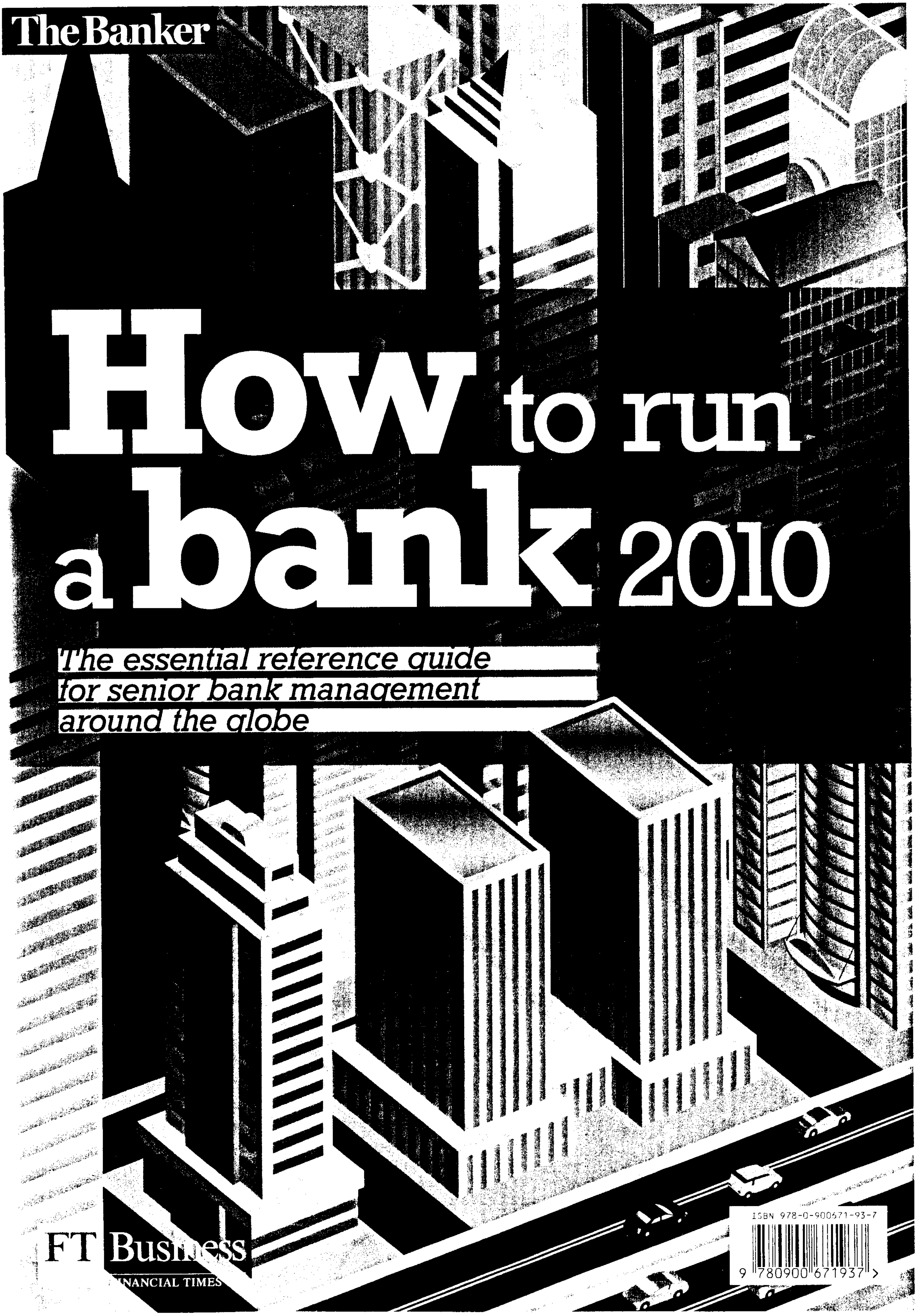
The Banker

How to run a bank 2010

The essential reference guide for senior bank management around the globe



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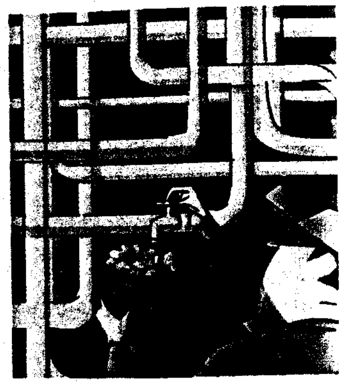
Published by Financial Times Business
Number One Southwark Bridge, London, SE1 9HL, United Kingdom

Tel: +44 (0)207 873 3000



What does the future hold for international banking?

Charlie Corbett
Commissioning Editor
How to Run a Bank 2010

As the dust begins to settle after the worst financial crisis in living memory, it is time for the banking sector to start rebuilding again. But what form will this post-crisis 'brave new world' take? *The Banker*'s second edition of *How to Run a Bank* has taken contributions from some of the world's leading industry figures. Bankers, regulators, academics and economists have all contributed to a universal guide on how to run a bank in this entirely altered financial and regulatory landscape.

John Varley, chief executive of Barclays, says that contrary to some schools of thought, banks are not 'socially useless', but the burden of proof is on them to establish that they are 'socially useful' by being engines of economic stabilisation and growth.

Chief executive of Standard Chartered Bank, Peter Sands, writes that the biggest beneficiaries of the crisis will be in Asia, with Asian capitals poised to take on the established international financial centres of Frankfurt, London and New York in the years to come.

Risk management lay at the heart of the crisis. With this in mind, HSBC's global head of risk strategy, group risk, Alan Smith, gives a blow-by-blow guide on how to avoid the errors of the past, while other senior risk specialists map out how risk managers need to change their ways.

