



The G20 / 20 Hindsight Debate

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On the 2nd and 3rd of April, the G20 Summit was held in London. The group of twenty (G20) leaders, their finance ministers and Central Bank governors brought together the views of the top 20 economies of the world.

After dwelling on the analysis of the Summit in the weekend papers, I was amongst a number of leading industry commentators, banking technologists and other key industry players who attended a G20 hindsight roundtable at IBM in London, for a broad and interactive discussion on the outcome of the Summit.

With the current global economic downturn, and individual bail-out packages and fiscal stimulus measures following one another with little result, the pressure was on for real substantive measures to be agreed by the G20 leaders. Never before have we faced such turmoil, never has the banking community had to turn to government for such support and never has so much been expected from the G20. Whatever the outcome of the G20, whatever the measures introduced, one thing is clear - banking technologists will be expected to make it work.

I was recently interviewed on my thoughts on the overall outcome of the G20 Summit:

Guy - what did you make of the G20/20 Hindsight debate?

The debate was very open and lively! Discussions ranged from transparency, regulations, risk management, regulators, standards bodies, global v local, the ability to have the right information to make informed decisions for the banks, whether innovation will be stifled, governance, cost reduction, efficiency improvements, and integration of business and technology.

A real range of subjects then! Was there a specific theme that came out in the discussions?

Definitely. In fact, there were multiple themes. Essentially I'd break the debate down into two parts - one focusing on behaviours and the other governance.

Do you see a need for a change in behaviours?

Exactly. There needs to be a change in behaviour both for the state-owned banks and private banks. As listed companies, the banks often take short-term views, forced by quarterly results and therefore that has to push them into taking higher risks. The only concern here is that the Execs spend all their time on the quarterly results, rather than the long term health of the business and keeping it in good shape. They continue taking on more and more risk until we have a major market collapse, similar to the one we have just witnessed.

I liken it to moving ever closer to the crater of a dormant volcano that hasn't erupted for a while, but with the signs getting stronger that there will be another eruption soon. It is incredibly difficult to predict when it is going to happen, just that it will do so in the near future, as we can see the "seismic activity" intensifying.

There are many factors that impact on the extent of risk taking. One is the way people are compensated - there are moves afoot to moderate and in some instances, cap these packages.

We have now seen many changes in ownership, mostly forced, which have introduced another organisation's working practices and oversight (be it the state or another banking group) on these financial institutions. This, accompanied by moderated compensation packages, will bring about a change, but the jury is out on whether this will work long term. Indeed, early indications are that the TARP (troubled assets relief program) banks in the States are working hard to release themselves from the constraints of the US government on Exec compensation.

What about better governance within banks?

The industry needs to address a bank's appetite for risk, with better regulatory reporting. It's actually not a bad thing; it has to be done, for the good of the bank. Banks do have to take on risk, it is one of the key functions they fulfil in our economies (they buy foreign exchange risks from businesses like ours, and equity price volatility from fund managers), however they should be aware of the impact of this risk, and should work within certain limits.

Currently banks have their own sensitivity models, where they are allowed to trade in certain volumes, which they have to submit to the regulator. This makes the risk they are carrying transparent, so they know how and when to mitigate it.

The likelihood is that going forwards the regulator will ask for more detail on banks' models, and their history of risk. Although in the real world, this is difficult to track, and unless the regulator has real teeth, banks will not be stopped from trading when they are taking on unreasonable risk.

The regulators will ask for better counterparty risk, so there will be more data aggregation and more reporting, which should increase opportunities for our risk-oriented solutions such as Eagleye, Risk Vision or Opics Risk Plus.

Whilst this may not fundamentally change the behaviours, it will certainly help drive better procedures and practices for analysing and mitigating risk.

For individuals working in banks, the regulator's mandate is not really a carrot for change, it's just something that has to be followed. Yet for Misys, the obligatory nature

of the mandate works in our favour, as there will be budgets set aside for risk and compliance projects, and therefore the potential requirement for our risk-oriented solutions. In reality, for senior executives in banks, the only downside of getting caught taking on more risk, would be the lack of bonus, and a potential resignation. However the upside is much more attractive – bigger deals and bigger bonuses, but the amount and frequency of "seismic activity" around the volcano will increase.

Do you see the need for any other step-changes in the way banks are run?

Yes I think there is a need for an infrastructure overhaul within banks. There needs to be more sharing of standard data to complement the regulators' efforts. Additionally there should be more focus on ensuring the ratings given to institutions are sustainable, and the rating agencies should be run by the industry or regulators themselves.

Critical to the banks' health is that costs are kept to a minimum – they need to optimise their operations, while managing the risks more effectively, all the while improving efficiency and profits. That is where we can make a real difference.

So, what are your conclusions on the hindsight debate, and the overall outcome of the G20 Summit?

I feel sure that the focus will be on the governance of banks, in an attempt to stop them taking unreasonable risks, when the better solution is to work on the behaviour of execs and traders to better align them with the state and the shareholders of the companies for which they work. This was an interesting debate with a good degree of agreement on what is likely to happen, and an equal measure of scepticism on whether it will fundamentally change the industry that we serve.

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