REGULATING THE UK FINANCIAL SYSTEM POST CRISIS UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 AS AMENDED

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ABSTRACT

This research Critically evaluate the regulatory objectives as compared to the efficiency in the regulatory structure from a single regulator (the Financial Conduct Authority) to the restructure of present multiple regulators (The Bank of England, the Financial Conduct Authority, and the Prudential Regulatory Authority) overseeing and regulating the financial market.

Financial Services and Markets Act 2000: Memorandum of Understanding between the Financial Conduct Authority and the Bank of England, including the Prudential Regulation Authority March 2015 Presented to Parliament pursuant to paragraph 5 of Schedule 17A to the Financial Services and Markets Act 2000. The Act was considerably amended by the Financial Services Act 2012 and the Bank of England and Financial Services Act 2016.

This Research will answer the question would separate regulators (FCA, PRA, BANK OF ENGLAND) achieve better regulatory objectives as compared to the FSA in light of the financial crisis in the last decade and any financial crisis will be facing the UK in the future?

To achieve this the researchers divides the article into three sections the article start with Introduction to introduce the article, the second section contain the results and discussions two major sections of the main body of this research consist of Regulatory objectives and efficiency, and The main issue of contention may also shift to the debacle of transferring the single-regulator structure to a multiple-regulator restructure, with special emphasis on the global financial crisis and its repercussions. The research has a suitable conclusion at the end.

Keywords: FCA, Financial Conduct Authority, Financial Crisis, Financial Services and Markets Act, FSMA, PRA, Prudential Regulation Authority, Banking Regulation Authorities.

INTRODUCTION

The financial regulatory structure of the UK was extensively reformed during the beginning of the 21st century. At that time, the regulatory functions were integrated under the umbrella of the Financial Services Authority (FSA) as required by the Financial Services and Markets Act (FSMA). According to Morgan and Yeung, the regulatory structure thus formed had established a highly integrated functionary with regard to the intricate relationships between securities regulation and financial law. Previously, the UK financial markets and banking system were regulated with the help of various statutory frameworks and regulatory mechanisms. The instruments like the Banking Act (Morgan & Yeung, 2007) constituted the separate legal context of banking regulation. On the other hand, the financial markets and products were to be monitored and standardised with the help of the legal mechanisms established by the Financial Services Act of 1986. It also played an important role in framing the financial regulatory objectives of the modern financial markets environment as put forward by the FSMA (Rawlings et al., 2014) in a significantly detailed and specific manner.

However, the economic recession that hit the UK during 2008-2009 proved to be disastrous for the FSA and its integrated approach towards market regulation. The "*lessons*" learned from the financial crisis showed a number of weaknesses of the contemporary financial monitoring and regulatory systems worldwide, with special reference to the integrated approach (Hoshi, 2011). Prior to the global financial crisis, Georgosouli had warned that there was a need of determining the "*economic rationale*" behind the contemporary protection and regulation mechanisms with regard to the financial markets and rights of the investors (Georgosouli, 2007). If growth and deregulation are given excessive importance, then the regulatory structure may face significant problems to tackle the new challenges of the financial markets. Ultimately, UK policymakers arrived to the conclusion that the integrated approach of the FSA had proved to be inadequate and posed significant efficiency issues. Hence, majority of the functions of the FSA were transferred to the Financial Conduct Authority (FCA), which got established by the more dynamic Financial Services Act of 2012 (Rawlings et al., 2014). In the same period of time, the Prudential Regulatory Authority (PRA) was also established within the working structure of the Bank of England and was overseen by the powerful Financial Policy Committee (FPC) (Treasury, 2011). In this way, the UK policymakers now moved towards a more complex regulatory framework as the FSA (predecessor of FCA) was abolished and surveillance mechanisms were diversified.

RESULTS AND DISCUSSIONS

A critical evaluation of the regulatory objectives as compared to the efficiency in regulatory structure from a single regulator (the FSA, succeeded mainly by the FCA) to the multiple regulators (the FCA, the PRA, and the Bank of England) would involve an approach of comparative analysis. The restructure of present, multiple regulators (with almost independent working styles) can be explained as a response to the Financial Crisis of the last decade and any financial crisis will be facing the UK in the future?

