



IFC

INTERNATIONAL FINANCE CORPORATION
WORLD BANK GROUP

Seven Habits of Highly Effective Bankers: Lessons Learned from IFC Bank Visits in 2008

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Introduction and Background

- During the Fourth Quarter of 2008, the IFC MENA team visited many of the banks within the Region to discuss the global financial crisis and their response to it
- In these visits, we met with senior bankers and regulators to assess how they had responded to the financial crisis, what lessons they had learned, and how IFC could possibly be of assistance
- The meetings were highly informative, and this presentation summarizes some of the lessons imparted to us by the leading bankers in MENA
- The findings fall into the following areas:
 - Funding
 - Leverage
 - Currency Mismatches
 - Corporate Governance
 - Credit Assessment
 - Operational Risk
 - Investments
- We would like to refer to these words of wisdom – from some of the leading financial figures in MENA – as the Seven Habits of Highly Effective Bankers

Habit #1: Avoid any Possibility of Getting Caught in a Funding Squeeze

- During the IFC bank visits, we noted that some Banks had high loan/deposit ratios and consequently relied on external funding and/or were competing to retain “hot money” deposits – sometimes paying as much as 40% for overnight funds!

So how to avoid a funding squeeze?

- Any bank whose long-term funding is coming due should initiate refinancing discussions well in advance of the due date – this is especially true in today’s difficult financial environment
- As more and more retail depositors shop around, banks can use focus groups, surveys, and promotions to design deposit products that will help them build up their core deposit base

Habit #2: Consider Other Measures besides CAR when Assessing Capital Adequacy

- During our client visits, we met with numerous banks to discuss their compliance with the Central Bank's regulatory capital requirements
- These requirements are normally based on the Basel II definition of CAR and in some cases escalating levels of paid-in capital
- In almost all cases, the Banks we visited fully complied with the CAR requirement – although in some cases, the Bank's leverage ratio (equity/assets) exceeded 20 to 1!
- In fact, the Basle Committee is considering introducing a maximum leverage ratio test, similar to the one now used in the U.S.

Next steps? While a leverage test may still be some ways off, banks should bear in mind that investors may become more cautious in assessing capital adequacy - a satisfactory level of CAR may not be enough!

Habit #3: Always Maintain a Careful Eye on Currency Mismatches

- In several cases, we noted that banks were experiencing currency mismatches (“macro” level) and/or were denominating loans in currencies that appeared inappropriate for borrowers (“micro” level)
- Rationale: During periods of currency stability, banks sometimes take on currency risk – on both sides of the balance sheet - when there is an interest rate advantage
- However, the Asian Financial Crisis of 1997, the devaluation of the Russian ruble in 1998, and the bad loans that have recently mounted in Eastern Europe are potent examples of how quickly markets can turn – and the same could happen in MENA

Habit #3: Always Maintain a Careful Eye on Currency Mismatches / continued

How to minimize this risk?

- Currencies can be highly volatile – so review the foreign currency denominated credits in your portfolio – does the borrower have a natural hedge? If not, explore the possibility of redenominating the loan in a currency that makes sense
- While you are doing this, look at your funding position and make sure that your new, *targeted* revenue stream can service any foreign currency funding that you now have on your books

Habit #4: Stay True to Sound Corporate Governance Principles

- A Corporate Governance culture is taking root within MENA
- But as banks become subject to more financial pressure, they could be tempted to cut corners in terms of transparency and disclosure

But that would be a mistake!

- In times such as these, investors, depositors, and other bankers are wary about the financial conditions of other banks
- A culture of openness provides reassurance
- Consider the fates of Citibank and Lehman, and contrast that to the recent steps of JP Morgan Chase to release its financial results as early as possible after the close of 2008

Habit #5: Critically Analyze Past Performance Data When Assessing Future Ability to Repay

- This has been a major problem in structured finance transactions, where ratings were based on performance data during a “growth” phase of the economic cycle

A better approach? Be conservative when applying historical data to predict the future. Even better yet, subject your credit analysis to a “stress test” to see under what conditions repayment could be a problem

Habit #6: Remain Highly Vigilant about Operational Risk during Periods of Change

- Periods of High Growth, Re-branding, and Retrenchment are all fertile breeding grounds for fraud and embezzlement within banks
- Why? Because the Bank's operations are changing - staff are either being increased, replaced, or let go, and senior management - in managing that change - may be more involved in broad issues and less involved in day-to-day operations
- The global move towards *defensive* banking is resulting in layoffs, weaker morale, and – very crucially - fewer people to mind the shop
- So banks could be vulnerable to greater operational risk at the very time when their capital levels are under significant pressure
- An adverse event could cause significant reputational damage, affecting the perception of the Bank by depositors, investors, and counterparties

Habit #6: Remain Highly Vigilant about Operational Risk during Periods of Change / continued

How to Develop this Habit? Maintain Internal Discipline!

- Discuss the possibility of heightened risk with the Internal Control team and develop a plan to manage it carefully
- Have a rigorous and swift check-out procedure for all departing employees
- Keep Internal Audit engaged – do not ignore units just because they have been downsized
- And bear in mind that recessions and downturns often bring out problems that auditors miss!

Habit # 7: Always know where your Money is being Invested!

- The Madoff incident involving an alleged Ponzi scheme has shocked and inflicted financial damage on bankers and investors around the world
- It serves as an awesome reminder that, just as they normally do in lending, bankers should carefully monitor the source and reliability of an investment's cash flow
- Moreover, within MENA, some of the banks we visited had invested heavily in high-grade corporate bonds issued by banks in OECD countries, only to incur unexpected losses on these assets
- And to make matters worse, *volatility* in financial markets is at an all-time high

Habit # 7: Always know where your Money is being Invested (Cont.)

So what can be done?

- Stay in regular contact with your fund managers
- Hold frequent ALCO meetings (including reps from Credit and Treasury)
- Read widely in the financial press
- Take an active role in repositioning your portfolio during turbulent times

The Eighth Habit

- GOOD HOUSEKEEPING BEGINS AT HOME,
AND FOR BANKERS THAT MEANS.....

Habit # 8: Make sure your Documentation is always in Good Order

- According to Bloomberg, 70% of all credit default swap documentation is missing or has never been formalized!

No need to get sensational – this final habit is a simple one that all of us know instinctively: good documentation is fundamental to sound portfolio management, which also involves regular review of credits and covenant monitoring

And in periods of financial stress, perhaps good housekeeping and sound portfolio management is the most important habit of all!