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AN AMERICAN PERSPECTIVE ON THE U.K. FINANCIAL SERVICES AUTHORITY: POLITICS, GOALS & REGULATORY INTENSITY

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An American Perspective on the U.K. Financial Services Authority: Politics, Goals & Regulatory Intensity

by

Howell E. Jackson*

Abstract

Although similarities between the British and American systems of financial regulation are often remarked upon in academic commentary, the organizational structure of financial supervision in the two countries has diverged substantially in the past decade, as the United Kingdom has now largely consolidated its financial regulatory agencies in the Financial Services Authority whereas the United States has maintained the world's most decentralized and fragmented collection of financial supervisory agencies. In this essay, Professor Howell Jackson explores various reasons why financial regulation in these two countries differs so dramatically in organizational structure. Focusing first on the differences in political economy that surrounded the enactment of the Financial Services and Markets Act of 2000 in the United Kingdom and the Gramm-Leach-Bliley Act of 1999 in the United States, Professor Jackson discusses deeper differences in the regulatory philosophies of the two countries and also presents data on the relative intensity of financial regulation in both jurisdiction. He speculates that the comparatively more ambitious regulatory agenda of the U.S. system pushes the country towards a more elaborate system of financial oversight that is inherently more difficult to consolidate. In the United Kingdom, in contrast, the goals of the financial regulators are more modest and, to the extent that cost efficiency is one of the country's regulatory objectives in the field of financial regulation, that policy tends to foster a less cumbersome system of financial regulation that more easily accommodates consolidation of regulatory functions. The paper concludes with some broader comparative data suggesting that while British financial regulation may be less intensive than financial regulation in the United States, it is substantially more intensive than financial regulation in many other jurisdictions, particularly civil law jurisdictions on the Continent.

JEL classification: D1, D6, D18, D61, D62, G2, G3, G20, G28, G38

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In much comparative corporate law scholarship, the United States and the United Kingdom are considered to be of one piece. Particularly in the area of capital markets, the "Anglo-American" approach to regulation is typically contrasted to continental or civil law systems. With their shared traditions of laissez-faire capitalism, common-law jurisprudence, self-regulatory organizations, and disclosure-based securities regulation, the United States and the United Kingdom are often portrayed as fellow travelers in the world of financial regulation. Indeed, in formal empirical work on the subject, the two countries are commonly occupy the same dummy variable.[1]

In terms of organizational structure, however, the U.S. and U.K. systems of financial regulation could not be further apart. Our system is the most decentralized and fragmented in the world; theirs now among the most centralized and integrated. Ours the product of centuries of bureaucratic accretions, with every generation adding new administrative units and regulatory requirements while seldom if ever abandoning innovations of the past. Theirs the precocious child of Labor Party reforms of the late 1990's, as unlike the old clubby ways of the City as the Canary Wharf towers are from the East End tenements they replaced.

So the puzzle arises how can two countries that are shoulder to shoulder on the substance stand so far apart when it comes to matters of form? In this essay, I identify several different factors that have contributed to the substantial divergence in U.S. and U.K. regulatory structures. I focus my attention on three reasons why the United Kingdom has developed such a markedly different system of financial regulation than the one that exists on this side of the Atlantic. First, I consider difference in the political context in which both countries undertook financial reform in the late 1990's; second, I note differences in the national objectives for financial regulation in the two

[1] See Raphael La. Porta, et al., Law and Finance, Journal of Political Economy (Dec.1998).

countries, and finally I highlight differences in the intensity of regulatory oversight in the two countries. All three of these considerations contribute, I believe, to the very substantial difference in regulatory structure that separate the United States and the United Kingdom.

While this essay limits its analysis to the regulatory structures in two jurisdictions, its implications are substantially broader. The premise of my analysis is that regulatory structures within individual countries are a product of numerous considerations that are likely to vary from jurisdiction. The structure and priorities of domestic political institutions as well as the goals of financial regulation within individual countries can factor heavily into the evolution of regulation structures, as the British and American experiences illustrate. These factors also influence the scale and intensity of financial regulation, which themselves may affect the likelihood that particular jurisdictions will pursue certain regulatory strategies, such as consolidation of regulatory functions. So, while there are many benefits to be gained from international comparisons of regulatory design and structure, there are numerous and entirely legitimate constraints on the harmonization of regulatory structures at least in the short and intermediate term.

I. The Political Economy of Financial Reform

As several recent papers have chronicled,[2] the path to the establishment of the Financial Services Administration has been long and arduous, dating back to election of the new Labor Government in the Spring of 1997. At roughly the same time, the United States was also engaged in its own process of financial modernization, culminating in the passage of the Gramm-Leach-Bliley Act in November of 1999.[3] What is striking about these two roughly contemporaneous legislative efforts is how different the scope of the regulatory reforms attempted. A major achievement of British financial modernization was the consolidation and centralization of regulatory power into a unified Financial Services Authority (FSA). To some degree, this process represented a continuation of efforts begun in the 1980's to move away from the self-regulatory model that had characterized British supervision for more than a decade. But the singular achievement of the legislative process that culminated in the passage of the Financial Services and Markets Act of 2000 was the consolidation of nearly a dozen supervisory units in a new organization with responsibility for nearly all sectors of the financial services industry.[4]

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[2] In addition to work prepared for this conference, good background on the evolution of the Financial Services Authorities can be found in Eilis Ferran, Examining the United Kingdom's Experience in Adopting the Single Financial Regulator Model, 28 Brook. J. Int'l L. 257 (2003); Gerard McMeel, An Overview of United Kingdom Financial Services Regulatory Reform (Draft of Apr. 9, 2001); Michael Taylor, Accountability and Objectives of the FSA, in Blackstone's Guide to the Financial Services & Markets Act 2000 (Michael Blair, et al., eds 2000). For an illuminating set of articles comparing U.S. and U.K. regulatory policies, see Heidi Schooner & Michael Taylor, The United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets, 38 Texas Int'l L.J. 319 (2003); Heidi Schooner & Michael Taylor, Convergence and Competition: The Case of the Bank Regulation in Britain and the United States, 20 Mich. J. Int'l L. 595 (1999).

[3] For a good overview of the Gramm-Leach-Bliley legislation, see Michael P.Malloy, Banking in the Twenty-First Century, 25 Iowa J. Corp. L. 787 (2000).

[4] See McMeel, *supra* note 2, at 6 (noting residual supervisory authority of the Council of Lloyd's, as well as overlapping jurisdictions of Bank of England and separate regulation of occupational

The Gramm-Leach-Bliley Act, in contrast, was almost devoid of bureaucratic rationalization or reform, even though the U.S. system of financial regulation is even more decentralized and fragmented than the traditional British system. At various points in years leading up to the enactment of Gramm-Leach-Bliley, Clinton Administration officials floated some relatively modest suggestions for consolidating depository insurance funds or creating a new high-level council of senior regulatory officials to resolves thorny jurisdictional issues, but even these limited proposals generated intense political opposition and were quickly dropped from legislative proposals.[5] In the end, the legislation limited itself to a relatively narrow range of issues, principally clarifying the scope of permissible financial activities for financial conglomerates and establishing modest protections for the protection of consumer privacy in financial matters. In terms of organizational changes, the legislation did not eliminate a single regulatory agency; indeed, it set in motion a process that might have created a new regulatory body for the oversight of insurance agents. [6]

So the question arises, why is it that reform efforts in the United Kingdom in the latter half of the 1990's led to substantial regulatory consolidation in the United Kingdom, while contemporaneous reform efforts in the United States led to no similar developments. While many considerations undoubtedly contributed to this difference,[7] I would note four contributing factors:

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pensions outside of the FSA structure).

[5] See Dean Anason, Financial Counci's Power, Scope, Makeup Criticized, Am. Banker, June 27, 1997, at 3.

[6] See Malloy, supra note 3, at 812-13 (describing Gramm-Leach-Bliley provisions call for establishment of a new National Association of Registered Agents and Brokers).

