Frankfurt EBC

Global Capital – Threat or Salvation?

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* Transcription from tape by the organizer of the Frankfurt European Banking Congress

Welcome Address

Petra Roth

Dear Dr. Walter,
Ladies and Gentlemen,

As the Mayor of Frankfurt, I would like to wish you all a very warm welcome to Frankfurt and to the Roemer, our city hall for 600 years now and still one of the city's most important landmarks.

Moreover, I'm delighted to welcome you in my favourite and perhaps the best-known room of the Roemer, this beautiful and impressive "Kaisersaal", or "Emperor's Hall", soaked with European history and tradition. Nowadays Frankfurt hosts one of Europe's most prestigious banking congresses.

I'm proud that this fruitful dialogue among policy makers, businessmen and bankers is so closely linked to Frankfurt, a truly mature location, which has always been an important merchant city and a meeting place for business, new ideas and inter-cultural exchange.

Frankfurt has a long-lasting tradition of being deeply involved in European and worldwide systems and networks, which has encouraged us to be cosmopolitan, progressive and entrepreneurial.

I feel confident that this deep-rooted tradition and open atmosphere will make also this year's Frankfurt European Banking Congress a success.

The theme of this year's congress "Global capital – threat or salvation" is broad, ambivalent and challenging. In my perspective, it's all about finding the right balance.

Finance is the brain of the market economy.

We should hope that the brain is able to learn from mistakes and to level off at a reasonable average behaviour.

At the moment, we are suffering the first crisis of our new world of securitised financial markets.

In view of the latest financial stress, one can respond to global capital with fear, but

I’m deeply positive about sustained openness, far-ranging transparency and monetary stability still as the basis of global wealth creation.

Tomorrow, I know, you'll have a highly interesting agenda and the opportunity to adress those challenges.

In closing, dear Ladies and Gentlemen,
I wish all of us a marvellous evening and a tasty dinner.

Introduction

Herbert Walter

Thank you, Mayor Roth, for your warm welcome. Your kind words of introduction showed us again that you are a real protagonist of Frankfurt as a financial centre. It's great to have your strong support.

Ladies and Gentlemen, Good evening! It is a great pleasure to welcome you to our traditional speakers dinner. It's fantastic to be in this wonderful setting here in the "Kaisersaal". We are surrounded by over a thousand years of European history. 52 kings and emperors. An impressive historical foundation for Frankfurt and its financial centre.

Tomorrow, we have our 17th European Banking Congress and it's made rather distinctive this year by the turbulent events of the last few months. Even in the midst of this heavy storm there has been one element of strength and stability: I'm talking about our currency, the euro.

It is strong and rising. On top of this, we no longer have the exchange rate strains between European countries. This really is a huge benefit, especially in times of market stress.

I think it is justified to say that the euro has been a great success. But there are new challenges ahead of us: One currency, one interest rate, 13 countries. Does "one-size" really fit all? Have the economies of member countries really adjusted to the rules of a single currency?

And, in the long run, will there be enough convergence?

One of the main players who shaped the euro and Monetary Union is with us tonight. He is the ideal man to answer these questions! He has been driving policy for over 20 years both at the Bundesbank and more recently at the European Central Bank. Today, he is the President of the Center for Financial Studies here at the Frankfurt University. Professor Otmar Issing: you are just the man to speak to us on "European Monetary Union at the crossroads". It's a great pleasure to have you with us.

Ladies and Gentlemen, I hope that you enjoy this evening and that it gives you the chance to start the dialogue. There will be plenty of opportunity to continue at the congress tomorrow.

But for tonight, after the main course, we very much look forward to hearing Professor Issing.

Thank you and Guten Appetit!

Global Capital – Threat or Salvation?

Welcome Address

Petra Roth

Dr. Walter,
Distinguished Guests,
Ladies and Gentlemen,

It's a great pleasure to welcome you at the Frankfurt European Banking Congress 2007.

We are very proud that Frankfurt is hosting this Congress for the 17th time.

When we – Commerzbank, Deutsche Bank, Dresdner Bank and the City of Frankfurt – established the Frankfurt European Banking Congress in 1991, we did not yet know what a great success this event would become.

However, the Frankfurt European Banking Congress is an important element for Frankfurt, the City of the Euro, where the European Central Bank as well as the General Secretariat of CEIOPS give the well developed financial community of the Financial Center Frankfurt even more international importance.

The conference has seen many highly important CEOs from the global financial world, governors of central banks as well as Presidents, Prime Ministers and Ministers of State from all over the world.

I'm convinced that the Frankfurt European Banking Congress has been established as one of the important events dealing with European affairs.

This year's topic, "Global Capital – Threat or Salvation?" is formulated as a question, as well as the headlines of the three panels, "Global Capital – Surrender of National Politics?", "Private Equity – A New Trojan Horse?" and "Central Banks and Global Capital – Ringmasters or Facilitators?".

When looking at international finance over the past few months and the media commentaries about it, you could say the question marks stand for the uncertainty that many people feel when thinking of the present situation and its impact on the real economy.

There is not only the question of being right in the diagnosis but even more the challenge of the correct prognosis of how things will develop. Moreover, there is some fear of a new recession which might stop the current economic upswing, globally, nationally and locally.

In Frankfurt, round about 100,000 jobs are connected with financial business directly or indirectly. These people and of course we from the City's government are watching this development closely. After all it is only five years ago that the bursting of the New Economy bubble resulted in a deep recession.

Such a development none of us want it again. In Frankfurt for example the recession cost 30,000 jobs or 5 % of employment, and it took more than 3 years until employment started to increase again.

And now the trouble in the credit markets has led to a crisis of confidence.

It is important that the central banks have played their part in getting back confidence by flooding financial markets with short-term liquidity.

But in principle I think what we need is a new order by establishing a system of incentives which are not connected directly to the motive of gaining ever more profit, and some protective measures which would make it more difficult to be so careless as the financial managers were when they set up the sub prime crisis.

It is hard to find the logic when people who are responsible for losses of some billions of euros pick up a three figure million compensation when they have to go.

I hope very much for the financial markets that reason, good judgement and a better atmosphere will prevail and that more stability can be achieved.

Ladies and Gentlemen,
now coming back to today, the organizers of the European Banking Congress have created a highly interesting programme.

The panels are once again composed of distinguished personalities from business, politics and science. I would like to express my gratitude to you, the panelists, for your cooperation and contribution in actively shaping this conference.

I also would like to thank all those who have made this conference possible.

Especially I thank Herbert Walter, Chairman of this year's Banking Congress, and his peers from Commerzbank and Deutsche Bank, Klaus-Peter Müller and Joseph Ackermann. And I want to thank the members of the steering committee who have prepared the programme.

Last but not least I'd like to thank you, the participants, for being here.
I wish you a successful congress and I hope you will have a pleasant stay in our city.

Global Capital – Threat or Salvation?

Opening Remarks

Herbert Walter

Good morning, Ladies and Gentlemen. On behalf of my co-hosts Josef Ackermann and Klaus-Peter Müller I'd like to welcome you to the 17th European Banking Congress. It's great to see you all here.

This year's conference is made rather more distinctive by the turbulent events of the last few months.

So, the subject of today's conference could not be more timely: "Global Capital – Threat or Salvation?" That may sound a bit dramatic, but the stakes are certainly high. Indeed, global markets are at a crossroads. How we tackle these problems in the coming months will be important for the long run.

I think we now have a clear understanding of what caused the financial turmoil. Partly it's a long-term issue, the seeds were sown many years ago by expansionary monetary policies. Partly it's a market issue. The result of a flurry of ingenious financial innovation combined with a low interest rate environment. All of this at a time where there was a huge appetite for risk. I'm sure we will discuss many possible solutions to these problems during the panels today. To me, it seems that a heavy-handed regulatory response would be misguided. It is mainly the responsibility of us market participants, banks, rating agencies and investors, to increase transparency and to re-establish confidence.

Regardless of how the current turbulence plays out or whatever swings we see in the future, it's clear that the globalization of capital markets is here to stay. That also means national politics will remain under pressure from global capital markets.

So, what are the national policy options? And how can national policies contribute in a global financial system? These questions will dominate the first panel of our conference, with its outstanding panelists. The theme is "Global Capital – Surrender of National Politics?"

The opening keynote speech will be given by Prime Minister Ferenc Gyurcsány of Hungary. Hungary is a country that has benefited from strong foreign investment in recent years. It has also had turbulent times due to the sudden withdrawal of short-term capital.

The second panel will be chaired by my colleague, Klaus-Peter Müller, and it will take a look at the question: "Private Equity – A New Trojan Horse?" Private equity has brought about a change in the culture of capital markets. Its march seemed unstoppable – at least until this summer. Is the credit crisis just a necessary correction on the way to further long-term growth of private equity? After all, there is still an enormous amount of capital in search of high yields. I am sure that our second panel will shed some light on a number of very interesting questions!

Our third panel today, chaired by Josef Ackermann, will focus on: "Central Banks and Global Capital – Ringmasters or Facilitators?" Is it likely that the events of the last few months will act as a catalyst for more far-reaching changes? The main item on the agenda will be how to increase international financial market stability. More than enough for our third panel to reflect on!

Ladies and Gentlemen, we can look forward to an excellent day. Let me now welcome the Prime Minister of the Republic of Hungary.

Prime Minister Gyurcsány, we are honored to have you here in Frankfurt.
Thank you for coming, the floor is yours.

Global Capital – Surrender of National Politics?

Keynote Speech

Ferenc Gyurcsány

Good morning, Ladies and Gentlemen,

Many thanks for the invitation and this opportunity to share my views on the current situation in Hungary, and to talk about how we see the current European situation.

I would like to talk to you about our fight for squaring the circle.

Squaring the circle – you may say – is a mathematical problem. Indeed it is, and in terms of mathematics it is an unsolvable one. For me, however, squaring the circle is the metaphor of a challenge for all societies, in the manner in which Professor Ralf Dahrendorf described it. A very short quotation from him:

"The issue in most countries remains the same: How to provide a sustainable basis for economic growth in the harsh climate of the global marketplace, while at the same time maintaining solidarity and a sense of fairness throughout society. Whoever governs, must try to square this circle."

This is our challenge: a strong economy and, in parallel, a fair society. These two concepts seem to be in conflict. But we can combine them by saying that we would like to make both our societies and our economies competitive at the same time. Here in Europe we face a permanent debate about who is responsible for making societies and economies stronger and more competitive: the European Union (however you mean it), or the nation states.

Ladies and Gentlemen, I am not one of those politicians who blame the European Union or the Commission in Brussels for insufficient competitiveness of the whole of Europe or the nation states. Not because I would not be aware of the fact that there are tremendous opportunities and very effective instruments in the hands of the Commission or the European Council, but because I am convinced that we – and by 'we' I mean the nation states – we have the most important instruments, like fiscal policy, income policy, the possibility to shape our education systems, public education, higher education and vocational training, the regulation of the labor markets and many other means at our disposal.

In many cases we make references to the European Union and the Commission when we are not brave enough to tell the truth that we, politicians of each individual country, are responsible to change our respective countries, to change the structures that are responsible for the nature and for the performance of our economies and our societies.

I think that the European Union and its establishment is a success story. For the first time in history we have created this area of peace, prosperity, democracy, and a great openness to understand each other. The introduction of the euro, the Schengen zone, or the permanent capability to enlarge Europe, although we do face some challenges there, well, all of this is a real success. Now we have some uncertainty about where to go on from this point.

Let me tell you that I support those who say that we have to permanently strengthen the capacity of the European Union to protect ourselves and, at the same time, we need a much more offensive policy to make this area more competitive. When I talk about these 'defence capabilities', I would like to refer to a few things that are obvious. I think that in this era of globalisation when we face new challenges, we need a stronger, deeper and more comprehensive common foreign and defence policy or home and justice affairs policy. This, I repeat, is more or less obvious to me.

But knowing for example what a sensitive impact we saw in Europe from the sub-prime market crisis coming from the United States, I think it is the right time to start discussions about in which way we can build up a new defence line. Working out the answers is not our task – I am talking about politicians. It is indeed difficult to answer how such a defence line can be built when the money and capital markets are globalised, whether it is the right idea at all to somehow build such a line of defence, whether it is feasible or not. It is, however, our obligation to at least raise these questions.

