

# The regulatory response to the financial crisis – the story so far

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Where did it all go wrong?



CDS

CDO<sup>2</sup>

CDO

SIV

ALT-A

SUB-PRIME



# The roll-call

September 2007

Northern Rock (nationalised February 2008)

March 2008

Bear Stearns

September 2008

AIG

Bradford & Bingley

Fannie Mae / Freddie Mac

Iceland

Lehman Brothers

# Some causes - internal

- Credit risk
  - assessment
  - rating agencies
- Liquidity risk
  - scenarios
  - trust
- Capital
- Greed
  - remuneration
- Governance
  - challenge

# Some causes - external

- Accounting
- Regulators
  - Basel II
  - Supervision
- Government
- Borrowers

# Regulatory responses - FSB

- Capital
  - quality and quantity
  - market risk
  - pro-cyclicality
  - stress tests
  - monitor Basel II
- Provisioning
  - accounting re recognition of provisions
  - accounting re disincentives to provisioning
- Asset valuation - fair value accounting
- Leverage ratio
- Liquidity (BIS and IMF)
- Margins for derivatives

[FSB, April 2009]

# Regulatory responses - BIS

- Capital – quality and quantity
- Capital – buffer against pro-cyclicality
- Leverage ratio
- Liquidity – stress tests
- Cross-border supervision
- Compensation aligned with risk and performance (over time)

[BIS, September 2009]

# Other policy responses

- Walker review (UK) 2009
  - Governance
    - Board composition
    - role of Chairman
    - risk awareness
    - NEDs
    - CRO
  - Remuneration
- The Governor and narrow banking, aka too big to fail, manage or regulate.

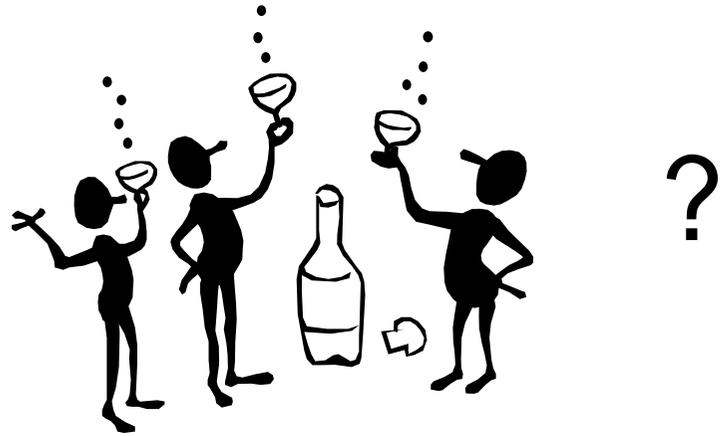
<b>CAUSES CHECKLIST</b>
Credit Risk - assessment
Credit rating agencies
Liquidity risk – scenarios
Trust
Capital
Greed
Remuneration
Governance
Accounting
Basel II
Supervision
Government
Borrowers

# Implications for banks and insurers

- The economy, stupid!
  - The bottom + 2 years (traditionally)
  - Raising capital
  - Liquidity constraints
  
  - Operational risk correlates with:
    - higher leverage
    - equity volatility
    - lower market to book value
    - number of employees
    - GDP
- [Chernobai, Jorion , Fu, *The determinants of operational losses*, 2007]
- Genesis 41:27



or



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