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Research Paper

Baking Regulatory and Market Framework in United Kingdom: Strengths, Weaknesses, Opportunities and Threats

Caesar K. Simpson

Swiss Management Centre University.

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ABSTRACT

In light of the recent financial crisis, which seems to be far from its end, too much has been said regarding the regulation of the financial sectors. This paper therefore discussed the banking regulatory and market framework in the United Kingdom (UK). The paper finds out that until 31 March 2013, the financial services industry in the UK was regulated by the Financial Services Authority (FSA). It was responsible for both conduct and prudential regulation. In 2012, following consultation, the government confirmed its decision to reform financial regulation, in part because in its view the remit of the FSA was so wide before the 2008 crisis that it was not sufficiently focused on financial stability issues. In view of this, the UK financial regulation was overhauled; the UK's banking regulator, FSA, has been abolished and replaced with two successor organisations: Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) with effect from 1 April 2013. Both regulators undertake broadly similar regulatory functions, in pursuit of different objectives. The Bank of England has also gained direct supervision for the whole of the banking system through its powerful Financial Policy Committee (FPC), which can instruct the two new regulators. The FPC is also responsible for macro-prudential regulation.

Key words: *Banking regulatory, Market framework, United Kingdom (UK)*

1.0 INTRODUCTION

The global financial crisis that began in 2007 continues to cast a long shadow over the banking industry, subjecting it to intense regulatory and public scrutiny. Indeed, the expectations of regulators regarding the governance and conduct of financial institutions are only heightening (KPMG, 2014).

The role of banks is integral to any economy. They provide financing for commercial enterprises, access to payment systems, and a variety of retail financial services for the economy at large. Some banks have a broader impact on the macro sector of the economy, facilitating the transmission of monetary policy by making credit and liquidity[1] available in difficult market conditions (Alexander, 2004). The integral role that banks play in the national economy is demonstrated by the almost universal practice of states in regulating the banking industry and providing, in many cases, a government safety net to compensate depositors when banks fail. Financial regulation is necessary because of the multiplier effect that banking activities have on the rest of the economy (Alexander, 2004).

Besides the aim of protecting small depositors, controlling systemic risk is cited as one of the main arguments for banking regulation and supervision. Systemic risk is the probability that the failure of one single

[1] The ability to convert an asset to cash quickly (Alexander, 2004)

bank leads to successive losses along the chain of institutions with negative impact on the whole economy (Stolz, 2002). The higher the interconnections within the banking system, the higher are the subsequent losses after an individual bank failure. As financial markets have increasingly become integrated across national borders, these losses can partially incur outside the country where the bank failure took place. This contagion effect is particularly relevant to the United Kingdom (UK) as a member of the European Union (EU) where the highly integrated interbank market could function as a channel for cross-border spillovers (Stolz, 2002).

However, in the EU, this national approach of supervision is implemented by the home country principle which assigns responsibility for overseeing banks to the national authority in the banks' home country.

Furthermore, the principle of consolidated supervision requires that the home supervisor is not only liable for a national bank's activities inside the country's borders, but for the control of the whole financial group (Stolz, 2002).

It is line of this national approach of regulation and supervision that this paper seeks to discuss the banking regulatory and market framework in the UK. The rest of the paper is section as follows: Section 2: EU banking regulatory and market framework; Section 3: UK banking regulatory and market framework; Section 4: SWOT analysis of the UK banking regulatory and market framework; and Section 5: Conclusion

2.0 EU BAKING REGULATORY AND MARKET FRAMEWORK

The European Banking Authority (EBA) is one of the three European Supervisory Authorities (ESAs) that together with the European Systemic Risk Board (ESRB) make up the new European architecture for financial supervision created in response to the financial crisis that hit the world in 2008 (EBA, 2012). Together with the national supervisory authorities, the ESAs, the EBA's Joint Committee and the ESRB represent the new European System of Financial Supervision (ESFS) (EBA, 2012). The EBA officially came into being on 1 January 2011. In addition to the new mandate derived from its Founding Regulation, the Authority has taken over all existing and ongoing tasks and responsibilities from the Committee of European Banking Supervisors (CEBS) (EBA, 2012). The EBA acts as a hub-and-spoke network comprising EU and national bodies safeguarding public values such as the stability of the financial system, the transparency of markets and financial products and the protection of depositors and investors (EBA, 2012). The EBA has a broad remit, including preventing regulatory arbitrage,[2] guaranteeing a level playing field, strengthening international supervisory coordination, promoting supervisory convergence and providing advice to EU institutions in the areas of banking, payments and e-money[3] regulation, as well as on issues related to corporate governance, auditing and financial reporting (EBA, 2012).

