
Book reviews

Global Financial Crisis: Navigating and Understanding the Legal and Regulatory Aspects

Consulting Editor:

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It is all too easy to feel overwhelmed by both the pace and complexity of the way in which the financial world has been changing since mid-2007, when the ripples of the current financial crisis first began to form on the horizon.

Nonetheless, lawyers and regulators cannot let themselves be beaten, for it is their immediate task to fight fire, limit damage and engage in the longer-term structural rebuilding of the global financial system and of those parts of the financial sector that have survived, whether in an altered or original, if somewhat battered, form. The consultant editor is to be congratulated for assembling an expert and practical team of authors to begin to chart a way through the morass of legal responses, laws, regulations, emergency assistance schemes, nationalisations, takeovers and consolidations, and last but by no means least, lawsuits that have been triggered around the world as the financial crisis has unfolded.

The work is divided into five parts and readers are likely to go straight to the part they find most useful or interesting from their own discipline's perspective or their own country or region's point of view. Part One provides a narrative of the

current financial crises and attendant government responses in the USA, the UK, Germany, the Netherlands and Iceland. Students of macroeconomics and economic and political geography will find the chapter on Iceland a fascinating case study of the financialisation of a small nation. In fact, much of this book will appeal beyond the legal and regulatory readerships that its title might suggest. Here, Tim Congdon's chapter, 'Central banking, financial regulation and property rights', ought to be read by every student of central banking as well as of financial and monetary law.

Part Two considers the various mergers and acquisitions activity, restructurings and liquidations that have gone on around the world as emergency surgery has been performed on several major financial institutions to enable them to survive. Many of the contributors to this part have been closely involved in the deals and liquidation processes of which they write, lending extra weight and accuracy to their explanations. The geographical reach of this part gives the lie to early theories (or rather hopes) that the developing world's financial sectors might have decoupled from those in the larger and more developed financial economies where institutions first began to encounter difficulties. For the ways in which the banking sectors of India, Argentina, Brazil and Russia have been rewrought and reorganised receive attention along with those of the UK, Spain, Italy, Germany and of course the USA.

Part Three deals with the role of intermediaries, investment managers and

private investment funds in this crisis. It does not purport to tell the whole story — indeed, we may need to await the outcome of some of the crisis-related litigation currently being brought against intermediaries (and touched on in the final part of this book) before we can begin to see more clearly the extent to which intermediaries and/or hedge funds ramped up this financial crisis. However, it provides a useful review of the legal underpinnings of the prime brokerage relationship, a review of US broker-dealer law as regards insolvency and liquidation, a view of the financial crisis from Bermuda, an analysis of how Luxembourg investment funds have fared, and finally, the impact of the financial crisis on the offshore world in general.

Part Four returns to the theme of restructurings and insolvency as many of the most complex legal issues and areas of uncertainty for the law manifest themselves only in the course of often messy, multi-party and cross-border insolvency processes. Insolvency practitioners will be seeking courts' directions on how to proceed when faced with unravelling the obligations, security and property interests in hitherto untested forms of structured product and structured financings. When liquidity runs dry in the spectacular way it just has, defaults occur and loan covenants are breached in the world of syndicated lending, project finance, derivatives transactions and 'normal' corporate lending. The resulting legal resolution can involve some fundamental conceptual analysis to make sense of some of the newer complex instruments, and some of the chapters in this part do this admirably well.

Part Five concludes by examining litigation that has arisen to date in

Germany, the UK and the USA as a direct result of the financial crisis. Just how the courts will be used to achieve redress and compensation based on both private law actions and under securities and regulatory laws will vary in both nature and extent from country to country, but in the more litigious cultures, such as the USA and the UK, this part of the book has really only begun to be written. However, this part provides useful summaries of procedural and costs principles as well as key substantive legal threshold tests, which will go some way to explaining the litigation that will or will not reach a courtroom over the next few years.

Legal practitioners and law students trying to collate key information from the wealth of official comment and news stories around the financial crisis will both find much in this book to be of use to them.

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Risk Management and Financial Institutions (2nd edn)

by **John C. Hull**

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With the second edition of *Risk Management and Financial Institutions*, Professor John Hull has produced a particularly good and useful book. Of particular note are the structure of the

work, its clarity and simplicity, its comprehensiveness and the breadth of its scope. For its target audience (more about this later) it would be difficult to find a better companion in the crowded field of risk management textbooks.

Refreshingly, Professor Hull does not begin talking about the usual staple diet of risk management books (statistics, profit-and-loss distributions, numerical techniques, value-at-risk etc), until almost a third of the way through his work. The first 150 or so pages are in fact devoted to a clear and simple presentation of the financial underpinning of asset valuation (risk and return, the efficient frontier, the capital asset pricing model, etc); to the institutional reality in which risk management takes place (banks, insurance companies, pension funds, etc); and to the financial instruments traded in the market (derivatives and non-derivatives). It is only on p. 157 (Chapter 8) that value-at-risk (VaR) finally makes its proper entrance. This is commendable. Far too often, statistical techniques such as VaR are presented in a sort of 'disembodied state', with no or little reference to either the theoretical framework (eg asset pricing and the risk-and-return trade-off in general), or to the institutional reality in which they are used. Both the student and the practitioner who approach risk management for the first time or want to move beyond their first steps in the field will greatly benefit from the bigger-picture approach afforded by Professor Hull's book.

For this readership, the book is a gem for its style, the tone and the clarity of exposition. These virtues are well known to readers of earlier books by Professor Hull, but should never be taken for

granted. In particular, the presentation is always as simple as it can be without becoming simplistic. Professor Hull has the gift of presenting a careful argument, with all the necessary fundamental qualifications, without becoming entangled in a web of subtle distinctions, defensive footnotes and meandering side arguments.

Similar considerations apply to the description of quantitative techniques.

The choice is always made to present topics in the simplest possible correct manner. The chapter on volatility and GARCH estimation in particular is an example of the book's clarity of exposition, non-pretentiousness and usefulness. The book looks beyond the traditional triad of market, credit and operational risk, to deal also with liquidity and model risk. From the credit side, it looks both at issuer risk and counterparty risk. It also presents metrics such as economic capital, RAROC (and RORAC). As the whole book does not reach 500 pages, one should not expect an encyclopaedic treatment of every topic. Nevertheless, the subject matters are never dealt with in a superficial manner. Of course, one might have wanted this or that aspect to be treated in greater depth, but overall the balance is commendable, and the reader is never led to lose sight of the wood for the trees.

Perhaps one aspect that this reviewer thinks should have had more emphasis is stress testing. In the wake of the subprime crisis, both practitioners and regulators are devoting unprecedented attention to this risk management tool.

Two of the new chapters (on asset-backed securities and structured credit products — Chapter 16, and stress testing — Chapter 17) have been

positioned next to each other in this second edition, but a deeper link between the two might have been profitably drawn: after all, the recent debacle that originated from credit-structured products has been one of the drivers of the renewed interest in stress testing.

Finally, the welcome institutional emphasis might have been coupled with more references to the governance aspect of risk management: having the right risk information is a necessary, but by no means sufficient, condition for an institution to reach sound risk management decisions. The question ‘What institutional and governance arrangements can best ensure that private decision makers reach risk management decisions in a way that takes into account

the systemic implications of their choices?’ has not been well addressed in the book. On the other hand, nobody, not even Professor Hull, may yet have an answer to this one.

In short, this reviewer will wholeheartedly recommend Professor Hull’s book to both junior and not-so-junior risk management colleagues as well as to students. Readers of this journal would most likely also benefit from it.

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