[7] One plausible explanation for the difference might stem from differences in our national tastes for federalism. Although devolution is on the rise in Britain, our federalism is much stronger and more deeply rooted. However, the regulatory fragmentation in the United States is not just a matter of federalism. Federal oversight of depository institutions is divided among the Federal Reserve Board, the Federal Deposit

Parliamentary System of Government. From an American perspective, one of the most striking features of reform in the United Kingdom was the ability of the Labor Government to control the terms of the reform debate, proposing an initial reform bill, maintaining control over the course of floor debate and amendments, and reaching a relatively prompt resolution within a relatively few years. When the Clinton Administration joined the debate, it was entering a process that had been underway for more than ten years.[8] Although the Treasury Department under the leadership of Secretaries Robert Rubin ultimately developed statutory language for congressional consideration, the bill that became the Gramm-Leach-Bliley Act was largely the product of legislative processes to which the executive branch made regular contributions but over which it could not exerted meaningful leadership, beyond a veto threat for a limited number of provisions. In the area of structural reform, political forces were particularly resistant to reform proposals, and in a number of areas were jurisdictional conflicts were especially acute, the Gramm-Leach-Bliley Act demurred by calling on the courts to resolve future conflicts.[9] To be sure, reform proposals in the late 1990's in the United States were complicated by the presence of a divided government – the

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Insurance Corporation, and the Comptroller of the Currency, and then further subdivided into specialized subagencies for thrifts (the Office of Thrift Supervision) and credit unions (the National Credit Union Administration). Securities and commodities are regulated separately at the federal level, in addition three different federal agencies share jurisdiction of pension regulation. Plus an assortment of other financial regulatory matters are delegated to a host of other federal agencies: money laundering the Treasury, mortgage lending to the Department of Housing and Urban Development; and various insurance issues to the Internal Revenue Service. Plus a wide range of self-regulatory agencies and trade groups perform important regulatory or quasi-regulatory functions on a national basis.

[8] Efforts to modernize the regulation of financial services in the United States date back to at least the first half of the 1980's when then Vice-President George H.W. Bush chaired a study group on the subject.

[9] See, e.g., section 304 of the Gramm-Leach-Bliley Act, 12 15 U.S.C.A. § 6714 (West 2004) (specifying that courts review decisions regarding the definition of insurance activities "without unequal deference" to either banking or insurance regulators).

Republican Party then controlled both the House and the Senate – as well as the added complexities of a presidential impeachment, but it is hard to imagine any American administration, even with both houses of Congresses in friendly hands, proposing so sweeping a program of governmental reform in the field of financial services and then seeing the proposal to successful adoption in only a handful of years.

A variety of factors contribute to difficulties that any American executive faces in proposing and gaining legislative support for structural changes in regulatory reform. The highly decentralized structure of traditional financial regulation in the United States creates numerous constituencies inclined to resist any efforts to make major changes in regulatory structures. These likely opponent for reform include not just participants in the financial services sector who may be disadvantaged from structural changes, but also their trade groups, regulatory officials, and even congressional representatives, all of whom may fear that movement from the status quo may cost them status or employment. One often cited example of this phenomenon is the opposition that members of the congressional agricultural committees typically voice in the face of proposals to consolidate the regulation of derivatives and securities in the United States, as the consolidated agencies would almost certainly be located under the control of the congressional committees focuses on financial services.

Of course, the American opposition to regulatory consolidation is not based solely on the self-interest of affected parties. One of the reasons that entrenched interests can mount effective challenges to regulatory reforms is that there is a strong historical bias against consolidated power at the national level. Division of power between national authorities and state officials as well as separation of powers at the federal level is a hallmark of the U.S. regulatory system. In defending

the status quo, opponents of regulatory reform in the United States can tap into heart-felt themes of American political thought that date back to the earliest years of the republic. This bias against consolidated governmental power partially explains why American administrations have had so little success in consolidating regulatory functions in the United States, at a time when their counterparts – and in particular their counterparts in the United Kingdom – have been so much more successful.

Acquiescence of Muddling Through: Another characteristically un-American feature of the British reform effort was the highly ad-hoc manner in which the reforms proceeded. The Financial Services Authority was established before its formal powers were fully enacted.[10] For its first few years of operation, the agency assumed supervisory functions delegated from other governmental units. Personnel from other agencies were routinely seconded to FSA offices, and gradually the staff of numerous agencies were merged into the FSA's own ranks of personnel. While this informal interregnum allowed the FSA staff a chance to grow into its powers and shape its ultimate legislative mandate, it is hard to imagine reform efforts proceeding in precisely the same consensual manner in the United States.[11] With so much regulatory power shifting hands and various oxen inevitably being gored at least in passing, one expects that a comparable exercise in the United States would have unleashed a barrage of lawsuits claim deviations from statutory grants of power or violations

[10] See Ferran, supra note 2.

[11] The only nearly analogous experience in the United States was the role the Securities and Exchange Commission play in the 1930's when it produced a comprehensive study of investment companies that greatly influenced the adoption of the Investment Company Act of 1940 and related legislation. See Howell E. Jackson & Edward L. Symons, The Regulation of Financial Institutions: Cases and Materials (1999). But, in that case, the SEC was already a formally established agency and the initiative involved only an extension of its authority into a new sector of the securities industry.

of separation of powers principles.[12] While the American aversion to unauthorized exercise of governmental authority has its virtues, the litigiousness and combativeness through which this sensibility is often expressed makes informal regulatory accommodation of the sort employed in the early years of the FSA difficult to achieve in the United States and seldom a major feature of our reform proposals.[13] Rather the tendency is to try to spell out all of the details of reform efforts at the outset, thereby clarifying their statutory basis but also presenting juicy targets at which potential opponents can take aim.[14]

A connection exists, I think, between the British willingness to muddle through and its system's ability to avoid the sort of political log-jams that characterize U.S. reform efforts. In my mind, a good example of this connection was the FSA's approach to personnel issues. As mentioned above, in the United States, a natural source of resistance to regulatory reforms has been regulators themselves who may reasonable fear that consolidation of regulatory functions will eliminate their positions or at least diminish prospects for advancements, thereby stimulating the sort of bureaucratic in-fighting that can derail the legislative process. To ameliorate resistance of this sort, the framers of the FSA process guaranteed continuity of employment for all regulatory

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[12] For example, the Clinton Administration's extraordinarily modest effort to have Congress authorize the creation of a National Council of Financial Services Regulators was almost immediately attacked on the grounds that the selection of a state insurance commissioner to participate in the council might violation the Appointments Clause of the U.S. Constitution. See Anason, supra note 5.

[13] For an overview of FSA accountability provisions, see Gwen Bevers, The Accountability of the Financial Services Authority under the Financial Services and Markets Act 2000, 22 Company Lawyer 7 (2001) (Sweet & Maxwell Ltd.).

[14] Outside of the financial services industry a good example of this tendency was the Clinton Administration's early efforts to reform the health care industry. Shortly after the Administration released its comprehensive legislative proposal, critics had little difficulty finding numerous details that in isolation seemed illogical or unpalatable.

personnel over the course of the consolidation process. Although a relatively minor feature of a major legislative agenda, this attention to individual concerns may have smoothed the reform process, albeit at the expense of recognizing economies of scale in the short term.[15]

While the Gramm-Leach-Bliley reform process never contemplated substantial consolidation of regulatory functions, it did include provisions designed to create uniformity of interpretations between the principal federal banking agencies: the Comptroller of the Currency and the Federal Reserve Board. Rather than leaving these interpretive issues to informal processes, the legislative process necessitate complex and multi-faceted negotiations between the Treasury Department of the Federal Reserve Board, culminating in a complex set of statutory provisions defining extremely precise scopes of authority with mandatory consultations and procedures for judicial review.[16] Far from muddling through, these provisions reflect a strongly legalistic and stylized approach to lawmaking in the financial services industry. Similar forms of cooperation were also specified for banking regulators and state insurance supervisors, and apparently the resulting framework has proved workable for the industry.[17] These ad hoc accommodations are, however, unlikely to promote the evolution of significant changes in regulatory design.

The Role of European Institutions: A further distinguishing feature of the political economy of the United Kingdom is the influence of the European Union and other European legal structures.

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[15] The emergence of the FSA during this period is very nicely summarized in Michael Foot's paper for this conference.

[16] See section 103(a) of Gramm-Leach-Bliley Act, 12 U.S.C.A. § 1843(k) (2004) (establishing procedures for coordination between the Federal Reserve Board the Secretary of the Treasury in defining financial activities).

[17] For an overview of this regulatory cooperation, see II Melanie L. Fein, Banking and Financial Services §17.04(B) (2002).

