



BANK OF ENGLAND

News release

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Credit is Trust - Speech by Andrew Haldane

In a speech given today to the Association of Corporate Treasurers in Leeds, Andrew Haldane - Executive Director for Financial Stability - talks about the parallels between the current financial crisis and those of the past, and the enduring importance of trust between banks and their customers.

Looking at the development of Yorkshire's financial sector since the 18th century, he says success was built on awareness of, and responsiveness to, the needs of the customer; a focus on long-term relationship-building and recognition of the benefits of mutualising both risks and returns. "In short, the importance of banks being built, first and foremost, on trust."

Andrew Haldane suggests that the credit crunch can be re-told as a story of the breakdown in trust between banks and households, investors and companies, and across countries. He says: "Between different parties at different times, that loss of trust has been the root cause of the devastating impact felt globally since the credit crunch began. Through successive waves, the world financial system has found itself with almost every link in the credit chain - in the chain of trust - having been weakened or broken."

That leads to the question of how trust, and thereby credit, can be restored? So far the answer has been to rely on governments and central banks whose credit has not been seriously questioned. Andrew Haldane notes that confidence has begun to return to consumers and businesses. But he argues that trust and confidence are subtly different. Confidence derives from observable, authoritative proof. So as the banking system has stabilised, confidence has recovered. But trust is grounded in perceptions rather than evidence. He says: "A clean balance sheet might instil confidence, but it need not repair trust. repairing trust can be a slow and painstaking business".

A raft of reforms to the financial system is currently being considered, aimed at strengthening banks' financial resources, risk management practices and governance - the high road to reform. But regulation might not be the whole answer. Andrew Haldane argues that regulation might be Bank of England News Release 2 insufficient to restore public trust in the financial system if financial institutions themselves are not seen to engage in 'root and branch' reform to create ". a self-generated sea-change in the structure and strategy of banking".

In his speech Andrew Haldane offers three areas for further debate on the structure and strategy of banking - the low road to reform.

On banks' size in relation to the services they provide, he notes that the economics of banking do not suggest that ". bigger need be better" and instead that ".there might be diseconomies of scale. ". He says: "Perhaps there is a case for a strategic focus on the 'local' as much as the 'global', for more micro-finance and less macro-finance".

On banks' strategy, he notes: "Their desire to diversify, individual banks generated a lack of diversity, and thus resilience, for the financial system as a whole" and ".recent crisis experience highlights some of the costs of bundling services". He says unbundling banking services ".would reduce the risks of spill-over between privately and socially beneficial banking activities. And it would help prevent banks making individually rational but collectively calamitous strategic choices". The resulting financial landscape would display greater specialisation and diversity - ".more farmers' market than supermarket".

On banks' governance, he discusses the misalignment in incentives between banks' management, shareholders, debt holders and the public sector. Mutuality, while no panacea, may offer a better means of aligning these incentives. "So in the heartland of mutuality, I am happy to say that reports of the death of the building society sector are greatly exaggerated".

Concluding, Andrew Haldane says thrift, mutuality and relationship banking - three principles that have long underpinned banking in Yorkshire - could ".offer a tried and tested - indeed, trusted - roadmap for the period ahead."

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech400.pdf>