

An agenda for better banking regulation

In many countries there are currently investigations by the politicians into banking regulation and what went wrong. There have been few conclusions publicly drawn as of yet. We list here five areas of regulation and practice that could be improved or introduced. There is no claim to complete answers with each needing much work in terms of clear definition.

1 Banks should have to justify the existence of off balance sheet vehicles and activities especially if they are of a financial nature. Where allowed at all, there should be the tightest monitoring. The liquidity crisis was not caused by the known problems of banks around the world but the unknown - each bank wondering how much the other bank was hiding off balance sheet. This item would probably be the most difficult to define and the outcome would not be perfect upon first introduction but these are not excuses for not doing this.

2 Chief Risk Officers (CROs) should dual report to both the chairman and the CEO. If the chairman and CEO is one person then the CRO should report to the chairman/ CEO and to the chief independent director. Chief Risk Officers should consider the systemic risk issues and should discuss this with the chairman, the CEO and the rest of the board. Quotas for how far into certain markets the bank wishes to be exposed should be drawn up. Whilst this might seem a statement of the obvious it is a fact that it did not happen in many banks. In many regimes there is still no requirement for a CRO to report to the CEO, and it is rare for any official reporting line to the chairman. There is frequently no official procedure for the CRO to raise matters of concern or trends directly with the board.

3 The Loan to Deposit (LTD) ratio should be highlighted along with the change to it over recent periods in every financial statement or update. The forecast LTD ratio should be provided also for the forthcoming financial periods.

4 Proprietary trading must be proportionate and watched close to real time by regulators. Many banks suffered from bad or of disproportionate proprietary trading to their total assets. UBS is the classic example in terms of total size getting out of control. WestLB is another example which for the size of bank, proprietary trading was allowed to grow too large. Regulators should be provided with updates on proprietary positions on a daily or weekly basis. Not necessarily down to the organisation invested in, but certainly values, sectors, details of hedges etc.

5 The introduction of the publicised Business Correction Plan, Japanese style. The tradition amongst many regulators is that matters are discussed with the bank in question in up-most secrecy. This has not always brought about change fast enough. The release of certain information by the UK Financial Services Authority relating to HBOS would appear an example where this did not work. If instead, banks were forced to respond to regulator reviews with a Business Correction Plan that was made public and had time-lines to be monitored it is likely that corrections would take place much faster.

Some may argue that bankers have learnt their lessons and therefore all of the above is unnecessary. In 7 years time when a new generation are in charge whether they would then truly remember the lessons is the question.

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