The Future of Banking: “Back to the Future?”

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The Future of Banking – Past is Prologue

What caused banking to change?

- Deregulation
  - Elimination of Reg Q
  - Development of capital markets
- Disintermediation on both sides of the balance sheet
  - Depositors and Borrowers both have more alternatives
  - Margin compression, adverse selection
- Communications and Computer Revolution
  - Pricing for risk, adverse selection, commoditization
- Not just in the US, but not universal

Cause and Effect -- How did Banking Change?

What was the response?

- Mergers and consolidation
- Increased wholesale funding
- Securitization
- Originate to distribute
- Fee businesses, especially wealth and asset management
  - Provides fees, but also can provide a place to distribute

Has the Credit Crisis Changed the Future of Banking?

- Underlying causes that drove change are still present
- Banks' role in liquidity transformation is still unique
  - SIVs tried it, and failed
- Banks cannot re-intermediate the entire financial system
  - Currently only ~25% of the financial system
  - Would require substantial additional capital
  - Could risk substantial deflation
- Structured finance likely to remain a part of the financial system

Has the Future Changed?

- Structured finance likely to remain a part …. BUT
  - Simpler structures
  - More "skin in the game" for originators
  - More on-balance sheet securitization
  - More capital
- Other changes?
  - Renewed focus on deposits (had already started)
  - More regulation
    - Capital, I-banks, disclosure
    - How limit overall leverage in the system when portions of it are unregulated
    - How limit systemic risks – credit derivatives, OTC markets, counterparty risk