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"Zest for Enlightenment"

Principle Follows Structure

How Industry Structure Affects Professionalism

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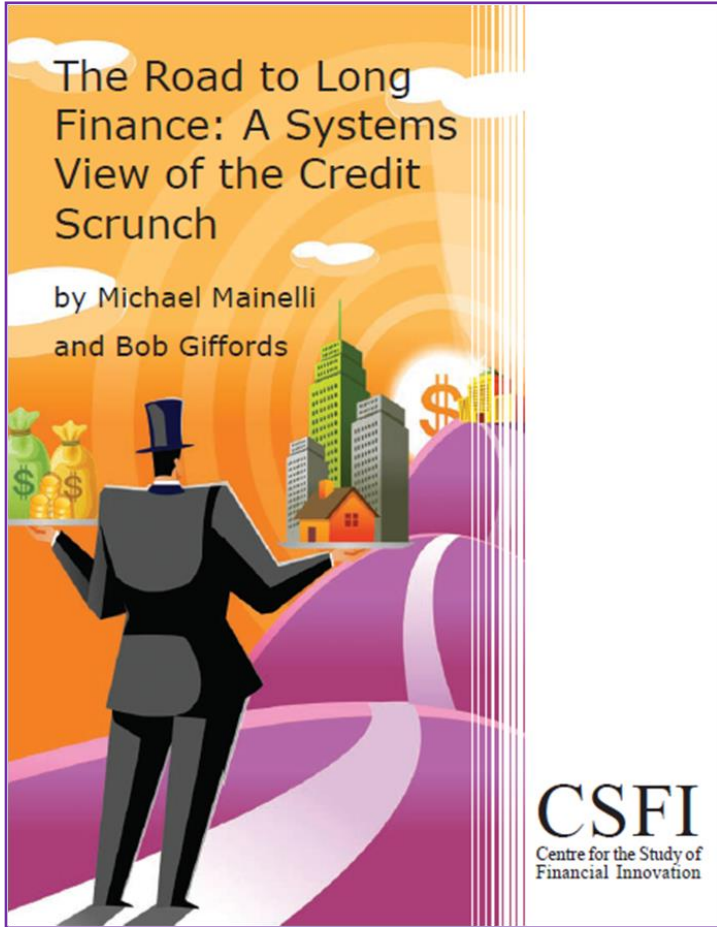
www.zyen.com





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About LONG FINANCE



‘When would we know our financial system is working?’

Objectives:

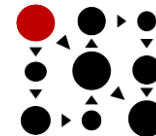
- ◆ Expand Frontiers
- ◆ Change Systems
- ◆ Deliver Services
- ◆ Build Communities



London Accord



Financial Centre Futures



Meta-Commerce



Eternal Coin



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Outline

- ◆ Trust
- ◆ Principle versus structure
- ◆ Open, competitive markets
- ◆ Professions and markets
- ◆ Cases and questions
- ◆ Discussion



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Backing Market Forces

“A commercial system in which actual and potential buyers and suppliers of products and services rely on conformity assessments.”

CISI
CHARTERED INSTITUTE FOR
SECURITIES & INVESTMENT

**LONG
FINANCE**

bsi.

Backing Market Forces:
How to Make Voluntary
Standards Markets Work for
Financial Services Regulation



November 2013

A joint paper from CISI, the Chartered Institute for Securities & Investment, and Long Finance



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Variety in Regulation

- ◆ Co-operative
- ◆ Delegated
- ◆ Devolved
- ◆ Facilitated
- ◆ Tacit



[Bartle and Vass (2005)]



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Swanning Around Professionals and Voluntary Standards Markets

Aspects or Purposes of Standardization	Intermediate Economic Effects	Ultimate Economic Effects
Variety Reduction	Scale Economies	Price
Quality & Performance	Division of Labour	Productivity
Measurement	Competencies	Entry
Codified Knowledge	Barriers to Entry	Competition
Compatibility	Network Effects	Innovation
Vision	Transaction Costs	Trade
Health & Safety	Precision	Outsourcing
Environmental	Trust & Risk	(Preventing) Market Failure

