

International Centre for Financial Regulation

Prospectus by Lord Currie

May 2007

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INTERNATIONAL CENTRE FOR FINANCIAL REGULATION

INTRODUCTION

1.1 An important component in maintaining the competitiveness and strength of the financial services industry, and its contribution to domestic and global economic development is the approach taken to financial regulation. Lord Currie, supported by the Treasury, is chairing a Working Group to develop this proposal for a new, world-class centre of financial regulatory expertise. This prospectus is the first output from the Working Group and sets out the proposed framework for the International Centre for Financial Regulation (ICFR).

1.2 The Working Group membership comprises:

- Lord Currie of Marylebone (Chair)
- Professor John Board - ICMA Centre, University of Reading
- Andrew Cahn – UK Trade and Investment
- Alastair Clark - Bank of England
- Miyan Mansur Mannan - Credit Suisse
- Professor Charles Munn - Chartered Institute of Bankers in Scotland
- Hector Sants – Financial Services Authority
- James Sassoon – Chancellor’s Representative for the Promotion of the City
- Teresa Sayers - Financial Services Skills Council
- John Stuttard – The Rt Hon Lord Mayor of the City of London
- Jonathan Taylor – London Investment Banking Association
- Bob Wigley - Merrill Lynch
- James Wilcox - Prudential

RATIONALE FOR A CENTRE OF REGULATORY EXPERTISE

1.3 Recent research indicates that the regulatory environment comes second only to the availability of skilled personnel as the most important factor underlying the competitiveness of the financial services industry. Maintaining a regulatory environment where the philosophy of the underlying regulation finds the right balance between protecting investors, ensuring orderly markets whilst facilitating business is central to the success of global financial centres. As more regulators adopt a principles based approach, the need for supervisors and regulators to have a deeper understanding of the businesses they regulate increases.

1.4 To reflect the central importance of regulation, the International Centre for Financial Regulation (ICFR) aims to establish a unique centre of excellence. In our changing global economy it is important to understand and explore the contribution that efficient systems of financial regulation make to global growth, including in developing economies. As financial markets integrate further there is a move towards greater regulatory co-operation and mutual recognition. And, although greater regulatory convergence, for example US Generally Accepted Accounting Principles and International Financial Reporting Standards, offers benefits to our capital markets it also presents substantial challenges. There is a need to stimulate debate on these issues and to analyse trends. The ICFR aims to do this by identifying the principles that will guide the regulatory response to these opportunities and challenges.

1.5 The ICFR will be international in reach, with important sponsors and partners located across the globe. So, although headquartered in the City of London, its research, training, conference and seminar activities will be distributed internationally. There is good evidence that such international co-operation will be forthcoming, including funding. A key purpose of the start up funding from firms in the UK is to enable the appointment of the Chief Executive Officer, for whom a key early task will be to create international networks and funding that will realise this international objective.

A NEW CENTRE TO PROMOTE INNOVATION AND EXPERTISE

1.6 The ICFR will promote world-class research and education in the field of financial regulation, and by doing so it will bring a new level of focus, ambition and industry collaboration to financial regulation both domestically and internationally. Initiating this project in the UK is a natural extension of the strong presence of UK-based professional bodies and business schools in delivering research and training to customers in a range of overseas markets.

1.7 The ICFR will connect the best academics and practitioners both within the UK and overseas; it will be structured to welcome and encourage the involvement of the public and private sector, trade associations and academic institutions. By doing so the ICFR will ensure a co-ordinated and cohesive approach to innovation and the identity of cutting edge best practice regulatory approaches and to educational provision in this

area. Given the importance of regulation to domestic and global economic development, the provision of research and training in this area should be increased. This will enable, for example, the latest thinking on the development of a principles-based approach to be taught and discussed with input from regulators, industry and academic experts. The ICFR will foster closer working with industry and academia to ensure that resources are allocated to those areas of regulatory policy that offer the best opportunity for genuine innovation. These collaborations will be a key mechanism for growing and encouraging the engagement of industry in research into regulatory policy - an area inadequately served by current arrangements. The Centre will also provide training and development opportunities in specific areas of regulation. Both the research and training should be responsive to the specific needs of the industry with the emphasis being on provision by practitioners, as well as academics.

