The FT's Year in Finance

Tuesday December 11 2012

www.ft.com/reports | twitter.com/ftreports

Survivors in the post-crisis world

A turbulent year led to heated debates about the future of the eurozone and of capitalism itself, writes *Sarah Gordon*

In the world of finance, the great survivor of 2012 is undoubtedly the euro, some would say against the odds. Last January, the Financial Times asked 83 leading economists whether they thought the currency would survive 2012 "broadly intact". Only 43 answered "yes". Yet, as the end of the year approaches, and even if the present calm proves temporary, the worst of the eurozone storm appears to have passed.

If the eurozone had broken up, it would not have been for want of champions trying to hold it together. The year has been marked by supportive policies – ranging from €1tn in loans to the region's financial system from the European Central Bank to bailouts of Spain's wobbling banks, not to mention repeated last-minute agreements on Greece's austerity programme and the establishment (in principle but not, so far, in practice) of a Europe-wide banking union.

A turning point was reached in July when Mario Draghi, ECB president, pledged to do "whatever it takes" to save the euro. The frequent all-nighters in Brussels, as well as developments around the region, were covered by our correspondents and analysed by influential commentators from inside and outside the FT.

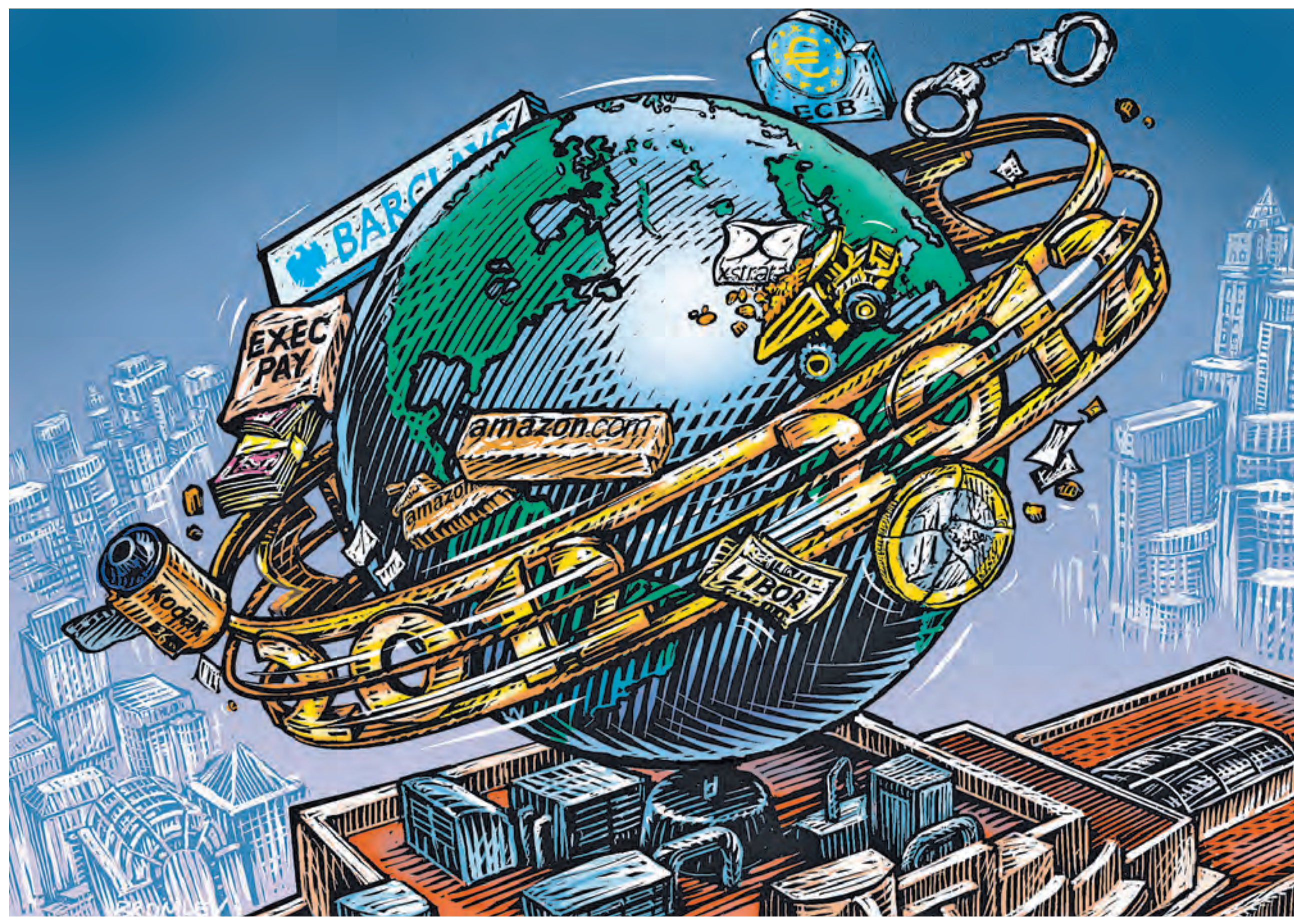
Beyond the eurozone, the wider discussion over the shape and nature of the post-crisis financial world remained heated. Martin Wolf followed the FT's series on Capitalism in Crisis with his suggestions for seven ways to fix capitalism, kicking off a fierce debate on the letters pages.

Fierce debate also characterised many annual meetings, as shareholders across the globe flexed their muscles. In the UK, WPP shareholders voted down the remuneration package of Sir Martin Sorrell, and Aviva's Andrew Moss and David Brennan of AstraZeneca both stepped down, partly in response to investors' ire over their pay. Executive pay was also a big factor in the year's most newsworthy deal, the takeover by Glencore of Xstrata. The deal had a difficult gestation; Glencore's final offer was a result of talks brokered by Tony Blair, the former UK prime minister, and almost came unstuck over Xstrata's proposal to pay £170m in retention payments to key staff. Pay was perhaps the only issue that was not a factor in the failure of another of the year's proposed deals – the £36bn tie-up of EADS and BAE Systems. Bogged down in wrangling between its shareholders, the deal finally fell apart because the German government wanted the merged company to be headquartered in Munich. Petty, though, was not the word to describe some of the losses caused by financial misbehaviour. UK banks racked up huge provisions – £10bn and counting – for their misselling of personal protection insurance. JP Morgan was hit by a $6bn loss due to unauthorised trading by the so-called "London whale". Kweku Adoboli, who lost his employer UBS $2.3bn, was sentenced to seven years.

