THE
TRANSPARENCY
TASK FORCE

# Ideas to Help Reduce the Chance of Another Global Financial Crisis

*A White Paper prepared for a special meeting on Financial Stability taking place at The House of Commons on Wednesday 7th February, 2018. Committee Room 3. 17:00 to 19:00*

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## Executive Summary

It is now some ten years since the Global Financial Crisis, and therefore a timely moment to reflect, refocus and reconsider what else can be done to prevent something similar happening again. Financial stability is a precious public good that warrants nurturing and protecting; and thinking about financial stability through the clear-eyed lens of transparency offers an opportunity to cut through to what really matters and allow the key public policy issues that arise to be dealt with responsibly and rationally. In this respect, we must counter the danger that the policy response to the last crisis will shape a future one, because in regulatory and monetary terms, we may be "fighting the last war."

The causes of the Global Financial Crisis are many and complex; but one thing is certain – everybody would like to avoid having another one. The Crisis caused tremendous harm at an individual, societal, economic and political level. It was so severe that it caused many to question whether it proved that capitalism was fundamentally flawed. Perhaps the simplest way to convey the terrible impact of the Global Financial Crisis is to reflect on the conclusions from research carried out by Oxford University in 2014 - that the crisis led to more than 10,000 extra suicides and likely a conservative number.[1] That is a shocking statistic. The research was carried out in 24 EU countries, the USA and Canada and it put the additional suicides down to the consequences of a far higher number of people losing their job, having a home repossessed or falling into serious debt.

Beyond the tragic human cost to 10,000 people, and of course their families and friends, there is the harsh reality that the Global Financial Crisis has brought financial hardship to *millions if not billions across the globe*. We, and our economy will continue to suffer the consequences of the Global Financial Crisis for many years to come. Austerity has been an enforced sacrifice to pay for these consequences but there remains the question of why exactly we have had to, and what can be done to avoid it happening again.

Furthermore, the inevitable reaction to measures put in place by governments has impacted the world's political landscape too. One wonders how much of today's "interesting" political landscape can be traced directly back to the Global Financial Crisis. Maybe it explains Brexit? Maybe it explains the shifts away from the moderate centre? Maybe it explains the ascendancy of anti-globalisation and national protectionism?

We cannot change what has happened but given the truly horrific impact of the Global Financial Crisis it is eminently sensible that we all do, all we possibly can to avoid something similar ever happening again; or if we cannot do that, to reduce the severity of the next one. Failing to make a serious and whole-hearted attempt to do so would be reckless in the extreme.

Any serious attempt to protect the system requires a good understanding of what causes markets to crash and a systematic approach to evaluating the merits of potential policies and practices that could provide the financial resilience, protection and stability we all want.

One of the problems to solve is that our financial ecosystem operates on a siloed basis with

[1] http://www.bbc.co.uk/news/health-27796628

constituents operating rationally from their perspective and within their mandates, but which when aggregated is sub-optimal or pro-cyclical. Few organisations have the wherewithal to consider the system at a systems level (even regulators are constrained) and therefore ownership of the problem is often lost. In short, our governance framework was not created for the interconnected world we now inhabit. This is understandable, and can only start to be improved upon by a more rigorous understanding of the component parts.

We believe this White Paper provides some essential insights into the factors that brought about the crash but far more importantly, it goes on to consider solution-orientated ideas that may help to prevent the next one from occurring; ideas including the need to:

- Harness the transformational power of transparency to see and mitigate risks
- Take a "whole system" approach to systems governance and stewardship, ensuring system ownership and responsibility are correctly allocated
- Understand the reality and consequences of the reverse intermediation nature of the banking system; reconsider the loan-creating process; create true diversity in the banking system
- Have the asset management sector adopt a more nuanced regulatory approach that better reflects the different investment horizons of savers; understand what forces are at play that are causing long term investors to behave like short-term investors; tackle the 'cult of liquidity' that exacerbates pressures
- Take a fresh look at people risk, culture risk and conduct risk; individually and collectively; properly incorporate the "human capital" element to market behaviour; defeat the damaging culture of short-termism
- Adopt specific counterweights to the extensive asymmetries of information that exist throughout the system
- Introduce specific indicators, metrics and guidelines to shine the light of transparency on the health of the system, including: transparency labels to manage product complexity; Shareholder Nominations to the AGM Committee (SNAC) to manage organisational complexity; Organisational Maturity Ratings that could help provide an alternative vision to traditional financial metrics; a Financial System Resilience Index to broaden understanding of the health status of the system
- Develop far more effective values-based rather than rules-based Codes of Conduct, that are rigorously enforced; consider the introduction of Fiduciary Oaths and Fiduciary Standards for the sector
- Ensure all the direct and indirect consequences of climate change are properly recognised as a major source of potential financial instability
- Forensically consider the destabilising risks posed by Brexit and the consequential potential withdrawal from and fragmenting of regulatory controls
- Successfully launch and secure sufficient backing for the Financial Stability All Party Parliamentary Group
- Initiate the launch of an extensive international network of similar Financial Stability forums, each funded at a national level, that will operate collaboratively and collegiately; sharing intelligence that will enable "diagnosis and prescription" to take place on a necessarily global basis; thereby helping to deliver financial stability as a public good to all the world and all its peoples

We do not believe that the above list is exhaustive in any way. The list has been compiled by our Financial Stability Team over several months and we are sure that there are more risks that need nailing down. Furthermore, beyond what can be readily identified there are always the “unknown unknowns” that could catch every observer by complete surprise. There is much to be done.

Wanting to achieve financial resilience is not a party-political issue: the quest for greater financial stability is an issue that appeals to people of all political persuasions. Indeed, it could be one of several unifying aspirations at this time, with a common bond of establishing what more can be done to enable the financial services sector as a whole to find and embrace a true sense of purpose which can act as a North Star in guiding the way it functions.

Given the cross-party interest in the topic there is huge value to be had in building a much-needed line of constructive communication between not just parliamentarians but also academics, practitioners, regulators, Civil Society Groups, relevant government departments, enlightened market participants and so on; and that an All Party Parliamentary Group on Financial Stability would be the ideal forum for the kind of analysis, debate and consensus-building that is needed. We believe that the principle of transparency is an a powerful and constructive one for this forum to adopt as part of its scope, as it implies recognising important issues, fostering widespread and deeper understanding of them and facing up to them across society.

The plan is that the Financial Stability All Party Parliamentary Group will be a safe and suitably informal environment, conducive to considering constructive and creative policy initiatives that may help to mitigate the risk of another Global Financial Crisis. The Financial Stability All Party Parliamentary Group has the potential to become an outstandingly useful forum for a wide range of stakeholders and we are hopeful that it will lead to candid yet collegiate conversations about the stewardship of our economy and the financial ecosystem as a whole.

## Introduction

This is not an academic paper, albeit it will draw from what we consider are some of the most relevant academic material. It is not purely a practitioner paper either, albeit it draws from the practitioner experience of many of its collaborators. We have therefore made use of the luxury to err on the side of over-simplifying matters. We believe we are in a better position to do this ten years after the crisis than in its immediate aftermath, and the urgency is just as great given that the longer we move away from its epicentre, the clearer it becomes that the lack of a coherent framework for understanding the ecosystem in which finance operates, does harm. Indeed, this vacuum has likely contributed to allowing a financial stability crisis to morph into something of a political stability crisis for many western democracies. Specifically, in a UK context, the prospect of Brexit brings even greater urgency to our need for transparency around the issues that concern financial stability.

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Outlining ideas to reduce the risk of another global financial crisis runs the risk of looking either like a fool's errand or else somewhat out of date. From one perspective, the integrated nature of globalisation in modern economies, suggests that the capacity to make significant strategic or operational design change is low; the size, complexity and significance of financial services organisations adds political risk to any meaningful interventions; and until we have a new set of facts that we can agree on that can help us better understand the nature of the ecosystem, actions are ripe for unintended consequences. From a different vantage point, much has been done since the crisis to address perceived failures, loopholes and weaknesses. Changes have been targeted at business models (e.g. Vickers report in the UK, Dodd-Frank legislation in the US); balance sheet structures (e.g. Basel directives on equity capitalisation and leverage ratios); level of taxpayer support (e.g. Financial Stability Board and Bank of England work on orderly resolutions incorporating bail-ins and 'living wills'); and conduct and culture (e.g. strengthening consumer protection within a new FCA framework).

