Institute of Chartered Accountants of the Caribbean

REGULATORY CHANGES WITHIN THE BANKING AND FINANCIAL SECTOR:

Is enough being done?

Presenter:
Aubyn Hill,
CEO - Corporate Strategies Limited

22 June 2012

Regulators have **muscle** and **teeth**:

- On Friday, July 15, 1991 the Bank of England, acting as one of BCCI's regulators, closed down BCCI's UK branches and precipitated a major jolt (not a crisis) in the world banking system.

Corporate Strategies

OUR AIM

- Examine some historic trading losses and the biggest bank failures.
- Identify what regulators are supposed to do.
- What are banks? How can we define them?
- Who are the Regulators?
- Can Regulators stop a Boris Yeltsin (LTCM Collapse)?
- Review Jamaica's late 1990's meltdown and Ponzi schemes in Jamaica and Antigua.
- In the information and social media age
  - new and better use of regulatory tools.

Corporate Strategies

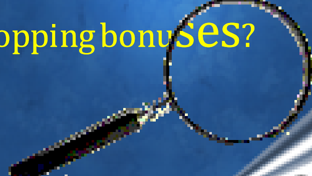
RECENT BIG BANK BAILOUTS

- USA: $700,000,000,000!
  TARP (654 banks)
  - By March 28, 2012: $431 billion disbursed (CBO)
  - $475 billion authorized by Dodd-Frank
  - Cost: Less than 1% GDP compared to 32% of GDP the 1980-90s Savings and Loan bailout cost the US taxpayer!

RECENT BIG BANK BAILOUTS

- PIGS in the EUROZONE
  - PORTUGAL: $8,250,000,000 of $100,000,000,000
  - IRELAND: $82,588,235,000 of $108,000,000!
  - GREECE: $171,000,000!
    **First bailout to Greek Banks was in October 2008 for about $35 billion.*
  - SPAIN: $125,000,000,000!

So where were the regulators when these bank managers were ripping into taxpayers pockets and earning eye-popping bonuses?



Regulators have had many opportunities to practice getting it right!

TOP 10 BIGGEST TRADING LOSSES IN HISTORY

VIBRANT, ENTREPRENEURIAL AND PROFIT DRIVEN ECONOMIES WILL HAVE TO ENCOUNTER RISKS:

failure is one outcome of risk taking.

Managing risk for profit is fine; threatening whole populations of many countries at one go with unbridled and under-regulated risk is *extreme irresponsibility.*

TOP 25 BIGGEST BANK FAILURES IN HISTORY

	NAME	LOCATION	YEAR OF FAILURE
(25)	New Frontier Bank	Colorado U.S.A.	2009
(24)	Bank of Credit & Commerce International (BCCI)	Pakistan/Luxemburg	1991
(23)	Integrity Bank, Georgia	Georgia, U.S.A.	2008
(22)	Herstatt Bank	Germany	1974
(21)	The Hokkaido Takusoku Bank Ltd.	Japan	1997
(20)	Southeast Bank of Miami	Florida, U.S.A.	1991
(19)	New York's Bank of the United States	N.Y. U.S.A.	1931
(18)	Franklyn Square National Bank	N.Y. U.S.A.	1974
(17)	Home Bank of Canada	Canada	1923
(16)	The Creditanstalt, Vienna	Vienna, Austria	1931

TOP 25 BIGGEST BANK FAILURES IN HISTORY *(Continued)*

	NAME	LOCATION	YEAR OF FAILURE
(15)	BrightBanc Savings Association	Texas, U.S.A.	1989
(14)	Long Term Credit Bank of Japan	Japan	1998
(13)	Goldome	N.Y. U.S.A.	1991
(12)	Silverado Savings and Loan	U.S.A.	1988
(11)	Gilbrator Savings	California, U.S.A.	1989
(10)	Northern Rock	United Kingdom	2008
(9)	Sachsen LB	Germany	2007
(8)	Netbank	Georgia, U.S.A.	2007
(7)	MCorp	Texas, U.S.A.	1989
(6)	Bank of New England	U.S.A.	1991

TOP 25 BIGGEST BANK FAILURES IN HISTORY *(Continued)*

	NAME	LOCATION	YEAR OF FAILURE
(5)	American Savings & Loan	California, U.S.A.	1984
(4)	First Republic of Texas	Texas, U.S.A.	1988
(3)	Continental Illinois National Bank & Trust	Illinois, U.S.A.	1984
(2)	WaMu	Washington, U.S.A.	2008
(1)	imb IndymacBank	California, U.S.A.	2008

Given the history of bank and other financial sector failures (1923-2009) and the enormous cost to shareholders, taxpayers and countries,

are regulators doing a good job?

What are Regulators supposed to do?

