The Future of UK Banking following the Financial Crisis

A Response from the Financial Services Research Forum to the Independent Commission on Banking September 2010 Issues Paper

Simon Ashby

1. Introduction

Following one of the most severe crises to have affected financial institutions and markets, the regulation and practice of banking are at important crossroads. Crucially the choices that we make now may either promote the stability and prosperity of our financial systems or sow the seeds for the next crisis. We therefore applaud the care being taken by the Independent Commission on Banking (ICB) in the performance of its mandate. Its desire to avoid rushing into ill-conceived solutions is reassuring, as is its willingness to consult widely and remain open to a broad range of options.

However, we are concerned that the focus of the ICB’s enquiries on potential reforms to the structure of banks and the markets within which they operate is too narrow and fails to give due importance to some equally important avenues of enquiry. Avenues that have not been addressed in an adequate fashion by policy makers in general – both in the UK and further afield.

These concerns stem from the findings of a recent report by the Financial Services Research Forum on the causes of the crisis and the lessons that need to be learned. As part of this research, risk management professionals, at Board or near Board level, from across the UK financial services sector were interviewed on a confidential basis. In October 2010 the Forum followed-up this report with an open roundtable discussion involving senior financial services practitioners – these were invited to share their reactions to the original report and identify priorities for research into the prevention and mitigation of future financial crises.

The Forum’s research indicates that the structure of UK banks and that of the financial markets within which they operate is secondary to more fundamental weaknesses in management and culture, coupled with flaws in the inherent design of international banking regulations. In the light of this research we re-examine the current focus of the ICB and provide answers to its questions. We also outline some further issues that we believe require investigation by the ICB.

1 Dr Simon Ashby
Associate Professor in Financial Services
University of Plymouth
Drakes Circus
Plymouth
PL4 8AA
Telephone: +44 (0)1752 585720
E-mail: Simon.Ashby@Plymouth.ac.uk

2 A summary of this report (Ashby, 2010) accompanies this response. A full copy of the report is available on request.

3 This roundtable was organised in conjunction with the Technology Strategies Board (TSB) and the Financial Services Knowledge Transfer Network (FSKTN). For more information on the role of the TSB and FSKTN, see: http://www.innovateuk.org/deliveringinnovation/knowledgetransferrnetworks.ashx.
2.   **Re-Examining the ICB’s Focus via a Fuller Understanding the Financial Crisis**

Like the ICB it is not our intention to outline the causes of the crisis in a comprehensive or detailed fashion, especially as we have published a report on the subject (Ashby 2010). However there are a number of observations and questions that arise out of our research which the ICB may want to consider.

2.1 **All major policy changes, including any proposed by the ICB, must be based on a proper understanding of the crisis and its causes.**

In order to prevent and possibly mitigate future financial crises we must first understand the causes of current/past events. However, it is unclear whether the work of the ICB is based on a thorough understanding of the underlying causes of our most recent financial crisis – causes that, for the most part, are the same as for previous crises – financial or otherwise.

As stated by the ICB (Box 1, p14), it is likely that the causes of the financial crisis will continue to be debated for many years. However, we already know a lot more about the crisis and its likely causes than is reflected in the paper. In particular, there is a very real danger that the scope the ICB’s analysis is too narrow: we believe that it is in danger of over-emphasising the economic and associated structural symptoms that characterised the recent crisis at the expense of more fundamental management and cultural factors.

The Forum’s research shows that the ICB’s economic-centric view of the financial crisis is not generally accepted by senior managers working in the market. Neither is the related view that structural issues such as the integration of retail and investment banking or financial innovation per se, were key causal factors. Instead the research indicates that the financial crisis was largely the result of weak management, on the part of both the financial institutions and their regulators/supervisors. The key weaknesses stemmed from human and or organisational deficiencies in risk perception, risk communication, and comprehension and risk culture. As some of the interviewees for our original report stated:

> “I’m a great believer that when you do look at underlying causes you use root cause analysis and try to go back to basics. I’m going to say this because of my bent towards people, but when I look at risk there are two underlying causes – one is god and one is people.” (Finance Director)

> “For me it’s human behaviour. Everything else comes off the back of that whether its governance, culture, capacity, capability or implementation of framework – it all comes back to the person.” (Risk Consultant)

It would, therefore, appear that those tasked with managing financial institutions reach somewhat different conclusions on the causes of the financial crisis – which should raise alarm bells for policy analysts/makers.