In the US, the probe into insider trading claimed more scalps. Rajat Gupta, once head of McKinsey, was sentenced to two years and a $5m fine for passing confidential information to Galleon Group's Raj Rajaratnam, although Mr Gupta remains free pending appeal. HSBC, meanwhile, was fined $700m for money laundering in Mexico. But the most far-reaching financial scandal of 2012 was the revelation that Barclays, and other banks, had rigged market interest rates, including Libor, the London interbank offered rate, for financial gain. Barclays' involvement led not only to a large fine but to the departure of its chief executive, Bob Diamond, and its chairman, Marcus Agius.

This special report gives a flavour of the FT's coverage of the continuing upheavals in global financial markets, of the attempts by politicians and regulators to address it, and of those contributing to it. There is much more we could have included – the slowdown in China's economy; Apple's rise to become the world's most valuable company; and commentary from the world of academia as well as business. For those who want more than we can fit on the printed page both now and in 2013, it can be found at **www.ft.com**.

Sarah Gordon is Companies Editor.



David Bromley

Inside »

Law of the jungle
Lex in Depth looked at the valuation of online retailer Amazon
Page 2

Fighting back from obscurity
Richard Waters on tech giants' fight for survival
Page 2

US cliff-dancing
Gillian Tett assesses the fiscal challenges facing Barack Obama
Page 3

In defence of the banks
Regulation can halt progress, says Patrick Jenkins
Page 3

Libor: aiming for a fix
Doubts at the heart of the lending indutsry
Page 4

Bitter fallout looms as Merkel seeks a change in relations

Martin Wolf

"Marry in haste; repent at leisure." Full of impetuous ardour, Germany's partners seduced – some might say blackmailed – the continent's most powerful economy into sacrificing monetary independence two decades ago. But, as the prince in Giuseppe di Lampedusa's *Leopard* remarked of his own indissoluble union: "Fire and flames for a year; ashes for thirty." Now is the eurozone's time of ashes.

Heads of government of the group of 20 leading countries who do not come from the eurozone must feel like marriage counsellors trying to reconcile partners far too different in character and values to live happily together. The careless lending before 2007 aggravated the danger. That carelessness, exacerbated by the notion that the marriage made all equal, has made the crisis far worse.

Those whom borrowing afforded a standard of living above what they could afford are being forced to accept a plunge into poverty.

Not surprisingly, they resent the change.

The Greeks, unhappiest of all, have apparently chosen a government of parties slightly less unenthusiastic about the agreed programme than the others. Antonis Samaras was an opportunistic opponent of austerity in opposition, while his party, New Democracy, bears a full share of responsibility for the pre-crisis mismanagement.

Much trouble lies ahead: Alexis Tsipras of Syriza, the far-left party, has 27 per cent of the vote already. He will be only too happy to exploit rising public anger. Spain is hoping for a €100bn bailout of its banks but, alas, one that benefits the creditors of banks at the expense of the creditworthiness of the government.

At current rates of interest, it is only a matter of time before Spain requires a fiscal rescue. That would exhaust the available resources of the eurozone. It also risks turning a proud country into a dependency, with frightening results for stability.

Italy's fiscal deficits are far smaller than Spain's, but its rollover problem is bigger. According to the International Monetary Fund's Fiscal Monitor, Italy needs new financing equal to 28.7 per cent of gross domestic product this year, far above Spain's 20.9 per cent. Moreover, what follows the government of Mario Monti, due to leave office next year, is an enigma.

To this, one must add the divergence of views on economic policy between France and Germany. François Hollande's parliamentary victory will add to the stress. The coming debate over what a growth strategy means, while necessary, risks becoming quite heated.

Why, then, does anybody imagine that this difficult marriage can endure? One answer is that most citizens of the eurozone wish it to do so. The most powerful, however, is that people are (rightly) terrified of the consequences of a break-up.

As time passes, finance is becoming more national. But economies remain highly integrated. Not least, today's EU has been built around the euro. It cannot be assumed that the integration would survive a break-up. It would certainly represent a violation of treaty commitments.

The marriage may have been foolish. But a divorce would be terrifying. It is against this background that we must assess the views of the dominant partner: Germany. According to a translation I have received from the German embassy, Angela Merkel, Germany's cautious chancellor, told the Bundestag last week that she wishes to say to "all those who . . . are intent on persuading Germany that we need eurobonds, stability funds, a European deposit guarantee scheme, many more billions and much more: yes, Germany is strong".

Moreover: "We're convinced that Europe is our destiny and our future . . . But we're also aware that Germany's strength isn't infinite."

Furthermore: "Quite apart from the fact that these seemingly simple proposals . . . are unfeasible in constitutional terms, they are completely counterproductive. They would make mediocrity the yardstick for Europe. We would thus be forced to abandon our goal of maintaining prosperity in the face of international competition."

> 'They would make mediocrity the yardstick for Europe'
>
> Angela Merkel, Germany's chancellor

To all this she added: "The fiscal compact is a first step towards combining greater unity with greater control at the European level. And it's going to be vital that national powers only be relinquished when it is clear that this will involve independent supervision of the European institutions." In sum, she made three crucial points: first, Germany is not about to stump up more money; second, everybody in the eurozone must become like Germany; third, when and only when strong rules and credible controls exist at the European level might Germany accept any further losses of national sovereignty.

