AFTER THE FINANCIAL CRISIS

Eleventh Annual WTO Conference,
London, 26 May 2011

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SLAUGHTER AND MAY

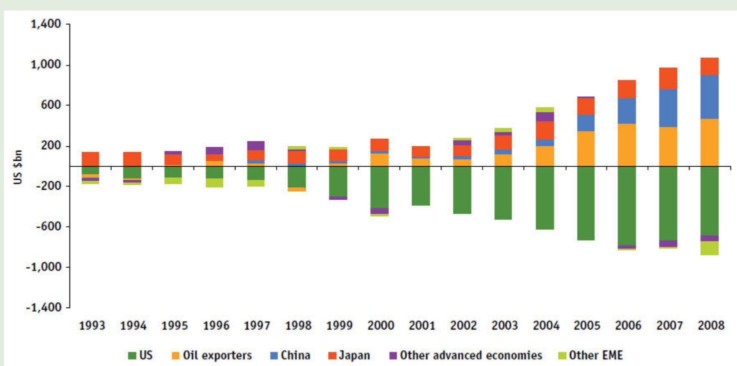
Overview

- 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?

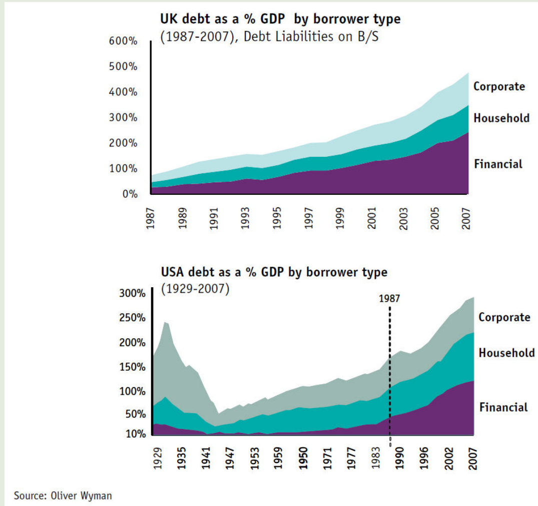
- Global macro-imbalances and capital flows
- … leading to an unsustainable credit bubble in some developed economies
- … which was allowed to develop further by loose monetary policy and inadequate regulation of leverage in the financial system
- … and included a huge bubble in residential and commercial 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

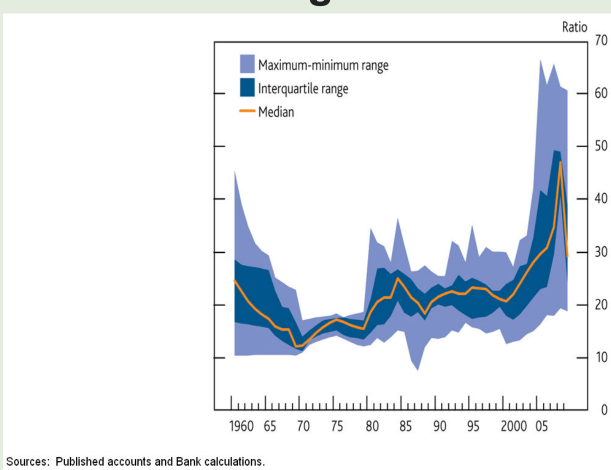


Source: IMF, FSA calculations

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)

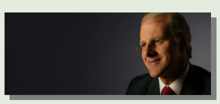
What still needs to be done?

- 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-imbalances?

  "… the global flow of funds could become an increasingly powerful generator of global financial instabilities."

  Andrew Haldane, Bank of England

Profile



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Joined firm
1980

Partner since
1989

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.