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A LONG-TERM VIEW OF FINANCIAL REGULATION

Fundamental flaws in the UK's system of financial regulation were exposed by the 2007-09 financial crisis, and the government has embarked on radical reforms to the current regime. The Financial Services Bill, scheduled to reach the statute book by the end of this year, will implement a new structure. This is based around the establishment of the Financial Policy Committee (FPC) within the Bank of England to monitor and respond to systemic risks, and the creation of two new regulators in the form of the Prudential Regulation Authority (PRA) to oversee the day-to-day supervision of financial institutions, and the Financial Conduct Authority (FCA) to take responsibility for monitoring the conduct of business.

Other initiatives have surfaced over the past few months. In June the Business Secretary, Vince Cable, announced a package of corporate governance measures designed to tackle the city bonus culture which are scheduled to be implemented by October 2013. Also issued in June, a white paper, *Banking reform: delivering stability and supporting a sustainable authority*, Cm 8356, set out the government's plans for implementing the recommendations of the Independent Commission on Banking which, among other measures, will entail ring-fencing retail and investment banking.

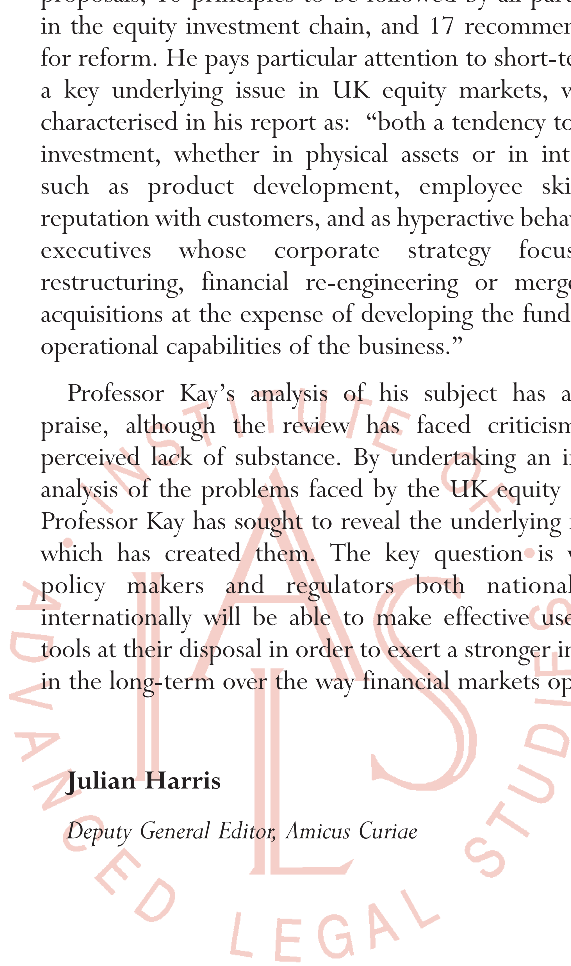
This was followed in July by a Treasury consultation, *Sanctions for the directors of failed banks*, which contained plans to strengthen the accountability of bank directors by amending the Financial Services and Markets Act 2000 (FSMA) to introduce a rebuttable presumption that a director of a failed bank is not suitable to be approved by a regulator to hold a similar future position. To back this up, consideration is being given to the introduction of criminal sanctions for a new offence of serious misconduct in the management of a bank. August saw the arrival of another consultation, *Financial sector resolution: broadening the regime*, Cm8419, which addressed the issue of how to deal with the risks posed by the failure of systemically important organisations other than banks.

All those involved with the reform of financial services regulation are aware that although the accountability of those in senior positions can be influenced by legislative intervention, there needs to be a change in long-term thinking within the financial markets to avoid a repeat of mistakes made in the recent past. Professor John Kay was asked by the Department for Business, Enterprise and Skills (BIS) to address this and other issues by examining the effect of the UK equity markets on the competitiveness of UK business, and his final review, *UK equity markets and long-term decision-making*, appeared on July 23.

