A muzzled watchdog?

WELL-CONSIDERED PROPOSALS ON THE FUTURE OF UK BANKING SUPERVISION COULD BE UNDERMINED IF A UNIFORM REGULATORY SYSTEM IS IMPOSED ACROSS EUROPE. **GRAHAM BUCK** REPORTS.

The future of UK bank supervision has been a topic regularly in the headlines this summer. Recent reports suggest that the proposed new UK regulatory system could be scuppered by the European Commission's plans to impose a uniform regulatory system across all EU member states.

The UK government is currently on course to replace the financial sector watchdog, the Financial Services Authority (FSA), in 2012 with two new regulatory bodies: the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The FSA's chief executive, Hector Sants, will move from his current role to head up the PRA, which will be overseen by the Bank of England.

The Bank and the FSA have launched a series of initiatives to outline to the City how the PRA will operate – presentations "from the regulator to the regulated" in the words of the ACT's policy and technical director John Grout.

The PRA's manifesto, Our Approach to Banking Supervision, outlines the principles underlying its forward-looking, judgement-led approach to supervision. The manifesto was launched on 19 May, when presentations were made by Sants, the Bank's chief cashier Andrew Bailey, who will become his deputy at the PRA, and its deputy governor for financial stability, Paul Tucker. The ACT was represented by Grout. The FSA will host more events this summer to explain future supervision of the insurance market and the role of the FCA. The FCA's basic function will be to address the overall stability of the UK economy, while the PRA will focus on the stability of individual institutions. The manifesto notes that the PRA will need to take account of the FCA's objectives and the methods it adopts to help achieve them.

Grout says the launch was impressive in indicating a much greater level of "joined-up thinking" on regulation than has been evident in the past. It also demonstrated the keenness of the UK's regulators to apply more stringent requirements for banks than those likely to be applied by the European banking regulator.

"The PRA will want to make changes to the capital and prudential requirements imposed on banks to stabilise the economy," he says. "However, at this stage it is still unclear whether it will have the authority to do so."

This uncertainty is acknowledged in the PRA's manifesto, which can be accessed and read in full on both the Bank and FSA websites (see end of article). Towards the end of the document, section 97 notes: "In Europe, there is a clear move towards establishing completely harmonised prudential standards. This is taking place through the implementation of regulatory standards as legally binding European-wide regulations and the increased use of maximum harmonisation of directives. In addition, the European Supervisory Authorities (ESAs) – including the European Banking Authority (EBA) – have the power to set a single European rulebook and binding technical standards, which national supervisors will have to enforce, and to mediate in cross-border disputes."

Sants and his colleagues have more recently voiced concerns that while any move to standardise the rules across Europe would prevent national regulators from falling short of them it also means that stricter rules cannot be introduced. Therefore, the PRA's powers would effectively be limited to policing European fixed standards.

Grout notes that the "maximum harmonisation" referred to in the manifesto would mean any new Europe-wide regime introduced at local community level would impose the new requirements in full, with no leeway possible. "Minimum harmonisation" would involve compliance only with the most basic requirements and enable individual countries to implement more regulation than others.

"The upshot is that the UK is seeking to reregulate when there is still a degree of darkness as to what can be done – and whether minimum regulation or maximum regulation will apply," Grout says. "The role of national regulators may be in deciding what local measures need to be taken; alternatively they may decide what needs to be done at national level. It's a debate that has not yet been decided at governmental level and it could restrict the PRA's ability to regulate UK institutions.

"So we don't yet have the full picture. What we have been offered so far in the PRA manifesto looks very promising. The next stage will be crucial."

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The PRA manifesto is at http://bit.ly/jFO2LR