These points of view should be looked at in tandem. Without a better and wider understanding of the structural make-up, processes and interconnectedness of the financial system, including connectivity with the macro-economy as a whole, it is difficult to have confidence that the actions undertaken over the last ten years go beyond a patchwork of solutions: a necessary first-response to the immediate matters at hand but without an organised and well-understood framework that can assess whether they have been sufficient, necessary or relevant. This paper seeks to begin laying out such a framework, from which we can assess which ideas might be most helpful in reducing the chance of the financial system being front and centre of another crisis.

The paper is divided into two parts. Part One outlines 'the system today', by considering financial stability matters against the core purposes of finance. Part Two takes the key learnings from Part One and outlines ideas for 'the system tomorrow', with specific recommendations that might improve upon the status quo.

# I. The System Today

1. Crises on the magnitude of the global financial crisis reflect an equivalent loss of confidence of similar magnitude. To try and avoid another one, we need to better understand the full sequence of actions that can trigger such a loss of confidence. This is not easy since all actions have causes. But trying to find any 'original sins' is useful, both as a way of building our confidence in trying to understand a complex system, and crucially as a more robust starting point from which to prioritise issues for reform.

2. John Kay[2] and David Pitt-Watson[3] among others have set out primers for assessing the health of the financial system as it exists today, which is to compare it to its core purposes in the real economy. There is broad agreement on the key areas that finance needs to involve itself with: Facilitating payments; Channeling savings into investment; Managing finances over lifetimes and between generations; and helping individuals and businesses to manage the risks associated with everyday life and economic activity.

3. Economists, thinkers and policy-makers should look at the most recent global financial crisis through the lens of these core functions, map the financial ecosystem that fulfils them, and ask whether we can attribute significant disconnects between purpose and practice. We should remain open-minded to the possibility that both purpose and practice may have changed at different times, which may start to reconcile our sense that there is something missing in our understanding of the relationships between macroeconomics and finance that need to be faced up to. In short, our understanding of the system today must incorporate accurate and up-to-date knowledge of the financial operations of the modern economy and the means by which they currently support the economy as a whole.

4. **Facilitating payments**. The amount of money that we hold in our bank account means very little without an efficient means to clear and settle payments for goods and services. This is a systemic risk in that an economy would move backwards if it could not deliver this function indefinitely; even if obstructed for a short period of time, it can create anxiety, as witnessed when the Bank of England's Real Time Gross Settlement (RTGS) architecture went down for a few hours in 2014. We do not believe, however, that there is a disconnect between current purpose and practice, and it had no bearing on the last crisis. Could market infrastructure failure have a bearing on a future one? A broader definition of facilitating payments incorporates the possibility of a permanent loss of the money in our bank account with which to make payments due to bank failures. The Northern Rock crisis revealed that a small deposit guarantee was not fit for purpose, and there are arguments for both no insurance at all (since insurance may lead to a lack of appropriate monitoring by both institution and individual) and a much higher level of insurance (which was the decision

[2] *Other People's Money: Master of the Universe or Servants of the People?* John Kay, 2015
[3] *The Purpose of Finance. Why Finance Matters: Building an industry that serves its customers and society*, David Pitt-Watson and Hari Mann, 2017

taken after the crisis)[4]. Further confidence for savers may be built via changing the bank business model entirely (e.g. 100% reserve ratios[5]) or by by-passing the banks (e.g. digital payment systems), and we will consider these in Part II: these would change practice. Technology may be a force for good or ill when it comes to payment issues; it is important here to distinguish solutions that work with the existing system and those that seek to change it. The specific issues around cybercrime are being addressed: it may be of course that in the end, threats are deemed so great that they reinforce recommendations for different payment mechanisms.[6]

5. **Channeling savings into investments.** Society has come to believe that there are two generic transmission mechanisms through which this purpose is fulfilled. One of them is in fact somewhat back-to-front, and this error is crucial for our understanding of financial stability matters. These mechanisms are examined in more detail below.

5a. ***The current view***. We are willing and able at times to hold off spending our current purchasing power for the prospect of spending it in the future. When savings are in ‘the banking system’, savers invest through the bank’s asset allocation process (because the bank itself lends money to businesses, house purchasers etc). When savings go through ‘the asset management system’, savers either chose to be their own asset manager or delegate this responsibility to commercial asset management firms. This same choice architecture for savings applies to individuals and corporates alike. The challenge is then to try and understand how the varied build-up of these underlying savings could contribute to the most recent global financial crisis.

One type of critique has focused on ‘global imbalances’, ‘savings gluts’ and ‘excess savings’. The argument, simply put, was that ahead of the crisis there was a structural build-up of savings, particularly in countries such as Germany and China which had current account surpluses and therefore plenty of savings. These savings were so significant in size that they were sent out to be invested outside of their home economies. Some of those savings, *whether through the banking or asset management system*, became concentrated and misallocated (e.g. to the US housing sector), and so an asset bubble developed, which *when amplified by borrowing*, burst and caused significant distress. Some of the most well-thought out versions of this argument outline many significant themes, including the linkage between the political dilemma of rising inequalities that drove the demand for necessarily credit-heavy housing.[7] Once the confident assumption of a virtuous circle of stable or rising house prices was threatened, a domino effect on all sorts of asset prices took place given that confidence is the basis for almost all valuations. A global financial crisis then became

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[4] Pre-crisis deposits were fully guaranteed up to £2000, and 90% of the next £33,000; post-crisis this was increased to £85,000. Socialisation of any losses, as is effected by a deposit insurance scheme, may be suitable where we cannot expect any particular individual to understand the risk factors associated with any particular bank, especially since the crisis revealed that even sophisticated investors struggled to understand these risks

[5] There are many descriptions of this: one recent well-cited paper is *The Chicago Plan Revisited*: Jaromir Benes and Michael Kumhof, 2012

[6] Banks are very alive to the threat to individual accounts being hacked and the resulting reputational damage, and e.g. multi-factor authentication is part of the solution here

[7] *Fault Lines: How Hidden Fractures Still Threaten the World Economy*, Raghuram Rajan, 2010

possible in this environment. For it to be likely, the banking and asset management systems must have been operating in a globally pro-cyclical and herd like fashion, without strong enough counter-cyclical forces to steady the system when the tide turned.

The banking and asset management systems both compete and partner with one other, and banks often own asset management arms as well. One of the crucial trends in the years running up to the crisis was for banks to create investment products which asset managers could manage on behalf of savers. A common preference for real estate exposure, leverage and complexity developed. To take an important example of the asset and liability side of this process:

- *Money market funds (asset management system).* Popular particularly in the US where savings are proportionately more concentrated in these ring-fenced funds than kept in banks, these asset management products enable savers to make short term loans to a variety of financial and non-financial companies. Ahead of the crisis, these had significant exposures to the real estate market because this was where higher yielding opportunities lay. But because money market funds offer immediate redemption similar to a bank's liability to customers' current accounts, the closure of some of these funds to withdrawals given the increasing inability to price some of the loans they held, was one of the defining 'penny drop' moments of the crisis.

- *Securitisation (banking system innovation).* The years before the crisis saw rapid growth in the innovation of products often linked to real estate exposure, which threw off investable securities as assets. These varied from the comparatively transparent (such as 'vanilla' mortgage-backed securities) to the highly opaque (such as 'CDO squareds'). A crisis is more likely when opacity and complexity end up in what are designed to be relatively simple, short-term savings vehicles such as money market funds. One variant in the UK that combined some of the higher savings features of money market funds, with the investment opportunities thrown up by securitisation, was the use of Structured Investment Vehicles (SIVs) or conduits. These off-balance sheet vehicles allowed banks to grow their lending business beyond conventional limits, by moving loans off their balance sheet into the asset management system. The benefit to banks was that instead of holding capital against asset impairments, banks provided contingent commitments to these vehicles at much lower initial cost to themselves.[8] Yet when the crisis hit, this particular firewall did not hold up and the significance of specific linkages between on-balance-sheet banking and off-balance-sheet asset management systems was revealed, with liabilities coming back onto bank balance sheets under stress.

