BusinessWeek EVENTS

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Finance Roundtable Summary

Panel
Chair: Barbara Ridpath, Chief Executive, International Centre for Financial Regulation
Co-Host: Charles Alexander, Board Director, Genpact Global
Moderator: Simon Collingridge, Managing Director, Structured Finance, Standard & Poors

Topics
- How do we get financial institutions to return to lending for growth
- Can we return to growth without falling into the same macro economic imbalance?
- Is there anything salvageable in the securitisation model?

Discussion summary

Causes of the Crisis

Five key elements to the Crisis: Capital, Liquidity, Provisioning, Accounting & Compensation.

In Financial Industry, with capital allocation by business line, **inadequate capital** was posted again risky asset classes.

Who was involved: Risk Managers, CRA's, Regulators, Accountants.

This led to inadequacy of or uncertainty as to **provisioning** levels

Banks don't go bust they become **illiquid** - post Lehman, Banks did not know who was next. So there was no alternative but to turn to the last resort i.e. Central Banks.

Accounting practices were a principal cause in the crisis i.e. US gap and 'mark to market'.

Compensation practices were a direct cause of the crunch by encouraging traders/banks.

What was the real event? - Large category of risk passed around like a bar of soap, each person thinking someone else must have dealt with the risk. If you underwrite to sell, you have a different goal than if you underwrite to hold.

Excess leverage moved from Banks to Governments.

What will the new regulations do to recovery?

Regulators trying to increase capital at Banks. Beware of unforeseen consequences?

Tried to attack too much at once. 20 different proposals, trying to see benefits of all of them is too hard.

Better to take a couple of actions and get them right and then take on some more.

Due to high leveraging, cost may be disincentive to increase loan business. In securitisation, originators will be required to hold 5-15% of transactions going forward.
Banks have to assess which business they want to be in.

What you can use as capital is going to change. Lower tier is going to largely disappear.

Banks equity will have to be shares, cost of raising capital to rise.

If you do all this too fast, you risk cutting off any recovery.

Need for a soft landing in terms of economy and regulations. Important that industry pushes back at Brussels – regulators let's adapt and not rush!!

Are we sleep walking towards the next disaster? Look at performance of the States and Federal Reserve. What has happened there in ten years?

Americans do not 'do' global regulation; they do American regulation and apply it globally. No one wants to follow us. Europe needs to take its own path.

Concern expressed that Politics is driving banking regulations. If regulations operate as if all banks have the same risk make-up there is the danger that they lose their individuality and diversified risks. Regulations are encouraging banks to act the same.

The role of the banks

UK Banks lending less now. They are altering their inventory levels, cost structures under control, not enough opportunity for Banks to lend new (and beware as top end of multi national companies start to cut jobs/costs etc - how much more can they take?)

Banks may be reducing inventories but then why in the last year has the level of IG bond issuance been higher than ever?

Bonds markets are refinancing (Corps) to cover lines over the next few years not the longer term. Banks are still nervous and trying to push out maturities.

Alternative view that it is a trust issue - Corporates don't want to be as reliant on banks as they have been.

Trust is an issue and has become a significant political issue - Banks considered broke and crooks – 'our' money, their pockets, and their friends.

Banks are even now seen to be taking advantage of low interest rates as lending spreads are getting higher.

There remains a public perception, politically encouraged, that banks are there to provide a social service – as the bubble grew it was seen as their role to enable aspirational lifestyles and lend to all, now they are pilloried for reckless lending.

It is a positive social aspect; unless banks tie this in i.e. portray positive image rather than everyone (Joe public) feeling cheated/stolen from.

Therefore encouraging that banks have been able to raise significant (£50bn) capital quite easily in recent months.

<u>How to get banks to lend again responsibly?</u>

Bankers In recent years, 40% of UK mortgages lending was funded through **securitisation** (RMBS). How do we get the mortgage market back? Can it be achieved without securitisation? Probably not and governments & regulators have woken up to this. There is much focus on restoring credibility through standardisation and transparency.

Securitisation has been 'legitimate' tool for years here. The problems that have arisen from the US sub-prime have tarnished the asset class. Need to educate and e.g. distinguish between European securitisation for funding vs. US sub-prime originate to distribute models.

Government has woken up and realised they do not control banks and they do not control the economy. All that was targeted was inflation.

Risk appetites have changed, diversity has gone. Has the loss of the Building Societies changed the risk and lending framework?

<u>What has to happen for recovery?</u>

Is growth what we want?

Yes, to replenish jobs you cannot sustain unemployment without growth. You cannot keep interest rates at zero!

Growth in US and Europe has been largely fuelled by (unsustainable?) consumer spending. Do we want this to return? Many borrowers borrowed beyond their means.

Who is responsible for return to growth - Banks or government? It has to be Government - reduce fiscal deficit, cuts in government spending: rises in tax inevitable.

If unemployment keeps rising then there are more serious implications.

Germany/France used to be highly taxed. Now it is the UK taxes that will only increase.

Cut backs in government spending have a domino effect on everything else. We were direly over borrowed so when the crisis hit we had nowhere to go. Fiscal stimulus means we do not get hit as hard or as fast but equally we have to face a much slower and flatter recovery.

Positive signs? -
Demand for growth will arise, after return to economic growth renewed appetite for credit. Banks will play an important part in this.

Improving figures in 'Emerging Markets'; Asia markets are growing; Japan returning to growth. – We need to start focusing on these, what service can we offer them?

Can these economies sustain themselves; will they sell to themselves or buy from us? This is a huge question technical innovation would encourage growth to the greatest good of greatest number.

In extreme crisis comes opportunity e.g. ***"DuPont in 1930's signed up all the scientists they could and made more patents than ever and made all their money"*** Financial Times.

Hopefully there are people thinking about how to do things differently and it's innovation that will bring us out of this.