Foreword

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In the case of most industries the primary purpose of regulation is to prevent the growth and abuse of monopoly power. The financial services industry is different. It is not a monopoly – indeed it is usually highly competitive – but it is regulated in almost every country of the world. The purpose of financial regulation reflects the special position of the industry for all of us – namely that we entrust financial institutions with our savings and want to know that they are being looked after properly.

With banks, there is an additional dimension. They provide the mechanism for money transfer around the economy, ranging from small retail payments to multi-million pound transactions between large companies. This is a service that is so much part of our everyday lives, and in the main invisible to us, that we can easily forget how essential it is to the performance of the modern economy.

The banking regulator must tread a fine line. He or she needs to look to the interests of depositors and the financial system as a whole without being over-intrusive into the affairs of private companies, which also have a legitimate duty to their shareholders for whom the regulator has no brief. The regulator must ensure that the standards set do not impose an undue burden on the regulated. It would be easy to stifle innovation and competition by inhibiting risk-taking by banks, but regulators understand that risk is fundamental to banking. Their job is to ensure that risks are understood, controlled and contained within manageable limits.

The UK has a very dynamic and innovative banking industry and the City of London's success as an international financial centre is a great national asset. Proper and well-balanced regulation is an important part of that success. The markets would not be here if their participants were not satisfied that the regulators were working to keep out the crooked and the reckless, but if our regulation became over-intrusive it could drive them away in a very short time.

Regulators must also be very sensitive to the costs that they impose on the banks. Providing the information that regulators need and making management time available to them can be expensive. On top of this the banks must also pay the regulator's own costs. Many consumers think of regulation as a free good,
so it is not surprising that they sometimes demand more of it. But of course banks have to recover regulatory costs like any others if they are to make a profit for their shareholders so the consumer pays in the end. The FSA makes extensive use of cost–benefit analysis to ensure that it does not impose unreasonable costs on the industry and no new policy, rule or requirement is allowed to go forward unless it passes the cost–benefit test. To help us pass that test we have recently formalized a system of risk-based supervision. This sharpens the supervisor's focus as never before and ensures that the process concentrates on the things that matter most.

Meeting regulatory standards for systems and controls and for the various financial buffers such as liquidity and capital also carries a price. Of course, left to their own devices, banks would undoubtedly put in place standards of their own, which theoretically might be tighter or looser. It is entirely legitimate to ask what the regulators can add to this process in a good bank, whose management brings its expertise to bear on creating safeguards that will protect the institution from harm. It is the regulators' job to work with the grain of such management and to allow it to find its own solutions. There is almost always more than one way to get to where we want to go and regulators recognize that they do not have a monopoly of wisdom. But, sadly, history shows that there have been many banks which have not made prudent decisions, and a few where the motivation of management has been questionable, at best.

As the financial world becomes ever more complex, the need for informed regulatory judgement will be more and more apparent. It will always be part of the regulators' job to set minimum standards, and for many banks that will involve a more straightforward, and perhaps more formulaic, approach. But in institutions where the highest standards prevail the regulator will want to be satisfied that the internally designed solution reaches the required standard rather than trying to find a single solution that works for everyone.

This new edition of the *Handbook of Banking Regulation and Supervision in the United Kingdom* is a timely and welcome addition to the literature. Its review of the major events in the history of supervision provide a context for our current system and its clear explanation of how banking supervisors currently go about their work is valuable to anybody with an interest in financial supervision.