These positions raise big questions. Is there time available to impose these new rules and procedures, given the huge internal imbalances, wide divergences in competitiveness and severe fiscal pressures? Moreover, does Germany have any flexibility over positions that are partly prudential, partly constitutional and partly moral? My guess is the answer to these questions is: No.

Yet whatever the answers might be, it is evident that Germany's approach guarantees continued strong austerity in the vulnerable countries and, in all probability, mediocre growth in the eurozone. That, in turn, ensures the recurrence of political and economic crises, even if the eurozone survives. If the marriage counsellors wonder why they must endure all this, the answer is clear: this time, Germany intends to secure the behaviour it wants from its partners.

I can envisage five outcomes: first, a happy marriage, on Germany's terms, albeit after a painful period of adjustment; second, a miserable marriage, which endures because a break-up is too costly; third, a degree of mutual accommodation, in which the north becomes more southern and the south more northern; fourth, a partial break-up, with the remaining members moving into one of the three previous categories; and, finally, total break-up. What is certain is that Germany will not get the eurozone it wants easily or swiftly. If partial or total break-up is avoided, the period of difficulty will be long and painful. The crisis of the eurozone is likely to be a very long-running soap opera – if it does not end in tragedy.

This article appeared on June 20

中国农业银行
AGRICULTURAL BANK OF CHINA
Hotline: 0086-10-95599
Website: www.abchina.com
大行德廣 伴您成長
together we achieve
Over 23,400 domestic and foreign institutions
420 million retail customers
2.9 million corporate customers

Amazon and law of the jungle

Lex in Depth The share price looks high in spite of a fast-changing industry and heavy investment. *By Robert Armstrong* and *Stuart Kirk*

Proceed to checkout, review your order, click, done. Buying stuff on Amazon is easy. It is a wonder, however, that investors ever find the nerve to hit the place-your-order button for Amazon stock. That is because the online retailer's shares are expensive – basket-bustingly so. Yet "buy investors" do. So what are the justifications for owning Amazon at these levels? Can its valuation possibly make sense?

Introducing Walmazon

To see the reason for owning Amazon in 2012, start by thinking about Walmart in 1991. The big-box retailer sold $44bn worth of merchandise that year, and had already changed the way Americans shop, using its sheer size to take costs out of its supply chain and pass the savings along to customers. Over the prior 10 years, Walmart's average annual sales growth had been 34 per cent.

Similarly, Amazon's sales reached $48bn last year, topping off a decade in which sales growth averaged 31 per cent. It too has changed the way many people in America (and to a somewhat lesser extent Europe and Japan) shop for books (paper and digital), electronics, nappies, shoes – almost everything that can be delivered in a cardboard box or streamed over an internet connection.

In 1991, as it turns out, Walmart was just getting started. Since then, the company's annual sales have grown 10-fold to $450bn. It has increased its share of US retail from less than 4 per cent to more than 10 per cent, and built a $126bn international business from scratch. And like Amazon's today, Walmart's shares did not look like a bargain in 1991; at the end of that year they were fetching more than 40 times earnings. Yet it is hard to argue that buyers overpaid. They have enjoyed a 500 per cent return since.

The comparison is far from perfect, of course, and it pays to consider the places where it does not fit. One need not understand the operational differences between bricks and mortar and internet retail to see the contrast. Just look at the difference in growth and profitability.

The bottom line

In 1992, Walmart's growth, while still high, was decelerating. Amazon's growth was as high as ever last year. It takes an ever bigger slice of a pie – internet retail – that is itself expanding at a solidly double-digit pace in the US, and is expanding into other businesses. But whereas Walmart has delivered operating margins between 6 and 8 per cent for three decades, Amazon's margins peaked at 6 per cent in 2004, dropped several points for the following five years, and then, in 2011, dropped to around 2 per cent.

Part of the decline stems from Amazon's practice of subsidising delivery; shipping losses have been rising and now amount to more than 5 per cent of revenue. This company will cut profits to the bone to attract customers.

Amazon bulls will object that operating margin is not the right metric. Because Amazon pays its suppliers much more slowly than it is paid by its customers, in 2011 it averaged 90 days' worth of sales in payables (money due to be paid out) versus 16 days in receivables (money due to come in). Good inventory management also frees up cash. Over the past five years, these benefits (known as negative working capital) have accounted for almost a third of Amazon's free cash flow.

So operating profit does not reflect the company's cash profitability. Fair enough. Bear in mind two things, though. Free cash flow has declined alongside Amazon's operating profits in recent years. And this working capital benefit will decline when Amazon's growth slows. Working capital will not be a significant source of cash flow for ever.

Amazon shipping losses have been rising and now amount to more than 5 per cent of revenue

Revenues and revenue growth

Walmart, 1981-2011* / Amazon, 2000-11 — Revenue growth (annual % change); Revenues ($bn)

Operating margin

Per cent

Sources: company data; S&P Capital IQ * Years ending Jan

A prime valuation

Here the bulls will interrupt again. It could be that in the coming years Amazon will deliver much higher margins than it ever has, for four reasons. First, its electronic media businesses – from ebooks to online video – are intrinsically high margin, have no associated delivery costs, and are set to keep growing. Second, margins have room to improve as the company develops its services to third-parties. Amazon receives highly profitable commissions as other retailers use the company's internet storefront and distribution centres to move their own goods. Third, the Amazon Web Services businesses, which supplies companies with computing power and cloud storage, could generate $2.2bn in revenue this year, Citigroup estimates. Its closest pure-play competitor, Rackspace, boasts 12 per cent operating margins.

Indeed, in the first quarter of 2012, service revenues (mostly made of third-party commissions and Amazon Web Services) rose by two-thirds from the year before, and represents 15 per cent of total revenue. These fast-growing and higher margin businesses should offset another trend that hurts profitability – the shift away from high-margin media to lower-margin electronics and general merchandise. During the first quarter, in fact, gross margins (the proportion of sales left after the cost of goods sold is deducted, but before overhead costs) expanded by 110 basis points year-over-year, Amazon's biggest-ever expansion.