Regulatory Objectives–What are they?

Regulation of financial markets is a diverse and complex area of discussion and debate. The 21st century financial regulatory system of the UK sought to clearly define the nature and scope of regulatory objectives with respect to the various stakeholders in the capital and stock markets. The framework of the FSMA was established according to one of the prime purposes of setting relevant regulatory objectives so that the regulatory structure can function better. The most important regulatory objective is all about "*market confidence*," and the regulatory structure remains tasked with the maintenance of assurance in the country's financial system. Next, the objective of harnessing "public awareness" is to be fulfilled by a well-regulated system of capital market information flows and also by educating the consumers who buy financial products or participate in the different financial market processes. The objective of the "*protection of consumers*" involves attribution of and education on the various degrees of risks and skills related with the different kinds of financial products, investments, capital market processes and/or other transactions. The final objective deals with "*reduction of financial crimes,*" according to which every business entity or person would be covered under proper surveillance mechanisms so that they may not be capable of committing financial crimes and hamper the confidence in the financial markets.

With an aim of achieving the regulatory objectives, the FSMA mandated the establishment of the FSA, which was tasked with financial surveillance and monitoring of the markets on the basis of an integrated approach. Contextually, the FSA also enjoyed a certain degree of autonomy, which provided it with the power of imparting certain flexibilities in its working methods (Ferran & Goodhart, 2001). The liberal economic framework, as favoured by UK policymakers in the 2000s, helped the FSA to seek for innovation and encourage decentralisation as per the perceived necessities of the 21st century financial markets. Modernisation now involved providing more powers to the banks and businesses which advocated for increasing self-regulation. But providing for self-regulatory mechanisms may not go well with the broader economic objectives of fiscal regulation, since a superstructure of economic surveillance is necessary even from the perspective of an integrated paradigm of regulatory structure (Booth, 2003) and (Llewellyn, 1999). Yet, as the single regulatory structure, the FSA had sufficient powers to take necessary steps for achieving the regulatory objectives of its functionality as a whole. According to Rawlings et al. (2014):

> *"In essence, the FSA determined the style and intensity of its regulation by an assessment of the risk posed to the regulatory objectives by sectors, activities, firms and individuals. Alongside this was an evidenced-based approach to the adoption of new strategies or initiatives, which, for instance, involved considering whether a market failure was most effectively addressed by new rules (Rawlings et al., 2014)"*

Further in this context, the legal powers delegated to FSA (and now FCA) included mechanisms aimed to reduce financial crime, which specially covered concerns regarding dishonesty and fraud under the relevant provisions of the FSMA.

Role of the FCA

In 2013, the FCA and the PRA took over all the regulatory functions from the FSA as per the specifications of the Financial Services Act (Financial Services Act 2013, ss. 6, 9). These organisations were now marked as the "*new regulators*" (Financial Services Act 2013, s. 6) that would regulate and monitor the financial services industries of the UK. The FCA has been formed to regulate the "*business conduct*" of about 26000 financial companies, while the PRA monitors the "*prudential behaviour*" of the different firms operating across the financial markets (Financial Conduct Authority, 2013). The FCA also plays an important role in regulating the market infrastructure of the country. It is the Listing Authority of UK for "*securities issuers raising capital on the UK markets*" (Financial Conduct Authority, 2013).

The statutory objectives of FCA can be transposed onto the regulatory objectives laid by the FSMA, with particular reference to the functional aspects of financial businesses. In this way, FCA can also be regarded as the successor of FSA. In fact, some financial markets experts like Hobbs think that FSA has been simply replaced by FCA, and any changes in the organisational purposes are not really possible. According to Hobbs:

> *"The FSA, and now the FCA, are carefully specified in statute as not acting on behalf of the Crown and their employees are not Crown servants. In effect they are Ministers' heat shield when things go wrong as the abolition of the FSA so amply demonstrates (Hobbs, 2013)."*

In functional sense, the FCA's prime regulatory objective is to detect and prevent any mistreatment of the consumers by the financial firms. For instance, the task of regulating conduct is intended to make sure that financial firm gives sufficient information about the financial product it sells (Financial Conduct Authority, 2013).

