

ABSTRACT

This paper will consider whether the scope of financial regulation should be extended and if so, ways in which this could occur. In order to carry out these tasks, it will not only address problems identified from the recent crises and Basel 2, gaps which exist in some of the responses to these issues, but will also consider what roles other parties such as central banks and external auditors can play in achieving financial objectives. To a certain extent, it will address these issues by making references to proposals which have been put forward from different sources. It will introduce the points of discussion through an overview of global developments which have necessitated the need for a review of financial regulation and through a review of the present regulatory objectives.

Reviewing regulatory objectives: Should the scope of financial regulation be extended?

Global developments which have prompted a review of financial regulation

Factors such as the growth of financial conglomerates and the derivatives markets, which have been facilitated by the impact of information technology and increased competition within the financial services industry, have instigated a change in the way financial regulation is carried out around the world. A realisation by countries and their financial institutions that they were at a competitive disadvantage as globalisation gained momentum, led to ultimate liberalisation in these countries.¹ Asymmetric distribution of information between the industry being regulated and the primary regulators, notably in North America, the UK and Japan, was partly responsible for the inability of regulators to challenge anti competitive behaviour of the financial services industry hence impeding their maximisation potential to regulate during the advent of globalisation.² In Germany and France where the financial sector was dominated by state ownership, the issue of asymmetry was not as important since banks were the dominant institutions in these countries – owing to their universal bank structure.³

As a result of the above mentioned global changes and developments, the benefits of financial regulation have not been realised to full potential since financial regulation also needs to evolve with changes such as the growth of financial conglomerates, social and economic changes. This has resulted in some arguments that regulation could also be detrimental.⁴ The reasons for differences in opinions between those who are in favour of regulation and supervision in finance and those who are against, focus around four key issues, namely:⁵ i) How financial institutions and markets work and operate in practice: This would require consideration of the domestic and global financial environment, ii) The incentive structures faced by financial firms iii) The extent of market imperfections and failures in the financial system and the power of regulation and supervision to address these, iv) the extent to which financial products and contracts are substantially different from goods and services which are not regulated to the same degree as financial institutions.

The rationale for financial regulation is an embodiment of two issues namely:⁶

The problem of systemic risk⁷: There being compelling evidence that a stable financial system provides conducive environment for efficient allocation of resources which in turn encourages

¹ See OECD Report on Regulatory Reform 1997 Volume 1: Sectoral Studies at page 73 -74

² *ibid* at page 74

³ *ibid*

⁴ D Llewellyn 'The Economic Rationale For Financial Regulation' (1999) Financial Services Authority London Occasional Paper 1 April 1999 at page 7

⁵ *ibid* at page 5

⁶ Speech by Howard Davies, former chairman, Financial Services Authority 'Building the FSA – Progress to Date and Priorities Ahead' Wednesday 30 September 1998 <<http://www.fsa.gov.uk>> (last visited 10 June 2008)

⁷ Regulation for systemic reasons is required when the social costs of the failure of financial institutions (particularly banks) exceed private costs and such potential social costs are not provided for in the decision making of the firm. Social costs could arise from systemic situations triggered by a bank run (withdrawal of deposits by depositors) which may have contagious effects on other banks. D Llewellyn 'The Economic Rationale For Financial Regulation' (Financial Services Authority London Occasional Paper 1 April 1999 p 13 Failure of an insolvent bank could therefore cause other bank depositors to withdraw deposits – thereby leading to social costs which the banks (of those other depositors) didn't anticipate or provide for. Private costs would be foreseeable costs of running a bank – costs attributable from a particular bank's activities and its own personal and private affairs. Way in which FSA could try to reduce externalities is by effective regulation and supervision as systemic crisis can arise from failure of just one bank. The arrangement (whereby the FSA seeks to achieve the objective of maintaining confidence in the financial system and the Bank of England has continued responsibility for overall stability of the financial system) between the FSA and the Bank of England in dealing with systemic risks was finally tested in the summer of 2007 following

economic growth⁸. Systemic risk is referred to as the risk that the failure of one firm may affect others, resulting in the collapse of the financial system.⁹

The problem of asymmetric information whereby certain information is known to some people but not to others¹⁰.