My friends, leaders of the money markets, leaders of the banks and investment institutions, how do you see this situation? What is your analysis of this situation? What can be the role of the ECB in creating a real defence line? Because we do not want to suffer from the problems caused in the United States or any other place of world. Is it a dream to defend ourselves from such harm, or can it be reality? Many people in Europe are looking at you and raising these questions: My friends, do you have any answer? I would like to urge and support a very intensive dialogue between your sector, the policy makers, the European bodies representing our nations and people to try to find some effective response to this challenge.

The second remark on defending ourselves is about energy policy. We are talking a lot about our vulnerability because there is a high level of dependence on Russian energy. We politicians like to speak about the necessity of one voice. We mean that if we are speaking in one voice with Russia, then we can perhaps represent our interests with greater success.

Let me tell you something. Our challenges are based on very clear structural imbalances in the European energy markets that are characterised by the phenomenon that the seller's side is monopolised and mainly state-controlled. There is no competition on the seller’s side, it is practically all in one hand. The buyers' side is fragmented. You can imagine what kind of market emerges when, on the seller’s side there is one player or a tendency for an oligopoly to form; and the buyers’ side is very fragmented, divided: sometimes the buyers are competing with each other instead of competing for better terms and conditions.

We can talk a lot in Brussels. We can establish new regulations or open borders, but at the end of the day, the question is the structure on the buyers’ side. I think the only way to break out of this situation is to urge the structural consolidation of the energy market on the buyers’ side. What we need is deeper cooperation and integration of the companies which have so far been mainly based on national frames. Yes, I think that that integration is unavoidable.

You may ask, why is the Hungarian prime minister saying that when in the recent months a very similar situation emerged between Hungary and Austria? Mainly because I think that this consolidation must be based on fair market negotiations and conformity with the market and agreement between the players that gives them support. We must avoid the situation in which any state tries to control companies that work in the strategic sectors of other countries. I prefer business solutions, but I have some concerns in case of solutions that are backed by political considerations with unknown backgrounds. This is the difference between the two approaches.

After my remarks concerning the challenges in the European political sphere, I would like to turn your attention to Hungary.

Hungary is going through a very deep transformation in these years. Summarising the route what we have taken in the last seventeen years, I will say that we have solved our obligatory homework. We have changed the political system, and we have converted our state owned, state-planned economy into a social market economy very successfully. Very successfully, indeed. I should say that this was the obligatory homework. It was dictated by history, no question about that. Now we are facing a little more complicated challenges. If changing the political system and changing the economy is seen as a house, the new house of the new Hungary, then what we are facing now is the duty to furnish this house based on our choices, facing the challenge that we need permanent adaptation to the globalised world.

As a politician from Central Europe I have to tell you that this is much more complicated than I ever thought or expected. Much more complicated. The main question is not how you can set up new institutions or how you can modify the existing regulations. The main task is: how can you change the mindset of the people? How can you change their attitudes, the attitudes of whole peoples, whole nations? In the last couple of hundreds of years, these peoples had never experienced democracy, national sovereignty, the feeling that this is your country. If your country is ruled by foreign powers for centuries, most of the people believe that hurting the rules and breaching the law is your obligation, that it is a patriotic act. And now, suddenly, people are told in our region that your country is yours. Be responsible. And the answer is "Oh my God, we just wanted to be free; we did not want to be responsible..." . A lot of freedom but no responsibility – this combination just does not work. Like many adolescents faced with the real burden of responsibility. "I would like to be free to date anybody, not asking my parents. I would like to have a choice, to choose my dresses." But when you are twenty or twenty-two and have to realise that freedom and responsibility go hand in hand, sometimes that is very difficult to accept.

This is the situation in case of these nations. It takes a long time to learn. Sometimes we would like to run away from these challenges. And being very honest with you, at this point I would like to be very critical with our performance, in many cases, not just Hungary. If you see the neighbouring countries and all the countries in our region, we politicians wanted to be more popular, and sometimes we were not brave enough to change our countries. And in this situation we turn our attention to Brussels and we say that Brussels is responsible for our failure. No. I don't think it is. We are responsible if we are not brave enough to change just because in most stages these changes are not popular at all. Look at France now, look at Germany – changing substructures from transport to pensions, it is sometimes extremely difficult even in these countries that have a long tradition of democracy. Imagine how difficult is that in our countries.

Last year if we had not intervened in the budgetary processes, we would have faced a budget deficit of around 11 % of GDP. That is almost unprecedented. I examined the European experience and I could only find one recent comparable case: Ireland in the middle of the eighties, when they were facing very huge imbalances, and they had to initiate a very harsh austerity programme like we did.

In less than two and a half years, by 2009 we intend to bring the deficit down to 3 %. We decrease the deficit by 8 percentage points of GDP. You can imagine how harsh it is: taking out 8 % of the GDP from the budget. We consider a 0.5 percentage point decrease to be very significant. And I am not talking about half a percentage point but about eight. Cutting back the expenditures, and – I know you, businesspeople hate that – simultaneously, because in the very short term we did not have any other choice, increasing some revenues also.

I have to tell you that the programme is more successful than we had thought, at least in terms of the budget. The figures are better, and for next year for example we plan 4 % deficit. Please remember: 15 months ago we had almost 11%, and for next year we are planning 4 %. It is beyond question that the price of this process is remarkable. There are tangible uncertainties, tensions in politics, and sometimes on the streets as well.

We had to sacrifice a small part, or at least half of our growth potential in the short term. This year we have more or less 2 % growth. However, let's see how we see the future. By 2009 the deficit should be around 3% – 3.2 %; the rate of inflation should come back to around 3 %; and growth around 4%. The recovery process is relatively short, although if you are in the middle of it, and right now we are, I know it is painful for many. But I have to tell you that I cannot see any other choice.

In fact, our challenge is even bigger because we have simultaneously initiated some very deep structural reforms. Because it became obvious that handling the budget situation alone, in itself, can only bring temporary results. But we do not need temporary results – we need sustainable ones!. Every four years in Hungary the budget has softened up. We had to understand that does not happen because politicians are weak (at least not only because of that), but because there are embedded causes in the structures. We have to modify these structures which are responsible for the cyclical softening of the budget.

We initiated 3-4-5 parallel reforms – it is just a matter of categorisation how many.

The most complicated one is the healthcare reform. Health services in Hungary are considered free by many, in fact, almost by everybody. That is an illusion. And in the focus of this sector are not the insured people who are looking for services, but much more the service providers, the doctors and the nurses. We say: come on, let us turn around this system. We, the insured, must be in the middle. This sector is about us! It must represent our interests. We have cut back the capacities, we have established a supervisory authority to guarantee the quality of services, we have introduced an obligatory co-payment: 1.2 EUR for a visit to the doctor. That became a symbolic step in the eyes of many, and now we are working on the insurers' side - no privatisation but opening the door to the private capital and creating a stronger link between the insurer, the insured and the service providers. This is the deepest reform we have ever done in the history of Hungary not because we were obliged by circumstances, but because we were brave enough to start it. And make no mistake, we shall get it done.

We have initiated a higher education reform. The core of this reform is to increase competition between the students for better education, competition between universities for better students and for better funding. The first results are very promising, although a significant part of the students is not so happy about having to pay an obligatory tuition fee even at public universities.

We have just started a pension reform. The objective is obvious: to secure long term sustainability which is jeopardised by the well-known phenomenon of population ageing. We have modified the regulations to increase the effective age of retirement which is much lower than the nominal age fixed in the relevant law. We have decreased the initial pension for new pensioners, and we have just started a public debate on increasing the legal age of retirement.

We have almost completed a public administration reform, restructuring the institutional capacities and framework. We have halved the number of budgetary institutions and agencies. We have decreased the number of civil servants in the state administration by 20 % in less than one year. We have also increased the levels of responsibility of leaders and government members. We have also implemented a new performance assessment system, and salaries now depend on performance. I do not want to continue, I do not want to bore you. I just wanted to give you some picture about how these two parallel things are being managed: budgetary reform and structural reforms.

In the very short term all this does not bring any popularity for us. We have lost more or less 40 % of our supporters in the last fifteen months, and I am frequently asked: "Prime Minister, are you strong enough to fulfill this programme? Prime Minister, do you have sufficient support in your party, in Parliament and in the society?" And I answer: yes, we are committed, we are strong enough, we shall win this fight. I am not an actor, I do not have to be popular in the short term. I have to win popularity by fulfilling this programme and by making the people understand that what I do was not just inevitable but it was in the favour of the country. It will have made the country stronger and more competitive. In the final phase I believe that people will come and say: "Thank you, thanks for holding our hands and being brave enough not to turn back." I am pretty sure that at the end of the day Hungary and the people will say that it was a tough job, but we had to do it, and we are happy that we are over it. And that will be the day when Hungary will resemble those countries that we have always wanted to be like. Because good fortune and wellbeing do not come as Christmas gifts, we have to work for them. It is great to get Christmas gifts from our friends, wife or children. But what really matters in our life does not usually come as a present; those things we have to struggle for.

Ladies and Gentlemen, in the beginning I told you that I would share my views with you. I would like to ask you to support us in changing Europe and changing Hungary for the better.

Thank you for your attention.

Global Capital – Surrender of National Politics?

Herbert Walter

Ladies and Gentlemen, let me kick off this panel. We thank Prime Minister Gyurcsány for his compelling words. I think that you perfectly set the stage for our discussion. It's my pleasure now to introduce three further high-caliber panelists to cover our subject: "Global Capital – Surrender of National Politics?"

First, let me welcome Professor Mario Monti, President of the world-renowned Bocconi University in Milan and formerly EU-Commissioner for Competition Matters. Next, it is my pleasure to introduce Mr. Jean-Claude Trichet, the President of the European Central Bank. He needs no introduction here in Frankfurt. I also want to welcome Mr. Angel Gurría, Secretary-General of the OECD, based in Paris, and formerly Minister of Finance of Mexico. Mr. Gurria, you are the first to speak. As I understand it, one of your main concerns at the OECD is to recommend successful policies to member countries. In your experience: have you seen "best in class" national strategies that have proved to be superior in our globalized environment? We very much value your views, both from inside and outside Europe. Over to you, Mr. Gurría.

(Remarks from Mr. Angel Gurría)

Mr. Gurría, thank you for your vivid presentation and your thought-provoking views.

Let me now turn to our second panelist, Professor Mario Monti. It is often said that European integration is the right answer to the challenges of globalization. Can the EU adjust quickly to the changing environment and where do we need to make faster progress? We are very much looking forward to hearing the insights of a former "insider". Professor Monti, the floor is yours.

(Remarks from Professor Mario Monti)

Thank you Professor Monti for your candid assessment of the state of affairs in the EU.

Now, to our final panelist, President Jean-Claude Trichet. Mr. Trichet, as we have seen with the subprime crisis, regional problems can quickly affect the global marketplace. We saw the ECB reacting very swiftly. Your institution has rightly received much praise for the action that it has taken. Recently you mentioned that for central bankers, not just every word, but every movement of the eye is searched for hidden meaning. So we shall not only be listening carefully to your words but also watching your eyes closely. Mr. Trichet, over to you.

(Remarks from Mr. Trichet)

Thank you, Mr. Trichet.

Well, we have covered various aspects of our topic and I think, we have heard some strong arguments. Let me now open the floor for discussion. If you would like to ask a question please use the little question cards that you have in your booklet. These will be gathered by our hostesses.

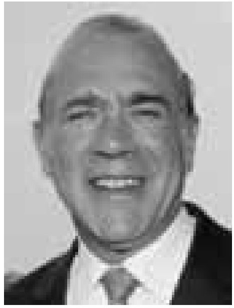
(Questions to panelists)

Ladies and Gentlemen, in closing this session, let me first thank all of our panelists for sharing their thoughts on our theme: "Global Capital – Surrender of National Politics?" Thank you very much! I think that it's been a very broad-ranging discussion. I am sure that we will hear more about this in the panels to come.

Ladies and Gentlemen, thank you very much for your attention. I hope you enjoyed this first panel as much as I did.

Global Capital – Surrender of National Politics?

Angel Gurría



Ladies and Gentlemen,

It is a great pleasure to be in Frankfurt for this important event in European Banking. I am particularly happy to address this meeting because I believe that Europe is a region where the financial sector has experienced a tremendous amount of change presenting daunting challenges to policy makers.