On the regulatory front, John Laker, the chairman of the Australian Prudential and Regulatory Authority, explains how Australia managed to avoid some of the pitfalls that other developed countries fell into. Robert Kelly, chief executive of BNY Mellon, writes that banking regulation needs a major overhaul and that risk, rather then size, needs to underpin the shape of any new regulatory framework.

How to Run a Bank will also tackle the thorny issues of bankers' bonuses, while publishing a contribution from Marcello Bianchi, the chairman of the Organisation for Economic Co-operation and Development's steering group on corporate governance, on forging a new governance framework. For some people, such as Andrew Hilton, a former World Bank economist and director of the Centre for the Study of Financial Innovation, nothing profound appears to have changed as a result of the past 18 months and the world has wasted a good crisis.

With almost 40 contributions from specialists across the banking and finance spectrum, *The Banker*'s 136-page guide on how to run a bank in 2010 aims to tackle every aspect of international banking, in time for a new decade. How will the securitisation market cope with a raft of new regulation and what will this mean for the industry? How will banks rebuild their shattered reputation in the public's eyes and what is the future for corporate and retail banks in the face of stiff new non-bank competition?

The book concludes with an article by *The Banker*'s editor, Brian Caplen, on what kinds of strategies banks will need to adopt in the future in order to succeed in an entirely altered financial and regulatory landscape. *The Banker* has attempted to leave no stone unturned in search of the best way to run a bank at this watershed time for the industry.

Chapter 4
CORPORATE GOVERNANCE ISSUES

GOVERNANCE, PAY, BONUSES, BOARDS

Chapter 5
TRENDS IN CORPORATE & RETAIL BANKING

NEW BRANDS, REVENUE MODELS, MID-TIER BANKS

Chapter 6
TECHNOLOGY

DATA USE, STAYING AHEAD

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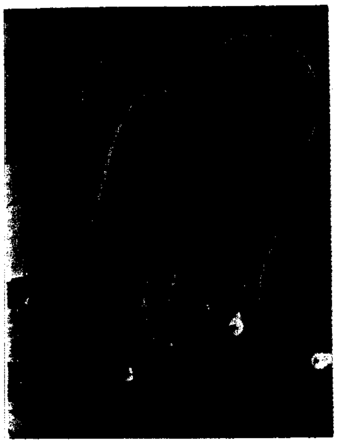
RESTRUCTU-RING THE BALANCE SHEET