Role of the Banks

In the regulatory context of UK, policies of the different banks (those are operating in the country) are guided by the Bank of England. In order to eliminate the ambiguities around the rules of the banking sector, the Banking Act has been passed in 2009. This measure can also be regarded as consequential to the economic crisis. When credit crunch began to trouble the US housing sector, the economic disturbances soon hit the large, multinational banking systems too. By 2008, global economic recession had overwhelmed the global financial system, which affected about all of the contemporary banking corporations (Haas and Lelyveld, 2011). Modern banks not only provide for deposit accounts and savings facilities but also they sell financial products and provide insurance facilities. Both regulatory and supervisory functions are involved in monitoring the different banking processes and transactions (Singh, 2002). Further in this context and in the wake of the recent financial crisis, banking systems and transactions worldwide have come under close scrutiny. A proactive economic surveillance measure can be instituted at the policy-level in the form of an "*early intervention*" model (Singh, 2011). Yet, this kind of regulatory manoeuvre has been dubbed as aggressive intervention in the financial premise of personal properties. According to Hsiao, the provisions of the latest Banking Act 2009 are nothing but an example of "*legitimised interference (Hsiao, 2010).*"

Of late, UK has enacted the Financial Services (Banking Reform) Act 2013 which can be interpreted as an attempt of synchronising the regulatory frameworks catering with the interests of the banking operations as well as the financial markets. According to this legislative framework, the UK banks are required to work in synchronicity with the regulatory structure instituted by the Bank of England. This regulatory structure consists of the FCA and the PRA, but the banks would also comply with certain banking specific regulatory functions and objectives. These have been clearly explained as the provisions for harnessing a well-regulated market environment, which involve various functions like different payment systems, competitive practices, reviewing the markets, etc. (Financial Services (Banking Reform) Act 2013).

Role of the PRA

From the viewpoint of the financial regulatory restructure, the term prudence can be explained as how the different financial organisations would manage the market volatilities and their risks, with special reference to financial risks. *"A prudent organisation will have appropriate systems and controls to manage its risks,"* (Financial Conduct Authority, 2013) and it would also be capable of providing financial backup when an unexpected, adverse situation is encountered or significant losses are incurred. The PRA monitors and provides guidance to hundreds of financial companies in the UK to ensure that prudential qualities are maintained in the financial markets of the country.

The Prudential Regulation Authority (PRA) is a United Kingdom financial services regulatory body, formed as one of the successors to the Financial Services Authority (FSA).

The PRA would strive to meet the regulatory objectives (as laid down in the FSMA) with the help of a bifurcated approach. Two statutory aims have been ascertained as a means of benefiting the regulatory framework with regard to prudential services in the aftermath of its separation from the general context of financial services. Firstly, the PRA is engaged in promoting "*safety and soundness"* (Bailey et al., 2012) of the different kinds of businesses and organisations it regulates (ranging from banks and insurers to credit unions and investment firms). This ensures that the firms must show fiscal resilience with regard to unexpected market volatilities. PRA is thus focussed mainly on the damage that the firms can bring about to the steadiness of UK's financial system. Secondly, the PRA has developed a specific approach towards the insurers, who would now be required to expand and enforce the risk coverage of their policyholders. PRA recognises the fact that the investment strategies of the various general and/or life insurance companies may have marked effects on the financial system as a whole. It is particularly true if the scale of the assets of the insurance companies permits their investment decisions for accentuating the changes in asset prices (Bailey et al., 2012).

Can Separate Regulators Achieve better Performance?

The present surveillance framework consisting of multiple regulators is aimed at achieving better regulatory objectives. From this viewpoint, the previous framework having only one major regulator (that was the FSA) is regarded as inefficient. However, that may not be the point of debate. The main issue of contention may also shift to the debacle of transferring the single-regulator structure to a multiple-regulator restructure, with special emphasis on the global financial crisis and its repercussions.

