

# CSFI

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## Press Release

### **Regulatory overkill seen as main risk facing banks** **New CSFI 'Banana Skins' survey pinpoints financial dangers** (Embargoed until Monday, February 21, 2005)

The remorseless rise in regulation has become the greatest risk facing the banking sector according to the latest 'Banana Skins' survey conducted by the CSFI, the independent City of London think tank, and sponsored by PricewaterhouseCoopers. The report finds that regulatory overkill saps bank resources, reduces risk diversification and creates a false sense of security.

This finding is based on responses from 440 bankers and close observers of the banking scene in 54 countries, but the threat is perceived to be particularly strong in the EU and North America. Many senior bankers described regulation as "out of control".

The CSFI's Banana Skins survey, now in its 10th year, ranks banking risks by their perceived severity, and analyses their potential impact on the industry. Other fast-rising risks identified in this year's poll are **hedge funds** (5<sup>th</sup>) and **electronic fraud** (6<sup>th</sup>), as well as **currency risk** (7<sup>th</sup>) due to the shaky US dollar.

Closely linked to overregulation is the high place given in the rankings to **corporate governance risk** (3<sup>rd</sup>). Although banks are seen to have weaknesses in this area, this Banana Skin also scores strongly because respondents – particularly bankers – perceive it to be part of the regulatory threat.

John Hitchins, UK Banking Leader at PricewaterhouseCoopers, said:  
"Bankers have thrown down a challenge against too much prescriptive regulation. Many are worried that it is beginning to stifle innovation and judgement across the industry. While few challenge the objectives of regulators, there is a clear need for further debate on how these are implemented. "

Other high level risks include **credit risk** (2<sup>nd</sup>) and **derivatives** (4<sup>th</sup>), both of which featured prominently in last year's survey. Unrest in the Middle East also gave a strong boost to **commodities** (up from 26<sup>th</sup> to 14<sup>th</sup>), where potential instability in the oil and gold markets is seen as threatening.

However broad concerns about **macro-economic trends** have eased (down from 3<sup>rd</sup> to 10<sup>th</sup>), along with fears of **political shocks** and **terrorist attacks**, as reflected in the sharp

decline of concerns about **business continuation** (down from 5<sup>th</sup> to 19<sup>th</sup>). Worries about the strength of the **insurance sector**, which featured strongly last time, have also diminished (down from 4<sup>th</sup> to 11<sup>th</sup>).

However the survey found that banks were seen to be less well prepared to handle risk than before. Fifty seven per cent of respondents thought banks were moderately well prepared or better to handle the risks, down from 69 per cent in the previous survey. One reason was the inclusion in this survey of a larger proportion of respondents from emerging market and EU accession countries where bank readiness was seen to be less advanced than in industrial nations. In the advanced banking markets, the considerable risk control work of recent years is considered to be paying off in higher awareness and better systems, though this is offset by fears that banks may be becoming too complacent or process-driven.

David Lascelles, the CSFI's co-director who ran the survey, said: "It is ironical that people now see the greatest dangers in regulation when new types of risk are emerging all the time: hedge funds, derivatives, electronic fraud. Banks should not be distracted from these risks by box-ticking and form-filling".

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Banana Skins 2005 is available through Central Books ([www.centralbooks.co.uk](http://www.centralbooks.co.uk)) at £25/US\$45/€40, or call the CSFI (020 7493 0173).

The CSFI is a non-profit think-tank, founded eleven years ago, which looks at challenges to and opportunities for the financial sector. It has an affiliate organisation in New York, the New York CSFI.

Hard copies of Banana Skins 2003 are available from the CSFI (price £25/\$45/€40), 5 Derby Street, London W1J 7AB. Tel +44 (0)20 7493 0173. The 2003 report can also be downloaded free from [www.csfi.org.uk](http://www.csfi.org.uk).

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## Banana Skins 2005

(2003 ranking in brackets)

- 1 Too much regulation (6)
- 2 Credit risk (2)
- 3 Corporate governance (8)
- 4 Derivatives (1)
- 5 Hedge funds (15)
- 6 Fraud (11)
- 7 Currencies (18)
- 8 High dependence on technology (12)
- 9 Risk management techniques (16)
- 10 Macro-economic trends (3)
- 11 Insurance sector problems (4)
- 12 Interest rates (9)
- 13 Money laundering (14)
- 14 Commodities (26)
- 15 Emerging markets (22)
- 16 Grasp of new technology (19)
- 17 Legal risk (-)
- 18 Equities (7)
- 19 Business continuation (5)
- 20 Banking market overcapacity (17)
- 21 Management incentives (20)
- 22 Political shocks (10)
- 23 Retail sales practices (21)
- 24 Rogue trader (23)
- 25 Payment systems (25)
- 26 Back office (24)
- 27 Merger mania (27)
- 28 Environmental risk (30)
- 29 Competition from new entrants (28)
- 30 Too little regulation (-)