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LAFFERTY

King's Revenge

By David Marsh

In the week where President Barack Obama has been presiding over the ritual humiliation of a UK corporate icon in the form of oil giant BP PLC, another well-known British acronym -- the Financial Services Authority, known as the FSA -- has also been biting the dust.

One essential point links BP's plight over the oil spill in the Gulf of Mexico and the demise of the FSA announced last week by George Osborne, Britain's new Chancellor of the Exchequer.

Both institutions have ended up victims of a surging blow-out -- the former a mile down on the seabed, the latter across the world's financial markets -- that has proven impossible for the politicians to control.

The FSA, born in 1997 as the successor to the old Securities and Investments Board, has had for more than a decade the power to regulate banks, insurance companies and financial advisers. This authority was taken away from the Bank of England in 1997 when the incoming Labour government decided to give the bank operational independence over monetary policy. The move caused significant ructions within the Bank of England and almost caused the then-governor Eddie George to resign.

FSA will now be abolished and its main functions will be returned to the Bank of England under a sweeping restructuring of the UK regulatory regime that will give considerable satisfaction to the Bank of England and an enormous increase in its overall powers. George's successor, Mervyn King, has seen his authority strengthened in a way that would have delighted his predecessor, who died last year.

A planned shake-up of the UK banking structure, also announced in Osborne's ceremonial Mansion House speech declaiming the regulatory changes, will please King too. An independent commission will review the UK banking structure and possibly decide to break up banks into retail and investment banking components, mirroring the US plan of Paul Volcker, the former Federal Reserve chairman -- a move that has been praised in recent months by the Bank of England governor as paving the way for possible action in the UK.

President Obama has been much criticised in the UK for taking chunks in recent weeks out of BP's hapless chairman and chief executive.

In the FSA abolition announcement on June 16, Osborne got his own back by hurling a verbal punch at former Citigroup Chief Executive Chuck Prince who, in a reference to global financial competition in July 2007, said: "As long as the music is playing, you've got to get up and dance," he said. "We're still dancing."

Last week in his Mansion House speech, Osborne told his audience the aim of the new financial stability regime was to "turn down the music when the dancing becomes a little too wild." He defined the essential problem of the FSA as diverting attention from the wider aspects of regulation. "The FSA became a narrow regulator. The FSA became a narrow regulator, almost entirely focused on rules-based regulation," Osborne said. "No one was controlling levels of debt and when the crunch came no one knew who was in charge."

The FSA will give up the majority of its functions to a new Consumer Protection and Markets Authority. The rest of the organisation will be refocused as a prudential regulator ensuring the overall health of the financial system, operating as a subsidiary of the Bank of England.

For King, the Osborne restructuring represents a major success, even a piece of rich revenge. He took over in 2003 from George after a seven-year spell as Chief Economist and five years as Deputy Governor. Many people thought that the lure of academia would be too strong, and that King would want to step down at some stage during his second five year term that started in 2008.

However King, who harbours strong grievances against the banks for promoting the excesses that nearly brought full-scale financial meltdown in 2007-08, will now during his remaining three years in the job preside over a wholesale revamping of the UK regulatory system.

One of King's best known remarks after he became Governor was that his ambition was "to make monetary policy boring." It has not quite worked out like that.

If he is lucky, he will go down in history as the man who gave banking regulation a new and more successful name. If he is unlucky, a new wave of worldwide banking problems will engulf him before the new system is up and running. The most likely outcome, however, is that King will be able to complete his work without major fresh drama.

Ensuring that the system is really resilient enough to cope with future upheavals will probably be a task left to his successor.