Of course the ICB might conclude that the opinions of a few industry professionals, especially those emanating from what many believe to be a sector in disgrace, should not be taken too seriously. However these industry professionals are not alone. There is an extensive body of research into organisational crises which confirms the views outlined in the Forum’s findings - research that has grown out of numerous post-mortems into a range of different crises, both financial and non-financial. This research confirms that the origins of many crises stem from weaknesses in management and or associated differences in organisational culture (for example: Reason 1990;
Turner 1994; Ashby et al 2003). Moreover, of key interest for the ICB, this research also points to the structure of organisations (for example in terms of their complexity and inter-connectedness, Perrow 1994) and particularly in relation to the recent crisis (Müßig 2009).

2.2 Does structure really matter?

One of the interesting features of the last crisis is that banks of all shapes and sizes got into difficulty. In the UK, most of those that required state intervention were predominantly retail banks and got into trouble as much for their retail banking activities as for their investment banking. Northern Rock and Bradford and Bingley, for example, were heavily into sub-prime and buy to let mortgages on their own account. Moreover in the case of ‘failed’ building societies like the Cheshire, Derbyshire and Dunfermline, investment banking activities such as CDO trading played no part in their forced takeovers.

Equally, certain conglomerate banks all but avoided any difficulties, HSBC being a case in point. In fact it was arguably the early warning provided by its retail banking activities (where arrears levels within its US sub-prime subsidiary were identified and quickly escalated) that prompted HSBC to reduce its CDO exposures just before the crisis broke.

For most of our interviewees and roundtable discussants, the causes of the financial crisis had little to do with the structure of banks. While conglomerate banks may appear to be inherently risky, participants pointed out that this risk can be controlled by effective management (by those who are competent and professional, and who are prepared to communicate with each other and work together) operating within an appropriate risk culture (which promotes risk awareness, values management judgement as much as models, and links risk and strategic management). Indeed, as illustrated by the HSBC example, combining retail and investment banking may at times help to reduce the risk of crisis, where management are able to spot potential issues and respond to them. Again it is management and culture that are the core issues, not structure.

2.3 What about competition?

The Forum’s research indicates that intense competition very probably did drive some banks and building societies to take risks that they were ill-equipped to manage, or which in some extreme cases exceeded their capacity to bear.

However, not all financial institutions chose to participate in some of the riskiest activities that characterised the last boom (excessive sales of sub-prime and buy to let mortgages, CDO warehousing, etc.). For many of our interviewees and roundtable discussants the distinguishing features were again the effectiveness of management and the risk culture that managers operated within.

The following quotes from our research illustrates that it is possible for a bank to resist competitive pressures where its risk culture is strong and or where it has in place effective risk appetite and risk assessment frameworks:

“It’s very difficult at the end of cycle, it’s one thing knowing the bubble’s going to burst one day but some of these people were saying this in 2000 or 2001, when it happened in 2007. You could argue that they were ahead of their time. It comes back to understanding risk appetite over the lifecycle, thinking the unthinkable, working that into your equation and being able to tweak your risk appetite..... If you look at the share
price of Northern Rock, that told you a long time before it collapsed that things were wrong because the valuation was going pear shaped. Smart money knew and was actually pulling their money out of Northern Rock very early on.” (Non-Executive)

“A good example would have been Lloyds who sort of bucked the trend but they then got caught out in a different area (laughs). They did remain relatively prudent and cautious compared to others and I think that’s because they had an excellent CEO and Chairman who weren’t prepared at that point to do what everyone else was doing. The risk culture was set at the top and they weren’t going full on for growth but taking it steady...” (Chief Risk Officer)

In would therefore seem that not all financial institutions are pre-destined to take excessive amounts of risk when market conditions allow. Rather those with effective risk management and appropriate risk cultures are likely to take a longer term view and or spot potential threats early and hence are less likely to get into trouble.

