THE MATTER OF TRUST

Dr Ben S. Bernanke, the Chairman of the US Federal Reserve, said, on Tuesday, in a speech to a Washington think-tank, that *'Even though from a technical perspective, the recession* (in the US) *is very likely over, at this point, it's still going to feel like a very weak economy for some time …'.*

Extrapolating from these words, one could arrive – without too much effort in mental calisthenics – at the conclusion that trust will take a great deal of time before it is restored.

Without trust, there can be no credit.

The word, *'credit'*, is derived from the Latin, *'credere'*, meaning '*to believe'*.

The problems of the past 18 months or so have been rooted in a very considerable lack of trust, globally.

Banks and finance houses stopped trusting customers and each other and, as a direct result, credit was frozen, solid.

In Asia, as **TARGET** () has written on many occasions, many Chinese-controlled banks, historically, have relied not on a person's/corporate entities' ability to demonstrate a supportable cash-flow – which has been long been considered a key to extending credit to a customer in the established US banking philosophy – or having collateral to cover a loan up to a comfortable level – the established British, core-banking consideration in extending credit – but by trust in the person, who is expected to stand behind a loan, come rain or come shine.

So, if a person loses the trust of a banking institution, regardless of his ability to demonstrate a supportable cash-flow in order to cover the debt service of a loan or sufficient collateral in order to cover a goodly amount of a loan, he will not obtain the financial support that he, or his corporate entities, requires, from time to time.

When Lehman Brothers Holdings Incorporated, on September 15, 2008, collapsed with the 159 year-old, banking entity, filing for Chapter 11, bankruptcy protection, following the massive exodus of most of its clients, activities, internationally, in financial and non-financial entities, froze solid.

The question was raised: Which bank will be next?

Big was no longer seen as being beautiful or even exciting.

When the pen-pushers went in to try to sort out the situation at Lehman Brothers Holdings Incorporated, it was discovered that, on the books of this failed bank, there was upwards of $US1 trillion in assets on the balance sheet.

But there was little to no cash!

There was not enough money to pay staff wages and the rent that was coming due on leased offices.

The pen-pushers even had trouble in understanding how the bank was able to translate assets into hard cash.

Even most of the senior management appeared to have no idea about this aspect of business, too.

The fact that international credit was frozen, solid, at this time, in effect, meant that there had been a complete and utter international breakdown in trust.

Therefore, what Dr Ben S. Bernanke has just told the world was that it will take a long time for the bridge to be rebuilt whereby banks and finance houses are willing to make use of it, trusting that, in their crossing, the bridge will not collapse.

As a result of this failure of banks and finance houses to trust, nearly everybody and nearly every corporate entity, regardless of past records of meeting financial obligations, very satisfactorily, and regardless as to whether or not debt service had been met in a timely fashion along with reductions in loans, in accordance with contracts, was suspect.

In the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC), September 24, 2008, there was a run on The Bank of East Asia Ltd () for no apparent or logical reason other than what was described as a malicious rumour.

The Bank of East Asia is the third-largest bank in the HKSAR and it is controlled by the Li Family, headed by Sir David Li Kwok Po ().

One dog barks; and, 100 dogs bark.

But it was a frightening experience for Senior Management of this bank which, no doubt, made an entreaty to the Government of the territory to assist it in assuring deposit-holding *'to trust'* this financially solvent bank.

Even to this day, trust has not been fully restored by either bank depositors or by most of the banks, operating in the HKSAR, in extending loans to even the bluest of blue-chip borrowers.

Today, in order to obtain credit, after a bank has vetted a corporate entity to its complete satisfaction, it will require personal guarantees from all of the executive directors in favour of the lending bank, a corporate guarantee in favour of the lending bank, in addition to having a sizeable deposit, with the lending bank, that deposit, being a pledged time deposit ... just in case all else fails.

Due to an inability to obtain a credit line from banks or other lending institutions, as in the past, many a corporate entity of the HSKAR has had to close shop for no real reason, other than being one of the many victims of a lack of trust on behalf of its bankers.

It will take some time for the bandages to be removed from the bleeding sores that are the result of the continuing legacy of Lehman Brothers Holdings Incorporated.

That which the Chairman of The Fed said, last Tuesday, therefore, may be rewritten along the lines that the repair of the trust between lending institutions and its customers will be a long and very winding road.

A main problem appears to be that many lending institutions do not even realise that there is that road, out there, a road that is available for them to use.

During the past few years, banks have pointed to the rising levels of defaults by home-owners, who are unable to meet their financial commitments as they fell due to them.

Repossessions rates in the US have more than tripled since 2007.

In the United Kingdom, in July 2007, there were not less than 9,500 sub-prime mortgage products, being advertised.

Today, there are none.

As the market values of bricks and mortar deteriorated, banks were caught in a bind and could not, easily, extricate themselves since to apply pressure on home-owners, who had mortgaged their properties to banks, would be counter-productive and could well – and very often did – result in the banks, being the legal and beneficial owners of vacant properties that nobody was interested in repurchasing.

As the situation continued to deteriorate, so the trust between banks and depositors and investors in banks took a turn for the worst.

Sovereign funds and mutual funds withdrew financial support from many a bank.

