



Summary of the UK Treasury's White Paper on “reforming financial markets”

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On 8 July 2009 Alistair Darling presented HM Treasury's proposal for upgrading financial regulations in the UK and for international cooperation.

The presentation will review the key points of the UK Treasury report on regulation.

Key Points

Macro Prudential Regulation

Remuneration

Pre-Funding to the FSCS

Liquidity and Capital Requirements

Fair Market for Consumers

FSA's Enhanced Powers

Role of the Bank of England

Corporate Governance

Depositor Protection


Offshore Financial Centres


Macro Prudential Regulation

The key objectives highlighted by Alistair Darling are:

- Making sure that regulatory authorities, in the UK and globally, are monitoring and addressing the build up of systemic risks across the global financial system
- Achieving a high degree of coordination and cooperation between the authorities, so that the links between macroeconomic and financial conditions are understood properly
- Establishing a new formal Council for Financial Stability comprising of the FSA, the Bank of England and the Treasury

Role of the Council of Financial Stability:

 *To analyse emerging risks to the financial stability of the UK's economy and coordinate the appropriate response*

 *Develop mechanisms for monitoring the build up of systemic risks, and use macro prudential tools to respond to such risks*

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Remuneration

The White Paper listed the following actions:

- Changing the culture in the banks and their boardrooms, with pay practices focused on long-term stability and not short-term profit
- FSA incorporating its Code of Practice to cover remuneration practices and apply it to banks, building societies and broker dealers
- FSA ensuring that bank executives are not unduly rewarded for excessive risk-taking
- Furnishing the FSA with powers to penalise banks if their pay policies create unnecessary risk, and are not focused on the long-term strength of their institutions
- FSA providing an annual report to the government on remuneration practices

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Pre-Funding to the FSCS

According to the White Paper the Financial Services Compensation Scheme (FSCS) plays a key part in protecting depositors with UK banks and customers of other parts of the UK financial services industry. The proposals for funding the scheme are:

- Pre-funding the scheme as a long-term approach to financing the FSCS
- Financial industry stakeholders financing the FSCS as they would benefit from the extra confidence among their customers due to the existence of effective deposit protection measures

The government has also decided that no pre-funding would take place before 2012 due to the current financial situation.

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Liquidity and Capital Requirements

The White Paper demands larger firms will need to increase their capital and liquidity resources in line with the FSA's new approach to regulation and lists the following actions:

- FSA being involved in enhancing regulation of liquidity risk to ensure that financial institutions are better able to survive market wide liquidity shocks
- The White Paper supporting FSA's proposals to reform liquidity standards in the UK, consisting of more extensive information requirements, quantitative liquid asset buffers determined for each bank
- Increasing the quality and quantity of capital held by banks, perhaps the ultimate increase in minimum capital requirements agreed will be the outcome of international discussion
- Focusing on banks building buffers of high quality capital which can be utilised to absorb losses
- Raising the capital requirements for riskier trading activities, the White Paper supports the FSA's proposal in the Turner Review of trading book risk management and the capital adequacy requirements

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Pre-Funding to the FSCS

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Fair Market for Consumers

The government recognises the need for support and protection for the consumers as they engage with the financial services industry.

In accordance with the White Paper the government has proposed the following:

- *Introducing measures to raise financial capability, through the provision of a national money guidance service*
- *Improving access to simple and transparent products to facilitate the ease of understanding the product*
- *Speeding the process of dealing with widespread consumer complaints*
- *The FSA and the government taking significant steps to improve the arrangements for depositor protection*

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Pre-Funding to the FSCS

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FSA's Enhanced Powers

The government added further FSA's statutory responsibilities for securing financial stability through:

- Increasing the FSA's powers to suspend individuals or firms for misconduct
- Adding powers to penalise individuals who perform a controlled function without FSA approval
- Strengthening the FSA's ability to impose emergency restrictions on short-selling
- Widening the FSA's consumer education capability the government will bring in forward primary legislation requiring the FSA to establish an independent consumer education and information authority
- Extending the FSA's Supervisory Enhancement Programme (SEP) to put in place a more intrusive and systemic supervisory approach

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Role of the Bank of England

The White Paper touches upon the regulatory role of the Bank of England by referring to the Banking Act 2009.

The Banking Act 2009 describes the role of the Bank of England as following:

- *A clear statutory objective to protect the stability of the financial system*
- *A streamlined and modernised Court of the Bank of England, with a dedicated committee for financial stability*
 - *The Financial Stability Committee, to support its work in this area*

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The White Paper mentions the responsibility of boards with regards to playing a stronger role in the corporate governance and control of financial companies but defers all other governance issues to the publication of Sir David Walker's report on governance, envisaged to be published on the 16 July 2009.

The White Paper points out that there have been widespread failures of governance by some bank boards in several areas such as:

-  *Understanding and probing proper risk management reporting*
-  *Comprehending how affiliated vehicles imply ongoing exposure*
-  *Grasping how remuneration policies encourage risk taking that may prioritise the short term at the expense of the long term*

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Depositor Protection

Effective depositor protection can be achieved through an effective and credible compensation scheme.

The FSA is considering wide range of detailed technical measures which will improve the provision of effective compensation to consumers by the FSCS:

- *Strengthening FSCS funding agreements*
- *Introducing simpler eligibility criteria for claimants*
- *Improving compensation schemes for bank customers*
- *Providing protection for balances temporarily above the deposit compensation level*

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- The White Paper states that the government will ensure that offshore banking centres will not provide firms with an opportunity to avoid effective regulation.
- The G20 agreed on the importance of protecting public finances and international standards against the risks posed by non-cooperative jurisdictions.
- An independent review of the long term opportunities and challenges facing the British Crown Dependencies and Overseas Territories as financial centres which have been brought into focus by recent financial events.(This report is due to be published in the fourth quarter of 2009).

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Registered Office 10 Upper Bank Street London E14 5JJ United Kingdom

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