Britain: Labour’s banking regulation means business as usual

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The Labour government’s proposals for regulating the banks and thus preventing another financial crisis in the wake of the collapse of Britain’s high street banks last autumn are a sham. They are a cynical exercise to cover up the fact that it is business as usual: Nothing must be allowed to stand in the way of the banks’ profits and the accumulation of wealth by the financial oligarchy that rules Britain.

Alistair Darling, the Chancellor of the Exchequer, rejected regulation of the banks and the shadow banks’ activities, the break up of the large banks, the separation of the banks’ retail and investment activities and any cap on bonuses. He called instead for higher capitalisation of the banks, a compensation scheme for depositors that would be pre-funded via a levy on the banks, and more financial education in schools to protect consumers.

These puny measures come nearly two years after the start of the financial crisis and a whole series of measures by the government to prop up the banks—measures that threaten to bankrupt the country.

Despite all this, the banks are on the verge of bankruptcy. The Bank of England’s Financial Stability Report warned that the banks are so debt laden and short of liquid assets that the economic recession and rising bad debts threatens their viability and that of the financial system itself. The banks are entirely dependent upon short term funding to keep afloat, and hence any volatility in the wholesale money markets can have—and has had—a drastic impact on the banks’ solvency.

According to the report, aggregate losses—as reflected in the price that the banks’ assets would fetch on the markets today—were a massive $14 trillion, more than ten times Britain’s GDP.

Since last autumn, the government took over some of the high street banks at a cost of £50 billion, allowed mergers to go ahead in breach of competition policy, bought up their toxic assets and made more than £500 billion available to the banks to stop them going under with little in the way of conditions or oversight. The Bank of England has resorted to printing money under its quantitative easing scheme to ensure that banks have enough capital.

The entire financial system has been explicitly guaranteed at a massive cost to the taxpayer. Even so, lending to business has all but dried up, while lending to the public is at least 5-6 points above the minimum lending rate.

At the same time, the banks have returned to their old ways. They have reinvented securitisation, which came to a halt last year, as a means of pooling their own risky assets into “smart” securitisation vehicles that can be sold. By getting their dodgy assets off balance sheets in this way, they aim to reduce their capital and thus get around the capitalisation rules.

The Treasury in Britain has largely followed what the Obama administration is considering in the US. It will set up a Council for Financial Stability, made up of the three existing regulators—the Treasury, Bank of England and the Financial Services Authority (FSA)—and chaired by the chancellor, to limit risk taking that threatens the financial system as a whole. But this is essentially the same set-up overseeing the banking sector since Labour came to power in 1997, and which has failed so conspicuously.

As the *Financial Times* explained, “no one can adequately describe the toolkit for this regulation, how the levers will be pulled or by whom. So it remains an empty aspiration.”

The Bank of England report has made it clear that the FSA, which had so spectacularly failed to regulate the financial sector, will continue to regulate it, be responsible for financial stability and will be given more powers to do so.

There is to be no limit on the banks’ size. The assets (loan portfolio) of just the major British high street banks were more than four times Britain’s GDP at the start of 2009. The government justifies this by arguing that breaking up large banks would be pointless, since even relatively small banks such as Northern Rock and the Bradford and Bingley can fail, posing risks to the entire system.

This refusal to break up the banks is a shot over the bow of the European Union. Just last month, Neelie Kroes, the EU Competition Commissioner, said that the Royal Bank of Scotland (RBS), one of the banks taken over by the government, was too big, too complex and "highly dangerous to the European single market". The EU has demanded the restructuring of German banks that received state aid and may demand restructuring of the British banks.

Neither will there be any curb on the banks' activities. The regulators will not interfere. This refusal to split the more risky investment banking, proprietary trading and hedge funds from retail and commercial banking means that the entire banking and financial edifice can continue to develop and trade in ever more complex financial instruments, underpinned by the taxpayer.

Instead, the larger and more complex banks that operate in more risky financial markets will be required to hold more capital to insulate them from any downturn in the market. But the Treasury failed to explain how the FSA would judge which activities and financial instruments and products were risky, how much extra capital would be needed or, crucially, in what form it should be held. The banks have for years been able to evade the feeble capital controls that do exist by including risky loans as capital.

Banks will be required to produce a "will" showing how they can be wound down in an orderly way in the space of a weekend, if they become insolvent.

The government refuses to regulate the shadow banking system—the hedge fund and equity funding industry—although it has the right to examine their books if they are deemed to pose a major risk to the system. It insisted that such regulation would have to be agreed at a global level, to avoid hedge funds migrating to "softer" jurisdictions. It is opposed to the EU's proposals to limit their ability to borrow, and to require greater financial reporting, saying that this would be "anti-competitive". With London home to 80 percent of Europe's hedge funds, the fear is that should these rules be adopted, hedge funds will relocate to Switzerland and the US.

The Treasury is considering whether to impose a new levy on the banks to pre-fund the Financial Services Compensation Scheme, an insurance scheme for depositors, currently covered by a government guarantee, starting in 2012 at the earliest. As this is only a proposal and has been met with hostility from the banks, it is unlikely to get off the ground.

Finally, after a raft of measures aimed at protecting the banks, the government claims it wants to protect consumers and their savings. But its only measure is to set up a free financial advice service for next year. It is calling for more personal finance education in schools.

What determines the government's attitude is above all the demands of the financial oligarchy and their insistence that the government protect London as a global financial centre, backed up with all the resources of the UK Treasury and future generations of taxpayers. The government's bailout of the banks and the entire financial system has only strengthened their demands.

The banks have virulently opposed even this minimal regulation, in particular the requirement to increase their holdings of cash and capital, as it would eat into their chances of making a killing on new and more exotic financial instruments.

Angela Knight, the chief executive of the British Bankers' Association, said that while the initiatives were "all right and proper," the higher capitalisation should be deferred for at least 10 years in the interest of getting Britain out of recession. She glossed over the fact that the banks were refusing to lend to business, thereby exacerbating the economic crisis.

Knight urged the politicians and regulators "to call an end to the blame game".

"The next stage is for the industry, regulators and country as a whole to come together," she continued. She likened regulation on liquidity and bankers' pay to "imposing a 30 miles per hour speed limit on motorways" to reduce accidents.

Even if these puny measures reach the statute book, they are unlikely to be implemented. The general election, which must be held by June next year at the latest, looks likely to bring the Tories back to power. George Osborne, the shadow chancellor, has pledged to overturn the legislation. He wants to get rid of the tripartite system of regulation and to see oversight returned to the Bank of England as it was before 1997.