The European banking sector has had some serious episodes I am thinking, for example, of the problems in the 1990s of banking systems in the Nordic countries; France had its difficulties with Credit Lyonnais; Italy and Spain experienced issues in regional banks. But the problems seemed self-contained and were managed skilfully by national authorities. Global crises happened elsewhere and Europe seemed little affected. When we tried to anticipate where crises would arise next, we thought of the emerging world. After Tequila in Mexico, Vodka in Russia and Samba in Brazil – where would the next source of financial and economic turmoil be? Wherever it was, chances were high that it would largely spare Europe.

But this has changed. The subprime lending crisis is only the most recent proof that vulnerability spreads rapidly all around the world. Global financial imbalances are now a common phenomenon. Almost every problem today becomes everybody's problem, regardless of its origins. And globalisation acts as a multiplier. It leverages good policies as well as bad ones.

Fine-tuning policies in a globalised world is not an easy task. Today, financial institutions engage in many diverse activities through multiple legal entities. They offer a wide range of products and services, both domestically and internationally. Business risk often extends across many jurisdictions and many sectors, and the legal jurisdiction of national supervisors may be smaller in scope than the geographic area in which financial institutions operate.

The recent crisis showed that the explosion of different financial instruments outside the core segment of the banking sector was underestimated. A large part of these transactions took place out of the reach of traditional banking and monetary regulation. Of course in some cases supervisors should have been more aware; and in other authorities did signal concerns about the conduits used to securitise loans and some of the underlying lending practices. But today we do need to look again at the set of tools that we have – and that we don't have – to influence financial market developments.

Finding the right balance will be the key challenge. On the one hand, formal rules and their application must be tailored to specific domestic needs and realities. On the other hand, this approach entails the risk that regulatory authorities with different mandates and constituencies will take inconsistent measures to solve similar problems. The consequences are higher costs and competitive inequalities for individual firms. And this problem is worse in times of rapid innovation. The response, like the problem, must involve multiple actors who work together in a continuous dialogue.

This brings me back to your question: Does globalisation mean that national policies are doomed? No. "Doomed" is too strong. Policy makers with floating exchange rates can run independent domestic monetary policies, and these can be made more effective in times of crisis if they are carefully coordinated. And this is already happening. We see that central banks around the world have actually responded very similarly to the fall-out from subprime mortgage lending. While all of them were concerned about the risks of moral hazard, the major central banks all provided liquidity to the market. No one has allowed the failure of a major institution which would create waves out into the system. In this sense, they have indeed been going down the same avenue.

Regulation is another area that comes into focus in times of financial turmoil. Countries have a large measure of independence, but again, coordination makes the system work much better. The OECD tends to favour industry-led initiatives in order to get things right at the micro level. In this context, it is worth noting that we should not think of the recent financial problems as coming wholly through globalization from somewhere outside of Europe. European banks have been in the thick of things when it comes to issuance of the new structured products. Coordinated industry initiatives between European and other institutions are going to be important too.

But I would also like to draw your attention to the global financial imbalances that I mentioned earlier, in particular an imbalance that may drive the emergence of protectionist policies. The rapid expansion of another type of investment vehicle, the sovereign wealth funds, has been leading to questions about the wisdom of allowing the free flow of capital, even in countries that used to be champions of freedom of investment.

Sovereign wealth funds (SWFs) are government-owned and most often funded by foreign exchange assets. These funds having been growing at spectacular rates, driven by large current account surpluses and increased revenues in oil producing economies. The estimate of total SWF pools is around $ 2.4 trillion, while in sovereign pension funds, which are similar to SWFs, total asset estimates range from $ 2.1 to 4.1 trillion, depending on the definition. With a few exceptions (like Norway) there is little information on the SWF's corporate governance and objectives and the funds' practices vary widely.

The international investments by SWFs are beginning to raise concerns that they may be not closely supervised by home country financial market authorities. And potential host countries fear that SWF investment decisions could be motivated more by political objectives than by profit considerations, and that the funds could target security-sensitive and other "strategic" assets. But let us be clear about one thing: the danger of investment protectionism existed before SWFs became an issue. The tendency to protect national "champions" has long been an issue among OECD countries – and emerging countries. It has only become more tangible now with the emergence of these new players.

At the OECD, we were sensitive to these stresses and in 2006 launched a comprehensive project on freedom of investment to deal with these concerns. OECD countries, in co-operation with some of the major emerging economies, are discussing and trying to agree on disciplines that will allow host countries to protect vital national security interests while minimising restrictions on international investment. We will be examining SWFs from that perspective.

In doing so we draw on several long-standing OECD instruments, in particular the OECD Declaration on International Investment and National Treatment. We are also working to improve transparency, for example through the OECD Principles of Corporate Governance and the OECD Guidelines for Multinational Enterprises. We are working with OECD and non-OECD partners to address the regulatory challenges from all of these new developments in the financial markets. We also aim to improve understanding how national systems interact with international rules and developments.

Only with international co-operation and a policy dialogue that includes all stakeholders will we be able to build mutual trust and keep our markets open. I am pleased that this is being recognised by national governments around the world. The G-8's mandate for the OECD to work with the O-5 countries in the Heiligendamm Process reflects this recognition. At the OECD we stand ready to work on bringing all players to the table, working with national governments, other international organisations and, of course, the European banking sector.

Global Capital – Surrender of National Politics?

Mario Monti*

Thank you very much, Mr. Chairman.

Yes, European integration is in my view the right answer to the challenges of globalisation. Indeed, it is the right answer to the challenges that globalisation poses to Europe but also more broadly to the challenges that globalisation poses to itself. First point, we have to cope with the rough winds of globalisation. Well indeed, providing unitary strong responses on the part of Europe is a key component of how to deal with globalisation. Let me give you two simple examples concerning respectively currency turmoils and corporate turmoils, that is the threat which is always there of abuses of market dominance by companies. Well, in these two areas gradually, silently the European Union has been creating world standards. World standards are emerging from Europe, out of Frankfurt, for sure, as regards the euro. The euro is perhaps replacing the dollar as the world currency standard. And Professor Issing in his thoughtful remarks last night referred to this issue. Also out of Brussels: to many observers in the world the competition policy done by the European Union is becoming the world standard for anti-trust. There was a lot of discussion about this, in particular after the recent court judgement on Microsoft. There were many statements pointing to the EU's influence on anti-trust being now stronger than the influence of the US. There was, characteristically, the outraged reaction by the Wall Street Journal who even entitled an article "European Imperialism" in relation to that. How often do we read about European imperialism? But, of course, as to the substance of these cases one can take a more moderate view and I think it is encouraging for Europe as regards competition policy to read what not a European newspaper but the New York Times wrote, namely: "Microsoft's resounding defeat in a European anti-trust case establishes welcome principles that should be adopted in the United States as guideposts for the future development of the information economy."

Now, obviously, we are not interested in the substance of these cases here but simply in noticing that in two key components of governance of the economy – monetary policy, competition policy – Europe is developing world-class standards. And why is that

* Transcription from tape by the organizer of the Frankfurt European Banking Congress

so? For the same reason that the Prime Minister of Hungary forcefully referred to in his impressive speech, namely in these two areas – monetary policy and competition policy – Europe is simply able to speak and act as one, unlike in so many areas. So, and it is very encouraging that the most recent treaty agreed upon in Lisbon, does make a substantial step to create this unitary entity even in the critical area of the foreign policy through the creation of an entity who of course will not be called the Foreign Minister of the European Union but closely resembles that.

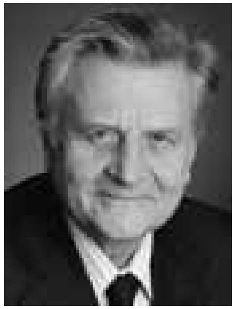
Of course, individual countries need to do much more for an appropriate overall European response to globalisation and I think what the Prime Minister highlighted to us is a very impressive indication of what individual countries need to do without putting blame on the European Union but reenforcing what the European Union is doing.

Mr. Chairman, my second dimension in which I believe that European integration is the right answer to the challenges of globalisation is in the sense that European integration is the right answer also to the challenges that globalisation poses to its own future of globalisation, not to Europe. I have perhaps a minority view but I do not believe that globalisation is an irreversible phenomenon. We saw in history already degrees of integration and globalisation even higher than today, the peak having been 1914. Then came world war one with the overall explosion of globalisation. Then came the efforts in the '20s to set up again a world order but those efforts failed. So, I think, globalisation could once again implode. Even though of course the technological conditions now are quite different. The threat of protectionism is there. There are backlashes. Secretary-General of the OECD referred to the difficulty of achieving the last mile to the door and the losers of globalisation are putting great pressure for globalisation to be stopped in some sense. Therefore, it does need to be governed, one must indeed maîtriser la globalisation. We need a global governance of globalisation, certainly not the unilateralism that has on occasions tempted our American friends in recent years. No, what is needed is something very very similar to what the European Union has been doing for fifty years. That is a double process of market integration by dismantling barriers on one side but also coordination of at least some public policies on the other side. The EU has this in its own DNA, it can help save globalisation from itself and also because the threat to globalisation – protectionism- is ready to change forms continuously. Now, given the good repositioning of the external position of the US it is true that for the time being the nightmare on Capitol Hill is no longer Chinese imports into the US, it is the domestic housing market. But we see on the other hand emerging threats of protectionism in the investment and financial areas.

My last note, Mr. Chairman, is on the subtitle of this panel: surrender of national politics? Well, this has occurred already. This has occurred in Europe. National politics in many senses has had to surrender, often in very concrete terms. France did not want the Mittal-Arcelor merger to take place, Europe was there, watching carefully, the merger did take place. Italy did not want certain banks to be acquired by external banks; it did happen. Spain wanted to create a national champion of energy. It was not possible for it to do so because of the European rules. Germany, if I remember well, desperately wanted to keep certain guarantees on the public banks, it was not able to do so, or it strongly wanted to keep a certain law by the name of Volkswagen-Gesetz. It was not allowed to do so. So, all these are retreats of national politics. But not retreats of public policies because public policies exist more and more at the higher level, the coordinated European level. I believe we need to do something more of this at a higher global level. Thank you very much.

Global Capital – Surrender of National Politics?

Jean-Claude Trichet



Ladies and Gentlemen,

Let me start off with one general remark: The present significant market correction with episodes of turbulences should not come as a surprise to us. The ECB, as well as the other central banks, has issued warnings in the past on the global phenomenon of underpricing of risks. In many respects the present episode can be interpreted as bringing to the forefront anomalies and structural deficiencies which we have identified earlier.

While it is too early to make a full assessment, I believe there are some first provisional lessons which can already be drawn at the current stage.

A lesson that can be drawn is that the growing complexity of instruments has to be monitored very closely. Structured credit markets are exposed to valuation problems, which make the market very vulnerable to a shift in investor sentiment.

In the absence of reliable market prices, instruments need to be valued by models. But estimates which the models produce are highly sensitive to underlying assumptions. Mounting losses in residential mortgage backed securities (RMBS) backed by US sub-prime loans have seemed to trigger a wide loss of confidence in the correctness of underlying assumptions and therefore in the valuation of structured credit products more generally. This apparently has set a vicious circle in force in which heightened uncertainty about the future value of complex assets and rising risk aversion caused many investors to withdraw from the market. Prices dropped massively, and investors incurred large unexpected losses, contributing to further pressure to sell.

A second lesson that can be drawn is that structured credit markets provide a pressing example of the need to increase transparency in financial markets.

That the market disruption spilled over into interbank markets can be explained by another key shortcoming of structured credit markets, namely the opacity of exposures of financial institutions to complex instruments and off-balance sheet vehicles. This lack of transparency about exposures of other banks exacerbated counterparty risk concerns, impairing the well functioning of interbank markets. In periods of turbulences, whatever the origin of those turbulences, opacity and absence of transparency are a recipe for propagation of turmoil and generalized contagion.

Third, the recent events have stressed again the particular role rating agencies play in structured credit markets.

The growing complexity of **instruments has** clearly induced some investors to overly rely on ratings. This is the more risky as ratings in structured finance are not yet as much tested as those of corporate issuers. Some investors may also have misinterpreted the risk dimensions covered by a rating. Against this background there is probably scope to improve the information content of ratings and to make the monitoring process more transparent. It also needs to be investigated further to what extent conflicts of interest may have arisen for rating agencies in their credit risk assessment of structured credit instruments. Several international fora are currently looking at those issues.

