

The future of financial services

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Governments at home and abroad must decide how they want financial services to operate post-credit crunch

There can be few policy areas of comparable size with a bigger 'in-tray' than that of financial regulation and services. While the world hesitantly recovers from the global financial crisis, its legacy is a profound re-examination of the adequacy of existing legislation and institutions, together with a consideration of just what society wants and expects from its financial institutions.

CONTRADICTIONARY OBJECTIVES

This consideration will inevitably involve making a choice between potentially inconsistent or irreconcilable outcomes. For example,

Banks should be forced to raise more equity capital to make them stronger.

Banks should be subject to higher taxation and controls on profits.

BUT *new equity is hard to raise if banks' profits are permanently lower in future.*

Or,

Bank lending should be more tightly controlled by restrictions on 'leverage'.

BUT *banks should lend more to industry and individuals.*

QUESTIONS TO BE ANSWERED

The issues currently facing regulators and legislators include:

- Capital adequacy – how much and what quality of capital should banks and others be forced to hold?
- Liquidity – what level of liquid resources should banks retain? What should these

consist of and how should they be measured?

- Size - should there be controls on the size of financial institutions? If so, should it be by way of splitting the banks by function, or by quantitative controls on the levels of business they can carry out? If not, might they be forced to pay a surcharge as an insurance policy against the consequences of future failure?
- Remuneration and 'corporate governance' – what structures need to be put in place to improve internal controls?
- Other agents and influences – what should be done regarding credit ratings agencies or short-selling hedge funds? Did the accounting profession and its standards contribute in some way to the problem? How 'complex' should complex financial instruments be allowed to be?
- Lastly, the regulatory system itself – is there a role for a more formal international supervisory system? If so, what powers and sanctions should it have over national authorities? What actually is macro-prudential supervision?

How will the UK Parliament make its voice heard in international discussions of the future of banking?

These issues will be decided upon at a variety of different policy levels. While some will be purely 'domestic' - for example, the future

regulatory structure in the UK - others, such as broad principles on capital adequacy, will be agreed on by international regulators in Basle and subsequently form the core of new European Union directives for implementation in EU Member States. In the UK, implementation might be by national legislation or by rules made by the current independent regulator, the Financial Services Authority (FSA), outside of Parliamentary control or scrutiny. One challenge for the future Parliament is to be able to exercise its voice and express its opinion within this framework.

The end of the cheque could disproportionately affect the most vulnerable firms and individuals

DOMESTIC CONCERNS

For Members for whom (saving) the world is not enough, an important domestic agenda awaits that they will find hard to ignore.

- By 2012 bank cheque guarantee cards will be withdrawn. By 2016, the Payments Council will have decided whether or not cheques should cease to be a recognised method of payment. The next five years therefore will see this argument unfold in public. The issues are likely to be the impact on groups that still use cheques – the elderly, small firms, traders etc and the adequacy of any technological replacement.

- 'High cost credit', or the provision of sub-prime credit to individuals excluded from the mainstream banks, is currently being reviewed by the Office of Fair Trading. When it publishes its conclusions, anticipate a lively debate over the balance between control, regulation and credit accessibility. More generally, the terms and conditions under which credit is made available will change with the imminent transposition of the EU Consumer Credit Directive.
- Last, but by no means least, approximately 10,000 small independent financial advisers are likely to cease trading following the FSA's Retail Distribution Review. The review was the response to the long-running complaint that a commission-driven sales model has contributed to past mis-selling scandals of financial products. Arguments stressing the commission system's lack of transparency and its potential for conflict of interest between seller and customer will be set against fears that, when faced with up-front charges, individuals will be put off seeking much-needed financial advice.

From consideration of the global regulation of credit derivatives to the possible death of the cheque book, from bankers' bonuses to credit for the poor, from 'too big to fail' to too small to survive, there is much for Members to consider and decide upon in the next five years. Watch that in-tray.