While not prominently featured in many accounts of the birth of the Financial Services Authority, developments on the Continent played an important role in the emergence of the agency. For one thing, a number of European Union directives required member states such as the United Kingdom to make certain reforms in their regulatory structure. For example, certain directives in the field of securities regulation called for the movement of certain regulatory functions out of self-regulatory organizations, such as the London Stock Exchange, and into governmental agencies. Moreover, the total volume of European Union directives in the field of financial regulation required British regulators to assume tasks and meet formal standards well beyond those traditionally assumed. While the old decentralized regulatory structure could have been adapted to meet these multi-lateral commitments, the presence of these new requirements contributed, in my view, to the national consensus in the late 1990's that full-fledged reform of the U.K. regulatory structures was in order. To a certain degree, this sentiment may have been enhanced by concerns that financial innovations on the Continent – both the rapid growth of stock markets in France and Germany plus the emergence of a Euro-zone in which the United Kingdom was not to be a member – contributed to a climate conducive of decisive action in the field of financial reform.[18]

For U.S. reform efforts, there is no ready analog to the European Union. To a certain degree,

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[18] In the years since the establishment of the FSA, the consolidation of regulatory agencies has itself become an agenda item for legislative reformers in the European Union and around the world. In the recent accession of new members, one structural issue that each new member nation faced was whether or not to adopt a system of consolidated supervision in the course complying with EU standards of financial supervision. See Karel Lannoo, The Emerging Regulatory Framework for Banking and Securities Markets in the CEECs, in The New Capital Markets in Central and Eastern Europe 85 (Michael Schröder ed. 2001). Though not formally a requirement of any EU directive, consolidated supervision is now firmly on the regulatory agenda around the world, thanks no doubt to the perceived successfulness of the model in the United Kingdom and elsewhere. While the trend towards consolidated supervision has not yet become universal, numerous jurisdictions have opted for this model of regulatory reform, particularly in smaller countries where the approach's potential for cost savings seems to have most salience.

NAFTA and, to a lesser extent, the WTO have had the effect of opening U.S. financial services markets to foreign firms, but these trade agreements have not required domestic reforms of the sort that, for example, the Financial Services Action Plan has had on the United Kingdom and other member states. In many instances, of course, U.S. regulatory requirements have informed the development of international standards, enunciated through organizations such as the Basel Committee on Banking Supervision or the International Organization of Securities Commissioners. But in these cases, the United States was generally exporting its regulatory requirements not bringing itself in alignment with externally developed standards. Moreover, where multi-lateral agreements have presupposed domestic regulatory reforms in the financial services industry, the United States has – at least of late – shown dogged reluctance to conform to the expectations of counter-parties. In the past year, the best example of this tendency would be the announcement that federal banking officials would impose extensively reformed provisions of the Basel Capital Accord. So, as a matter of experience and predilection, the evolution of external regulatory standards has not been a major factor in forcing regulatory reforms in the United States.

Local Political Considerations: Last and not least are significant differences in the local political dynamics. When the Blair Government came to power in 1997, British consumers had suffered through a series of domestic scandals, ranging from widely publicized abuses in the sale of pensions to the spectacular failures of Barings and the Maxwell interests. Reformers could and did capitalize on these issues to expose perceived weaknesses in traditional regulatory systems and to justify far-reaching regulatory reforms such as the FSMA. By the late 1990's in the United States, by contrast, outrage over our then most recent financial scandal – the savings and loan crisis – has largely faded, and the country had enjoyed several years of record-high stock prices and record low

bank failure rates. Aside from concerns of financial privacy which overtook the legislative process in the mid-1999, the politics of financial modernization in the United States were fairly low-key. The most zealous advocates for reform were members of the financial services industry seeking to eliminate long-standing, but already partially eviscerated activities restrictions. The substantially higher level of public interest in financial regulation in the United Kingdom in the late 1990's helped propel the United Kingdom to much more substantial regulatory reforms that would have been feasible in the United States.

Since the passage of the Gramm-Leach-Bliley Act, of course, the United States has encountered major financial scandals, including the bursting of the technology stock bubble in 2000, coupled with corporate accounting scandals and securities industry abuses uncovered in the new few years as well as more recent scandals of the mutual fund industry and New York Stock Exchange compensation arrangements. Major legislation in the form of the Sarbanes-Oxley Act of 2002 ensued with much fanfare and substantial implications for corporations in the United States and around the world. The reforms of Sarbanes-Oxley, however, did not address regulatory consolidation or simplification. Indeed the only structure reform of the Act was to add a new regulatory in its creation of the Public Company Accounting Oversight Board. While difficulties at the NYSE have prompted some to call for a reduction in our reliance on self-regulatory organizations, no specific reform proposals have been adopted, and at least for the time being, prospects for such changes seem unlikely.

While one must be circumspect in locating differences national regulatory strategies in any single factor or set of factors, the substantial differences in the regulatory scope of the FSMA and the Gramm-Leach-Bliley Act at roughly the same time does invite speculation as to the reasons for

those differences. In my mind, striking points of difference were the capacity of the new Blair government to utilize a strong parliamentary majority to effect the changes; the flexibility of the British system of government to allow such a large-scale legislative reform to be worked out in a pragmatic but substantially more informal process than the United States political system would have allowed; pressures from political developments at the European Union level that necessitated a variety of reforms at the domestic level; and recent political developments that created some degree of public support for regulatory reforms included in the FSMA.

II. A Comparative Analysis of Regulatory Objectives

Another explanation for the differences in U.S. and U.K. regulatory structure is a substantial divergence between the objectives of regulatory structures in the two countries. As explained below, the United States has an ambitious set of goals for its financial regulators. The British objectives are, on balance, more modest, and in certain critical respects better suited for a consolidated supervisory apparatus.

A. Regulatory Objectives in the United States

As I have written at length elsewhere, the United States has a broad set of regulatory goals for its financial regulators.[19] While the importance of these goals varies somewhat from sector to sector within our financial services industry, the four following categories reflect our dominant regulatory priorities.

1. Protection of Depositors, Policyholders and Investors.

First and foremost, our financial regulatory structure is designed to protection consumers from losses and abusive practices. In some contexts – including bank deposits of less than $100,000 and certain pension plans – the protection we afford is absolute. Elsewhere, for example, in the field of securities regulation, we impose significant restrictions on the terms of permissible competition and mandate the disclosure of large amounts of information, both to promote consumer self-help and to secure the protection of market forces. Much financial regulation in the United States serves the goal of consumer protection.

2. Reduction of Externalities.

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[19] See Howell E. Jackson, Regulation of a Multisectored Financial Services Industry: An Exploratory Essay, 77 Wash. U. L. Q. 319 (1999).

A separate justification of financial regulation in the United States is the elimination of various externalities associated with financial failures. The Federal Reserve Board's lender of last resort function serves this purpose, as does the oft-maligned but still extant too-big-to-fail policy of federal banking regulators. The extent to which financial regulators should impose regulatory restraints out of concern for externalities is controversial, but there is little doubt that one of the reasons we regulate financial intermediaries in the United States is to prevent potential losses to parties that are not indirect contractual privity with intermediaries.

3. Redistributive Policies and Other Equitable Norms.

A third, and less well publicized goal of financial regulation in the United State is to advance various redistributive policies and other equitable norms. A good example of this phenomenon is the Community Reinvestment Act for depository institutions, but analogs also exist in the insurance industry and, to a limited extent, the securities field. In many respects, we see our financial intermediaries as vehicles to implement a range of social policies, and financial regulators often find themselves agents in advancing these goals. Insurance regulators, for example, must often opine on whether it is permissible for the price of car insurance to vary based on the gender or educational level of drivers, and pension officials must decide whether lower-income workers receive an equitable share of retirement benefits.

4. Considerations of Political Economy

Finally, broader considerations of political economy routine factor into our system of financial regulation. Perhaps the best example of this practice has been our historic aversion to nationwide banking, which still influences a profound effect on our banking system. In addition, political preferences for state control explain the persistence of state control over the insurance

industry and overlapping state and federal jurisdiction in both banking and securities. Moreover, one might well attribute the fragmentation of supervisory control at the federal level to a national taste for separation of powers dating back to the early years of the republic.

B. Regulatory Objectives in the United Kingdom

In defining the regulatory goals of the financial regulation in the United Kingdom, we are fortunate that Parliament went to considerable lengths in the enactment of the Financial Services and Markets Act of 2000 to articulate a series of four statutory objectives as well as seven principles of good regulation. I will first review these regulatory goals and then contrast them with the goals of financial regulation in the United States.