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[8] The most 'infamous' of these off-balance sheet conduits were Granite and Grampian. Operated by Northern Rock and HBOS, these vehicles allowed the banks to covertly increase their leverage. Their revelation represented one of the most notable shocks to hit the UK banking sector during the crisis; the contingent liabilities had to return on balance sheet to become real liabilities, which crystallised the issue for the banks that they had not properly been structured in the first place

5b. ***An updated view***. The narrative outlined above contains the premise that prior accumulated savings are the *sine qua non* feature that drives the initial process. If the upwards process starts with savers turning accumulated cash into assets, the downwards process presumably ends with them increasingly keen to turn those assets back into cash, and something like this has been implicitly assumed: spooked by new information in 2007-8, investors went on strike in both the banking and asset management systems and brought the show to a crashing end. This also gives somewhat the flavour of the most popular 'secular stagnation' hypotheses since the crisis.[9] One of the challenges to this narrative is that we cannot hide away from the fact that the 2007-8 period did not see significant aggregate sales of assets or removal of deposits from the system, which suggests that savers might not have been responsible for the mood swings.

There is a process which can explain this. It is not described directly in any of the mainstream academic or popular narratives, and the mechanism was only first acknowledged openly by the Bank of England in 2014, albeit in a somewhat technical quarterly bulletin.[10] In the paper, the Bank of England exposes the myth of our traditional understanding of the savings-investment channel. Contrary to the idea that savings are the driver for funds available to banks to lend out, the Bank of England makes very clear that it is in fact the other way around: that loans drive saving, and that the act of making loans creates deposits. The explanation for why prior savings do not add to the deposit base within a domestic economy is straightforward: because an individual saving more comes at the expense of their spending more, which would have added to someone else's savings i.e. there has been no net excess saving beyond what is accumulated through economic growth. This allows us to understand that the high level of private debt borrowing that was built up in the years ahead of the crisis is actually *an intrinsic and independent function of a bank's license to issue loans, rather than a function of waiting for the savings base to get big enough*. As the Bank of England states: "Whenever a bank makes a loan, it simultaneously creates a matching deposit in the borrower's bank account, thereby creating new money."

We now have a more intuitive perspective in reconciling some of the facts of recent economic history with the nature of the most recent global financial crisis. Economic growth in the last forty years has not been significantly different (and certainly not significantly higher) than economic growth in the thirty years following the end of the second world war. Yet the growth of the UK's banking system has grown hugely in this period, well ahead of economic growth. Whilst part of this growth is related to the UK's status as a repository for

[9] There are variants and nuances of this hypothesis: the one most well-cited since the crisis is by Larry Summers (*Why Stagnation might prove to be the new normal*, December 15, 2013) which embeds a savings-investment disequilibrium as a critical part of the narrative for the initial crisis and subsequent slow recovery
[10] *Money Creation in the Modern Economy*, Bank of England, Quarterly Bulletin, Q1 2014. Much credit for applying intellectual pressure to the Bank to publish this paper must be given to the New Economics Foundation, and their 2011 book, *Where Does Money Come From? A guide to the UK monetary and banking system*, Ryan-Collins J, Greenham T, Werner R and Jackson A.

Further technical work on the implications of this continue to be worked on by the BoE, e.g. *Working Paper No. 529 Banks are not intermediaries of loanable funds — and why this matters*, Zoltan Jakab and Michael Kumhof, May 2015. More recently, the process of money creation has been openly acknowledged by the Central Bank of Norway *(What Should the Future Form of our Money Be?* 25 April 2017) and the Central Bank of Germany (*How Money is Created*, 25 April 2017)

excess savings arising from global imbalances, a large part is simply endogenous to the banking system itself. Political encouragement for wider housing ownership can be brought into effect straightforwardly through the banking system and its ability to create loans. The banking system then diversifies this exposure by repackaging these loans into a number of other structures that are then sold externally, thus also contaminating the asset management system when the tide turns. The high effective loan-to-value of bank balance sheets means that as with individuals, only a small percentage fall in prices might drive it into zero or negative equity.

This critique can help us with organising the system for tomorrow. Banks build balance sheets by creating savers, not relying on them; ahead of the crisis they could do this without effective guidance as to the limits that were appropriate; with the wrong incentive structures to cushion against the temptation to overreach; and with poor information for borrowers. Moreover, the size and concentration of financial institutions, which are somewhat natural consequences and rewards of the mechanism described, makes the system less resilient when the cycle turns. The term too-big-to-fail focuses on moral hazard issues and associated taxpayer bailouts; it might be better to describe the banks as too-big-to-succeed in societal terms, given the enormous difficulty in allocating such large pots of capital and the associated herd like and lowest common denominator instincts that can arise.[11]

6. **Managing finances over lifetimes and between generations.** The long-term investment market within the asset management system, unlike the banking system, is a real intermediation process and ought to be a central countervailing force. Pensions and insurers are very significant allocators of professionally managed assets[12], and their different horizons suggest that they ought to be able to discipline the shorter-term tendencies that may be found in the banking system and elsewhere in the asset management system. To put it another way, if 50% of assets are managed for the long-term and 50% of assets are managed for the short-term, you might expect that long-term investors would be willing to pick up under-priced assets systematically from short-term investors and thereby net off acute confidence pressure points in the overall system. Yet the evidence suggests that these pools of capital were not able to row against the global financial crisis, and managed money too similarly to short-term investors to act as the countercyclical safety net.[13] As we see below, this is due to market failures on both the investment side and the savers side.

7. Effective intermediation of long-term savings and long-term investments should lead to a longer-term focus for companies invested in, including financial organisations. The Kay review however made clear that the virtuous vision of long-term investors providing fresh equity and a strong, stable and scrutinised equity base for companies' long-term investment plans is out of date.[14] On the contrary, when the banking system is confidently providing

[11] *The End of Alchemy*, by Mervyn King contains a number of valuable insights gained both during and after the crisis

[12] World Economic Forum in 2011 calculated that out of $65 trillion in professionally managed assets worldwide, $27 trillion, or 40%, was controlled by longer term institutions

[13] *Procyclicality and structural trends in investment allocation by insurance companies and pension funds: A Discussion Paper by the Bank of England and the Procyclicality Working Group*, 2014

[14] *The Kay Review of UK Equity Markets and Long-Term Decision Making*, John Kay, 2012

fresh loans, companies will often borrow money to give equity back to shareholders in the form of dividends and buy-backs. When shareholders owned large percentages of companies, there was a stronger possibility of deeper reflection on the aggregate consequences of such actions on financial stability. With modern diversified asset management funds having 2,000 small percentage listed shareholdings, it is difficult for shareholders to hold the executive to a longer-term horizon. True fresh, patient capital is often seen more regularly now in venture capital and private markets, and large long-term pension funds and insurers have made increasingly larger allocations to these unlisted markets over the last fifteen years. Such allocations to true patient capital were not significant enough ahead of the crisis to counter headwinds, and they still remain a minority proportion of overall allocations. Through adopting and adapting to the risk and liquidity measures found in listed markets, which may or may not be appropriate to apply, they may then in practice not contribute as much to financial stability as is possible.

8. The secular decline of single-sponsor defined benefit pension funds may have been a longer term contributor to financial instability as a result of the weakening of the bonds between employees and employers that combined savings into long-term investment vehicles providing an income for life. In more recent years, it is unfortunate that the unknowable and large decline in bond yields over many years ahead of the crisis, exacerbated by central bank actions since then, and all framed within a mark-to-market psychology, has converted structurally stable and counter-cyclical investors into more volatile ones. The end result has been that the triangulated attempt to manage assets and liabilities in these pension fund structures, has become heavily constrained. This has reduced the appetite of such funds to bear investment risk contributing to a slower economic recovery, and accelerated the move away to savings and pension products that may not have the same psychological or investment horizons.

9. **Helping individuals and businesses to manage risks**. This core purpose incorporates all activity in which the finance industry earns some form of income, from lower-risk activity such as current banking services[15] to higher-risk activity such as managing investments. Whether the costs borne by individuals and businesses for receiving such financial services are fair is very much alive. In one highly cited paper from 2014[16], Thomas Philippon evidenced that the total cost of intermediation had stayed close to 2% from 1886 until today. This suggests that the size and concentration effects that we witness within the system, have not structurally benefited consumers, and therefore produced no particular mitigating benefit to the periodic crises that the financial industry has contributed to.

