

## Introduction

### Conference on the UK's Financial Services Authority

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In recent months, there have been several reports suggesting that excessive regulation and litigation are impairing the ability of the United States to compete with other financial centers. The competitive financial center most often cited was London, and much of London's success in attracting financial activity from the United States has been attributed—probably too simplistically—to the relatively light regulatory hand of the Financial Services Authority. In today's conference, we will look at how the FSA actually functions, and probe the real differences between its regulatory focus and that of U.S. regulatory agencies.

We in the United States frequently boast that we are the home of entrepreneurship and economic freedom—that we welcome the “animal spirits” that energize capitalism. Well, maybe that's true in other areas of our economy, but as we will see in the course of today's discussion, when compared with other countries, we devote more resources per capita to the regulation of financial services—and we expect a greater range of protection from our regulators—than many other developed countries, the United Kingdom in particular.

The FSA is a single agency that regulates banks, insurance companies and securities firms. One of the reasons for regulating all three members of the financial services industry in the same agency is that they compete with one another, and it makes little sense to have three competing industries all regulated in different ways. So one reason we might admire the structure of the FSA is that it eliminates the problem of differential regulation among three competing industries.

However, as many will note, the scope of regulation in the United States is quite different for each of the members of the financial services industry. For the most part, banking regulation is oriented toward safety and soundness, the prevention of systemic risk, and the protection of the deposit insurance funds. Securities regulation, on the other hand, is primarily focused on consumer protection, with little overt concern—except insofar as it becomes a consumer protection issue—about safety and soundness. Insurance regulation is somewhere in the middle.

Is there a way to reconcile these different approaches?

The FSA structure addresses this problem by dividing its structure along functional lines—not by industry, but by the kind of regulation that is required. Accordingly, if there were to be a similar consolidated structure in the United States, the

agency would have a division that is concerned with safety and soundness, and another division that is concerned with consumer protection—in both cases for all three industries.

A second major difference is the enforcement orientation of regulation in the United States, particularly at the SEC. The FSA's approach for all the industries it regulates is much closer to the way banking agencies in the United States deal with banks; it is prudentially-oriented, with a bias in favor of guidance and quiet resolution of compliance issues, rather than a public charge and eventual litigation.

This is not only a cultural difference that would be difficult to bridge; there is also a question whether these staff-intensive procedures could be followed by a U.S. agency that is trying to regulate roughly 10,000 banks, 10,000 investment advisers, 6,000 securities firms and 660,000 registered securities sales personnel.

Another major difference between the FSA and the U.S. regulatory structure is the focus on consumer protection. Although consumer protection is one of the objectives of the FSA, it does not seem to assume the same priority for the FSA that it has for the U.S. regulators. The enormous controversy associated with the Comptroller of the Currency's attempt to pre-empt state consumer protection laws under certain circumstances—partially to protect the safety and soundness of national banks—demonstrates how important this issue is in the United States and how difficult it would be to reconcile these differing objectives within the same agency.

This raises an interesting question. Many of the issues that have been cited as reasons why foreign companies are reluctant to enter our markets are consumer protection issues, including the Sarbanes-Oxley Act, the aggressive enforcement approach of the SEC, and the risk of becoming a defendant in a costly private class action. If these turn out to be serious obstacles to the participation of the United States in the global securities market that is now developing, we might anticipate a serious clash in the future between the consumer protection culture in the United States and a demand from the rest of the world for less regulation as a condition of entering our markets. It seems likely to me that this important issue, if it arises, will not be resolved through a substantive change in regulatory policy. Rather, it will be resolved through a change in regulatory structure, with an explicit or implicit understanding that the new regulator must consider the competitiveness of the U.S. financial services market when making regulations.

That leads into another difference between FSA and the U.S. regulatory structure. At one point in the not-so-distant past, regulatory agencies were charged with promoting the industries they were responsible for regulating. The Federal Home Loan Bank Board, which regulated savings and loan associations, had exactly this statutory mandate. When the S&Ls collapsed, with huge losses for the taxpayers, one of the lessons drawn from the episode was that regulatory agencies should not have any responsibility for promoting the industries they regulate, except for maintaining the safety and soundness of the constituent institutions.

It is noteworthy that the FSA has a specific regulatory goal—not to promote the regulated industries, but rather to maintain London as a leading financial center. It's difficult to see how this is different from promoting the financial services industry, but if in the future the competitiveness of the U.S. market becomes a dominant issue, Congress could well authorize one or more U.S. regulators to consider the effect of their regulations on the competitiveness of the United States in the global financial services economy. In that case, it will become important to understand how the FSA implements this mandate.

Finally, Howell Jackson raises a point in his paper that he doesn't resolve but which is certainly worth thinking about. The differences in resources devoted to regulation of the financial services industries in the United States, and those devoted to similar regulation in the UK and elsewhere, are so striking that it begs the question which of these jurisdictions has got it right. There is probably an optimal point for regulation—a point where its tendency to promote confidence among market participants is in balance with its tendency to drive away those who would be regulated. If that's true, either we or they are following sub-optimal policies.

One way to look at the migration of financial transactions away from the United States is that the market is telling us something—principally that the overall benefits of regulation in the United States are no longer equal to the costs. If so, this provides a practical way to judge whether a country's regulatory system is too lax or too heavy-handed, and the migration of financial transactions from the United States to the United Kingdom suggests that it is the United States that has the sub-optimal system.

If this idea takes hold, it will also be important to understand how the FSA does its work, and that is the purpose of this conference.