# UK Financial Services Regulation — Back to the Future

On 16 June 2010, at the Mansion House in the City of London, the Chancellor of the Exchequer, George Osborne, announced major changes to the financial regulatory system in the UK. Although the process will not be completed until 2012, the announcement dispels rumours of the FSA's survival under the UK's coalition government.

Under the announced changes, the old 'tripartite' system to deal with financial stability issues, involving the Treasury, the Bank of England, and the FSA, will be abolished. Instead, responsibility for ensuring financial stability will be the responsibility of the Bank of England alone. A new prudential regulator (the Prudential Regulation Authority ("PRA")) will be created as a subsidiary of the Bank of England; as a result, microprudential supervision of banks, taken away from the Bank of England as part of the process that created the FSA in 1997, will return to its former home. However, the PRA will have a remit that covers all financial firms, including building societies and insurance companies, but also (it would appear) smaller firms without any systemic importance.

In a move perhaps designed to reassure FSA staff and regulated firms alike, the Chancellor has persuaded FSA chief executive Hector Sants (who had previously announced his intention to leave the FSA in the summer) to remain as the chief executive of the PRA; he will also become a Deputy Governor of the Bank of England. The PRA will be chaired by the Governor of the Bank of England, Mervyn King. Mr King will also chair the new Financial Policy Committee, a committee of the Bank of England responsible for addressing macroeconomic and financial issues that may threaten financial stability, whose decisions will be implemented by the PRA.

The second part of the new structure will see the creation of a Consumer Protection and Markets Authority. This body will regulate the conduct of business of every authorised financial firm in the UK, both retail and wholesale. Although the Chancellor did not dwell on this in his speech, the name suggests that the Consumer Protection and Markets Authority will also be responsible for the regulation of markets in the UK. This may risk tensions within the new authority, since consumer protection issues (such as inadequate advice and unfair contract terms in the retail market) are not natural bedfellows with issues involving market participants in exchange trading. One also assumes that this body will deal with fund authorisation issues, and will act as the UK listing authority. Since the FSA already covers all these aspects, it seems distinctly possible that the legal entity that forms the new authority will be a rebranded FSA (in the same way as the FSA was a rebranded Securities and Investments Board, back in 1997), albeit an FSA with fewer powers than at present.

The third part of the new structure involves the creation of a new agency to take on the work of tackling serious economic crime. Again, the Chancellor gave few details, other than to note that currently the work in this area is divided over a number of government departments and agencies. It would appear, however, that part of the current FSA enforcement workload would be transferred to this new agency, which would also take over cases currently prosecuted by the Serious Fraud Office and the Office of Fair Trading. But one imagines that more minor infractions would be handled elsewhere — presumably by the new

Consumer Protection and Markets Authority. If that is so, there will need to be clarity over which cases are handled by which agency.

In addition, the Chancellor announced the creation of an independent committee on the banking industry. The committee is to report by September 2011, and will examine the structure of banking, including the topical (but vexed) question of whether investment banking and retail banking should be split.

Although the Chancellor's announcements were of a regulatory system that will take effect in the future, it seems to have some similarities with the structure that the FSA replaced in 1997. Though we await the details, it would appear that banks and other financial firms will have more than one regulator: the PRA will regulate prudential aspects (such as the amount of capital firms need to hold), whilst the new Consumer Protection and Markets Authority will regulate non-prudential aspects (such as compliance with conduct-of-business rules). This recalls the position in the early 1990s, when (depending on the business carried out) firms could have one regulator for their securities business, another for their fund management business and a third for their insurance business. One of the criticisms of that system was the duplication of work that this involved for firms, and it remains to be seen whether the new proposals can deal with that aspect. Certainly if banks and other financial institutions (and the individuals that work for them) are subject to regulation both by the prudential and the conduct-of-business regulator, they are likely to bear a greater regulatory burden than at present.

The new proposals will require primary legislation to become effective, and the government will be keen to mitigate the risk that, in concentrating on creating the new regulatory system, regulators may miss or be slow to react to a future crisis. One area that may become contentious is deciding what at the margin is 'prudential' and what is 'consumer protection': the fact that there will be two regulators rather than one creates the real possibility of a turf war. In any event, 2012 may not mark a clean break with the past: it seems quite likely that large parts of the current FSA rulebook (and of the statutory underpinning for that rulebook, such as the Regulated Activities Order and the Financial Promotion Order) will linger on in the new regime. This would also be an echo of what went before: in this case, of the position after the major change to financial services regulation in 1997.

Mr King has described his new role of preventing the build-up of risk in the financial system as that of 'turning down the music when the dancing gets a little too wild'. It will be interesting to see whether Mr King is successful in finding the volume control and, if so, what the reaction of the dancers in the market will be.

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