   Much attention around financial stability has focused on the use of derivatives and risk management more generally. Hedging, managing and insuring risks has a creditable history, from farmers looking to lock in the price of future production, to individuals looking to lock

[15] A previous TTF White Paper, *Free If In Credit: Mis(ing) Information*, May 2017, highlighted the issues around current accounts that particularly affect lower-income and borrower groups

[16] *Has the U.S. Finance Industry Become Less Efficient? On the Theory and Measurement of Financial Intermediation*, Thomas Philippon, 2014. This finding remains the case even when incorporating the potentially higher screening and monitoring costs for the same dollar of borrowing for newer and riskier businesses as well as lower income households, that started to access the market in the 1990's

in income for an uncertainly long retirement, to households wanting to insure against the small probability of a potentially catastrophic event. These easy-to-follow examples are generally understood transactions, for a quantity and price that is linked to realistic observations in the real world. When we look at the global financial crisis, this definition had become somewhat wildly extended to create more complex, specific and legally dense risk and return profiles. The pure leverage that we see in the banking system's ability to create loans had parallels with the virtual leverage created and managed within the asset management system; the most infamous form of this was the synthetic CDO of mezzanine ABS structure, creating a leveraged return profile on a fictional asset base that was itself highly leveraged. Such products create the potential for severe disconnects between the size of specific investments and their size in the real economy – this amplified the crisis rather than mute it, as real hedging instruments might do.

Financial products are generically more challenging for consumers since they are not tangible or visible like physical goods. When this opacity is labelled safe and subsequently exposed as harmful, a growing lack of confidence and trust between buyers and sellers of financial services can lead to financial instability. The opacity itself may be deliberate or purely based on misconceptions of a product and or service, either by the customer (buyer) and/or financial institution (seller). What is clear is that the outcome for consumers, institutions and even society itself can be affected by this lack of transparency: the interest rate swap products for SMEs and the complex multiplication of US sub-prime exposure are just two clear exemplars of this process. Much prize-winning work has been done on the problems related to such informational asymmetries in markets. However, one missing piece when considering this work in relation to the global financial crisis is the awkward truth that in many cases, even if the opacity was deliberately created, neither buyer nor seller understood some of the things being bought and sold. In a potentially very significant contribution to the literature, Richard Field has described this as the 'blind betting' problem.[17] On a descriptive basis, this helps create a more measured interpretation of the crisis. As the process of making products got more opaque, we reached a point where nobody, including e.g. the independent credit rating agencies that were meant to measure their risk, understood all the risks involved.[18] It is often easier for everyone to hide behind a quantitative computer model that says an investment is low risk and high return, and therefore a good investment. Common sense would dictate that a higher return points towards higher risk for financial loss, but this was not the spirit in the years running up to 2007-8.

A fuller informational asymmetry framework that incorporates whether the specific market is completely opaque (in which case we need to do a better job of labelling and valuing these products), or whether it is opaque only to the buyer or seller (in which case we need to better understand the culture of the ecosystem that allows one side to get away with this) would open up avenues for better understanding financial stability matters.

One-sided asymmetry tends to be flagged more often and is always problematic at the individual level but the potential scale of the problem at the societal level, can be evidenced

[17] Richard Field's work on this can be found on http://www.instituteforfinancialtransparency.com
[18] *Securitization and structured finance post credit crunch*, Markus Krebsz, 2011

when it is a sophisticated firm lacking the right information.[19] To use just one example, In the years running up to the crisis, insurers could generate large revenues by writing insurance premiums against complex expected loss profiles; this kind of activity in large size, reflected an upside-only fantasy version of economic reality, which is quite at odds with traditional insurance risk management. These were complex and relatively new markets, and therefore an instinctive sense of the risk to an insurance company was impossible for senior leaders to oversee effectively. Again, the reliance on quantitative techniques proved deadly, highlighting the necessity for appropriate human stewardship of the financial ecosystem, at the level of individuals, firms and policy-makers.

[19] The day after the Lehman bankruptcy in September 2008, it was announced that the US government was providing a $85 billion bailout to AIG, a traditional insurer that had got heavily involved in these new derivative markets. Separately, 5 of the 7 bond insurers collapsed during this period

## II. The System Tomorrow

10. A robust system of tomorrow can only be built when we have clarity of understanding of the facts of the system today. From Part I, we can deduce two critical thought-patterns:

    (A) There is a core purpose of finance in facilitating growth in an economy, and we have become reflexive in lumping all of this under the idea of channelling savings into investment. Yet whilst the asset management system can describe itself as such an intermediation process, the banking system may be better described as a reverse intermediation process. Understanding each of the two processes better and the interactions between the two systems is crucial to getting at the heart of financial stability issues.

    (B) Financial services are complex in themselves and their complexity is amplified by both the interconnectedness and latency of the ecosystem they form part of; some of this is by design, some of this by accident and some by both. We need to be more transparent about acknowledging this level of complexity – even if this leads to the realisation that, in some instances, we may not be able to sensibly handle all of it. Despite the increasing reliance on "artificial intelligence", robotics and automation within financial services, there is no substitute for human stewardship incorporating all of the concerns of customers, organisations and society.

**(A): Differentiated understanding and treatment of the systems**

11. *Banking System.* The UK banking sector remains one of the largest in the world relative to its host economy, and remains one of the most highly concentrated in the world with the sector dominated by four listed banks (RBS, Lloyds, HSBC, Barclays) and the UK subsidiary of Santander.[20] Given the scaled possibilities created by the loan-creating process, we believe these two facts are in fact closely linked. Therefore, **creating true diversity in the banking system** could change the nature of the growth trajectory in the banking sector which may then make the system more resilient.[21] Steps in the right direction would include ensuring the regulatory environment is conducive to different model structures such as co-operatives, as well as giving much deeper consideration to the possibility of new strategic publicly-owned lending institutions.[22] **Whether and how to change the loan-creating process itself** is an important debate that has been increasingly addressed by both academics, commentators and think tanks.[23] Much credit must go to the likes of New

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[20] The only mutual bank of any size is Nationwide. Other mutual banks and building societies are much less influential than in many comparable markets. So-called 'insurgent' banks such as Metro, Aldermore and others are also very small, typically pursue niche strategies, and have only had a marginal impact on sector diversity. In time, the development of peer-to-peer lending may help, but for now it too remains marginal

[21] *Stakeholder Banks: The benefits of banking diversity*, Greenham T and Prieg L, 2012, New Economics Foundation

[22] Both the Green Investment Bank and British Business Bank are tiny compared to the size of the private banking sector

[23] Mainstream versions can be found in the writings of Martin Wolf and Adair Turner, albeit there are important differences in nuance

Economics Foundation and Positive Money for raising broader awareness of these matters, yet it appears to remain somewhat too radical for official policy discussion. This needs to change, partly so as to deepen the debate on the advantages and disadvantages of the current structure based on a sounder understanding of the facts above. It is very understandable that some judgements were already made on alternative visions of a new banking system at the time of the Vickers Commission. 2011 was too soon after the crisis for a fully formed and coherent set of alternative strawmen, and for the Commission to be able to digest such proposals; 2018 is not. One of the implications of better understanding would be to focus the mind on whether **standard regulatory measures focus excessively on mitigating the effects of excessive credit, implicitly assuming that the build-up of credit is simply a function of savings, rather than the rules that govern credit creation**. The recently introduced UK mortgage affordability rules are an example of a step in the right direction, but need to be extended more widely.[24]

In any event, technology has raised the potential for **decentralised payment mechanisms**, whether organised privately or publicly.[25] One of the valuable aspects of bringing the public variant further into the debate is the much-needed requirement for governments to be more joined-up and mature in their assessment of the collective scope of fiscal and monetary policy, acknowledging that they both have asset and liability mixes that can help in growing, managing and redistributing economic growth.