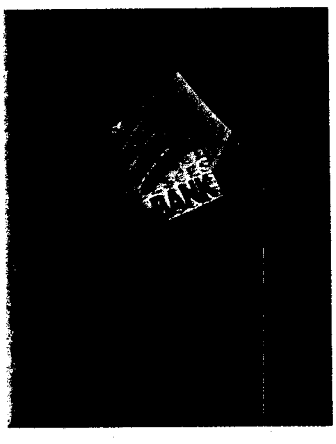
Chapter sponsored by SAS

SECURITISATION, STANDARDS, RISK FRAMEWORK, LIQUIDITY

Chapter 8
HOW TO RUN AN ISLAMIC BANK

INNOVATION, FUTURE CHALLENGES





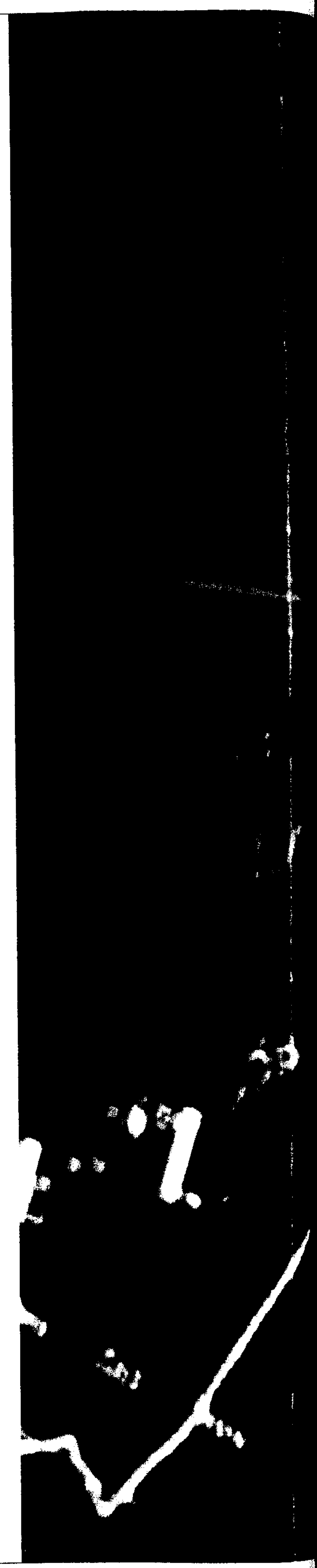
Six ways to avoid boom and bust

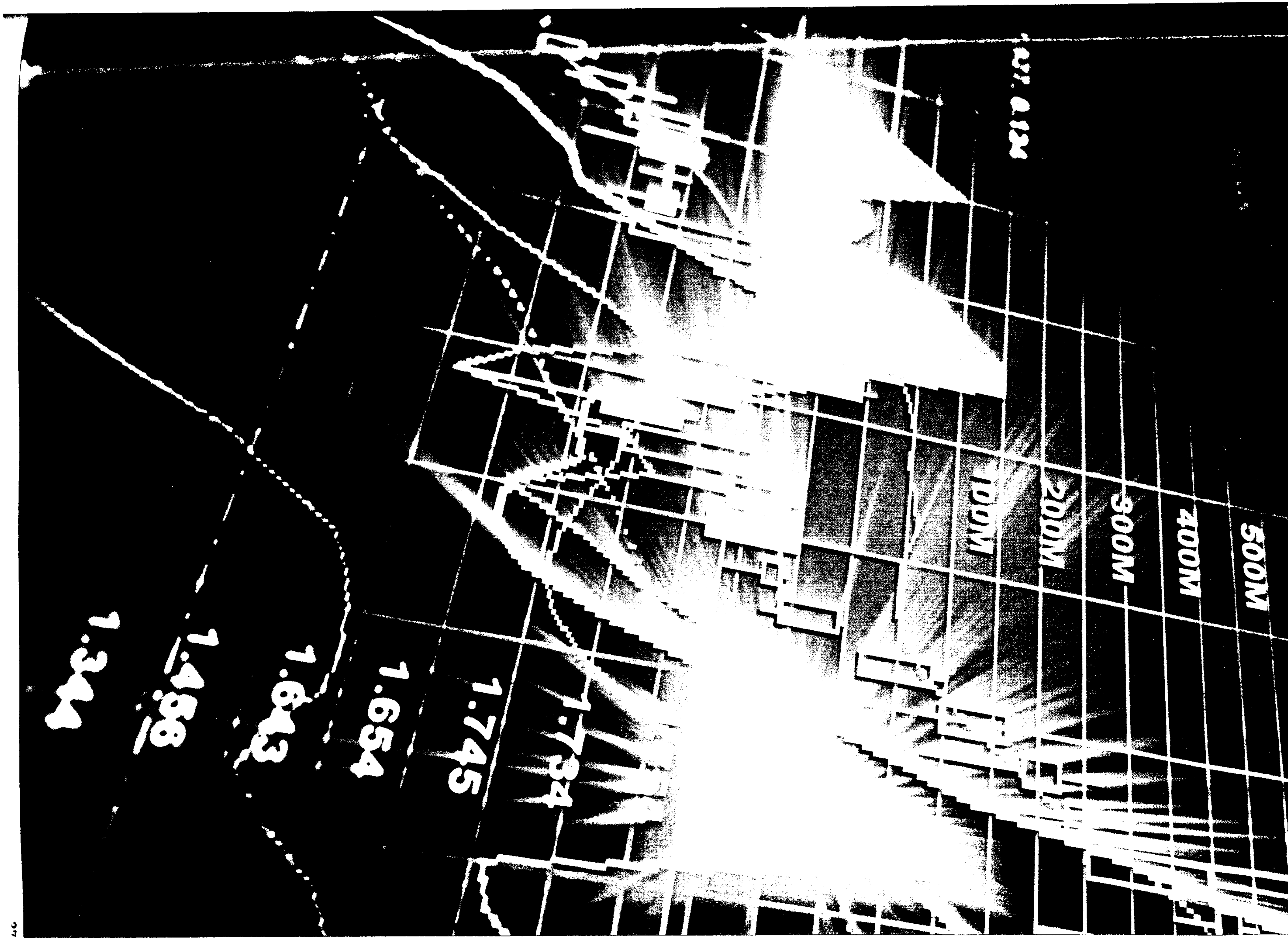
Franz Nauschnigg
Head of European Affairs
Central Bank of Austria

THE HEAD OF EUROPEAN AFFAIRS AT THE CENTRAL BANK OF AUSTRIA MAPS OUT SIX WAYS TO REFORM EUROPE'S FINANCIAL ARCHITECTURE IN A BID TO AVOID ANOTHER BOOM-BUST CYCLE

The current crisis is the worst global financial and economic crisis since the Great Depression of the 1930s. As a consequence of the Great Depression, the Bretton Woods System was established in 1944. The financial system was strongly regulated, and a strong role was assigned to the state (fixed exchange rates, capital controls and demand management). It was quite successful, bringing strong growth, low unemployment and inflation. There were few financial crises until its breakdown in 1971.

This was followed by a worldwide trend of deregulation (especially of the financial sector) and privatisation under the monetarist and neo-liberal paradigm. The failure of the state and the alleged greater efficiency of market solutions were stressed. The insight of John Maynard Keynes, that the Great Depression ▶

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had its roots in the imperfections of the monetary-financial system, was forgotten. Financial crises became more common. The IMF has counted 124 banking, 208 currency and 63 country debt crises in the period from 1970 to 2007.

