



Once upon a time in Ireland and elsewhere



by Dan Remenyi
Visiting Professor,
Trinity College Dublin
dan.remenyi@tcd.ie

Having suffered through a degree in Economics I was convinced that it was a subject which did not offer any great intellectual challenges. Admittedly it was not considered in my day to be a soft option, but it was a subject which with a modest amount of interest and about the same amount of application, could be mastered well enough for a respectable pass. It is true to say that there were those who were more disparaging about Economics and what can be achieved by it and such people were heard to say, "Well, what do you expect. Teach a parrot to say Demand and Supply and you have an Economist!"

Economics provided me with a number of principles which, although simple - some could say no more than common sense - provided a framework for understanding both business and organisations and their financing in the public centre. It is my feeling that these common sense principles have been seriously violated during the current financial fiasco that I find so offensive. Of course it is an old chestnut to say that "common sense" is one of the more rare commodities on the planet, but at the same time we do expect our senior politicians and senior civil servants to be endowed with enough sense, common or otherwise, to avoid the catastrophic events of the past years. The basic principles of Economics are not, as they say, rocket science.

There were clues that the banking system was potentially unsound. The first modern banking fiasco occurred in Singapore when

Nick Leeson lost his marbles and a couple of billion euro for Barings Bank, causing the bank (the oldest bank in the UK) to be sold for £1 to whoever was prepared to salvage the leftovers. In this case it was ING a Dutch finance house. (Nick went on to become the manager of Galway's football team.) Then came John Rusnak in the Allied Irish Banks' New York office and he lost the bank a mere \$700 million. A few years later the Credit Lyonnais debacle occurred when Jerome Kerviel lost about 5 billion euro through rogue trading. But Credit Lyonnais was already government owned and thus only the French tax payer lost out. In retrospect all these events can now be seen as warnings that the banking system were not under adequate control.

I remember so well being told when Nick Leeson went to trial that banking had become so sophisticated and no one really understood Derivative Markets and thus

no one could adequately control what was going on. I heard this again when our banks' troubles began to surface in 2008 and it was nonsense.....complete nonsense. It is true that some whizz kids had been given far too much influence in the big banks and that they produced untried and test mathematical models. At the end of the day these models basically showed that something could be made from nothing. Who believed this?

The Singapore courts gave Nick Leeson six and a half years to think about his regrettable trading strategies. John Rusnak got seven and a half years for his follies. Jerome Kerviel is expected to come to trial in June this year. Devil's Island and the Chateau d'If could be refurbished or at least reopened for him. Alas it is too big a job to rebuild the Bastille.

The other bankers who played with our money leading up to the 2008/09 collapses simply got their

multi-million euro bonuses as souvenirs. I wonder what Nick Leeson, John Rusnak and Jerome Kerviel make of the justice they received relative to the bankers who broke the whole system? Is there something called natural justice?

Suggesting that high finance is not all that complicated the San Francisco Chronicle published on Friday, March 26, 2010 gave us the following simplified version of what went wrong in the financial markets and the government controls thereof. I hope readers will find this explanation amusing and easy to follow.

The Heidi Theory of Economics - "An Easily Understandable Explanation of Derivative Markets," by Jon Carroll

"Heidi is the proprietor of a bar in Detroit. She realizes that virtually all of her customers are unemployed alcoholics and, as such, can no longer afford to patronize her bar. To solve this problem, she comes up with a new marketing plan that allows her customers to drink now, but pay later. She keeps track of the drinks consumed on a ledger (thereby granting the customers loans).

"Word gets around about Heidi's 'drink now, pay later' marketing strategy and, as a result, increasing numbers of customers flood into Heidi's bar. Soon she has the largest sales volume for any bar in Detroit. By providing her customers freedom from immediate payment demands, Heidi gets no resistance when, at regular intervals, she substantially increases her prices for wine and beer, the most consumed beverages.

"Consequently, Heidi's gross sales volume increases massively. A young and dynamic vice-president at the local bank recognizes that these customer debts constitute valuable future assets and increases Heidi's borrowing limit. He sees no reason for any undue concern, since he has the debts of the unemployed alcoholics as collateral.