Systemic risk

According to Schwarcz, institutional systemic risk and market systemic risk should be considered individually since both can involve markets and institutions.¹¹ A distinction is also made between “institutions which are “individually systemic”, “systemic as part of a herd” (for instance, highly levered hedge funds), non systemic large and not highly levered, and unlevered institutions¹². Further, the design of rules such that banks have no incentive to move assets into off-balance sheet vehicles is considered desirable with regards to “individually systemic” institutions.¹³ Hedge funds are considered by some to be instruments which do not present significant threats. Schwarcz argues that as disintermediation increases, systemic risk should be considered according to its impact on markets and not institutions.¹⁴ In his opinion and from the perspective of systemic risk, “the business or legal characterization of any given institution” should be far less important than whether such an institution was a critical financial intermediary.¹⁵ Accordingly, he goes on to say that hedge funds are not critical financial intermediaries since they do not particularly play a key role in the funding of companies **when viewed from the perspective of systemic risks.**¹⁶ However, he adds that hedge funds may present a greater threat of risk than other types of business organisations when poor management controls operate within the companies, and particularly, when operated in today’s financial environment.¹⁷

The interconnectedness between modern financial institutions and market participants, along with the complexity of such institutions, contribute to failures which result in systemic risk.¹⁸ The role played by bank depositors’ perceptions in triggering bank runs is illustrated by Kaufman.¹⁹ If bank depositors

the collapse of Northern Rock.

⁸ Speech by Howard Davies, former chairman, Financial Services Authority 'Building the FSA – Progress to Date and Priorities Ahead' Wednesday 30 September 1998 <<http://www.fsa.gov.uk>> (10 June 2006)

⁹ P Cartwright, Bankers, *Consumers and Regulation* 2004 Hart Publishing at pg 192; For a consideration of the role of law in the prevention of bank failures and for causes of bank failures when they occur, see A Campbell and P Cartwright, *Banks in Crisis: The Legal Response* 2002 Dartmouth Publishing

¹⁰ Ibid; Market failures include information problems, externalities and conflict of interests. If financial services were operated in perfectly competitive markets (there were no information problems, externalities, conflicts of interests etc) there would be no reason for regulation. Since market imperfections and failures are unavoidable, the FSA could help reduce the problem through its objectives of consumer awareness (thereby preventing information problems). It could also impose rules relating to the way in which the regulated firm must behave (in order to avoid conflicts of interest). The establishment of the Financial Services Consumer Panel has contributed a lot towards helping to deal with the problem of asymmetric information.

¹¹ S Schwarcz, 'Regulating Complexity in Financial Markets' *Washington University Law Review*, Vol. 87, No. 2, 2009-10 at page 202

¹² See M Brunnermeier and others, 'The Fundamental Principles of Financial Regulation: Geneva Reports on the World Economy 11', Preliminary Draft 2009 at page 24; A distinction is also drawn between regulation which is involved with factors that affect the stability of individual institutions (micro prudential regulation) and regulation which involves factors that affect the stability of the financial system as a whole – see *ibid* at page 6

¹³ *ibid*

¹⁴ S Schwarcz, 'Regulating Complexity in Financial Markets' *Washington University Law Review*, Vol. 87, No. 2, 2009-10 at page 202

¹⁵ *ibid*

¹⁶ *ibid* at 203

¹⁷ *ibid*

¹⁸ S Schwarcz, 'Regulating Complexity in Financial Markets' at page 30

¹⁹ G Kaufman, *Bank Failures, Systemic Risk and Bank Regulation* <<http://ideas.repec.org/p/fip/fedhfi/wp-96-1.html>> (last visited 25 May 2009)>

perceive other banks in the system to be solvent and re deposit at those institutions, the aggregate effect of such a run will be relatively small.

