

A low-angle, black and white photograph of a modern skyscraper with a curved glass facade. The building's lines converge towards the top of the frame. A horizontal red band is superimposed across the middle of the image, containing the title text. The sky is filled with white, fluffy clouds.

Nine Steps to Financial Stability in 2020

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ACCA's role

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. ACCA has its headquarters in London and 141,330 of our members, students and affiliates are based in the UK. Globally, we support our 131,500 members and 362,000 students throughout their careers, providing services through a network of 82 offices and centres around the world.

We use our expertise and experience in areas such as tax and finance to work with governments, donor agencies and professional bodies to develop the global accountancy profession and to advance the public interest. By promoting our global standards, and supporting our members wherever they work, we aim to meet the current and future needs of international business.

Our staff around the world have been working with members and others in the financial services sector to develop the network necessary to understand the financial crisis from the perspectives of governance, remuneration, regulatory and accounting stances. ACCA has played an active role in influencing the G20 discussions, including the production of our position papers: *The G20 Summit: April 2009*, and *Complacency vs Reform: ACCA Position Paper on the G20 Summit September 2009*,¹ which includes analysis and recommendations to leaders and policy makers in advance of the meetings.

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Introduction

In 1998, the UK Government published its *Code for Fiscal Stability*, based around five key principles:

- transparency in the setting of fiscal policy objectives, the implementation of fiscal policy and the publication of the public accounts
- stability in the fiscal policy-making process and in the way fiscal policy impacts on the economy
- responsibility in the management of the public finances
- fairness, including between generations
- efficiency in the design and implementation of fiscal policy and in managing both sides of the public sector balance sheet.

It is this code that has required the Government to publish clear rules for public sector borrowing and provide full information on the public finances at least once a year, to account for their success or failure in meeting their borrowing targets and that has enshrined the annual pre-Budget consultation exercise.

Governments have a key role to play in providing a stable economic environment in which people and businesses can plan for the future, and growth can prosper. Openness and predictability on policy are indispensable ingredients in this. But in 2009, as the world's economy begins to emerge from the recession and the fiscal stimuli wind down, the outlook for debt gets worse, not better. The reality is that no one country alone can ensure fiscal stability. The current financial crisis began in financial markets in the United States and its effects have spread into the real economy around the world. The response must also be a global one, involving all parts of society.

There has been much discussion, in which ACCA has played a full part, regarding the causes of the crisis, including the roles of global macro-economic imbalances and financial innovation, failures in regulation, supervision and corporate governance. The time has come to move on to discuss what needs to happen to ensure financial stability for the future. ACCA has produced this paper to outline nine key elements that it believes must be in place by 2020 to ensure stability and to avoid a repeat of the current financial crisis.

ACCA'S NINE STEPS TO FINANCIAL STABILITY

1. **A separation of retail – or at the very least deposits - from investment banking and a return of distressed banks to the private sector in a profitable way**
2. **A return to savings over debt and a decent State post-retirement provision**
3. **An effective transition to a low-carbon economy**
4. **Full governmental support for small businesses**
5. **A permanent secretariat for the G20**
6. **Ensuring a stable, transparent, fair and certain system of taxation.**
7. **The adoption of International Financial Reporting Standards**
8. **Ensuring safe payments and consumer protection**
9. **Effective corporate governance**

1. Banks

The banking sector undoubtedly played a role in the financial crisis, with corporate and investment banking, bringing both significant profits but ultimately also billions of pounds in toxic debt and trillions in banking bailouts around the world. Steps need to be taken to ensure that this issue is addressed and specifically, that retail banking activities, which have long accounted for much of the profit of many banks and which focus on deposits and supporting consumers, are protected.

The case for separating retail from investment banking and insurance was acknowledged during the Great Depression in the US in the form of the 1933 Glass-Steagall Act, which limited banks to retail activities and making working capital loans to companies. This remained in place until the late 1990s, with the merger of Citibank and the Travelers insurance and investment banking group. Glass-Steagall was repealed soon afterwards.

In October 2009, the Bank of England Governor, Mervyn King, was one of a series of influential voices advocating the idea of splitting traditional retail banking operations from riskier investment banking businesses, an idea that was rejected by the Government.