Whilst the national supervisory authorities remain in charge of supervising individual financial institutions, the role of the EBA is to improve the functioning of the internal market by ensuring appropriate, efficient and harmonised European supervision and regulation (Breuss, 2013).

The main task of the EBA is to contribute, through the adoption of Binding Technical Standards and

Guidelines, to the creation of the European Single Rulebook in banking. The Single Rulebook [4] aims at providing a single set of harmonised prudential rules for financial institutions throughout the EU,

[2] A practice whereby firms capitalize on loopholes in regulatory systems in order to circumvent unfavourable regulation (EBA, 2012)

[3] European Commission website describes electronic money (e-money), as "a digital equivalent of cash, stored on an electronic device or remotely at a server."

[4] The term Single Rulebook was coined in 2009 by the European Council in order to refer to the aim of a unified regulatory framework for the EU financial sector that would complete the single market in financial services (EBA, 2012).

helping create a level playing field and providing high protection to depositors, investors and consumers (Breuss, 2013).

The Authority also plays an important role in promoting convergence of supervisory practices to ensure a harmonised application of prudential rules. The EBA is also mandated to assess risk and vulnerabilities in the EU banking sector through, in particular, regular risk assessment reports and pan-European Stress Test[5] (Schüler, 2003; Breuss, 2013).

Other tasks set out in the EBA's mandate include investigating insufficient application of EU law by national authorities, decision-making in emergency situations, mediating disagreements between competent authorities in cross-border situations, and acting as an independent advisory body to the European Parliament, the Council or the Commission (Schüler, 2003; Breuss, 2013).

In the EU, it is the "home country" which has full responsibility for banking supervision of individual banks (Stolz, 2002). This national approach means that supervisors are accountable to their own jurisdiction and that their mandate is to guarantee prudential behaviour of home banks and to safeguard systemic stability in their own country. Accordingly, incentives are such that supervisors use their discretion to follow national interests (Stolz, 2002). This institutional design has two consequences for the national supervisors' behaviour. First, supervisors will pay attention only to the repercussions the failure of a financial institution has on their own economy. However, they will disregard the potential negative effects which are transmitted into other EU countries via the highly integrated interbank market (Stolz, 2002). Second, although supervisors would like to take the risks into account which derive from the bank's activity abroad, they may lack information to do so as their foreign colleagues do not have incentives to deliver the necessary data on the bank's activities abroad (Stolz, 2002).

It is therefore consequential that the banking regulatory and market framework prevailing in the UK be in conformity with that of the EU umbrella body - EBA. The next section investigates the banking regulatory and market framework in UK.

3.0 UK BAKING REGULATORY AND MARKET FRAMEWORK

In the UK, the model of financial regulation has been a tripartite system under which the responsibility for financial regulation is shared by HM Treasury (HMT), the Bank of England and the Financial Services Authority (FSA) (Allen & Overy, 2013a). The financial regulatory framework under the UK Financial Services and Markets Act 2000 (FSMA)[6] requires banks and other authorised financial firms to establish internal systems of control, compliance, and reporting for senior management and other key personnel (Gonzalo, 2010). Under FSMA, the FSA has the power to review and sanction banks and financial firms regarding the types of internal control and compliance systems they adopt (Gonzalo, 2010). These systems must be based on recognised principles and standards of good governance in the financial sector. These regulatory standards place responsibility on the senior management of firms to establish and to maintain proper systems and controls, to oversee effectively the different aspects of the business, and to show that they have done so (Gonzalo, 2010).