"At the bank's corporate headquarters, expert traders transform these customer loans into DRINKBONDS, BOOZEBONDS and WHOAREYOUAGAINBONDS. These securities are then bundled and traded on international security markets. Naive investors don't really understand that the securities being sold to them as AAA secured bonds are really the debts of unemployed alcoholics. The bond prices continuously climb, and the securities soon become the hottest-selling items for some of the nation's leading brokerage houses.

"One day, even though the bond prices are still climbing, a risk manager at the original local bank decides that the time has come to demand payment on the debts incurred by the drinkers at Heidi's bar. He so informs Heidi. Heidi then demands payment from her patrons, but being unemployed alcoholics, they cannot pay back their drinking debts.

Since Heidi cannot fulfil her loan obligations, she is forced into bankruptcy. The bar closes and the eleven employees lose their jobs.

"Overnight, DRINKBONDS, BOOZEBONDS and WHOAREYOUAGAINBONDS drop in price by 90%. The collapsed bond asset value destroys the bank's liquidity and prevents

it from issuing new loans, thus freezing credit and economic activity in the community. The suppliers of Heidi's bar had granted her generous payment extensions and had invested their firms' pension funds in the various bond securities. They find they are now faced with having to write off her bad debt and with losing over 90% of the presumed value of the bonds. Her wine supplier also claims

bankruptcy, closing the doors on a family business that had endured for three generations, her beer supplier is taken over by a competitor, who immediately closes the local plant and lays off 150 workers.

"Fortunately though, the bank, the brokerage houses and their respective executives are saved and bailed out by a multibillion-dollar no-strings-attached cash infusion from their cronies in government. The funds required for this bailout are obtained by new taxes levied on employed, middle-class, non-drinkers who have never been in Heidi's bar."

I do not know what the relationship between the American legislators, civil servants and the bankers was in the USA. I think that the word "cronies" may be harsh and I doubt if it is relevant in Ireland. But the principle which drove our banking crisis parallels Heidi's bar; all that is necessary is to substitute property for drink and developers for alcoholics. The other difference is that the toxic securitisation spread nearly world wide and it spread quickly. It is true that the banking system was saved by governments pouring billions of euros into rescue package and thus we did not see runs on the banks. We did not have hun-

dreds of thousands of people lose their life savings. There we no punch ups in the streets between angry depositors and bank employees. But no one has told us what the banking system was saved to do in the future? The banks have largely returned to business as usual. It seems that as things stand now they could easily do the same thing over again?

Neither does Jon Carroll's anecdote adequately address the issue of the hardships suffered by the population. I don't think anyone needs to be reminded of job losses and higher tranches of tax, the loss of national pride and the general depressing economic outlook.

The main facts are that the economic issues facing our society were and still are not complex. The mistakes were obvious to anyone who had even a rudimentary acquaintance with Economic knowledge or even just common sense. Our leaders, lulled into believing in their own good fortune, gave themselves generous pay awards and, seeing the value of their houses soar, decided that somehow the world had changed and that money could be splashed around with no need for sobriety. The artificially created boom resulted in record tax receipts which no minister (nor many in the opposition parties) was prepared to admit might be but temporary. In fact for many the prosperity was actually illusory as they over committed themselves in different ways.

On the watch of the government billions of euro were wasted and millions of euro were inappropriately paid as bonuses to people who could not fail to have known that what they were

doing was flying in the face of the simplest laws of economics. How could the bankers, the civil servants and the ministers not have known that the economic chickens would sooner or later come home to roost? And how could the auditors have signed off balance sheets which were loaded with toxic debt? How come no one has raised the issue of the responsibility of the auditors?

There is no use crying over spilt milk and calling for the law to seek out any wrong doers,-that is not popular these days. However although it is true that it is too late as the horse has bolted, there may be more horses to come. It is important that we do not go back to how the economy was run through the first decade of the millennium. There is also the fact that the debt which the government has had to run up, to save the banks, will take quite some time to pay off. Some say that the government has put our future and the future of our children in hock. Are we going to say to our kids, "Sorry I can't afford to because I have to pay extra tax as my taxes are needed to fund or refund the damage done by the bankers (and other fat cats)?

What is sad is that what our society seems to want is to get us back to the state we were in before the Great Crash of 2008, and all this will do is to rub salt into the wounds of the unemployed and those whose incomes have been slashed. What is really needed is a more radical approach, including full nation wide discourse during which the role of all the major players are fully aired so that everyone can fully

understand how the country got into this mess. And it needs to be made clear where all the money actually went to. An indication of repentance on the part of those who landed the country in the mire would be regarded by most to be important.

