



UNIVERSITY OF ICELAND

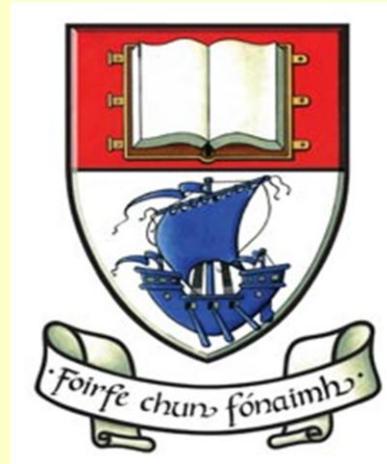
After the Goldrush

Reykjavik

26th May 2010

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A city settled by the Danes about 1200 years ago.
Prepared for service

A Consumer Perspective on Financial Regulation

Debts

Taxes

Savings and Pensions

Jobs and Incomes

Services

Migration



Consumers are having difficulty paying their debts, are subject to higher taxes, have had damage done to their savings, especially their pensions, have lost jobs and have had their pay cut, are experiencing a reduction in government services and are now considering emigration on a much wider scale again.

Structure of the Paper

- Context
- Regulation
- Regulatory Architecture
- Contrasts
- Regulatory Culture
- Summary & conclusion



We have an obligation to restore opportunity and the chance of fulfilment for those we educate by helping to devise a way forward.

Purpose

- Examine
- Expand
- Elicit



Examine the concept of regulation.

Expand on its enactment.

Elicit some feedback on the ideas expressed here.

Some historical observations

- If you have 10,000 regulations, you destroy all respect for the law.

Winston Churchill

- Trade and Commerce, if they were not made of Indian rubber, they would never manage to bounce over the obstacles legislators put in their way.

Henry Thoreau

- Behind every great fortune is a crime.

Henri Balzac

These views reflect contrasting views of regulation and financial activity.

What is Regulation?

A sustained and focused control exercised by a public agency over activities that are valued by a community.

P Selznick (1985)

Regulation expressed in terms of control in 1985.

What are the activities and why do they have value and what is the nature of that value?

Giving credit, transmitting money, storing savings, financial intermediation.

Focused on WHAT rather than HOW.

What is Financial Regulation?

The body of policies, methods, techniques and procedures that are designed to influence the behaviour and results of economic agents or participants in a market economy.

Zuhayr Mikdashi (2003)

Note the behavioural emphasis.

Market Economy : the price mechanism, incentives, free movement of labour and capital, property rights etc

Designed by whom?

The Challenge

Regulation is always about making judgements and tradeoffs particularly when considering costs and benefits.

Goodhart et al (1998)

Who judges?

Who determines the tradeoffs?

Who bears the costs?

Who enjoys the benefits?

Cui Bono?

Note the absence of a subject.

Rationale

- Monopolies
- Externalities
- Information Deficits
- Continuity & availability of supply
- Anti Competitive Behaviour
- Public Goods
- Moral Hazard
- Unequal Bargaining Power
- Scarcity & rationing
- Distributional justice (equity)

We have discovered that conventional banking is akin to a public utility.

Regulatory Forces

- Ideas
- Interests (Public, group/collective, private / individual)
- Habitat changes – new circumstances/market conditions
- Internal deficiencies /failings

*Relative Strength, Visibility, Frequency,
Lifecycle, Self awareness ?*

Ideas -Neo liberalism. The Washington Consensus.

Interests : Money talks : sometimes it shouts and sometimes it whispers but it is always heard.

Ideas themselves may have a lifecycle. Is the pendulum on regulation going to swing in another direction for a period?

See also the Tasc report on the Golden Circle.