The tripartite system has been under fire since the start of the financial crisis in 2007 for failing to address deficiencies within the financial system (Allen & Overy, 2013a) The FSA was roundly criticised for failing to spot the lending boom and subsequent bust and for not curbing the risky trading of banks, which ended up

5 A bank stress test is a simulation based on an examination of the balance sheet of that institution (Schüler, 2003).

6 FSMA is an Act of the Parliament of the United Kingdom that created the Financial Services Authority (FSA) as a regulator for insurance, investment business and banking (Allen & Overy, 2013a).

seeing banks like Northern Rock, Royal Bank of Scotland and Lloyds all spectacularly collapse and be bailed out by the taxpayer following the global financial crisis in 2008 (Andrew, 2011).

In view of this, the UK financial regulation was overhauled; the UK's banking regulator, FSA, has been abolished and replaced with two successor organisations: Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) with effect from 1 April 2013 (NAO, 2014). The Bank of England has also gained direct supervision for the whole of the banking system through its powerful Financial Policy Committee (FPC), which can instruct the two new regulators. The FPC is also responsible for macro-prudential regulation[7] regulation of the ability and resilience of the financial system as a whole (Allen & Overy, 2013a).

Chancellor George Osborne[8] announced the changes back in 2010, aiming to make it clear who is in charge over supervising the financial services sector and avoid a recurrence of failing banks and enormous state-backed bailouts. The regulator changes see the Bank of England gain much more control over the functioning of the financial system and are the biggest changes to the central bank since it was given its independence in 1997 (NAO, 2014).

The PRA was created by the Financial Services Act 2012 and formally began operating alongside the new FCA. As the Bank of England is operationally independent of the Government of the United Kingdom, the PRA is a quasi-governmental regulator, rather than an arm of the government (Allen & Overy, 2013b; NAO, 2014). The PRA is headed by the central bank's deputy governor Andrew Bailey, and will regulate around 1,700 financial firms. The authority is structured as a limited company wholly owned by the Bank of England and is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. It sets standards and supervises financial institutions at the level of the individual firm. PRA ensures the stability of financial services firms (NAO, 2014).

The PRA's role is defined in terms of two statutory objectives to promote the safety and soundness of these firms and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders (NAO, 2014). In promoting safety and soundness, the PRA focuses primarily on the harm that firms can cause to the stability of the UK financial system. A stable financial system is one in which firms continue to provide critical financial services-a precondition for a healthy and successful economy (Allen & Overy, 2013). It has close working relationships with other parts of the Bank, including the Financial Policy Committee and the Special Resolution Unit (BoE, 2013). The PRA's most significant supervisory decisions will be taken by its Board-comprising the Governor of the Bank of England, the Deputy Governor for Financial Stability, the Chief Executive Officer of the PRA, and Deputy Governor for Prudential Regulation, and independent non-executive members.[9] The Board is accountable to Parliament (NAO, 2014).

The PRA's approach to regulation and supervision has three characteristics:

- A judgment-based approach: The PRA uses judgment in determining whether financial firms are safe and sound, whether insurers provide appropriate protection for policyholders and whether firms continue to meet the Threshold Conditions (BoE, 2013).

- A forward-looking approach: The PRA assesses firms not just against

[7] The term macro-prudential regulation characterises the approach to financial regulation aimed to mitigate the risk of the financial system as a whole (Allen & Overy, 2013a).

[8] The UK government's chief financial minister.

[9] Members of the board of directors of a company who does not form part of the executive management team.

current risks, but also against those that could plausibly arise in the future. Where the PRA judges it necessary to intervene, it will generally aim to do so at an early stage (BoE, 2013).

- A focused approach: The PRA focuses on those issues and those firms that pose the greatest risk to the stability of the UK financial system and policyholders (BoE, 2013).

The PRA approach to supervision does not seek to operate a "zero-failure" regime. Rather, the PRA seeks to ensure that a financial firm which fails does so in a way that avoids significant disruption to the supply of critical financial services (NAO, 2014).

