a model that fits neatly into any one of the above approaches. Most developed countries such as the United Kingdom, Switzerland, Canada and Australia have adopted a twin peaks system. On the other hand, the United States of America appears to have an institutional approach with multiple regulators for one type of financial institution. Singapore, Trinidad and Tobago, and Cayman Islands exhibit traits of a mega or integrated system as there is one combined regulator with a mandate for all types of regulation.

It should be noted that several regulatory arrangements are possible whereby the single or multiple regulators can function while ensuring appropriate coordination, sharing of facilities, and, where appropriate, establishing clear-cut responsibilities. These arrangements may include establishing an oversight board over the multi-regulatory structure, unifying the support systems while leaving the regulators separate and establishing a memorandum of understanding (MOU) among all of the regulators, thereby reducing issues relating to accountability, transparency and information exchange.

2.4 The Role of the Central Bank

Another important factor that must be considered when contemplating changing the regulatory structure is the role of the central bank. More specifically, to what degree should the central bank, with responsibility for monetary (macro-monetary) regulation, be involved in prudential regulation? There are three main issues which must be considered in determining the central bank's role: The interaction between financial stability and prudential supervision, the concentration of power and the independence of the central bank.

One school of thought espouses that the central bank is well placed to perform the dual role of monetary and prudential regulator. Schoenmaker (2013) supports this view on the grounds that the objectives of financial stability and prudential supervision are two sides of the same coin since disruptions in the financial system have an impact on the real economy, with related effects on output and inflation.

Combining the responsibilities for monetary policy and prudential regulation can also be advantageous in crisis management arrangements. For example, in the United Kingdom, the memorandum of understanding between the Bank of England and the Financial Services Authority gave the Bank of England lender of last resort responsibility while the Financial Services Authority had responsibility for the conduct of operations in response to problem cases affecting firms, markets, and clearing and settlement systems within its purview. When the bank run on Northern Rock occurred in September 2007 the authorities were criticized for failing to respond sufficiently promptly to avert the run on the bank. This led to a revival of the argument that the central bank should also be the bank supervisor, since it is very difficult for the lender of last resort to act promptly when the agency with the knowledge of a particular failing bank is not the same agency responsible for extending credit (Taylor, 2013). The authorities' response in the United Kingdom was to unify the Financial Services Authority with the Bank of England.

Further support for combining central banking with prudential supervision focuses on the positive synergies between the macroeconomic and microeconomic goals. The close relations with banks, through bank supervision, will assist the central bank in anticipating the direction of the economy and in addressing financial crises. Intimate knowledge of banks will prevent inappropriate access to lender of last resort lending. Also, responsibility for bank supervision enables the central bank to protect the payments system from the risk of contagion (Schooner and Taylor, 2010).

The argument for the dual role of the central bank must be balanced against the concern about concentration of power. Some of the normal checks against the abuse of regulatory power might be relaxed when the regulatory function is combined with other powers. For example, a bank might be reluctant to challenge regulatory actions (anything from proposed rulemaking to an enforcement action) for fear that the central bank might retaliate by limiting its access to liquidity support in times of need (Taylor, 2013). In addition, the central bank may suffer loss of credibility if it performs poorly as a bank supervisor, which could compromise its effectiveness in implementing monetary policy.

However, in developing countries such concentration may prove beneficial. The stature of the central bank may be necessary to compel change in the culture of regulation. The central bank may be a necessary force behind a nascent supervisory regime. Indeed, The World Bank's Bank Regulation and Supervision Survey 2012 notes that in more than 60% of jurisdictions, central banks are the agencies that supervise commercial banks for prudential purposes.

Independence of central banks is generally considered desirable with respect to monetary policy. There is also a trend to require regulatory and supervisory independence; hence, if the supervisory role is performed by the central bank, it is assumed that the independence the central bank has over its monetary policy function will also apply to its prudential function. In many emerging market economies, the central bank possesses a degree of prestige and independence not enjoyed by a regulatory agency under a wing of a government ministry. This allows the central bank to pursue a forceful regulatory policy free from political interference. However, the type of independence that is necessary for the central bank's macroprudential function may not be appropriate for microprudential regulation since microprudential regulation has the potential to impact on individual rights (for example, those of shareholders). Therefore, the bank supervisor must be limited by the checks and balances provided by judicial review and political accountability (Schooner and Taylor, 2010).

