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Are we ignoring the lessons the crisis taught us?

Presented by



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Kristina Cooke/Reuters

Louis Gagnon is worried. The associate professor of finance at Queen's School of Business has built a career in and around capital markets and risk management and he doesn't like what he's seeing today.

"It feels like we're getting back to normal and we may be missing an opportunity to implement reforms that could prevent this type of financial crisis from happening again." Prof. Gagnon points to

U.S. President Barack Obama's stalled attempts to pass financial system reform. "Now is the time to make changes, to learn the lessons the crisis taught us, but that window of opportunity to bring about the changes we need is closing."

Perhaps the most important lesson financial services executives should take away is also the simplest: Have the capital in place to cover potential losses. "The financial crisis was a failure in common sense," Prof. Gagnon says. "The financial institutions at the heart of it did not have the money to cover their bets. The signs were there, but the illusion of never-ending profits took over. Everybody got caught with their pants down. And the risk managers, who should serve as that little voice you hear when you are about to make a decision that can put you in danger, either weren't saying anything or weren't heard."

Of course, as Prof. Gagnon points out, it's hard to say stop when you're making so much money. At the same time, that money was only possible because of the high levels of risk. "Trading cultures had taken over, and when the traders, or risk takers, run the show, the risk manager has little to say. We need to find a balance."

Striking that balance will be difficult - and will require the efforts of both the financial institutions themselves and the state, says Robert Adamson, executive director CIBC Centre for Corporate Governance and Risk Management at Simon Fraser University's Segal Graduate Business School.

"There are two elements to this problem: What are banks and financial institutions doing themselves? And what is government doing when those institutions aren't willing or able or incentivized to undertake risk management? A bank may be able get hold of its own individual risks, the products it sells, its own investments but who is taking a look at macro credential risk oversight? Are there any institutions being created at the government level to oversee all these complex inter-relationships of

risk? This is what created the problem in the first place: the lack of coordination among banks and between banks and government."

Prof. Adamson says other countries, most notably the United States and Britain, are doing more on this front than Canada, which came through the crisis in much better shape, largely because Canadian banks are more inherently conservative and risk averse than their international counterparts. Still, he says, it's a mistake to remain complacent. "Yes we do have a relatively good regulatory governance framework but to say that the Canadian regulatory system is what protected Canadian banks puts a lot more faith in that system than it deserves. Most importantly, now other countries have used this crisis to study the inherent flaws - regulatory and self-regulatory - and are coming up with sophisticated policy."

So what should we be doing? Prof. Adamson would like to see better guidelines for boards, companies and their risk-management procedures.

"There is a lot of intelligence out there," he says. "Other companies around the world are doing best practices that Canadian companies are not picking up on." Beyond self regulation, Prof. Adamson would also like to see securities or corporate law mandate better risk management. And, finally, he sees a role for educators to play in developing curriculum to help better train future directors and executives. "If you meet with some board members, the whole concept of risk management, particularly macro risk management, is a confusing concept to them that a lot of directors reject because it confuses them."

Both Prof. Gagnon and Prof. Adamson agree a similar crisis cannot be avoided unless changes are made.

"Why didn't the Bear Stearns or the Lehman Brothers of the world see the crisis coming? A lot of that has to do with their failure to institutionalize risk management and to really understand the inherent risks in these sophisticated products the global market now produces," Prof. Adamson says.

"Collateralized debt obligations, credit default swaps - there will only be more and more of these products or efforts to create them. So what tools have we developed to make sure a similar situation couldn't be prevented? Increased capital liquidity of banks, for example, is one of the things being proposed but nothing has been implemented.

"In Canada, a lot of that conversation isn't even going on. There is too much complacency at the company, board and state level. We think our regulatory framework and inherent conservatism is enough - and my view is that it isn't."