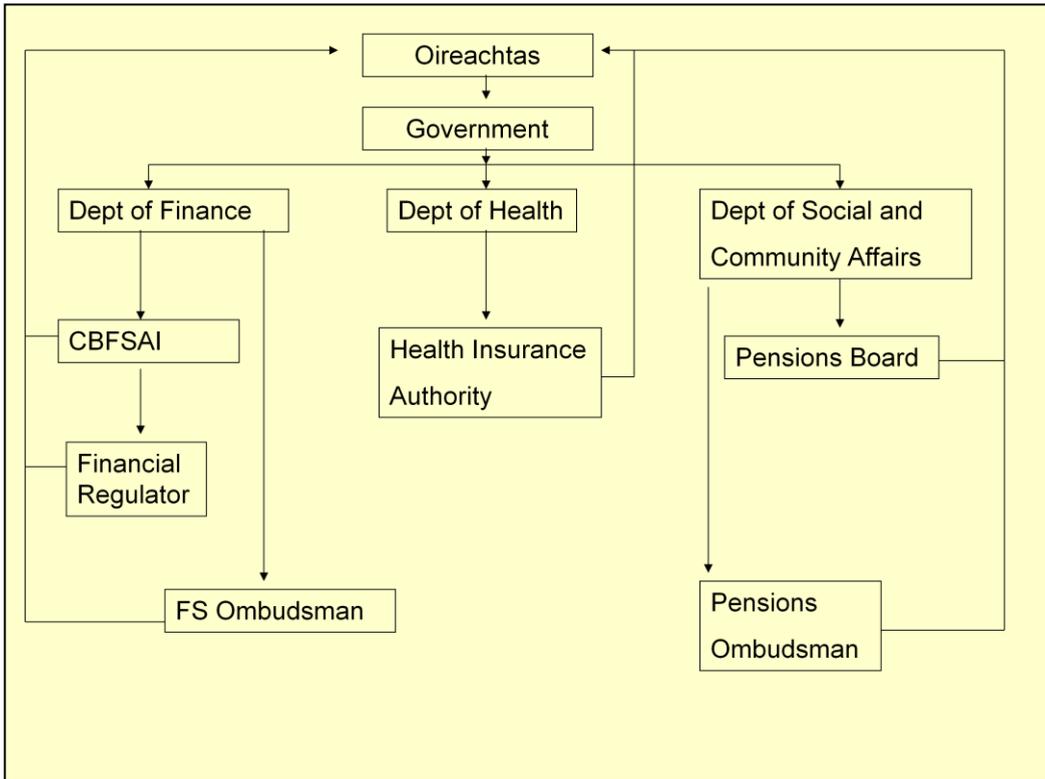
How is it done?

- Licences
- Returns
- Administrative Sanctions
- Inspections
- Codes
- Regulations
- Guidance
- Directions
- Moral Suasion
- Criminal Sanctions
- Ad hoc reporting
- Ad hoc two way communication

Tool Kit

Know How, Know When, Know What, Know Who, Know Where and Know Why

The combination of tools and their use in intensity is critical.



Complexity

Some parliamentary scrutiny.

Dispersal of regulatory expertise.

Regulatory Interventions (& Non Interventions !)

		Outcomes	
		Desirable	Undesirable
Outcomes	Intended	<i>Purpose</i>	<i>Cost</i>
	Unintended	<i>Bonus</i>	<i>Damage</i>

Adapted from the Johari Window construct.

All four occur in every situation. In an ideal world , regulatory impact assessment would render all four quadrants visible but we live in an imperfect one.

At the moment in Ireland we are dealing with DAMAGE!

Fluid Nature of Risks

Risk management is not pure science; rather, it's a finely intertwined helix of analysis, economics, behaviour, chance and experience. And the helix continues to fatten as each element grows in complexity.

(Hartigan 2002)

Non linear, curved like a corkscrew

An example of Financial Regulation

Basel II Framework for Banks Solvency

- *Minimum Levels of Capital*
- *Supervisory Review*
- *Market Discipline*

In Ireland, minimum levels of capital were too low. This exposure existed elsewhere also.

Supervisory review was not sufficiently rigorous and robust.