1. Statutory objectives

The Financial Services and Markets Act set out of the FSA four statutory objectives:[20] market confidence, public awareness, consumer protection, and reduction of financial crime.

a) Market Confidence. Market confidence relates to the preservation of both financial stability and the reasonable expectation that the financial system will remain stable. Its maintenance is supposed to provide market participants and consumers with the relevant incentives to trade in financial markets and use the services of financial institutions. According to the FSA, achieving market confidence involves the imposition of two steps: a) to prevent material damage to the soundness of the UK financial system caused by the conduct of, or collapse of, firms, markets or financial infrastructure, and b) to explain on what basis confidence in the UK financial system is

[20] FSMA, Secs. 2(1) and 2(2).

justified. The latter includes stating explicitly what the regulator can and cannot achieve.[21]

b) Public Awareness. With the enactment of the FSMA, the FSA was also given a specific objective in the area of consumer education. Reflecting a concern that consumers are not always in a position to judge the safety and soundness of particular financial institutions or to assess the risks associated with certain products,[22] the Act requires the FSA to pursues two main aims under the objective of public awareness: a) to improve general financial literacy, and b) to improve the information and advice available to consumers.[23] The FSA not only provides generic information and advice to consumers, but also it encourages others to improve the availability and quality of their advice. In doing so, the FSA has developed a system of information and Inquiry services, which includes the statutory register of authorized firms and the Consumer Helpline. To enhance public awareness about financial services, the FSA has developed partnerships with regulated business, trade associations, consumer groups and educational institutions.

c) Consumer Protection. Public awareness is closely interlinked with the objective of consumer protection. The FSMA charges the FSA with the task of "providing an appropriate degree of protection for consumers." The legislation envisages that the prime responsibility for dealing fairly with consumers rests with the management of regulated firms. So the FSA's regulatory

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[21] FSA, A New Regulator for the New Millennium 6 (January 2000). Although the FSA seeks ways of minimizing the impact of failures on market confidence, it is of the view that achieving a "zero failure" regime is not only impossible but also undesirable, as it would be excessively burdensome for regulated firms and the economy as a whole and would not accord with the statutory objectives and principles. *Id.*

[22] For an analysis of the "information problem" and the FSA's objective to provide financial education, see Patrick Ring, Education, Advice and the Financial Services Authority's Statutory Objective, 4 Journal of Financial Regulation & Compliance 333 (2000).

[23] FSA, supra note 21, at 7.

approach is designed to focus and reinforce that responsibility emphasizing the robustness of firms' systems for identifying, measuring and controlling risks both to the firm itself and to its customers. To this end, the FSA has also put in place mechanisms for complaints' handling and redress, which offer greater simplicity and ease of access to consumers. As required by the FSMA, a single financial services ombudsman scheme and a unified compensation scheme have been introduced, with a range of mechanisms different markets and types of customers.[24]

d) Financial Crime On the grounds that market confidence and consumer protection are significantly undermined if the financial system is not adequately protected from criminal abuses, the FSA is also obliged to reduce the extent to which it is possible for regulated institutions to be used in connection with financial crime.[25] This objective integrates the relevant efforts of financial regulators with those of other criminal law intelligence, investigation and prosecution agencies. Together with certain new powers set out in the FSMA, it enables the FSA to build on the work which existing regulators have undertaken in this area in the past. Its prime focus is to ensure that financial institutions have systems and practices in place to protect themselves against being used as vehicles by financial criminals, especially by way of money laundering. In its effort, the FSA works closely with other organizations, such as the police and various public prosecutors.

2. Principles of good regulation

In pursuing its objectives, the FSA is required to take account seven additional principles of

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[24] FSMA, Sec. 225 et seq.

[25] According to the FSA, the three main types of financial crime are: a) money laundering, fraud or dishonesty, including financial e-crime and fraudulent marketing of investments, and c) criminal market misconduct, including insider dealing. See FSA, supra note 21, at 9.

good regulation set out in the FSMA.[26] The principles and the FSA's interpretation of them are:

a) Efficiency and Economy

This principle relates to the way in which the FSA allocates and uses its resources. When addressing a specific risk, the FSA is required to choose the options, which are most efficient and economic. It goes beyond the statutory requirement to consult on fees and consult on its budget, explaining how it plans to use the funds levied through regulated firms. The non-executive committee of the FSA Board is required, among other things, to oversee the use of resources and to report to the Treasury every year.

b) Role of Management

A firm's senior management is responsible for its activities and for ensuring that its business complies with regulatory requirements. This principle is designed to guard against unnecessary intrusion by the regulator into firms' business and requires the FSA to hold senior management responsible for risk management and controls within firms.

c) Proportionality

The restrictions imposed on firms and markets should be in proportion to the expected benefits for consumers and the industry. In making judgments in this area, the FSA takes into account the costs to firms and consumers. One of the main techniques the FSA uses is analysis of the costs and benefits of proposed regulatory requirements. This approach is shown, in particular, in different regulatory requirements applied to wholesale and retail markets.

d) Innovation

The FSA should allow and encourage innovation, for example by avoiding unreasonable

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[26] FSMA, Sec. 2(3).

barriers to entry or not restricting existing market participants from launching new financial products and services. This duty is best pursued through the maintenance of close relationships between the regulators and regulated institutions. Institutions are thus encouraged to discuss new product ideas and new market developments with the FSA at an early stage to ensure that the risks, for them and their customers, are properly understood and managed from the outset.

e) International character of Financial Services and Markets and the Desirability of Maintaining the Competitive Position of the UK

London is a uniquely international center of financial services, with many foreign banks and other financial institution conducting business within the jurisdiction. Much of the business undertaken in the UK is internationally mobile and almost all aspects of the FSA's responsibilities have an international dimension. The FSA is therefore committed to playing a full part in discussions with international regulatory bodies, to ensure that the UK's influence on the development of international regulatory standards is commensurate with the weight of its markets in global terms. In many areas this work proceeds in partnership with the Bank of England.

The FSA also considers the effect on UK markets and consumers of the economic, industry and regulatory situation overseas. It takes into account the international mobility of financial business and seeks to avoid damaging the competitive position of the UK. This involves cooperating with overseas regulators, both to agree international standards and to monitor global firms and markets effectively. Especially within the European Union (EU), cooperation with other Member States' regulators has taken the form of formal networks, such as the Committee of European Securities Commissions.

f) Competition

The FSA must avoid unnecessarily distorting or impeding competition.[27] This includes avoiding unnecessary regulatory barriers to entry or business expansion. Competition and innovation considerations play a key role in the FSA's cost-benefit analysis work. Under the FSMA, both the Office of Fair Trading and the Competition Commission will have a role to play in reviewing the impact of the FSA's rules and practices on competition.

C. A Comparative Analysis

When one lines up the justifications for financial regulation in the United States with the regulatory goals of the FSA as articulated in the FSMA, a number of interesting differences emerge, many of which factor into the differences in organizational structure that have evolved in the two countries.

1. Primacy of Market Confidence Over Consumer Protection

An initial point of divergence is over the primary mission of each country's system of financial regulation. In the United States, consumer protection is typically advanced as the most prominent justification for financial regulation. Although systemic risk is also a consideration – particularly in the area of depository institutions – the primary mission of much of U.S. financial regulation is to protect consumers from corporate over-reaching or unexpected financial failures. Under the FSMA, the priorities of the regulatory agency are reversed. The first statutory goal of the FSA is the maintenance of market confidence – an aspiration highly analogous to the containment of systemic risk.

2. Different Approach to Consumer Protection

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[27] In order to assist policy makers when they deal with the principle of competition, the FSA has issued a guide to competition analysis in financial services; see FSA, Making Policy in the FSA: How to take Account of Competition (July 2000).

The degree of consumer protection sought under the FSMA is also quite different than that characteristic of U.S. regulatory structures. While the United States through its public insurance programs and extensive enforcement apparatus – both public and private – often purports to afford comprehensive or near comprehensive protections for consumers, the FMSA establishes a much more modulated approach to the problem. In its statutory objectives, the Act calls for only an "appropriate degree" of consumer protection and then expressly notes the important of managerial oversight from private firms. The principles of good regulation amplify this perspective, by again noting the role of management in ensuring regulatory compliance and in two different principles (the one on efficiency and economy and the second on proportionality) emphasizing the importance of cost-benefit analysis in financial regulation.

3. Competition and Innovation as a Regulatory Goal

From an American perspective, another striking characteristic of the regulatory mission of the FSA is the prominence given competition and innovation as explicitly goals of the agency. While U.S. financial regulatory are often directed to take competitive considerations into account, typically these directions are framed as limiting principle on other regulatory goals.[28] Under the FSMA, competition and innovation are expressly listed as independent principles of good regulation. Even more strikingly, the preservation of London as a leading financial center is elevated to a

[28] Under the Banking Holding Company Act, for example, the Federal Reserve Board has long been required to consider whether its approval of an acquisition will cause competitive harm. This sort of oversight is quite different than competitive considerations reflected in the FSMA, which seek more to enhance the competitive posture of U.K. firms and markets in comparison to their foreign competitors. Within U.S. regulatory circles, it is not uncommon for officials to be mindful of competitive harms that new requirements might impose on U.S, firms or markets – consider for example recent debates over the impact of the Sarbanes-Oxley Act on foreign firms – but the advancement of U.S. competitive interests is seldom described as a principal goal of U.S. regulatory policy.

regulatory goal. To a certain degree, this elevation of competition and innovation could be understood as an extension of other principles advancing goals of cost-justified regulation. However, there is also – it seems to me – something of a legacy of an older system of self-regulation in the City that has a quite different flavor than most financial regulation in the United States.