1.8 The ICFR will shape the strategic direction of the provision of regulatory research and training on offer for professionals in the UK and overseas. It will offer courses without duplicating existing provision, working with and through current providers. This could range from courses covering the changing international regulatory landscape to those specialising in thematic areas such as the regulation of evolving derivatives markets, or the regulation of new emerging markets, for example Islamic Finance.

1.9 In summary, the aims of the ICFR are:

- establish a centre of excellence for research into cutting-edge regulatory issues;
- influence and support regulatory developments internationally, including the provision of high quality training to regulators and practitioners in emerging economies; and
- match supply of regulatory training to demand by establishing a centre that has the buy-in and involvement of senior industry figures.

OBJECTIVES OF THE CENTRE

1.10 As stated, the aim of the ICFR will be to shape the strategic direction of the provision of regulatory research and training on offer for professionals in the UK and overseas. The centre will achieve this in two ways. First, the ICFR, through the commissioning of cutting edge research will seek to influence the regulation of the world's financial markets by analysing and debating the issues raised. To this end, the ICFR might make a contribution to topics such as:

- the move towards principles-based regulation;
- the economics of regulation;
- best practice in regulating new, sophisticated and complex financial instruments;
- how to forge regulatory cooperation at the international level; and

- steps required to effectively supervise consolidation in the industry.

There is also the prospect of the centre broadening the range of issues for further research to include, for example, the dynamics of financial stability.

The ICFR will differentiate itself from providers in the current market through the sustained support of, and engagement of and with, financial market practitioners and industry.

1.11 Second, regarding training, the ICFR syllabus would offer courses covering the changing international regulatory landscape on a particular topic (for example, Basel II) or thematically (for example, what does principles based regulation mean in practice); specialised areas (for example, derivatives regulation, money laundering); and the regulation of new markets (for example Islamic finance).

Two case studies are presented below for illustration.

1.12 The location of the ICFR in London will ensure the UK continues to be associated with a world-class regulatory debate and practice. Indeed an intention would be to hard wire in the ICFR's constitution an objective to ensure the ICFR defines the global approach to financial regulation based on a balance between protecting investors and ensuring orderly markets whilst facilitating business, limiting regulatory intervention to situations of market failure and then after cost benefit analysis.

Case study I – Growing markets

Islamic finance is now recognised as one of the fastest growing markets within the financial services sector. Fuelled by the economic prosperity of Muslim countries and growing awareness, Islamic finance has begun to compete with mainstream banking.

Rapid growth presents its own challenges: Islamic finance products and services do not fit easily into mainstream financial regulatory systems. The prohibition against interest, undue uncertainty and risk, and the need to have a base transaction on real assets, has led to a unique set of products and services with its own risk and reward structures and governance policies. This rapid growth has also resulted in a shortage of skilled personnel in this sector.

The ICFR could play a key role in the further development of the industry by:

- providing technical support to the various standard setting institutions and assist them as they seek solutions to converge the Islamic finance sector with mainstream banking;
- undertaking research and providing advice to the regulators in developing regulatory systems to effectively supervise the Islamic finance sector; and
- providing tailored regulatory training for practitioners in this field.

Case study 2 – Emerging markets

The economies of Asia, both developed and nascent, continue to present significant opportunities for global wholesale and retail financial services communities. On the retail side, the current and projected high levels of economic activity continue to translate into high levels of personal wealth, greater disposable incomes, and a growing appetite for financial services products of both increasing sophistication and high quality.

In Asia's nascent markets, the growing domestic consumer base, and the sophistication of the firms that seek to serve them, typically translates into an increased appetite among the regulatory authorities of these markets for access to information outside their home jurisdiction as they seek to respond to these and other market developments.

Building the capacity and competency of regulatory authorities and regulatory systems is critically important for the market in question, for consumers, and for businesses. The ICFR can play a leading role in this evolving landscape by seeking to satisfy the highly diversified demands of regulatory authorities for information on best international practice as they devise a regulatory approach best suited to their individual stage of development, and ultimately, support the businesses that operate there and the consumers they serve.

ORGANISATION AND FUNDING OF THE CENTRE

Governance 1.13 The ICFR will have a strong governance structure in place to ensure the optimal allocation of funds, the commissioning of research and the development of the courses. A Chief Executive Officer (CEO) will be selected to provide day-to-day leadership of the ICFR. The CEO will be a high-calibre figure with strong industry experience and high-level influencing skills. The CEO will be supported by a Director for Training. The Chief Executive will report to the Executive Committee who will be responsible for governance and administration.

