



# FOOD FOR THOUGHTS

by Andrew Capon

## Robert Jenkins

former FPC member,  
at the Reform Club

**R**obert Jenkins chose the venue and your columnist greedily accepted. Though not exactly on the bucket list, the thought of eating Reform Club chops in the place they were first served was enough of a draw. This meaty treat of lamb coated with breadcrumbs, parsley and chopped ham, was created by the club's first chef, Alexis Soyer, the Gordon Ramsey of his day, without the expletives.

The Reform Club was a fitting setting for another reason. Jenkins has spent a long career in financial services, notably at Citigroup and latterly as CEO and then chairman of London-listed asset manager F&C. But he is now a passionate advocate of the radical overhaul of the financial services industry. Jenkins admits that banks are probably feeling overwhelmed by the welter weight of regulation, but that is as far as his sympathy goes.

He believes there is still too much leverage, individuals as well as institutions should be held to account, supervisory authorities are subject to "regulatory capture", and that whinging about the higher cost of capital reveals that bankers do not understand their own business. In short, he argues that the entire financial system needs to be rebooted.

### Still crazy after all these years

If that has already caused a bout of dyspepsia, you should probably not read on. Jenkins believes the biggest piece of unfinished business is capital requirements and the Basel Committee has not gone nearly far enough. "Under the new improved Basel rules a bank can still leverage 33 times. At 33 times leverage with 3% equity plus 97% borrowing, a bank's balance sheet needs to lose only 3% to wipe out 100% of its equity. If it loses 1% it will be 50 times leveraged, a 2% loss would leave it 100 times leveraged and friendless in terms of raising new capital," says Jenkins.

He adds: "In the midst of the biggest credit bubble in history that does not inspire confidence. Bubbles are not new and regulators cannot do anything about greed or stupidity. But they can control the other characteristic of all bubbles, namely excessive leverage." Jenkins has what he calls a "modest proposal", that banks raise their tangible equity capital to 20% of assets. "Then they can pay themselves whatever they want. Shareholders would pick up the tab when something goes wrong and taxpayers and the system will not be at risk."

Jenkins is at pains to say he is not in favour of regulation for its own sake. He believes this back-to-basics approach would allow regulators to pare back the rulebook. He accepts his modest proposal is unlikely to be adopted. But he still believes the banking



**'Regulators cannot do anything about greed or stupidity... but they can control excessive leverage'**

lobby is guilty of bamboozling both regulators and the public by making a fallacious connection between higher capital requirements and a decline in the ability to lend to businesses. "It's quite simple. Let's take a bank that has a £1tr balance sheet supported by £50bn of equity. If the equity rises to £100bn and it retires £50bn of debt, has the balance sheet shrunk? Is there any impairment in the ability to lend? It's a myth."

Jenkins believes these myths are given credence because of a phenomenon he calls regulatory capture. Essentially it means that regulators are too cowed by, or complicit with, the industries they represent that they forget the public good that they are supposed to serve and end up in their pockets. The revolving door between regulators and bank compliance departments is the most obvious and commented on example.

However, Jenkins believes regulatory capture is more nuanced. "In the US it is based on the campaign contributions of the financial industry. It is simple: follow the money. In the UK there is intellectual or cognitive capture. That starts with access to policy-makers. The UK financial services industry is a significant contributor to the economy, so the argument goes it is only right and proper that senior bankers should have that access. The problem is that there is an asymmetry of information, the bankers have much more access than their critics," he says.

One example he points to is the obsession of regulators with so-called shadow banking, financial transactions such as direct lending gravitating beyond the banking system. As the former chairman of Investment Management Association, this might sound like special pleading, but it is impossible to fault his logic.

"If you have a pooled investment vehicle making loans in a part of the market such as loans, you have replaced 33 times leverage

with 100% equity-backed loss absorbing capital. The irony is that this substitution gets labelled with the pejorative term shadow banking as it were a bad thing. The reality is that this intermediation is improving financial stability. The difficulty for asset managers is they rarely employ battalions of lobbyists and they do not know the banking supervisors who are driving regulation."

### Naming and shaming

Jenkins is also prepared to name and shame individuals. He thinks HSBC group chairman Douglas Flint should already have stepped down. Flint, he points out, joined the board as finance director in 1995. In 2002, HSBC acquired Grupo Financiero Bital in Mexico on his watch and in 2003 it acquired sub-prime lender Household in the US. In 2012 HSBC settled with the US Department of Justice for \$1.2bn and admitted to processing drug trafficking proceeds through Mexico and transmitting funds from sanctioned countries including Iran.

"If you acquire a Mexican bank and discover there is money laundering and take action that is one thing. If you acquire a Mexican bank and are told by authorities money laundering has been going on for a decade since you acquired it, you really have to ask about competence. We talk about things like money laundering of drugs money and sanctions violations as if they are operational oversights. Lives are lost as a result of this malfeasance," he says.

"Either they knew, they didn't know, or they couldn't be expected to know. If they knew, they are complicit and they should leave office, or possibly go to prison. If they didn't know they are incompetent and they should go. And if they couldn't be expected to know, that tells us banks should be broken up because they are too big to manage. Take your choice."

There is no space to talk about food. It was better than the club average. Alexis Soyer can rest peacefully. But unless you are a member, or are invited, you cannot go to the Reform Club. Fortunately meeting Jenkins provided an excess of food for thought. My doctor would not approve of the chops but they, the company, and the wine, were all excellent. ■

**Reform Club:** 104 Pall Mall, London, SW1Y 5EW  
**Starters:** Octopus salad with aioli; pea and ham soup

**Mains:** Reform Club chops; lamb chops

**Drinks:** 1 X bottle still mineral water; 1 X half bottle of Chateau Lafon-Rochet, Saint Estephe 1998 (half bottle); 1 X Chateau Longoa-Barton, Saint Julien (2008)

**Total:** A gentleman does not ask and I would not have been permitted to pay

**Foodie rating:** AA