Information disclosure

Regulation facilitates the enhancement of information disclosure through the management of a database of transactions, from which market participants can determine how risks have been allocated.²⁰ This reduces the possibilities of risks, such as counter party risks²¹, from developing.

Evaluating Responses to Global Developments

Problems identified from recent crises: Maturity mismatches

According to Brunnermeier et al²² failures such as Northern Rock, Lehman Brothers and Bear Stearns were triggered not only by their inability to transfer their liabilities (funding illiquidity), but also their inability to sell mortgage products at “non-fire sale-prices” (market illiquidity). The extent to which the maturity of funding determines the risk of an asset is an important lesson from the Crash of 2007/2008.²³ A reason which was attributed to Northern Rock’s vulnerability was its excessive reliance on wholesale funds.²⁴ “Wholesale funds are obtained from non financial corporations, money market mutual funds, foreign entities and other financial institutions. Typically, the funds are raised on a short-term basis through instruments such as certificates of deposit, commercial paper, repurchase agreements and federal funds.”²⁵

Consideration of an asset’s market liquidity is considered to be an essential pre requisite for the effective maturity of an asset.²⁶ “.....if capital is to be risk sensitive, it must be sensitive not just to the risk of assets, but to the risk of the combination of the asset and its funding, which includes the leverage and maturity mismatch.”²⁷ Four potential sources of protecting the financial system from failure of wholesale financial markets, and hence illiquidity, are identified²⁸ and these are: i) Banks and other financial institutions ii) private insurance iii) the central bank iv) public insurance

Basel II

Risk cycles are usually pro-cyclical due to misperception by banks and markets about how risks move over the period.²⁹ There has been worry that the new Basel Accord on banks' capital standards could worsen this misperception by banks and markets – danger being that from 2006, banks would have to adjust their minimum capital requirements over time to align with changes in measured risk.³⁰ As a result, banks' internal risk assessment would vary more than it should over the course of the cycle.³¹

²⁰ For further information on this, see S Schwarcz, ‘Regulating Complexity in Financial Markets’ at page 41

²¹ Counter party risk is a form of information failure which occurs where there is a lack of transparency regarding the financial condition of the counter party. Such information failure is aggravated where no contracts exist between private parties. Uncertainty is increased as a result of the inability of market participants to gauge the extent of the other participant’s exposure on these contracts; *ibid* at page 30

²² See ‘The Fundamental Principles of Financial Regulation: Geneva Reports on the World Economy 11’, Preliminary Draft 2009 at page 36

²³ see *ibid* at viii

²⁴ S Cociuba, ‘Seeking Stability: What’s Next for Banking Regulation?’ Chart 3
<http://www.ideas.repec.org/a/fip/feddel/y2009iaprnv.4no.3.html> (last visited 25 May 2009)

²⁵ *ibid*

²⁶ See M Brunnermeier and others, ‘The Fundamental Principles of Financial Regulation: Geneva Reports on the World Economy 11’, Preliminary Draft 2009 at page 42