1. **PRUDENTIAL:** To protect Depositors by reducing the level of risk to which bank creditors are exposed.
2. **SYSTEMIC RISK REDUCTION:** Take measures to avoid (reduce) the disruption risk associated with difficult or adverse market trading conditions for banks which could cause multiple bank failures.
3. **AVOID CRIMINAL ACTIVITY IN BANKS:** The BCCI/Franklin Square National Bank phenomenon Reduce the risk of banks being used for criminal purposes such as money laundering and funding criminals and their illegal activities.
4. **PROTECT BANK CONFIDENTIALITY**
5. **CREDIT ALLOCATION:** to direct credit to favoured sectors.

AND

What are Regulators supposed to do?

Protect taxpayers from "private sector" bankers loading them with very public and pervasive "moral hazard" – unsuspecting taxpayer becoming bankers, insurers and funding suppliers of last resort.

TAXPAYERS AND ORDINARY CITIZENS BEWARE!!!

What are Banks? How do we define them?

Banks are unique deposit-taking businesses with extraordinary state-supplied licences to make money, and even create or participate with the State in creating and disbursing money, with less than ordinary accountability and responsibility (unelected) to taxpayers who are banks' effective lenders and insurers of last resort. ***No other company in most any other sector has this kind of licence to wealth.***

TAXPAYERS = Banks' paymaster and Insurer of last resort

And if you are lucky to be part of a union of states like the **USA** or the **Eurozone**, **you may even be able to get some poor sucker of a taxpayer from a more prudently fiscally managed region, say, Wisconsin or Maine in the USA, or Germany in the EU to pay for bad bank management decisions and losses in New York State or the "Euro-states of Greece and Spain", respectively.**

Who are these Regulators?

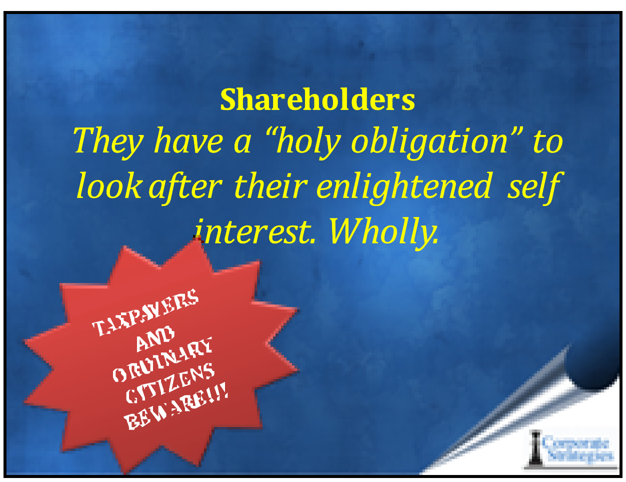
1. **Bank Directors and senior executives** *(The fish stinks from the head).*
2. **Shareholders**
3. **Central Banks and similar regulatory bodies funded by the public purse**
4. **Accountants**
5. **Credit Rating Agencies**
6. **Technical Financial Parliamentary Oversight Committees**
7. **Taxpayers and the general public**

Have Regulators done enough?

The answer would have to be "no" – even if the question was framed rather narrowly to address only regulatory changes.


Consider the German and French banks' exposure to the PIGS (Portugal, Ireland, Greece and Spain) in July 2011 was in excess of $900 billion.
Where were the regulators? Who needs a bailout – Greece, or German and French banks?


Bank Directors and Senior Executives
They, almost by edict from the kingdoms of capitalism, are there to look after the interest of shareholders.
TAXPAYERS AND ORDINARY CITIZENS BEWARE!!!


Shareholders
They have a "holy obligation" to look after their enlightened self interest. Wholly.
TAXPAYERS AND ORDINARY CITIZENS BEWARE!!!

Central Banks

Keep banks' management accountable and responsible to their many-sectored public. Crises push Central Banks close to recklessness – flooding the economies they manage with pools of cash.

ACCOUNTANTS

How do accountants leave as unqualified financial statements of banks which gave "secured loans" (subprime) when in many cases the real state of the "security" was equal to, or less than, the value of the loan?

ACCOUNTANTS

How can banks have a book of $600 trillion in derivates given their comparatively miniscule capital base and avoid serious sanction or disqualification?

ACCOUNTANTS

What about the inflation of the credit default swap (CDS), market by about 28 trillion of the $600 trillion figure?

ACCOUNTANTS

Where do accountants locate the capital for these banks to handle that mountain of risk and avoid qualification of their financial statements?

ACCOUNTANTS

Are accountants raising big enough and early enough red flags to warn management, statutory regulators, shareholders, customers and taxpayers in time of the enormous risks they face when dealing with some banks?

ACCOUNTANTS

How many of the bailout banks came to the bailout table with qualified financial statements?

CREDIT RATING AGENCIES

"Missed the boat" with Asian crisis, countless banks and came to the game late in some cases in the Eurozone sovereign debt problem. ***Conflicted by paymasters?***

TECHNICAL FINANCIAL OVERSIGHT COMMITTEES

These get very vocal, very public and *<u>slightly active</u>* ***after the fact!***

TAXPAYERS

The final and weakest player as the Regulator. This group, which is left carrying the proverbial bag from the banks and sovereign bailouts must be, and should be, very aggrieved.

