Transaction Banking by D Sign

Blog

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"Regulation, Regulation, Regulation, The New Location For Transaction Banking"

At a recent relocation meeting I realised how much times had changed. Over the past few decades I've seen the debate on headquarters location move from where the money is, to where the customers are, to least cost, to where the tax is lowest. Our last relocation client focused on where the regulatory costs would be lowest. Their definition of regulatory costs included an interesting element – the likelihood of fines. In fact, the auditors were pondering whether likely future fines should be deducted from current revenue figures. The location that won, in Asia, was the one with the perceived most predictable regulatory system.

Don't Under-Misattribute Me

Attributed to Lord Harold Samuel, "There are three things that matter in property: location, location, location". New York Times columnist William Safire pours a bit of cold water on the origins of the phrase. "Here it is, from a 1926 real estate classified ad in the Chicago Tribune: 'Attention salesmen, sales managers: location, location, location, close to Rogers Park.'" [William Safire, "On Language: Location, Location, Location", New York Times (26 June 2009)]

So if the financial services mantra has now become "regulation, regulation, regulation", these are sad times indeed. There is a presumption that some jurisdictions, e.g. the USA, will be levying fines as 'rents', just the cost of doing business in the USA, or even just near it. And to pour salt on the wound, I spent some time in Switzerland listening to Swiss institutions so concerned about data protection conflicting with USA regulation and snooping that they won't use cloud providers with strong USA connections.

Lit Up, Not Light

Regulation is a major challenge for the financial services industry, its regulators, its investors, and its customers. Since the financial crises of 2007 there has been an unprecedented amount of new, complex, incomprehensible, and even contradictory, regulation. There is so much new regulation that nobody seems capable of staying on top of it or up to date with it. Financial institutions are being driven by rules rather than by business.

Z/Yen completed a Long Finance study of two hundred people in February 2015, "Comparative Regulatory Environments - A Comparison Of Financial Services Regulation In Eight Jurisdictions", sponsored by the Toronto Financial Services Alliance. The report

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compared regulation in Canada, Dubai, European Union (EU), Hong Kong, Singapore, Switzerland, the United Kingdom (UK), and the United States of America (USA).

Whilst there are some jurisdictions that perform better than others, the overall picture of the regulatory environment is depressing. Not unexpectedly, financial professionals seem jaded by the whole focus on regulations in the industry. Most believe that the regulations will continue to become more onerous, less easy to comply with, and more costly - yet at the same time, less effective. Most also believe that regulations will become a greater barrier to entry in the future. Regulation is stifling the industry. The action seems to be moving elsewhere.

The study did conclude that there were some clear divisions. The top rank comprised two jurisdictions, Canada and Singapore, followed by a second tier of Hong Kong, Switzerland, the UK, and the USA. The third tier consisted of the EU and Dubai. Interestingly, the better centres did not correlate with higher costs. Respondents were fairly clear about the strengths and weaknesses of the jurisdictions, but what they mostly wanted was to be treated fairly. The EMEA Centre for Regulatory Strategy sums up things well: “Senior management can no longer afford to treat regulation primarily as a matter of compliance: some regulatory developments raise fundamental questions about the economics of the business that go to the heart of the organisation’s strategy.”

Predictability, Predictability, Predictability

The easy quip is “I used to be uncertain, but now I’m not so sure”. Business people are attracted to jurisdictions with fair and stable rules (I often wonder if that’s why business people use so many sports metaphors – a firm belief that somebody, somewhere, ought to enforce stable rules fairly seems core to our being). Business people like governments without too much party fanaticism, because party fanaticism means the rules of the game can be changed rapidly. Business people can handle uncertainty as long as the *rules for changing the rules* inspire confidence. A rigid system is not predictable as it will have to break some time. Principles should be stable and rule changes predictable, which almost certainly implies numerous stakeholders and a wide polity. So the balance is predictability about how the rules of the game will change as circumstances develop.

How might a competitive centre deliver such predictability? Well, some quick thoughts include:

- set out a **Memorandum of Understanding between a government and its domestic financial services** on such items as inward investment, infrastructure investment, tax changes, or venture capital rules – basically agreements on how governments will change the rules in consultation with industry. This could be combined with scorecards or indices that underpin targets and evaluation. There should be timetables, e.g. one year of consultation, one year of drafting, one year of implementation on a three year timetable not tied to elections;
- consider issuing **Policy Performance Bonds** that would pay investors if the more important policies in the Memorandum of Understanding were not delivered, yet give interest-free money to governments that did deliver. Such bonds would be investment hedges and reduce political risk. Governments would pay for non-delivery of policy outcomes. The terms of the bonds would reflect the pace of change and the

commitment to longer-term goals such as educational attainment or % of GDP taken by taxation;

- deliver **full, early compliance** on people and tax, e.g. anti-money laundering rules, FATCA, know-your-customer. Malta is a good example of a country which has attempted to be first to implement new EU regulations on the basis that delay rarely if ever helps it be competitive, whereas early compliance does. Fight for tax simplicity so the rules, and obedience to the rules, are easily determined. Naturally there are wider tax issues of certainty and corruption, but simplification might be the most positive theme.

There are other ideas too. Governments also need to navigate international regulation as much as domestic regulation, making it hard to ensure that domestic commitments aren't overrun by international confusion. Perhaps it's best to look at governments as the writers of rules of the game who need to keep the players at the table convinced the rules are being rewritten fairly.

Don't Misattribute Me By Halves

Of course one must conclude with another misattribution puzzle, the old saw that "half of all advertising budgets are wasted, the trouble is, no one knows which half". The remark is frequently attributed by Britons to Lord Leverhulme, founder of Lever Brothers, and by Americans to John Wanamaker, who opened Philadelphia's first department store. Though references to such a saying date from at least 1919, no authoritative reference has been found linking either man to it. This leads one to observe that at least half the attributions are false, the trouble is no one knows which half. So perhaps today's mantra is more accurately, "Location & Regulation".

[1,197 words]

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