2.4 How central an issue is moral hazard?

A key theme in the ICB’s issue paper is the phenomenon of moral hazard, where mis-aligned incentives, coupled with asymmetric information create both the motive and opportunity for bad behaviour. While we would not dispute the temptations that can be caused by this phenomenon we would, as in 2.3 above, counter it with the observation that not all financial institutions submit to temptation.

The issue therefore is not only about understanding potential moral hazard problems, but also the managerial/cultural characteristics of those financial institutions that decide not to exploit them in the first place. Of course from a neo-classical economic perspective this is ruled out, as rational decision makers will not pass up profitable opportunities, however selfish and unethical they might seem. Yet in the real world this ‘homo-economicus’ view of materialistic decision making is not always correct, and there is a growing literature which challenges its dominance (e.g. Ghoshal, 2005; Ghintis and Kurahna, 2007).

The central issue therefore is not moral hazard, but again relates to the effectiveness of a financial institution’s risk management framework and most importantly of all its risk culture:

“I think it’s probably history, culture. I think the history probably helps – you’ve been around for hundreds of years so you don’t want to be the guy who takes the risk and brings it down.” (Head of Operational Risk)

“...the problems in the sub-prime market were flagged very early in the organisation, the decision to reduce activity and provision in that area was taken very early, the organisation is fundamentally conservative in its attitudes and I suspect that more than anything helped us in the current crisis. We hadn’t gone down the gearing up of the balance sheets and almost the commercialisation that some of the other organisations had done, which indicates that there is a more robust management culture.” (Risk Consultant)

In short institutions are capable of looking into the long term and considering the ultimate consequences of excessive risk taking. In addition they can look beyond shareholder value to consider the effects of their behaviour on other groups such as consumers, regulators or their employees.
2.5 The systemic question

The ICB is right that the interconnectedness of financial institutions and markets can create significant risks that threaten the stability of the financial system: however this is a risk that we have long been able to live with in the UK with little ill-effect. Hence the question is arguably not about the inherent interconnectedness of banks and other financial institutions, but rather about the factors that may have amplified its effects.

The Forum’s research suggests that poorly designed regulation helped to amplify the systemic nature of the crisis in a number of ways. One such factor was the well known phenomenon of pro-cyclicality - a flaw that was built into the original Basel I and II accords. A number of our interviewees observed that this factor was a key source of systemic risk, helping to accentuate the impact that paper losses had on their balance sheets:

“To make things easy for themselves does not necessarily lead to good regulation. They were told about pro-cyclicality – I remember sitting there at the 4th annual supervision conference at the BBA where they went through Basel 2 and said ‘well excuse me doesn’t this stink, as soon as there’s a bad time it’s going to be a deck of cards’. ‘Well yes’ they said. ‘So what are you going to do about it then?’ I asked and they obviously never had an answer to it, which is a shame really because it’s just so obvious.” (Head of Control)

More importantly the drive towards capital modelling and the use of tools such as Value at Risk modelling encouraged many financial institutions to become overly reliant on mathematical risk models at the expense of management judgement:

“I’m a bit of a Luddite when it comes to risk frameworks. Because the way the regulations work now it tends to lead you into defined categories and you imagine a room with green, red and amber lights and you spend all your time watching them and reacting to how they go off.... The point of risk management is to think about where the emerging risks are and what the regulators do is focus on what can be measured and they’re not the same thing.” (Chief Risk Officer)