4. Differences in Other Regulatory Goals

Another telling difference between U.S. and U.K. regulatory goals relates to the secondary regulatory missions that characterize each country's regulatory aspirations. Under the FSMA, the FSA is given a relatively modest set of supplementary goals: improving the financial education of consumers and reducing financial crime. Analogs of both regulatory goals can be found in the U.S. regulatory structure. Improving understanding of self-directed retirement savings accounts, such as 401(k) plans, has been a priority of the Department of Labor for a number of years, and the SEC also devotes some of its resources to individual investor education. On the financial crime side, federal legislation regarding money laundering has been on the books for many years, and was substantially enhanced in the Patriot Act after the September 11th terrorist attacks. But notably absent from the FSMA are the relatively extensive set of secondary roles that U.S. financial regulators are called upon to play. As explained above, these goals include both social equality and income re-distribution, regulatory objectives that are singularly absent from the FSA's mandate. In addition, our regulatory system expressly advances certain visions of political economy, including the preservation of smaller, local financial institutions (particularly in the field of depository institutions) and also a fragmented system of financial regulation (both between federal and state authorities and within the federal government). The FSMA shares none of these missions. Indeed, to the extent that the agencies mandate includes the preservation of London as a financial center, one might infer a

slight bias in favor of larger institutions and a unified system of oversight.

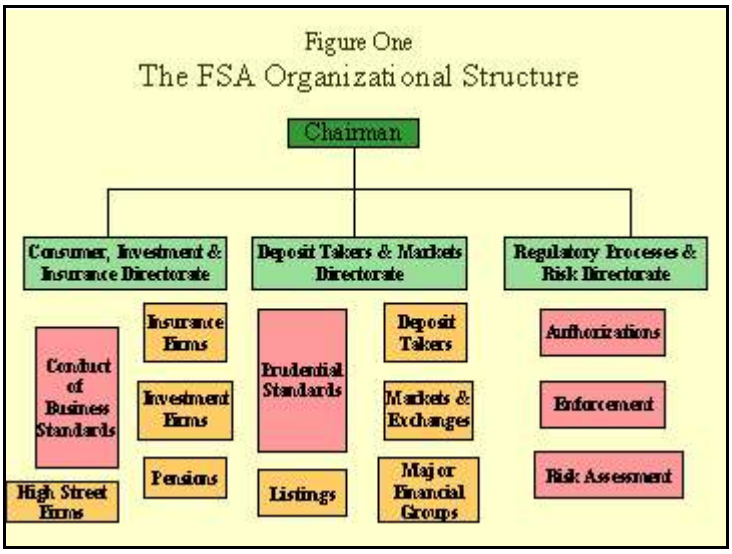
D. Implications for Regulatory Structure

The differences in the goals of financial regulation in the United Kingdom and the United States have, in my view, a direct impact on the regulatory structure that each country has adopted. The relationship is most obvious in the case of our political preference for divided systems of financial regulation, which is flatly inconsistent with a consolidated supervisory structure. But the other differences noted above also, I think, play into the differences in organizational structure noted above.

For example, both the FSMA's mandate for cost-effective regulation and regulation that promotes innovation and competition tend to favor less extensive regulatory structures. Moreover, to the extent, that the FSA's primary mission is to prevent systemic risks and not to ensure the safety and soundness of each consumer's investments, the scope of regulatory oversight is likely to be less extensive than in the United States, where consumer protection is of central importance. When one factors in the cost of imposing the much more extensive secondary regulatory goals of U.S. supervisors, the likely differences in regulatory intensity between the two countries expands further. While one might quibble about the relationship between regulatory intensity and organizational structure, a plausible hypothesis is that, as the degree of regulatory intensity increases, consolidation of regulatory functions becomes more cumbersome and difficult to achieve.

The organizational structure of the FSA itself also reflects, I believe, the policy goals of the underlying legislation. As has been elaborated in other articles, one of the distinctive features of the

British Financial Services Authority is the functional manner in the agency is organized.[29] Rather than maintaining separate divisions for the various sectors of the financial services industry, the FSA's regulatory staff is divided into three functional directorates. (See Figure One) As explained below, this organizational structure can be explained in terms of the FSMA's statutory objectives and principles of good regulation.



The first directorate - the Regulatory Processes & Risk Directorate – handles authorizations (that is licensing) and enforcement for all sectors of the financial services industry in addition to maintaining a division that considers regulatory strategies and risk analysis. This directorate is truly cross-sectoral in that all of its operating divisions span the financial services industry.[30] To achieve this same result in the United States, the insurance company licensing offices of the fifty states were combined with the OCC's chartering unit along with SEC, NASD and state Blue Sky procedures for registering new

[29] See Michael Taylor & Alex Fleming, Integrated Financial Sector Regulation and Supervision in the Context of EU Accession, in European Union Accession: Opportunities and Risks in Central European Finances 141 (World Bank, 2000); Giorgio Di Giorgio, Financial Market Regulation and Supervision: How Many Peaks for the Euro Area?, 28 Brook J. Int'l L. 463 (2003); Jeroen J.M. Kremers et al., Cross-Sector Supervision: Which Model? in Brookings-Wharton Papers on Financial Services (2003).

[30] Curiously, in recent organizational reforms, the FSA has added a division of High Street firms – that is, companies that provide certain mortgage and insurance services to retail customers – and this division includes a separate authorization department that is outside the Regulatory Processes and Risk Directorate. It is unclear what the FSA departed from its cross-sectoral approach to licensing in this instance.

broker-dealers were all combined in a single division of a regulatory body. And then, as part of the same division, the enforcement staffs of all banking, securities, insurance, and futures regulatory agencies would be located as part of the same division in neighboring offices. Although it is not clear whether consolidations of this sort would be cost-effective within the context of the U.S. regulatory structure, within the United Kingdom this approach to licensing and enforcement arguably improves efficiency and is thus consistent with this aspect of the agencies statutory objectives. Similarly, setting up a separate unit to consider regulatory strategy and overall risk allows the agency to deploy its supervisory resources in a more cost-effective manner than would likely be possible if the organization were divided into more familiar sectoral divisions.[31]

The FSA's two other functional divisions – the Consumer, Investment & Insurance Directorate and the Deposit Takers and Markets Directorate – also strike me as heavily influenced by the agency's statutory objectives, although in a manner that may not be immediate apparent to foreign observers. Both of these directorates include divisions linked to particular sub-sectors of the financial services industry as well as more general functional authority. What is confusing for U.S. observers about this arrangements is that elements of the securities industry are spread across the two directorates. Exchanges are located in the Deposit Takers and Markets Directorate, whereas collective investment vehicles and certain retail brokerage functions are located in the Consumer, Investment & Insurance Directorate. While this allocation of responsibility divides what we think of as SEC functions in the United States, it arguably follows the functional divisions implicit in the FSA's regulatory objective. The Deposit Takers and Markets Directorate has responsibility for the agency's foremost missions: the preservation of overall market integrity. The directorate therefore

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[31] See FSA, supra note 21.

deals with those financial activities most likely to threaten that integrity, including major financial conglomerates and exchanges, and include a separate division specializing in prudential regulation. The Consumer, Investment and Insurance Directorate, on the other hand, deals with the areas in which consumer protection, rather than market integrity, is the key concern.

This division between market integrity functions and consumer protection functions strikes me as one of the most interesting features of the FSA's regulatory structure with potentially far-reaching consequences for regulatory policy. As others have noted before, this organizational structure allows for truly consolidated supervision. Of necessity, consumer protection in various sub-sectors of the financial services industry – whether insurance, banking, or securities products – will be informed by practices in other sectors. Similarly, oversight of market integrity will tend to become more comparable across sectors as supervisory standards emanate from a unified authority. So the twin peaks approach to financial supervision allows for more consistent oversight across sectors of the financial services industry.

But the separation of market integrity from consumer protection at the FSA also strikes me as an important manifestation of the FMSA's twin goals of achieving an extremely high level of protection of the integrity of markets but imposing a lighter touch in the in field of consumer protection. Empowered to focus its efforts exclusively on identifying and eliminating risks that might plausibly threaten the overall financial system, the Deposit Takers and Exchange Directorate can keep its eye on the big fish of systemic risk without being constantly distracted by the multitudinous minnows of consumer protection. The regulatory muscle of the Directorate can therefore be deployed where perceived risks to market integrity are greatest and not in a manner

required to eliminate the largest number of relatively minor harms.[32]

The creation of the Consumer, Insurance and Investment Directorate similarly splits off what I would characterize as the FMSA's lesser goal of advancing consumer protection. As mentioned above, the Act in ways characterizes consumer protection as a regulatory function that should be advanced in a limited manner and on a cost-conscious basis, with consumer education and delegation of responsibility to management as viable alternatives to direct regulation. By separating out issues of market integrity – where supervisory standards towards infractions and risk are necessarily more absolute – the FSA structure increases the likelihood that consumer protection goals will be advanced on a more cost-effective basis.

