5. Legislation and Split Regulation

(continued from page 3)

‘Far too much regulatory effort globally has been wasted looking at things that, in retrospect, just do not seem to matter’

In the UK there is less need for change. The legal structure is sound and can address any change that is necessary. What does need to change dramatically is the Bank of England and the Financial Services Authority rule book. This is too long and too detailed to meet the needs of the market. A move back to principles and objectives in regulation would be much more effective. Rules that do not clearly add value to the overall objectives of regulation should be abolished. Perhaps the FSA could adopt an objective of halving the size of its rule book in a year.

A better focussed series of rules and regulations would be far more appropriate that the detailed analysis that is currently in place.

We remain concerned that there will be knee jerk regulation in response to the crisis. Without doubt any regulation passed in haste will need to be repented at leisure. Putting additional burdens on the banks at this stage will slow their recovery and deepen problems in the economy generally. This should be avoided.

There will be countless people calling for additional disclosure and reporting from the banks. Much of this will be based on the bizarre notion that reporting would have made any difference to the crisis. We take the firm view that additional disclosure to the markets is the least of the problems that we are currently facing.

Bank’s accounts are full of disclosure, much of it academic, such that the accounts are already almost impossible to decipher. Additional disclosure will make them even harder to understand and the weakness of the press to analyse such matters would actually cause the next failure to be even worse.

Without doubt the main cause of the current credit crisis was liquidity. However, from a regulatory perspective, what we believe is required is not more disclosure, but better disclosure and here we take issue with international accounting standards. IAS39 in particular is one of the causes of the crisis effectively requiring assets to go to fair value regardless of the reason why they are held. In our view it remains completely incorrect to force a fair value adjustment onto an asset which is likely to repay at full value.

The standard resulted in securitised asset tranches no longer being appropriate for exactly the reason that they were created. Without anyone else actually wanting the assets the results were always going to be obvious – freefall of securitised asset prices. These are not toxic waste mortgages, purely an accounting standard that has undermined an entire market.

Again too many people are aiming their fire at the wrong culprits.

6. The International Accounting Standards Board

The IASB needs to replace IAS39 as a matter of urgency. They also must make sure in future that their theoretical ideas are fully reviewed to understand practical impacts and also the law of unintended consequences which clearly applied in this case.

7. The Banks

Enterprise Risk Management (ERM) must be the new mantra of all banks. Our views are that for too long many banks have not really embedded risk management fully into the way that they do business. The consequence is that unexpected events cause them to have unexpected problems. The embedding of risk management such that all staff really understand their roles within the Bank and how that leads to ERM being achieved has not been done.

This will need major educational programmes and changes to systems and behaviour. Risk management will need to be far more approachable and appreciable to all staff. It is not a regulatory construct, it is the way that you should do business to ensure that your institution survives.


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For more information about our services please contact Lisette Mermod, Commercial Director at +44 (0)20 7638 5559 or email her at LM@riskrewardlimited.com for a professional, prompt and courteous reply.

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