In addition we found evidence of a peculiar kind of moral hazard, where capital operates as a substitute for good risk management. Hence risk management weaknesses and or high risk strategies may be tolerated by the management of a bank and its supervisors when capital levels are high:

“...if you are looking at some of the prophecy driven capital adequacy measures that have been introduced they need to have something to encourage people to also manage risk. Often there isn’t any. There’s nothing to make the manager stop and think... Instead the manager simply says ‘my target is to grow by 10% this year so that means my capital is going to grow by 10%, so am I going to devote resource and expense to how I manage the risk?’” (Risk Consultant)

Fundamentally these observations illustrate that it may not be necessary to reduce the interconnectedness of banks; rather the same ends could be achieved, at lower cost, by implementing more carefully considered regulation.
3. **Responses to the ICB’s Questions**

We have only responded to those questions where we have a meaningful contribution to make.

**Question 1.1:** What is the relationship between the Commission’s two primary objectives of financial stability and competition (including consumer choice)? Are these goals fundamentally in harmony? If not, what are the tensions between them and how can reform proposals be designed to alleviate the tensions?

Financial stability and competition can exist in harmony, but we agree that the financial crisis has revealed tensions between these two objectives, though not just in relation to the banking sector. As one of our interviewees observed:

“I was speaking to people who said this is unsustainable but when the whole world is on this drug crazed party it’s very difficult to say stop the music and the drugs and it just carried on until it couldn’t carry on any more..... the environment we were in worked for everybody really well and the government created tax revenues, people were feeling better so were voting their governments back in so nobody saw that the emperor had no clothes on. It wasn’t just greedy capitalism – we’d gone beyond that and it seemed OK for people to earn vast sums of money producing financial instruments that made short term killings for the people. Everything worked – the fact it couldn’t be sustained without generating more wealth nobody really cared about.”

(Non-Executive)

The Forums recent report explores the role of competition in causing the financial crisis and makes a number of recommendations that could promote more constructive competition in the future. In summary these are:

- Improved market disclosure: better information would enhance the disciplinary powers of stakeholders.
- The promotion of better risk management and internal control practices
- Regulation and supervision that is less metric driven and more focussed on understanding and enhancing the cultures and behaviours of banks.

**Question 2.1** Are there other broad options for reform that should be added to this framework? For example, should any of the “other reform initiatives” listed in Paragraph 4.33 be matters on which the Commission should seek to make recommendations?

We agree that the ICB should seek to make recommendations on its current list of other reform initiatives, some of which are likely to prove more effective than structural reform.

However there are a number of additional reform options that should be considered by the ICB. These are outlined in section 4.

**Question 2.2** Which (if any) of the reform options identified in the above framework most deserve further development, specification and analysis?

Since structural issues did not lie at the heart of the recent crisis and are unlikely to do so in future crises we are not convinced that measures such as enforcing the separation of retail and investment banking will prove effective. Such reforms will not prevent the deficiencies in risk cultures and
management behaviours/competencies that will very probably lay the foundations for most, if not all, future financial crises

The areas that we believe most deserve further ‘development, specification and analysis’ are outlined in section 4.

Question 3.1 What would the benefits of these options be, in particular for financial stability and competition? How can these benefits be quantified?

In the light of the arguments presented in this response we do not anticipate that there would be substantial benefits from most of the reforms proposed by the ICB. We are unconvinced by the argument that there are significant circumstances where structural regulation is likely to be superior to properly designed behavioural regulation (paragraph 4.3 of the ICB paper). This is because structural regulation will do nothing to remove the inherent tendency that some banks seem to have towards excessive risk taking – a tendency that is largely driven by management and cultural factors. Moreover, there is a danger that structural reform might create an illusion of safety, addressing only the most apparent structural deficiencies and leaving the system open to future instability as a result of some newly discovered structural problem. Addressing the problem at its source – in terms of changing behaviours – would therefore seem to be the most permanent and beneficial option.