In practice, no bank regulator could, or should, ever be totally independent of the central bank. The central bank is the monopoly provider of the reserve base and the lender of last resort. Moreover, the central bank, in its macro policy operational role, must have a direct concern with the payments and settlements system, the money markets and the development of monetary aggregates. Thus, there are bound to be, and must be, very close relations between the bank regulator and the monetary policy authority.

3. OVERVIEW OF THE BARBADIAN FINANCIAL REGULATORY FRAMEWORK

In order to determine whether the Barbadian financial system would benefit from a consolidated regulator and to opine on the role of the central bank, the current structure of the regulatory system must be understood.

The Barbadian financial system comprises the central bank, commercial banks, merchant banks, finance companies, trust companies, credit unions, insurance companies, financial asset management firms (mutual funds), financial brokerage firms and a stock exchange. These institutions operate mainly in money, credit, equity, bond, and foreign exchange markets; and are both of domestic and international ownership (Howard, 2013). The July 2014 Central Bank of Barbados Financial Stability Report indicates that assets in the financial system as at March 2014 were estimated to be in the region of 21 billion of Barbadian dollar (BBD) or 250% of the gross domestic product. Commercial banks dominate the financial system, accounting for 59% of total assets, followed by insurance companies with 17%, mutual funds with 9%, credit unions with 8% and finance companies with 7 percent.

The regulatory framework in Barbados is currently structured to give coverage to every financial institution. The main regulators are the Central Bank of Barbados (CBB), the Financial Services Commission (FSC) and the Fair Trading Commission (FTC). The CBB was established by the Central Bank of Barbados Act 1972 and commenced operations with the pivotal central banking mandate to safeguard and ensure monetary and financial stability, while seeking to promote economic development. Other important roles performed by the CBB include maintaining the external reserves to safeguard the external value of the Barbadian dollar, administering the country's exchange control regulations, issuing and making a market for government securities, acting as a banker to government and commercial banks, and providing advice to Government (Wood, 2012).

Within its mandate for prudential regulation the CBB monitors the operations of commercial banks, finance companies, trust companies, merchant banks and mortgage finance companies on the basis of the Financial Institutions Act 1997. In addition, it has responsibility for the regulation of international or offshore banks on the basis of the International Financial Services Act 2002. The CBB effects supervision of the financial institutions under its charge through the Bank Supervision Department and the Research Department which houses the Financial Stability Unit. The Bank Supervision Department is responsible for microprudential regulation and the Research

Department for macroprudential regulation. The Bank Supervision Department is divided into three sections: The policy section which has responsibility for producing guidelines, amending legislation and developing prudential reporting norms; the approvals section which is responsible for approving new applications and applications to change business models; and the supervision section which focuses on reviewing data submitted and conducting onsite inspections. The Research Department monitors the impact of macroeconomic developments on the financial system and monetary policy impacts and, through the Financial Stability Unit, conducts stress tests on individual banks and the entire financial system.

Other departments within the CBB play important supportive roles. The Banking, Currency and Investments Department monitors interbank activity and performs the lender of last resort function of the CBB, and the Foreign Exchange and Exchange Control Department monitors all external capital flows and is, therefore, constantly kept abreast of the external transactions of financial institutions (Howard, 2013).

The Financial Services Commission was established by the Financial Services Act of 2010 and commenced operations in April 2011. The FSC is responsible for the regulation of the non-banking financial services sector. The creation of this regulatory body represents a significant development in the evolution of Barbados' regulatory framework since it is an amalgamation of the regulators of non-bank financial institutions (Wilson, 2011). These agencies are the Supervisor of Insurance which regulates the operations of insurance companies, the Department of Cooperatives which regulates credit unions and the Securities Commission which is responsible for the Barbados Stock Exchange and its market participants. The FSC has seven divisions: Securities, credit unions, insurance, pensions, registration and licensing, research and examinations. The examinations division deals with onsite inspections of all entities under the purview of the FSC.