The terms of reference for the review were wide, and its proposals reflect this. They concentrate on restoring relationships of trust and confidence in the investment chain, and establishing high level statements of good practice for its key players such as asset holders, asset managers and company directors. The quality of engagement by investors with companies needs to be improved, emphasising and broadening the existing concept of stewardship. "Misaligned incentives" in the remuneration practices of company executives and asset managers need to be tackled, along with the pressures for short-term decision making that arise from excessively frequent reporting of financial and investment performance (including quarterly reporting by companies), and from an over-reliance on particular metrics and models for measuring performance, assessing risk and valuing assets.

Professor Kay presents his findings in the form of proposals, 10 principles to be followed by all participants in the equity investment chain, and 17 recommendations for reform. He pays particular attention to short-termism, a key underlying issue in UK equity markets, which is characterised in his report as: "both a tendency to under-investment, whether in physical assets or in intangibles such as product development, employee skills and reputation with customers, and as hyperactive behaviour by executives whose corporate strategy focuses on restructuring, financial re-engineering or mergers and acquisitions at the expense of developing the fundamental operational capabilities of the business."

Professor Kay's analysis of his subject has attracted praise, although the review has faced criticism for a perceived lack of substance. By undertaking an in-depth analysis of the problems faced by the UK equity markets Professor Kay has sought to reveal the underlying mindset which has created them. The key question is whether policy makers and regulators both nationally and internationally will be able to make effective use of the tools at their disposal in order to exert a stronger influence in the long-term over the way financial markets operate.



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Long term financing means financing by loan or borrowing for a term of more than one year by way of issuing equity shares, by the form of debt financing, by long term loans, leases or bonds and it is done for usually big projects financing and expansion of company and such long term financing is generally of high amount. The fundamental principle of long term finances is to finance the strategic capital projects of the company or to expand the business operations of the company.Â Limitations of Long Term Financing. Strict regulations laid down by the regulators for repayment of interest and principal amount. High gearing on the company which may affect the valuations and future fundraising.Â Monitoring the financial covenants in the term sheet is very difficult. International Financial Reporting Standards, tax regulations and stock exchange regulations â€“ all of which aided investors and helped to place Asia-Pacific markets on a level playing field with the US and Europe â€“ were viewed as the most helpful rules in creating shareholder value. Interestingly, even Sarbox, widely regarded in the West as the epitome of knee-jerk over-reaction to a crisis, was found to be helpful by over half of respondents in the south east Asia region.Â Such short-term political loss of nerve can only damage the prospects of global accounting standards at a cost of long-term damage to business and does not bode well for wider financial regulation. Establish Comprehensive Regulation of Financial Markets. III. Protect Consumers and Investors from Financial Abuse.Â Taking access to short-term credit for granted, firms did not plan for the potential demands on their liquidity during a crisis. When asset prices started to fall and market liquidity froze, firms were forced to pull back from lending, limiting credit for households and businesses.Â The current financial crisis occurred after a long and remarkable period of growth and innovation in our financial markets. New financial instruments allowed credit risks to be spread widely, enabling investors to diversify their portfolios in new ways and enabling banks to shed exposures that had once stayed on their balance sheets. However financial regulation is more than just having rules in place â€“ itâ€™s also about the ongoing oversight and enforcement of these rules. The Central Bank of Ireland regulates and supervises over 10,000 financial service providers operating in Ireland. Since 2014, the responsibility for supervising banks is shared between the Central Bank of Ireland and the European Central Bank (ECB).Â Poorly regulated financial institutions have the potential to undermine the stability of the financial system, harm consumers and can damage the prospects for the economy. Thatâ€™s why strong financial regulation is important â€“ to put rules in place to stop things from going wrong, and to safeguard the wider financial system and protect consumers if they do go wrong. Housing finance implicates nearly all aspects of financial regulation. Prudential regulation of banks and specialised savings institutions can create incentives for them to make and keep, or sell, housing loans, and can affect their willingness to restructure distressed assets.Â While Reg NMS did seek to improve market competition and automation, and did seek to protect investor orders, the Order Protection Rule component of Reg NMS has led to serious unintended consequences, as was predicted before its passage. Some observers (e.g., Oâ€™Hara, 2004) have noted that Regulation NMS does not account for the diverse needs of different types of traders and has led to a deterioration of liquidity.