

The trust thing

Executive summary

- The collapse of credit is ultimately about the collapse of trust in the banks. And that trust will only return when the issues of organisational size, strategy, and governance and accountability have been properly addressed.

From time to time one of the ACT's regional groups hosts a meeting of national interest, and that was the case for the Yorkshire and Humberside group, which in Leeds early last month hosted the "credit is trust" speech by Andy Haldane, executive director for financial stability at the Bank of England.

Haldane took as his theme the importance of trust and used the history of banking and financial services in Leeds and Yorkshire as an example demonstrating "an awareness of, and responsiveness to, the needs of the customer, whether saver or borrower; a focus on long-term relationship building, often starting from the earliest age; a recognition of the benefits of mutualising both risks and returns". In short, banks in the region had been built, first and foremost, on trust.

He used this premise to sustain an argument about the roots of the financial crisis of the past two years and some of the thinking about the development of financial services in the UK and globally. His view of the slide into crisis was that while sub-prime loans were commendable as a social objective for low-income borrowers, when securitised they had confused the relationship between borrower and lender and lender and investor. The financial system replaced due diligence with trading, but as losses began to become apparent, trust in these securities was undermined and with it trust in the banks (and the agencies) issuing them.

The sorry outcome of the process is well known but one particular

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statistic quoted by Haldane will resonate with UK corporates: "Home bias by investors – a lack of trust in foreign investments – has returned with a vengeance. Cross-border lending by international banks grew by 20% per year between 2003 and 2007. In 2008, it fell 5%. This has had material adverse effects on UK companies, around a third of whose borrowing comes from foreign lenders."

Haldane's overview of the current economic situation was that although stability has been restored to the financial system, recovery, particularly in credit availability, looks like it will be a slow process. The view that governments and regulators can encourage progress is one shared by the Bank, but Haldane said that this was insufficient on its own at least partly because the institutions of regulation have been subject to some criticism and loss of confidence.

In Haldane's view, the players in the financial system could take it on themselves to participate in restoring lost confidence by supporting both regulatory change and self-generated change. In particular, in his speech Haldane considered what he believes are the three key areas for review: organisational size, strategy, and governance and accountability.

Haldane's earlier lessons about the history of banking and mutuality in Yorkshire served his argument about the potential negative impact of size, which therefore has roots in both "traditional" relationship banking as well as the impact of micro versus macro finance. Big needn't always mean better.

The size debate led neatly into what banks actually do and, more technically, what their strategic objectives have been. Haldane's view was that by becoming one-stop supermarkets the banks had, despite their belief to the contrary, increased their exposure to economic downturn. A potential solution could lie in unbundling banking services, reducing the risks of a further spill-over between privately and socially beneficial banking activity.

Lastly, Haldane looked at the governance issue and especially the

THE BANK
OF ENGLAND'S
ANDY HALDANE GAVE
HIS SINCE WIDELY
REPORTED "CREDIT IS TRUST"
SPEECH TO MEMBERS OF THE ACT'S
YORKSHIRE AND HUMBERSIDE
REGIONAL GROUP.
PETER MATZA WAS THERE.



Box 1: ACT regional groups

ACT regional groups are run by volunteers who are members and students of the ACT. Their periodic meetings are a key part of the service provided by the ACT to its members and their professional contacts, particularly for members based outside London, who may find it hard to attend events in the capital. Regional groups meet regularly to discuss and explore topical areas of concern and interest to all in the corporate and financial sectors. For more, go to:

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relationship between shareholders and profit-oriented managers, and between them and other stakeholders (depositors, system users and regulator/government). He was careful not to suggest that mutuality was the only answer and said a modern industrial society needed a full range of financial institutions to support its economic activity.

The speech was followed by a wide-ranging discussion involving a number of delegates representing different business sectors and experiences. Topics included the apparent lack of credit availability despite very low cash interest rates on balances held at the Bank by UK banks, the likely changes to the credit insurance and credit ratings industries from increased scrutiny and regulation, and the likely changes in regulatory regimes across the UK, the EU and the US given both the credit crisis and probable government changes in the UK, Germany, Japan and, of course, the US. Overall, delegates were extremely pleased to see the Bank of England's executive management making its presence more widely felt across the UK.

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