²⁷ *ibid* at 41

²⁸ *ibid* at page 7

²⁹ “Bubble and squeak” *The Economist* Sept 26th 2002

<http://www.economist.com/displaystory.cfm?story_id=1336105>

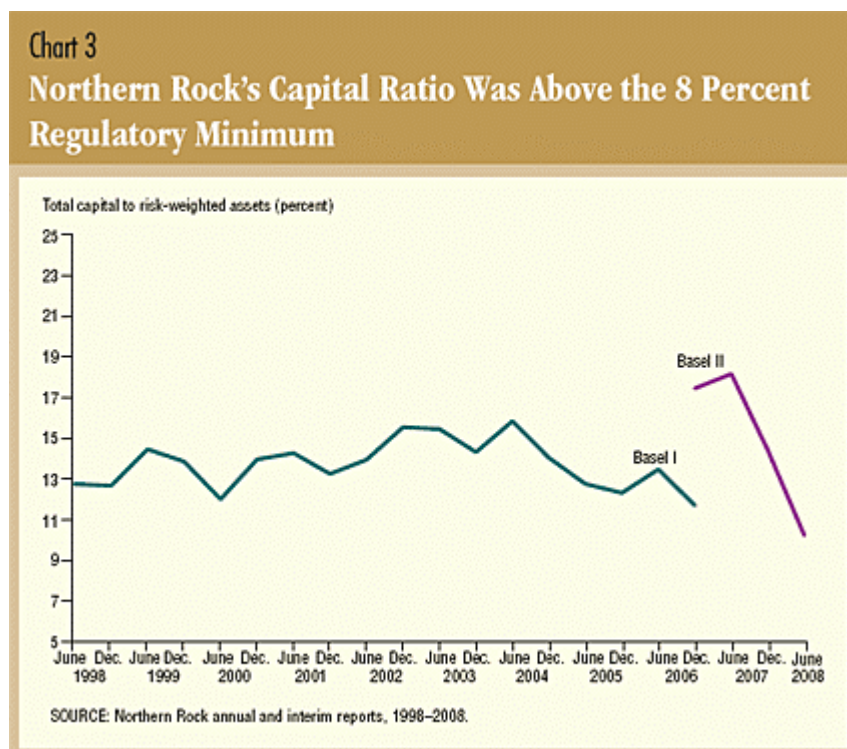
³⁰ *ibid*;

³¹ *ibid*

Pro cyclical problems were revealed following the collapse of Northern Rock where it was highlighted that it was complying with Basel capital requirements and had excess capital on the eve of its crash.³²

Another problem identified with Northern Rock was that it had high leverage – relying heavily on debt to finance its assets.³³

In response to Basel II's shortcoming and since capital regulation contributes to the degree of economic downturns³⁴, a complement of the rules on bank capital with rules on liquidity and leverage is proposed by Cociuba as a means of addressing the inadequacy of risk based capital measures in promoting the stability of the financial system.³⁵



Source³⁶

Furthermore, counter cyclical regulatory mechanisms have been proposed to address pro cyclical problems which have not been addressed by Basel II.³⁷

³² see S Cociuba, 'Seeking Stability: What's Next for Banking Regulation?' Northern Rock had obtained approval from the Financial Services Authority to switch to Basel II advanced approach in order to calculate risk weights for its assets using the bank's internal models. In December 2006, its capital ration was 11.6 under Basel I calculations but this jumped to 17.5 under Basel II. In June 2007, this had risen to 18.2%; for further information on this see S Cociuba, 'Seeking Stability: What's Next for Banking Regulation?'

³³ Ibid; Leverage is pro cyclical – being high during booms and low during downturns. Whilst some other institutions adjusted their balance sheets by raising new equity or selling assets to repay some debt, Northern rock did not reduce its debt; *ibid*.

³⁴ Since banks choose to reduce lending when capital is scarce

³⁵ *ibid*

³⁶ Taken from S Cociuba, 'Seeking Stability: What's Next for Banking Regulation?' Chart 3 <http://www.ideas.repec.org/a/fip/feddel/y2009iaprnv.4no.3.html> (last visited 25 May 2009)

³⁷ See M Brunnermeier and others, 'The Fundamental Principles of Financial Regulation: Geneva Reports on the World Economy 11', Preliminary Draft 2009 at pages 29-35

Other criticisms directed towards Basel 2 include supervisory discretion – that this could result to regulatory capture, that it is excessively risk sensitive, that its capital formula is too prescriptive and complex and that it is not well-suited for 90% of the world's population.³⁸

Regulatory responses to corporate failures

One of the aims of the Sarbanes Oxley Act, a post Enron consequence, is directed towards restoring investor confidence in financial reporting. One of the major problems with Enron was the off balance-sheet debt which resulted from direct application of rules without the ability to consider the substance of the transaction because accounting standards did not permit this. Section IV of the Act³⁹ concerns itself with measures aimed at enhancing financial disclosures.⁴⁰ Corporate collapses, particularly that of Enron, raised consideration of the following points: i) The regulation of auditors – Enron highlighted the fact that self-regulation and peer review in the US were no longer enough ii) The elimination of conflicts of interests in accounting firms; iii) compulsory rotation of auditors – highlighted from the fact that Arthur Andersen had audited Enron since its establishment in 1983.⁴¹ The collapse of Enron also led to suggestions that the Securities and Exchange Commission (SEC), its standard setting body (the FASB – the Financial Accounting Standards Board) may have to consider embracing international accounting standards.⁴²