The Fair Trading Commission was established in January 2001 through the Fair Trading Commission Act. The duties of the FTC include determining principles, rates and standards for regulated service providers; monitoring general business conduct; investigating possible breaches of the Acts administered by the FTC; educating and informing businesses and consumers about the requirements of these Acts; and taking enforcement action when needed. With regard to the financial sector, the FTC's focus is on conduct-of-business (consumer protection) regulation and competition regulation. The FTC has three divisions: Fair competition division, consumer protection division and utility regulation division. The sections are not further broken down by industry since the size of Barbados does not allow for such a level of specialization.

4. METHODOLOGY

The main purpose of the research is to review the financial regulatory framework of Barbados to determine whether the current structure of financial regulation provides suitable coverage of all areas of regulation and whether the Central Bank of Barbados' responsibility for monetary and prudential regulation is appropriate.

Data were obtained via structured interviews with managerial personnel of the regulators and selected financial institutions during the period July to September 2014. This approach was preferred over self-administered questionnaires for the following reasons. The interviewer can explain questions that the respondent has not properly understood and there is the opportunity to probe respondents to elaborate on answers (Seale et al., 2011). Hence, the interviewer can pursue in-depth information around the topic. However, we should note that interviews may be subjected to the influence of the interviewer (Bryman, 2012).

Two triangulation methods were used to validate the research findings: Data triangulation and methodological triangulation. Data triangulation involves the use of different sources of information. Potter (1996) asserts that a researcher whose findings are derived from many sources will be more convincing than another researcher whose conclusions are based on observations from one source. To effect data triangulation the views of the key stakeholders in the financial sector (the regulators and the regulated institutions) were sought. Methodological triangulation is the use of multiple research methods to study a phenomenon. Methodological triangulation was effected by combining document review with the interview technique. The documents reviewed include regulators' websites and published literature in the area.

Two general instruments were developed to capture information from the targeted categories of participants.[1] The questions to the regulators cover areas such as the purpose of the organization, the organization's interaction with other regulators, the entity's coverage of various areas of regulation, principles guiding the supervisory approach and the response to the possibility of a unified regulator. The questions to the regulated institutions cover areas such as the similarity in products by various financial institutions, the frequency of reporting, opinion about the effectiveness of regulation and the response to the possibility of a unified regulator.

The instruments were not pre-tested because of the relatively small size of the target population. However, the structure of the questions was reviewed by University personnel for clarity, ability to initiate discussion, sequencing and whether it adequately covered the area of investigation.

Purposive sampling was employed in conjunction with the snowballing technique to determine the sample. Purposive sampling, also referred to as judgmental sampling, is based on specific characteristics a population meets. The persons targeted in the research were those holding managerial positions at the regulatory agencies and the regulated institutions and were actively involved in the regulatory process. However, we should note that purposive sampling, as a non-probability method, has the limitation of being prone to researcher bias. Nevertheless, the presence of researcher bias is only a serious drawback when

1 The instruments are available on request.

the researcher's justification for utilizing purposive sampling is ill-conceived or poorly understood (Wood and Brathwaite, 2014). The snowballing technique, also referred to as chain-referral sampling or respondent-driven sampling, is a recruitment method which requires participants with whom contact has already been made to use their social networks to refer the researcher to other potential participants. The snowballing technique allows the most relevant persons to be contacted and provides encouragement for their participation.

The regulated entities were selected based on whether they interacted with both the Financial Services Commission and the Central Bank. Interaction with both regulators was considered to be occurring if the financial institution provided services that were regulated by both regulators, was a member of a financial group where members of the group were regulated by one of the authorities or if there was a recommendation that the entity be regulated by an authority other than the one which currently regulated it. These criteria were used since these entities were considered most suitable to envisage the impact of any change in regulatory structure because of their familiarity with the work of the regulators. The sample of regulated financial institutions includes one bank that was regulated by both regulators, one credit union and finance company group, one large credit union which the recent Financial Sector Assessment Report recommended be moved to the regulation of the Central Bank, and one insurance company and finance company group.