Fourth, the turmoil has revealed some challenges for the liquidity management of banks.

Banks, including those in continental Europe, have increasingly relied on secured funding, both via securitization and off-balance sheet vehicles. This has rendered them more vulnerable to a sudden disruption of structured credit markets. Let me recall that the regulatory framework requires EU banks to have policies and procedures for the measurement and management of net funding positions on an ongoing and forward-looking basis and have in place contingency funding plans. In this context, recent events have demonstrated that banks need to further strengthen their liquidity risk stress-tests, encompassing for example scenarios such as a protracted closure of a broad range of securitization markets and the drawing of contingent liquidity obligations by commercial paper programmes. Moreover, those elements should also be incorporated into their contingency funding plans. The ECB, together with the ESCB Banking Supervision Committee, is carrying out work on this important topic.

Indeed, the current turmoil has underscored the importance of robust liquidity management by banks, as well as the need for supervisory approaches which keep pace with structural market developments. Many initiatives with a view to addressing issues and risks arising from the recent financial market turbulence that go into the right direction have already been launched, both at the international level, namely by the Financial Stability Forum, and at the EU level, with the ECOFIN agreeing to a roadmap for action by 2008, and also by the private sector. They must be pursued now with even stronger impetus. In this respect, co-ordination at the global level should be ensured. In closely interlinked financial markets, any policy measure should be agreed to and consistently applied at the international level.

Fifth, in the same vein, there is a need to reflect carefully on the "originate-and-distribute" business model.

The period ahead is likely to provide a first material test of changing banking business models and the increased reliance on secured funding. Although currently profitable and well capitalized, many banks will experience income and credit losses, which may trigger a re-assessment by some of them of the suitability of the so-called originate-and-distribute business model. The current episode has also shown that the transfer of credit risk outside the banking sector may ultimately not be effective. This is related with reputational and other concerns, which induce banks to take credit risk back onto their balance sheets.

Sixth, with respect to our own crisis mitigation tools, a lesson that we can draw at this stage is that the operational framework of the Eurosystem has proved able to cope with stressed market conditions.

So far, the Eurosystem has been able to manage the turmoil in an effective and flexible manner. Two ingredients of its operational framework have been particularly important:

The *first* is the clear separation between on one hand the ECB's management of the aggregate liquidity conditions and on the other hand the setting of its monetary policy stance, which is signaled by the minimum bid rate in main refinancing operations. This separation has been extremely valuable under present circumstances. Looking ahead, and in line with its previous communications and actions, the ECB will continue to steer very short term interbank rates close the minimum bid rate.

The *second* ingredient is the Eurosystem's collateral framework. The broad list of eligible assets has ensured that a broad range of counterparties could access the credit operations of the Eurosystem during the turmoil. This has helped counterparties to effectively mitigate funding liquidity risk when interbank markets stopped functioning properly. As a side effect, the acceptance of ABS in the sizeable refinancing operations has allowed to address also asset refinancing needs of counterparties effectively. This has certainly contributed to a better functioning of the money market since counterparties know that they can turn to the Eurosystem to refinance these assets.

And finally the ongoing process of significant market correction which we experience since August should trigger a very deep and candid review in all the areas which have a substantial influence on the functioning of the global financial markets.

This review process should concentrate on what could be done to promote financial stability and to diminish to the maximum extent possible the elements of procyclicality that may be inbuilt in a large number of fields.

The financial stability forum, which has been set up by the G7, under the proposal of Hans Tietmeyer, to draw the lessons of the Asian crisis, is in an ideal position to identify the areas where appropriate improvements could be introduced.

I encourage very strongly the Financial Stability Forum and all the Committees that are actively working at a global level, including the Basel Committee, to draw all the lessons of the present turbulences and to examine the situation without any complacency.

In my view no single area should be put aside from this review which should concentrate on the ways and means to foster financial stability, prevent propagation of disturbances and contagion, improve risk management at all levels, and diminish procyclicality, in particular, in the domains of accounting rules and accounting practices of rating agencies, of supervisory banking rules – the first duty being to implement globally Basel II which is largely superior to Basel I – including harmonization of liquidity rules and requirements, of supervisory insurance rules, of market supervisory authorities regulations, of regulated and non regulated private institutions (whether highly leveraged institutions or so-called S.I.V. and conduits), and of market practices.

This does not mean necessarily dramatic changes of rules and overloading of new regulations. I am of the firm opinion that voluntary code of best practices, the set up of voluntary "Principles" and the working out of voluntary benchmark best practices are most of the time preferable to the addition of new layers of rules and regulations.

But we have, in any case, the duty to be effective in working out the lessons of the present market correction. This is no time for complacency in any respect.

Thank you very much for your attention.

Private Equity – A New Trojan Horse?

Klaus-Peter Müller

Ladies and Gentlemen,

Some things are not what they seem to be at first glance.

This is the lesson the Trojans learned the hard way in the Trojan War, when they let a wooden horse into their city to be surprised that it held enemy soldiers.

Is there really a connection between this ancient tale and the topic of our second panel on private equity? Of course this title was chosen to raise curiosity and interest. But there are indeed many critical voices which do see private equity investors as a potential threat in disguise, at least here in Germany.

These critics paint a picture of purely profit-driven investors, pursuing short-term strategies in order to maximise cash-flow via job-cutting and asset-stripping. According to their view, other stakeholders are neglected and would suffer ultimately from the large amount of debt involved. It seems as if Private Equity has an image problem.

In contrast, the private equity industry itself stresses the positive impact private equity has on the economy and on the targeted companies. Facilitating necessary changes and access to new capital is part of their business model. For companies in need of restructuring this can mean salvation.

So private equity is a form of global capital on which quite controversial views do persist.

Controversy, especially on an informed basis, is much better than ignorance: a recent study showed a stunning lack of information. Nine out of ten Germans (87 %) never have heard of "private equity" – in spite of the lively locust-debate we had in Germany. I am convinced that this is not representative of todays' audience – you would not be here if you thought that ignorance is bliss.

But even for professionals well known questions remain and new issues are raised:

- concerning the role and responsibility of the different types of private equity investors – from small venture capital to global buyout firms,
- or concering the role these "Highly Leveraged Investors" have played in the recent market turmoil.

How is private equity itself affected by the current market developments? The industry seems to be at a crossroad regarding its business model and future prospects.

Another new phenomenon is the emergence of sovereign wealth funds.

They act as investors in private equity funds or in private equity firms. And they are seen as competitors in search of profitable investment opportunities. This raises interesting new questions for the industry.

In order to gain more insight and tackle such a controversial topic, it is always very helpful to examine and compare various standpoints. Therefore, I am very pleased that we have a panel with the right composition – people who represent different perspectives and types of experience on this subject.

So as panellists let me now introduce:

• Thomas Pütter, Chief Executive of Allianz Capital Partners GmbH, Munich and Managing Director of Allianz Alternative Assets Holding. In this position he is responsible for the direct private equity activities of Allianz Group. From June 2005 to April 2007 he served as chairman of the German Private Equity and Venture Capital Association e.V. (BVK) and in 2006 he participated as an observer to the EU Commission's Alternative Investment Funds Expert Group (Sub Group Private equity). He brings to this panel both a global investor's perspective and German market knowledge.

• Let me also welcome our second panellist, Professor John Kay, a distinguished academic and one of Britain's leading economists. Like Thomas he started his academic career in Oxford. He has been professor at London Business School and Oxford University and is currently visiting professor at the London School of Economics.
He also has hands-on business experience as founder and executive chairman of London Economics, a consulting firm. Interested in a wide array of economical and political topics, he voices his insights not only in his books, but on a regular basis as a columnist in the Financial Times.

So now we have the investor's side and the Anglo-Saxon academic view. The picture would not be complete without the corporate point of view.

• So last but not least, I welcome Dr. Axel Herberg, Chairman of Gerresheimer Group, which he joined in 1992. His former experience includes a number of years' activity as a consultant with McKinsey. He holds degrees in business management and mechanical engineering and a doctorate in economics. Over the years Gerresheimer Group went through several changes in its ownership structure and has had several financial investors. This summer it became a listed public company on the Frankfurt stock exchange and is pursuing an international growth strategy. Formerly a traditional glass producer it specialises more and more on pharma and the life science sector.

But that's enough by way of introduction. Let's now listen to the experts and discuss with them.

Private Equity – A New Trojan Horse?

Thomas U. W. Pütter*

Ladies and Gentlemen, good morning.

I came a little later to this conference because I couldn't decide whether to put on my locust costume and I couldn't find my honeybee costume. But somewhere between the two lies the truth for private equity for the debate which for my liking is held far too emotionally, and much more dangerously, is held against the background, as Mr. Mueller has said, of complete ignorance and lack of information.

In my opening comments I would like to touch on five points. I will do so briefly and then, as per interest, we can delve into greater details on each of them. The five points are:

No. 1, it is important to me to try to put the discussion on private equity and the dangers that it supposedly holds into some kind of context for the financial markets.

No. 2, I would like to touch on what does private equity actually do.

No. 3, I would like to touch on how does it do it.

No. 4, I would like to touch on how well does it do it. Because there are a lot of myths about that.

And no. 5, I would like to touch on the question: is this industry going to grow or has it just died because of the calamity of what happened in the financial markets in the summer.

The context: private equity unfortunately is intransparent. That is the main reason why it is viewed with such suspicion and in the less financially sophisticated markets around the world that suspicion is greater than in those financially sophisticated markets.

It is roughly estimated to be an industry that has assets under management in an amount of about 1.1 to 1.4 trillion dollars. About 0.7 to 0.9 trillion dollars of that is leveraged buy-outs.

* Transcription from tape by the organizer of the Frankfurt European Banking Congress

And the entire public debate about the controversy of private equity is a misnomer because of this controversy of large leveraged buy-outs. There is nothing controversial about venture capital people supported, there is little controversy about mezzanine capital people supported. It is when companies are acquired by financial investors with the intention to effect change and therefrom to realise capital gains on disposal that is where the public unease starts.

Of the 0.7 to 0.9 trillion dollars, approximately 60 % are the US market, 25 % are the European market and 15 % is the rest of the world, in particular, Asia where it is interesting to note, Asia is growing very quickly especially in China and especially in India.

Let us put this into context. Pension funds around the globe manage approximately 22 trillion dollars of assets. Mutual funds manage approximately 19 trillion dollars of assets, insurance companies around the world manage approximately 19 trillion dollars of assets. These investors dwarf by far the financial investor universe in private equity. If you put the assets under management in private equity in relationship to the equity market capitalisations around the world: in the United States it is about 2.2 percent, in Europe it's about 1.3 per cent. That is a doubling over the last ten years but it is a doubling from a very small percentage to a still small percentage. So let's keep it in perspective of how big and how "dangerous" to the financial system private equity supposedly is. In terms of the so topical financial markets currently the debt volume that the leveraged buy-out industry raises in 2006 represented approximately 10 % to 11 % of the corporate debt market overall. So again, it is a minority of the debt volumes that we are talking about.

Having tried to put this a little bit in context, what does private equity actually do? Number one, private equity is a business. It has a responsibility to its clients on the basis of a contract that it has made, namely to invest monies entrusted to it for capital gain in the medium term and then the compensation in order to align interest as a profit share and a management fee on those monies raised. The investors in these funds are the most sophisticated institutional investors around the world, first and foremost pension funds, insurance companies and fund of fund managers.

Private equity was born out of an interesting and intensifying interplay of sources of supply and demand. By sources of supply, I mean, where does the money come from and why is it being increasingly allocated to this sector of the alternative asset universe? You all know what the demographic challenges are that we are facing and the vast majority of funds entering private equity come from institutions concerned with old age provisioning for the future. They are looking for outperformance and over a 20-year period where interest rates were declining, where equity markets were considered to be volatile there was a search for alternative assets which latterly has also led this industry to invest in hedge funds and in other forms of investments.

But that is where the supply of money comes from and private equity will continue to grow – if I advance my fifth point already – as long as that supply of capital increases.

And the supply of capital will increase if only because of the reinvestment of investment profits.