Finally, bulls insist, Amazon's lack of profitability merely reflects that the company is in the middle of an investment phase. Spending on technology and content (rights to music and video as well as research and development), marketing (as it pushes Kindle devices) and capital expenditures (18m square feet of offices and distribution and data centres were added in 2011) has expanded much faster than sales this year.

The potential leverage from reduced investment is striking. For example, if capital expenditures over the past 12 months had stayed at the level relative to sales of two years ago, free cash flow would have been almost double the reported number.

Cheap questions

There is, however, a big problem to solve before any of these bullish scenarios can be realised. One of Amazon's crucial advantages – low prices – is coming under pressure.

Until recently, Amazon has enjoyed the advantage that most of its customers do not pay sales tax, even if they live in one of the 45 US states that charge it, at rates of 4 and 9 per cent. This represents a discount for Amazon customers, but it is ending. Amazon is already collecting sales tax in six states; the rest are likely to follow. A shift in what customers pay may steer some of them back to traditional retailers, crimping growth.

That said, Amazon would reap one benefit from this change. Traditionally it has put distribution centres only in states without sales tax. Freed from this constraint, the company can add to its network and increase its lead in how quickly it can deliver goods. As universal same-day or next-day delivery comes closer, the range of goods it would make sense to buy from Amazon increases. Toothpaste could be ordered the morning it runs out and appear that evening.

> Can it shift its sales mix and rein in spending enough to expand margins sustainably?

Low prices are also coming under increasing attack from Amazon's suppliers. Book publishers may or may not have colluded, as the US justice department alleges, when they demanded that Amazon must not discount titles below levels they set. In many of Amazon's key product lines, from digital media to electronics to fashion, suppliers see price and value as linked, and will threaten to stop shipments if they see Amazon's bargains as tarnishing their brands. Already, Sony and Samsung have moved towards a "universal pricing policy", insisting that all distributors respect certain minimum prices.

A pricey piece of the future

Trying to assess the value of a company that is as complex, innovative and fast-growing as Amazon is difficult. But there are two well-defined questions that potential buyers at the current share price must answer with a confident yes. Can the company shift its sales mix, and rein in spending, enough to sustainably expand margins? And can Amazon maintain sales growth in spite of upward pressure on its prices from an eroding tax advantage and dissenting suppliers?

On the first question, there is at least one good reason for hesitation. In its low-margin core retail business, Amazon competes with relatively fragmented traditional retailers that are generally struggling to form coherent online strategies. But in higher-margin web services and electronic media, it competes with aggressive and deep-pocketed companies that have staked their futures on media and cloud services: Apple, Google and Microsoft. Even if Amazon prevails, it will be an ugly fight.

On the price question, it is hard to gauge how the demands of price and convenience balance out for the average customer on the average Amazon item. The burden of proof is squarely on those who think that upward pressure on selling prices will not hamper top-line growth.

What is more, there is a third, much less defined question relating to valuation. In fast-changing industries such as internet retail, cloud services or digital media, how much faith should be put in the dominance of the early leader? In other words, investors know Amazon is spending heavily to protect its position; but is it spending enough? Valuations must include a thick margin for error to reflect the risk of a competitor landing a big blow.

This last point must – given Amazon's heady share price – be decisive. Consider again the Walmart of two decades ago: its seemingly unlimited potential also came at a high valuation. That potential was fulfilled in spades, and investors did well. But returns were not nearly as extraordinary as the company's operational performance. Yes, the intervening two decades have given Walmart investors a sixfold return; but so has the S&P consumer staples index. Even the plain old S&P 500 has returned 400 per cent.

It is impossible not to admire what Amazon has achieved so far or not to feel excited about what it could achieve in the next 20 years.

But investing is not about excitement. It is about balancing risk and reward and knowing what is predictable and what is not. Wait for a reduced valuation before clicking "buy".

This article appeared on July 12.

Lessons in how to come back from the brink of irrelevance

Technology

Stripping out failed strategies and finding new ways to excite customers can revive a group's fortunes, writes *Richard Waters*

From troubled BlackBerry maker Research In Motion to fading internet power Yahoo and bankrupt Eastman Kodak, the business headlines this year have told a familiar story: the fortunes of once-dominant technology powers can fade with unnerving severity.

Disruptive shifts in technology platforms and business models have become an unpleasant fact of life for tech companies and their investors alike. As Facebook gears up to make its regulatory filing as early as Wednesday that will set its initial public offering in train, the latest batch of troubles is a sombre reminder that the longevity of a seemingly entrenched business is far from assured.

Yet the shortening life cycles of tech powers are not inevitable. As companies as different as Apple and IBM have shown, it is possible to come back from the brink of irrelevance. Microsoft, frequently written off as a relic of the fading PC age, has also been laying the groundwork for a broader repositioning of its business, though its success is still unproven.

Given the sort of rapid shifts that can afflict technology companies, being alert to the danger is the most important quality needed for survival. That makes RIM, once comfortable in its role as the pioneer of mobile email, Exhibit A in corporate denial.

Asked about the threat to BlackBerry from the launch of the iPhone, the Canadian company's leaders brushed aside any danger, points out Rita McGrath, an associate professor at Columbia Business School. By the time they saw the need to overhaul their product line-up – a move that eventually forced them into an acquisition to buy a suitable new mobile software platform – it was too late.

RIM has fallen foul of some of the biggest forces to shape technology markets. One is the "consumerisation" that has turned parts of the once slow-moving corporate technology business into fashion-driven markets demanding new skills. RIM hardly believed that its BlackBerry users, tied to their corporate email systems, would so quickly cut the tie.

Another is the winner-takes-all nature of technology platform shifts that can quickly leave former industry leaders out in the cold. With software developers switching their attention to the new Apple and Google mobile software platforms, RIM now faces an uphill battle in putting itself back at the centre of the mobile technology ecosystem.

