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Banking reforms expert Q&A: will relaxing the rules help the UK economy and what are the risks?

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Boom or bust? Chris Bull/Alamy

Jeremy Hunt, the UK chancellor of the exchequer, has unveiled a package of measures aiming to protect the City of London's position as one of the world's leading financial capitals. With the UK having lost nearly a tenth of the financial assets it manages since Brexit, plus at least 7,000 jobs, mostly to mainland Europe, much of the focus of these "Edinburgh reforms" is on making London more competitive.

This includes rowing back on rules introduced a decade ago to avoid a repeat of the global financial crisis, such as the ring-fence between customer deposits and investment banking activities, and holding finance bosses personally and financially responsible for things that go wrong on their watch.

Various other measures are designed to encourage UK financial regulators to prioritise delivering growth and international competitiveness, as well as making it easier for companies to raise capital ahead of a flotation and a consultation on a digital pound. We asked Robert Webb, a professor of banking and applied economics, for his take on what we know so far.

How are these reforms shaping up?

I really worry about the prospect of a race to the bottom on regulation rather than prioritising global rules for finance. Each generation forgets how bad we messed up the time before. If you think about the 21-year-olds that I lecture, they were only seven in 2008. So people under a certain age have no first-hand experience of what happened.

The crisis hit because we had no handle on the securitisation process [in which mortgages were packaged up and sold into the financial markets as new products to investors who didn't understand the risks in the underlying loans]. This meant that the loans were no longer on the mortgage banks' balance sheets, which meant the bank didn't have an incentive to keep monitoring them for risks. It also meant they didn't need to hold as much capital to protect against defaults by homeowners. In effect, these securitised investments were misunderstood and unregulated.

The reason we got into that situation is because of reforms since 1986. Traditional retail banking is pretty boring: you basically make your money on the spread between the interest you pay depositors and the interest you charge for loans. It's very conservative and laborious and needs a lot of checks and balances.

The big bang reforms in 1986 were part of a long-term liberalisation of banking rules in the run-up to 2008. Martin Mayer/Alamy

The culture in investment banking is totally different. It's one of spectrum-filling the financial markets with products of different levels of risk and reward. It's very fast-moving, very sales-based. Those two cultures don't sit well next to each other. But starting with the big bang reforms of 1986, securitising retail bank loans was the kind of thing that became possible.

The regulations introduced after 2008 are necessary to protect consumers. As we saw during that crisis, it's very difficult for people outside of banking to see what's going on inside the machine.

How does this relate to the new proposals?

The reforms introduced from 2009-11 were about ring-fencing retail banking from the world of investment banking again. We'll have to see the detail of the proposals, but if Jeremy Hunt is now saying we should get rid of that and allow things like using retail deposits in investment banking activities, that's a dangerous move.

As for reducing the liabilities of senior managers, where is the advantage in doing that? We used to talk in risk management about the tone from the top. It emanates down through an institution. If the chief executive is no longer responsible for risk in the same way, how is that going to affect the tone within organisations?

It's the same with the new duties for regulators. If they are trying to undercut the EU's regulatory system, that's worrying.

Hunt is saying that financial rules have evolved since 2008 and will still protect people – what are your thoughts on that?

The post-2008 regulations were valid when they were introduced and there is nothing to suggest that they are not valid now.

One point to make is that there are two things here: what the reforms actually do and how the City reacts to them. A lot of companies can circumvent regulations, but the regulations are there to draw a line in the sand. It's not that exactly the same problems will arise; it's the culture you create by introducing new relaxations.

What should be the government's priority for making UK finance more competitive?

If we want to compete with Europe and other financial centres, it needs to be on actual business. We need to be more efficient and offer better, more innovative products.

We'll win at finance by winning at technology. We need to put the infrastructure in place to entice fintech [financial technology] companies to establish themselves in London. People under 35 don't care about, say, Barclays; everything is on their phone through Apple Pay, Google Pay or whatever. China has led the way here and that's what we need to prioritise too.

The Chinese have led the way on mobile banking. Lou Linwei/Alamy

You could also offer tax breaks to financial start-ups, as well as making it as easy as possible for companies to work within the regulations – like they are doing with the open banking initiative. Everything should be about pushing London as a hub for next-generation banking. That will look very different to the skyscrapers that we associate with finance today: people don’t need that anymore.