The demand factors for this sort of finance are equally very strong. They are born out of change happening in global economies, out of globalisation, out of industrial factors, out of technology change, for example, and out of political change, the opening up of the euro zone. Reunification in Germany alone has opened opportunities that needed to be financed, and the traditional sources of finance at that time were not equipped and unable to meet the capital demand, particularly the equity capital demand. So an industry arose, called private equity saying: we have the analytical skills to understand these drivers. We will make this risk capital available and if we do it smartly we can make money out of it.

How does private equity do this? Very simply, private equity combines the public market model of permanent capital provision with the private market model of corporate governance. In a sense, it tries to combine the best of both worlds. And that is where the appeal lies to many management teams. It says we can finance this company's ambitions, this management team's ambitions. We have direct control, we can take decisions faster and we can do it to a large extent out of the glare of public or regulatory scrutiny. Therein may lie a problem we can discuss in the questions and answers session.

In this approach, private equity differentiates between three drivers that are much confused in the public debate. These drivers are: value drivers for the actual business, price drivers of factors that influence what price you can get for something, either that you have to pay or that you can realise on exit, and proceed drivers, how much money irrespective of the price and irrespective of the value you have created actually ends up in your investors' pockets.

How well does the industry do it? Approximately 60 % of the assets of the industry are concentrated in the hands of 30 funds around the world. The performance of the top quartile of the leveraged buy-out industry is spectacular. It is somewhere around currently 29 % IRR net of cost and fees and profit shares to the investing institutions. But that is the top quartile. If you go to the mean, the situation looks very different and you are somewhere around 11 or 12 per cent. And if you go to the third or fourth quartiles you frankly with hindsight may not have wanted to be invested because you could have made more money elsewhere. So the performance curve is very skewed to those institutions who have found the methodology, the method, the system, the approach of consistently creating value in the private equity model.

Will private equity grow? I am convinced that it will. I have staked my career on it. But it will only do so if the value proposition of the top quartile continues to hold, if more is done to increase the social acceptability of this activity.

Because if I only constrain it to Germany for example where you have 5,900 businesses now that are being financed by private equity, employing one million people and turning over 190bn euros of revenue, that industry can no longer say: we are private. You are not. You have economic influence and you have economic might and you need to explain yourself and make sure that you are understood and that in fact what you are doing is good for an economy and not negative.

There is an estimate by McKinsey that says that by 2012 the leveraged buy-out segment of private equity will double from the current 0.7 trillion to 1.4 trillion and on the assumption of certain benign developments it could reach 2.6 trillion. So this industry will grow irrespective of what has happened in the summer.

Private Equity – A New Trojan Horse?

John Kay*

If we had had this debate seventeen years ago when this conference began, or even ten years ago, we would have been having that debate in a completely different context:

- We would then have been talking about the irresistible rise of the public market place.
- We would have contrasted the capital markets of Britain and the United States where market capitalisation was typically one to two times national income with those of Continental Europe where the more typical figure of the total market capitalisation was about half of national income.
- We would have been noting the way in which companies were steadily becoming private, private in the sense meaning public, the privatisation of state enterprises across the world.
- We would also have noticed the way in which partnerships and mutual companies like Goldman Sachs or Crédit Agricole were acquiring quotations and flotations.
- We would have observed the rise of new market places like Nasdaq, AIM or the Neuer Markt, in which smaller companies at an earlier stage of their development than had previously been involved in the public market were able to obtain listings at a very early stage of their development.

Well, what a difference a decade makes. We are talking today in a completely different environment.

There are several events that led to that. One is that after 1997 the New Economy bubble expanded and then burst and after 2000 investment institutions started the search Dr. Puetter has described for alternative assets in the hope that they could find somewhere else where they could make the double-digit returns to which they had become used in the 1990s.

At the same time as that bubble collapsed it exposed some of what had been going on in large quoted companies, the way in which a number of companies had been involved in domestic, internally corrupt activities and in unsatisfactory relationships

* Transcription from tape by the organizer of the Frankfurt European Banking Congress

with their advisers which then in turn promoted a somewhat heavy-handed regulatory response to the abuses that had been revealed.

At the same time people started to notice the pressures of the quarterly earnings cycle, the business by which companies gave earnings guidance, managed and massaged their three-month figures in order to satisfy the expectations of Wall Street and other financial markets. We started to recognise the ways in which these pressures got in the way of effective long-term business strategy.

And finally and most recently the most important part of these developments were the rise of securitisation and asset-backed securities that transformed the nature of debt markets and made risk capital available more and more cheaply. And the explosion, of course, of the large transactions and private equity markets in 2005 through 2007 came very largely from that source.

It was the risk mispricing which grew on an increasing scale in credit markets through the period. And I noticed in the earlier panel this morning a tension between some of the questions from the audience who wanted to talk about the current credit crunch as the subprime lending crisis, and some of the speakers on the panel who regarded in my view rightly what has been happening in credit markets as a symptom of much wider risk mispricing which has been going on in debt markets over the last two or three years. There is still a desire to say this is primarily a crisis about subprime lending. But it goes wider than that and the finance which has been provided for private equity deals is indeed part of that crisis.

A year ago I noticed that there were sitting on my desk at the same time both checks which I had received for companies which I had sold to private equity buyers and prospectuses inviting me to make applications for new private equity funds. I realised that what was happening was that I was being asked to pay large fees to buy companies like equity office properties and Sainsburys from myself at a very large premium to the market price. It became clear to me that I could not continue to go down and teach students about the way in which market prices emerge efficiently in securities markets and maintain a straight face.

The final surge of this boom was generated then by this mispricing of risk in asset markets and that is a mispricing which is now as we all know in the process of unwinding itself. That means that there will be fewer of these very large leveraged transactions of well established businesses in future. This will itself be a problem because of the size of the funds which has been raised in the last two or three years. The people who are hoping to collect fees from these funds will not therefore be in a great hurry to want to give that money back to their investors. It also means that some of the recent rounds of private equity financing are likely to be loss-making both to the private equity investors involved, to the people who are subscribers to the asset-backed securities involved and to some of the banks themselves involved in these transactions. Although the nature of private equity activity means that so long as these underlying operating businesses remain profitable – and it is likely at the operating level they mostly will – these losses need not emerge very quickly or be taken directly necessarily onto balance sheets.

So we are looking ahead then to a world that is different from the one we have seen in the last couple of years and which probably achieves a better balance between the swings of fortune between public markets and private equity over the last decade which I have described. If we look forward to the implications of that I think we can find them in two main areas and I want first to talk about large companies and then I want to talk about small companies.

As far as the large companies are concerned the real issue which we face is the relative merits of concentrated share ownership versus diffused share ownership of the large company. And that was an issue which was widely discussed in that earlier debate of the 1990s. It was a debate which was then conducted at least in the Anglo-Saxon world in terms which tended to point to the superiority of the more diffused Anglo-American model of share ownership over the more concentrated Continental European model of share ownership. I think even at that time the balance of advantage of these different models was much less clear-cut than that debate represented it. And there is also creating some reconciliation between the two some of the role that private equity owners play or private equity houses play just as there is a role that activist shareholders play in getting some of the advantages of more concentrated ownership with a more diffused structure in which a wide range of investors actually provide the finance.

But the question we need to ask looking forward is the fundamental one of if we judge by the criteria which regime is better at promoting the long-term development of operating businesses. Is that better done for large businesses with concentrated or with diffused share ownership? And there are arguments either way. At its best, private equity can be a more patient owner backing more strategic development than the public markets. But equally at its worst private equity can be concerned to massage earnings by postponing all avoidable expenditure for a year or two in order to go through what I thought of as the revolving door of taking a company out of the public market in order after a year or two to take it slightly spruced up back to the public market. Private equity can be patient but private equity can also be impatient.

Equally public companies have been in the past able to take a long-term strategic view. But especially through the 1990s and in recent years they have become locked in what I described earlier as this increasingly dysfunctional cycle of earnings management and quarterly reporting.

So I don’t want to argue today that private equity is good and public markets bad or vice versa. And indeed looking forward I think we will want to make use of both models. But a larger challenge we have is to learn from each model in ways that improve the other to create more transparency on the private equity model and equally to create more informed strategic activist shareholding in the public equity model.

That's the set of issues as I see them as far as large companies are concerned.

As far as small companies are concerned if we had been having this discussion ten years ago we would have regarded the terms private equity and venture capital as essentially interchangeable. They have ceased to be interchangeable because of the growth of large leveraged transactions.

I hope that more of the focus of private equity will once again be directed back to the support of small and early-stage businesses. There is no doubt that here the activist informed shareholding model of private equity is set up to do better. And which is a model which can justify because of its detailed involvement the kind of two and twenty fee structure which generates ridiculous numbers when applied to the very large businesses that have been subject to these leveraged buy-outs.

I think all of us must know of small start-up businesses of the kind I have been describing which when they have approached venture capitalists in the last couple of years have been told that they are not interested in small start-up businesses any more. "Come back and talk to us when you are rather bigger and better established". And that to my mind is private equity failing to fulfil the role for which it is in fact best suited and the role for which it is desperately economically necessary.

So I am in the end a somewhat neutral and balanced observer of all of this.

I believe there is a large and important economic role for private equity going forward but I think these huge leveraged transactions of well-established, stable, mature businesses which was such a feature of capital markets in 2006 and 2007 will very largely be a thing of the past.

What had happened recently and the events that prompted the allegations of locusts, Trojan horses and the like were largely a distraction from the proper role and future development of the private equity business.

Private Equity – A New Trojan Horse?

Axel Herberg

Mr. Müller, Ladies and Gentlemen,

First of all, it is a great pleasure to be here today and have the opportunity to share a real-life experience of working with private equity investors. There have been some horror stories in the press about private equity investors, not only in Germany. Well, in our case, I can say that this has not been our experience at all.

Gerresheimer today is a global and successful supplier to the pharma and life science industries. We employ 10,000 people at 37 locations across Europe, America and Asia and enjoy a leading position in all the markets in which we operate.

We have come a long way – only seven years ago Gerresheimer was an integral part of "Deutschland AG," a mid-sized company controlled by a German conglomerate with a majority shareholding. The share price of the company was not something that anyone paid much attention to. Most importantly, a truly entrepreneurial approach as a key element of corporate strategy and management was conspicuously absent. Political games with the majority shareholder were more important.

What followed were two leveraged buy-outs with a period of restructuring and repositioning, and then a process of dynamic and rapid growth. The new Gerresheimer AG went public in June 2007, the third biggest IPO in Germany this year so far, and is listed today on the Frankfurt Stock Exchange. Within the last four years alone:

- Sales have almost doubled
- The number of employees has almost doubled
- And the value of the company has almost tripled.

Today we have a solid financial structure, acknowledged leadership in our industry, and a strong base for continued growth.

How did we achieve this?

Gerresheimer's remarkable development is a unique growth story – and we achieved this over a short period of time in the course of two leveraged buy-outs. I believe that we would not have achieved this without private equity investors.

Why do I say this? Well, when you are in a leveraged buy-out situation, you inevitably learn to move fast under the pressure from the debt. You either sink or swim. We chose to swim. We knew exactly what we wanted to do. We wanted to become truly international, tap new markets, launch innovative new products and thereby grow into a global player.

Let me draw your attention to something else that is special about Gerresheimer's transformation: Gerresheimer was listed beforehand as a publicly traded entity with a quoted value on the stock exchange. This is important to bear in mind because it shows that, for our first private equity investor, we were not the classic "hidden gem" to be picked up among unlisted German SMEs. We already had a stock-exchange valuation. We were quite visible, with all the transparency that comes with being listed among Germany's top 100 companies. Despite this, we were convinced that we could create more value by taking our company private. Now, let me tell you what actually happened:

There was a two-phase process supported by different investors.

The first phase was a process of focussing which took in all our business units. We sold unprofitable businesses and started to streamline our processes with regard to all aspects of management and operations. This was a painful but very healthy exercise. We did it silently and without publicity.

The second phase was a period of sustained organic growth within the refocused group - combined with a sharply targeted buy-and-build strategy which was financially backed by our new equity sponsor. In the past two years alone, we have acquired and successfully integrated eight companies in Europe, the US and Asia. The old focus on the German market was left behind, and we went forward with a new international strategy. Today, Gerresheimer generates less than a third of its turnover in Germany.

This strategy was a resounding success.