12. *Asset Management System*. The central challenge is for the sector to be able **to adopt a more nuanced regulatory approach that better reflects the different investment horizons of savers**, both as a service to its customers (in terms of costs and returns) and as a service to society in being able to act as an important counter-cyclical force when tides turn. This is proving extremely challenging to get right, because much of the policy direction more generally has conflated issues that are pertinent to the banking system with issues relevant to the asset management system. Understanding that the asset management system operates a different intermediation mechanism to the banking system should mean tackling the **'cult of liquidity'**, **challenging the use of short term volatility measures for long-term risk**, and **distinguishing between 'bank runs' and 'fund redemptions'**. Common among these ideas is that the price at which an asset may be sold is not unique. Much depends on the time horizon over which the sale needs to be completed. More complete recognition of this time dependency in our reporting mechanisms as a supplement to "mark-to-market" valuations based on the latest standard lot size transactions would provide a more balanced view of fundamental value. This should open the space for a more thoughtful quid pro quo that allows for much longer investing horizons aligned with savers' needs, in return for transparency and lower costs.

[24] There is a very good discussion of the distinction between credit risk and credit affordability in a recent FCA Occasional Paper (OP28) and associated Consultation Paper (CP17/27) on FCA lending rules

[25] The 'bitcoin' group of currencies is an example of a privately organised, decentralised payment system . A working paper by the Bank of England on the possibility of central bank issued digital currencies was written in 2016 by John Barrdear and Michael Kumhof: *The macroeceonomics of central bank issued digital currencies*

13. *Interactions between the Bank and Asset Management systems*. From a financial stability perspective, the crisis revealed the parasitic element of the banking system's credit creation process into the asset management system. As we saw in Part I, the wall between these systems may be more leaky than realised. Since the crisis, the somewhat indirect pressures on banks' ability to grow their balance sheets, as well as the low-yielding environment for savers, has created space for the **shadow banking** industry to grow significantly. Whilst the definition of this is wide, we might describe it here as savings that flow into investment products of varying risks, potentially outside the scope of banking regulation. A future crisis might therefore start the other way around from what we saw in Part I, this time with the asset management system leading the way ahead of the banks; it would be a good idea to understand how and where this set of activities can be better controlled. The concerns are transparency of the activities in question, the potential for pro-cyclicality arising from liquidity imbalances, and the difficulty of designing and applying effective systemic controls or remedies. With this in mind, a **Financial Stability Council** merits consideration. The goal of this body would be to capture ideas, views and concerns from academics, observers, industry professionals and members of the public. The mechanism would need to allow for financial companies and industry bodies to make their own contributions, but not in a way that would allow them to swamp or 'capture' the process: making resources available to civil society representatives to participate in this process on a level playing field would go some way to reducing lobby imbalance. The body could periodically submit its ideas to the Bank of England (or other relevant public bodies), which would be required at a minimum to make some form of public response. The outputs of the process should be made public and could be scrutinised by Parliamentary Committees, the media, etc. The overall goals would be to make the monitoring of financial stability risks more diverse, more flexible, and more transparent.

**(B): Complexity, Governance and Sustainability**

14. *Specific and Network Complexity*. Specific complexity in financial services should not be a source of shame – it comes with the system. The most recent global financial crisis exposed what can happen however, when informational and human technology lose connection with common sense. At a high level, policymakers need to be able to assess holistically the connection between financial instruments and their economic purpose when designing regulation.[26]

    The most complex and opaque financial products often come associated with high degrees of leverage, optimisation, low-probability outcomes and large pools of data. Notwithstanding the necessity of educating the public at large around the broader transmission mechanisms in financial services, we should start to label these products better and make it easier for consumers and investors to handle complexity. One proposal that merits further review is a **Transparency Label Initiative**[27], which would aim to draw a bright line between transparent and opaque financial products. Once we know what is

[26] In one particular market this is being acted on: MIFID II sets position limits for commodity derivatives which have been brought into effect as of 3 January 2018

[27] This is Richard Field's idea and is outlined in more detail in his work, *Transparency Games*

opaque, we might start to build more confidence around the risks associated with that opacity. Distributed ledger technology could be harnessed to replicate a broker model at scale and so narrow the information gaps between buyers and sellers on transactions in an anonymised and compensated way; when aggregated and seen by a regulator this might give us more insights into the risk dangers embedded in current activity.[28]

A stronger focus on network complexity would acknowledge that the financial system's resilience may currently be less than the sum of its own parts.[29] The combination of more stringent testing of the UK banking system, combined with higher capital requirements, builds some confidence that banks can withstand certain aggressive scenarios as independent entities[30] and that more stable banks can contribute towards more economic growth[31]; yet as we have noted, this is narrow given the interconnectivity and latency both within the financial system as well as across other systems. In any event, there can be no grounds for complacency, given also that the debate around competitive deregulation may increase as Brexit approaches. There is a significant challenge just to stand still, let alone reduce stability risks.[32]

As part of showing network complexity in action, we should broaden the indicators that we use when considering the purpose of financial services in supporting the real economy. Giving more emphasis, for example, to **changes in private debt (including significantly housing-related debt) relative to existing economic activity** would help us more intuitively understand the role of the loan-creation process in daily lives[33]; a **Financial System Resilience Index** could assess the direction of the system's resilience through changes in underlying factors that influence it.[34]

15. *Governance*. Our ecosystems operate on a siloed basis with constituents operating rationally from their perspective and within their mandates. But too often the ecosystem has become corrupted or is behaving in a way which is sub-optimal or pro-cyclical at a systems level. Few organisations have the wherewithal to consider the system at a system level (even regulators are constrained and have their own objectives) and therefore ownership of the problem is often lost. Understandably our governance systems were not created for the interconnected world we now inhabit. **A parliamentary body with the right mandate would be able to consider the issue of system ownership and ensure ownership is allocated**.

Even if somehow we were able to move forward on everything above immediately – a more robust and common understanding of the pertinent issues, structural changes to the ecosystem, and better indicators and oversight of it, we would still be reliant on humans to

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[28] One variant of such a proposal has been put forward by Michael and Constance Erlanger, more detail can be found at www.marketcore.com

[29] Some of the broader thinking relating complexity theory to different public policy matters can be found in *Complex new world: Translating new economic thinking into public policy, IPPR*

[30] *Stress testing the UK banking system: 2017 results*; Bank of England, November 2017

[31] *Adding It All Up: The Macroeconomic Impact of Basel III and Outstanding Reform Issues, BIS Working Papers No. 591*, Ingo Fender and Ulf Lewrick, November 2016

[32] *The 2017 Banking Package: One Step Forward, Two Steps Back*, Finance Watch, June 2017

[33] This sort of analysis informs much of the work of Professor Steve Keen

[34] *Financial System Resilience Index*, Berry C, Ryan-Collins J and Greenham T, New Economics Foundation, 2015

execute it and not drift. There can be no guarantee against this, and therefore no guarantee of financial stability. We must acknowledge cultural failures that created, facilitated and could not monitor the excesses that developed ahead of the previous financial crisis.
Accountability must ultimately lie with Boards, and therefore proposals developed by ShareSoc, UKSA and RBS shareholder representatives to create voluntary **Shareholder Nomination to the AGM Committees (SNAC)**[35] should be taken seriously and could in time be rolled out to more of the 2,500 UK listed PLCs. Trialling this with a systemically important UK bank such as The Royal Bank of Scotland, RBS, that is majority-owned by government would seem sensible as a way to deal with the increasing perception of "ownerless corporations" and sheep mentality of important shareholder decisions and votes.

Boards must set the example for management and executives to follow. Individuals within the system should no longer be rewarded for behaviour that hurts others and damages society overall, and society should aspire to depending upon the honesty and ethics of the industry. **New Codes of Conduct** are required to change the standard of professionalism to values-based and not rules-based; and they need to be monitored and enforced. We should debate the introduction of **Fiduciary oaths and standards**[36] that move the default setting from arms-length to fiduciary. Such standards could help to change the professional self-identity of people working in the financial services industry, which itself has been a key contributor to financial instability through the culture that has flowed from that identification.[37]

At an organisational level, it is important that stakeholders within the ecosystem find a more nuanced metric with which to assess the health of individual firms. The Maturity Institute does this with its Total Stakeholder Value measure, starting with a conventional organisational measure of performance but then rewarding or penalising a company for its performance across seven qualitative measures, most of which have played a part in drawing out this paper: purpose, systems, risk, incentives and networks. We need to encourage organisations to have a more holistic dashboard and the Maturity Institute's related forward-looking **Organisational Maturity Rating** could help provide an alternative vision to the traditional equity or credit indicators currently used.

