THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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Your ref:

Reforming Financial Markets consultation process
Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

By email: banking.reform@hm-treasury.gov.uk

Dear Sir or Madam

HM Treasury Reforming Financial Markets

The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the consultation paper *Reforming Financial Markets* published by HM Treasury in July 2009.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

PRIMARY LEGISLATION PROPOSALS – Annex A

Formalising and strengthening the arrangements for institutional cooperation

There are benefits in formalising the arrangements in this way, although this clearly does not guarantee success in safeguarding financial stability. It is critical that the new body acts so as to avoid duplication between the three parties involved, while ensuring that micro-prudential and macro-prudential issues are tackled in a way that helps foster financial stability. Within this, transparency has an important role to play as a discipline over the effectiveness of the new framework.

We nevertheless presume that name-specific disclosure (eg, of firms in trouble) is not the intention, since it brings with it risks, as is recognised in paragraph 4.13 of the paper. In addition publication of particular policy options can sometimes be destabilising eg, ahead of negotiations in international fora.

If neither is to be done, there is a question as to how useful or informative the minutes of these meetings will be. Whilst the Bank of England and FSA already produces some very interesting and prescient material, the more fundamental problem is that too little of it is read by practitioners.

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Strengthening the governance arrangements and statutory framework of the FSA

We accept that the achievement of this objective inevitably involves regulator, central bank, and finance ministry. That said there is potentially a risk of confusion if the FSA and Bank of England have overlapping statutory objectives, particularly if it is unclear exactly what ‘financial stability’ is, or what tools exist to safeguard it. Unless these points are resolved there will be a lack of accountability.

We support the idea that the FSA should take into account wider economic costs in its decision-making, while noting that it is already the case that acting to safeguard financial stability both helps to foster market confidence and to protect consumers. Similarly we believe that the FSA already strives to promote sound international regulation and supervision, although we can see a case for amending the Principles to which the FSA should have regard, to make this more explicit.

Enhancing the FSA’s powers

In general the proposed changes appear sensible, although it is not always entirely clear to us that all of these powers are currently lacking.

It will also be important for some safeguards to be in place – eg, for individuals that are suspended before an investigation is complete, or those who are asked by their firm to carry out a controlled function, but for whom the necessary processes are not followed.

We welcome the fact that action on short-selling will be separated from powers relating to market abuse, if the reason for the former relates instead to the wish to maintain orderly markets.

Expanding the role of the FSCS

We support this proposal. We also support the proposals (in annex B) to make the FSCS a single point of contact for depositors seeking compensation.

Other issues (Q15-26)

We have not responded to these questions.

AREAS FOR DISCUSSION – Annex B

Managing systemically significant firms

We see the case for linking capital requirements to the systemic significance of a firm, to take account both of the likelihood and the impact of a firm’s failure. Nevertheless it will be technically difficult to calibrate these effects accurately, and it is essential that implementation should be on a global basis.

There does, however, need to be clarity within the official sector as to which firms will be subject to this regime, perhaps through an adjustment to their Pillar 2 capital charge. As such, if there is to be a linkage with capital, we believe that a sliding scale – based on complexity and interconnectedness as well as size – would be better than a fixed surcharge. We would also warn against an overly complex approach, unless one is supported unambiguously by analysis and historical evidence.

We do not therefore see a role for a public list of such firms, which would exacerbate moral hazard, create rather than reduce the scope for panic, and mislead. On some occasions, when the market is fragile, a small institution will be rescued by the authorities: on others, a larger one will be allowed to fail. Such state-dependency is very difficult to communicate effectively.

We also agree that systemically significant firms – including service providers such as clearing houses - should keep a ‘war book’ of intra-group transactions and dependencies (eg, in the form of IT or staff), to help either the firm itself, or someone charged with unwinding its operations, to do so as smoothly as possible.

Access to simple, transparent products

We see some issues in labelling, if a green light was to be misinterpreted as regulatory approval for a product, with the risk of litigation that this might entail. Money Guidance and an appropriate range of independent financial advisers, as envisaged in the Retail Distribution Review, might be a better way of addressing the issue.

Other issues (Qs 5-11; 18-32)

We have not responded to these questions.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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