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<u>*'The Crunch: The scandal of Northern Rock and the escalating credit crisis.'* A round-table on his recent book, with Alex Brummer (*Daily Mail*) held on July 16, 2008, from 6:30pm to 8:15pm, at the City Marketing Suite, Basinghall Street, London, EC2P 2EJ</u>

Now the dust has settled on Northern Rock, who is to blame for the debacle? The first speaker said the blame fairly and squarely on greedy bankers and incompetent regulators. He joked that he had been worried the credit crisis would be over by the time was published but, three banking crises on; there is little danger of that. The heart of the book is an expose of the regulators' attitude towards the crisis. Back in the 1970s the secondary banking crisis prompted co-ordinated action with £1.5bn (£25bn in today's money) doled out to steady the ship. Contrast that with the six week delay between Northern Rock alerting the FSA to a problem on 9 August and the final rescue on 17 September.

In the meantime an "extremely firm" offer from Lloyds TSB foundered on its request for a £30bn government guarantee. Mervyn King believed it would contravene European law and that it was wrong to try to do a secret deal in the modern era. Perhaps he was instinctively against a backroom deal. Hoe was not alone – the other London felt banks saw themselves as global and felt no need to help a small Northern mortgage bank. Ultimately Eddie George – who organised a 1999 package to prevent liabilities from Korean trade credits – is a different person from King. Many bankers felt that if Eddie had been Governor, Gordon Brown Chancellor and Howard Davies head of the FSA, then a deal would have been done. The combination of a weak chair and CEO at the FSA, a new Chancellor and a Governor hostile to banks put paid to that. Across the Channel, France and Germany were busy bailing out their banks.

When the rescue did come it was "fouled up". Firstly there was disagreement between Alistair Darling and King over announcing insuring insurance for depositors, with king objecting. A planned strategy of press releases and a statement to reassure shareholders and depositors was undermined when the details were leaked. Because the Rock was an Internet bank with just 70 branches with three staff in each, the extent of the run on the bank was magnified by TV pictures of the queues. The attempt to find a private sector solution for the Rock was also a disaster, culminating in the highly-publicised moment when Richard Branson, one of the bidders, shared a plan trip with Gordon Brown. Only when it became clear that neither bid was acceptable did the Treasury start working on the nationalization option.

One member asked to respond, said the book made very strong criticism of the management that seemed hard to justify. It was a relatively minor event that turned into a shocking event thanks to the failure of the authorities to act. The member, who bought shares in Northern Rock in July 2007, said it was an exogenous shock from the US that caused the problem. There was nothing in the published accounts of Northern Rock that it showed it was badly run. The average loan-to-value (LTV) ratio of its mortgage book was

60% versus 55% for the industry. Even in the first half of 2007 when it moved aggressively into new lending these new loans had an average LTC of 78%. The default rate was 0.01%.

In terms of the way that Northern Rock was funded, using securitisation on the wholesale market, it was not inherently bad. A securitisation offer launched by the Rock in early 2007 was three times over-subscribed. Later that year the company's credit rating was raised. All the bank was doing was continuing with a strategy that had been rewarded by shareholders who had sent the share price to £12 a share. One cannot say with certainty now that its mortgage book was crummy. He asked what information in the public arena was flagging up the problems.

Another member said it was clear that Northern Rock was being aggressive into taking on new lending at a time when others were pulling back. Its share of new loans jumped from 7% to 25% in the first half of 2007. This combined with its reliance on the wholesale markets for 70% of its funding left to vulnerable to a liquidity crunch that arrived on 9 August. Some members worried about the Government's refusal to allow a bank to fail, perhaps because there are 21 Labour MPs in the North east. Another bemoaned the absence of a "sword of Damocles" hanging over banks.

Wrapping up, the first speaker said the institutional structure was found wanting. He recommended returning powers of intervention in such a crisis to the Bank of England. What was needed was someone high up in the bank who, unlike King, was an expert on banks and markets and in close touch with them. The departure of Sir John Gieve as deputy governor – the fall guy in the crisis – created that opportunity. Finally he disclosed some of the anecdotes about the trauma suffered by directors at Northern Rock. One non-executive director became so obsessed to prove that what the Rock had done was right that he took all the relevant files into his office. When the bank was finally nationalized he was said to have been removed screaming from his office where the files were still piled high.