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IRISH DEATH NOTICES

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## Apocalypse now? banks enter crisis week

Finance minister Brian Lenihan has announced new legislation on financial regulation, but what rules are needed to prevent another collapse?

### Jon Ihle reports

This week the banking sector will experience more balance sheet carnage than at any point in its history. Tomorrow the first – and worst – tranche of bad loans will begin transferring into Nama from the five participating institutions, which collectively will take initial write-downs in excess of the 30% haircut the government signalled in September.



Matthew Elderfield

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On Tuesday, Anglo Irish Bank will report its 2009 annual results. The bank has indicated loan losses could range from €12bn to €14bn as the nationalised property lender takes the staggering hit on its €35bn Nama portfolio up front. Bank of Ireland (B of I) is also delivering 2009 results this week. Again, write-downs will be in the billions.

To prop up these and the rest of the Nama banks, the long-suffering Irish taxpayer will have to provide billions more in capital on top of the €11bn the state has already pumped into Anglo, AIB and B of I.

To prevent all of this happening again, finance minister Brian Lenihan has announced a major new legislative programme to revamp financial regulation. The first step is the reunification of the Central Bank and Financial Regulator into one organisation, reverting to the pre-2003 status quo. The draft bill for this long-signalled change was due last week, but delayed for an unspecified period due to printing problems and a logjam of business in the Department of Finance due to Tuesday's "big bang" announcement on restructuring.

This bill will deal exclusively with the new structure of financial regulation in Ireland. The real meat of the reform – new rules, enforcement and penalties – will have to wait for the second bill in the autumn. With the new architecture already taking shape in the Central Bank under new governor Patrick Honohan and head of financial regulation Matthew Elderfield, the question now is: what kind of rules do we need to keep the foundations of our financial system from collapsing once again?

"The critical issue is whether the legislation will set out statutory objectives, which at the moment are very weak," said Peter Oakes, director of regulatory training consultancy Compliance Ireland. "Without this it will be very difficult to build enforcement powers."

Britain's Financial Services Authority (FSA) has set out four objectives: to deliver market confidence, to raise public understanding of the financial system, to protect consumers and to reduce financial crime. The FSA uses the last one to a great degree, Oakes said, to clamp down on insider dealing, money-laundering and market abuse.

"The FSA is accountable for meeting these objectives," said Oakes, who is a former enforcement lawyer and investigator for the FSA. "Therefore it goes after people when their actions cause the FSA to miss them."

Any high-level objectives have to be supported by something more concrete, such as rules. However, Elderfield has rejected the traditional rules versus principles debate in favour of what he calls a "risk-based approach". In other words, the rules weren't the problem; it was the industry's attitude to risk and the regulator's inability to recognise it.

"There is a view that rules don't need to be changed that much," said Garvan O'Neill, partner in PricewaterhouseCoopers' financial services practice in Dublin. "You'll never have enough rules for every situation. It is better to have intelligent, sophisticated people who are empowered and given the resources to act."

O'Neill said the Irish regulator will largely be implementing a series of new regulations

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sent down from Europe and other international regulatory bodies, such as the Basel Committee which decides appropriate capital levels for banks. He said the major changes will be in capital requirements, solvency levels for insurance companies and new curbs on how hedge funds operate in the EU. As far as Ireland goes, new rules matter less than the power and wherewithal to enforce them.

"Heretofore the Central Bank hasn't really been able to instruct any institution to stop doing something," he said. "The regulator already has a reasonable degree of power, but can they make it more painful for institutions when they break the rules?"

Oakes said Elderfield and his staff will need specific powers for disciplining breaches of fitness and probity standards for senior management, such as removing directors from boards or appealing to the High Court to strike directors off.

"Right now there is no legal avenue to compel someone to leave office and this had to be addressed," said Oakes. "We also need a rule requiring the reporting of unethical behaviour in regulated firms, because people undoubtedly knew what was going on in the banks."

#### Hiring wave at financial regulator

Head of financial regulation Matthew Elderfield plans to double his staff to 720 by 2012 from just 360 people last year. The massive hiring wave is already under way, with head count expected to reach 520 by the end of this year.

The new staff will be deployed to beef up supervision intensity at the biggest financial firms, which will be watched by up to 10 dedicated staff per institution. Elderfield is also building special enforcement action and investigation teams so that normal supervision can continue while the regulator takes action when rules are breached, instead of supervisors having to down tools to pursue cases.

The Central Bank/Financial Regulator has advertised a "large number" of positions in compliance, risk management, funds policy, anti-money laundering and EU regulations, suggesting that under-resourced areas will be addressed over the coming months.

Industry sources said the regulator is now setting a high benchmark for candidates in skills, expertise and seniority. It is understood only one in 12 candidates is being offered a job – a sign that the regulator is being selective and that financial talent is being attracted to the regulator in large numbers.

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