

press release

23 January 2009

The banking crisis: an alternative solution

- The Share Centre's Chief Executive suggests an alternative solution to nationalisation

In the light of Paul Myners' (Financial Services Minister) and Stephen Hester's (CEO, Royal Bank of Scotland) assertions that the UK Government does not want to nationalise the banks, I would like to suggest an alternative approach.

It is based on Lord Turner's analysis* that a very substantial part of bank over-indebtedness lies in the complex web of claims between financial institutions: in other words, not in lending to business or for mortgages. If these claims could be netted off, there would be a massive reduction in the scale of bank losses and potential write-offs.

It takes account of the problems faced by auditors in signing off year-end accounts, highlighted in the Companies section of yesterday's Financial Times (22 January 2009).

It also recognises the current 'Penny Share' status of most leading banks; at these levels market valuations reflect little more than an option against nationalisation, and do not provide the basis for any further injection of private sector capital to resolve future needs.

There would need to be coordinated agreement between the UK, US and European Union Governments and Central Banks due to the international nature of inter-bank claims which require resolution, with this agreement being best implemented over a weekend (non-trading) period. They would agree to the following simultaneous course of action:

- To suspend trading in the shares of all relevant financial institutions;
- To delay the dates of publication of the audited accounts of these institutions until all realistically possible netting-off of inter-bank claims had been achieved; and,

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- Under 'State of Emergency'-equivalent conditions, to take powers to require bank boards to co-operate with each other to prioritise this netting-off process. This will involve a degree of 'force majeure', since it will in many cases act to override commercial contracts. The complexity of the process could well take up to six months, but it will hugely reduce the level of systemic risk. For the avoidance of doubt, these powers would not be used to direct higher levels of lending to business or for mortgages: the guarantees already provided are appropriate to restore normal banking activity once the systemic internal risk has been removed. Any additional capital required during this period would be provided by Government on a 'preference' rather than equity basis.

Once bank auditors were able to confirm that the netting off had been substantially completed, bank audits would be published on a 'going concern' basis, the suspension of share trading would be lifted and normal corporate governance would resume

Gavin Oldham, Chief Executive for The Share Centre

Extract from Lord Turner's speech 'The Financial Crisis and the future of financial regulation' 21 January 2009 (The Economist's Inaugural City Lecture):

"...this disproportionate growth [in financial sector assets and liabilities] represents an explosion of claims within the financial system, between banks and investment banks and hedge funds – that multiplication of balance sheets involved in the credit intermediation process which I suggested earlier has accompanied the increasing complexity of securitization.

This huge growth of intra-financial system leverage has a relevance to the urgent issue of short term macro economic management. The more that we can ensure that bank deleveraging takes the form of the stripping out of inter-trader complexity, and the less it takes the form of leveraging vis-à-vis the non-bank real economy, the better."

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