STEP 1 TO FINANCIAL STABILITY

By 2020, the separation of retail – or at the very least depositors – from other forms of banking will have taken place. Banks will have been returned to the private sector in a profitable way, and ethics and risk training for all bankers will be in place. Banking will be a highly competitive sector with few barriers to entry, and a renaissance of mutual funds and cooperative forms of organisation. Regulation and regulators will be finely attuned to the danger of institutions developing into serious systemic risk for the banking sector and for society as a whole.

The payments system will be accorded the importance and centrality of any other utility such as roads, water or electricity and as such will be clearly governed and maintained in a secure, low-risk environment.

2. Savings

The last decades have been marked by a combination of low savings rates and high debt levels, especially in the US and UK, which both have economies largely based on consumption, the housing market and the expansion of personal debt. This is highlighted by the 2008 Office for National Statistics report into the nation's economic well-being, which showed that 13 million adults have no financial savings or investments. It is difficult to divorce the current financial crisis from this short-term approach.

The time has come to rebuild the savings culture – to reject the credit card in favour of the piggy bank, and it is for the Government to cultivate an environment that encourages this. This should be addressed urgently through the reform of pensions and benefit systems in order to restore the social and economic benefits of a low time preference culture.

STEP 2 TO FINANCIAL STABILITY

By 2020, a savings culture will flourish, and public and private sector occupational pension provision will be on equal footing. This will have come about due to the abandonment of auto enrolment and personal accounts legislation and instead the establishing of an independent fiscal modelling unit within The Pensions Regulator, one of whose first steps was to recommend an increase in National Insurance contributions borne equally by citizen and state leading to an immediate and significant increase in pension provision. This culture will have been fostered by a longstanding and effective public service campaign driven by the BBC.

Savings products and financial advice will be priced transparently, with consumers either choosing to pay for advice on a time basis or clearly stated annual commission basis. One outcome of the BBC's public service campaign will be a clear understanding of the effect of compounding and discounting products over the medium and long term.

3. Green collar and the transition to a low-carbon economy

Recent projections from the Intergovernmental Panel on Climate Change (IPCC) warn that unless action is taken to cut greenhouse gas emissions, global warming will exceed the danger level of a 2°C increase. According to the IPCC's worst-case scenario, climate change could reach dangerous levels as early as 2050. Current assessments show that this is likely to happen. Unprecedented action is required nationally, regionally, and internationally to address this.

For pessimists, the current economic downturn has substantially delayed green economy plans, with governments now pre-occupied with the recession and focusing on fiscal stimulus measures. There is an increased reluctance by countries to commit resources to climate change policies and taking measures which (in the short-term) will harm the competitiveness of domestic industries. The phenomenal financial bailout has prevented any large scale investment in climate change mitigation and the green energy sector. The economic downturn will lead to a decline in direct investments and reduce the rigour of future climate change legislation and environmental taxes to protect the competitiveness of industry in the dire financial climate.

However, the trillion dollar banking sector bailout is proof that governments can work together, quickly, to help resolve global catastrophes. These difficult economic times, which could actually provide a golden opportunity to encourage investment in a low-carbon economy, specifically in energy-efficient technologies and renewable energy and in creating lower-carbon growth and green jobs. But developing a global framework to address climate change needs to be a collaborative effort between government, business, scientists and society, to promote a common understanding across all stakeholder groups of the issues at hand and how they should be addressed.

STEP 3 TO FINANCIAL STABILITY

By 2020, there will be clear carbon metrics and an international Emissions Trading Scheme which actually works. The only viable mechanism for co-ordinating global emissions reductions is a carbon-trading scheme. The schemes already in place, such as the EU's ETS have had early problems, but are being reformed. The next period of the ETS will see an end to many of the free permits that have undermined the project, while many governments are considering introducing carbon price-floors to ensure an incentive for businesses to go green.

The job creation potential of freeing the economy from energy dependency will be fully realised with considerable investment in physical infrastructure to accommodate a plethora of renewable technologies as well as the retrofitting of the existing estate.

4. Small and medium sized enterprises (SMEs)

At a time when the Government's finances are becoming increasingly tight and small businesses are facing mounting pressures, we must not lose sight of the fact that small businesses are the growth engine of economies around the world. During the worst of the recession, one in every five net jobs lost in the UK was replaced by a self-employed person, demonstrating that the role of entrepreneurs during economic downturns is crucial. Not only do they introduce new economic activity when existing businesses tend to reduce theirs, but through this process they create new employment, paving the way towards economic recovery. SMEs are an important part of developed and developing economies as they play an important role in creating jobs, innovation, supporting stability, macroeconomic growth and act as a growth engine. In OECD countries, SMEs represent 95 percent of all enterprises, accounting for two thirds of employment and being the main source of new job creation. As such, SMEs in many countries around the world are the major source of economic recovery and assist the return to sustainable growth. In fact, some of the most innovative and fastest growing companies were started during recessions such as Wal-Mart (1962), Starbucks (1971), Microsoft (1975) and Virgin Atlantic (1982).

