



# International Institute of Certified Public Accountants

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26 October 2010

**Professor Mervyn Allister King**  
**Governor**  
**Bank of England**  
**Threadneedle Street**  
**London EC2R 8AH**

Dear Governor King:

**Your Speech at the Buttonwood Gathering October 2010**  
**"Misconceived Men of Très Haute Banque: Our Central Bankers" (2010)**

There are two unforgivable flaws in your thinking:

- (1) Bank capital is an abstract, the so called residual, the difference between assets and liabilities, and to have Basel III require this difference to be larger than today does not give the depositors any protection at all. Central bank funds are needed.
- (2) As you correctly observed at the latest Buttonwood Gathering in New York, banks are mixing the public's deposits (liabilities) with their highly risky assets, and the taxpayer serves as the general insurer. You say, "no more."

In (1) above you are patently wrong because an abstract is just an idea that cannot redeem deposits, a liquid asset is needed such a deposits at your Bank of England (central bank money which is effectively legal tender).

In (2) above you are not addressing (not thinking of) the point that turns the issues of risky bank deposits. It is very simple: bank deposits are an accounting entry (quasi money), and each bank

deposit is based at the bank that created it and cannot leave (transfer) to pay depositors except by offset in the daily clearing of payments.

In Canada, the Bank of Canada puts the adverse balance of one bank into the system. In America, banks have to borrow federal funds, and in a crisis cannot.

Irvin Fisher (whose name is on one of the halls of the BIS in Basel, to which he would most likely vehemently object), pointed out in his *100% Money* book (1935) that the banks' deposit and lending functions do not mix and must be separated. This point was even raised by one the BIS's very own: Stephen G Cecchetti in his Opening Remarks at the Eighth Annual Conference of the Bank for International Settlements, 25–26 June 2009.

I am enclosing my booklet for your further study, from a professor of accounting and finance (I am also a CPA and a former commercial credit banker) to the professor of economics, now the UK's top bank regulator.

*There is no harm in being sometimes wrong —  
especially if one is promptly found out.*

John Maynard Keynes. *Essays in Biography* (1933)

Sincerely,



Michael Schemmann PhD CPA CMA  
Director of the IICPA  
Box 9, Pak Thong Chai  
Thailand 30150

Enclosure

"Misconceived Men of Très Haute Banque: Our Central Bankers" (2010)  
(available at amazon.com — booklet and also as "Kindle" edition)

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*London EC2R 8AH*

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*The Governor*

*Mervyn King*

11 November 2010

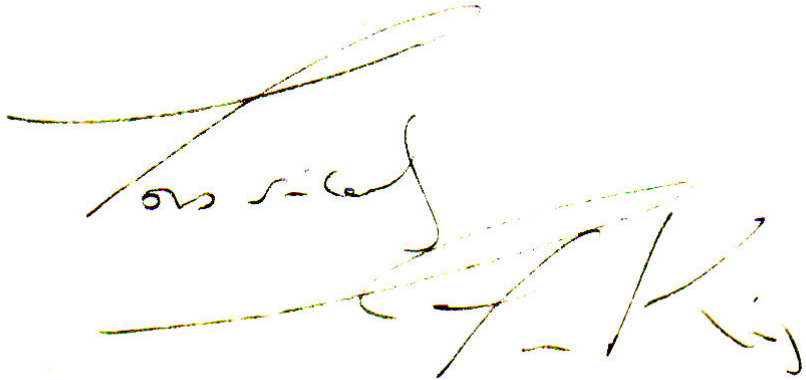
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*Dear Mr. Schemmann,*

Thank you for your letter of 26 October. I am always very grateful to people for taking the time to share their views with me. I have much sympathy with some of the points you raise in your letter. I strongly support spending more time thinking about liquidity regulation in addition to capital regulation – the Bank of England has regularly supported and championed better liquidity standards. As I noted in my speech at the Buttonwood gathering, I feel that Basel III has not gone far enough in this area.

I also agree that there is no reason why there should not be serious consideration of banking functions being separated, with deposits being backed by 100% liquid money. As you may have noted, I referred to Irvine Fisher's (1953) thoughts on this issue in my speech at the Buttonwood gathering. I also stressed my confidence in the high-quality team at the Independent Commission on Banking, which I am sure will in time be able to draw the right conclusions. I would encourage you to share your views with the Commission if you have not done so already.

With all best wishes.

A handwritten signature in black ink, appearing to read 'Mervyn King', written in a cursive style. The signature is positioned at the bottom right of the page, below the closing text.