AFTER THE FINANCIAL CRISIS


Charles Randell

Overview

● What caused the financial crisis?
● How did Governments respond?
● What has been done to strengthen the system?
● What still needs to be done?
What caused the financial crisis?

- Global macro-imbalances and capital flows
- … leading to an unsustainable credit bubble in some developed economies
- … which was allowed to develop further by loose monetary policy and inadequate regulation of leverage in the financial system
- … and included a huge bubble in residential and commercial real estate, fuelled by securitised lending
- … which inevitably collapsed, causing acute liquidity crises, and then capital crises, at some institutions
- … which eventually infected the entire financial system due to the transmission of risks by complex financial products and inadequate information about where losses would eventually fall

Global current account balances

[Graph showing changes in global current account balances from 1993 to 2008]

Source: IMF, PSG calculations
Growth of the financial sector

UK bank leverage

Note: See Bank of England Financial Stability Report, December 2010, Chart 5.10 for basis of preparation
How did Governments respond?

- In the UK (as elsewhere), the costs of the financial crisis were largely socialised
- UK Government interventions included:
  - Nationalisation of Northern Rock
  - Resolution of Bradford & Bingley under the Banking (Special Provisions) Act 2008
  - Administration of UK subsidiaries of Landsbanki and Kaupthing
  - £68 billion recapitalisation of RBS and Lloyds/HBOS
  - £280 billion Asset Protection Scheme for RBS
  - £250 billion Credit Guarantee Scheme
  - £200 billion Special Liquidity Scheme

What has been done to strengthen the system?

- Reform of regulatory architecture in some jurisdictions
  - e.g. UK Financial Policy Committee & Prudential Regulation Authority; European Systemic Risk Board and European Supervisory Authorities; US Financial Stability Oversight Council
- Strengthening of capital and liquidity standards
  - Basel III
- Strengthening of market infrastructure
  - Central clearing and trade reporting of derivatives (e.g. European Market Infrastructure Regulation)
  - Enhanced regulation of central counterparties
- Enactment of domestic bank resolution powers
  - e.g., UK Banking Act 2009; German Restrukturierungsgesetz; Orderly Liquidation Authority under US Dodd-Frank Act
  - Coupled with "living wills" concept
  - And, in some cases, structural changes to banks (e.g. the Volcker rule)
What still needs to be done?

- Further strengthening of capital standards for systemically important financial institutions
  - FSB proposals due in November 2011
- Addressing the cross-border resolution issue
  - Proposals under way within the EU
  - But internationally, no consensus on this issue
- Addressing the underlying macro-imbalance?
  "… the global flow of funds could become an increasingly powerful generator of global financial instabilities."
  Andrew Haldane, Bank of England

Profile

Charles has a broadly-based corporate practice. He also covers public sector work. His recent major transactions include advising HM Treasury on a range of assignments arising from the credit crunch, including Northern Rock; Bradford & Bingley; the Icelandic banks; the recapitalisation of the banking sector, including the investment of up to £45 billion in shares of RBS and £23 billion in shares of the merged Lloyds/HBOS; and the £280 billion Asset Protection Scheme.

Charles is included in the highest ranking for Corporate/M&A in Chambers Global, 2011.

He speaks French and German.