

DAVID DE ROTHSCHILD

Group Chairman, Rothschild

Nicolas Barré, Deputy Managing Director, *Les Echos*

David de Rothschild, maybe you could share some of your thoughts on financial reforms with us.

David de Rothschild, Group Chairman, Rothschild

There are very few topics that are as linked to both governance and world economy as the concerns of the banking industry. I belong to this very popular category of European private bankers. I will stay on that subject and just make a few quick comments.

First of all, as the previous speakers said, we have covered a lot of ground and a lot of the acute elements of the crisis are now behind us. Banks have gone through an unbelievable ordeal since 2008. Most of that is behind us and Governments, regulators and the industry itself have worked towards reducing the risk factor around banks. They protect depositors, creditors and taxpayers. Hopefully, they are still able to finance the economy, which is an important function of banks.

A lot of things have been done in terms of structural modifications of the banks and in terms of governance. I do not want to be too boring or too technical, but the main thing is that the change in equity ratio means the banks have to have much more capital. The liquidity ratio has changed, which means the banks have to be better-funded with longer-term funding. Therefore, it will probably be slightly more expensive over time. The leverage ratio has changed, which means that the balance sheets have to be smaller. When Lehman went down, the leverage was between 30 and 40. The Americans have fixed a leverage ratio at 5%, which means 20 times your shareholders' fund in terms of balance sheet. This is a fundamental change.

In terms of governance, we are living in a historic time, because two things are being put in place within the Eurozone. There is centralised supervision, which is great because the lady who is going to run the supervision is a remarkable French lady called Madame Nouy. All of us who are in the financial sector know her well and I think she will do a great job. Harmonising control is extremely important, because we have seen lots of discrepancies in the past regarding regulators and how one approaches banks.

If the recent reports in the press are to be believed, there will probably be action regarding the banking union by the end of this year. The banking union will mean that there will be a resolution mechanism regarding how you are going to treat banks which are in trouble. There will be a unified approach. Obviously, the shareholders will be hurt and that is normal. The creditors will also be hurt, which is new. The depositors with less than EUR100,000 will be protected but those with more might be hurt at some point. Ultimately, Governments, meaning the taxpayers, will be hurt.

All this is positive. Does it restore confidence in banks and the credibility of the banking industry? I suppose it does. Questions have to be put on the table, because this does not mean just describing the things but asking oneself what the consequences are of all this. First of all, it is interesting to realise that profitability of the banking sector before 2008, by which I mean return on equity, was somewhere between 15% and 25%. It is now going to be somewhere between high single digits and low double digits for the best performance. Considering the constraints that have been put on the industry, profitability goes down.

You can say two things. You can say that if you look at a bank as a utility, with a nine, 10 or 12% return, it is a great investment. Therefore, when banks need to grow and increase capital, they will find capital because they are safe. If you consider that there is a strong risk component in a bank, you may say that that sort of return is not enough. Therefore, there might be an issue for the development of the banks going forward in terms of capital increase.

The second question is directly linked regarding the consequences of all this. Can they perform the lending job properly to fuel growth? It is very difficult to give a quick answer. In some countries you would say no and in other countries you would say yes. Some banks are in a perfect position to do so and some are not. It is a difficult answer, but it is a question that we will be faced with for a fairly long time. The short answer is yes, but there are a couple of things that will need to be verified over time.

In 2014, there will be another round of stress tests and there will be another asset-quality review. Therefore, I think that by the end of 2014, we will have a fairly stable environment in all this. It means that the banking sector, which has always been regulated, is very highly regulated. There is nothing wrong with being regulated, but another question that comes on to the table centres on the fact that there is a lot of shadow banking. Shadow banking is something very respectable. It just means banking which is not regulated and where a lot of interesting things happen in terms of finance.

You would say that you have to regulate the shadow-banking area. My own view is that too much regulation is never something that creates a lot of prosperity in the economy. Equally, the balance between too much and too little regulation is very tricky. If you go too far in regulation and think a couple of years ahead, you face the risk of having talent transfer from the regulated sector to the non-regulated sector. Therefore, it weakens the banking sector as we define it.

It is an interesting period. Pascal Lamy is the expert, so it is always silly to make comments in front of an expert, but the issue for Europe centres on whether there is too much or too little regulation. I think it is a combination of both. There are too many areas that you would prefer Europe not to look after, and some key factors of convergence that you would like to see in order to have a better Europe. We are in the middle of the river and we cannot go back, so we have got to be more European and have a better Europe. I think what is happening in the banking sector caters to a more organised and a better Europe.

Since 2008, the overall mergers-and-acquisition market has dropped by 25-30%. This is a small measure but is a measure. It has not come back yet, so this is an indication that people are more cautious and are afraid of overpaying. They do not want to sell too cheaply and they are not sure they will find exactly the financing they need. However, we are slowly seeing a little bit of light at the end of the tunnel. Thank you for your invitation, Thierry. It is a great privilege to be here.