BANK OF ENGLAND

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

News release

26 March 2012

Crisis and crash: lessons for regulation - speech by Michael Cohrs

In a speech delivered in Edinburgh on 23 March 2012, Michael Cohrs – a Member of the Bank's Financial Policy Committee (FPC) and a Non-Executive Director of Court, the Bank's governing body – reflects on the causes and consequences of the financial crisis, the authorities' response and the changing structure of financial regulation in the UK.

Michael Cohrs says "it is clear (in hindsight) that the premise of 'efficient' market behaviour, the structure of the banking industry and the regulatory framework were unsuitable prior to 2008". He acknowledges widespread criticism of the tripartite structure, saying "attention was myopically, and (as it happened) dangerously, focussed on individual institutions". And "given its lack of levers, even when the Bank pointed out its growing concern about what was going on it had little effect".

Michael Cohrs describes the changes to the regulation of the financial sector in the UK following the crisis as "substantial" and says "there are good reasons to believe that this new system will work better than the system that it replaces". But, he warns, "we shouldn't be under any illusion that a change in the structure of regulation in itself will rule out another financial crisis or indeed that this new system will prevent the collapse of individual banks or other financial services companies ... Ultimately it is the culture within individual banks and the incentive systems that drive risk taking which need to be changed. The good news is that I see evidence that banks are changing incentive systems and this will lead to a different culture within the banks which society will prefer."

Michael Cohrs underlines the importance of the FPC's role, protecting and enhancing the resilience of the UK financial system as a whole, within the new regulatory environment. He describes the Committee's policy deliberations as "rigorous" and says that members speak their mind. "I have seen little evidence of the much talked about 'group think'". He highlights the difficult balancing act between public accountability and the need for independence which the FPC faces. "While it might seem easy to decide it's time to take away the punch bowl, this is likely to mean curbing an electorally popular credit boom. The howls one will inevitably hear when doing it make it hard unless the FPC (and the Bank) have a strong degree of independence." So "transparency in accountability is extremely important for the FPC". But at the same time, he notes that establishing effective accountability processes for the FPC is more complicated than for

the MPC, owing in part to data sensitivity and a mandate which is less easy to grasp for an uninitiated audience; “it turns out that defining ‘financial stability’ is not straightforward”.
Outlining the FPC’s advice to HM Treasury on the statutory tools it should have at its disposal, Michael Cohrs says the FPC have chosen to recommend a small tool kit that contains those tools with which there is more familiarity within the regulatory community. He stresses that “the need for suitable tools is clear if the Bank is to do something meaningful when it next determines that there is systemic risk building dangerously within the financial system or indeed if it wants to allow financial institutions in bad times to utilise a countercyclical capital buffer built up in good times … Creating a FPC that is only able to provide advice or give sermons won’t move us very far from where we were when the financial world broke apart in 2008.” Avoiding a repeat of the current crisis will, he says, undoubtedly be difficult and the process to get macroprudential regulation up and running will be long and complex. But “the prize for succeeding will be huge”.

Reviewing the regulatory agenda for 2012, Michael Cohrs cautions that “more work needs to be done to give us confidence that we can deal with the failure of a large or important financial institution, while avoiding the chaos that enveloped us after Lehman”. This, he says, “is absolutely critical – if we are not able to solve the ‘too big/important to fail’ issue, society will not be being served as it should be.”

Michael Cohrs concludes by saying “we must be honest about the fact that time is required to heal much of what’s broken. The time needed goes beyond normal cycles that businesspeople and politicians work to. There will be temptations to apply quick fixes or jump quickly into new regulatory regimes ... Many of the fixes that have been put in place or proposed will make a difference but it will be many years before the changes are evident. A notion that markets don’t work at all or that we need draconian regulation will lead us to a bad place. Striking the right balance between too little and too much regulation is perhaps the most difficult judgement financial policymakers face at the moment. But it is also one of the most important.”

Key Resources

Crisis and crash: lessons for regulation (54KB)
http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech558.pdf
Full speech by Michael Cohrs