To make the proceeding points slightly more concrete, compare the US approach to the regulation of depository institutions to that of the FSA's. While the United States does have some specialized regulations for large financial conglomerates, it generally organizes its regulatory structures by industry sector and imposes mandatory on-site examinations of depository institutions on a regular basis, regardless of whether the depository institutions in question impose any substantial threat to market integrity. A variety of factors explain this system of comprehensive examination – the exposure of both the FDIC and uninsured depositors to losses is undoubted an important consideration. But also, I would argue, U.S. financial regulatory authorities are not constrained by a governmental mandate, of the sort made explicit in the FSA, that supervisory initiative, particularly those in the area of consumer protection, should be imposed only when cost-effective. Rather their tendency is to favor equal treatment in the regulation of financial institutions, regardless of the risks particular institutions impose on market integrity or the efficacy of regulation

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[32] See FSA, supra note 21.

from an economic perspective, and keep financial failures to a minimum.[33]

III. Intensity of Financial Regulation

In speculating as to the reasons why British financial regulation was consolidated into a unified regulatory agency whereas nothing remotely comparable has occurred in the United States, I would propose as a further factor differences in regulatory intensity between the two countries in the area of financial regulation. To a certain degree, this difference is a function of the relatively broader goals of U.S. financial regulation that I recounted in the preceding section. After all, in seeking to advance more social functions, U.S. financial regulators inevitably require more staffing and larger budgets. Moreover, certain of the regulatory goals in each country, contribute to differences in levels of regulatory intensity. The British requirement that cost efficiency factor into all regulatory initiatives tends to constrain the level of regulatory intensity in that jurisdiction, where the U.S. predilection for divided governmental authority tends to produce overlapping jurisdictions and larger overall regulatory budgets.[34]

Whatever the explanation for differences in regulatory intensity, their existence offers an independent factor in explaining why the United States has not moved to a system of regulatory consolidation found in the United Kingdom and elsewhere around the world. The size and intensity of U.S. financial services regulation – both in absolute and adjusted terms – is exceptional. The

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[33] Another example of this phenomenon in the United States is the traditional uniformity of pricing of deposit insurance for small and large banks, notwithstanding substantial differences in risks and costs of failure.

[34] The overall effect of overlapping jurisdictions on regulatory intensity is ambiguous. In certain context, overlapping jurisdictions might lead to regulatory competition of the sort that reduces regulatory intensity. Although one cannot discount this possibility out of hand, the data on regulatory intensity in this section casts doubt on the significance of that sort of regulatory competition in this context.

substantial differences in regulatory intensity between the two jurisdictions also raises fascinating (and extremely difficult) normative questions whether both countries are maintaining appropriate levels of regulatory intensity or whether one of the countries is operating at a level of intensity that is substantially suboptimal. Aside from noting their intrinsic importance, I will leave these issues to another day.

The data presented in this section comes from several sources; partially my own research, partially from data that the FSA itself compiles each year in its annual reports, and partially from research conducted under my supervision by students at Harvard Law School. I first compare regulatory staffing and budget levels for U.S. and U.K. financial authorities at the turn of the Millennium, as the FSA was being established. Next I offer an expanded data set offering comparable data about these two countries and several other jurisdiction. I then present some additional and more detailed data about securities enforcement efforts in both jurisdictions during 1999 to 2001. The section ends with some tentative conclusions and suggestions for further research.

A. Overall Regulatory Budgets and Staffing Levels

An initial and useful point of departure is a review of the overall staffing levels in both jurisdictions. For the United Kingdom, this task is fairly straightforward as the country's regulatory functions are now largely centralized in the FSA; for the United States, however, the undertaking is considerably more substantial as our system of regulatory oversight remains highly fragmented. I therefore begin this section with a quick review of my own estimates of U.S. regulatory budgets and staffing levels in the 1998-2000 period, and then compare them to the levels of staffing reported for the FSA in its 2000-2001 annual report.

My estimates for US regulatory budgets and staffing levels are presented in Table 1 below and present data compiled during the 1998 to 2000 time period, roughly contemporaneous to the enactment of Gramm-Leach-Bliley and the establishment of the FSA. As summarized in the table, personnel and annual expenditures are divided into the financial subsectors of depository institutions (including banks, thrifts, and credit unions), insurance companies, the securities industry, the futures industry and pension and benefits. The table is denominated partial because data on certain elements of the U.S. financial regulatory structure are not available, notably data about budgets and personnel for state securities regulators.[35]

The data presented in Table 1 is striking in several respects. First is the absolute size of the country's financial oversight efforts: nearly forty two thousand employees and an annual budget in excess of $4.5 billion dollars. Second is the relatively large share of both overall budgets and personnel the U.S. allocates to the regulation of depository institutions: more than 53 percent of total personnel and nearly 61 percent of budgetary resources. A third point of interest is the variation in the ratio of annual expenditures to personnel in the various sectors of the financial services industry. The average expenditure levels per employee in the insurance industry ($62,452) is dramatically

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[35] The data underlying this table is to be presented in a separate technical note. In certain areas where regulatory agencies perform multiple functions, I have had to allocate a percentage of budgets and personnel to financial regulatory purposes. One example is the Federal Reserve Board which provides both central banking and payment systems services, as well as regulatory functions. In addition, two of the U.S. agencies responsible for pensions and employee benefits – the Internal Revenue Service and the Department of Labor – conduct many activities that are unrelated to financial services. As mentioned in the text, the table does not include data on state securities commissions; data on the principal securities industry SROs (the NYSE and NASD) are, however, included. Also not included in this table are several agencies that perform relatively modest oversight functions in the financial services industry, such as the Federal Trade Commission and the Department of Housing and Urban Development, which oversees certain elements of the mortgage market as well as certain government sponsored enterprises, such as Fannie Mae and Freddie Mac, which are a form of financial institution. Because of these omissions, the data presented in Table 1 somewhat underestimates the level of financial service regulation in the United States.

lower that of other subsectors. While costs of operation may be lower for insurance regulators, as they are located throughout the country and not concentrated in more expensive urban centers such as Washington and New York City, one might reasonably infer that some of the difference reflects difference in expertise and training. In contrast, annual expenditures for personnel regulating the

Table 1
Summary of Annual US Regulatory Costs
(1998-2000 Data – Partial)

Sector	*Personnel*	*Annual Expenditures*	*Annual Expen /Personne*
Depository Institutions	22,175	$2,751,089,581	$124,064
Insurance Companies	11,817	$738,000,000	$62,452
Securities Industry	4,889	$644,900,000	$131,908
Futures Industry	556	$62,761,000	$112,879
Pensions & Benefits	2,285	$331,147,000	$144,922
Total	41,722	$4,527,897,581	$108,526

securities industry ($131,908) and pensions and benefits ($144,922) tend to be higher.

Table 2 presents roughly comparable data for the Financial Services Authority and is drawn from the FSA's 2000/2001 Annual Report.[36] In some areas, there are similarities between the FSA's levels of expenditures and those presented for U.S. regulatory agencies in Table 1. In both countries, resources are distributed across industry subsectors, and the ratio of annual expenditures to personnel in the U.K. ($119,349) is similar to total annual expenditures to total personnel in the U.S. ($108,526).[37] On balance, however, the differences between Table 2 and Table 1 are more striking than the similarities. Note first the difference in the allocation of resources. Whereas more than half of U.S. regulatory personnel and budgets were allocated to depository institutions, the FSA allocates over 60 percent of its budget to the securities industry and only slight more than a quarter to depository institutions.[38] A number of factors undoubtedly contribute to the smaller percentage of budgetary resources allocated to depository institutions in the United States – notably, the very high

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[36] See FSA Annual Report 2000/2001, Appendix Six, at 81 (available on-line at http:www.fsa.—). The data presented in the FSA annual report is only roughly comparable because certain regulatory functions in the United Kingdom – most notably oversight of certain employment based pension schemes – are regulated elsewhere. The London Stock Exchange also still engages in a limited amount of regulatory functions not captured in Table 2. The FSA Annual Report denominates expenditures in pounds Sterling; the data presented in Table 2 are presented in U.S. dollars, converted at an exchange rate of 1.5 dollars per Pound Sterling.