Even when they do succeed in identifying the mortal threat posed by a future technological disruption, however, it has proved remarkably hard for many tech concerns to adapt.

"The evolving digital technologies had been obvious to us since the late '70s," says Larry Matteson, a former Kodak executive who was once in charge of 23,000 people in the company's manufacturing division. That foresight did not prevent a long slide that resulted in a filing for bankruptcy protection earlier this month.

Kodak played it by the management textbook: it identified its sustainable competitive advantages and sought to use these as a basis for diversification into new markets that would make up for an expected erosion of its film business.

Those strengths, according to Mr Matteson, now a professor at the Simon Graduate School of Business at the University of Rochester, included a powerful research and development base, particularly a world-leading position in organic chemistry; a specialist manufacturing capability learnt in the film business; and one of the top global consumer brands.

Kodak followed the logic of this analysis into markets as diverse as blood tests, photocopying and pharmaceuticals. None proved to be the foundation for a big new business and all were later spun off.

> Winner-takes-all nature of platform shifts can quickly leave leaders out in the cold

This sequence of failures points to two of the main lessons from failed attempts by tech companies to adapt.

One is that it is not enough to dabble in new technologies. "Innovation needs to be treated as material and systematic, not an on-again-off-again process," says Columbia Business School's Ms McGrath.

The vested interests inside corporations arrayed against disruptive change can be powerful. Sony, for instance, has struggled to overcome the entrenched interests of its powerful product divisions, leaving it vulnerable to the sort of disruptive new products that often cross internal corporate boundaries, like the combination of Apple's iPod and iTunes store.

Despite often being the product of recent innovative thinking, tech companies may be worse suited to the challenge than other types of company, Ms McGrath adds. The hubris from their success is still strong, and they often lack broad management skills.

The other lesson is that strategic choices still count. Simply trying to change course and copy a disruptive new technology is often the wrong path to take. IBM, seeing the threat to its mainframe computing business from the rise of the "client-server" era, threw its full corporate weight behind the PC business in the early-1980s. Yet it was only IBM's eventual decision to retreat from PCs that signalled it had learnt the strategic lesson: to stick to its high-margin IT business with the addition of software and services.

Kodak made a similar strategic mistake. Two decades ago, seeking a new direction, it brought in a rising star from Motorola, George Fisher, to help lead a move into digital cameras. "They were thinking about taking a business with 60-80 per cent [profit] margins and going into consumer electronics, where 5 per cent is pretty good," says University of Rochester's Mr Matteson.

Failing to make a go of it in digital photography, Kodak compounded its error by switching course into another challenging market: ink-jet printers. That has left it struggling against the likes of Hewlett-Packard, Lexmark and Canon, which dominate the consumer market.

IBM and Xerox, by contrast, turned in their moment of crisis to their core businesses, looking for ways to reinforce their value to their customers by enhancing what they had always done best.

"Too many companies focus on their products and not what the products are solving for the customer," says Ms McGrath. "Xerox finally figured out that customers don't want copies, they want workflows that allow them to get the right information to the right place for the right reasons, cost-effectively."

As Steve Jobs proved after returning to a near-bankrupt Apple in 1997, stripping away failed product strategies of the past and finding new ways to excite customers is the surest way to revival.

For other executives struggling against the apparent inevitability of tech-company decline, it is a high mark to match.

This article appeared on January 31.

Prepare for era of US political cliff-dancing

Gillian Tett

A decade ago, economists sometimes like to say, the west was experiencing an era of "Great Moderation"; at least, in the sense that inflation was tame, central bankers looked wise and economic growth assured. Then, when the financial crisis erupted, moderation was replaced by an Age of Turbulence (to use the ironically apt title of Alan Greenspan's memoir).

But now we have entered a third phase: an era of political brinkmanship. In the aftermath of President Barack Obama's victory, there is intense speculation among investors about whether America will fall off a fiscal cliff at the end of the year, as it hits the trifecta of a debt ceiling, the expiry of Bush-era tax cuts and pre-planned spending cuts, which could reduce gross domestic product by 4 per cent.

But what probably looms now is not a simple, binary "fall" – or a grandiose bargain to avert that blow – but a series of rolling showdowns. In the coming months, politicians may tiptoe to the brink of the cliff; they may even spark some mini-crises, by failing to cut a deal before, say, the debt ceiling expires, or tax rises loom. But I suspect they will then tiptoe back from disaster, with delaying mechanisms, before embarking on yet more brinkmanship. This game of cliff-dancing could last a long time.

Some senior Obama officials strongly reject this scenario. After all, they argue, the results from Tuesday's election should give the president confidence to force a grand fiscal deal, particularly since he has less incentive to appease voters in his second (final) term and the Republicans are on the back foot. Second, since politicians have now been arguing about fiscal issues for more than two years, which means the terms have been laid out.

Thus there is no need to fret about the President's failure to back the 2010 Simpson-Bowles bipartisan plan for tax rises and spending cuts, optimists insist; what matters is that this scheme exists as a starting point for debate, and that will accelerate the negotiation process.

Close to the edge: Barack Obama has less incentive to appease voters Reuters

Thirdly: dozens of American business leaders are now – belatedly – speaking up, along with the Federal Reserve, and pushing for a grand fiscal deal, be that via the Simpson-Bowles plan or something similar. That should also raise the chance that Mr Obama will deliver a grand bargain. Or so the argument goes.

But those reasons for hope are also offset by at least three concerns. One, immediate doubt is whether Republicans will co-operate in serious talks. For though John Boehner, House Speaker, has indicated in the past 24 hours that he is willing to discuss tax increases, he faces strident opposition from his party to this. Secondly, even if business leaders are raising pressure for a grand fiscal deal, there is still no dramatic external event that could shock both political camps into compromise.