This exacerbated the situation even further.

Banks were forced to go cap in hand to governments for short-term loans.

In the US, so far this year, a total of 92 banks have gone belly up.

And there is every indication that many more banks will have to own up to their problems.

<u>Don't Try To Be All Things To All Men</u>

Up until the failure of Lehman Brothers Holdings Incorporated, banks had been in the habit of making loans, based on forward sales.

Loans became tradable securities and the term, *'securitisation'*, became a buzzword, as common, in fact, as the utterances of ladies of the night who roam the streets of Wanchai in search of a john, or a john.

Banks made the tragic mistake of creating securities and, then, selling them, forward.

This was a terrible mistake, as any manufacturer will tell you: You either make things, or sell things; but you don't try to do both.

You cannot be all things to all men.

In the words of Aristophanes, a 5^{th} Century B.C. playwright:

> *'Lysistrata women: Stick to your spinning or I shall make your pretty little headikins weep and wail: War is the business of the male!'*

As banks embarked on making loans with a view to selling them forward, banks' due diligence became sloppy: The quantity of the loans rose; the quality of loans fell.

This securitisation of questionable assets was thought to have cost banks and owners of last resort not less than $US45 trillion.

And the tally is far from being complete.

As the losses became known and trust in the securities waned, appreciably, with them was the trust that the issuing banks once enjoyed.

Blame not the customers of the banks because the banks, themselves, were quite able to help in the commission of self-imposed, financial suicide.

With credit, having been slashed, naturally the trust in the viability of lending organisations, from one part of the globe to another, was questioned.

In many cases, queues of depositors were seen, waiting to withdraw their money from banks for fear that they could end up with nothing if they did not act, immediately.

Sadly, in many cases, these depositors were correct.

In many cases, governments had to step in, in order to rescue the lending organisations.

But, in the case of Lehman Brothers Holdings Incorporated, the US Government determined not to step up to the plate even though this banking house was the largest failure in history.

Many people thought that the US Government could not afford to allow Lehman Brothers Holdings Incorporated to fail.

They were wrong.

People in the HKSAR, today, rue the day that they invested in certain bonds, issued by Lehman Brothers Holdings Incorporated, and they have taken to the streets in protest of their plight.

The protests continue to this day.

In order to avert a complete and irreparable, international financial disaster, the US Government, various governments of the European Union, the Government of the PRC, the Government of Japan, etc, etc, etc, all sat down together in order to try to nut out an answer to the growing problems, confounding the economies of the world.

About 50 percent of the largest lending institutions of the world had gone, at this time, cap in hand to their governments, asking for a handout.

Hundreds of billions of dollars/euros/renminbi/yen, etc were made available to lending institutions.

And it seems to have alleviated the situation, somewhat, so much so that the Chairman of The Fed made the statement that it appears that the recession in the US is, technically, at an end.

It is estimated that the total amount of money, made available to lending institutions by various governments, around the world, was at least $US14 trillion.

Never in the history of the world had there been such a huge injection of taxpayers' money into the economies of the world.

Such an amount of money is equivalent to about $US2,000 per man, woman and child on the planet.

The recession may, technically, be at an end – recession is defined as 3 consecutive quarters of negative growth – but the trust between the lending institutions and its customers and between investors and these lending institutions is a long way from being repaired.

Moral determinations are required for there to come about trust between individuals and/or customers and lending institutions, but, in any event, it is a long and, often, painstaking business.

There is a big difference between a safe loan and a secure loan, as most banks, around the world, have learned, most pointedly, since December of 2007.

A secure loan, such as a loan, secured by bricks and mortar, ships, motor vehicles, etc, can be eroded or has the ability to disappear in a relatively short period of time, due to a number of factors and/or forces, but a safe loan depends, inter alia, on the integrity of the individual and that individual's relationship to his/her lending institution.

Trust is based, not so much on observable proofs, but more on perceptions of an individual, perceptions that may not be predicated completely by evidence.

The balance sheet of a company might look good, in normal times, and based on that balance sheet, it might instil more than a modicum of confidence.

But a balance sheet is unlikely to be able repair trust – because trust is based on a moral determination.

The answer, therefore, for there to be an economic recovery is not whether there are 3 or more quarters of positive growth of an economy, but whether the bandages may be removed to find that healing is complete.

In other words, trust has been restored, once again.

Governments may demand that lending institutions observe certain regulations in order to mark the highway back to financial health, but forcing lending organisations to toe a certain governmental line may not be, in the long run, a good idea.

This is because such regulations may be an overkill in the same way as a foolhardy doctor may overmedicate a patient.

Instead of governmental regulation, it would appear preferable for there to be intelligent but somewhat elastic guidelines, leaving leeway for managements of lending institutions to make calculated decisions, based on other factors rather than have regulations thrust upon them.

Repairing public trust would appear to be the first priority in this respect; governmental regulations will not accomplish this.

In the HKSAR, today, the Monetary Authority is so gung ho with its rules and regulations that many banks are afraid to move outside the boundaries, laid down for them to follow.

This is not the way to build trust.

This is not the road that led this territory of just 416 square miles to become the bastion of entrepreneurialism, laissez-faire and envy of many an economy that embraced the concept of free enterprise.

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