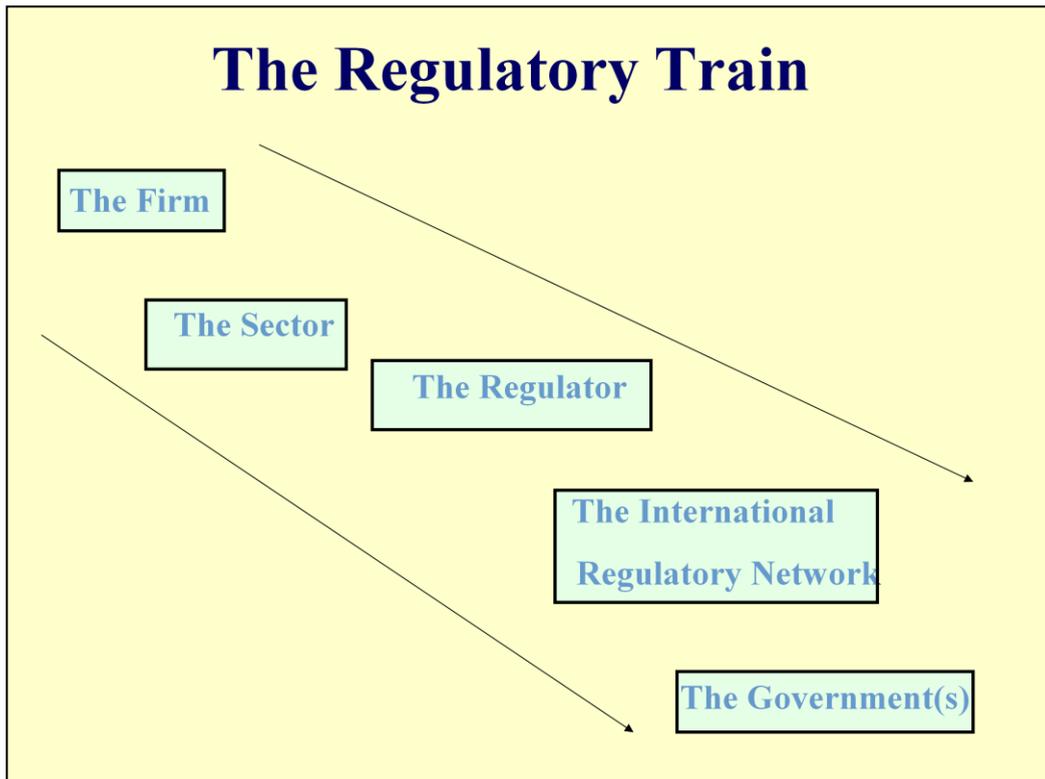
Market discipline did not kick in until it was too late.

Generally accepted now that risk was not well priced.

Internationally there was an inordinate level of trust in quantitative models.

The Efficient Markets Hypothesis has been discredited.

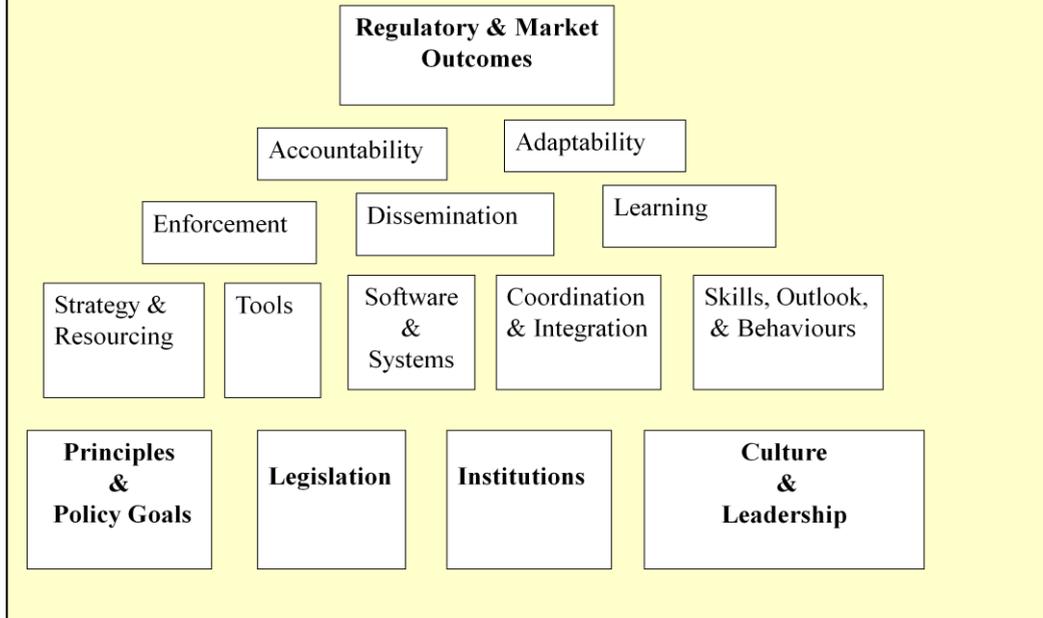
The Regulatory Train



What is the track? Are all carriages well connected? Are consumers the passengers who are carried along? Is each element appropriately policed? What is the power source and how is it transmitted?

The hinterland is the wider society.