On 19 December 2012 the Financial Services Act 2012 received royal assent,[10] and FCA came into force on 1 April 2013 (HM Treasury, 2012). The FCA is headed by Martin Wheatley, who worked at the FSA and was responsible for the review into the Libor rate-rigging scandal at banks. FCA operates independently of the United Kingdom government, and is financed by charging fees to members of the financial services industry (Allen & Overy, 2013a), The FCA regulates financial firms providing services to consumers and maintains the integrity of the UK's financial markets (NAO, 2014). It focuses on the regulation of conduct by both retail and wholesale financial services firms (Allen & Overy, 2013a). Like its predecessor the FSA, the FCA is structured as a company limited by guarantee.[11] The FCA is now the City's behavioural watchdog (Brooke, 2012). In broad terms, under FSMA, the FCA is responsible for:

- regulating standards of conduct in re tail and wholesale markets;
- supervising trading infrastructures th at support those markets;
- the prudential supervision of authori sed firms that are not PRA regulated; and
- The functions of the UK Listing Aut hority and other functions under Part 6 of FSMA (NAO, 2014).

The FCA has a single strategic objective to ensure that the markets for financial services function well. Three operational objectives support this: securing an appropriate degree of protection for consumers (including investors in financial instruments and wholesale consumers); protecting and enhancing the integrity of the UK financial system; and promoting effective competition in the interests of consumers in the markets for financial services (BoE, 2013).

The authority has significant powers, including the power to regulate conduct related to the marketing of financial products. It is able to specify minimum standards and to place requirements on products (BoE, 2013). It has the power to investigate organisation and individuals (BoE, 2013; Allen & Overy 2013a; NAO, 2014).

In addition, the FCA is able to ban financial products for up to a year while considering an indefinite ban; it will have the power to instruct firms to immediately retract or modify promotions which it finds to be misleading, and to publish such decisions (BoE, 2013).The authority will regulate the consumer credit industry from 1 April 2014, taking over the role from the Office of Fair Trading[12] (BoE, 2013; NAO, 2014).

[10] Royal Assent is the name for the method by which a country's constitutional monarch formally approves an act of that nation's parliament, thus making it a law or letting it be promulgated as law (HM Treasury, 2012).

[11] Incorporated firm without share capital, and in which the liability of its members is limited to the amount each one of them undertakes to contribute at the time the firm is wound up (Allen & Overy, 2013a)

[12] The Office of Fair Trading (OFT) was a not-for-profit and non-ministerial government department of the United Kingdom, established by the Fair Trading Act 1973, which enforces both consumer protection and competition law, acting as the UK's economic regulator (NAO, 2014).

4.0 SWOT ANALYSIS OF THE UK BANKING REGULATORY AND MARKET FRAMEWORK

4.1 Strengths

The FCA's regulatory framework covers consumer credit products provided under the Consumer Credit Act 1974 (CCA 1974) hitherto under the responsibility of the Office of Fair Trading (OFT) (Allen & Overy, 2013a). The FCA have stronger powers and greater resources than the OFT has had in order to tackle detrimental practices in the consumer credit market (Allen & Overy, 2013a). Unlike the OFT, the FCA is able to make binding rules on firms to ban specific products or product features that cause harm, and to require firms to pay redress. It will also be able to apply greater scrutiny to applications for credit licences and make it more difficult for rogue firms to enter the market (Allen & Overy, 2013a).

The UK banking regulatory and market framework is also hard-hitting in tackling financial crime and able to issue unlimited fines on culprits (Allen & Overy 2013a). The regulator conducts thematic reviews within the banking, insurance and asset management sectors aimed at assessing firms' approach and management of financial crime risk, with a particular emphasis on anti-money laundering[13] (AML) and anti-bribery and corruption (ABC) systems and controls. These thematic reviews are swiftly followed by enforcement actions against financial institutions that fall culpable (NAO, 2014). For example, in 2013, FCA has fined Swinton Group Limited, one of the largest insurance retailers on the high street, £7,380,400 for mis-selling. The FCA found that Swinton's aggressive sales strategy meant that it failed to treat customers fairly in its telephone sales of monthly add-on insurance policies. Also, the latest being £7.6 million fine imposed by the FCA on Standard Bank in January 2014 for failings in its AML controls relating to corporate customers connected to politically exposed persons [14] (PEP) (Eversheds, 2014).