Location 1.14 The ICFR will not have its own dedicated building but it will have a physical presence in the form of office facilities (in close proximity to the City) for the CEO and secretariat. Teaching activities will be undertaken at a number of competitively selected private sector and academic institutions based in the UK and further afield, thus delivering high quality teaching and best practice in a co-ordinated and light-touch way.

Funding 1.15 While the funding of the ICFR will depend on the physical model, the scale of the research and the scope of the syllabus, the preference remains for the ICFR to have a light touch operating model. The Working Group's initial estimates suggest that the ICFR will require start up funds in the region of £2-3m, per annum, over three years, after which it will gain financial independence through course fees and tuition. To maximise the impact and ambition of the ICFR, private sector support is essential in funding the start up costs. Furthermore, industry partners will play a key role in the ICFR by shaping the initial research priorities and training agenda so that the ICFR's products are responsive to the needs of the financial sector. It will also do this by linking academic research to the commercial world and by driving the agenda on areas of international interest and co-operation. While it is anticipated that initial contributions

will come from UK-based firms, it is the firm intention to widen the net to include a geographical spread of organisations.

1.16 Budget 2007 announced that the Government will make a financial contribution towards the start-up costs for the centre for three financial years.

KEY SUCCESS FACTORS

1.17 The successful launch of the ICFR will require two critical factors: the clear backing (both financial and otherwise) from the industry; and, the recruitment of an influential and dynamic Chief Executive.

TIMELINE TO FULL OPERATION

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|---|-------------|
| • Report back to High Level Group | 9 May 2007 |
| • Identification of Chief Executive | Autumn 2007 |
| • Expression of interest from core industry partners | end 2007 |
| • Identification of key academic centres | during 2007 |
| • Finalising structure and organisation of the Centre | Spring 2008 |
| • Institute legally established and fully operational | end 2008 |

ANNEX A – GOVERNANCE MODEL

1.18 The ICFR will need to have a strong governance structure in place to ensure optimal allocation of research funding and development of courses. The ICFR provides a unique opportunity to develop courses collaboratively with employers to ensure that they are tailor-made to the needs of the sector. The governance structure would therefore need to involve industry in all processes concerning research and course development.

Proposed structure **1.19** It is proposed that the governance structure could consist of three tiers: the Executive Committee, Council of Advisers and subscribers.

1.20 The ICFR's Executive Committee would be drawn from core industry partners and public sector partners. Initially they will be largely based in the UK, but it is the firm intention to widen the net to include international partners. As suppliers, the public sector partners would provide teaching or courses that fulfil the centre's objectives, and as end-users the core industry partners and representatives of the wider industry would need to direct the undertaking of these projects to ensure that they meet the needs of the financial services industry.

1.21 The Executive Committee would establish a Council of Advisers to advise on the selection and assessment of training and research programmes, operating within clear criteria set out by the Committee, to ensure that the objectives of the ICFR are met. The Council Chair would report to the Executive Committee via written recommendations, to which a written response would be required. The Council of Advisers would have the responsibility of ensuring that the ICFR interfaces well with organisations already offering training in this area, e.g. academic institutions, training agencies and trade organisations.

1.22 A Chief Executive (plus Directors of training and research and a small administrative staff) would be selected to provide day-to-day leadership of the ICFR. The CEO would have a strong track record in the financial services sector and would need to have proven influencing skills. The CEO would report to the Executive Committee, which will be responsible for governance and administration.

1.23 The establishment of the ICFR (e.g. teaching and research contracts) and the appointment of the Chief Executive will take place via transparent process.

MODUS OPERANDI

1.24 The ICFR would need to make use of a number of leading teaching institutions to provide the training and research on the syllabus.

Training 1.25 The ICFR would select, commission and fund the delivery of teaching programmes. The teaching will be carried out in a number of institutions across the UK and, where essential to the objectives of the ICFR, overseas. Teaching teams will be drawn from industry, the public sector and academia through a competitive process.

Research 1.26 The ICFR would also select, commission and fund the delivery of research programmes. The Executive Committee will use competitive mechanisms to allocate research funds, along with peer review quality assurance from the Council of Advisers.