Finance Watch
Making finance serve society

Introdutory remarks by Christophe Nijdam, Secretary General of Finance Watch

At the Finance Watch conference "The long term financing agenda – the way to sustainable growth?", The Square, Brussels, 4 February 2015

Ladies and gentlemen, good morning and welcome to the Finance Watch conference.

It is a pleasure to welcome today a very diverse group of delegates, which includes representatives of civil society, the European institutions, the financial sector, the productive/real economy industry, academics and the press. Such diversity is not only good for democracy; it should also make for an entertaining and lively day of discussions.

My name is Christophe Nijdam, and I'm the new Secretary General of Finance Watch. Although my last name is Dutch, I'm French, an externality of the Brussels "melting pot" – let's hope that this one will be a "positive externality" -- and while I'm definitely a European citizen, I sometimes see myself as a citizen of the world. I'm a former commercial and investment banker and I've spent 13 years as a bank executive at a number of large French banks in France and in the US, enabling me to see at close quarters the financialisation of the economy in the nineteen eighties and the rise of dogma about efficient markets. Twenty one years ago, I crossed to the investor side as a stock analyst, most recently working at AlphaValue, Europe's leading independent equity research firm. My operational experience in bank management and investor's perspective are keys to my strong convictions of the need to reform the financial sector.

In my last role as an equity analyst specialising in banks, I saw that investors who questioned the common view ended up ahead in the long-term. I hope that our conference today will pay similar dividends as we question a number of common views about long term financing and growth.

I would like to introduce today's programme by asking you three questions - about securitisation, policies for growth, and collateral - and by sharing a few thoughts with you along the way.

1. The first question is: what is this high quality securitisation that we hear so much talk about? The revival of high quality securitisation has been promoted as a cornerstone of the political response. There have been several consultations and definitions put forward, but very little real public debate.

That will be the task for the experts on our first panel. Before that, our head of policy analysis, Frederic Hache, will present Finance Watch's perspective on good securitisation. And this afternoon, I am delighted to welcome Dennis Kelleher, president and CEO of Better Markets - Finance Watch's US counterpart - to give us an American perspective on the US securitisation market since the crisis.

2. The second question is about the EU's overall approach to diversifying and increasing the supply of finance and credit to the real economy. Is it likely to achieve its ambitious objectives, and have we considered all the options?

One issue is how to channel the growing pile of excess financial capital to where it is needed without creating new dangers. We support the European Commission's view that institutional investors must do more but only if they use their long term liabilities to act in a countercyclical manner, i.e. to buy when everybody wants to sell and vice versa.

The crisis showed that institutional investors tend to herd together with the rest of the market, amplifying economic cycles. As Andy Haldane of the Bank of England put it in a recent speech: "*Patient capital ought to be part of the solution to the long-term financing puzzle. In practice, it may have been part of the*

problem." Any moves to promote the involvement of institutional investors should therefore include clear incentives to act, not as short term traders, but as true buy-and-hold long term investors.

We must also be wary of shifting too much risk to pension funds and of making pensioners the new depositors. If tomorrow a pension fund runs into trouble, it is quite likely that politicians would be willing to bail it out. We should therefore pay attention to how much risk pension funds can absorb and be careful not to think that every tool that promotes the role of institutional investors is a silver bullet.

In asking if we have considered all the options, it is worth noting that several prominent economists and industry figures have cited a lack of aggregate demand as one of the causes of weak growth. Linked to this is the well-documented rise in inequalities as low and middle class households, many already in debt and worried about the future, face a relative decline in their purchasing power. Ahead of the recent Davos forum, leading economists warned that "*rising inequality was perhaps the biggest challenge facing industrialised economies.*"

A recent OECD study put it even more clearly: "*higher inequality lowers economic growth. (..) Policies that help to limit or reverse inequality may not only make societies less unfair, but also wealthier.*"
Let's face it, the much vaunted "trickling" wealth effect of inequality did not percolate down into aggregate demand this time around, if it ever did…

So it is in the long term interests of the *financial* industry itself to recognise this problem, not least to protect its client base.

Another factor to consider is that the Commission's Long Term Financing Initiative promotes the investment banking model over traditional banking. As a former investment banker before I became an analyst, I understand very well the positive role that investment banking can play. But we might ask which bank business models have focussed more on lending to the real economy? Traditional relationship lending, especially by small and medium sized banks, has proven especially valuable in this area and our first keynote speaker, Dr Lothar Blatt-von Raczeck, will say more about this in a few minutes.

I would add that, in relation to investment banking, local relationship banking is also less interconnected, less procyclical, creates less elasticity in our financial system and leads to less correlated balance sheets between institutions.

We therefore believe that promoting traditional relationship banking should also be part of the solution. Possible measures could include:

> a. removing the inbuilt advantage of the internal model approach over the standardised approach in CRD, which favours large banks over small and medium ones, when determining risk-weighted assets
>
> b. redesigning liquidity ratios to favour stable funding over liquid assets,
>
> c. and addressing the negative externalities of securities financing.

I have commented briefly on investment problems, inequalities and banking models. Martin Wolf, associate editor and chief economics commentator at the Financial Times, has written a book looking at these and other questions in much greater detail. I am very pleased that he will be joining us to speak – and participate in an extended audience Q&A - in the session after lunch.

3. My third question is about the plumbing of the financial system, as a revival of securitisation will create more assets that can be used as collateral. Is it desirable, from a stability and sustainability point of view, to increase the central role of collateral and securities financing?

Collateralised funding can be extremely useful in uncertain times when trust can disappear quickly. But making collateralised funding the new normal is likely to create a more interconnected and more procyclical financial system.

When I started in banking over 35 years ago, I was taught that a sound lending decision relied upon three sources of repayment, in decreasing order:

- First and foremost, the cash flow generated by the asset itself being financed – we called that "self-liquidating"
- Second, by the value of the collateral if the cash flows proved short of expectations
- Last, but least this time, by a creditworthy third-party guarantor if the first two sources of repayment were unsufficient

It is worth remembering that the core job and expertise of banks and investors is to lend based on the assessment of the creditworthiness of the borrower, not based on the securities that they can give as a guarantee.

It is also worth remembering that the ubiquitous role of collateral is a recent phenomenon that can be traced back to the collateral directive from 2002. It is not an irreversible fact.

As this topic is likely to have strong implications for the architecture of our financial system and as the negative externalities of securities financing have been clearly demonstrated, we think it is important to have a debate on it, which will be our second panel of the day.

We will then have the honour of hearing Commissioner Jonathan Hill share the European Commission's view in a keynote speech to close the conference.

We have excellent speakers and panellists here today, whom I would like to thank very much for their participation.

I should also add my gratitude to a speaker who was able - at short notice - to join our second panel on collateral and whose name therefore does not appear on the printed programme: Kevin McNulty, chief executive of the International Securities Lending Association, welcome.

I hope that you will find the programme stimulating and that you will continue the discussions during the coffee-breaks and lunch-break, and during the cocktail reception at the end, when I look forward to meeting many of you for the first time.

As you can see, the subjects that will be discussed today by these experts are highly technical. And as you may know, technicians are sometimes humorously defined as people who make mistakes by abiding by the rules. With regards to one of the insolent definitions of experts, they're people who know absolutely everything there is to know in their field, while knowing absolutely nothing about the rest… My hidden agenda for today is that you won't leave this conference feeling like you have become "technical experts"

I will now give the floor to our first keynote speaker, Dr Lothar Blatt-von Raczeck, head of the EU representation from DSGV, the German Association of Savings Banks.