In terms of the quantification of any benefits we would add that this is unlikely to be achieved with any degree of accuracy. When dealing with extreme low probability and high impact events like the recent financial crisis it is very difficult to calculate changes in exposure. This is primarily because of a lack of reliable data.

Question 3.2 What would the likely costs be of the various options? For example, what lost efficiencies might there be if banks were required to reduce the range of activities they could undertake, and/or their size? How can these costs be quantified?

Our research has not looked in detail at this issue. However, we have identified situations, where combining retail and investment banking activities proved to be risk reducing. This indicates that properly run banks, with appropriate risk management frameworks and risk cultures, can derive significant benefits from combining such activities.

Question 3.3 What are the implications of the role of the (less regulated) shadow banking sector for the Commission’s work? To what extent would the different reform options simply shift problems from the banking sector to the shadow banking sector?

Our research indicates the regulatory arbitrage has been a significant problem in relation to the regulation of banks. The source of this often being poorly designed regulation. As one of our interviewees commented:

“There were a lot of people making a lot of money out of what was effectively … the rules allow me to do this, I am working within the guidelines that have been set by the regulator, I perform all those things and tick all the boxes therefore it says that my return is ‘y’ and as long as it continues like that, great but if you are left holding the baby at the end it’s a problem.” (Head of Control)

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4 We would add that capital and liquidity regulation is not behavioural regulation in the truest sense of the work. This is because it does not affect behaviour directly, simply the payoffs that are received. For more on this see our response to question 3.4.
Hence it is very probable that future regulatory reforms will drive similar behaviour. Much research has been done on the area of regulatory arbitrage (e.g. Jones 2000; Miles 2010); we would strongly recommend that the ICB gives this work serious attention.

Question 3.4 Should any of the broad options be ruled out as impractical? If so, why?

As indicated throughout this response we have reservations about the overall focus of the ICB’s work. However we have particularly strong reservations about the following options:

- Separation of retail and investment banking
- Narrow banking and limited purpose banking
- Structure related surcharges

See sections 2.1 and 2.2 for our primary rationale for this. On the subject of structure related surcharges our research also indicates that increased capital and liquidity requirements are unlikely to prove effective. This is well illustrated by the following quote from Howard Davies, the first Chairman of the FSA:

“But we have learnt, from better experience, that no amount of capital is enough if the management in charge of it is incompetent, and the control systems are fatally flawed.”

Based on our research we also have strong reservations about the following ‘other reform initiatives’:

- General capital and liquidity requirements
- Regulation of pay structures

The reasons for these are outlined in our report (Ashby 2010). In summary:

- Such initiatives are unlikely to change the behaviours of financial institutions. Contrary to the ICB’s assertion in its paragraph 4.3, capital and liquidity regulation is not truly behavioural, doing little to change the fundamental motivations of banks and their management. Moreover to the extent that such regulations are behavioural they can often change behaviour in undesirable ways, for example by promoting regulatory arbitrage.
- The debate on pay has been dominated by too much rhetoric about the size of bankers’ pay packets and the receipt of bonuses. Our research shows that pay quantum is secondary to the design of compensation arrangements (whether they promote proper risk management or not) and the culture of the bank (whether it is sales driven or adopts a longer term view).

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5 Davies (2001).
4. **Recommended Issues Requiring Further Investigation by the ICB**

Based on our research we believe that the ICB should focus on the following:

4.1 **The promotion of better risk cultures**

If we want to effect lasting change in the banking sector we cannot ignore the role of culture. Structural reform may seem like an easy solution. However it will do little to change the fundamental priorities, attitudes and competencies of banks and their managers/directors. Removing temptation only creates the illusion of good behaviour with bad behaviours returning quickly as soon as a new source of temptation is identified.

Understanding the risk cultures of banks and finding ways to promote more appropriate risk cultures was seen as a top priority for our interviewees and roundtable participants. Hence the ICB should not underestimate the importance of behavioural regulation, as it seems to do in section 4.3, but rather consider its role and benefits much more carefully.

