Researching the Credit Crisis - how information units can help steer a course through troubled waters.

Held at Macfarlanes on 27 January 2009.

Locked rooms, Ninjas, lotteries, vanilla banking and numbers with more zeros that we could have ever dreamt off... Sylvia James, consultant and business information expert gave a talk which clarified many of the more mysterious aspects of the credit crunch and gave us an insight into where the banking system is, where it is headed and what we as information professionals could confidently do to assist our firms in the current crisis.

Sylvia began by making general observations about the situation, saying that 'money markets' are not generally understood or explained; that assumptions about peoples' knowledge are made; and there are (as usual) a range of obscure and (sometimes) contradictory terms, jargon and phrases used without real explanation or context. It is up to us as information people to ask enquirers what they mean when they talk about obscure terms because sometimes even the experts aren't sure exactly.

Background is essential for a topic like this and she set the scene by pointing out that the crisis is global and 'systemic', covering all areas of financial activity from US, Ireland, Hungary, Asia, and the UK. She defined Ninja Loans (No Income, No Job, (and) no Assets) which banks had given to people in the States and she went on, rather incredulously, to wonder why banks such as Northern Rock had thought it a good idea to sell 125% mortgages - all of which added up to a trillion dollars worth of property debt globally.

To put the problem into a practical context she used a £10 million lottery win as an example. Where do you immediately put that amount of money? One solution was to put it in the *money market*, which was a short term, safe place which earned interest under the London Interbank Offered Rate (LIBOR) and domestic and international banks used this pool of money to lend to other banks at a reasonable cost. However this has now gone. Any lottery winner would have to forego immediate interest on their £10 million but it's even more devastating for the person coming up to retirement as this safe pot was used by institutional investors for pension funds.

So when did it all start to go wrong? At the end of the 1970s banks felt that the 'plain vanilla' money markets needed geeing up and so the 'Accepting Houses', merchant banks such as Rothschild, Hambros Bank were able to facilitate the lending of money. In comparison to markets such as stock markets, it's unregulated, informal and done from person to person meaning that tracking of documentation is nearly impossible.

Further developments in the late 70s, early 80s resulted in banks setting up 'packaging departments'. These produced what we know as securitisations - basically 'the process of repacking illiquid (untradeable loans, with no ready market) into marketable securities, usually bonds'. Almost anything could be securitised - car loans, water company bills, credit card debt, back catalogues of music.

So where has all the securitised debt gone? Briefly sub-prime mortgages in the US, other mortgages problems in UK, Spain & Ireland, commercial property mortgages, loans to LBOs (leveraged buyouts) and unsecured credit card debt. Sylvia pounced on this last one saying it was going to be a future headache because no one knows how much unsecured credit card debt there is out there, whereas at least mortgages can be counted.

The difference between the domestic interest rate and LIBOR gave the first significant indication that there was going to be trouble in August 2007. The new(er) sophisticated (and riskier) Asset Back Securities, Credit Derivatives and Collateralised Instruments (as opposed to the traditional, conventional (and safer) Bonds, Acceptances and Bills) were clearly going to cause problems.

Firstly the (SPEs) Special Purpose Entities which were created so that an independent trust or special company could purchase and hold assets that backed securitised instruments. These are then usually taken off the balance sheet of the parent bank. Sylvia demanded, where were the auditors? What were they doing? Were there locked rooms as in the BCCI and Enron cases? How many locked rooms are there in banks such as RBS?

Secondly regulation of the banks is being revisited. Capital adequacy in banks is the most critical element in banking supervision as it prevents runs on banks.

Thirdly there are the rating agencies that were now in the pay of the banks rather than the investors, quite clearly a conflict of interest and consequently they are being investigated in the US and Europe.

Having brought us up to date, Sylvia then took us through some famous historic financial crises; the Wall Street Crash (1929), the Secondary Bank crisis (UK 1973), Savings & Loans crisis (US late 1980s), Japan property bubble (early 1990s) and the 1998 Asian financial crisis. All or any of these may hold the key to solving the present crisis.

So what about us? What can we do? She quoted Jack Welch in the FT July 26/27th 2008, 'this is not a time to skimp on resources, but to focus them on your best businesses: stop the weakest, invest in the strongest'. She pointed out that we know much more than we may be displaying to our users; we can spot anomalies and explain why things looks strange or different; and that we should develop our knowledge of financial reporting and statements. Basically we should compare, contrast, continuously. For instance she spotted that Mr Madoff's multi billion dollar outfit was using a 2 person accounting firm which was clearly anomalous.

The final point and most useful/generous part of the presentation was the huge 25 page annotated bibliography containing masses of information on the crisis. It includes websites, bulletins, non/government sites, glossaries, 'must read' books, stats, think tanks etc., and will be used as a first step by everyone on their credit crunch research.