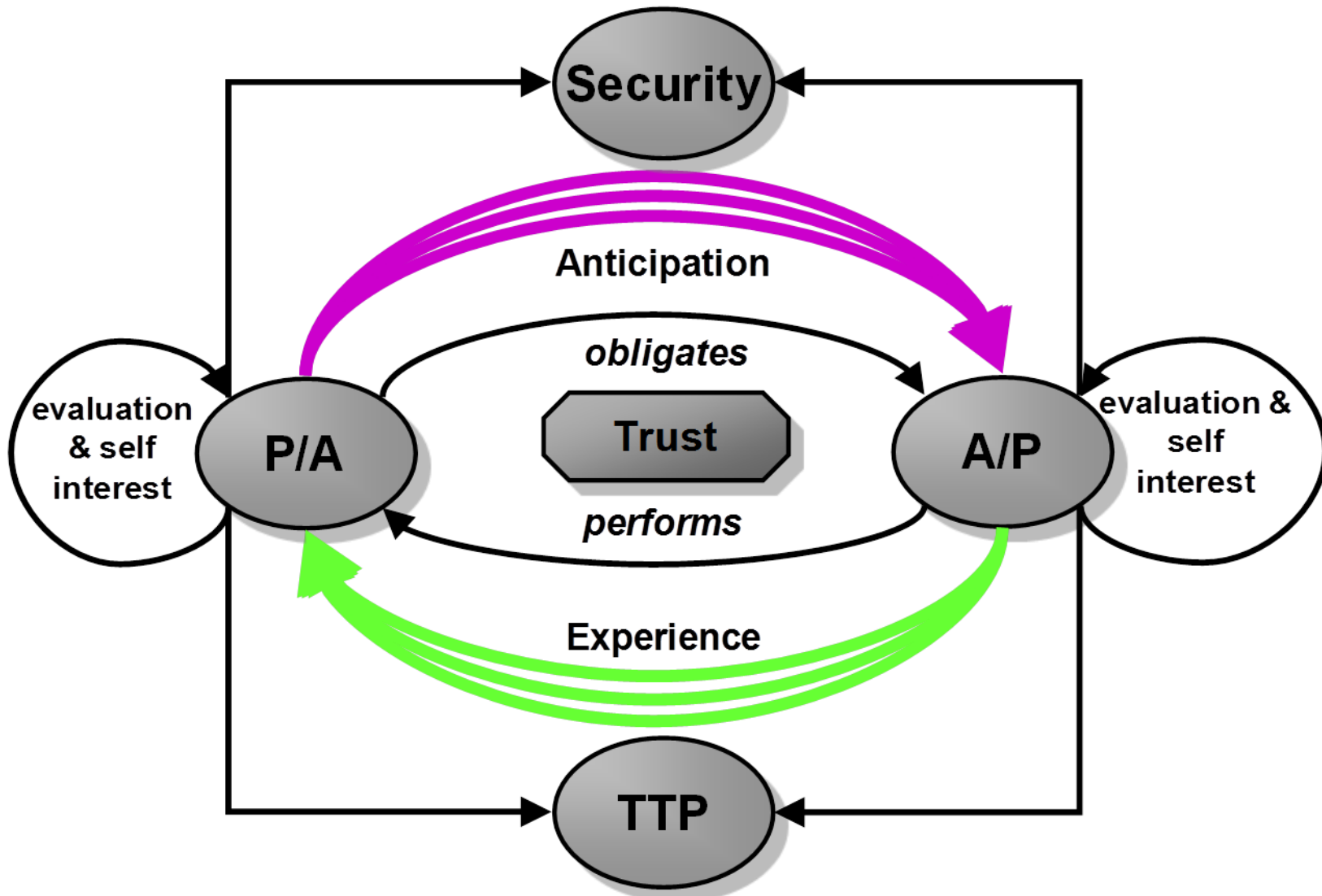
[Swann 2010, page 22]