Although we note a much greater use of artificial intelligence, interconnectivity and robotics process automation (RPA) it is ultimately people that will prioritise workflows. **Conduct risk and organisational culture(s) are becoming increasingly enshrined into 'robots' behaviours and require new paradigms to ensure automated processes are governed robustly**.[38] The

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[35] Contributions to forming this proposal include Swedish Shareholders Association, Cevian Capital, Tomorrows Company, Gavin Palmer, ShareSoc, Chris Philp MP and UKSA

[36] The Committee for the Fiduciary Standard formed in May 2009 to advocate for the authentic fiduciary standard as established under the Investment Advisers Act of 1940. The Committee seeks to help inform and nurture a public discussion on this subject. See http://www.thefiduciarystandard.org/fiduciary-oath

[37] *Business culture and dishonesty in the banking industry*, 2014 http://www.nature.com/articles/nature13977

[38] *Global Conduct Risk Paradigm (GCRP - for banks/FIs)* and *Universal Conduct Risk Paradigm (UCRP - for non-banks, corps, governmentts, NGOs, any legal entity)* can be found at www.krebsz.net

next financial crisis may be due to machines going haywire or AI turning out to not being programmed so intelligently after all.

16. *Sustainability.* The actuarial and insurance professionals, and the Bank of England among many others, have recognised climate and other ecological risk as potentially major risks to financial stability. A stable financial sector and market infrastructure in steady-state could help mitigate globally growing systemic risks, increasing the chance for survival and with long-term sustainable benefits, but to do so, it will also need to comprehend the nature of those environmental risks better. To achieve systemic transparency, accountability and systems-level stability it will be necessary to ensure that **disaster, climate and planetary health risks are revealed in financial transactions and encoded in relevant banking, securities, insurance and accounting operations**. This can create the economic rules necessary to recognise the value of proportionate, fair and consistent investments and interventions within the public, private and mutual sectors at local, regional and global scales. This is a necessary precursor to help alignment with the overall outcomes enshrined in the UN Global Compact's 17 Sustainable Development Goals (SDGs).

## Conclusion and next steps

The ultimate purpose of the Transparency Task Force's Financial Stability Team is to influence policymakers to develop and promote policies that align with the achievement of greater financial resilience and thereby help mitigate the risk of future financial crises. This White Paper is a significant first step in galvanizing interest in and support for the All Party Parliamentary Group on Financial Stability which has excellent potential to be a "force for good" for the benefit of all.

Market crashes are man-made disasters; there is nothing natural about them and they do not need to happen. They are not typhoons, tornadoes or tsunamis; they are the manifestation of opacity and policy failures; they are the consequence of errors of judgement and mistakes. However, given the extreme complexity and inter-connectivity of the world's financial ecosystem which is riddled with uncertainties and risks of all kinds, many of which are literally invisible, there is no surprise that mistakes were made by many policymakers, right around the world.

Nevertheless, the work of the Transparency Task Force is about finding solutions, not apportioning blame and it has been with a sense of noble intent and civic duty that our Financial Stability Team has embarked on this volunteer-driven initiative to try to make a difference, to the best of our ability, despite having no resource or support of any kind.

We believe our White Paper completely disproves any notion that "everything that should be done to mitigate the risk of another Global Financial Crisis has been done," and we therefore believe the Paper has merit in its own right as a thought-provoking discussion document.

However, the real test of the efficacy of this Paper is whether it achieves its underlying objective – to attract the interest of Parliamentarians who inhabit one of the oldest and most responsible democracies in the world, in the hope that it inspires them to become founding members and leaders of the new Financial Stability All Party Parliamentary Group; thereby enabling them, in turn to carry out their noble and civic duty to the best of their ability.

*What would be the Financial Stability APPG's raison d'être?*

The problem of Financial Stability can't have a 'once and done' solution. Continuous analysis, monitoring and adaptation is required. Furthermore, no single individual or organisation has a monopoly on ideas and building consensus is absolutely vital if real and sustainable solutions are to be found.

The APPG will form a highly valuable "whole system" view, supported by the insights and experiences of all that wish to feed in their ideas and perspectives; we envisage that it will become a shining example of what can happen when stakeholders with a variety of outlooks work together to achieve a common and noble goal. The Financial Stability APPG will be free to consider all perspectives and evaluate a plethora of ideas, acting as a repository for all relevant thought leadership. It will be a fantastic conduit for all Civil Society Groups, thought

leaders, academics, researchers, economists and so on (whether part of the Transparency Task Force or not) to get their voice properly heard.

*How might the Financial Stability APPG operate?*

We envisage that it would have quarterly meetings; starting with lunch at 12:00, ending at 17:00. The meetings would be publicised well in advance to all interested stakeholders through a "call for papers" on specified topics.

Each meeting would deal with one or more questions, for example:

- What can we do about the way the banking system operates to reduce the chance of another Global Financial Crisis?
- What can we do about improving corporate culture to reduce the chance of another Global Financial Crisis?
- What can we do about information gaps to reduce the chance of another Global Financial Crisis?

The more resource and support the Financial Stability APPG has, the more swiftly it can work through the very long list of risks that need to be assessed and mitigated.

Of course, we would hope and expect that suitable representatives of the Bank of England, The Financial Reporting Council, the Financial Conduct Authority, The Pensions Regulator, The Government Actuarial Department, The Department for Work and Pensions, The Department for Business, Enterprise and Industrial Strategy and so on would be regular participants.

Furthermore, senior representatives from relevant organisations that have engaged in the "call for papers" process for each meeting would be very welcome to participate.

The new APPG is intended to be a safe and suitably informal environment, conducive to considering constructive and creative policy initiatives that may help to mitigate the risk of another Global Financial Crisis. It has the potential to become an outstandingly useful forum for a wide range of stakeholders and we are hopeful that it will lead to candid yet collegiate conversations about the stewardship of our economy and the workings of the financial ecosystem as a whole.

We anticipate that the new APPG will be able to work with, be supported by, support and feed ideas and policy recommendations into: The Bank of England, The Financial Reporting Council, The Financial Conduct Authority, The Pensions Regulator, HM Treasury, The Department for Business, Energy and Industrial Strategy any other relevant bodies including other APPGs, for example the APPG on Better Business Banking that has recently led a very successful debate in the House on the misbehaviour by RBS' Global Restructuring Group.

The Financial Stability APPG will seek to both scrutinise and serve; thereby enabling it to have a synergistic relationship with all stakeholders – it will be the enemy of nobody and a friend to all.

*What are the initial questions to be answered regarding the new APPG?*

The most obvious questions that come to mind are:

- Which parliamentarians are to be included?
- Which government-related agencies are to be included?
- Which non-Governmental organisations are to be included?
- What can we do to secure resource and support?

In relation to securing resource and support, one possibility of course is that perhaps the Bank of England, the Financial Conduct Authority, the Financial Reporting Council, The Department for Business Energy and Industrial Strategy, The Prudential Regulatory Authority, The Pensions Regulator and HM Treasury can share the load between them, on the basis that the work of the Financial Stability APPG is so well aligned with their statutory remits.

*What are the immediate next steps?*

The very next step will be a special meeting taking place at The House of Commons on Wednesday 7th February in Committee Room 3 from 17:00 to 19:00. Places are limited and must be booked in advance via andy.agathangelou@transparencytaskforce.org

The subsequent step will be a preliminary meeting of the Financial Stability APPG itself, details to be provided. Expressions of interest are invited from all interested parties – please contact through andy.agathangelou@transparencytaskforce.org.

Finally, and very importantly, whilst successfully launching and securing sufficient backing for the Financial Stability All Party Parliamentary Group will in itself be a tremendous achievement by our no-resource network of volunteers, we must face the harsh reality that attempting to fix a global problem with a constrained, national solution is fundamentally flawed.