There were a few limitations associated with the data-collection process. First, the sample size of the dual regulated entities was somewhat limited. Representatives of other financial institutions were approached but declined to participate in the study. Second, the analysis was restricted to the domestic component of the financial system; hence, the impact of regulation on the international financial sector was not included. Only the domestic system was reviewed because the international financial sector (while providing benefits to the economy via job creation, fees and tax payments, and benevolent donations) is not allowed to conduct business with most residents and, therefore, does not impact the local financial intermediation process in a significant way.

5. FINDINGS

The findings are presented in two sections. The first section considers the views of the regulators and the second section focuses on the views of the regulated financial institutions.

5.1 Regulators' Views

Relations between Regulators

The regulators' responses revealed that the CBB and the FSC have a close working relation which was formalized via the signing of a memorandum of understanding between the two entities. This document was designed to allow for information sharing and established clear lines of responsibility for dealing with various matters by each agency. The two regulators communicate on a very frequent basis and have formal meetings at least quarterly. However, leading up to the publication of the Financial Stability Report they meet more frequently. They tend to focus on matters such as regulatory and supervisory issues since there are a number of dual registrants. Trends or concerns from either regulator on financial groups are also discussed. In addition, because the CBB is the more seasoned regulator the FSC draws on the Central Bank for guidance.

On the other hand, the three regulators agreed that the CBB and the FSC have a limited relation with the FTC. The FTC mainly consults the other regulators when conducting studies.

Basis and Principles of Supervision

The CBB applies a risk-based supervisory method, in line with the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision.[2] These principles state the powers a supervisor should have enshrined in law and the minimum prudential requirements that supervisors should impose on licensees. While all banks are monitored, an assessment of the risk in each bank is done and higher-risk banks are reviewed more frequently. The CBB also follows the Financial Action Task Force recommendations on combating money laundering and terrorist financing. These include ensuring that the financial institutions have information systems, personnel and processes in place to monitor customer transactions for suspicious activity and that they are adequately reported.

The FSC also uses a risk-based system of regulation where the greatest level of resources is placed on those entities that pose the greatest level of risk to the stability of the system. The processes of the FSC are guided by international core principles and best practices in all of the sectors which it regulates. For example, the FSC follows the principles of the International Association of Insurance Supervisors (IAIS)[3] for insurance supervision and utilizes the monitoring system PEARLS[4] developed by the World Council of Credit Unions for credit unions under its purview.

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[2] The Basel Committee on Banking Supervision (BCBS) is a committee of banking supervisory authorities which was established by the Central Bank Governors of the Group of Ten in 1975. It is hosted by the Bank for International Settlements and provides a forum for cooperation on banking supervisory matters.

[3] The International Association of Insurance Supervisors (IAIS) is a voluntary membership organization of insurance supervisors and regulators. The mission of the body is to promote effective and globally consistent supervision of the insurance industry.

[4] The PEARLS system allows regulators to evaluate the protection, effective financial structure, asset quality, rates of return and costs, liquidity and signs of growth of licensees using predetermined ratios in each category.

Roles and Responsibilities of the Regulator

The views of the respondent from the CBB can be summarized as follows:

1) The main role of the CBB is to monitor the safety and soundness of the banks and finance companies. In addition, the CBB is represented on the Caribbean Financial Action Task Force (CFATF) and is part of the local Anti-Money Laundering Authority Board. A Bank's representative sits on CFATF working groups on behalf of the Barbados delegation and also offers services as a financial assessor for mutual evaluations.

2) The CBB also has responsibility for macroprudential supervision, as facilitated through the Financial Stability Unit. Currently, the Unit prepares the Financial Stability Report and conducts stress tests on individual banks as well as system wide. Eventually, the Unit will have responsibility for policy matters, for example, if credit is growing too quickly in the sector what may be needed to slow the pace of growth. The Unit benefits from an information-sharing arrangement with the Bank Supervision Department and vice versa.