Previously, the FSA does not have explicit competition powers. These lie with the OFT and, with respect to mergers and markets investigations, the Competition Commission. The FCA does have, however, a new mechanism to refer a matter to the OFT for consideration (Allen & Overy, 2013a). The FCA's new competition objective and duty means that the FCA will be required to identify and address competition problems and adopt a more pro-competitive approach to regulation. The FCA will seek to minimise or limit distortions in competition with a particular focus on meeting consumer needs and ensuring that there are no undue barriers to entry or expansion (Allen & Overy, 2013a).

Combined with the judgement-led approach to supervision, this is likely to mean that firms' engagement with the regulator becomes more adversarial in nature than it has been under the FSA. The impact judgement-led supervision will have on firms' day-to-day engagement with the regulators is less clear but in some cases firms may need to re-evaluate whether their practices, while being in strict compliance with the rules, are not within the spirit of the rules (Allen & Overy, 2013a).

The requirements that firms need to meet in order to remain safe and sound are rooted in the PRA's statutory objective, the statutory Threshold Conditions for authorisation, and UK and EU law. The PRA's statutory Threshold Conditions, which set out the minimum requirements that firms must meet in order to be permitted to carry on the regulated activities in which they engage, are designed to promote safety and soundness (Allen & Overy, 2013b).

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[13] A set of procedures, laws or regulations designed to stop the practice of generating income through illegal actions (NAO, 2014).

[14] People who have been entrusted with prominent public function, or an individual who is closely related to such a person. A PEP generally presents a higher risk for potential involvement in bribery and corruption by virtue of their position and the influence that they may hold (Eversheds, 2014).

An effective framework for financial stability needs to combine firm-specific supervision with work to protect and enhance the resilience of the financial system as a whole. The PRA therefore works closely with the rest of the Bank of England, including, crucially, the FPC, which is able to make recommendations and give directions to the PRA (Allen & Overy, 2013b).

For all banks, building societies and designated investment firms, the PRA determines a minimum regulatory capital level and a buffer on top of this expressed in terms of the Basel and EU risk-weighted framework (Allen & Overy, 2013b). The PRA's assessment of this 'Capital Planning Buffer' (CPB) takes into account the options a firm has to protect its capital position under stress, for example through internal capital generation. The CPB is intended to be drawn upon in times of stress. The PRA therefore expects and will allow it to be used in stressed circumstances (Allen & Overy, 2013b). If a firm's CPB is used, the PRA will expect the firm to indicate how it plans to rebuild it and over what timescale. This framework will be revised in light of forthcoming changes to European Directives, particularly to the Capital Requirements Directive (CRD IV), which is likely to set out a number of additional requirements for capital buffers. This includes some buffers agreed via the FSB and covered in Basel III [15] that reflect a firm's size and systemic importance (Allen & Overy, 2013b)

4.2 Weaknesses

Lack of rules is considered to be the origin of the recent financial crisis, asking for more rules is one of the inevitable reactions, if not the first and more poignant (Howard, 2011). The rules of both FCA and PRA are aligned to prevent future financial crisis but have overlapped in many circumstances (Allen & Overy, 2013a; Allen & Overy, 2013b; NAO, 2014) which is an indicative of overregulation.[16] Overregulation has significant costs not only to the private businesses regulated, which will have to devote more time and money to

Compliance (Keating, 2011), but also to the regulators and supervisors themselves. It has to be taken into account that more regulation eventually leads to an additional burden for the supervisors. For every rule created, one more duty of supervision will be added and one more potential violation appears (Ackerman, 2012). Of course financial oversight is more easily performed today with the aid of technological tools, making on-site supervision an exceptional measure. But even the most prepared and well-equipped supervisory authority will face a huge task (Prates, 2013). Since there will be an extensive and complex array of rules to enforce, supervisors will face many hurdles to properly and timely assess the compliance with all relevant rules by the financial institutions (Prates, 2013). Hence, it is important to have a well-designed supervisory structure, with a number of staff proportionate not only to the number of financial institutions under supervision, but also to the number of rules that has to be enforced. Unless this symmetry [17] is properly accomplished, the sense of impunity may come as a result (Prates, 2013).