Small businesses need a genuine commitment from the Government that their varied needs are recognised and taken into account, adopting the 'think small first' approach when designing fiscal, economic, regulatory and legal environments. Thinking small first does not mean subsidising smaller businesses at every opportunity. It means making sure that, in complying with government's requirements and accessing its support network, a business' size, resources and administrative capacity do not confer an implicit subsidy.

STEP 4 TO FINANCIAL STABILITY

By 2020, policy makers will have finally taken to heart the fundamental importance of Small and Medium Enterprises (SMEs) to any economy's health. The small business and enterprise portfolio will be elevated to Cabinet level and continuity in small business policy will be assured. The 'Think Small First' principle will have been enshrined in government, with public policy considering small businesses not as an exception, but as the norm. More will be understood about the optimal density of company stock and about the behaviour of entrepreneurs in economies. Regulation will become a last, not first, resort, and there will be better publicised support available to SMEs at the local and national levels. Civil servants and local authority officers will have a better understanding of the circumstances and behaviour of SMEs, and the public procurement market will become accessible and transparent for all sizes of business.

5. G20

The G20 was established in 1999 in the wake of the Asian financial crisis as a forum for cooperation and consultation on matters relating to the international financial system. A G20 summit represents a pragmatic approach to finding effective solutions to key global challenges such as financial instability and the need to reform the global financial institutions. Representing the world's 20 leading industrialised and emerging economies, and accounting for 90% of the world's GDP, it is a more representative and inclusive global steering committee than the Group of Eight (G8).

It is clear that the financial crisis and other issues such as climate change, are too big for individual nations to tackle on their own. Thus, governments are looking more and more to global agreements, and to reinforce international cooperation. ACCA believes that there should be a formal agreement to make the G20 feature a long-term feature of global governance.

STEP 5 TO FINANCIAL STABILITY

By 2020, the organisation will be formally recognised as a permanent structure, with a secretariat located in Beijing. As the global recession has demonstrated, the financial problems of a globalized world are too big to be tackled by individual countries. The G20 offers a framework for co-ordinated action. Importantly, the G20 provides an opportunity for developing nations to take part in the process of global economic discussion and governance, whereas previously, they had been excluded. Representing over two thirds of the world's population and 90% of global GNP, the G20 is imbued with a high degree of legitimacy and influence. If the G20 is to build on the rapid progress it has made since its creation in 1999, its temporary, rotating secretariat must be replaced by a new, permanent, secretariat to ensure efficient operation.

6. Taxation

It has been argued by the International Monetary Fund (IMF) that the global financial crisis has been exacerbated (though not caused) by tax policies which fuelled the credit boom that preceded the economic downturn. The IMF proposes that governments should consider changing the rules that have encouraged companies to seek finance using debt rather than equity, and allowed individuals to take out larger mortgages. Many tax regimes allow companies to deduct interest payments against tax but not against returns on equity; this has resulted in an increase both in leveraged buy-outs by private equity organisations and in the holding of debt rather than equity by other financial institutions. The IMF argues that 'corporate level tax biases favouring debt finance including in the financial sector are pervasive, often large and hard to justify given the potential impact on financial stability.'

STEP 6 TO FINANCIAL STABILITY

By 2020, there will be a stable, transparent, fair and certain system of taxation. A significant problem with tax policy around the globe at present is that its formulation is rife with politicisation, leading to an overtly short-termist approach to tax policy. Meanwhile, the specialist nature of tax law means that it is often improperly scrutinised by democratic bodies. It is vital that more technical support be given to democratic scrutiny committees, and means must be developed to remove short-termism, and the instability it produces, from the formulation of tax policy. All jurisdictions will adopt a 'dead heading' approach to removal of irrelevant legislation. Civil servants will have 'deadheading' of old legislation built into their annual performance appraisals. All new tax legislation will be subject to Plain English vetting.

