



## Restoring confidence in financial systems

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Moderator: **Rodrigo de Rato**, Senior Managing Director, Lazard  
**Adrian Blundell-Wignall**, Deputy Director, Financial and Enterprise Affairs, OECD  
**Neelie Kroes**, Commissioner for Competition, European Commission  
**John Monks**, General Secretary, European Trade Union Confederation  
**Maria Nowak**, Chairman ADIE and REM member, France  
**Ulrich Schröder**, Chairman of the Managing Board, KfW, Germany  
**Eva Zamrazilová**, Member of the Board, Chief Executive Director, Czech National Bank

Financial market failure, whether because of regulation, governance or weak behaviour, was at the root of the crisis, and there is concern that the problems have not been resolved. Policymakers have to do more, and not revert to business as usual. The panel shared some examples of better practice, but new approaches will be needed if confidence is to be restored.

**Rodrigo de Rato** opened the session by recalling that the current economic crisis not only started in, but to a large extent was fuelled by, the financial system. Setting the tone for many of the subsequent interventions, Mr de Rato stressed how recovery hinges on the importance of confidence—“restoring confidence is the key to moving forward”—and questioned the extent to which massive government intervention in financial markets is changing the rules of the game, not least the competition rules. Mr de Rato identified regulation as one of the fundamental issues now facing policymakers, and questioned how the right balance can be struck between the benefits of financial innovation and the inherent instability of innovative systems: “there is a trade-off between regulation and innovation...competition between financial centres is good for dynamism, but is a cause of mistakes”

**Maria Nowak**, founder and chairman of the ADIE, an organisation created in 1989 to facilitate access to microcredit, urged policymakers to go back to the drawing board and answer basic questions about the role of finance. For Ms Nowak, it is crucial to acknowledge the dual character of credit as both a public and a private good, and to treat it as such—and not to be led by its exclusively private virtues during good times and its public dimension in a crisis. In this setting, microcredit is an invaluable tool for growth as it helps to put capital and labour into the same hands. Ms Nowak points out that business starts in France are currently rising sharply, but a lot of the new entrepreneurs—many of whom were unemployed—still lack access to capital. To help rectify this situation, Ms Nowak advocates three policies. First, introduce regulations that ease access to credit for all members of society. Second, remove regulatory barriers to the provision of microcredit. Third, provide incentives to financial institutions to provide microcredit.

**Ms Eva Zamarzilová** from the Czech National Bank, outlined the lessons to be learnt from the Czech economy's experience of the crisis. The Czech banking system has remained comparatively stable and according to Ms Zamarzilová, a key reason for this achievement has been the creation of a centralised regulatory authority within the Czech National Bank rather than having sectorally fragmented supervision. This has allowed information to flow more freely, decisions to be co-ordinated, and external communication to be transparent and robust. From this, three lessons for the design of future international regulatory framework can be learnt. First, improving the quality and transparency of existing regulatory bodies is much more effective than the creation of new, more complicated schemes. Second, the power of a regulatory body should be balanced by clear responsibilities, not least towards taxpayers. Third, efforts to boost financial literacy among the general population should be stepped up, as well-educated citizens are the best regulators.

**John Monks**, General Secretary of European Trade Union Confederation called banks to account for this crisis: “banks go one way, while the world goes the other way” he said. Even confronting this unprecedented crisis, banks still seem to think they will just go back to business as usual. Considering their influence on the real economy, banks cannot be optimistic any more. Thanks to the deregulation and innovation of financial products, banks and bankers had benefited from high margins and enormous bonuses. “Don’t regulate,” banks roared. However, as a consequence, the financial boom has driven the real economy to bust. According to him, CDS (credit default swaps) were “fool’s gold” and should be banned so what were the solutions? Prison for bad bankers? Mr Monks focused on the leadership role of bankers and urged reforms to capital adequacy requirements. Excessive incentive systems had captivated bankers’ minds. In addition, the tax system had distorted rewards. He claimed that the tax bias is damaging and it should be corrected.

**Ulrich Schröder** of the German Managing Board, KfW, admitted to being apprehensive about the consequence of what is an incomparable crisis, and suggested that the worst has yet to come in terms of rising unemployment and insolvencies. “The banking solvency crisis is not solved” warns Mr. Schröder, adding that banks have been flooded with short-term money, but still cannot raise money beyond a 3-5 year time horizon on an unsecured basis. This means that small investment projects can be funded with short-term credit – “there is no credit crunch in the short-run”- but large companies and investment projects are still being starved of funding. He cited the example of new €2.5bn airport in Berlin, which could not attract project financing from the banks, not because of risk aversion, but because the banks cannot tap long-term funding. Mr. Schröder outlined seven proposals to resolve these issues and restore confidence in financial systems: banks should only do what they understand; they should draw up prudent internal credit rules (and not blame external credit rating agencies); they should have a business model; corporate governance should be reinforced and based on long-term incentives; toxic assets on bank balance sheets must be removed to restore confidence; the pro-cyclicality of regulations needs to be eliminated; and regulatory bodies need to be based on international standards, transparency and be all inclusive in nature.

**Ms Neelie Kroes**, European Commissioner for Competition, described the financial subsystem as the “blood circulation” of the economy, warned that while temporary rescue measures were needed for short-term viability, they are not a long-term solution, particularly as competition was so important: “banks have to be off state support and working with new business models if we want properly functioning markets”. In this respect, Ms Kroes expressed deep concern about the results of 22 confidential bilateral meetings she had held with bank chiefs, describing the results as “depressing” – “too many bank executives are still denying the situation they are in”. Ms Kroes painted a “nightmare scenario” in which “banks become addicted to public subsidies and governments become addicted to running banks”. She warned gravely against taking a nationalist perspective – “we must protect our crown jewel, the single market” – and called for the need for new, cross border regulatory and supervisory rules for the single market. “When I’m retired, I want to tell my granddaughter “we did our utmost””.

**Adrian Blundell-Wignall**, OECD deputy director for financial and enterprise affairs, laid the blame for the crisis at the feet of government policymakers. Policymakers were a cause of the crisis, Mr Blundell-Wignall said, “and they still do not understand”. Rather than seeing green shoots in the recent positive economic and market signals, he argued that we could instead be witnessing the beginnings of another global liquidity bubble fed by excessively loose monetary policy. It is therefore key to address “the governance of government”, he argued, and to eliminate the incentives for regulatory and tax arbitrage that are created by misguided or overly complex regulations. An effective response to the crisis, according to Mr Blundell-Wignall, would tackle three important aspects. First, address the macroeconomic stresses by reducing excessive liquidity. Second, move to prevent regulatory arbitrage by simplifying and harmonising taxation and accounting rules. Third, ensure better corporate responsibility, including the creation of a new chief risk officer, who would report directly to the board of directors, and reduce corporate contagion risk by encouraging the creation of non-operating holding companies—entities that would facilitate the winding up financial institutions that have gone bad without endangering the whole of the financial system.

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