This matters. Congress only agreed to back the financial rescue programme in 2008 after the markets crashed. But now the markets are extraordinarily quiet, partly due to the Federal Reserve's policies; indeed, the 10-year Treasury yield has actually dropped this week. And dire warnings from rating agencies – or even the International Monetary Fund – have lost some of their ability to shock. Unless America does fall off that "cliff", the sense of drama may stay distinctly muted.

There is also a more subtle, structural problem: a mismatch in time horizons. As Claudio Borio of the Bank for International Settlements observed in a recent speech, credit booms and busts occur on multi-decade cycles, and require equally long-term policies; however, the effective US political cycle is two years. "The economic developments that really matter now take much longer to unfold – economic time has slowed down relative to calendar time – and yet the planning horizons of economic agents have shortened."

This is pernicious. Any package that truly works will need two crucial elements: clearly articulated, proactive long-term fiscal trade-offs, and an intelligent sequencing of policies (say, some stimulus followed by austerity). Delivering this will be hard.

None of this is a reason to despair. The "good" news is that investors have had plenty of chance to get used to cliff dancing in the past year – on both sides of the Atlantic. Dramatic headlines about disaster might sap confidence, but they do at least cause less shock than a decade ago, and thus may spark less sudden market reaction. But then again, precisely because markets have become more wearily blasé about brinkmanship, it may be that much harder to create the sense of drama to force an early bipartisan political deal.

Unless, of course, Mr Obama finds the capacity to spring another bold surprise, or politicians and investors alike finally – belatedly – lose patience, and that Age of Turbulence once again takes hold.

This article appeared on November 8.

Regulation can prolong misery

Inside Business
PATRICK JENKINS

At the risk of being lynched, I am about to come to the defence of some well-paid bankers. These are men who, their critics would say, epitomise the worst aspects of capitalism, breaching laws willy-nilly and exploiting profit opportunities with no moral compass. But both Peter Sands and Bob Diamond have been hard done by – and dangerously so. A few weeks ago, Mr Sands, chief executive of Standard Chartered, was accused by one US regulator of running a "rogue institution", which "carefully planned its deception" of US authorities over financing Iranian operations. Sounds like a pretty bad man. On Friday, Mr Sands duly sealed an expensive settlement with Benjamin Lawsky of New York state's Department of Financial Services (DFS), paying $340m to make amends for the bank's transgressions. A little earlier in the summer, Mr Diamond, the former head of Barclays, was tarred and feathered.

One of Britain's best paid bankers until he resigned in July, Mr Diamond had been accused by the UK authorities of using aggressive, complex structures to get around rules on capital and tax. He had also been implicated in a period of now infamous abuse of the process used to set the Libor interbank borrowing rates. It is perhaps understandable that the mood of the establishment has become enmeshed in the public's anti-banker sentiment. But it is particularly worrying how politicised the supervision of our banks – at least in the UK and US – appears to have become.

Consider Mr Diamond's fate. Whatever your perspective on the man – brilliant trader, inspiring manager, arrogant schmoozer, or all of the above – the important fact was, even after regulators concluded their assessment of Barclays' Libor misdemeanours, they considered Mr Diamond still to be a "fit and proper person" to run the bank. Barclays' expensive global settlement, which saw it pay £290m to regulators in the UK, US and elsewhere, was supposed to draw a line under the issue. It only took a few days, though, for the bank's chairman Marcus Agius to be summoned before Sir Mervyn King at the Bank of England (which is not Barclays' regulator) and told that Mr Diamond had to go. Prime minister David Cameron and chancellor George Osborne were said to be delighted. This is not the way banks should be regulated. If transgressions are serious enough, regulators (in the UK, that is the Financial Services Authority) should remove a chief executive. Otherwise, if there is any ousting to be done, it should be at the hands of the board, not the government or the central bank. The tale of StanChart also has two sides. While the bank clearly breached US sanctions on Iran, there is an almost comic gulf between the $250bn of wilful abuses that Mr Lawsky alleges and the $14m of clerical errors that StanChart has talked about. It is impossible to know what the real figure is. But the unusual strength of Mr Sands' rebuttal of the DFS's initial complaint is noteworthy – evidence, to the bank's critics, of its consummate arrogance; proof, to those suspicious of Mr Lawsky's motives, the scope of the complaint was overdone.

The truth is that StanChart – whatever the morals of doing business with Iran – was stymied by US rules designed to make the country look like it was barring Iranian business dealings while at the same time retaining valuable petrodollar trade. The mechanism to achieve that – the so-called U-turn rule – facilitated dollar trade, as long as deals did not originate or end up with a US counterparty. StanChart was caught between that complexity and the evident political ambitions of Mr Lawsky – a former sidekick of Andrew Cuomo, the former New York attorney-general, now New York governor. Given that Mr Lawsky had the power to revoke the bank's New York operating licence, $340m to settle the dispute was a small price to pay – even if only $14m of transactions were genuinely in breach of the rules. Losing that licence would have jeopardised as much as $200bn of trading a day – disastrous for the bank and its investors.

For a bank whose business is spread across emerging markets, some of them beset by political instability and volatile economies, it is ironic that the biggest risk to hit StanChart for some time has come from the supposedly stable US. Banks and bankers are the bogeymen of governments around the world. But, as long as economies are structured as they are, they will need banks to help them rebound. If even the US and UK are policed by unpredictable forces, investors will stay away, and that can only prolong the misery.

Patrick Jenkins is the FT's banking editor.
This article appeared on September 24.

ChinaAMC

Our performance, your trust.