Rules they say cannot modify reality (Black, 2002), it is important to stress that regulation is nothing but organising and controlling by restriction or incentive. Regulation does not have the intention of transforming the regulated fact or activity into something else. Its aim is to limit or to stimulate a fact or an activity because they are relevant not only for their stakeholders,[18] but also to society. And its

[15] Basel III (or the Third Basel Accord) is a global, voluntary regulatory standard on bank capital adequacy, stress testing and market liquidityrisk(Allen &Overy, 2013b).

[16] Excessive regulation; the imposition of excessive rules and regulations.

[17] Sense of harmonious and beautiful proportion and balance (Zee, 2007).

[18] People or things that are affected by the organization's actions, objectives and policies.

main boundary is respecting the essence of the fact or activity regulated, even if the regulation involves the attempt to alter the behaviour of others (Black, 2002). Notwithstanding how tough the new banking regulatory framework is, it would not be able to completely change negative behaviour of players in the sector. It is important to observe that, on one hand; rules do not predict or anticipate facts, because rules always come after facts. And, on the other hand, some facts go unnoticed by legislators. So, financial rules are thought and created today taking into account the financial reality of yesterday (Prates, 2013).

The regulatory environment is forcing banks to rethink of their operating model. However, long-standing weaknesses in data quality and aggregation capabilities in addition to outmoded risk governance structures are making it difficult for the industry to change (KPMG, 2014). The new regulatory system unfortunately could not address this age long weaknesses in the sector. Banks have introduced risk management structures and reporting procedures in accordance with regulator demands, but they still lack sophisticated risk systems or strategic approaches (KPMG, 2014). The regulatory framework has therefore not been able to provide any solution to these lack of sophisticated risk systems or strategic approaches of banks.

The FPC, PRA and FCA are each to have their own objectives, which introduce an extra level of complexity to the interrelation of objectives. For example, the FPC has an objective to support the economic policy of Government, including objectives for growth and employment, which may conflict with the FCA's operational objective of promoting competition. Because the FCA is subject to the FPC's recommendations, conflict between the priorities of the two organisations may only be resolved to the detriment of the FCA's operational objectives (Allen & Overy, 2013a.)

4.3 Opportunities

Trying to solve these problems by regulating all situations that may lead to a financial crisis will inevitably breed overregulation. In addition to organising the best possible prudential regulations, [19]having a solid and well-developed financial safety net would be a good complement. This could be done by answering at least three main questions: (a) how to organize a deposit insurance and resolution fund to be used as the first response to a problem in the financial system; (b) how to find a private solution instead of a public one when it comes to deal with failure in the financial system; and, very important, particularly to reduce the moral hazard [20] that may follow the safety net, (c) how to hold executives personally liable for the losses caused by failed financial institutions (Prates, 2013). Properly answering these questions and creating a legal framework directed to minimize the consequences of financial crises seem to be the more suitable, if not the only effective, legal response when it comes to financial regulation (Prates, 2013).

Banks will need to incorporate the Financial Stability Board's (FSB'S) proposed 'risk culture [21] indicators' to show that they are truly reforming their internal approach to risk, by demonstrating genuine leadership commitment and accountability, by encouraging people to challenge risk practices, and by providing incentives to do so (KPMG, 2014). Banks have enhanced the role of the CRO function but must find ways to apply risk management capabilities to support strategic and commercial decision-making (KPMG, 2014.)

Since the global financial crisis, supervisory approaches are increasingly becoming more direct and more intense to promote the resilience of the financial system. The challenge for supervisors is to

[19] An appropriate legal framework for financial operations to preventing or minimising financial sector problems (Prates, 2013).

[20] A situation in which a party is more likely to take risks because the costs that could result will not be borne by the party taking the risk (Prates, 2013).

[21] The system of values and behaviours present in an organization that shapes risk decisions of management and employees.

strike the right balance between taking a more intensive, proactive approach and not unduly influencing strategic decisions of the institution's management. Risk culture is an area where a growing number of supervisory authorities must take a more active role, and the range of supervisory approaches toward assessing risk culture (FSB, 2014).