That does not mean that prescriptive regulation is necessarily required on culture (the ICB is right that behavioural regulation can be costly, especially when poorly conceived). Not least because our research suggests that there is no one optimal culture for all banks. However, there does appear to be certain characteristics which are shared by many ‘good’ risk cultures and which could be promoted more explicitly:

- A focus on risk awareness and long term sustainability;
- No blame environments where managers are encouraged to report issues/concerns; and
- A willingness to take action to reduce risk when necessary, even where this might be unprofitable in the short run.

Hence we believe that the ICB should include the promotion of more appropriate risk cultures within the scope of its investigations, seeking answers to the following questions:

1. Why is it that certain large and complex banks, which combine retail and investment banking, seem better able to control their operations than others? What are the cultural characteristics that distinguish these banks?
2. What are the cultural characteristics, if any, that should be promoted across all banks?
3. Can/should regulators help to promote appropriate risk cultures? If so how?

4.2 **The appropriate design of compensation arrangements**

The ICB should look at the regulation of compensation arrangements. However it should focus on the rules that are applied to these arrangements rather than the amounts or mechanisms involved.

Specifically our research indicates that pay and bonus arrangements should be:

- Awarded over longer term performance horizons - thus helping to prevent short-termist sales driven behaviours.
- Aligned with a bank’s risk management and governance policies. In so doing they should be designed in such a way that managers are incentivised to not only consider their institution’s risk appetite when making business decisions, but also assess and report on risk issues in a
timely and efficient way. Such arrangements should be enforced using clear rules that highlight the kinds of risk taking/reducing behaviours that will be rewarded as well as those that will not:

- Reinforced by a strong risk culture that promotes risk awareness and sustainable attitudes to risk taking.

4.3 Promoting better risk management and internal control

Our research shows that financial institutions that implement effective risk management and internal control frameworks are better able to resist competitive pressures, manage systemic risk and address any inherent weaknesses that may be associated with either their own structure or the structures of financial markets. Hence along with risk culture this should be a key area of focus for the ICB.

In this regard we believe that the ICB should try to:

- Identify the essential elements of good risk management practice – looking at the contents of an effective risk management framework, its role (strategy support, compliance, etc.) and its position within a bank’s governance arrangements.
- Understand the impact of regulation on risk management practices. For example has the Basel II accord helped to improve risk management practices or has its focus on risk models and capital adequacy made things worse?
- Revisit the role of regulation and supervision as tools to help promote effective risk management. For example do prescriptive rules work best or should we continue to reply on principles based regulation? How can supervisors more effectively benchmark risk management and internal control frameworks?

4.4 The unintended consequences of capital requirements

At our recent roundtable it was commented that the Basel II Accord was designed and implemented with good intentions, but failed because it did not take account of the behaviours of banks and their management.

The Forum’s research has revealed a range of potential behavioural problems that can interfere with the proper functioning of risk based capital requirements, all of which need further investigation. The table below summarises these problems.

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<th>Problem</th>
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<td>Adverse Financial Incentives (Moral Hazard)</td>
<td>Regulatory capital requirements can create a range of adverse financial incentives:</td>
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<td>- They can cause complacency, reducing the inherent incentives that creditors and consumers have to monitor the behaviour of financial institutions (since they may see capital requirements and any associated monitoring of these by regulators as a substitute for their own monitoring activities).</td>
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<td>- They may incentivise financial institutions to invest in higher risk assets in order to cover their associated costs.</td>
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The costs associated with regulatory capital requirements can reduce the future franchise value of a financial institution thus reducing the inherent incentives that shareholders and managers have to behave conservatively (where the prospect of future profits can discourage risk taking in prior periods).

Where financial institutions are in danger of breaching minimum capital requirements they may take greater risks in an attempt to ‘go for broke’. The hope being that large positive returns will be generated thus restoring the institution to health.

