Anat Admati

The problems with Australia's banks … heaps

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In a typically controversial session at the Investment Management Research conference last week – formerly run by the Paul Woolley Centre for the Study of Capital Market Dysfunctionality – the US academic, Professor Anat Admati, of Stanford University, took a big aim at Australia's banks. Banking, it seems, is not just potentially immoral, it's dangerous.

Notwithstanding its changes, the conference, now run by Graham Rich's Portfolio Construction Forum, has not lost its edge. The speakers are happy to have a shot at anyone and everything who are active in our industry. And they do so with a solid academic background.

Professor Admati said that with banking, more than any other business, trouble was stored up in the good times and discovered in the bad times. The big problem, she said via video conference from the US, was the fact that banks had very little equity in their own business. By contrast, other successful businesses where she lived, near Silicon Valley, companies re-generated through re-investment of their earnings and provided their own funding. Banks were "very anxious" to pay dividends, she said. I Australia, this was about 75 per cent of their earnings.

The distinction between banks and other businesses "happens on the downside", she said. "A heavily indebted banks doesn't feel like it. Their creditors are not always paying attention. Their depositors tend to be passive and mat be protected by governments. So, living with just 3 per cent equity doesn't feel so bad. There is no other type of company that could survive like that."

Professor Admati, who was the first keynote speaker at the conference, recommended that banks be encouraged, by regulation or otherwise, to have about 15 per cent of their assets as equity. Otherwise, she said, banks had an inefficient and dangerous funding mix. Off-balance=sheet funding by the banks was currently higher than what it was in 2007, before the GGC.

"Confusion and politics can be a toxic mix," she said. "As Upton Sinclair [the author]said, it's difficult to get a man to understand something when his salary depends on not understanding it."

There were many "enablers in the system, she said, including institutional investors, regulators, academics and the media. The audit industry, for instance, gave all the major banks a clean bill of health before they failed in 2008. Banking and finance represented an "extreme case" of governance failure.

The conference was bigger than normal, having now been taken over by Portfolio Construction Forum and produced on a more commercial basis, However, it has maintained its off-beat academic flavour. Graham Rich said he was pleased to see that it had maintained its mix of academic, practitioner and professional investor attendees. "I'm not aware of any other program that does that," he says.

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As part of its new professionalism, the conference analysed attendees' views. Rich reported that 76 per cent of the 150-odd attendees voted that they believed the financial services industry had "turned the corner" following the revelations in the Royal Commission.

Two new academic papers funded by what is now known as the Investment Management Research Course, linked to CIMA, the were presented at the conference, although Rich expressed disappointment that none of the academics who are part of the Financial Planning Academics Forum attended.

Meanwhile, Professor Carl Rhodes, also of the UTS Business School, said that the solution to the current problem with banking and funds management lay not so much with the individual application of ethics as with the rise of customers and citizens to apply their pressure on organisations.

"Things got so bad," he said, "that even ASIC had to ghire a PR firm last month because they felt they needed to protect their own reputation." He said that ethics could not reasonably be expected to come from inside corporations themselves – they needed to be applied from the outside through regulations and customer pressure.

– G.B.

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