Assessing risk culture is complex and requires a range of skills, tools and approaches (FSB, 2014). Supervisors need to develop broad-based experience and a set of appropriate skills to derive sensible assessments and interact with institutions at the senior level on the role played by their risk culture (FSB, 2014). The regulatory authorities should ensure that supervisors making these assessments are adequately trained and are able to apply experienced judgment and clearly articulate these judgments. Failure by an institution to remediate findings in relation to risk culture by a supervisor should be subject to the existing suite of supervisory options that is proportional to the size of exposures and materiality of the risks involved (FSB, 2014).

4.4 Threats

The regulators face challenges in ensuring they have the right staff capacity and capability. The range and depth of skills required by the regulators has increased as their remits have expanded (NAO, 2014). In order to implement the changes to regulatory approaches, certain technical competences and behaviours will have to be adopted by the regulators' workforce. The PRA and FCA are currently introducing new frameworks, and feedback on staff training and support has generally been positive. Both regulators are working to develop long-term strategies to attract the best talent. However, current levels of staff turnover result in the consistent

departure of skilled and experienced staff, for example 26 per cent of all PRA resignations in 2013 were classified as 'high performers' and 34 per cent of FCA staff in October 2013 had less than two years' service at the FCA (previously FSA) (NAO, 2014). This could undermine industry confidence in the regulators, poses a risk that knowledge will be lost within the organisations and impacts on the regulators' capacity to carry out their functions (NAO, 2014).

Banks face a myriad of issues around data quality and management. Data demands are growing all the time, but ensuring these data are fit for purpose remains difficult given the fragmented systems and processes through which the data flow (KPMG, 2014). The regulators are acting to improve how they collect, use and manage information, but it is too early to conclude on the effectiveness of the new approaches (NAO, 2014). The importance of information to the success of the changing regulatory approaches is understood and the regulators recognise the weaknesses associated with the data collection systems inherited from the FSA (NAO, 2014). The PRA and FCA are working to improve their approach to data collection and are imposing a more disciplined approach to data governance. However, the regulators do not yet have a complete understanding of their inventories of regulatory data collections and are adopting a more strategic approach to understanding what data are held and what are needed (NAO, 2014).

The two new regulators cost more than the FSA did. The regulators are funded from fees paid by regulated firms, and ultimately by customers of the financial services industry. Both regulators plan more judgment-based, forward-looking and proactive regulation compared to the FSA's approaches (NAO, 2014). While this approach currently costs more, these increased costs are set in the context of the potential benefits from changing regulatory approaches by more effectively reducing harm to consumers and limiting future taxpayer liabilities resulting from financial crises (NAO, 2014). The regulators' forecast combined cost of their ongoing activities in 2013-14 is £664 million-£127 million (24 per cent) higher than the 2012-13 cost of the FSA. The regulators attribute the forecast increase mainly to changed approaches, particularly additional front-line staff, and additional costs to replace information technology (IT); and to the costs of running two regulators instead of one, with new IT, support and premises costs (NAO, 2014). It is therefore probable that in the very near future, the additional regulatory costs; including appointments of 'skilled persons' may be substantial posing serious threat to the survival of the system.

5.0 CONCLUSION

These are still early days for the new regulators. There are some encouraging signs that the regulators' changing approaches are bedding down; but for the future (NAO, 20140). Both regulators undertake broadly similar regulatory functions, in pursuit of different objectives. Some firms are subject to 'dual regulation', with their conduct regulated by the FCA and prudential matters regulated by the PRA (Allen & Overy, 2013a). This requires coordination between the two regulators to ensure not only that there is no duplication, but also that there are no gaps in regulatory cover that firms are exploiting.

As independent regulators, both set rules in line with UK and EU legislation and international agreements; rules are published in a handbook (NAO, 2014). The regulators seek to use rules and their application through supervision to incentivise firms to adopt the kinds of behaviour that the regulators expect, alongside published guidance and speeches. The regulators authorise firms, supervise them to ensure they are following the rules, and take enforcement action where necessary to deal with non-compliance. Building on their work to date, they will need to link clearly resource allocation to regulatory effectiveness, and demonstrate how they will address the problem of attracting and retaining the right staff to make the more proactive approaches to regulating financial services work (NAO, 2014).

In short, regulating the consequences of financial crises might be the best option even to have a more effective prudential regulation, which eventually will help to prevent the very causes of financial crises.

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