Leveraging the research expertise of our parent company in China, we offer the following strategies to help investors seize market opportunities:

- China A-shares
- Offshore Chinese Equities
- China Equity Absolute Return
- Onshore China Fixed Income (via RQFII*Scheme)
- Index Product (Physical A-share ETF via RQFII*Scheme)

* Renminbi qualified foreign institutional investor

华夏基金(香港)有限公司
CHINA ASSET MANAGEMENT (HONG KONG) LIMITED

www.ChinaAMC.com.hk

Customer Service Hotline: (852) 3406 8686

Email: hkservice@chinaamc.com

This advertisement is intended as a branding exercise of China Asset Management (Hong Kong) Limited and it does not constitute an offer or solicitation to enter into any transactions. Investment involves risks, investors may be subject to substantial losses, and a loss of original capital may occur. This advertisement has been issued by China Asset Management (Hong Kong) Limited. China Asset Management (Hong Kong) Limited is a wholly owned subsidiary of China Asset Management Co., Ltd. This advertisement has not been reviewed by the Securities and Futures Commission.

Interest rates: Libor – a benchmark to fix

Investigation How financial reference points are set has cast doubt on a process at the heart of the lending industry, write *FT Reporters*

"At what rate could you borrow funds, were you to do so by asking for and then accepting interbank offers in a reasonable market size, just prior to 11am?"

Every day, employees at the world's leading banks are asked an inelegantly worded question used to calculate the benchmark rates that help determine the price of mortgages, the cost of corporate lending and the interest added to credit card bills.

Their answers are now at the heart of a sprawling regulatory investigation into possible manipulation of the London interbank offered rate, one of the most important reference points of the global financial system.

At least 10 enforcement agencies in the US, Canada, Europe and Japan are examining whether bankers and brokers colluded to rig Libor – the index interest rate used for $350tn worth of financial products – and other widely watched rates to boost profits from their in-house trading positions.

For 18 months, officials have been scrutinising whether some banks, through electronic bids processed in London, submitted artificially low Libor numbers to mask their own mounting financial difficulties as a worldwide credit crisis deepened in late 2007 and 2008. The probe, in which investigators are still sorting through allegations of criminal intent and regulatory shortfalls, has threatened the best efforts of the banking industry to draw a line under the crisis, which led to taxpayers bailing out the financial system. Proved manipulation of index rates could expose banks to a legal and regulatory bonanza, from big fines to class action lawsuits, several of which have already been filed.

"Any confirmed manipulation of these interest rates would imply a very significant cost to the European economy,'' Joaquín Almunia, European Union competition commissioner, said last month.

Three of the world's biggest banks – UBS, Citigroup and Barclays – have voluntarily approached regulators with information about possible abuse of the rate-setting process by current and former staff. More than a dozen employees at other institutions, including JPMorgan Chase, Deutsche Bank, Royal Bank of Scotland, HSBC and the interdealer brokers Icap and RP Martin, have been fired, suspended or placed on administrative leave in recent months as the investigation gathers pace.

In Canada, court filings by local competition officials have publicly documented a scheme allegedly used to rig a Libor rate, masterminded by a small group of traders. In Tokyo, Japanese financial regulators have taken action against UBS and Citi over attempts by former employees to "influence" benchmark rates, while in a Singapore court case, a former trader at Royal Bank of Scotland has claimed that requests for certain Libor rates were "regularly made" by employees in recent years to maximise profit.

As investigators probe to see whether a process designed to be impervious to manipulation has been purposefully subverted, the British Bankers' Association, a trade group that sponsors Libor, last week launched a comprehensive review, acknowledging that the way the rate is set may need updating. "We are committed to the continuing and ongoing evolution of Libor as appropriate," says Angela Knight, the BBA's chief executive.

Prior to the current inquiry, the relatively old-fashioned mechanism used to fix Libor and other benchmark interest rates was of interest only to market practitioners and a small cadre of critics, who argued that it was a poor gauge of banks' actual borrowing behaviour.

At their simplest level, Libor, Tibor and Euribor, as the main rates are known, are supposed to be daily measures of how much banks are paying to borrow from one another in dollars, euros, yen and other currencies for set lengths of time, ranging from overnight to 12 months.

The rate-setting process, largely unchanged for 26 years, offers a crucial indicator of the overall health of the financial system. A jump in Libor can signal that banks are increasingly reluctant to lend to each other – one of the contributing factors in the credit crisis. Libor also serves as the underlying reference for the interest paid on scores of everyday financial products. The average US adjustable rate mortgage, for example, is indexed to Libor, with a premium of 2-3 percentage points tacked on. Because the rates are based on banks' own estimates as opposed to actual loan data, critics have long argued that at times of financial stress, lenders have an incentive to "lowball" their submission in order to appear healthier.

The Libor investigation has attracted attention in part because it upends a basic assumption of how the market functions. Bankers argue that even if individual traders try to co-ordinate their quotes, the algorithm used to calculate the rate should make it impossible for them to succeed in moving the benchmark index enough to profit from it. Regulators are piecing together a mosaic of information about how Libor and other rates may have been targeted. No individual has been charged with wrongdoing, and officials involved with the case in different countries caution that fines or other penalties are not imminent. In some areas, multiple enforcement agencies are co-operating, such as the US Department of Justice, the Federal Bureau of Investigation and the Commodity Futures Trading Commission.

Several lawyers representing individuals involved say, however, that the inquiry is neither as advanced nor as globally orchestrated as some suggest. "As far as I can see, you have two or three regulators floundering around with no co-ordination," says one UK-based lawyer.

Some banks have been co-operating with regulators – in effect blowing the whistle on their own employees in the hope of securing leniency from future enforcement actions. Their statements, found in court documents and releases, have helped flesh out some of the contours of the multi-pronged investigation.

> 'Any confirmed manipulation . . . would imply a very significant cost to the European economy'

Barclays, for example, came forward to the European Commission and the UK's Financial Services Authority after uncovering internal communications that suggested former employees may have breached internal "Chinese walls" barring information-sharing between traders and the bank's rate-setters for Euribor, say two people with direct knowledge of the case. Philippe Moryoussef, a derivatives trader who left the bank in 2007 and now works at Nomura in Singapore, is one of the former employees being investigated, those people said. He did not respond to requests for comment.

On Friday, Barclays revealed in its annual report that it had been informed by unnamed authorities that it may face regulatory action relating to the probe, and that it was "engaged in discussion with those authorities about potential resolution''.

