Some observations post the height of the global financial crisis

The scenario post the height of the global financial crisis remains fairly fragile, with various global sovereign and banking systems still in the midst of attempting to deal with many serious issues resulting in the perpetuation of a level of uncertainty to which most participants in the financial sector are not accustomed.

One observation that seems to carry some degree of certainty, however, is that of Richard H Clarida, Executive Vice President, Global Strategic Adviser, Pacific Investment Management Company (PIMCO), who talks about the so-called new normal. The following are a few thoughts that he put forward during 2010 in this regard:

> *Rules of thumb and historical correlations will likely prove to be irrelevant or misleading guides to portfolio positioning. The unthinkable has become thinkable. There is likely to be frequent flips between "risk on" and "risk off" days with repositioning likely to be more frequent and fluctuations in risk appetite being more frequent with leverage being discouraged.*

William H Goss, Managing Director of PIMCO notes: "We overdid a good thing and now the financial reaper is at the door, scythe and financial bill in one hand, with the other knocking on door after door of previously unsuspecting households and sovereigns to initiate a 'standard of living' death sentence". He further states that "there is a lack of global aggregate demand or perhaps an inability or unwillingness to finance it. Slow growth in the developed world, insufficiently high levels of consumption in the emerging world and seemingly low total returns on investment portfolios – bonds and stocks – lie ahead."

Mark Gilbert of Bloomberg noted in June 2010 that the new normal turns out to be a world where scenarios move from impossible to inevitable without even pausing at improbable.

Similarly, the International Monetary Fund (IMF) notes in two of its Staff Position Note (SPN) papers on 18 May 2010 (SPN/10/08) and 3 October 2010 (SPN/10/15) that fundamental changes are required going forward.

SPN/10/08 ("The Making of Good Supervision: Learning to Say 'NO'") notes that, unlike in the period of the "good times", good supervision should be intrusive (i.e., supervision is premised on an intimate knowledge of the supervised entity); sceptical (supervisors must question, even in good times, the industry's direction or action); proactive (supervisors cannot act only after operations have gone off the rails); comprehensive (supervisors must be constantly vigilant about happenings on the edge of the regulatory perimeter to identify emerging risks that may have systemic portents and draw the proper implications for the institutions they supervise); adaptive (supervisors must be in a constant learning mode – new products, new services and new risks must be understood and responded to appropriately); and conclusive (supervisors must follow through conclusively on matters that are identified as these issues progress through the supervisory process). The note goes on to observe:

> *To achieve these elements, the "ability" to supervise, which requires appropriate resources, authority, organization and constructive working relationships with other agencies must be complemented by the "will" to act. Supervisors must be willing and empowered to take timely and effective action, to intrude on decision-making, to question common wisdom, and to take unpopular decisions. Developing this "will to act" is a more difficult task and requires that supervisors have a clear and unambiguous mandate, operational independence coupled with accountability, skilled staff, and a relationship with industry that avoids "regulatory capture". These essential elements of good supervision need to be given as much attention as the regulatory reforms that are being contemplated at both national and international levels. Indeed, only if supervision is strengthened can we hope to effectively deliver on the challenging – but crucial – regulatory reform agenda. For this to happen, society must stand with supervisors as they play their role as naysayers in times of exuberance.*

SPN/10/15 ("Shaping the New Financial System") notes that financial systems and transactions became distorted along several dimensions, that is, the financial system grew highly complex, opaque, over-leveraged and heavily interconnected; liquidity risk was higher than recognised; large complex institutions enjoyed the benefits of being "too important to fail" and financial intermediation has increasingly shifted to the shadow banking sector. It further notes that, looking ahead, financial regulatory policies should aim to ensure

- financial intermediation that delivers products better geared to satisfy the needs of households and firms;
- a better-governed and more transparent financial system – in terms of corporate structures, instruments, and markets;
- institutions endowed with higher, better quality, and globally consistent capital and liquidity buffers that weigh systemic risk appropriately and discourage procyclical lending behaviour;
- institutions – even systemically important ones – that can be resolved in an effective and timely way, and with minimum cost to the taxpayer;
- a financial system that is competitive and allows for ease of entry and exit; and
- a better understanding and oversight of risks in the non-bank financial sector and greater transparency about the risks that institutions are taking and the protections they are receiving as a result – extending the regulatory perimeter to include all systemically important institutions, markets and instruments.

When all of the above is taken into account, it is abundantly apparent that all stakeholders should recognise the shift from the exuberance that existed in the period of the run-up to the global financial crisis. South Africa is not disconnected nor decoupled from the rest of the world and shareholders, together with all other stakeholders, should factor in these observations when calculating their demands and expectations of the banking sector in the future.