

The New York Times

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Edited by Andrew Ross Sorkin

January 27, 2011, 2:46 pm

Few Signs of United Approach to Financial Regulation

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6:45 p.m. | Updated

DAVOS, Switzerland — This heavily guarded ski

village is probably the only place on the planet where you can get the world's top

central bankers, regulators, economists and business leaders to sit down together in

the same room.

Simon Dawson/Bloomberg News
Peter Sands, chief executive of
Standard Chartered, said regulation
was not properly focused.

But although the [World Economic Forum](#) could be the setting to reach consensus on how to prevent financial disasters, experience shows that is unlikely.

Last year, according to several participants, private talks among major figures from government, academia and the private sector succeeded only in convincing the rule makers that bankers were in denial about their role in causing a global financial crisis.

“There was not a meeting of the minds,” said Paul Achleitner, chief financial officer at the German insurer Allianz. “Regulators said, ‘Bankers don’t get it.’ Bankers said, ‘Regulators don’t get it.’ I hope this year’s discussions will be more fruitful.”

Early indications were not promising. At one of the opening panels Wednesday, Peter Sands, chief executive of the British bank [Standard Chartered](#), said that regulation was not focused on the risks that mattered most.

“It’s hard to argue that you shouldn’t have better seat belts on planes,” Mr. Sands said. “But when the plane crashes, better seat belts are on the margins.”

Of course, 2010 was a big year for bank regulation, even if the meetings in Davos contributed little.

Congress passed the Dodd-Frank Act on financial regulation. The [Group of 20](#) economies endorsed the Basel III rules, which require banks to raise the amount of capital they hold in reserve and take other measures to armor themselves against financial shocks.

But some of the most important issues remain unresolved, and some involved in the debate say that the global financial system is still vulnerable.

“I wouldn’t say Basel III is beside the point,” said Martin Hellwig, an economist and co-director of the Max Planck Institute for Research on Collective Goods in Bonn, Germany. “But there are significant issues that it fails to address, and on the issues it does address, it doesn’t go far enough.”

Still awaiting action is the question of what to do about the [Lehman Brothers](#) of the world: banks that are so big or so intertwined that they have the potential to foment financial chaos if they get in trouble, just as Lehman did when it collapsed in 2008.

Many economists argue that those banks are more likely to take risks precisely because their executives believe that governments cannot let them fail. That de facto taxpayer insurance policy encourages recklessness.

“Although quite a lot has happened over the last year, the central problem that got us into the crisis has not been solved,” said Dennis J. Snower, president of the Kiel Institute for the World Economy in Germany, who was to moderate a panel in Davos on global risks.

“Profits are privatized, and there is an assumption that losses will be socialized,” Mr. Snower said. “No amount of capital buffers will solve that.”

Mr. Snower and others say that government officials are intimidated by what they perceive as the complexity of the financial system, and worried about unintended consequences.

“Many policy makers are seriously scared of making fundamental decisions,” Mr. Snower said. “People in the banking industry have an interest in making the situation seem complex and difficult, even if it isn’t.”

Bankers argue that there has already been plenty of new regulation and warn of a credit squeeze if there is any more.

“There can be no doubt that these reforms will have significant consequences for the financing of the real economy,” the chief executive of Société Générale, Frédéric Oudéa, said in a statement Monday.

“As we see it, the regulations challenge the transformational role performed by banks, whereby individual savings can in turn ensure the funding of corporate investment,” said Mr. Oudéa, who also oversees regulatory issues for the Institute of International Finance, an industry group.

Such statements lead some economists to conclude that the industry is no less in denial than it was last year.

“You see the desire to return to business as usual,” said Nicolas Véron, a senior fellow at Bruegel, a research institute in Brussels. “It just demonstrates the tin ear of private sector executives.”

When bankers, government officials and economists again meet behind closed doors at Davos this year, the debate will take place in the shadow of the European sovereign debt crisis. The problems of Greece, Ireland and other overly indebted countries were only just emerging in 2010.

As a result, banking issues this year will have an especially European hue.

The co-author of the Dodd-Frank Act, Representative [Barney Frank](#), Democrat of Massachusetts, said after meeting bankers in Davos last year that tougher regulation was coming, whether the industry liked it or not. With Republicans now in control of the House, analysts do not expect much more regulation from the United States.

“The U.S. is certainly not going to be absent from the debate, but there is a different sort of momentum than 12 months ago,” said Mr. Véron, who is also a visiting fellow at the Peterson Institute for International Economics in Washington.

The sovereign debt crisis makes it harder for regulators and political leaders to impose

stress on institutions with new requirements. As it is, banks have until the beginning of 2019 to comply fully with the Basel III rules, a transition period analysts consider generous.

Mr. Hellwig of the Max Planck Institute said that even in 2019, capital reserves would still be a fraction of what they should be.

In an influential essay last year, Mr. Hellwig faulted the Basel III rules for relying too much on risk-weighted assets, in which bank holdings are assigned different values for regulatory purposes depending on how risky they are believed to be.

Capital ratios should be based on gross assets, Mr. Hellwig said, because it is too difficult to estimate risks reliably and too easy for banks to manipulate the weightings. The Basel III rules include a leverage ratio of 3 percent of gross assets, but Mr. Hellwig said the ratio should be as much as 10 times that high.

He is not optimistic that discussions in Davos or anywhere else will produce such a requirement. "I don't think we are due to get much more in terms of radical changes," Mr. Hellwig said.