3) The CBB does not have code-of-conduct responsibility. Any responses to queries are voluntary, but responsibility may be in the remit of the FTC. However, the FTC "appears to focus more on competition." In the past the CBB has issued guidance notes to the industry on some fees; however, there are drawbacks in that regulating fees may take away from competition. In addition, there may be a conflict of interest since the regulator, when reviewing a licensee's capital position, may have concerns about the licensee's ability to generate revenue and, therefore, grow the capital base; but the same regulator may have restricted the growth in the capital base by limiting the level of fees that licensees can charge. The representative suggested that

there may be a need for an Office of Financial Ombudsman, as there is in Trinidad which is staffed by officials from the Central Bank of Trinidad and Tobago.

4) The CBB does not have competition authority. However, at licensing the agency ensures that the new entity would not be breaching the legal limit of 40% of market share of total assets. After this stage the FTC has sole authority for competition. The view was expressed that there is a need for the FTC to consult the CBB before making a decision on a merger or acquisition, since from a prudential perspective there are times when having a larger company acquire another, even if it breaches the 40% of market share rule, may actually help the market concerns and be in the interest of financial stability. This is especially true in cases where a bank is in distress and is unable to meet its obligations. If such an institution is taken over by a large, well established bank this reduces panic in the market and in a sense restores confidence to the banking system.

The views of the respondent from the FSC can summarized as follows:

1) Facilitation of macroprudential regulation was not organized across all of the sectors at present. There are, however, elements of macroprudential regulation included in the analysis of the sectors. The FSC is currently formalizing a program through which there can be a more structured approach to this type of regulation. The FSC is also implementing a risk-based supervisory framework which incorporates the use of stress tests, especially in relation to the insurance and credit union sectors. Further, the FSC participates in the Financial Stability Report preparation with the CBB.

2) The FSC has in its mandate to properly ensure that customers are treated fairly and that "it takes market conduct abuses seriously." In addition, the FSC is indirectly responsible for maintaining an appropriate level of competition.

Hence, it is concerned with prudential, market conduct and competition regulation.

3) With regard to Anti-Money Laundering (AML) regulation the FSC collaborates with the Financial Intelligence Unit and has a seat on the Board of the Anti-Money Laundering Authority.

The views of the respondent from the FTC can be summarized as follows:

1) The FTC's role is to safeguard the interest of consumers, promote and encourage fair competition and ensure efficient regulated utility services.

2) In relation to the financial sector, the FTC receives consumer complaints about banks and these are dealt with via the Consumer Protection Act. When a complaint comes, it is investigated to determine if the financial institution has misled or acted outside of the arrangement agreed with the customer. It was noted that the Consumer Protection Act is a criminal act with an aim of changing behavior. Once the FTC intervenes the issue is resolved but the circumstances surrounding the issue, if any, must also be addressed to prevent it from affecting other customers.

The FTC also investigates financial institutions in an effort to determine if there is collusion.

Opinions on the Adequacy of Regulation

All of the regulators expressed the view that the financial sector was well regulated, though there are some areas where regulation can be improved. The FSC representative noted that "at this point in time with a 'dual-regulator' regime there are sufficient tools to ensure adequate regulation." The regulators, however, cautioned that regulation will not prevent institutional failure or crisis. The banking regulator stated "regulation will not prevent crisis as there are constantly new products emerging and it is difficult to capture everything. But they (the licensees) cannot be left to do their own thing as they have people's funds, so they must be regulated." Further, none of regulators felt that the sector was over-regulated. They responded that given the importance of the sector, it needs to be subjected to strong and effective regulation which allows business to function but safeguards policyholders, depositors and investors. The CBB representative went further saying, "I think the right balance has been struck in Barbados, it is not as tough/heavy-handed as the case in other jurisdictions or as the Financial Sector Assessment Program assessors may have wanted. That is, we do not impose punitive penalties; we try to work with licensees to comply. The United States of America, for example, has a more punitive, heavy-handed approach." The FSC representative believed that the sector was not over-regulated since "the two key signals of over regulation are the increasing cost of and availability of capital. Thus far, in Barbados there is still the positive availability of capital and the cost of capital is reducing."