[37] The ratio of annual expenditures to personnel for the FSA is not shown in Table 2, but can be derived from the data in that table. To some degree, the fact that FSA expenditure per employee is higher than U.S. expenditures per employee is perhaps surprising, as average wages and GDP per capital is significantly higher in the U.S. Partially, this difference may be attributed to the fact that the bulk of FSA employees work in the London area, which has a high cost of living. In addition, the FSA has made more of an effort to match market compensation levels, at least for its more senior employees.

[38] Were Table 2 expanded to include oversight of other sources of British financial regulation, for example occupational pension schemes, see supra note 4, the ratio of total expenditures allocated to depository institutions would fall further.

number of depository institutions that still operate in the United States and the balkanized system of banking regulation that we maintain – but the resulting difference in the level of budgetary expenditures remains nonetheless noteworthy.

Table 2

FSA Annual Budget & Personnel

(Data from FSA 2000-2001 Annual Report)

	Annual Expenditures ('000s)		*Personnel*
Total Depository Institutions	**$91,500**		**n.a.**
Credit Institutions		$82,500	
Credit Unions		$1,500	
Mortgages		$7,500	
Total Insurance Companies (life, pension & non-life)	**$22,500**		**n.a.**
Total Securities Industry	**$216,000**		**n.a.**
Securities Firms		$28,500	
Exchanges		$6,000	
Capital Markets		$6,000	
Listings		$16,500	
Collective Investments		$27,000	
Financial Advisors		$84,000	
Ombudsman & Compensation Scheme		$48,000	
Grand Total	**$330,000**		**2,765**

For current purposes, an even more important difference between the regulatory expenditures and personnel levels of the FSA and those of the United States is the absolute difference in scale. Total U.S. annual expenditures on financial regulation in the United States during 1998-2000 was in excess of $4.5 billion or 13.7 times the annual expenditures of the FSA presented in Table 2. Personnel levels of the U.S. (41,722) were more than 15 times higher than those of the FSA (2,765). These huge differences in regulatory scale offer, I think, an independent reason why consolidation of the sort accomplished in the FMSA for the United Kingdom was never even discussed in the period leading up to the passage of the Gramm-Leach-Bliley Act.

In pondering the different levels of regulatory expenditure and personnel noted in the previous paragraph, one must recognize that these multiples do not simply reflect differences in the size of the two economies in question. In 2003, U.S. GDP was 6.8 times U.K. GDP.[39] The U.S. 2000 population was 4.6 times the U.K. population.[40] Nor is the difference simply a reflection of financial markets. As reported in the FSA 2000/2001 Annual Report, U.S. banking assets were only 2.2 times U.K. banking assets and U.K. equity market capitalization was only 5.8 times U.K. equity market capitalization.[41] None of these ratios approaches the ratios of regulatory expenditures and personnel levels revealed in Tables 1 and 2. Accordingly, even if one normalized annual expenditures for the size of the economy or capital markets, substantial differences would remain.

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[39] World Bank Estimates of GDP for 2003..

[40] See Alan Heston, Robert Summers and Bettina Aten, Penn World Table Version 6.1, Center for International Comparisons at the University of Pennsylvania (CICUP), October 2002.

[41] See FSA 2000/2001 Annual Report Appendix 5, at 81.

The relatively higher levels of regulatory costs and personnel levels for British authorities is consistent with the hypothesis advanced above that the mission of U.K. financial regulators is more narrowly constrained than the mission of their U.S. counterparts. That these differences persist even after adjusting for relative size of the two countries' economics and financial markets is all the more striking when one considers that economies of scale might be expected to lower the size-adjusted costs of U.S. financial regulation.

B. Expanded Set of Comparative Data from FSA 2002/2003 Annual Report

To confirm that the data presented above is not a statistical anomaly peculiar to a period when the FSA was just getting started and the Pound Sterling was relatively weak compared to the U.S. dollar, I have also examined data presented in the FSA's 2002/2003 Annual Report, which includes more recent information on FSA budget and staffing levels, as well as comparable data for a number of other jurisdictions, including the United States.[42] With respect to all of comparison and contrast noted above, the later compilation of data confirms the points I have made about differences between U.K. and U.S. regulatory intensity a few years earlier. But this expanded data set also illuminating in that it suggests how the regulatory intensity of U.K. and U.S. financial regulation compares with regulatory counterparts around the world.

Consider first total financial regulatory budgets and personnel levels for the ten jurisdictions

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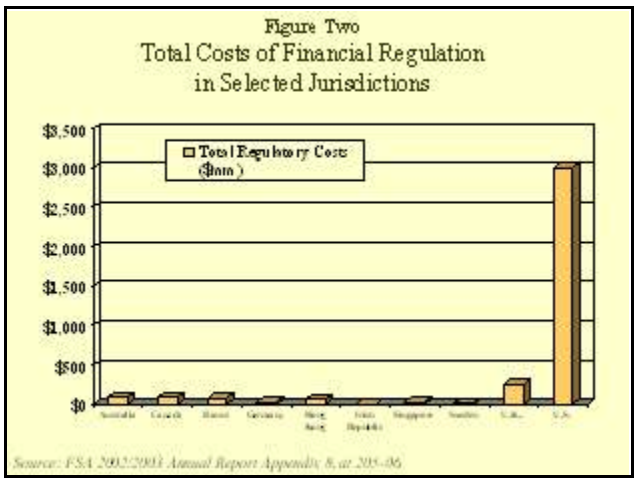
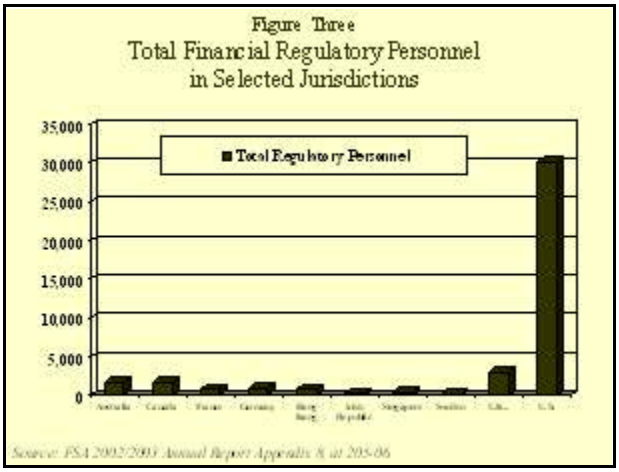
[42] See FSA Annual Report 2002/2003 at Appendix 8 (Pounds Sterling converted to U.S. Dollars at 1.7 dollars to the Pound). The FSA's data on U.S. financial regulators is less extensive than my own, but I present their data here in order to maintain – to the extent possible – comparability with other jurisdictions on which the FSA also collected data. As the notes accompanying the FSA cost estimates make clear, comparative surveys of this sort are difficult to undertake and some of the data is necessarily incomplete and incommensurate across jurisdiction. Accordingly, the data presented in the following pages should be regarded as suggestive rather than definitive. As explained below, the overall import of the data is I think sufficiently clear that one can draw at least preliminary conclusions from the data.

on which the FSA collects data. (See Figures Two and Three.) By both measures, U.S. enforcement budgets and staffing levels overshadow not only those of the United Kingdom but also of all other jurisdictions covered. (Indeed, when one looks at the United Kingdom's regulatory intensity in this comparison set, one sees that, if one puts the United States to one side, the absolute level of regulatory effort in the United Kingdom is much higher than that of the other jurisdictions reporting, thus offering some support for the conventional wisdom that the Americans and British have much





in common in this area.)

As before, the differences in regulatory intensity hold up even when one makes adjustments for the size of the financial services industry in eight major jurisdictions.[43] To illustrate this point, I have presented in Figures Four through Six, the FSA's estimates of regulatory budgets in the principal sub-sectors of the financial services industry (depository institutions, insurance companies, and securities firms) adjusted for proxies for the size of each subsector: banking assets in the case of depository institutions; insurance premia in the case of insurance companies, and equity market capitalization in the case of securities firms. Undoubtedly there are limitations in the quality and comparability of the data upon which the figures are based, the broad consistency of the evidence is strongly supportive of several propositions.