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Trust = Obligation/Reputation

Reputation = Σ (Experiences-Anticipations)*



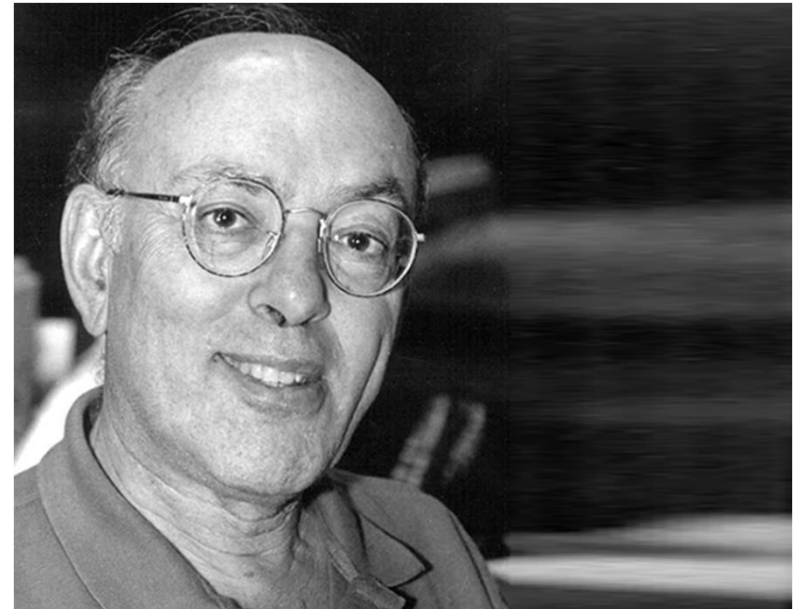
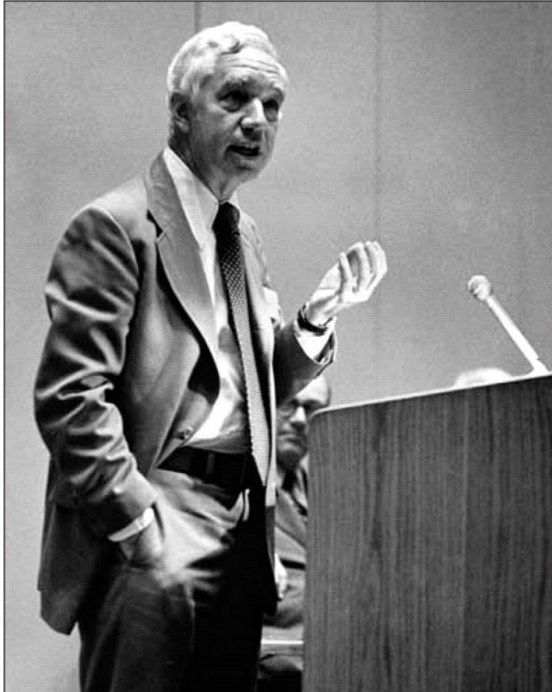
* wonder about incorporating volatility



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Chickens & Eggs

- ◆ “Strategy follows structure”, Chandler
- ◆ "Structure follows strategy ... as the left foot follows the right." Mintzberg





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Market Conditions

- ◆ Well-defined property rights
- ◆ Complete knowledge
- ◆ Enforceable contracts
- ◆ No agency
- ◆ Non-collusion
- ◆ Price taking and market clearing
- ◆ Free entry and exit