European response to corporate scandals has been more confined – relying more on self-regulation, corporate governance codes and the “comply or explain” principle.⁴³ According to Hopt⁴⁴, an improvement of corporate governance in Europe, in the aftermath of Enron would require the involvement of intermediaries such as external auditors. Furthermore, he notes that the control of the Board by auditors is not only the “most common”, but also the “most prominent control mechanism”.⁴⁵ The fact that Enron’s board appeared to have been exemplary, by corporate governance standards, and yet failed to protect its shareholders⁴⁶ provides sufficient proof of the need for a reform of the Board.

In its preamble, the 2008 Revised Combined Code on Corporate Governance states that good corporate governance should not only contribute to better company performance by helping a board discharge its duties in the best interests of the shareholders, but should also facilitate efficient, effective and entrepreneurial management that can deliver shareholder value over the larger term.⁴⁷ Transparency and Disclosure rules are set out under the Listing Rules of Schedule C.⁴⁸ In countries

³⁸ K Alexander, 'Corporate Governance and Basel II' (paper presented at the Institute of Advanced Legal Studies, Russell Square on the 7th October 2004)

³⁹ See House of Commons Select Committee on Treasury; Examination of Witnesses: Mr Michael Groom, Mr Peter Wyman, Mr David Bishop, Mr Roger Adams, Mr Bruce Epsley and Mr Richard Mallet, Wednesday 10 April 2002 at page 1

⁴⁰ The section deals with disclosures in periodic reports (section 401), enhanced conflict of interest provisions (section 402), disclosures of transactions involving management and principal stock holders (section 403), and the disclosure of audit committee financial expert (section 407), amongst other provisions.

⁴¹ See 'Enron: The real scandal' *The Economist* Jan 17th 2002
<http://www.economist.com/displaystory.cfm?story_id=940091>

⁴² *ibid*

⁴³ M Becht., P Bolton, and A Röell., 'Corporate Governance and Control' (2002). ECGI - Finance Working Paper No. 02/2002. <http://ssrn.com/abstract=343461> or DOI: 10.2139/ssrn.343461 page 72

⁴⁴ K Hopt, 'Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron' *CGI Law Working Paper No. 05/2002* at page 476 <
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=356102>

⁴⁵ *ibid* at page 497

⁴⁶ See Corporate Governance and Control Finance Working Paper N°. 02/2002 page 74

⁴⁷ See

<[http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008\(2\).pdf](http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf)> (last visited 27 May 2009)

⁴⁸ In Hopt and Leyers' opinion, disclosure constitutes an important link between internal controls and the supervisory board or, in the one-tier board model, non-executive directors and external controls. Further, a strategic finding of the High Level Group of Company Law experts in their report to the European

such as Germany, Italy and the UK, a special body of rules for listed companies, have arisen from both hard and soft law.⁴⁹

At European level, the challenge presented by corporate reform is considered to extend beyond the identification of “the key elements of, and most desirable reforms for corporate governance”.⁵⁰ According to Hopt and Leyer, recent developments in Europe have not only indicated a trend towards specialised rules for listed companies, but also point to increasing convergence of internal control mechanisms – independently from board structures.⁵¹ In Germany, the key role assumed by the supervisory board (Aufsichtsrat) was bolstered by the German Corporate Governance Code of 2002⁵² whilst the duties of the Italian internal auditing committee (Collegio Sindicale) were extended by the Testo Unico of 1998.⁵³