**Regulatory Arbitrage**

Poorly designed capital requirements can distort the returns that are generated from certain assets thus causing the investment behaviour of financial institutions to divert from the market optimum. The effect that the Basel banking accords have had on the growth in mortgage securitisation, including the now infamous Collateralised Debt Obligation (CDO), is a prime example of this.

**Fraud and Reporting Mis-statements**

Financial institutions may misstate their financial position in order to avoid regulatory intervention. For example they may report false information to the regulator on their financial strength.

Also in the case of risk based capital requirements institutions may engage in model arbitrage in an attempt to present a more positive picture of their risk exposures than is actually the case. The purpose of this being to limit regulatory capital requirements.

**Pro-Cyclicality**

Regulatory capital requirements can reinforce market movements. In particular they can increase the adverse effects of a recession by preventing financial institutions from using their capital to finance new lending. They can also force them to raise capital and or dispose of assets at the precise time when it is very costly to do so. Moreover this behaviour can further reduce the supply of capital (liquidity) within financial markets and lead to downward spirals in asset prices, thus increasing the systemic nature of such events.

**Effectiveness of Risk Measures for Risk Based Requirements**

Many modern systems of capital regulation (e.g. Basel 2 and the forthcoming Solvency 2 regime) allow financial institutions to use their own internal risk models to determine their capital requirements. However such an approach exposes both individual financial institutions and the financial system as a whole to model risk. Whereby the data/models that are used by financial institutions may be flawed, providing a misleading picture of their exposure to risk. For example the Basel Accord’s reliance on VaR based models has been criticised both before and after the crisis.

We would strongly recommend that the ICB investigates these problems and considers their effect on the stability and competitiveness of the UK banking sector. The effectiveness of capital requirements as a means for regulating banks is far from proven and increased capital requirements following the recent crisis may well do more harm than good.

4.5 Enhancing market transparency and disclosure

One key issue that was surprisingly absent from the ICB’s paper is the promotion of greater market transparency and disclosure. There is strong empirical evidence that market disclosure rules are the
most effective means for disciplining risk taking within financial institutions and should be given a more central role\textsuperscript{6}.

Of course existing UK and international regulations already include some disclosure requirements for banks. However, what is questionable is the limited amount of policy attention devoted to them, along with their predominantly accounting focus. As one interviewee stated:

“Bland statements about numbers that don’t mean a great deal.” (Non Executive)

The ICB should consider enhancing UK disclosure requirements for banks. In so doing it should review the scope of information that should be disclosed; along with its method of presentation. In particular we believe that more attention should be given to the disclosure of risk management information that is less quantitative and accounting biased and more relevant to a wider range of stakeholders (e.g. small shareholders/consumers). We also believe that disclosure documents should contain more qualitative information about the future prospects of a bank and the effectiveness of its risk management and governance frameworks.

5. Conclusion

Financial crises are complicated, multi-faceted phenomena that are hard to control. In this regard we strongly agree with the ICB that a range of options must be considered before we can be sure about the best course of action for reform.

Despite the apparent breadth of the ICB’s scope there is a very real danger that it is too narrow. Disciplines such as economics help us to understand reality, however they are only one way of looking at the world and the ICB would be wise to consider alternative views. In particular it is our view that the ICB should do more to investigate the related managerial and cultural dimensions of financial crises and how best these can be controlled.

Ultimately the effective prevention and mitigation of future financial crises will require a combination of tried and tested, though possibly forgotten, solutions and out of the box thinking. Limited structural reform may well have a place in this brave new future; however its role should be more supporting than central. Lasting change will only be achieved when we understand and are able to control appropriately the fallibilities of financial institutions and their managers.

“In four years when hopefully everything is sorted, lethargy will set in and then something else will happen…. Inevitably it comes back to human fallibility. I just wish people realised that. Today’s ‘Thought for the Day’ quote was ‘what we remember we avoid, what we forget we repeat’ and I thought how appropriate!” (Finance Director)

\textsuperscript{6} See, for example: Barth et al. (2004 & 2006); Delis et al. (2008)
References