7. Accountancy

In 2008, before the financial crisis really hit, the US Securities and Exchange Commission (SEC) published a roadmap laying out a proposal for how US companies should shift to using International Financial Reporting Standards, or IFRS, starting in 2014. Earlier this year, the SEC sought additional comments on its proposal, but discussions surrounding the roadmap have generally fallen out of the spotlight after the financial crisis and the Madoff scandal took center stage.

The financial crisis and the current focus on accounting standards provide a unique opportunity to simplify, improve and clarify accounting standards. IFRS sets out to provide a single set of high quality and internationally accepted accounting standards, developed after due process and consultation by an international standard setter that seeks to reflect the changing distribution of world economic activity. IFRS is helping to make financial information more transparent and comparable across countries, industry sectors and companies. In doing so, it improves investor information, comparability and investment choice.

STEP 7 TO FINANCIAL STABILITY

By 2020, IFRS will have been adopted around the world, and the International Accounting Standards Board will focus on implementation rather than standard-setting. The increasing globalisation of business requires one set of reporting standards, and these standards should be principles-based rather than rules-based. The IFRS represent the most viable and credible solution to this requirement. The alternative is a fragmented system of reporting that will hamper comparability and limit the financial transparency that is a necessity for international investors and other stakeholders. Not having a global standard would be a step away from a globally coordinated response to the global financial crisis.

8. Safe payments

The increasing availability of the Internet and digital TV means that it is becoming easier and quicker for consumers to shop without leaving home. Shopping is also becoming a truly global experience, with more and more consumers turning to their computers to buy goods such as software and CDs, higher priced items such as cars and holidays, as well as services such as insurance. Taken alone, the UK's Internet shopping market is worth more than £21.4 billion, with more than 20 million people buying online in 2008 .

Online shopping has become a multi billion pound business, but online fraud has also increased exponentially. However, online fraud is not the only risk facing those who do online shopping. There are also company insolvencies and unethical business practices to negotiate.

Banking has also gone digital, with millions of customers taking advantage of the convenience, speed and environmental benefits of online banking, despite security issues, data leaks and cracks in security that enable hackers to gain access to private information and accounts. These are all issues that urgently need to be resolved.

STEP 8 TO FINANCIAL STABILITY

By 2020, there will be widespread limited liabilities for individuals for unauthorised or incorrect payments made in their name online. Browsers and e-mail systems will have become more effective at protecting personal information, while protections for computers against outside interference will have become significantly advanced.

9. Corporate governance

Underlying much of the credit crunch has been a fundamental failure in corporate governance. While the financial institutions involved may have been in compliance with local requirements and codes, they have ignored the key point – good corporate governance is about boards directing and controlling the organizations so they operate in their shareholders' interests. Boards should be answerable to company owners, to account properly for their stewardship and to ensure both sound internal control and the ethical health of the organizations. The use of overly-complex financial products, which thwarted effective supervisory control, and the unethical advancement, at the point of sale, of loans to people with little realistic hope of repaying them shows a lack of basic corporate governance. All of these issues need addressing in order to prevent a further financial crisis in the short-term.

STEP 9 TO FINANCIAL STABILITY

Many of the causal factors seem to be inextricably linked to a failure in corporate governance. Regulatory boxes may have been ticked but fundamental principles of good governance were breached. There should be more emphasis in the performance of corporate governance than with its regulatory compliance. To help improve understanding about governance performance, ACCA has published a set of ten corporate governance and risk management principles which we believe have to be observed to achieve good corporate governance.

TEN CORPORATE GOVERNANCE AND RISK MANAGEMENT PRINCIPLES

1. Boards, shareholders and stakeholders share a common understanding of the purpose and scope of corporate governance.
2. Boards lead by example.
3. Boards appropriately empower executive management and committees.
4. Boards ensure that their strategy actively considers both risk and reward over time.
5. Boards are balanced.
6. Executive remuneration promotes organisational performance and is transparent.
7. An organisation's risk management and control is objectively challenged, independently of line management.
8. Boards account to shareholders and, where appropriate, other stakeholders for their stewardship.
9. Shareholders and other significant stakeholders hold boards to account.
10. Corporate governance evolves and improves over time.

These principles are presented in full in *Corporate Governance and Risk Management Agenda*, ACCA, 2008. www.accaglobal.com/pubs/general/activities/library/governance/cg_pubs/tp-cga.pdf