Opinions on the Consolidation of the Prudential Regulators

Respondents from the prudential regulatory agencies acknowledged that there would be advantages and disadvantages to having one regulator for all types of financial institutions. The identified advantages are as follows. First, there would be better coverage of financial groups since the use of one regulator would lessen the challenges associated with information sharing even with a MOU in place. These challenges relate to the timeliness and completeness of the information. Second, in a crisis the single regulator may be better able to manage the knock-on effects, thereby achieving a greater containment of risk. Third, as noted by one respondent "in a properly functioning entity, the removal of bureaucratic blocks and having to deal with different sets of organizational and regulatory cultures can be very effective." Finally, the volume of work handled by a consolidated regulator would allow for adequate utilization of an enforcement team.

A major disadvantage identified with having a single prudential regulator is the potential loss of focus since the consolidated regulator's operations may be too unwieldy to properly manage. This could also lead to the development of silos and information not being properly disseminated. One respondent suggested that the consolidated supervisor be organized so that *common risk* across the entire financial sector can be reviewed by specialist teams. For example, consider that credit risk can be found in banks, credit unions or insurance activity. This means staff would need to be very flexible, knowing the standards for insurance companies, banks and credit unions.

An area of concern for the bank regulator was whether the consolidated supervisor would be within the central bank structure or a separate body. He opined that if the consolidated regulator was not incorporated into the CBB this would be a major disadvantage to the CBB, as the situation would create a potential disconnect between the CBB as the lender of last resort and the banks. The CBB would therefore lose the intimate knowledge of the banks which was ascertained via the regulatory oversight of them. On the other hand, if the CBB was the regulator, one of the advantages would be that its lender of last resort function could be extended to non-banks, if required.

5.2 Financial Institutions' Views

Types of Reports Submitted to the Regulators

The respondents from the financial institutions indicated that they are required to submit financial information such as balance sheets and income statements on a monthly and quarterly basis to both prudential regulators (CBB and FSC). They also reported that they are required to submit qualitative information such as changes in management, policies and manuals, and minutes of the meetings of the board of directors and senior management committees on request.

Differences in Products

The interviewees noted that there was no significant difference between their products and those of other institutions. They stated that credit unions, finance companies and banks basically offered similar services. The representative from the banking group noted that their ability to offer chequing services, facilitate payroll and provide letters of credit and guarantees differentiated them from credit unions, insurance companies and finance companies. One finance company respondent also noted that insurance companies were now also competing in the mortgage market and offering loans against policies. On the other hand, the insurance company respondent did not find its services similar to the other types of financial institutions since its focus was on providing various types of insurance such as life, health, creditor life, and mutual funds and pension plans with its mortgage lending business not being considered core to the company.

Differences between the Financial Services Commission and Central Bank Requirements

The representatives from the financial institutions did not identify any differences between the Central Bank requirements and those of the Financial Services Commission. One respondent noted that "the FSC guidelines and regulations tend to mirror the CBB." It was also noted that the requirements for credit unions relating to non-performing loans are now very similar to those for banks. While there were no differences, one of the respondents indicated that it often meant seeking approval from one regulator before it could carry out the instructions of another. She explained that "for example, currently the FSC requires the use of the name brokerage in the list of entities involved in that type of business. To facilitate, we want to set up a separate brokerage subsidiary since that is not part of our core business; however, we have to get written approval from the CBB to proceed. If the CBB's response is delayed, we may miss the FSC's correction timeline."

Opinions on the Effectiveness of the Sector's Regulation

The interviewees considered the current regulatory regime effective. They stated that since the financial crisis, the regulatory oversight and guidance by the Financial Services Commission has increased. This is evidenced by the issuance of guidelines and regulations. However, two of the respondents cautioned that the FSC is still a very young organization and has not faced any significant tests in terms of enforcement of the regulations. One of the interviewees expressed concern that her organization, given its size and contribution to the sector's assets, had not yet been inspected by the FSC. To directly quote the respondent she felt "on paper there was effective regulation, but more experienced regulators of credit unions from jurisdictions like Canada are needed to assist in the FSC's development." Another respondent, while acknowledging the effectiveness of the regulation, noted that the cost of regulation, particularly anti-money laundering legislation, is high.

