BIS Workshop on "Accounting, risk management and prudential regulation"

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Welcoming remarks by
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It is a great pleasure to welcome all of you to this workshop on accounting, risk management and prudential regulation. Over the next two days you will be addressing issues that are very much at the forefront of the policy and practitioners' debates these days.

The BIS is delighted to have the opportunity to host events like this. Indeed, this workshop embodies many aspects of the role that the BIS plays in the international financial arena.

Our mission is to promote cooperation among policymakers across countries. Since financial sector supervision has become an ever more complex and multifaceted task and is increasingly being performed by dedicated financial system supervisory agencies, we are extending our efforts to promote cooperation beyond central banking circles to other official agencies that are responsible for various areas of financial supervision. A key goal of our work is to try to catalyse the dialogue and help bridge the differences in perspective that various parties bring to the table, by highlighting common objectives and improving mutual understanding.

This workshop is a fine example of this trend. For it focuses on a topic that lies at the intersection of three areas that do not always interact closely, despite the fact that they have quite a lot in common: financial reporting, risk management theory and practice, and prudential regulation of financial firms. All three areas are fundamentally concerned with fostering decision-making processes that, ultimately, support the efficient functioning of the financial system and its stability, be that at the level of individual institutions or more broadly. And all three have experienced the declining economic significance of national borders and have focused increasingly on developing best practices and norms with international applicability.

We hope that this event will be a positive step in the evolving and ever closer dialogue among the key players involved in these three areas. We hope, too, that at the end of your discussions over the next two days we will all have a deeper understanding of the issues that fuel the current debate and a glimpse of the more promising directions in which the convergence of perspectives can progress.

To achieve this goal, we felt it would be helpful to provide a setting conducive to a dispassionate and analytical exploration of the questions involved, even though some of them are deeply controversial; to take a "step back" and examine some of the more fundamental issues from first principles. In this spirit, I hope that – despite the different perspectives of the institutions you work for – you will approach the subject as far as possible in a personal capacity, suspending the "rules of engagement" that apply to those forums where the hard practical decisions are actually taken.

Let me now say a few words about the importance of the questions that will be debated at the workshop against the background of the shared goal of building a more efficient, stronger and more resilient financial system.

Accounting and risk measurement

Except among specialists, accounting questions have not received the attention they deserve in economic discussions generally. In particular, they have often been overlooked in discussions of the various elements that play a role in financial stability. This neglect can partly be blamed on today's very high degree of specialisation in individual academic and professional disciplines – a situation which can become a barrier to understanding the profound interrelationships among problems in the real world.

This state of affairs is unfortunate for several reasons:

First, we tend to take asset and liability valuations for granted, but there are important conceptual and operational difficulties in getting the numbers "right".

Second, errors made in measuring the value of those assets and liabilities and in recognising the associated income can have first-order effects on the valuation of capital and profits, and ultimately on the performance, risk profile and soundness of institutions. To take one example, think of the serious implications of mismeasuring the value of loan portfolios, all too often highlighted by experience.

Third, and quite apart from the technical issues involved, the recent spate of accounting and corporate governance scandals has hammered home the message that incentive and transparency issues are just as important in this area of financial reporting as elsewhere.

The financial reporting challenge is, indeed, a daunting one. Financial reporting standards need to strike a balance between meaningfulness and verifiability of valuations. And those same standards need to work against the incentives of "insiders" to misreport, while at the same time enhancing the ability of all "outsiders" to discriminate between honest differences in opinion and intentional deception. Not an easy task!

Accounting and financial stability

Here at the BIS we have consistently expressed our strong belief that good accounting practices are essential in fostering financial efficiency and stability. I am pleased that this point is very much highlighted in this workshop. I know that many accountants prefer to see their role as one of describing economic reality in a way that is neutral with respect to business decisions. But I think that accounting standards invariably influence behaviour at both the micro and macro levels, both inside and outside the firm. Importantly, better accounting standards are, almost by definition, those that encourage better behaviour.

Several of the papers in the programme for these two days pay particular attention to the interconnections between accounting and prudential frameworks. A key question here is whether a single set of accounting numbers can simultaneously serve all stakeholders in firms, be these preparers, users (investors, potential investors and analysts) or prudential authorities. Hence, implicitly, it also raises the question whether there are special issues arising in the context of banks and financial firms.

The regulators are increasingly dealing with these questions. A notable example relates to the heated debate on the appropriateness of fair value accounting for the banking industry, where the tension between competing perspectives is clearly exposed. The broader question here is how to balance the objective of providing accurate financial reporting with the desire of regulators to ensure that appropriate prudential buffers are in place to absorb potential sources of strain in the financial system. For example, current regulatory practices and rules for intervention in weakening financial firms would not be compatible with the full marking to market of liabilities, in which changes in valuations reflect gains resulting from deterioration in a financial firm's own credit standing.

And, alongside prudential supervisors, firms' management, too, is also facing similar challenges. You need only think, for instance, of the heated debate surrounding hedge accounting, notably its compatibility with firms' internal risk management practices.

Reconciling these different perspectives may require addressing more specific questions, which will be taken up in the rest of the workshop.

One such question is the appropriate degree to which forward-looking assessments can and should be applied to the valuation of different types of assets and liabilities of financial firms.

A second question is how far measures of valuation should be firm-specific (the issue of so-called "entity-specific" value).

A third question relates to the exact nature of the information that should be disclosed within an ideal financial reporting framework.

A fourth question concerns the impact of financial reporting, not just on the behaviour of individual firms, but also on the system as a whole, and hence on the possibility of, and possible remedies for, any unintended "general equilibrium" effects.

The search for the right answers requires analysis that lies at the intersection of a number of disciplines: microeconomics, macroeconomics, finance, accounting and law. And it equally requires meshing the perspectives of academics, market practitioners and policymakers.

We hope that this workshop will play a small role in encouraging further discussion and analysis along these lines. The policymaking community would stand to benefit greatly from this.

Two very busy and, no doubt, very fruitful days are ahead of you all.

I look forward to receiving the feedback from your deliberations.