Using the Ballot Box.

OTHERS WITH RESPONSIBILITY

Aggressive, underinformed, uninformed, risk-happy, and greedy ***borrowers*** *(individuals engaged in sub-prime borrowing, ponzi schemes, countries like Portugal, Ireland, Greece, Spain – and Jamaica!)*

CAN REGULATORS STOP A "BORIS YELTSIN"?

- Monday, August 17, 1998 Yeltsin's Russia defaulted on Russian debt;
- Yeltsin devalued the Russian Ruble massively;
- After a lull and bravado statements by big banks – the financial markets went into panic;

CAN REGULATORS STOP A "BORIS YELTSIN"?

(Continued)

- Just before Yeltsin's announcement, LTCM had capital of US$3.6 billion and two-fifths of that sum was for a very few partners!
- **Six weeks later, all LTCM's capital was wiped out!**
- The US banking system was shaken but survived without any fatalities in 1998 *(not so in 2008!)*

CAN REGULATORS STOP A "BORIS YELTSIN"?

(Continued)

- The US Federal Reserve was rumoured to have arranged market liquidity with the Bank of England, Bundesbank and the Bank of Japan with about US$88 billion.

SHOULD REGULATORS HAVE BEEN QUICKER TO LIMIT LTCM'S TRADING AND EXPOSURE TO BANKS?

- The Banks who loaned LTCM were among the "who's who" of the American banking establishment:
  - ***Bankers Trust***, ***Bear Stearns***, *Chase Manhattan, Goldman Sachs, J.P. Morgan,* ***Lehman Brothers***, ***Merrill Lynch***, *Morgan Stanley Dean Witter and Solomon Smith Barney*

LTCM

Formal Regulators had access to all their books!

SHOULD REGULATORS HAVE BEEN QUICKER TO LIMIT LTCM'S TRADING AND EXPOSURE TO BANKS?

- LTCM was low-keyed but highly leveraged *(all its money was borrowed)* and traded in equity spreads derivatives;
- *Derivatives were largely unknown but leverage was not;*
- Leverage and Foreign Exchange Trading were always the *"Achilles heel"* of banks – derivatives were moving rapidly up the ladder of risk.

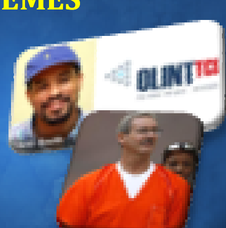
JAMAICAN MELTDOWN AND PONZI SCHEMES

- The booming world economy allowed Government to feed its insatiable appetite for debt.
- *Just load the ever more expensive debt on to future generation.*
- GOJ's high interest rates on its paper discouraged productive investment *(classical economics at play!)* in the real economy.

Allen Stanford

JAMAICAN MELTDOWN AND PONZI SCHEMES

- Many banks got into trouble through bad real estate and esoteric loans.
- *Politics – "black man time now" drove many economic decisions.*
- The Ponzi Scheme found a fertile economic environment, which was hooked on high returns. The middle class swallowed copiously and suffered sustained and severe pain when the bubble burst.



Allen Stanford

JAMAICAN MELTDOWN AND PONZI SCHEMES

- To be fair on the Ponzi schemes, the Financial Services Commission sounded the alarm – but the voice of greed drowned those warnings.
- ***Not one Ponzi operator has been convicted in Jamaica!***

Allen Stanford

Regulators, please use:

- More and regular reporting by banks *(and other Financial institutions)* directly to the public.
- ***Bank's spreads*** – *report, monthly to the public, average interest costs on categories of deposits + aggregate number and, average interest costs on loans.*
- Report monthly and to the public, major non-loan assets with detailed explanations of equity backing for this asset class – or leverage booked for backing.

Regulators, please use:

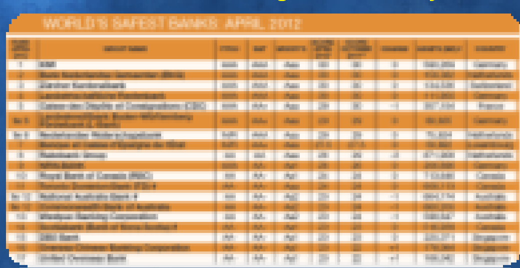
- Force bank boards to make bad management decision-makers to be more accountable. Tie tenure to performance – "good" clearly defined in terms of leverage, unbacked-by-equity off-balance sheet, leveraged transactions (derivatives, etc) and not just short term profits.
- *Governments need to publish their accounts according to international accounting standards. Often, one is charitable when what is published now is labelled "misleading".*

In the broad scheme of things, the world is getting riskier and banks may be forced to take more and bigger risks.

- *"Too big to fail" is a growing concern, but an interconnected world with huge trade and financial flows needs big banks – with large shareholders' equity.*

Corporate Strategies

There are still some good banks left –



WORLD'S SAFEST BANKS APRIL 2012

We need more of these.

Thank You!

Corporate Strategies