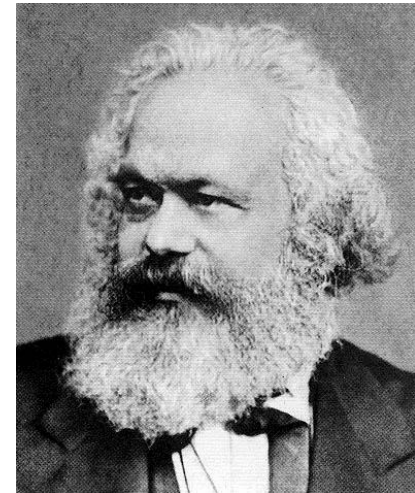
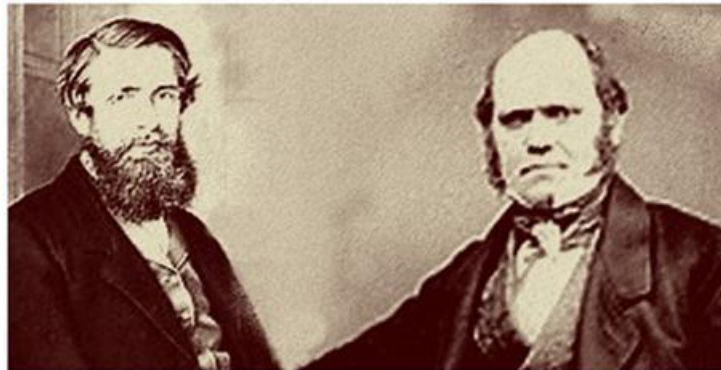
[Henderson and Ramanna, 2013]



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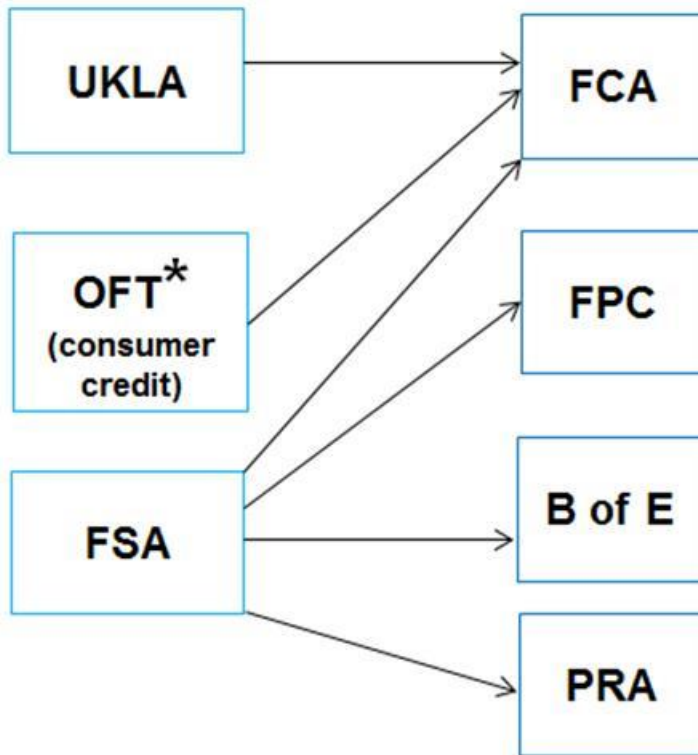
Open Market or Capitalist?

- ◆ Free information (missing from Freiwirtschaft's 'Freigeld, Freiland, Freihandel' – 'money, land, trade')
- ◆ Controls on size
- ...
- ◆ Information as private property
- ◆ Defining markets, e.g. international





Evolving Regulation



Financial Conduct Authority – becomes the listing authority and is charged with ensuring that the markets function well by (i) ensuring appropriate protection for consumers, (ii) protect and enhance integrity of UK financial system, (iii) promote competition amongst FS providers. Responsible for supervision of all financial services firms not supervised by the PRA.

Financial Policy Committee – based at the B of E. Objective is to identify, monitor and take action to remove or reduce systemic risks to the UK financial system.

Bank of England – recovering some of the powers held by B of E pre-FSA. Will be responsible for recognising investment exchanges.

Prudential Regulation Authority – a subsidiary of the B of E. Supervision of banks, building societies, insurers (approx 1,700 financial businesses). Objective is to “promote the safety and soundness of these firms”.

* Note that transfer of the consumer credit role from the OFT to FCA is expected to take place in April 2014.



