

CSFI

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Blue-skying Armageddon...Free-thinking about the current financial crisis, and its regulatory and macroeconomic impact. A (sort of) round-table with John Hitchens (PwC), Peter Thal Larsen and John Plender (*Financial Times*), Michael Foot (Promontory Financial), Jeffrey Goldfarb (Breakingviews.com), Philip Augar, Pete Hahn (Cass Business School) and Ian Stewart (Deloitte). Held Monday, October 6, 2008, at Eversheds LLP, One Wood Street, London, EC2V 7WS, from 6:30-8:15pm.

With support from Eversheds LLP

The first speaker kicked off the debate – which preceded the UK’s £500bn banking rescue plan and the coordinated global rate cut – by saying the banking system needed recapitalisation but it was unclear by how much. He noted that the US government had so far injected cash into banks rather than capital. Secondly, he stressed the need to unlock confidence in the financial system to improve liquidity.

The second speaker called on governments to get the best possible deal for taxpayers when they bail out financial institutions. The third speaker had more advice for the UK government: he said it must appear to be ahead of the curve and big gestures were needed, including on interest rates. He urged governments to work together and to sort things out after the event, such as competition issues posed by Lloyds TSB’s takeover of HBOS and Santander’s acquisition of Bradford & Bingley. Evoking former BoE Governor Eddie George’s description of the lender of last resort, he questioned whether the government had a strategy.

The fourth speaker said the good news was that governments were starting to panic; the bad news that even in the best-run rescues (for example Sweden in the early 90s) the adjustment in asset values and balance sheets took “extremely long” and had a big negative effect on growth. The fifth speaker warned that the shake-up of the banking industry would create several “whales and a lot of sardines” but no-one in the middle, and would also restrict the availability of credit to small firms.

The sixth speaker said there was only so much central banks could do and US fiscal policy would have to take the strain. He thought there was the political will in the US to crack the problem but held out no hope for a European-coordinated policy. Only the US has the kind of leadership to get us out of this bind, he reiterated.

Turning to the underlying causes of the crisis, the seventh speaker pointed to deregulation along with the relentless pursuit of shareholder value and the abandonment of prudence and balance sheet strength. Regarding the latter, he called on the Association of British Insurers and the National Association of Pension Funds to send the right messages.

The eighth speaker thought the crisis had undermined the multi-national bank model and the idea of a pan-European financial services market. Shareholders are the big losers in this crisis. Another warned of a herd instinct emerging among the banks as a result of the crisis, or systemic behaviour.

A lively debate ensued when a member said executives should be punished rather than shareholders, or no one will invest in banking shares any more. In response, one of the speakers admitted corporate governance had gone wrong. He also held out the prospect of the banking world becoming very dull as stringent capital controls seem likely, with the more creative types seeking out “the next shadow banking world”. Another speaker lamented that lessons from crises were never learnt, noting that the finance industry exams do not cover history. He predicted that ten years from now we will be back in the same leveraged game.

One speaker pointed the finger at two villains: central banks and institutional shareholders, but another blamed insufficient disclosure from financial firms. A member talked about the asymmetry of information with senior executives not knowing – or not wanting to know - what junior staff were up to. Another blamed regulators for their failure to grill top executives.

Several speakers called for an overhaul of corporate governance and executive pay. One said the demise of Enron should have taught everyone a lesson about off-balance sheet assets. A member worried that if the crisis got worse, the whole banking system could be shut down for a week or two. Another thought it could be nationalised.

The host asked: how do we get out of this mess? There was a broad consensus that only the government, as the final guarantor of the system, could put an end to the crisis. One member asked: Aren't we talking ourselves deeper into depression? He questioned whether Fortis, Dexia and the Irish banks were really so badly managed. Another asked: given that debt is the problem, isn't inflation the answer? That is a worry, a speaker replied, predicting a substantial build-up of public sector debt. In return for banking bail-outs, the government should demand more disclosure and additional write-offs, another said.

Turning to regulation, one speaker talked about misapplied regulation after the collapse of Enron and the dotcom boom, pointing to the Sarbanes-Oxley Act. Another said global capital flows called for global regulation.

Opinion on America's \$700 billion bail-out package was divided. One speaker was concerned that there wasn't enough money and the structure was unclear. He thought it more sensible if the government used the fund to buy new securitisations of new mortgages to get liquidity flowing again. However, one member believed the main problem was bank solvency and slammed the Paulson plan to buy up toxic waste for being the wrong plan.

The general view was that as the crisis spreads from wholesale markets to retail banks and the real economy, much of the world will sink into recession and confidence will take a long time to recover. Rather worryingly, the proportion of banking assets with real estate exposure has risen from 18% to 40%, according to Bank of England figures.

In closing remarks, several speakers called for “overkill” from the government – quicker, more aggressive action in the shape of interest rate cuts, more bail-outs and more liquidity being pumped into the system. Most on the panel thought it was up to the US government to take the lead as Europe was too divided. However, one speaker warned: “Don’t rely on Bernanke, Paulson and Bush.” He said 20 months had passed since HSBC’s profit warning signalled a crisis was coming, and the crisis probably had another 20 months to run. A member agreed, and described the lack of a coordinated response from politicians and regulators as “very dangerous”.