Also, none of the interviewees felt that the sector is overregulated. One representative remarked there was a balance between the regulators' control and their ability to conduct business. Another interviewee felt that the sector is not overly regulated since "to a large extent, the market is allowed to dictate fees, interest rates and introduce new services as well as increase overall lending and lending to specific sectors without restrictions being imposed by the regulators, unlike in other jurisdiction which have restrictions enshrined in legislation."

Impact of a Consolidated Supervisor

None of the respondents believed that a move to a consolidated regulator would impact on their organization's structure. Those respondents representing organizations that are part of a financial conglomerate felt that each of the institutions in the group still had different purposes to allow them to remain separate. It was noted, however, that if the consolidated entity represented a merger between the CBB and the FSC "this should provide synergies and give the non-banking sector the benefit of the Central Bank's long standing regulatory experience." Hence, the respondents also suggested that the consolidated regulator should be part of the CBB rather than a separate body. They did not believe that the prudential role would conflict with the CBB's monetary policy role.

Another interviewee outlined the benefits to the organization of having a consolidated regulator such as less reporting requirements, a standard train of thought across the organization and a standard set of enforcement.

Preference of Regulator

All respondents considered the CBB the stronger regulator. This view was based on its length of time in operation; therefore, it is more experienced and has greater presence via the frequency of inspections and influence on the financial sector. The respondents noted, however, that with time the FSC should develop into an equally strong regulator as the Central Bank.

6. DISCUSSION OF FINDINGS

Barbados' regulatory regime, like most other countries, does not fit neatly into one of the types of regulatory structures previously discussed. The FSC is an integrated regulator with oversight of all non-banking institutions. It also carries some elements of a super/mega regulator since it has code-of-conduct and competition authority. However, because there are other regulators with responsibility for code-of-conduct and prudential regulation it cannot be considered a mega regulator. The system also bears some elements of the institutional regulatory approach in which the type of regulation is based on the legal status of the entity. The remainder of this section presents an analysis of the findings.

Benefits to the Financial System of Having One Prudential Regulator

The findings revealed that there are possible benefits to having one prudential regulator. First, one consolidated supervisor would allow for better oversight of financial groups and could lead to better enforcement through the development of a specialized enforcement team. Also, one prudential regulator would allow for better monitoring of key risks throughout the sector. These views of the respondents are congruent with the widely-held views in the literature that one prudential supervisor can provide economies of scale and scope, and lead to more effective regulation (Reddy, 2001; Podpiera and Čihák, 2006; Pellerin et al., 2009). Second, from the financial institutions' perspective, one consolidated regulator should reduce the number of duplicated returns currently submitted to the two regulators. It should also remove the need to seek approval from one regulator in order to fulfil the requirements of another.

The regulators, however, cautioned that a combined entity could pose one main disadvantage: The loss of focus of the entity as the operation becomes too large to be properly managed. This view is also consistent with the literature which notes that one of the drawbacks of the consolidated regulator is the lack of focus which may undermine its efficiency and effectiveness (Reddy, 2001; Llewellyn, 2004).

From the responses it was observed that the two prudential regulators are involved in macroprudential supervision. This represents a duplication of effort. The literature suggests that where regulators are performing the same task it may indicate a need to combine the regulators.

The Role of the Central Bank of Barbados

Currently the CBB operates as the regulator for banks in addition to its responsibility for monetary policy. Both categories of respondents are supportive of this dual role for the CBB instead of moving bank supervision within the FSC. Their rationale for this preference is that the experience and stature of the CBB is beneficial to the oversight of the sector and they do not find the monetary policy role in conflict with the regulatory role. This position finds some support in the literature where it is noted that prudential regulation in some developing countries may benefit from the perceived independence and prestige associated with the central bank (Schooner and Taylor, 2010). Further, the CBB's dual responsibility for monetary policy and prudential regulation is similar to the structure that exists in more than 60% of jurisdictions covered in the World Bank's Bank Regulation and Supervision Survey 2012. In this regard the CBB is following a well-established practice.

