



The Government White Paper: tighter scrutiny for financial regulation

Summary and implications

On 8th July, the government published its long awaited White Paper "Reforming Financial Markets". The paper sets out the government's analysis of the causes of the financial crisis, the subsequent action taken as a result of the crisis and the regulatory reforms necessary to prevent a crisis happening in the future. There are broad similarities between the proposals in this paper and those made in Barack Obama's "white paper" published last month.

Some of the key issues addressed in this paper are:

- The role of the FSA and the Bank of England in the regulatory structure in the UK.
- How the UK financial system should approach banks which are "too big to fail".
- European cooperation in light of the recent financial crisis.

Comment and conclusion

Despite the length and detail of the paper there are several areas that still need further discussion with the financial service industry and international regulators consideration. The paper has predictably received criticism from the opposition. However, the message coming out of the paper is clear: Banks will face tougher supervision from the FSA and consumers should receive (and expect to receive) a better deal. This continues the subtle shift from "principles based" towards "outcomes focussed" regulation.

Ask a question

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White Paper : Reforming Financial Markets

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The Financial Services team

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The White Paper – key areas for reform

In dealing with the issues and the problems that have arisen since the financial crisis, the paper sets out several key areas for reform:

- a) Current regulatory structure.
- b) Corporate governance.
- c) Significantly systemic firms (SSFs).
- d) The EU / UK regulatory framework.

Unfortunately, the paper fails to provide answers on two key areas of reform. First, how to deal with the concept of banks that are too big to fail and secondly, a definitive answer as to who leads on macro prudential regulation, the FSA or the Bank of England.

Two questions remain: first, how to deal with banks too big to fail and second, who leads on macro prudential regulation, the FSA or the Bank of England?

a) Reform of the Current Regulatory Structure

One of the main aims of the paper is to strengthen regulatory institutions. The Government is keen to highlight that it believes that the current tripartite structure is the correct regulatory structure for the UK financial services industry. However, it recognises there are some areas that can be improved.

Consequently, one of the key elements of the paper is the creation of a new formal Council for Financial Stability (CFS). The Government intends to create a new statutory committee which will replace the existing Standing Committee. Similar to the current Standing Committee, the CFS will consist of the Treasury, the Bank of England and the FSA and will be chaired by the Chancellor. The objectives of the CFS will be to analyse and examine emerging risks to the financial stability of the UK's economy and to coordinate an appropriate response. The CFS will also have an additional role of coordinating the UK Authorities' position on EU and international financial stability and regulatory policy issues.

The Government also sets out detailed measures to enhance and expand on the FSA's enforcement powers. Currently the FSA has enforcement powers regarding both authorised and approved persons who are in breach of FSA rules or guilty of misconduct. These powers enable the FSA to impose a penalty on individuals or publish a statement of misconduct. Under the proposals, the FSA will be able to suspend individuals or firms for misconduct and penalise individuals who perform a controlled function without the necessary FSA approval.

The FSA is to have a broad remit over unregulated entities posing a systemic threat to the financial system

Further, and perhaps more interestingly, the paper sets out proposals which would allow the FSA to have a broad remit over any entity which poses (or potentially poses) a systemic threat to the financial system. This may include wide information gathering powers.

b) Reform of Corporate Governance

In addition to giving its support to the FSA's Code of Practice (the Code) on Remuneration that is shortly due to be incorporated in the FSA Handbook, the Government has asked the FSA to provide an annual report on remuneration practices, detailing compliance by firms with the new Code. The report will also assess whether remuneration practises are likely to lead to a build up of systemic risk, and the FSA will also be asked to make recommendations for action if they believe any are necessary.

In his announcement to the House of Commons the Chancellor also announced that the Walker Review of Corporate Governance is due to publish some interim findings next week, ahead of a full report in the autumn.

c) Reform of Significantly Systemic Firms

In looking at the issue of whether banks are too big to fail the Government has set out several areas for consultation. However, one issue the Government is very clear on is the concept of imposing limits on the size or complexity of banks. The Government is emphatic that there is no benefit to the UK in introducing a "Glass-Steagall" separation and that artificial restrictions on a financial institution's size or complexity would not reduce the likelihood of failure.

One area where the Government is open to reform and an issue that is emphasised several times throughout the paper, is the idea that SSFs should be subject to more regulation and specifically higher capital requirements (supporting findings from the Turner Review). The Government believes it is important that these higher capital requirement levels are significant enough to change bank behaviour.

In line with other work published by the FSA over the past year the paper states that firms should have detailed practical resolution plans for dealing with their own failure, and in particular expects the FSA to work with "high impact" firms to make sure that sufficient plans are in place.

The issue of defining SSFs is one of the key areas where the paper requests consultation, specifically as to the issue of how SSFs should be categorised, whether this should be linked to regulatory capital and whether there should be a fixed list or a sliding scale of importance.

Artificial restrictions on a financial institution's size or complexity would not reduce the likelihood of failure.

The FSA's Code of Practice on Remuneration

For our Briefing on the Code [Click here](#)

For a copy of the code itself [Click here](#)

What is Glass-Steagall?

The Glass-Steagall Act of 1933 introduced to the United States the **separation of commercial and investment banking** and founded the Federal Deposit Insurance Corporation for insuring bank deposits.

The Turner Review

For our Briefing on the Turner Review

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d) The EU / UK Regulatory Framework

The issue of how the UK and EU can work together regarding financial regulation has been highly topical given the differing approaches of the de Larosiere Report and the Turner Review. In this paper the Government has set out its support for the creation of a European System of Financial Supervisors and the European Systemic Board. Throughout this paper the Government is keen to set out its belief that cross-boarder cooperation between national authorities and regulators is an important part of the regulatory process. However, the true nature of the UK / EU relationship is possibly highlighted towards the end of the paper where concern over the Alternative Investment Fund Managers Directive is noted.

Although the UK is working with Europe for enhanced monitoring of system-wide risks, the Chancellor was keen to stress that the day to day regulation of the financial sector should be carried out by governments and regulators on a national level and not on an EU wide basis.

The de Larosiere Report

For a copy of the De Larosiere Report

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The day to day regulation of the financial sector should be carried out by governments & regulators on a national level and not on an EU wide basis

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