Arguments against Multiple Regulators Framework

During the 1980s and 1990s, the UK financial system consisted of various statutory frameworks and regulatory authorities. Simplification of both the regulatory and the legal frameworks thus appeared to be necessary. On certain instances, the roles of the different financial regulators were also reviewed. For example, in R v London Stock Exchange ex p Else, the court attempted to define the limits of the powers of the stock market regulators (or exchanges) (Case Law, 1993). On several occasions, the court also attempted to define and limit or implement the powers of the contemporary investment regulators like the Securities and Investments Board (Case Law, 1995). In this way, throughout the 1990s, it became increasingly evident that the presence of multiple regulators like autonomous investment boards and powerful stock exchanges created ambiguities in the financial regulatory structure of the country. An integrated approach proved to be very suitable with the idea of simplifying the different business principles and procedures in the financial sector. In this context, "*proceduralisation*" is one of the key processes, which can help the integrated approach to mature (Baldwin, 2013). Diversifying and simplifying the regulatory working processes along with legally compatible and functional procedures further involve encouragement for "*self-reflexivity*" and "*self-learning*." (Baldwin, 2013) Hence, a single regulator based structure appears to be appropriate since the regulatory institution can be tasked with a number of procedural activities while handling the different regulatory measures along with appropriate procedural or punitive actions (if necessary). General functions of the FSA and its appropriateness for encouraging competition have proved to be viable explanations behind its establishment as a unified regulatory platform (Ferrari, 2001). This regulatory structure, therefore, added emphasis to procedural justice along with balancing of monitoring powers.

By the mid-2000s, UK's FSA had emerged as one of the most powerful and largest financial regulatory bodies of Europe. Instead of emphasising the importance of different monitoring techniques, the FSA started to pay attention to the procedural outcomes for fulfilling its regulatory objectives. Furthermore, the FSA believed in *"leaving more of the judgement calls on how to achieve those outcomes to the senior management of firms."* (Financial Services Act, 2007) So, the integrated approach of financial regulation practically encouraged autonomy of businesses. It provided for flexibilities in procedural arrangement, although the overall structure of the regulatory system remained very rigid. The FSMA framework delegated different powers to the FSA without actually delimiting the scope of the financial markets. Hence, at a policy-level, the legislative framework continued to support the free market ideology and neo-liberal paradigm of trade and commerce. Nevertheless, the framework provided for *"a critique of the effectiveness of the existing regulatory structure,"* which translated into the FSA's diverse monitoring and procedural functions aimed at meeting its regulatory objectives (Rawlings et al., 2014). Instead of having multiple regulators with overlapping functionalities, establishment of a unitary platform can also prove to be beneficial in organisational terms.

Even when economic recession struck the international financial system at a global scale, the EU framework of regional financial regulation did not radically change its approach. Instead of criticising an integrated approach towards financial markets regulation, the EU policymakers held that the contemporary regulatory structures (in different EU Member States including UK) were still capable of ensuring consumer protection, functional transparency, and market efficacy (Kluwer, 2008). Hence, a reformative approach can also be deemed as necessary if a single-regulator surveillance structure falters. Contextually, the FSA required utilising the available resources in an economic and efficient way. The FSA also had the authority to watch the managers of different financial businesses and ensure their responsible behaviour. The integrated framework, under the guidance of the FSA, attempted to ensure that the burdens of compliance for the financial firms might not become disproportionate with respect to the benefits along with a greater emphasis on *"mitigation of any adverse effect on competition."* (Rawlings et al., 2014) Effectively, the integrated framework of financial regulation and the working of FSA have proved to be beneficial for international coordination of the UK's fiscal economy. It also ensured functional credibility with reference to overseeing and monitoring the financial markets.

Arguments in Favor of the Present Restructure

One of the main objectives of the modern financial regulatory system is to ensure accountability and fairness. This kind of theoretical approach has been developed largely for avoiding financial mismanagement and criminal activities. Yet, from the very beginning of the financial reforms (as stipulated by the FSMA), experts like Lomnicka stressed the importance of developing FSA into an accountable organisation that would adopt a principled methodology and practice procedural transparency (Lomnicka, 2000). However, by the year 2007, the FSA was moving away from the statutory rules and regulatory principles. Instead, the organisation was now adopting a *"principles-based approach with the aim of creating a cooperative relationship,"* where the financial companies would be enlisted into a paradigm of self-regulation (Rawlings et al., 2014).

