FOCUS ON

FINANCIAL SERVICES REGULATION

Julian Korek, chief executive officer at Kinetic Partners, discusses the regulatory changes expected in 2015

Julian Korek, CEO and founding partner at Kinetic Partners (a division of Duff & Phelps), has more than 25 years' experience in the asset management industry. Prior to co-founding Kinetic Partners, Korek was partner in charge of the London office of RSM Robson Rhodes.

If the financial services industry has not grown to love regulation, it is starting to accept it, according to Kinetic Partners' Global Regulatory Outlook (GRO) 2015. The report includes survey responses collected from nearly 300 financial services professionals from around the world asking about the industry's expectation of the key regulatory developments impacting business through 2015 and beyond.

INDUSTRY REACTION TO REGULATION

Following the significant regulatory changes in recent years, 2015 will likely be characterised by how firms address the challenges of newly implemented requirements. The survey findings from GRO 2015 show increasing acceptance of the role of recently introduced regulation. More than one-third (39%) of senior executives (and 38% of non-executives) now say regulation is promoting stability in the financial services world. This figure still represents a minority, but it is up from 30% last year and just 19% two years ago. The proportion of survey participants believing that regulations have little or no impact has shrunk over the same period, from almost two-thirds (63%) to under half – at 48% – today.

This softening in attitudes reflects a number of factors, two of which particularly stand out. First, there has been growing confidence in the industry, despite recent market wobbles. The majority of the big US banks have reported strong third quarter profits (Emily Stephenson and Susan Heavey: "US bank earnings rise to $38.7bn in third quarter 2014 –FDIC," Reuters). In the UK, despite some struggles, the Office of National Statistics' (ONS) recent figures show that financial sector profits are back to their pre-crisis peak and, most eye-catchingly, bonuses are at their highest rate since the crisis.

With profits and bonuses strengthening, it is difficult to argue that regulations are undermining the industry to any significant degree. However, 11% of all respondents in the GRO 2015 survey do believe regulations have made the financial services world less stable.

REGULATION IN REALITY: FROM CONCEPT TO PRACTICE

There is a second factor likely to be tempering firms' concerns: regulators and the industry have moved from debating and drafting legislation to implementing and enforcing it.

Of course, that is not without difficulties for firms. Despite some criticism, the US Securities and Exchange Commission (SEC) shows no appetite to abandon its 'broken windows' approach to regulation, cracking down on even minor infringements. Meanwhile, in the UK Bank of England Governor Mark Carney has publicly lamented how executives at large banks largely emerged from the 2008 crisis unscathed without sanctions. The *Daily Mail* quoted him stating: "Bankers caused the crash and got away with it."

However, the flipside is that firms are now operating increasingly in a post-implementation environment. The focus has shifted from assessing proposed regulation to planning how to meet requirements currently in place. In short, they have greater certainty. There are a portion of industry professionals who support making executives criminally responsible for the actions of firms. Whilst the majority of survey respondents still believed it would be a bad thing, nearly a quarter (23%) of senior executives (and 33% of others) backed the idea, as opposed to 40%, who say it will have a long-term negative impact.

IMPACT ON INDUSTRY STABILITY AND REPUTATION

There is still scepticism about how much regulation can achieve, however. Even if some think regulation is adding to stability, the number of individuals who are confident that we are safe from another crash remains small. Just 2% of executives believe changes to regulation since the crisis have been adequate to prevent another crash. Over half of those polled (54%) think the risk has been only partly addressed.

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Furthermore, when respondents were asked 'what are the most important factors to get right for the industry to avoid regulatory issues', more than half of executives (53%) said organisational culture was the most important internal factor and 30% of senior executives said principles-based regulation was the most important external factor.

There is also limited faith in the ability of regulation to restore the industry's reputation. While 43% of senior executives believe regulation can help rebuild financial services' reputation, more than half think it will either have little impact (50%) or tarnish the industry further (5%). What's more, according to those polled, rebuilding trust requires public education (34%) and greater transparency in governance and management functions (27%), rather than increased fines on firms (5%).

Beyond mere compliance, firms would do well to understand the value of transparency and keeping their client base informed. Regulators will likely continue developing policy aimed at fostering greater provisions of information in the market, and those companies that have taken steps to preempt this shift will be the winners.

REGIONAL APPROACH TO REGULATION

Consistency across borders and single international regulatory standards are often central to maintaining an effective regulatory system, as cited by a quarter of senior executives in the GRO 2015 survey. This view echoes recent regulatory trends across the globe, particularly the introduction of the foreign account tax compliance act (Fatca) and the Alternative Investment Fund Managers Directive (AIFMD) as well as the push by the Organisation for Economic Co-operation and Development (OECD) for international tax standards. Additionally, in its most recent report on global financial stability in October, the International Monetary Fund (IMF) again called for international cooperation, this time to tackle the risks of shadow banking (IMF Global Financial Stability Report October 2014 Risk Taking, Liquidity, and Shadow Banking).

If rules are to be coordinated, however, the question arises as to whose standards will dominate.

LEADING FINANCIAL CENTRES IN THE FUTURE

Of those surveyed, 59% say they think the leading financial centre is New York and 38% cited London. Further to this, in five years' time these two cities are still expected to dominate with 46% predicting it to be New York and 28% predicting it to be London. Just 6% of survey participants expect Hong Kong to lead. The survey also found that the leading emerging market centre in five years' time is expected to be Shanghai, by a significant margin – 53% of respondents.

As capital markets in China open to the outside, it is interesting to ask how long the traditional centres and their regulators can assume that it will be their standards that apply. As it is, Hong Kong is already trailing only New York and London in the number of IPOs in mid-October, according to Dealogic. This finding is in line with a recent report by Credit Suisse in July 2014 that predicted China would overtake the UK (and Japan) to become the second-largest global equity market after the US by 2030 (Credit Suisse, 'Emerging Capital Markets: The Road to 2030'. July 2014).

> "REGULATORS WILL LIKELY CONTINUE DEVELOPING POLICY AIMED AT FOSTERING GREATER PROVISIONS OF INFORMATION IN THE MARKET"

The fate of London in our survey is interesting in this respect. Just two years ago 65% of survey respondents believed it to be the preeminent global financial centre, against 31% who cited New York. Now, the positions are almost entirely reversed. Here, two lessons can be drawn. First, while the industry can learn to live with regulation, there's little tolerance for uncertainty. The tortuous progress in enacting and implementing AIFMD and the continuing shadow of the proposed EU financial transaction tax, for example, will have done London few favours.

The other lesson, however, is more certain and simpler: while Western financial centres dominate today, things can change quickly. In the debate and development of global standards, governments, regulators and firms in those centres should not assume theirs will remain the only voices for long. ■

To learn more about the regulatory trends and issues affecting the financial services industry, download Kinetic Partners' Global Regulatory Outlook 2015 at: http://www.kinetic-partners.com/news-media/global-regulatory-outlook-2015/