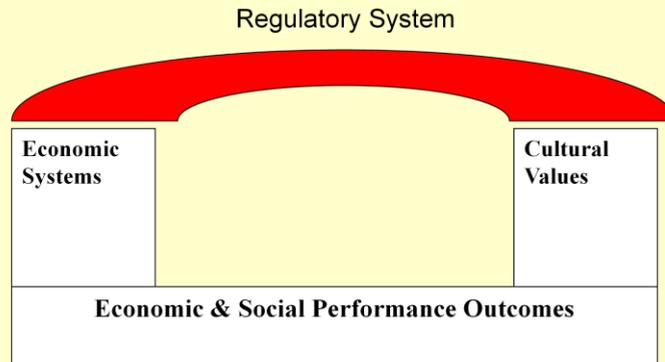
Regulatory Pyramid Construct



Completeness, Order, Balance, Stress Bearing, Mortar?

How are the above elements reflected in the new architecture?

Regulatory Culture



Pryor 2008, Journal of Economic Behaviour & Organization

OECD countries, Econometric analysis.

Change only likely to arise if there is either a major economic shock or a seismic political shift.

Irish Government support for Banks

- Anglo Irish Bank : Nationalised & injected with €12.3bn so far.
- Allied Irish Banks : €3.5bn capital injection.
- Bank of Ireland : another €3.5bn.
- Irish Nationwide Building Society: also €2.7bn.
- Government Guarantee of debts/deposits of 6 Irish Banks/ Building societies up to 29 September 2010 : a commitment of between \$400 and \$500bn
- Increased retail deposit guarantee to €100k for all institutions.
- Government acquiring circa €54bn of distressed property loans.

Barack Obama : “My administration is the only thing between you and the pitchforks”. 27th March 2010

Lender of last resort or a reinsurer of catastrophic risk?

Accounting Dimensions

- How risk was recognised?
- How provisions were made?
- How capital adequacy was assessed?
- How disclosure was effected?
- How interdependencies were disclosed?
- How values were determined?
- How transfers were authorised?
- How control was exercised?
- How remuneration & incentives were designed.?

Users of accounts and financial statements will seek answers on these issues more assertively.

Preparers of accounts and auditors of them will need to be more mindful of the expectations that exist with respect to financial statements and their use in financial markets .

Sociological Dimensions

- How elites behave and perpetuate themselves?
- What are the clan values?
- Why consent is given to leaders?
- What are the mechanisms for learning about new landscapes, new tools, and new exchanges?
- What will it take to renegotiate the relationships internally and externally?
- How will burdens and opportunities be shared?
- How will new institutions emerge and with what purpose?

Sociology : The science of society, social institutions, and social relationships, and specifically the systematic study of the development, structure, interaction, and collective behaviour of organized human groups. From Answers.com

A definition, whether popular or scholarly, can prompt reflection on the conceptual dimensions of a situation.

What could /should we do next?

- Reframe
- Redesign
- Refocus
- Reveal
- Restore
- Re-educate
- Reward
- Rebel



Reframe the financial regulatory system.

Redesign its constituent elements.

Refocus on the regulatory objects and objectives.

Reveal the exchanges that occur

Restore trust.

Re-educate those who remain involved but who were compromised by their omissions or commissions.

Reward that which is acceptable.

Rebel against that which is unacceptable.

Essential to find a way out from what is now a social pressure cooker.

How should Financial Regulation be evaluated?

- Life Chances
- Adaptability & Innovation
- Cost
- Failure
- Access
- Monopolistic Behaviour / Competitiveness
- Stability of the Market
- Soundness of the Providers



Think about the weighting and the order.

Summary

- A new contract with the sector.
- A better frame & units of analysis.
- Some new tools for regulation.
- Change in orientation of the actors.
- Cultural shift on risk, reward, integrity.
- Less complacency : *original sin*?
- Different outcomes : no guarantees!

This time is different!

Nil aon rud nua faoin ghrian. (There is nothing new under the sun!)

Mistakes were made but not by me!

Financial Crises

A banking crisis is generally triggered by macroeconomic shocks, but it can be made significantly worse by microeconomic structural problems eg

- Poor corporate governance,
- Distorted incentives generated by poorly structured regulatory arrangements,
- Illegal activities such as insider dealing and fraud,
- General ineptness caused by factors such as poor internal controls.

William C Hunter (2003)

How many jurisdictions engaged in analysis of the financial crises could cut and paste this observation in their public reports?

Faoi dheireadh...

Plé agus Caidreamh.

Buíochas daoibh uilig.

Takk fyrir



Finally....

Dialogue and discussion,

Thanks to you all (in Irish)

Thank you (Icelandic)