The new world

The future shape of the financial sector is being re-defined as we speak, with proposals from the April G20 meeting in London, the EU's Larosière report and the Turner Review from the Financial Services Authority (FSA) all mapping out necessary changes after the meltdown of last year. **Angela Knight**, chief executive of the British Bankers' Association (BBA) responds

There is a growing realisation that as we confront ongoing financial and economic turmoil, our industry and the authorities must work together as never before. And this means globally; the international nature of the challenges demands co-ordinated action. Regional or national responses alone could undermine the benefits of international trade and the spark of protectionism needs no further fanning. An international industry must operate in a framework where regulators and policymakers co-operate globally.

At the time of going to press, the April G20 meeting of government leaders in London, has dominated discussions about expected international co-operation thus far, but a good deal of work has already been undertaken by the EU and other existing international institutions. More opaque but of equal importance, serious discussion recently got underway in the European Council about their report into financial supervision across Europe, authored by the French banker Jacques de Larosière (see news page five for more). The impetus for a change in legislation in Europe is unstoppable, which is why engaging now in every direction and in every respect to achieve the right de Larosière result is essential. Otherwise we will see a gravitation of power towards the eurozone and a consequent marginalisation of the UK.

Meanwhile, the FSA is talking tough about the future of financial regulation in the UK. In a well-received speech on 12 March (I was in the audience and I clapped along with the rest of them) the chief executive Hector Sants referenced the coming Turner report, and perhaps gave an indication of the UK regulators' thoughts when he announced a bold step forward, shifting the watchdog from the previous light touch 'principles-based' approach towards 'outcomes-focused' regulation, which could perhaps have foreseen the systemic risks of excessive leverage. As I see it, Sants has confirmed there is a place for principles-based regulation but he is taking it another way: not moving towards prescriptive rules but towards what really matters – judging firms on their outcomes.

I have long thought that the FSA was too concerned with the execution of rules – looking at firms in a compartmentalised way rather than across the broad sweep of their business. Now he is saying that the FSA is going to supervise the businesses, looking at their decision making processes and the outcomes of the choices they make. This also means ensuring the non-executive directors are up to the task of questioning and criticising business strategy, including the controversial issue of pay, which when you are talking about an internationally-active bank, means finding and resourcing some exceptional individuals. This can only be right.

The 129-page Turner report, itself setting out the future of UK financial regulation, was published on 18 March and is commendably well organised. Key points to note include a counter-cyclical policy where banks hoard money in good times so that they have higher capital ratios for bad times and, crucially, stronger guidance as to the suitability of business models and products (hopefully negating any more Northern Rocks or 'novel' securitisation instruments). The report's recommendations also include enhanced protection for consumers against bank failure and more support for the risk management function by increasing its independence and integrating risk matters into remuneration packages. Other proposals cover standardised accounting, an overhaul of 'shadow banking' with increased scrutiny of hedge funds, and confirmation that there is to be no separation of retail and investment banking arms. Board-based banking is to continue to be allowed, which is good news as it will be an important support to the economy moving forward.

Detailed discussions will, of course, follow the Turner report and it is vital that we ensure the new framework is appropriate for small banks, as well as larger institutions, and that the UK retains its attractiveness for foreign banks. The key to getting it right is to ensure the optimum interaction of capital, liquidity and managing risk effectively. As the FSA is the first to admit, a lot of these proposals are also subject to the international agenda. Some of the key financial stability proposals of Turner, for instance, will need to be on the agenda of international bodies, particularly those covering capital adequacy, accounting and the need for clearing and central counterparty systems in the credit default swaps space.

As Lord Turner himself, the chairman of the FSA, said: "The changes recommended are profound. The banking system of the future will be very different from that of the last decade." So prepare for change. Now is the time for all involved – the banks, the regulators, central bankers and governments – to work together to restore confidence in the industry and the financial system and so provide the impetus for economic recovery.