Before the financial crisis took place, the single-regulatory framework of the UK appeared to be quite successful in terms of ensuring integrity and encouraging self-regulation. But attempts to move towards the creation of flexible and self-regulated financial markets proved to be controversial since protection of investors was not taken care of (Georgosouli, 2007). All during the financial crisis, the FSA failed to manage a number of issues regarding bankruptcy, insolvency, and credit crunch. Hence, the UK lawmakers had to pass the FSMA, which led to the formation of a diversified, flexible, and well-coordinated system of three regulatory organisations consisting of the FCA, the PRA, and the banking sector regulators (with increased emphasis on the Bank of England). They replaced the FSA and its minor partners like the Bank of England and Treasury (Valitov and Nigmetzyanov, 2014). Previously, the FSA was most powerful in regulatory matters. But now, the Financial Policy Committee (FPC) has been formed within the Bank of England, which oversees the agencies like the PRA and works in close coordination with the FCA (Valitov and Nigmetzyanov, 2014). According to Fisher:

> *"The PRA and FCA arrangement is an example of the modern 'twin peaks' model for financial regulation, pioneered in Australia in 1998, which separates out the prudential regulator–which covers the larger, more systemic firms–from the conduct regulator (Fisher, 2015) "*

The advantage of having separate regulators is that they can concentrate more on their respective socialist areas. In UK, PRA acts as the prudential regulator and FCA acts as the conduct regulator. PRA is tasked with monitoring the different credit unions, housing boards, etc. and reporting directly to FPC. On the other hand, FCA handles the matters of large industrial firms and financial companies. So, the system of FCA and PRA coordination benefits from division of functional areas and availability of specialist manpower accordingly (Treasury, 2011).

Another advantage of having multiple-regulators restructure involves the way of working of the FCA. By allowing self-regulation and providing autonomy to the financial companies, FSA used to implement a preventive regulatory paradigm. However, the FCA follows an interventionist model that would allow it to handle almost every macro-prudential issue in a proactive manner. The FCA can decide upon how to set statutory aims to meet its greater regulatory objectives, while the PRA can manage the less intense micro-prudential issues. Although the frameworks of erstwhile FSA and today's FCA do not significantly contradict on procedural issues, FCA's functional power is greater than that of the FSA. Along with the PRA and the higher authorities of the Bank of England, FCA can indeed emerge as a strong financial regulator within the more dynamic restructure (Valitov and Nigmetzyanov, 2014).

CONCLUSION

A critical evaluation of the regulatory objectives relative to the efficiency in the different regulatory structures reveals that the various regulatory structures have diverse advantages and drawbacks. In the case of UK, two kinds of regulatory structures can be analysed: Single-regulator structure and multiple-regulators structure. In the wake of globalisation, the single-regulatory framework of FSA consistently oversaw the increasing international coordination of UK's financial markets. It also allowed a certain degree of autonomy for the firms so that self-regulation could be encouraged. Nevertheless, practical monitoring techniques of the FSA proved to be inadequate. Possibly, the highly diversified working methodology of FSA did not allow it to be sufficiently prepared for the economic recession of 2008-2009. FSA has now been replaced by the FCA, the PRA, and the banking regulation authorities. Nevertheless, the overall regulatory objectives of the regulatory system of UK have not changed.

On the other hand, the new framework of multiple regulators has not yet been tested in difficult times. Although differentiation between prudent behaviour and general conduct is an innovative move, there is a need to allow for more flexibility. Besides, there are a number of areas where the functions of FCA and PRA are overlapping. Yet, separation of responsibilities will simplify the operational burdens. Workload on the individual regulatory bodies will be controlled since duties and powers have now been distributed. Moreover, the Bank of England is now participating more actively to look after banking regulations and operational mechanisms. New statutory objectives have also been designed for FCA and PRA, which are aimed at simplifying the short-term goals of these regulators. Finally, it can be concluded that the new multiple-regulators framework should be given more time to mature. Since the new restructure still adheres to the regulatory objectives as defined by the FSMA framework, the policymakers have now more chances to emphasise on the efficiency issues.

ACKNOWLEDGMENT

The authors would like to thanks Applied Science Private University–Amman, Jordan/Alfalah University–Dubai, UAE. For its supports of this research.

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