It is interesting to note that the real value enhancement came only in this last phase. About 80 % of the increase in value was achieved in the second leveraged buy-out. As a result of the business focus on pharma/life science, our organic growth rate came close to double digits compared to a growth rate of only 2-3 % in the previous years.

This again shows that a strategy of growth creates much more value than a strategy of restructuring.

You may ask how private equity investors breathing down our necks helped us.

First of all, you have to be fast on your feet. You have to change structures and create an entrepreneurial spirit within the organisation. Gerresheimer rapidly left its old structures behind to become a competitive player in a globalised economy. On the other hand you have to resist "immoral" requests from time to time. If you want to pursue a growth strategy, recapitalisation ideas are not helpful and as the CEO you have to take a firm stand. This is first and foremost the CEO's responsibility.

Admittedly, we experienced quite high leverage – that is what a leveraged buy-out is all about. But looking back today, I believe this had an important benefit for the company: we had to develop a high sense of urgency and decisions had to be made instantly. In any case, spending money wisely is never a bad principle.

Of course, it is essential to team up with the right private equity people, which we did. On the other hand private equity needs strong management teams. The investors are first of all financiers who provide mezzanine capital and financial know-how but they are not industry experts.

The company and the investor need to work in close partnership and have the same clearly-defined aims. Trust is an essential part of this teamwork, and the key to success. That also means management needs to know that the investors will come up with hard cash if the circumstances require it. This kind of thing you will never get in writing – it will always be an unspoken understanding.

In seven years we went through two leveraged buy-outs, launched two corporate bonds, took the company private, and squeezed out the minority shareholders. Since the 11th of June Gerresheimer is a successful listed company again. So after gaining all this experience why did we not go for a third buy-out? Quite simply, we were ready for the stock market again. Being ready meant that our case was strong and convincing for investors who wanted to buy into our growth story as a publicly listed entity, with future growth based on a strong balance sheet.

Both of our private equity investors exited when it was right for them, but also at the right time for us. They left us in a much stronger position. And, needless to say, both made substantial returns on their investments.

Gerresheimer today is a completely changed company, transformed during the time of private ownership. For us, the familiar "horror story" certainly does not apply.

Central Banks and Global Capital – Ringmaster or Facilitators?

Josef Ackermann

Ladies and Gentlemen,

It is a great pleasure to welcome you to the third and final panel entitled "Central Banks and Global Capital – Ringmasters or Facilitators?"

When we started on the organization of this Congress about a year ago, of course, no one was able to actually foresee the recent financial turbulence and its repercussions. And these financial market tensions have highlighted the importance of the role central banks play, not only in preserving price stability, but also in safeguarding financial stability.

In light of these developments, our discussion today – relating to the role of central banks and their influence on global financial markets – could not be more relevant or timely.

While the increasing integration of global financial markets is generally considered to be beneficial, the recent turmoil has again underscored how closely integrated our economies have become and, in particular, how quickly negative movements – in this case in the U.S. mortgage markets – can be contagious for Europe and the rest of the world.

There is a set of four questions that are worth to be discussed today:

First, does the globalisation of financial markets help or hinder financial markets in reaching their ultimate policy objective of preserving monetary stability?

Second, while decisions on global capital flows are made by market participants, some believe the overly expansionary monetary policies have invited investors to incur excessive risks and "mis-price" risks. Is this an appropriate assessment?

Third, what lessons can and have central banks to draw from the current market turbulences?

Finally, fourth, the globalisation of financial markets also stimulates questions regarding the supervision of the various financial market players and an appropriate regulatory framework. In other words: What about the division of labour between supervisory and monetary authorities?

In this context, it would have been also interesting to hear a U.S. view on the financial turmoil and the role of central banks. This applies all the more since some criticism has been expressed against the Federal Reserve for its overly accommodating monetary policy stance for so many years after the meltdown of the "new economy", which may have contributed to the crisis. Unfortunately, because of the Thanksgiving holiday, we were unable to secure the participation of a Federal Reserve representative here.

However, I am delighted to introduce three very distinguished panellists from Europe and Asia who will share their knowledge about this wide range of issues and discuss these questions.

First, it is a great pleasure to introduce Ms. Teo Swee Lian, Deputy Managing Director, Prudential Supervision, of the Monetary Authority of Singapore (MAS), with responsibility for the regulation and supervision of all banks, finance and insurance companies licensed in Singapore. It is interesting to note that the tasks of Singapore's central bank are very broadly defined and include, for example, issuing government securities and promoting Singapore as an international financial centre.

Such a broad approach is likely to give the MAS very good insights into the integration of the global financial markets. As a key international financial center and small country, Singapore is perhaps uniquely positioned to play the role of a facilitator. I am looking forward to hearing Ms. Teo's comments on our topic today from an Asian perspective.

Secondly, let me welcome and introduce Professor Axel Weber, President of the Deutsche Bundesbank, and in this capacity, a member of the Governing Council of the European Central Bank.

As things stand now, the euro area has caught up with the U.S. financial markets in several segments, and the euro has also gained considerable ground as an international trade, investment and reserve currency. Thus the ECB is responsible for setting monetary policy in one of the world's most important currency areas and has a strong impact on the smooth functioning of the international financial markets. In this demanding role, it has earned widespread respect for its work over the course of the past few years.

Finally, I would like to introduce Sir Callum McCarthy, who is Chairman of the Financial Services Authority in London.

Before joining the FSA in September 2003, Sir Callum McCarthy's previous roles included Chairman of the Gas and Electricity Markets Authority as well as a number of senior-level positions in the financial industry. At the FSA, he now performs a key supervisory role in the world's largest financial centre, which is also the major hub for business with the euro. It will indeed be interesting to hear his views on whether the FSA should be seen as a ringmaster or facilitator.

I would now like to ask Ms. Teo to take the floor.

Central Banks and Global Capital – Ringmaster or Facilitators?

Teo Swee Lian

Dr. Ackermann, Excellencies, Ladies and Gentlemen,

Introduction

It is my great pleasure this afternoon to join my fellow central bankers and regulators in a discussion of this very current topic. As MAS performs both the functions of a central bank as well as a financial regulator, I will be taking on both perspectives this afternoon.

As you all know very well, the recent market turbulence was triggered by concerns over a very specific segment of high-risk borrowers, but very rapidly spilled over more broadly to other credit and asset markets that were fundamentally sound. With the continued growth of global capital mobility, such spillover effects are likely to become ever more pronounced, and in this regard, financial authorities have to work together in order to be proactive and effective in fostering financial stability, while allowing the positive effects of globalization to continue.

Role of Central Banks and Financial Regulators

In today's marketplace, the roles of "ringmaster" and "facilitator" are not mutually exclusive. Global capital has become a way of life and there are good reasons why many would want to tap into these flows in order to achieve greater economic potential. The "ringmaster" role becomes relevant as we acknowledge that certain checks and balances need to be put in place in order to facilitate these flows in an orderly and sustainable fashion.

The ringmaster structures the circus program so as to facilitate the performances of the various acts. He also ensures that the safety nets and protective barriers are put up to protect both performers as well as the audience when the more risky acts come into the ring. In much the same way, one key responsibility of financial authorities is the maintenance of reliable infrastructure to facilitate the smooth functioning of global capital.

For example, the ease of global capital mobility was not the only culprit during the Asian Financial Crisis, as equally guilty was the absence of robust financial market systems and infrastructure to handle the influx of capital when markets were opened up to international investors. Apart from the building of such structural capabilities, financial authorities should be unobtrusive during day to day operations, only to step in when disorderly behaviour or market failure makes it necessary to do so in order to preserve financial and macroeconomic stability.

The Central Banker's Toolbox

In recent debates, much has already been said about the issue of potential moral hazard when financial authorities intervene in markets. According to that argument, the assistance of financial authorities for struggling institutions could have the undesirable effects of encouraging risky behaviour in the future and undermining the efficient pricing of risk. On the other hand, many bankers would argue, as some of you in the audience have, that the incentives for prudent risk management in the private sector are still in place, as can be seen from the numerous heads that have rolled because of the recent market fallout.

To me, the more pertinent issue is a hazard of a different kind, and I am not sure if it is moral or otherwise. This hazard is the potential loss of effectiveness of financial authorities' policy tools. A central bank clearly has a case to intervene if a crisis threatens its objective of financial stability, however in doing so, it should avoid creating expectations that may undermine its effectiveness in future crises. In many, if not all crises, the management of sentiment and expectations are just as important as the management of fundamentals. Under "business as usual" conditions, predictable and consistent policy actions are the best facilitator, but ironically in times of crisis, financial authorities may need to have a more varied array of policy options so as to retain the ability to "shock and awe."

In order to remain effective, central banks need to have a variety of tools at their disposal. In light of recent events, one current issue worth considering is for central banks to expand the range of acceptable collateral. While valuation difficulties may present some challenge, such an option would allow central banks more leeway to tailor their response to a crisis. Additionally, central banks may even have to consider developing instruments tailored not just for their domestic markets, but which also accommodate foreign markets that their institutions operate in.

Apart from an arsenal of crisis management tools, the enhancement of preventive tools is also important to aid in risk detection and mitigation. Furthermore, central bankers and supervisors need to continually upgrade their skills so as to keep up with latest market innovations.

Effective Regulation Requires Cooperation

Cooperation amongst regulators is also crucial as markets become more complex and global. While no one denies that financial innovations have many positive uses, some of which actually reduce risk, the misuse of these new fangled instruments can also mean that risks are obscured and transferred to less well-informed investors in an unsavoury manner. As many of these risk transfers occur across geographical borders, home and host regulators need to engage in greater dialogue and collaboration in order to gain a better picture of systemic risks that could affect a broad range of market participants.

At this point, I would like to acknowledge the sharing by US and European financial authorities of their experiences and supervisory information regarding the impact of the recent subprime crisis. For host regulators such as the MAS, such forthcoming cooperation has been very useful in helping us discharge our supervisory responsibilities. I hope that this exchange of information between financial authorities will continue to strengthen so that system-wide problems can be more effectively dealt with. Better collective understanding and cooperation among regulators are essential in managing risk of a global financial institution.

Allow me now to touch briefly on the effect of the subprime crisis on Asia.

Effect of the Subprime crisis on Asia

Generally speaking, Asian financial systems are much less securitised than the US or European markets, and thus have been less affected by the recent turmoil. Asian holding of US mortgaged-backed securities (both subprime and otherwise) amounted to about 1 % of banking assets in Asia. However, Asia was not entirely unscathed.

The month of August saw a significant widening of Asian sovereign spreads coupled with a fall of Asian currencies and a sell-off in the Asian equity markets. Yet risk aversion in Asian financial markets abated fairly quickly. Once bitten, twice shy. I believe that one of the major reasons for Asia's resilience is the experience of the Asian Financial Crisis, which continues to reside in the collective consciousness of the region. Asian financial institutions are much stronger today than ten years ago when the Asian crisis unfolded. The Asian markets are now deeper and investors are much more cognizant of possible downside risks. There has also been a substantial build up of foreign reserves across the region which underlies a systemic effort to reduce vulnerabilities. Another reason Asia was less affected was because banks were still getting decent returns from the more traditional deals in recent years without having to do as much searching for yield in the universe of more esoteric instruments.

Asia has thus far weathered the sub-prime crisis well and fundamental growth prospects remain generally sound as there are now more growth engines in the region. Most Asian economies also run current account surpluses and have built up a cushion of foreign reserves over the years. Nonetheless, caveats still remain. The biggest risk to the region's macroeconomic outlook remains a sharp downturn in the US economy as Asia is still highly dependent on exports. In addition, the Asian region would continue to face challenges associated with large capital inflows such as the impact on exchange rates, asset prices and credit growth. The recent sharp increase in oil prices would also lead to some inflationary pressures, thus posing further challenges to policy-makers.

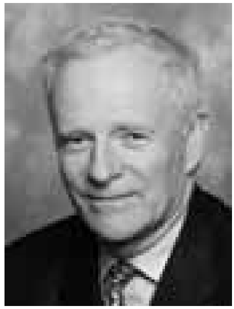
Conclusion

On a day to day basis, financial authorities have the responsibility of ensuring the efficient functioning of the necessary infrastructure to facilitate orderly capital flows. In order to effectively discharge this duty, financial authorities need to be proactive in identifying emerging risks so as to be able to develop strategies to mitigate them. Central bankers in particular need to develop and refine a variety of tools in order to act decisively in times of stress. Furthermore, close cooperation amongst regulators will aid the early detection of problems and better facilitate the coordination of efforts in the event of a global financial crisis.