We must therefore go on to launch an extensive international network of similar Financial Stability forums, each funded at a national level, that will operate collaboratively and collegiately; sharing insight and intelligence and thereby helping to deliver financial stability as a public good to all the world and all its peoples.

## Appendix 1: About The Transparency Task Force's Financial Stability Team

Our Financial Stability Team was launched at a Transparency Symposium held on 13th September 2017 entitled "It must never happen again!"

The event was all about the Global Financial Crisis and the date on which it was held was significant; it marked the 10 Year anniversary of the collapse of Northern Rock.

The speakers shared their thoughts on the causes of the Global Financial Crisis and what might be done, that hasn't yet been, to prevent a similar disaster occurring again. Many excellent presentations were given, outlining a range of ideas worthy of further consideration.

We invited speakers and participants to volunteer to become members of a new volunteer team, the Financial Stability Team, with the intention that it would capture the valuable thought leadership shared during the speeches and discussion that day. The Team would develop its collective thinking such that it could produce a White Paper entitled "*Ideas to Reduce the Chance of Another Global Financial Crisis*;" to be presented to a range of stakeholders including parliamentarians, The Bank of England, the Financial Conduct Authority, the Financial Conduct Authority, The Department for Business, Energy and Industrial Strategy and so on; at the House of Commons on 7th February 2018.

Leandros Kalisperas, now Global Head of Pensions at Aberdeen Standard Investments, was invited to Lead the Team and he accepted. The team started with seven members but through word of mouth it has grown.

All the team's members joined the collective effort to work on an entirely voluntary basis, freely sharing their ideas and insights such that we could capture and articulate ideas that will hopefully help to avoid another Global Financial Crisis. The team has operated with a strong sense of purpose since day 1 and it has become an excellent example of what can be achieved when a group of concerned citizens freely volunteer their time, effort, experience and insight for the common good.

The Financial Stability Team has been having monthly conference calls since it was launched. Initially, participants were invited to provide a set of bullet points to give an overview of their thoughts on what should be included in the White Paper. Individuals that covered similar ground were then encouraged to buddy-up such that they could provide a consensus-based set of thoughts. These were then combined through extensive input provided by Leandros Kalisperas, the Team's Leader who also held meetings and calls with many of its members.

Please note that it is highly unlikely that every member of the Financial Stability Team agrees with every element of the White Paper; building consensus and forming an overall collective view has been a very important part of the process. Over a period of several months and after continued enhancements we finally arrived at the White Paper that you are now reading. A substantial amount of work has been done.

Members of the Transparency Task Force's Financial Stability Team as at 31st January 2018:

| First Name | Last Name | Job Title | Organisation | Country |
|---|---|---|---|---|
| Andrew | Mills | Owner | Insight Financial Research | UK |
| Andrew | Clare | Professor of Asset Management | Cass Business School | UK |
| Andy | Agathangelou | Founding Chair | Transparency Task Force | UK |
| Anthony | Walters | Head of Public Affairs | ACCA Global | UK |
| Ashok | Gupta | Deputy Chair, Bank of England Working Party on Procyclicality; Chair PLSA DB Taskforce | | UK |
| Benoit | Lallemand | Secretary General | Finance Watch | Belgium |
| Connie | Erlanger | Founder and Managing Principal | Marketcore | USA |
| David | Rowe | President | David M. Rowe Risk Advisory | USA |
| David | Pitt-Watson | Independent Consultant | | UK |
| David | Clarke | Head of Policy and Advocacy | Positive Money | UK |
| Frank | van Lerven | Economist | New Economics Foundation | UK |
| Gavin | Palmer | Founder | SNAC Shareholder Nomination to the AGM Action Group and ShareSoc Association | UK & Holland |
| Geoff | Tily | Chief Eonomist | The TUC | UK |
| Greg | Ford | Senior Adviser | Finance Watch | UK |
| Heather | Buchanan | Director of Policy & Strategy | APPG on Fair Business Banking | UK |
| Henry | Leveson-Gower | Founder | PEP | UK |
| John | Christensen | Director | Tax Justice Network | UK |
| John | Hipperson | Managing Director | A&D Hipperson Ltd | UK |
| Jonah | Mendelsohn | Law Student | Queen Mary, University of London | UK |

| Julia | Graham | Deputy CEO and Technical Director | Airmic | UK |
|---|---|---|---|---|
| Leandros | Kalisperas | Global Head of Pensions | Aberdeen Standard | UK |
| Margaret | Snowdon | Chairman | Pensions Administration Standards Association | UK |
| Maria | Power | Partner | Power & Baker Consultants | UK |
| Mark | Falcon | Director | Zephyre | UK |
| Markus | Krebsz | Member / Chief Risk Officer | United Nations Economic Commission for Europe, Group of Experts on Risk Management in Regulatory Systems | UK |
| Martin | White | Board Member | UK Shareholders Association | UK |
| Michael | Erlanger | Founder and Managing Principal | Marketcore | USA |
| Nick | Silver | Director | Callund Consulting Limited | UK |
| Paul | Fox | Research and Advocacy Officer | Finance Watch | Belgium |
| Philip | Meadowcroft | Independent shareholder/consumer activist | | UK |
| Polly | Turner-Ward | Law Student | Quueen Mary University, London | UK |
| Rebecca | Wood | Senior Research and Advocacy Officer | Finance Watch | Belgium |
| Richard | Field | Director | Institute for Financial Transparency | USA |
| Roger | Miles | Principal, Conduct Academy | UK Finance | UK |
| Scott | Williams | Global Delivery Director | Resilience Brokers | Switzerland |
| Shonan | Kothari | Communications and Outreach | Finance Watch | Belgium |
| Steve | Conley | Chief Executive | Values Based Adviser | UK |

| Steve | Hubbard | Retired | Public Sector Education Management | UK |
|---|---|---|---|---|
| Steve | Keen | Professor | School of Social and Behavioural Sciences, Kingston University | UK |
| Stuart | Woollard | Managing Partner | OMS LLP | UK |
| Tony | Greenham | Director of Economics | RSA (Royal Society of Arts, Manufactures and Commerce) | UK |
| Wojtek | Kalinowski | Co-Directeur | Institut Veblen | France |

## Appendix 2: About The Transparency Task Force

**What are the core beliefs that the TTF is built on?**

#1: The Financial Services industry as a whole is profoundly important to the well-being of society

#2: The Financial Services industry as a whole has a moral, ethical and professional duty to behave transparently

#3: The Financial Services industry as a whole should apply the 'North Star' question to act as its guide: "What's best for the consumer?"

#4: There is a strong correlation between transparency, truthfulness and trustworthiness; and the industry desperately needs to regain trust

#5: People that are aware of opacity that is having an adverse effect on the consumer should act on that knowledge - they should "stand up rather than stand by" and not just leave the problem with the Regulators to sort out – far better to fix the problems from within

#6: Margaret Mead was absolutely right when she famously said: *"Never doubt that a small group of thoughtful committed citizens can change the world; indeed, it's the only thing that ever has."*

**How is the Transparency Task Force involved with the United Nations Global Compact?**

The United Nations Global Compact is an important United Nations initiative designed to drive positive change, globally. The TTF became co-signatories to the United Nations Global Compact at our very first Transparency Symposium, held in London on 7th October 2015.

At that Symposium a Letter of Commitment to His Excellency Ban Ki-Moon, Secretary-General of the United Nations was publicly signed in the presence of Steve Kenzie, Executive Director, United Nations Global Compact Network, UK.

In that letter we pledged to campaign for greater transparency in financial services around the world; this aligns closely with the United Nations' desire for greater transparency and accountability in banking and financial services worldwide.

The TTF are proud to be co-signatories to the United Nations Global Compact; we take our pledge very seriously - it has been a guiding light in all our activities

**What is the mission of the Transparency Task Force?**

The mission of the Transparency Task Force is "to help fix financial services by harnessing the transformational power of transparency."

Our work helps to drive out poor market behaviour, helps the Financial Services Sector to repair its damaged reputation and helps to achieve better outcomes for the consumer.

**How did the Transparency Task Force start?**

The first Transparency Task Force meeting was held on 6th May 2015 at Senate House, London University. The meeting was about the fact that the financial services industry needs to be trusted; but isn't; and that by driving up the levels of transparency in the sector confidence and trust could begin to be restored.