Besides an open discourse what else is to be done and where do we go from here?

To return briefly to the Heidi analogy, as anybody in Alcoholics Anonymous or any other addiction treatment programme will tell you, the first step to recovery is the admission that you have a problem. A deep worry in Ireland today is the seeming inability of those responsible to admit that they made mistakes, in particular, that the government cannot or will not acknowledge that it was policies between 2001 and 2007 which set the scene that allowed the situation to develop. There is a tendency to blame Lehman, the US subprime market, hedge funds, the world economy, developers, banks and even the citizenry - anybody or anything to avoid acknowledging that policies open the doors for the resulting catastrophe. When the politicians and some senior public servants appear not to realise the folly of the decisions made, what confidence can the public have that the errors of the past will not be repeated?



Pictured at the launch of a new Code of Practice for Corporate Governance Assessment, from left to right: Maurice Buckley, CEO, NSAI, (on ground) Mr. Billy Kelleher, T.D., Minister for Trade and Commerce, and Ann Riordan, Chairman, NSAI and President of the Institute of Directors. The new code provides a best practice standard for independent evaluation of an organisation's compliance with existing corporate governance codes. Both NSAI and IoD are encouraging company directors, board members, senior management and business owners to look to the Code as a vital tool that will help their organisation operate to the highest standards of corporate governance.



New code of practice for corporate governance

A NEW CODE of practice for corporate governance has been launched by the national standards authority, NSAI, and the Institute of Directors (IoD). The aim of the code is to assist Irish companies and public bodies in meeting governance standards.

The new code provides a best practice standard for an independent evaluation of an organisation's compliance with existing corporate governance codes such as the OECD principles, the Combined Code on Corporate Governance and the Code of Practice for the Governance of State Bodies.

The code, SWiFT 3000: 2010 Code of Practice for Corporate Governance Assessment in Ireland, is the first of its kind in the EU and the first to award certification to companies which meet the required standard. Evidence based evaluation of an organisation's corporate governance practices will be carried out by independent assessors who have met comprehensive qualification and experience criteria. Companies which meet the specifications of the Code will be awarded the SWiFT 3000 Certification by independent accredited certification bodies.

"Good corporate governance is a key factor in sustaining economic growth and development," said Billy Kelleher TD, Minister for Trade and Commerce. "Organisations that undertake the independent assessment will send clear signals to their shareholders, stakeholders and to the international community that they are operating to the best standards in

corporate governance."

The corporate governance assessment will focus on three core areas, board composition, board processes and fulfilment of board responsibilities, as well as looking at other aspects of governance procedures including Chairman-CEO separation. The assessor will have access to all relevant internal documentation and will evaluate an organisation by using processes that will include:

- Completion by boards of a questionnaire based on the principles enshrined in these codes
- Interviews with company directors, Chairpersons, CEO and other directors as deemed appropriate
- Reviewing a company's compliance with relevant corporate governance codes

Speaking at the launch, Ann Riordan, chairman, NSAI and president of the Institute of Directors in Ireland, said "One of the most important aspects of the new code is

the assessors cannot have an existing relationship with the organisation they will be evaluating for 24 months on either side of the assessment. This is a crucial step in re-establishing stakeholder confidence and rebuilding Ireland's reputation as a country to do business with."

The development of the Code, which commenced in October 2009, is the output from new NSAI's priority development process (SWiFT). More than a dozen key professional bodies engaged in the promotion of best corporate governance practice participated in its development, including NSAI, IoD, the public and private sectors, the Financial Regulator, Office of the Director of Corporate Enforcement, Corporate Governance Association of Ireland (CGAI), Irish Small and Medium Enterprises Association (ISME), Institute of Chartered Secretaries and Administrators (ICSA), Institute of Public Administration (IPA), Standards in Public Office Commission and corporate governance experts from academia. The code will be reviewed on a regular basis to reflect changes in regulation, legislation and corporate governance codes.

www.n sai.ie



Pictured left are Ann Riordan, chairman, NSAI and president of the Institute of Directors, Billy Kelleher TD, Minister for Trade and Commerce and John Smyth, chair of Code committee