The German Corporate Governance Code of 2008⁵⁴ is aimed not only at making the German Corporate Governance system more transparent and comprehensible⁵⁵, but also to increase confidence amongst international and domestic investors, customers, employees and the general public.⁵⁶

Two arguments in favour of mandatory rules for regulatory intervention are as follows:⁵⁷ The main argument consists in the fact that there would be a tendency for the founder of the firm or the shareholders to draft inefficient rules even if they were able to design and implement their preferred corporate charter. The second argument is that firms may want to break or amend efficient rules later – even where the right incentives to design such efficient rules exist initially. Furthermore, it is argued that corporate governance should not operate in isolation – and that it requires capital market law.⁵⁸

Commission at the end of 2002 is that general disclosure rules can facilitate greater integration within the internal market. See K Hopt, ‘Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron’ [CGI Law Working Paper No. 05/2002](#) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=356102> at page 23

⁴⁹ See K Hopt and P Leyens, ‘Board Models in Europe: Recent Developments of Internal Corporate Governance Structures in Germany, the United States, France and Italy ECGI Working Paper No 18/2004 at page 20

⁵⁰ K Hopt, ‘Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron’ at page 449. Furthermore, in Hopt’s opinion, the fact that a rule may be good or necessary for good corporate governance does not necessarily indicate that it is appropriate at European level.

⁵¹ See K Hopt and P Leyens, ‘Board Models in Europe: Recent Developments of Internal Corporate Governance Structures in Germany, the United States, France and Italy ECGI Working Paper No 18/2004 at page 5 of 30

⁵² Which has been consolidated by the German Corporate Governance Code of 2008

⁵³ See K Hopt and P Leyens, ‘Board Models in Europe: Recent Developments of Internal Corporate Governance Structures in Germany, the United States, France and Italy .The Testo Unico 1998 has been consolidated with the coming into force of the Testo Unico 2008

⁵⁴ German stock corporations operate according to a dual board system which consists of : 1) The management board who is responsible for managing the enterprise whilst the chairman of the management board coordinates the work of the management board and 2) The supervisory board who appoints, supervises and advises the members of the management board. Furthermore, the supervisory board is also responsible for setting up the Audit Committee which deals with matters relating to accounting, risk management and compliance, the required independence of the auditor, issuing of the audit mandate to the auditor and the stipulation of audit fees.

⁵⁵ In making the corporate governance system more comprehensible, the code clarifies the rights of shareholders, who provide the company with the required equity capital and who bear the entrepreneurial risk.

⁵⁶ See <http://www.corporate-governance-code.de/eng/download/E_Kodex%202008_final.pdf> (last visited 27 May 2009)

⁵⁷ See D Denis and J McConnell ‘International Corporate Governance’(2003). ECGI - Finance Working Paper No. 05/2003; and Tuck-JQFA Contemporary Corporate Governance Issues II Conference. <<http://ssrn.com/abstract=320121> or DOI: 10.2139/ssrn.320121> at pages 10,11 of 122

⁵⁸ K Hopt, ‘Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron’ [CGI Law Working Paper No. 05/2002](#) at page 23

The extension of roles assumed by parties to the regulation and supervision of the financial system

In some countries like the UK, regulatory and supervisory functions have been transferred from the central bank to a separate agency – hence resulting in a reduced role for the central bank in supervision. This paper is in favour of the central bank playing a greater role in supervision.⁵⁹ In addition to the need for such an increased role, functions assumed by third parties such as the external auditor, need to be increased. In supporting an increased role for the central bank, reference will be made to the second main issue which embodies the objectives of financial regulation, namely, the problem of asymmetric information. In supporting the external auditor's potential to carry out direct supervisory functions (on behalf of the regulator), reference will be made to the issue of systemic risk.

Systemic risk

In order to overcome the myths surrounding the quantification and control of risks, “risks must be made auditable and governable.”⁶⁰

Since societal risks⁶¹ are difficult to quantify, it could be argued that focus should be placed on preventing, detecting and rectifying the effects of institutional risks.⁶²

Risk management of institutional risks, even though this generates risks (which are the consequence of an omission of other significant risks), can be undertaken using the audit risk model – especially since the assessment of risks, based on differences in perceptions⁶³, is so subjective.

