



## UK White Paper on Reforming Financial Markets

On 8<sup>th</sup> July 2009 the HM Treasury (“UK Treasury”) published its long-awaited White Paper titled “Reforming Financial Markets” (the “White Paper”).<sup>1</sup>

The White Paper is part of a comprehensive review by the UK government (“Govt.”) of UK financial regulation and supervision, which has been ongoing since the outbreak of the global financial crisis in 2007 and the ensuing turmoil in the UK financial markets.

As such, it provides the Govt.’s formal response to the proposed actions recommended in the “Turner Review: A regulatory response to the global banking crisis” (18<sup>th</sup> March 2009) (the “Turner Review”),<sup>2</sup> which set out in-depth analyses of the causes of the financial crisis and identified a number of key areas requiring regulatory reform.

Some reforms have already been implemented, notably the special resolution regime and new bank insolvency procedures under the Banking Act 2009, which empower the “Tripartite Authorities,” consisting of the Financial Services Authority (“FSA”), the UK Treasury and the Bank of England (“BOE”), to deal with failing banks more effectively.<sup>3</sup>

Building on the recommendations of the Turner Review, the White Paper proposes extensive reforms to UK banking regulation in order to strengthen the UK banking and financial sector and to enable it to better withstand future financial shocks.

### The Govt.’s Firm Policy Proposals for New Primary Legislation

Specifically, the White Paper proposes the following key reforms to be implemented by new legislation:

#### 1. Reforming regulatory institutions

- Formalising and strengthening the arrangements for institutional cooperation

In the autumn of 2009 new legislation will be introduced to create a new Council for Financial Stability (“CFS”) comprised of the Tripartite Authorities and chaired by the Chancellor. The CFS will meet regularly to assess, and to formulate and implement policy responses to, systemic risk and intervene if financial stability is threatened.

<sup>1</sup> HM Treasury White Paper: “Reforming Financial Markets” (8<sup>th</sup> July 2009), [http://www.hm-treasury.gov.uk/d/reforming\\_financial\\_markets080709.pdf](http://www.hm-treasury.gov.uk/d/reforming_financial_markets080709.pdf).

<sup>2</sup> Turner Review: A regulatory response to the global banking crisis (18<sup>th</sup> March 2009), [http://www.fsa.gov.uk/pubs/other/turner\\_review.pdf](http://www.fsa.gov.uk/pubs/other/turner_review.pdf). See also FSA Discussion Paper (DP09/2): A regulatory response to the global banking crisis (18<sup>th</sup> March 2009), [http://www.fsa.gov.uk/pubs/discussion/dp09\\_02.pdf](http://www.fsa.gov.uk/pubs/discussion/dp09_02.pdf).

<sup>3</sup> See, e.g., Morrison & Foerster client bulletin: “Update on the UK Government’s Banking Support Measures and the Banking Act 2009” (30<sup>th</sup> March 2009), <http://www.mofo.com/news/updates/files/090330UKBank.pdf>.

- Strengthening the FSA's governance arrangements and statutory framework

From the autumn of 2009, the FSA will be charged with statutory responsibility for financial stability (a potential conflict with the BOE's remit). Among other things, it will underline the need for the FSA's regulatory and supervisory approach to be more focused on systemic risk (including, e.g., the consequences of a "high impact" firm's failure).

- Enhancing the FSA's powers

The FSA should be granted greater rule-making, information-gathering and enforcement powers (e.g., suspension or penalisation of individuals or firms) in order to address not only market or consumer risks but also systemic risk. The Financial Services and Markets Act 2000 ("FSMA") will be amended to give the FSA continuing power to impose emergency short-selling restrictions.

- Expanding the role of the Financial Services Compensation Scheme ("FSCS")

The FSCS should continue to be funded by the financial services industry. In this respect, however, the White Paper envisages that it would be better to have some pre-funding and the Govt. will introduce a level of pre-funding in the future (although not before 2012). The FSMA may be amended to expand the FSCS's role and enable it to operate more effectively when acting as the UK single point of contact for deposit guarantee schemes ("DGSs") in other EEA countries or as UK agent for DGSs or other arrangements in other (EEA or non-EEA) countries providing for compensation to be paid to UK customers.

## **2. Competitive markets that work for consumers**

- Financial capability and money guidance

There should be better consumer education to enable informed and responsible investment decisions. To this end, a new, publicly funded "national money guidance service" will be rolled out in spring 2010.

- Strengthening the FSA's consumer capability

The FSMA will be amended to require the FSA to establish and operate an independent consumer and information authority.

- Swift and effective redress

The FSA's 'backstop powers' will be updated to enable delivery of collective redress for consumer complaints where voluntary redress by the firm concerned is not possible. In addition, a mechanism may be introduced for collective legal action by consumers.

### **Other Potential Reforms for Wider Discussion**

In addition to the 'firm policy proposals,' the White Paper suggests a number of other potential reforms for wider discussion and public consultation, prior to formulating firm policy proposals. Those other reforms cover the following areas:

#### **1. Managing systemically significant firms**

The FSA should be given powers to regulate "systemically significant" financial institutions more strictly and require more stringent capital and liquidity requirements. Such firms will be required to prepare detailed contingency plans for their own failure.

## 2. Competitive markets that work for consumers

Reforms are proposed in such areas as (i) barriers to entry and encouraging new entrants to the retail banking market, (ii) access to simple, transparent products and improvements in mortgage insurance, (iii) FSCS governance and accountability and (iv) strengthening crisis management and depositor protection across the EU.

## 3. Strengthening mutuals

Building society governance should be improved, as well as the disclosure provided by industrial and provident societies to their members.

Market participants are invited to provide their comments and feedback on the White Paper by 30<sup>th</sup> September 2009, following which the Govt. intends to conduct more detailed consultations on selected areas of reform through the end of this year.

Initial reaction to the White Paper has been somewhat muted. Although it contains a number of specific proposals as set out above, many important issues remain subject to discussion. This is understandable in areas such as bank capital requirements which will need to be aligned to changes to the Basel II framework and the EU Capital Requirements Directive. Despite the introduction of the CFS, however, there is little change to the tripartite arrangements between the FSA, the BOE and the UK Treasury which have come in for criticism during the financial crisis. A number of the issues raised in the Turner Review therefore remain unresolved and will continue to be debated through, and in many cases probably beyond, the White Paper consultation process.

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We will continue to monitor further developments and provide updates on the implications of the evolving UK regulatory framework for international banks and other financial institutions.

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