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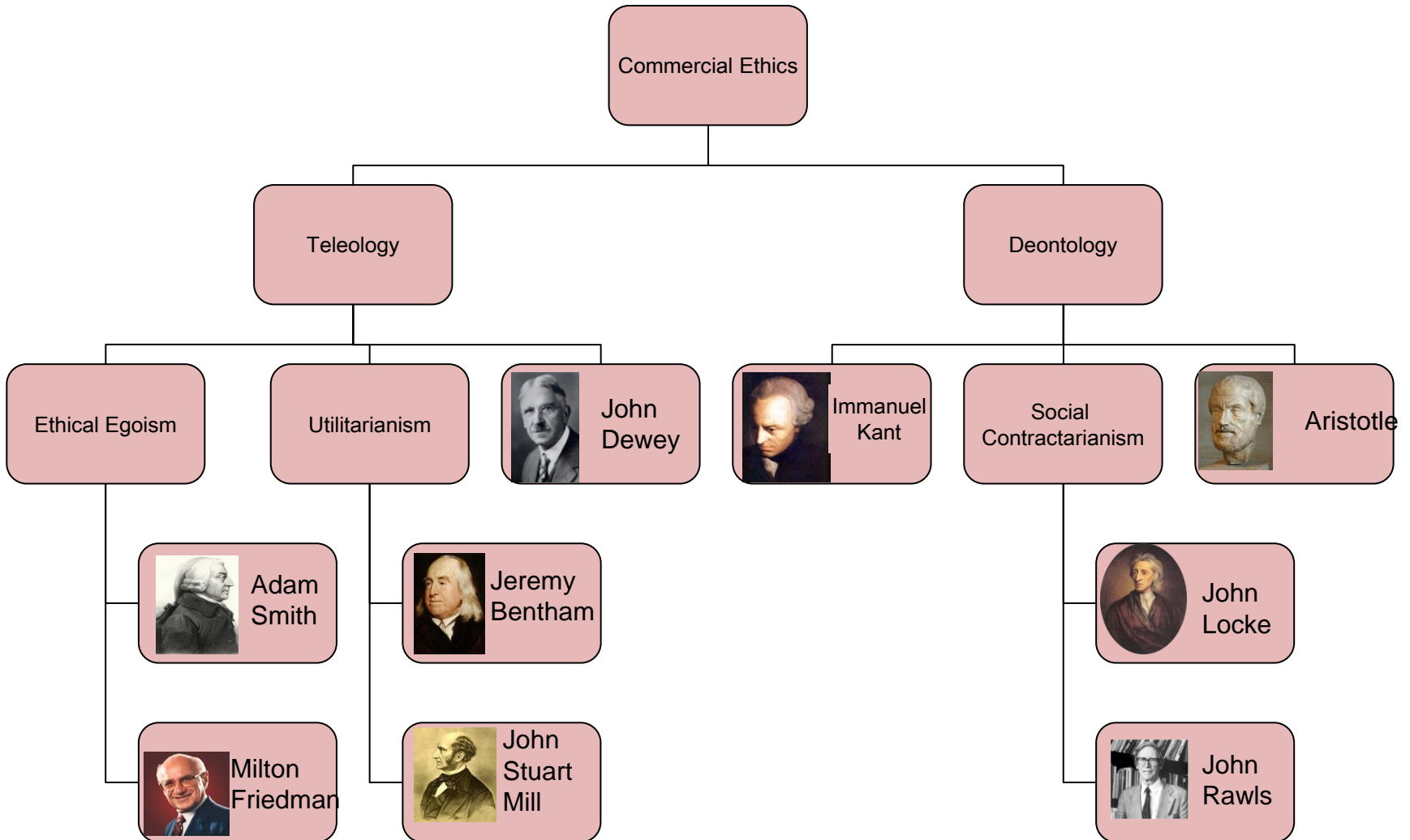
Normative Objectives of Open, Competitive Markets

- ◆ Libertarian - maximize freedom from encroachment
- ◆ Utilitarian – Pareto efficient
- ◆ Fair – widest possible participation of individuals in a society



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Taxonomy of Commercial Ethics