The events in recent months hold many important lessons for the financial community, and to a large extent, we are still in the midst of the learning process. Yet in thinking about how to prevent a similar crisis in the future, we must be careful not to let the regulatory pendulum swing too much to the conservative, as stifling markets will not make them healthier. The first line of defence should always be the financial institution's own internal risk management process, and it is the ultimate responsibility of senior management and the Board to ensure that the risks are understood, correctly assessed and within acceptable parameters. As such, I would like to acknowledge the work done by banks in Europe and international organizations such as the IIF , in fostering self-awareness amongst the banking community by identifying current weaknesses and recommending best practices for the industry.

Thank you for your kind attention.

Central Banks and Global Capital – Ringmaster or Facilitators?



Sir Callum McCarthy

One of the pleasures of this occasion is the admirably firm instructions which the organisers – and the chairman of this session – have given to the central bankers and financial regulators speaking: an example of the tables being turned, the regulated dictating to the regulators – with, I suspect, a degree of pleasure. In keeping with my normal concern to maintain and improve the regulatory relationship, I will try to respond to the particular exam questions I was set. They were:

- What should be the regulatory relationships in a globalised world?
- How do we enhance transparency and boost risk management?
- Do we need closer cooperation between national regulators?
- What should be the division of responsibility between supervisory and monetary institutions?

Of necessity, I will be very brief. Each question could occupy us extensively.

Regulatory relationships

2. Let me deal with the first and third questions together, since they are obviously related: how should national regulators work together to provide effective supervision of the major international financial groupings which are of such increasing importance? Responding to the justified demands of the large international banks, insurance companies and securities companies which already are so significant and which I believe will become much more so is a major challenge to the regulatory community, in Europe and globally. It is a challenge to which the response is not yet adequate – either conceptually or in relation to particular initiatives.

3. Conceptually, we need to agree what I have on other occasions called a taxonomy governing home and host issues. This cannot be based on a simplistic rule that the home regulator for any institution is the decision maker for that institution's activities, wherever they may be situated. This subordination of host responsibilities to home supervisor has the benefit of simplicity – but simplicity at the cost of ignoring important realities. There are at least four realities which the home country supervisor approach, at least in its simple form, does not acknowledge:

• First, there is a question of legitimacy: regulators are accountable, and cannot be expected, in relation to a financial institution which is important in a host country, to answer questions about that institution by referring them to the sometimes distant "lead regulator". I do not think you can, for example, expect the Hungarian Financial Supervisory Authority (PSZAF) to respond to questions about Citibank's extensive and – to Hungary – significant activities in Hungary by referring them to the US Federal Reserve Board or the Office of the Comptroller of the Currency.

• Second, there are substantial differences between the legal powers granted to different regulatory organisations in different countries. Even within the EU there is no common basis of legal powers. And beyond the EU the position is even less clear.

• Third, there are questions of political will: it is clear that the degree of independence of financial regulators is not uniform across the world, nor is it uniform even within the EU.

• Fourth, there are questions of competence. Not all countries are able to devote the resources, or have the experience, to discharge all the responsibilities that might be expected of a lead regulator even with the benefit of some collaboration with host authorities. We should recognise that this is a real problem, which should not be glossed over.

Instead of a simple policy of lead or home supervisor supremacy, we need to develop a more realistic taxonomy which recognises that some – but certainly not all – banks are too important in host countries to be left to the home regulator; and we need to develop protocols which define, forthe various issues and circumstances which arise, the rights and duties of both home and host regulator.

4. We also have to develop effective and practical means of translating these principles into day-to-day cooperation between national regulators. There have been helpful developments, both of a legal nature and in terms of developing working practices. Legally, the combination of the EU Financial Groups Directive and the US Consolidated Supervised Entities ("CSE") regime for the large US investment banks has led to a welcome expansion in the scope of the SEC activities to take account of the global consolidated position of the major broker-dealer groups, including their capital on a Basel basis. The CSE has also led to the identification of a coordinating authority at EU level charged with coordinating the regulatory relationship and information flows. These arrangements enable us to address some of the central questions of capital adequacy, both atgroup level and in terms of its availability to different parts of a group. And in terms of developing good working practices between regulators, we have made real advances. For major international banks we at the FSA are establishing or supporting other regulators in establishing groups of regulators who meet together to exchange information on and to discuss the regulatory issues associated with the bank as a group. For Credit Suisse and UBS, for example, the Swiss EBK has established "trilateral" arrangements with the UK FSA and the New York Fed. By exchanging information and

views about the bank among this group, it is possible to prepare for and hold a single regulatory meeting with the bank, with the benefit of both a reduced, non duplicative information demand on the bank, and – I hope – an improved quality of regulatory discussion. We, as a host regulator, are happy to contribute to this from the FSA. The FSA has done the same as home regulator in the context of Basel implementation by holding a series of regulatory colleges for our most important banks with extensive overseas operations. We have organised these, for example, for HSBC, Standard Chartered and RBS. We have also aimed to develop those groups beyond the most important jurisdictions by involving, in variuos ways, regulators from a range of countries in which the banks operate. In February, for example, we organised a two-day meeting at the FSA of some 83 regulators of HSBC, drawn from 44 countries. We are developing for Standard Chartered a regional approach, under which we talk with regional groups of that bank's regulators.

5. In summary, the challenge to regulators of responding to international financial services groups is important. We need a framework which is not just simple, but rather reflects realities. And, for all that we have made progress, it remains a challenge to which the regulatory response is not yet fully developed.

Risk management

6. The issues raised by transparency and risk managemment are wide and central to the questions we all – bankers and regulators – have to address in framing our responses to the present stresses in the world's financial systems. I will make only two comments on this very broad range of issues.

7. First, it is important not to confuse transparency – which I will define as the provision in comprehensible form of information which is relevant to risk and reward – with disclosure – which I define as the provision of more and more data. To be truly effective, transparency needs to be principles-based, that is to say designed to meet the needs of decision-makers. There is always a risk that prescribed levels of disclosure may allow firms to meet the letter of the requirements but not necessarily in a way which assists the market to make the necessary judgements. The 2006 annual report of Citigroup ran to 200 pages; but when Citi announced on 4 November that its US sub-prime related super senior exposures amounted to approximately US$ 43 billion it came as surprise to the market. There is a growing problem that disclosure of data can be so copious that information is obscured: the last annual report of Deutsche Bank ran to 308 pages; that of HSBC of 458 pages; that of Goldman Sachs to 137 pages. None of these distinguished institutions set out to do other than meet their legal obligations as to disclosure. But it is far from clear that the disclosure of so many data aids information. We need to ensure that the principle of transparency does not become translated into counterproductive data requirements. This is why, when implementing Pillar 3 of the new Basel 2 framework, we have made clear our view that these disclosures should be by the market for the market.

8. Second, as to risk management recent events have underscored – as if such emphasis was needed – the central importance of both strong processes of the sort which the Counterparty Risk Management Group under Gerry Corrigan's leadership has done so much to advance, and of the fundamental importance of stress testing by firms of the central vulnerabilities to which they are subject. I know of no subject more important for prudential supervision than first the identification, and second the stress testing, of severe but plausible states of the world. I should emphasise that stress testing itself – namely the selection of stresses, and the taking of strategic decisions on the basis of the tests – is a task for management, while it is for the supervisor to be satisfied that the tests properly reflect the risks being taken. This area will continue to test both the management and the regulators of banks. It is testing because at the heart of the process is judgement – what severe stress could plausibly occur and would mitigating action provide comfort in those circumstances – not the application of statistical analysis; because the judgement is specific to each institution; and because – as recent events have shown – it is only too easy to make misjudgements. But it is clear that we will need to devote more time and thought to stress testing.

Responsibilities

9. The last question I have been asked to address is the division of responsibilities between supervisory and monetary policy organisations. On the question of whether these responsibilities should be combined in one organisation or divided, I would repeat what I have always said, namely that it is manifest that either model can be made to work. I see very considerable advantages in avoiding the regulatory arbitrage which is inevitable if banking, insurance and securities regulation occur in separate organisations; and I am struck by the stylistic and organisational differences between between the repeated consideration of a single question in relation to monetary policy – the centralised decision normally taken monthly as to hold or change interest rates – on the one hand, and the enormous range of supervisory decisions, distributed across any supervisory organisation, taken at many levels within the organisation on a day-to-day basis, which comprise the task of regulation. Because of this, both the Bank of England and the FSA continue to believe there are advantages in maintaining monetary policy separate from the supervision of individual institutions.

10. This division of responsibilities also involves substantial areas of mutual interest. For example, the setting of liquidity requirements for individual institutions must clearly take into account the central bank's policy as to what instruments it will accept as eligible collateral for various liquidity purposes; the central bank's balance sheet is normally central to systematically important payment systems; and the central bank, rather than the regulator, will have the balance sheet assets which permit provision of liquidity support. Whatever the separation of certain responsibilities, there will remain very substantial shared interests and responsibilities, which emphasise the need for close, continuous and cooperative working.

Central Banks and Global Capital – Ringmaster or Facilitators?

Closing Remarks

Herbert Walter

Ladies and Gentlemen, this year's European Banking Congress is coming to an end.

I think we've had a useful day! In our panels we have had very wide-ranging discussions. I hope that this year's congress has helped to find common ground between everyone involved in these markets.

So, on behalf of all of us, I want to thank the speakers and panelists for their excellent contributions. I also want to thank all those in front of and behind the scenes who helped make this congress a success. Next year's event will take place on November 21st. My co-hosts and I look forward to seeing you again here in Frankfurt.

But before, after so much talk about subprime, we can now look forward to a prime event tonight, the Finanzplatz Gala, starting at 7pm.

Take care, goodbye and auf Wiedersehen.

Information about the EBC

The Frankfurt European Banking Congress (EBC) premiered in 1991 on the initiative of the International Bankers Forum Frankfurt (IBF). Since 1992, the congress has been hosted annually by Germany's three leading banks based in Frankfurt – Commerzbank, Deutsche Bank, and Dresdner Bank - as well as by the Deutsche Bundesbank, the City of Frankfurt and the IBF. Each year, the chairmen of Commerzbank, Deutsche Bank and Dresdner Bank take turns in officially hosting the EBC. Traditionally, the EBC takes place on the Friday prior to the very last Friday in November at the Alte Oper Frankfurt.

The EBC aims at providing a forum for open and forward oriented discussion of European issues, their role in the world of politics and financial markets. European politics and finance are discussed by leading decision makers and eminent heads-of-state in three panel discussions. The first panel brings together political leaders, the second panel top bankers, and the final panel governors of central banks. Topics and speakers for each year's event are chosen by the EBC's steering committee.

Today, the EBC is among Europe's most prestigious banking congresses. The EBC is an established meeting place for high level representatives from politics, business, finance, and academia and attracts every year approximately 1,000 delegates and 300 press representatives from more than fifty countries to the Alte Oper in Frankfurt. Admission to the congress is by personal invitation only.

The steering committee of the Frankfurt European Banking Congress consists of members of Germany's three leading banks based in Frankfurt - Commerzbank, Deutsche Bank, and Dresdner Bank - as well as representatives of the Deutsche Bundesbank, the City of Frankfurt and the International Bankers Forum. The steering committee meets regularly and is the sole organ responsible for the EBC's structure and content.