A separate but similar development came in the summer of 2010 at Citigroup's London office. Employees raised concerns about what they saw as attempts by Thomas Hayes, a senior trader in Tokyo, to alter the bank's daily bids for yen-denominated Libor, according to six people familiar with the case who asked not to be named, citing the sensitivity of the case. Having recently joined Citi from UBS, Mr Hayes was billed as a star hire who would transform Citi's fortunes in Japan following a series of clashes with local regulators.

Hired by Christopher Cecere, the former head of rates trading for developed countries in Asia, Mr Hayes had been a big money-maker for UBS, according to people familiar with his employment. Within less than a year, however, both Mr Hayes and Mr Cecere had left Citi after they were accused in an internal investigation of attempting to influence yen Libor or the separate Tokyo interbank offered rate (Tibor), according to current and former Citi executives with direct knowledge of the investigation.

Instead of attracting big profits, the two men's trading positions were unwound at a more than $50m loss after they left. At the time, Citi executives say, the trading irregularities seemed both isolated and unusual. One former senior banker at the US group who was briefed at the time about Mr Hayes' and Mr Cecere's actions said colleagues were mystified at what appeared to be an attempt to influence the rate: "It seemed an incredibly dumb thing to do." Mr Hayes has not responded to repeated attempts by the Financial Times to contact him directly and through his lawyer. Mr Cecere, who now works for the hedge fund Brevan Howard in Geneva, has told the FT that he was never questioned by regulators and left the bank in good standing.

Japanese regulators barred Citi in December last year from conducting derivatives transactions related to Tibor and yen Libor for 13 days over its failure to prevent the inappropriate approaches to rate-setting staff.

In an official finding by Japan's Securities and Exchange Surveillance Commission, the regulator said an employee known as "Trader B" had begun targeting Citi staff who submitted yen Libor quotes beginning in December 2009, repeatedly asking them to change the figures. By April 2010, an executive known as "Director A" had been "continuously conducting" similar approaches to Citi employees who submitted the bank's quotes for Tibor, the SESC found.

The agency has declined to identify the two men publicly. But six people with direct knowledge of the case have confirmed to the FT that "Trader B" is Mr Hayes and "Director A" is Mr Cecere.

When staff in Tokyo rebuffed the traders' approaches, Mr Hayes and Mr Cecere contacted rate setters in London, according to people familiar with the case. London employees reported their approaches to internal compliance supervisors, those people say. Regulators are scrutinising Mr Hayes' activities at UBS before his move to Citi in 2009, according to public filings and people familiar with the investigation.

Like Citi, UBS was subject to official action by Japanese regulators in December over attempts by a former trader to influence the bank's rate setters for Tibor and yen Libor from 2007 onwards. While the trader is referred to only as "Trader A" in those documents, six people familiar with the case said it was Mr Hayes. The Swiss banking group, having lurched from crisis to crisis in recent years, including an alleged $2.3bn rogue-trading scandal, was the first bank to disclose the existence of a global Libor probe in March 2011. It was also the first to come forward to several regulators with detailed information about potential abuse of the rate-setting process by current and former employees. Last July, the group revealed it was co-operating with regulators in the US and Japan in exchange for partial immunity over the potential manipulation of yen Libor and Tibor. As the investigation has widened, UBS has suspended some of its most senior traders in Zurich. Recently filed documents in the Ontario Superior Court by the Canadian Competition Bureau, which is looking at whether Canadian consumers were harmed by the alleged rigging of benchmark borrowing rates, provide the most detailed roadmap yet as to how traders and interdealer brokers may have worked together to manipulate yen Libor. According to a sworn affidavit from one of the lead investigators in that case, employees at an unnamed bank "were able to move yen Libor rates to the overall net benefit by the participants" by working with interdealer brokers and traders at rival banks in London including HSBC, Deutsche Bank, RBS, JPMorgan Chase and Citi.

In one instance, an employee identified as "Trader A" told an interest rates trader at HSBC "his trading positions, his desire for a certain movement in yen Libor, and instructions for the HSBC trader to get HSBC to make yen Libor submissions consistent with his wishes", according to an affidavit sworn on May 18 2011 by Brian Elliott, a Canadian law officer.

UBS is not identified in that lawsuit but three people with direct knowledge of the case say it is the institution that provided information about the attempted manipulation of yen Libor. UBS and other banks named in the case declined to comment.

Lawyers and regulatory officials involved with the case warn that the scheme detailed in the Canadian court documents is just one part of a wide-ranging investigation and is not the core focus of enforcement agencies in other jurisdictions. Traders and brokers who have been suspended or named in various filings may be "people of interest" – those who may have seen rather than participated in any sort of rate fixing – who can help elucidate the scale of the alleged problem, those people say. "We could," admits one UK lawyer working on the case, "be just at the tip of the iceberg."

Reporting team: Megan Murphy, Caroline Binham, Michiyo Nakamoto, Cynthia O'Murchu and Kara Scannell.
This article appeared on March 11.

Probe: the City of London was under the spotlight over Libor
jasonhawkes.com

Corporates & Markets

No matter how markets and the global economy may change, some things remain constant. Like the client focus you have come to expect at Commerzbank – some banks talk about it, we are structured to deliver it.

Through our integrated corporate & investment banking teams, we support our clients at every stage of their growth by developing solutions in any permutation needed, without product bias.

It's a formula based on integrity.
It's a formula we believe in.
It's a formula you can rely on.

Choose Commerzbank – because we put your business needs at the heart of everything we do.

www.cbcm.commerzbank.com

Any securities transaction by US persons (institutional clients only) must be effected with Commerz Markets LLC, a US registered broker-dealer and member of FINRA and SIPC. Commerzbank AG London Branch is authorised by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and authorised and subject to limited regulation by the Financial Services Authority. Details available on request. Incorporated in Germany as a stock corporation with limited liability.

The bank at your side