[Harris 2008]



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Forward View - Banking

Banking – Chartered Banker in an oligopoly -

<http://www.charteredbanker.com/MainWebSite/Resources/Document/Rebirth%20of%20a%20Big%20Idea%20-%20Special%20Report.pdf>

Personal Current Account Provider	March 2010 market share (%)
Lloyds TSB / Halifax Bank of Scotland	30
Royal Bank of Scotland Group (RBS)	16
HSBC (including First Direct)	14
Barclays	13
Santander (Abbey, Alliance & Leicester)	12
Nationwide Building Society	7
Co-operative Bank	3
National Australia Group Europe (Clydesdale Bank & Yorkshire Bank)	2

Source: Office of Fair Trading

The Herfindahl-Hirschman Index (HHI) (one measure of concentration) for the personal current account market rose in the UK from 1,410 in 2007 to 1,736 in 2010.



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Forward View - Auditing


- ◆ Four firms control the global market
- ◆ A product forced on (many) clients by governments, that is too late for shareholders to use, that no-one reads, that has no indemnity, and that has only rarely been prosecuted successfully despite numerous breaches...
- ◆ No measure of quality

When concentration is measured using the Herfindahl-Hirschman Index (HHI), the figure for the FTSE 100 is 3,175, while the figure for the FTSE 250 is 2,772. A HHI figure in excess of 1800 for a market is typically considered to represent a highly concentrated market.




Confidence Accounting – Scientific Measurement


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ACCOUNTANCY FUTURES

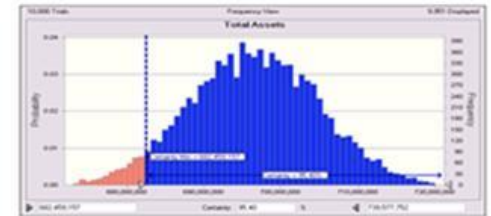
Confidence accounting: a proposal



A joint paper from ACCA, the Chartered Institute for Securities & Investment and Long Finance

Balance Sheet as at T0
in millions

Assets	Nominal	Expected loss	Estimated value	
Loans and advances - banks	50,000,000	5E-04	25,000	49,975,000
Loans and advances - corporate customers	100,000,000	0.007	700,000	99,300,000
Loans and advances - retail customers	200,000,000	0.015	3,000,000	197,000,000
Debt securities				
Level 1 and 2	60,000,000	0.002	120,000	59,880,000
Level 3	10,000,000	0.002	20,000	9,980,000
Derivatives				
Level 1 and 2	150,000,000	3E-04	45,000	149,955,000
Level 3	10,000,000	5E-04	5,000	9,995,000
Other	120,000,000			120,000,000
Total	700,000,000		3,915,000	696,085,000



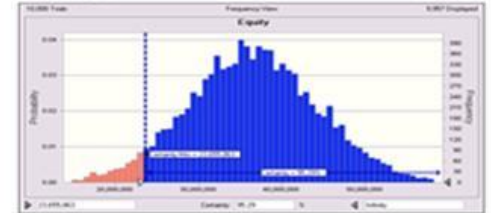
Liabilities

Deposits	350,000,000	350,000,000
Debt securities	75,000,000	75,000,000
Derivatives	150,000,000	150,000,000
Other (accruals, tax, short positions)	25,000,000	25,000,000
Subordinated debt	60,000,000	60,000,000
Total liabilities		



Equity

40,000,000	36,085,000
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Total

700,000,000	696,085,000
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Markets Affect Regulation

We need markets to simplify principles and ethics

- ◆ Diversity provides comparisons
- ◆ Small firms have to prove small solutions
- ◆ Snitching is good – PPI, audit, credit default swaps, leverage, ...



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Questions

- ◆ Can principle-based professionalism only begin in an open, competitive environment with diversity?
- ◆ Will principle-based professionalism decline in monopolistic or oligopolistic systems?
- ◆ Does a professional have a moral obligation to support competition and open markets?



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Principle Follows Structure

Thank you!