A deregulated financial system has a pro-cyclical tendency, which leads to overshooting and creates boom/bust cycles, and usually also massive overshooting of capital flows. Monetary policy is undermined by carry trades and foreign currency loans, which increase vulnerability. Despite widespread market failure, market elements were incorporated into banking regulation (Basel II) and accounting rules (mark-to-market), providing for strong pro-cyclical effects. The pro-cyclical tendency of the financial sector became stronger, with more overshooting and stronger boom/bust cycles. The pro-cyclicality of Basel II and the international accounting rules must be corrected to make the financial system less pro-cyclical. The remaining pro-cyclicality of the financial system must be compensated by policy action.

the IMF has counted 124 banking, 208 currency, and 63 country debt crises from 1970 to 2007

Bubble contagion

In Europe, financial deregulation and liberalisation triggered lending booms, speculative bubbles in the deregulated financial markets and boom/bust cycles. Finland, Norway and Sweden experienced severe systemic crises in the early 1990s. More regulated European Free Trade Association (EFTA) countries such as Austria and Iceland, however did not experience a crisis at that time. After extensive liberalisation, Iceland experienced a boom/bust cycle with a severe financial crisis in 2008.

Boom/bust cycles developed also in the central eastern and south-east Europe (CESEE) region. The crisis in Iceland led to contagion in Hungary in autumn 2008. In early 2009, contagion also affected CESEE countries with strong fundamentals, when their currencies came under pressure. Euro area banks and countries with large exposures to the CESEE region also suffered.

In this crisis, monetary, fiscal and financial policies have played a central

role in cutting the adverse feedback loops between the financial and the real sector. International co-operation – in particular the EU, G-20 and IMF – has been central to providing financial support to financial systems, banks and states. The CESEE region, and countries and banks with large exposures to this region such as Austria, have benefited from this concerted action. Countries outside the euro area are vulnerable to currency crises, whereas the euro acts as a protective shield for eurozone countries.

Strengthening the system

There are a number of measures that would strengthen the European financial architecture and deepen European integration:

1 In a boom, a credit growth stabilisation tax (CGST) on all new private sector credit should be introduced to limit credit growth. The receipts would flow into a cyclical stabilisation fund (CSF) to be used in downturns.

2 For the euro area member states, the creation of a €200bn counter-

the remaining pro-cyclicality of the financial system must be compensated by policy action

cyclical financing facility, based on Article 122 of the EU Treaty. It should have incentives to bring the structural deficit under control.

3 For non-euro area EU member states, the creation of a €50bn counter-cyclical financing facility, in addition to the existing EU balance of payments assistance facility.

4 For the European Economic Area, EU candidates, EFTA and EU neighbouring countries, the creation of a €50bn EU combined balance of payments and macro financial assistance facility.

5 The bonds issued and backed by the EU would create an EU bond market. The benefits of this would be high, allowing the EU to better compete for international investors.

6 The establishment of bilateral swap or repo facilities between the Eurosystem and EU as well as other European central banks. For comparison, the Federal Reserve has concluded swap agreements worldwide.

The measures would help to achieve the needed strengthening of the automatic fiscal stabilisers in Europe, which have been weakened with the welfare state.

The stabilisation of expectations of economic agents against both external and cyclical shocks would be supported. They would help stabilise financial markets, stimulate our economies, correct market failure and deepen European integration with no cost for the EU taxpayer.

Substantial welfare gains for the eurozone, the EU and other countries in 'extended Europe' could be achieved.

biography

Franz Nauschnigg is head of the European affairs and international financial organisations division at the Central Bank of Austria.

Key ideas

Crisis management

- **The pro-cyclicality** of Basel II and the international accounting rules must be corrected to make the financial system less pro-cyclical.
- **The remaining** pro-cyclicality of the financial system must be compensated by policy action.
- **In this crisis** monetary, fiscal and financial policies have played a central role in cutting the adverse feedback loops between the financial and the real sector.
- **International co-operation** – in particular EU, G-20, and IMF – has been central to providing financial support to financial systems, banks and states.