The message delivered was that those of us who truly care about the importance of the Financial Services sector and the people it serves can, and should, work together to help put things right.

We referred to the famous Margaret Mead quote: "Never doubt that a small group of thoughtful, committed citizens can change the world; indeed, it's the only thing that ever has" and our call for right-minded financial services professionals to '"stand up, not stand by" landed well – people immediately volunteered to get involved.

Since then, through word of mouth, through our Transparency Symposia, through our coverage in the press including the Financial Times and Radio 4, through publication of the Transparency Times and through many speaking slots in the UK and overseas, many more people have heard about our aims and objectives and stepped forward as volunteers.

The conclusions that came out of the 6th May 2015 meeting were:

- There is far too much opacity in Financial Services
- Opacity is one of the reasons why the Sector is not trusted
- Distrust of the Financial Services sector is a huge problem for it and society
- We cannot make people trust us; we need to behave in a consistently trustworthy way to rebuild trust
- People should be told about costs, risks, performance and so on
- Transparency alone is not sufficient – it can create a 'snow-storm' of data
- Information must be shown in a clear, intelligible and user-friendly way
- Standardisation makes sense because it's efficient and aids comparability
- There is merit in people who care about the Sector and the people it serves collaborating to drive the change needed by harnessing the transformational power of transparency

The response to what the Transparency Task Force is all about has been profoundly positive, with many people aligning very naturally with our 'North Star' question: "What's best for the consumer?"

**What is the Transparency Task Force today?**

From our very humble beginnings and despite a terrible lack of resource the Transparency Task Force has made tremendous progress:

- The TTF is now established as the collaborative, campaigning community, dedicated to driving up the levels of transparency in financial services, right around the world

- We believe that higher levels of transparency are a pre-requisite for fairer, safer, more stable and more efficient markets that will deliver better value for money and better outcomes
- Furthermore, because of the correlation between transparency, truthfulness and trustworthiness, we expect our work will help to repair the self-inflicted reputational damage the sector has been suffering for decades
- The Transparency Task Force brings together academics, thought leaders, market participants, professional associations, trade bodies, policymakers, regulators and politicians to harness the transformational power of transparency in Financial Services through collaboration, consensus-building and campaign
- The Transparency Task Force seeks to operate in a collaborative, collegiate and consensus-building way; focusing on solutions not blame
- We are an informal but increasingly influential forum of ethically-minded people that care about the industry and the people it serves
- The Transparency Task Force aims to become internationally recognised as the pre-eminent driver of transparency in Financial Services
- We believe that healthy, efficient and competitive Financial Services markets are profoundly important to the wellbeing of society, the global economy and political stability; but there's much that needs fixing

Our mission: "To help Fix Financial Services by harnessing the transformational power of transparency"

**What is it that the Transparency Task Force is helping to fix?**

- A culture of profit before principle
- Conflicts of interest
- Asymmetries of information
- Miss-selling
- Malpractice
- Rent extraction

- Hidden costs
- Hidden risks
- Opportunistic opacity
- Opportunistic obfuscation
- Opportunistic complexity
- Regulatory Capture around the world
- Scams and scandals
- Reputational damage
- Harmful incentive structures
- Short-termism
- Inadequate client-centricity
- The Engagement Deficit
- The Understanding Deficit
- The Trust Deficit
- Financial instability; and so on

**What is the Transparency Task Force approach to helping to fix the problems?**

In essence, our approach is all about shining a light into the darkness to raise awareness of the problems; we think of that as 'Parading the Problem.'

Our experience to date has shown that if we 'Parade the Problem' effectively the attention we bring to the problem will create momentum to help solve it from the market, regulators, politicians, the press and so on.

Fortunately, the problems we seek to solve tend to be self-evident and difficult to argue against. For example, it is obvious that there shouldn't be unmanaged conflicts of interest; or costs being hidden from investors; or incentive arrangements that encourage malpractice; or opacity that makes decision-making difficult etc.

There is nothing new in our approach, it can be traced back to 1914, when Louis D. Brandeis stated: "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman"

With all that that in mind, our approach to helping to fix the problems is entirely pragmatic:

- Step 1: We identify a financial services problem that needs solving and is solvable
- Step 2: We recruit volunteers with deep subject-matter expertise who are keen to work collaboratively with others to help solve the problem

- Step 3: We organise and mobilise the volunteers into a solution-orientated team; agree Team Leaders
- Step 4: We facilitate the development of the Team's objectives and a pragmatic campaign strategy to achieve those objectives
- Step 5: We liaise with relevant members of the press, regulators, parliamentarians, government officials, leading academics, thought leaders and so on to create supportive engagement
- Step 6: We implement the campaign strategy, which is normally a combination of activities such as research, producing White Papers, running Thought Leadership events, responding to consultations, holding meetings with key decision-makers and influencers, raising awareness through the press and so on
- Step 7: We continue to facilitate the ongoing development of the Team's work through regular meetings and conference calls

**What are the Transparency Task Force Teams?**

Volunteers have been organised and mobilized into Teams; with each Team being made up people with relevant subject-matter expertise who feel strongly about particular issues.

We started off with a handful of teams but we now have 12, with several others "on the drawing board." We now have well over 300 volunteers in 18 countries.

Here's a list of our Teams:

- The Foreign Exchange Team
- The Banking Team
- The Market Integrity Team
- The Costs & Charges Team
- The Financial Stability Team
- The Scams & Scandals Team
- Team PISCES (Purpose, Impact Investing, Sustainability, Corporate Social Responsibility, Environment Social & Governance, Socially Responsible Investing)
- Team PAM (Progressive Asset Managers)
- Team APAC (Asia Pacific)
- Team Americas (North and South America
- Team EMEA (Europe, Middle East and Africa)
- Team GTI (Global Transparency Index)

**What is the Transparency Task Force Strategy for Driving Change?**

Our Strategy for Driving Change is all about bringing together two groups of people:

#1, those with a sense of passion & purpose about what needs to be changed;

#2, those with the power & position to make change happen

We do this in many ways, for example through our Transparency Symposia; and through Special Events.

Here's two good examples of our Special Events:

#1:

12th September 2016, House of Commons, Co-Chaired with Tom Tugendhat MBE MP

"The First Transparency Strategy Summit in the World." The event focused on a very important issue:

*The primary purpose of the first Transparency Strategy Summit in the world is to begin to build consensus on the best way to protect the interests of the UK's pensions-saving public through full disclosure on all the costs and charges they are paying but not being told about'.*

There was excellent representation of and participation by numerous Regulators, Government Departments, Trade Bodies, Professional Associations and so on:

#2:

26th June 2017, House of Commons, Co-Chaired with Lord Cromwell

The event took place to Launch the Transparency Task Force's Banking Team's White Paper on Current Accounts, which contained "*Sensible recommendations about the lack of transparency around charges for Free-If-In-Credit personal current accounts."*

Again, there was excellent representation of and participation by numerous Regulators, Government Departments, Trade Bodies, Professional Associations and so on:

**What is the Transparency Task Force, by numbers?**

- The Transparency Times goes to 12,000 people, monthly
- We have run 15 Transparency Symposia; 13 UK, 1 in Boston, 1 in The Hague
- We have awarded 14 Transparency Trophies
- We have over 300 volunteers; organised and mobilised into 12 Teams
- We have responded to 7 formal Government/Industry Consultations
- Have had dozens of meetings & calls with Regulators & Government Officials
- We have produced 3 Thought Leadership White Papers
- We have gathered over 100 Transparency Statements
- We have had 100's of articles/comments published; on Radio 4 three times
- We have spoken at dozens of conferences and events
- We have recruited 26 Ambassadors
- We have a growing presence in 18 countries

**How can I get involved?**

There are two main ways.

Firstly, you can get involved with one of our existing teams (or even help us create a new team if there is an important problem that we are not yet addressing).

Secondly, you can become a **"**Supporter of the Transparency Task Force" which is about providing financial and/or operational help - we're desperate for both.

For further information on either of these options; or if you have any feedback on our White Paper please connect using andy.agathangelou@transparencytaskforce.org

www.transparencytaskforce.org

Thank you.