Limitations of the audit risk model

The audit risk model does not account for certain risks which the auditor is exposed to. Examples of such risks include loss or injury to their professional practice from litigation, adverse publicity or other events which relate to the audited financial statements.⁶⁴ Those risks which are not accounted for within the audit risk model are generally referred to as “engagement risk”, “client risk” or “client continuance (or acceptance) risk”⁶⁵.

Furthermore, the definition of audit risk does not consider the risk that the auditor may mistakenly deduce that financial statements are materially misstated.⁶⁶ Where such situation arises, the auditor simply makes a re consideration or extends audit procedures with requests that specific tasks be

⁵⁹ However, in jurisdictions like Italy, the central bank's powers had to be curtailed in order to increase the powers of CONSOB – the stock exchange regulator-. This was a way of ensuring that greater accountability was fostered between regulatory agencies.

⁶⁰ See M Power, *The Risk Management of Everything: Rethinking the Politics of Uncertainty* 2004 Demos at page 10; also see U Beck, *Risk Society – Towards a New Modernity* (London: Sage, 1992)

⁶¹ “Traditional and novel” risks, are referred to as “societal risks”. See H Rothstein, M Huber and G Gaskell “A Theory of Risk Colonization: The Spiralling Regulatory Logics of Societal and Institutional Risk” (2006) *Economy and Society* (35) 1 at page 92

⁶² institutional risks are implied to include risks encountered by institutions which are responsible for managing and regulating societal risks and/or legitimacy risks (to their rules and practices) - regardless of whether these institutions are state or non state institutions; see H Rothstein, M Huber and G Gaskell “A Theory of Risk Colonization: The Spiralling Regulatory Logics of Societal and Institutional Risk” (2006) *Economy and Society* (35) 1 at page 92

⁶³ Attitudes to risk vary with individuals and may be different at different levels of an organization. “Risk attitudes or appetites may also vary across different aspects of the same risk, may in reality not correspond to any stated appetite and may change with new or better information.” See M Power, *The Risk Management of Everything: Rethinking the Politics of Uncertainty* 2004 Demos at pages 19 and 20. Also see B Hutter, *Risk and Regulation* (2000) Oxford: Oxford University Press

⁶⁴ See <<http://www.aicpa.org/download/members/div/auditstd/SAS107.PDF>> page 2 of 20

⁶⁵ ‘The Audit risk Model’ <<http://www.pobauditpanel.org/downloads/appendixa.pdf>> at page 177

⁶⁶ See <http://www.aicpa.org/download/members/div/auditstd/SAS107.PDF> at page 2 of 20

Having considered the lessons from the recent crises, Basel 2, and the continued systemic importance of non bank institutions and hedge funds, it is without doubt that the scope of regulation needs to be addressed. The importance of roles played by parties such as the external auditor and central banks in regulation and supervision has been highlighted. In relation to more difficult areas, such as the regulation of hedge funds, steps are being taken to strengthen the regulation of institutions within such areas through⁷³ clearer and tougher rules on consolidation which should operate alongside more effective supervision of the activities, entities and risks of financial institutions. Furthermore, work is being carried out, not only to strengthen the supervision of counter party risk in regulated institutions, but also to ensure that an effective framework operates both for solo and consolidated prudential supervision of regulated securities and insurance companies.⁷⁴ The regulatory objectives as they stand may appear to accord greater importance to systemic risk. However the potential of asymmetric information problems to contribute to problems attributed to systemic risk should also be given consideration. Furthermore, in those jurisdictions where the central bank is not involved in supervision,⁷⁵ clear allocation of responsibilities between the central bank and the agency responsible for carrying out supervision and regulation is vital to ensuring the stability of the financial system.

⁷³ See *ibid* at 4

⁷⁴ *ibid*

⁷⁵ In this sense, the degree of involvement of the central bank may also be minimal