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How to streamline City regulation [1]

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The Financial Services Authority grew significantly in the 2000s, to 4,000 staff. But its tick-box approach to regulation took its focus off fundamental issues and it was unprepared for the unfolding financial crisis. Hence George Osborne?s decision to replace it with new agencies, the Financial Conduct Authority (FCA) for consumer protection and the Prudential Regulatory Authority (PRA) to supervise financial firms.

It is a mistake to have two regulators, second-guessing each other. They intend to be continuously monitoring financial firms, rather than just setting broad rules and punishing transgressions, which will increase the volume and cost of regulation on the sector. They also seem to have no understanding of the value of competition in regulating firms? activities; and their high regulatory cost will not encourage new firms to set up.

The FCA seems to believe that it can train new staff in a matter of months, and specify in detail how firms in a complex sector should compete. It has provided no performance measures by which its success or failure could be judged.

A better model for consumer protection is the Financial Ombudsman Service (FOS), which sets broad rules and deals with hundreds of thousands of complaints on a staff of just 1,000. The FOS could protect consumers well, without the need for a further regulator in the form of the FCA.

The Bank of England has recovered its supervisory role. In this, it must not be diverted into the bureaucratic tick-box culture of the FSA.

The Prudential Regulatory Authority is conflicted between saving troubled firms and ensuring the health of the financial system as a whole, which will require some firms to fail from time to time. Early signs are that it does not appreciate the regulatory role of auditors, shareholders and boards and will load more unnecessary bureaucracy and cost onto companies.

Where malpractice is found, there is confusion over whether individuals or firms should be penalised. Targeting individuals would be more effective. Auditors should also face personal penalties for failure.

Libor malpractice does not require endless committees and investigation. The solution is quite simple. What should happen is that the firm contracted by the British Bankers Association to consolidate the figures should also be contracted to collect the data from their sources and ensure their probity, .e.g. by checking claimed interest rates by payers with payees. In other words, the role of the submitters should be taken out of the bankers? network.

The heavy price of French participation in the 2010 G20 meeting in London was to hand financial services rule-making to Brussels. We should ensure that EU-wide rules are enforced uniformly across the EU, and not gold-plated here.

George Osborne?s plan to replace the FSA actually makes things worse, with more overlapping and conflicting regulators and greater costs arising from the bureaucratic tick-box culture. Regulation would be

stronger if it were simpler. With this in mind, we recommend:

? The FCA is unnecessary and should be wound up

? The PRA should be slimmed and become an early-warning team to inform other regulators.

? The Money Advice Service, set up from the FSA, should be commercialised or dismantled.

? Regulators must understand and accept the role of brands and competition in bidding up service and value levels. The importance of boards, shareholders and auditors must be strengthened too.

? EU financial regulation must be enforced equally across the EU.

? The Bank of England must resist regulatory creep in EU regulation.

? Auditors and executives must be personally accountable.

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