Similarly, the CBB's respondent prefers the CBB to maintain responsibility for at least banks and finance companies since the CBB has the lender of last resort responsibility to banks. The literature provides some support for this view, noting that the lender of last resort needs to be adequately knowledgeable about the financial viability of the institutions which it may be called upon to assist. Further, the literature suggests that the separation of the prudential regulator and the lender of last resort function in England may have contributed to the collapse of Northern Rock (Taylor, 2013).

Conflicts between Regulators

It was observed from the respondents that currently the mandates of the CBB and the FSC are complementary and their relation is guided by a memorandum of understanding which reduces the likelihood of conflict between the two regulators. However, no memorandum of understanding exists between the two prudential regulators and the FTC. Hence, there is a likelihood of conflict in some situations between the FTC and the CBB, and between the FTC and the FSC.

The situation is more acute in the instance of the FTC and FSC since both entities have in their mandate code-of-conduct and competition authority. Both regulators also indicated that they have limited contact with each other. As a result the environment exists for the financial institutions under their dual auspices to receive conflicting instructions from the two regulators. Further, in the absence of a MOU between them it cannot be easily determined which regulator may have priority in a particular situation.

A similar situation exists between the CBB and the FTC. The main difference is that the CBB does not have either code-of-conduct or competition authority. However, it still handles customers' queries and issues guidance on fee structures to the industry. While this may have been necessary before the formation of the FTC, it creates an environment for conflicting guidelines. Further, in the area of licensing the CBB and the FTC may conflict on whether a financial institution should merge with another since the impact on competition in the sector may be irrelevant to the CBB when compared with the financial health and stability of an institution.

To deal with the instances of conflict the two prudential regulators should establish a MOU with the FTC outlining their roles and responsibilities (with respect to each other) in various situations. It is also recommended that the FSC relinquishes responsibility for code-of-conduct and competition authority to eliminate the conflict as suggested by the financial stability assessors (International Monetary Fund, 2014). Further, the informal role of the Central Bank as code-of-conduct regulator should also be relinquished. The public would then have to be properly sensitized that code-of-conduct and competition issues would have to be directed to the FTC. We should note, however, that appropriate arrangements would have to be made for the operationalization of the proposed MOU to ensure maximum effectiveness.

7. CONCLUSION

It is well established that the financial system plays a vital role in the growth of economic activity. It is therefore incumbent on governments to have strong and effective regulatory structures in place to ensure safe and efficiently functioning financial systems. Hence, periodic review of the effectiveness of the financial regulatory framework is necessary. This paper therefore examined the adequacy of the financial regulatory framework in Barbados.

Some important findings emerged from the analysis. First, while there may be benefits from having one prudential regulator, it is not necessary since the respondents are satisfied with the current system and the change would not have a significant impact on the products and services offered by financial groups or the efficiency and effectiveness of prudential regulation. Hence, the current dual prudential regulatory framework (with the CBB and FSC) can be considered adequate for Barbados. Nonetheless, if in the future the decision is made to have a consolidated prudential regulator it should be part of the Central Bank.

Second, there are instances of conflict between the two prudential regulators and the Fair Trading Commission. Thus, a MOU should be created between the prudential regulators and the FTC to ensure that the lines of responsibility for certain aspects of regulation by the three agencies are better delineated.

Third, respondents did not perceive any conflicts with the Central Bank's responsibility for prudential regulation and monetary policy. This view is based on the CBB's history in regulation and its status in society. The dual regulatory role played by the CBB is a structure that is well-established in many other countries.

Though the study provides an interesting review of the Barbadian financial regulatory framework, it can be extended to include the international financial services industry and the impact of regional regulation since many of the financial institutions operate throughout the region.

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