

UK Institutional reform - 'Clear blue water' between the Conservatives' plan to scrap FSA and Labour's plans to maintain and improve the existing tripartite regime

The structure under Labour

[See chart for overview of the institutional structure that the Labour government supports](#)

The government plans to strengthen FSA regulation through a process of incremental change. FSA would remain a unitary or universal supervisor responsible for both financial/micro-prudential regulation and for conduct of business. FSA's unitary role and the tripartite structure have now been reaffirmed in the government's Financial Services Bill, which gives FSA extended micro-prudential powers and a new statutory, macro-prudential objective to enhance financial stability. The role of the Bank of England (BoE) was put on a statutory footing under the Banking Act 2009, and the new financial stability objective came into effect in June 2009 with the Financial Stability Committee (FSC) (on which FSA is represented). Under the bill, the tripartite will operate through a new Council of Financial Stability.

The structure under a Conservative government

[See chart for overview of the radically different structure that the Conservatives have announced](#)

The Conservative Party alternative White Paper 'From crisis to confidence: plan for sound banking' talks a much more radical game with a less industry-friendly tone. Politics dictate that they point the finger of blame at FSA and its creator Gordon Brown. The big idea is to scrap the Labour-conceived universal regulator, FSA, and the related tripartite system and to move financial regulation to an expanded BoE. The BoE would become a super central bank/regulator responsible for both macro-prudential regulation (regulation directed at systemic risks across the financial system as a whole) and the financial supervision (micro-prudential) of individual banks and insurers (to be carried out by a new Financial Regulation Division). It also provides liquidity support to banks – both normal support via the Discount Window Facility (DWF) and emergency support. These functions would all underpin its broad financial stability objective, which it would operate in conjunction with its well-developed role on monetary policy. This will make the BoE a much more powerful institution than it was previously under either Labour or the Conservatives. It will supervise not only banks (as it did before Labour moved this role to FSA) but also to insurers, life offices and some fund companies.

Under the Conservative plan, FSA's other roles will be taken over by a new, narrowly focused CPA. This will take over consumer credit licensing (currently an OFT role) and FSA's current responsibilities for conduct of business regulation and supervision. It will also handle the prudential regulation of firms that are not systemically important such as insurance, investment and mortgage intermediaries.

It is still very unclear exactly how the current FSA handbook would be divided between the CPA and the BoE. The Conservatives are still considering who would be responsible for various areas of the handbook, such as approved persons and the listing authority; and have floated the idea of creating a third new body – a continental-style markets authority responsible for markets and securities regulation combined with the roles of the Takeover Panel and the Financial Reporting Council (FRC).

FSA is pushing ahead with internal recruitment and re-organisation to reflect its expanded role under Labour's plans and to take account of the lessons learnt in the Turner review. This includes a new division dealing with systemic risk.

Open issues about the Conservative proposals for regulatory reform

There are many open issues still to be considered. The following questions were raised on the subject in a CMS Regulatory Reform Q&A session with Mark Hoban MP, Shadow Financial Secretary to the Treasury, earlier this year:

The end of the FSA and the tripartite system

- Why would the Bank of England (BoE) be a better prudential supervisor?
 - Because the BoE is closer to the fundamentals of the banking/financial system (as a bank itself with commercial relationships with banks), as the provider to banks of liquidity (both business as usual and emergency) and as a better judge of financial stability/systemic risk?
 - Is there a need to have one body in charge of the financial system (given its economic importance and potential exposure of the public purse)?
- Supervision by central banks in Europe – is this likely to increase/reverse the previous trend towards single/unitary regulators?

Prudential Regulation – Role of the BoE's new Financial Regulation Division

- Which firms will the BoE regulate? The Conservative White Paper indicates it will regulate banks, building societies and other significant institutions, including insurance companies – does this include:
 - all life offices/general insurers/composites, the Society of Lloyd's, Lloyd's managing agents and pure reinsurers?
 - regulated markets/recognised investment exchanges/large multilateral trading facilities – unless regulated by a third 'markets authority'?
 - large/all (MiFID) investment firms and large fund operators/management companies?

Prudential Regulation – Role of the Consumer Protection Agency (CPA)

- Which firms will the CPA regulate? The Conservative White Paper indicates the CPA will be responsible for the financial rules applicable to other/small firms such as mortgage and insurance intermediaries, stockbrokers and small asset managers – will this include:
 - commercial and wholesale insurance brokers - including Lloyd's/London market brokers and Lloyd's corporate advisors and members' agents?
 - IFAs and non-MiFID investment firms?
 - non-bank payment services firms and E-money issuers?

Conduct-of-business regulation – Role of the CPA

- The CPA will regulate various firms from a consumer protection perspective – including the consumer credit role currently undertaken by the OFT and regulation currently undertaken by the FSA such as retail conduct of business rules, treating customers fairly and unfair contract terms/practices.
- Will the CPA also regulate conduct of business in commercial markets (e.g. insurance under the IMD) and be responsible for high-level supervision of wholesale markets - such as the London insurance market (which seems problematic), or might this fall to a markets authority?
- The CPA will regulate large banking and insurance groups and the smallest one-man credit brokers, but there is a precedent for this in BaFin's role in Germany.

Dual regulation issues

- Many firms will be subject to prudential regulation (by the BoE) and conduct-of-business supervision (by the CPA) and possibly to regulation by a third 'markets authority'.
- There are concerns about:
 - supervision of one firm/group by multiple authorities with the potential for duplication and conflict – has the idea of single/lead supervisor been rejected?
 - duplication/conflict in relation to the regulatory functions which straddle the CoB/financial divide such as individual regulation/codes/approved persons, non-financial prudential regulation (governance, SYSC, risk management, remuneration), authorisation, client money/asset protection, fund product regulation, money laundering and training and competence?

- investigation and enforcement (duplication, conflict and double jeopardy) - will responsibility mirror supervisory roles or will there be a single investigation/enforcement agency?
- How does this tie in with the proposals for a new single prosecutor for financial crime (replacing the SFO and other bodies)?

The other bodies

- Will there be a continental-style markets authority (UKLA, Market conduct, Takeover Panel, etc) – or will this be another BoE division? Concerns re Panel status and duplication/conflict?
- Plans for the Financial Ombudsman Service?
- What is the Conservative policy on the FSCS and deposit protection?

Timing and transition

- Will the expert panel report due by end March 2010 be published? What will be fixed and what will remain open for consultation?
- Big bang or step-by-step – possibly starting by moving FSA under BoE responsibility? Could this end up being a permanent solution? Will any other bodies (such as HM Treasury) carry out interim functions in the transition?
- Repeal or amendment of current legislation – FSMA and all the SIs, Consumer Credit Acts and SIs, the Banking Act 2009?
- Will new authorities inherit current rulebooks; will BoE and CPA rules be co-ordinated as under FSA? Will consumer credit move from SI requirements to FSA-style handbook regulation with high-level principles etc?

Other policies/big ideas (outside the organisation of the authorities) – are there any that are not dependant on international consensus and further debate?

- The latest 'finesse' on the Volcker Rules proposed by President Obama, Tobin-style tax or systemic risk levy?
- Talking tough pre-election – fines too low, more criminal prosecutions – how will this translate to the new regime?

Europe

- What is the Conservative Party's policy on European reform – is it in favour of the new European System of Financial Supervisors (ESFS)?
- How would the CPA be represented in the ESFS – would the BoE take the lead?

Impact

- Can firms really absorb the impact of further (and fundamental) regulatory reform?
- The risk of taking the collective eye off one of the balls during the turf war/transition?