First, with respect to both depository institution (Figure Four) and insurance company (Figure Five) regulation, the United States outstrips the United Kingdom and, for that matter, all of the other major jurisdictions presented. Compared to the other jurisdictions surveyed, the intensity of U.K. regulation does not appear to be especially high, being at the lower end of the comparison set for depository institution regulation and in the middle for insurance regulation. Where the relative intensity of the U.K. regulation rivals U.S. intensity is in the field of securities regulation (Figure Six), reflecting the fact noted earlier that the bulk of U.K. financial regulatory resources are deployed to the securities field. Two other common law jurisdictions also have very high relative levels of securities regulation – Australia and Canada – both actually outstripping the United States

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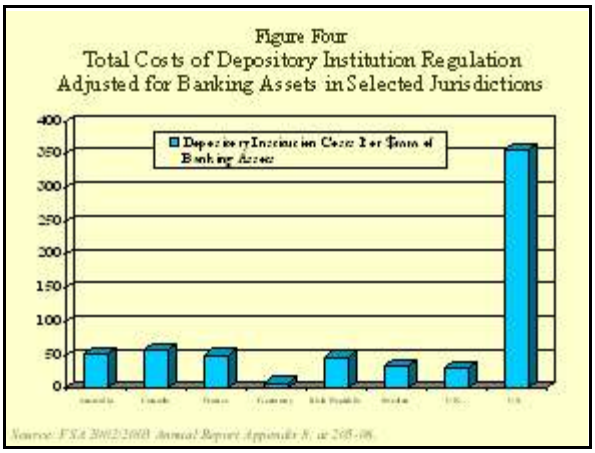
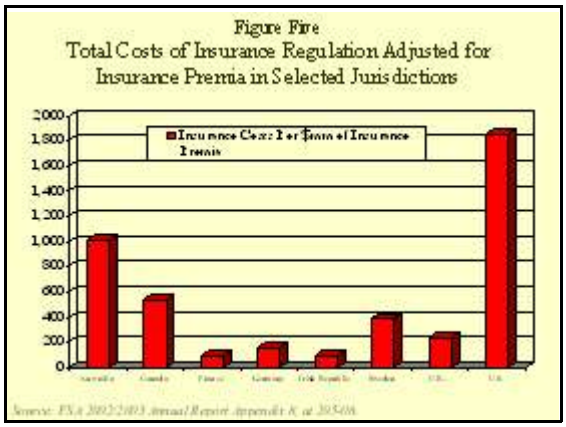
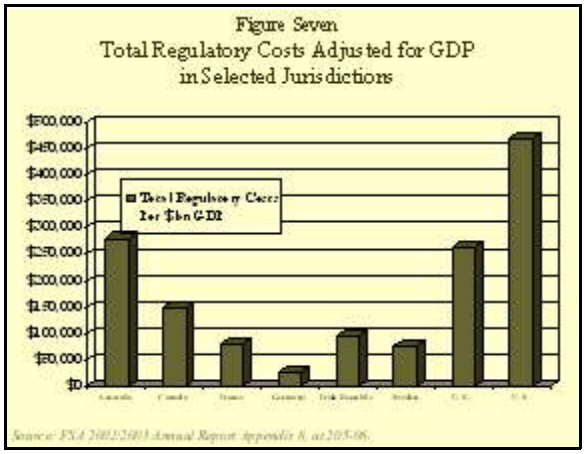
[43] For purposes of these presentations, I have excluded two jurisdictions presented in earlier figures: Hong Kong and Singapore. Their position as financial services centers distinguishes them from the other jurisdictions. Interestingly, the intensity of their financial oversight – as measured in these figures – is often quite high – in the area of insurance regulation even higher than that of the United States. While tangential to the subject at hand, the relative intensity of the regulatory effort of Hong Kong and Singapore warrants further study.

when adjusted for market-capitalization.[44] The three major civil law jurisdictions presented in Figure Six – France, Germany, and Sweden – all show much lower levels of intensity for securities market regulation.







[44] The relative intensity of Australian and Canadian securities enforcement likely reflects both the decentralized system of regulation adopted in these two jurisdictions and also their relatively low levels of stock market capitalization.

In an effort to summarize the foregoing data on financial regulatory intensity, Figure Seven presents total financial regulatory costs per billion dollars of GDP. Again, the United States leads the way with substantially higher adjusted regulatory intensity. The United Kingdom slips into third place by this measure, just behind Australia (buoyed by its relatively high intensity supervision in the securities field.) The three civil code jurisdictions – France, Germany, and Sweden – again fall to the bottom of the rankings of intensity, with the two other common law jurisdictions (Canada and the Irish Republic occupying the middle terrain).

In sum, the comparative data on regulatory costs presented in the FSA's 2002/2003 Annual Report is consistent with my claim that regulatory intensity (as well as absolute levels of regulatory effort) are higher in the United States than in the United Kingdom. But the data also indicates that measured against a broader set of international comparison, the United Kingdom is at the upper end of most measures of regulatory intensity and consistently above measure of regulatory intensity in the leading civil law countries surveyed.

B. Evidence of Comparative Enforcement Intensity

Another approach to regulatory intensity is to consider the outputs of regulatory oversight rather than inputs, such as budgets and personnel levels considered above. In this spirit, several students of mine at Harvard Law School have recently undertaken comparative studies of securities enforcement efforts in various jurisdictions, including the United States and the United Kingdom.[45] While the data in these studies should also be regarded as preliminary, the results are both striking

[45] See Joseph Martin, Comparative Enforcement of Securities Laws (Apr. 2002). See also Wai-Yin Alice Yu, The Enforcement of Securities Laws in East Asia: A Comparative Analysis of Hong Kong, Singapore, South Korea and Taiwan from 1998 to 2002 (Apr. 29, 2003); Duncan Herrington, Insider Trading and Market Performance (May 3, 2004)

and consistent with my claim that there are substantial differences in regulatory intensity between the United States and the United Kingdom, even in the field of securities regulation where regulatory expenditures are not substantially different when adjusted for market capitalization.

A good example is the work of Joseph Martin (HLS '02) on overall securities enforcement levels. Figure Eight summarizes Martin's findings with respect to average annual securities enforcement actions for the United Kingdom and the United States. Data for the United Kingdom is first presented in terms of actual enforcement actions and then adjusted to reflect the fact that the

Figure Eight
Annual U.S. v. U.K. Enforcement: 1997-2001
(from J. Martin, Comparative Enforcement of Securities Laws (Apr. 2002))

	U.K. Actual	*U.K. Adjusted*	U.S.
Total Actions	758	*3,319*	10,641
Total Monetary Penalty	$103 million	*$449 million*	$4,804 million - $ 4,034 million private - $ 770 million public
Suspensions & Expulsions	47	*206*	2313
Censures	14	*63*	1207
Warnings	128	*560*	0
Total Prison (months)	282	*1236*	1661

U.S. capital markets are larger than U.K. markets.[46] Aside from the area of warnings – where there

[46] The adjustments in Martin's paper are based on trading volumes as opposed to stock market capitalization.

is no ready U.S.analog – United Kingdom sanction levels are lower than those of the United States. Only in the area of criminal sanctions is the U.K. system roughly comparable. In terms of total actions, suspensions & expulsions, and censures, U.S. enforcement efforts outstrip United Kingdom actions by large multiples, even after adjusting for relative market size.

Large differentials are also apparent in the area of monetary penalties, although this aspect of Martin's analysis requires additional explanation. In the United States, there are two major sources of monetary sanctions for securities law violations: public enforcement action (which Martin estimates to be imposed at an average annual rate of $770 million during the period in question) and securities litigation, both settled proceedings and cases that go to trial or other forms of dispute resolution (averaging slightly over $4.0 billion a year). In the United Kingdom, Martin reports that monetary sanctions are principally imposed to regulatory actions, and while these sanction levels on an adjusted basis are not wholly out of line with U.S. public sanctions, the overall level of securities sanctions in the United Kingdom falls far short of those in the United States once one adds in sanctions private litigation. (Note that the data in this analysis predates the Enron scandal and associated enforcement proceedings over the past few years and thus substantially understates differences in enforcement that one would likely observe if this analysis were updated.)

* * * * *

In sum, the level of regulatory intensity in the United Kingdom appears to be substantially lower than that of the United States, both in absolute and adjusted terms. Numerous factors may contribute to this difference. As I have suggested above, different and generally more modest regulatory goals in the United Kingdom as compared to the United States likely explain a portion of this lower level of regulatory intensity. Other factors – differences in the composition of the

financial services industry in the two jurisdictions as well as the lawfulness of market participants in the two countries – may also explain some of the difference in regulatory intensity. For current purposes, I make only the modest claim that differences in regulatory intensity offer another reason why British regulators were able to consolidate much of the financial regulatory system in the late 1990's when U.S. counterparts made no similar efforts. I leave for another day the more intriguing and difficult question of whether the substantial differences in regulatory intensity that separates the United States from not just the United Kingdom but most other industrialized nations might suggest substantial misallocation of regulatory resources and enforcement efforts in some major financial markets.

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