Further information about the EBC can be obtained from the

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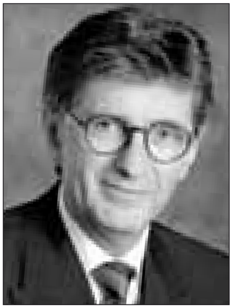

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Managing Director
Frankfurt Economic Development
Frankfurt

Norbert Walter
Chief Economist
Deutsche Bank Group, Frankfurt

List of Speakers (1991 – 2007)

Surname	First Name	Organization	Year
Abelein	Manfred	European Bank for Reconstruction and Development	’91
Achleitner	Paul	Allianz AG	’00
Ackermann	Josef	Deutsche Bank AG	’02 -’07
Alexander of Weedon, Lord	Robert	National Westminster Bank plc	’95
Al-Mannai	Jassim	Arab Monetary Fund	’06
Alphandéry	Edmond	Ministère de l’Economie et du Budget, France	’93
Al Suwaidi	Sultan Bin Nasser	Central Bank of the United Arab Emirates	’06
Andersen	Bodil Nyboe	Danmarks Nationalbank	’97
Arthuis	Jean	Ministère de l’Economie, des Finances et du Plan, France	’96
Aznar	José María	Prime Minister, Spain	’99
Bäckström	Urban	Sveriges Riksbank	’96
Bangemann	Martin	European Commission	’92
Balcerowicz	Leszek	Minister of Finance, Poland	’98
		National Bank of Poland	’01
Baldassarri	Mario	Vice Minister of Economy and Finance, Italy	’05
Barre	Raymond	Mayor of Lyon, France	’97*
Bischoff	Manfred	DaimlerChrysler	’99
Blessing	Martin	Commerzbank AG	’03
Breuer	Rolf-E.	Deutsche Bank AG	’97-’01
Brittan	Sir Leon	European Commission	’98
Brodsky	William J.	Chicago Mercantile Exchange	’94
Brok	Elmar	European Parliament	’95
Bryan	Lowell L.	McKinsey & Company, Inc.	’96
Bürkner	Hans-Paul	The Boston Consulting Group	’96,’03
Burggraf	Nikolaus	City of Frankfurt am Main	’05*
Buxton	Andrew R. F.	Barclays Bank	’98
Cartellieri	Ulrich	Deutsche Bank AG	’91
Caruana	Jaime	Basel Committee on Banking Surpervision, Banco de España	’04
Cavallo	Domingo Felipe	Fundación Mediterránea	’97
Christophersen	Henning	European Commission	’91, ’02

* Dinner Speaker

Surname	First Name	Organization	Year
Ciampi	Carlo Azeglio	Minister of Treasury, Budget and Economic Planning, Italy	’96
Corcóstegui	Ángel	Banco Santander Central Hispano S.A.	’00
Crockett	Andrew D.	Bank for International Settlements	’94, ’98, ’99
Dallara	Charles H.	The Institute of International Finance	’04
Davies	Howard	The Financial Services Authority	’00
Davignon, Viscount	Etienne	Société Générale de Belgique	’95
Dervis	Kemal	State Minister, Turkey	’01*
Doerig	Hans-Ulrich	Credit Suisse	’93
Duisenberg	Willem F.	European Central Bank	’97-’01
Eichel, MP	Hans	Minister President of Hesse,	’91
		Minister of Finance, Germany	’99
Enger Lahnstein	Anne	Center Party, Norway	’95
Fagiolo	Silvio	Ambassador of Italy, Berlin	’04
Fahrholz	Bernd	Dresdner Bank AG	’00 -’02
Fazio	Antonio	Banca d’Italia	’96, ’04
Ferrer	Carlos	Ferrer International S.A.	’94
Fini	Gianfranco	Deputy Prime Minister, Italy	’03
Fischer, MP	Joschka	Federal Minister for Foreign Affairs, Germany	’00,’03
Fisher	Richard W.	Federal Reserve Bank of Dallas	’06
Floether	Karl-Heinz	Accenture	’03
François-Poncet	Jean	French Senate, France	’97
François-Poncet	Michel	Banque Paribas S.A.	’95
Franz	Wolfgang	Centre for European Economic Research, The German Council of Economic Experts	’06
Freeman	Ron	European Bank for Reconstruction and Development	’93
George	Sir Edward A. J.	Bank of England	’93, ’95
Gordon	Noel	Accenture	’06
Greenspan	Alan	U.S. Federal Reserve System	’98, ’04
Gronicki	Mirosław	Minister of Finance, Poland	’04
Gronkiewicz-Waltz	Hanna	National Bank of Poland	’93
Gurría	Angel	OECD Organisation for Economic Co-operation and Development	’07

* Dinner Speaker

Surname	First Name	Organization	Year
Gyurcsány	Ferenc	Prime Minister, Hungary	’07
Hambrecht	Jürgen	BASF	’05
Harney	Mary	Minister for Enterprise, Trade and Employment, Ireland	’98
von Hauenschild	Caspar	Bayerische Vereinsbank AG	’91
Heikensten	Lars	Sveriges Riksbank	’03
Herberg	Axel	Gerresheimer AG	’07
Hirano	Eiji	Bank of Japan	’05
Howe	Robert M.	IBM Corporation	’96
Howe of Aberavon, Lord	Geoffrey	Former Foreign Secretary, United Kingdom	’96*
Hübner	Danuta	Minister for European Integration, Poland	’02
Hüppi	Rolf	Zurich Financial Services	’99
Iozzo	Alfonso	Istituto Bancario San Paolo di Torino	’91
Issing	Otmar	Center for Financial Studies	’07*
Iwata	Kazumasa	Bank of Japan	’04
Járai	Zsigmond	Minister of Finance, Hungary	’99
Jeancourt-Galignani	Antoine	Banque Indosuez	’92
Jin	Liqun	Asian Development Bank	’05
Jin	Renqing	Minister of Finance, People’s Republic of China	’04
Kallas	Sjim	Minister of Finance, Estonia	’01
Kay	John	London School of Economics; Financial Times	’07
Kempe	Frederick	The Wall Street Journal Europe	’93
Klaus	Václav	Prime Minister, Czech Republic	’97, ’06
Koch	Roland	Minister President of Hesse	’02
Koch-Weser	Caio K.	Federal Ministry of Finance, Germany	’05*
Kohl	Helmut	Chancellor, Germany	’96
Kohlhaussen	Martin	Commerzbank AG	’92-’00
Kohn	Donald L.	The Federal Reserve System	’02
Kopper	Hilmar	Deutsche Bank AG	’92-’96
Kostrzewa	Wojciech	BRE Bank	’01
Kraus	Adolf	Schröder Münchmeyer Hengst & Co	’91

* Dinner Speaker

Surname	First Name	Organization	Year
Lagarde	Christine	Ministry of Foreign Trade, France	'06
Lagayette	Philippe	Caisse de Dépôts et Consignations	'93
Lamfalussy, Baron	Alexandre	European Monetary Institute Université catholique de Louvain	'94-'96, '00, '02
László	Csaba	Minister of Finance, Hungary	'03
Lefebvre	Olivier	Euronext	'02
Leigh-Pemberton	Robin	Bank of England	'92
Lemierre	Jean	European Bank for Reconstruction and Development	'01, '04, '05
Lindh	Anna	Minister for Foreign Affairs, Sweden	'01
Liener	Gerhard	Daimler Benz AG	'93
Lim	Hng Kiang	Second Minister for Finance, Singapore	'02
Maas	Cees	ING Groep NV	'95, '00*
Mallinckrodt	George W.	Schroders PLC	'92
Marsh	David	Financial Times	'92
Martini	Eberhard	Bayerische Hypotheken- und Wechsel-Bank AG	'91
McCarthy	Callum	The Financial Services Authority	'07
McDonough	William J.	Federal Reserve Bank of New York	'94
Mentré	Paul	Banque C.S.I.A.	'91
Merkel	Angela	Chancellor, Germany	'06
Messerlin	Patrick A.	Sciences Po	'06
Mikloš	Ivan	Deputy Prime Minister and Minister of Finance, Slovak Republic	'04
Monti	Mario	European Commission Bocconi University	'99 '94, '07
Müller	Horst	Dresdner Bank AG	'03
Müller	Klaus-Peter	Commerzbank AG	'91, '01-'07
Müller-Vogg	Hugo	Frankfurter Allgemeine Zeitung	'98
Naumann	Klaus	General, retired	'99*
Ng	Kok Song	Government of Singapore Investment Corporation	'97
Nilekani	Nandan M.	Infosys Technologies	'05
Nonnenmacher	Günther	Frankfurter Allgemeine Zeitung	'95
Obolensky	Arianne	Ministère de L'Economie et du Budget, France	'92
Ogata	Shijuro	Yamaichi Securities Co. Ltd.	'91
Olechowski	Andrzej	Minister of Foreign Affairs, Poland	'94
Orbán	Viktor	Prime Minister, Hungary	'98*, '00

* Dinner Speaker

Surname	First Name	Organization	Year
Padoa-Schioppa	Tommaso	European Central Bank	’02
Papademos	Lucas D.	Bank of Greece	’99
		European Central Bank	’06
Prodi	Romano	University of Bologna	’92
		Prime Minister, Italy	’98
		European Commission	’00, ’02
Profumo	Alessandro	UniCredito Italiano	’01
Pütter	Thomas U. W.	Allianz Capital Partners GmbH	’07
Quinn	Ruairi	Minister for Finance, Ireland	’96
Raghuram	Ganesan	Indian Institute of Management	’06
de Rato	Rodrigo	Ministerio de Economía y Hacienda, Spain	’96
		International Monetary Fund	’05
Rau	Johannes	Federal President, Germany	’02
Repše	Einars	Bank of Latvia	’01
Richardson	James	Cisco Systems Inc.	’00
Rolander	John S.	Gemini Consulting	’96
Röller	Wolfgang	Dresdner Bank AG	’92
Roth	Jean-Pierre	SBN Swiss National Bank	’03
Roth	Petra	Mayor, City of Frankfurt am Main	’95-’07
Roth	Wolfgang	European Investment Bank	’93
Rudloff	Hans-Jörg	Barclays Capital	’03
Sampaio Malan	Pedro A.	Minister of Finance, Brazil	’99
Sanio	Jochen	Federal Financial Supervisory Authority	’04
Sarrazin	Jürgen	Dresdner Bank AG	’93-’97
Schäuble	Wolfgang	Group of the Christian Democratic Union/ Christian Social Union	’97
Schlesinger	Helmut	Deutsche Bundesbank	’91, ’92
Schmögnerová	Brigita	Minister of Finance, Slovak Republic	’01
von Schoeler	Andreas	Mayor, City of Frankfurt am Main	’91-’94
Scholey	Sir David	S.G. Warburg Group plc	’93
Schulmann	Horst	Landeszentralbank in Hessen	’92
Schüssel	Wolfgang	Federal Chancellor, Austria	’01
Seifert	Werner G.	Deutsche Börse AG	’00, ’02
de Silguy	Yves-Thibault	European Commission	’95
Simon of Highbury, Lord		Ministry for European Trade and Competitiveness, United Kingdom	’97
Simmons	Hardwick	The Nasdaq Stock Market	’02
Sobchak	Anatoly	Major, City of St. Petersburg	’91

* Dinner Speaker

Surname	First Name	Organization	Year
Strutz	Wolfgang	BHF-BANK Aktiengesellschaft	’91
Tănăsescu	Mihai Nicolae	Minister of Public Finance, Romania	’01
Taylor	Charles R.	The Group of Thirty	’94
Teo	Swee Lian	Monetary Authority of Singapore	’07
Thalwitz	Wilfried P.	The World Bank	’92
Thiemann	Bernd	DG Bank	’91
Thygesen	Niels	University of Copenhagen	’92
Tietmeyer	Hans	Deutsche Bundesbank	’93-’98, ’04*
Titzrath	Alfons	Dresdner Bank AG	’91
Tošovský	Josef	Czech National Bank	’91
		Bank for International Settlements	’01
Trichet	Jean-Claude	Banque de France	’94*, ’97
		European Central Bank	’03*, ’03-’05, ’07
Tůma	Zdeněk	Czech National Bank	’03
Tyson	Laura D.	London Business School	’06*
Verheugen	Günther	European Commission	’01
Viermetz	Kurt F.	J.P. Morgan & Co. Incorporated	’93
Volcker	Paul A.	Federal Reserve Bank of the United States of America	’97
Vita	Guiseppe	Schering AG	’98
Wagner	Udo N.	ABB Asea Brown Boveri AG	’94
Walter	Bernhard	Dresdner Bank AG	’98, ’99
Walter	Herbert	Dresdner Bank AG	’04-’07
Walter	Ingo	New York University Salomon Center	’92
Weber	Axel A.	Deutsche Bundesbank	’04-’05, ’07
Weiss	Heinrich	SMS group	’05
Welteke	Ernst	Deutsche Bundesbank	’99-’01, ’03
Weston	John Pix	British Aerospace	’99
Yamaguchi	Yutaka	Bank of Japan	’02
Yavlinsky	Grigory	EPICENTER	’95*
Zeti Akhtar Aziz		Central Bank of Malaysia	’05

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