

Lessons..., Indians have to learn from The American Financial Crisis..

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Brief about Financial Crisis in the United States:

This crisis has its roots back to the big 'american dream' for own house. People aspired for having own house and started borrowing monies without proper backing to repay them on time. At the same time the bankers, brokers, investors and mortgage agencies came forward with relaxed conditions (of course with higher interest rates) to fund the American dream (called the Sub-Prime loans). In the process of such lending, there were major compromises on account of checking of credit history of the borrowers, valuation of the properties, securitisation, documentation...etc. Soon, these loans became bad by non-payment of the loans taken by the

individual borrowers. On account of this, the intermediary agencies could not perform their obligation of repayment of loans, which they took from the banks to fund the individual borrowers. These amounts were not small even to the biggest bankers of this world. This caused panic among the biggest names in financial sector ever known to mankind. Quickly, this sub-prime crisis spread to prime mortgages, home equity loans, to commercial real estate, to unsecured loans, student loans, credit cards dues, auto loans to industrial / commercial loans, etc

This risky business ultimately resulted in closure of Major Banks, Investment Banks, Securities Trading and brokerage firms on

THE GREATEST GRIEFS ARE THOSE WE CAUSE OURSELVES.

account of bankruptcy. The number of U.S. household properties subject to foreclosure auctions by end of 2nd Quarter 2008 is estimated at 7,39,714 and the total estimated housing loans outstanding in the United States is estimated at \$ 12 Trillion US (equivalent Indian Rupees. 5,40,00,000 Crores).

The LOSS reported by of one Investment Banking Company (until it filled for bankruptcy on 15th September 2008 with United States Bankruptcy Court, New York) in the United States, by name Lehman Brothers (which was in existence over 150 years) amounted to \$

2.8 US Billion and \$ 3.9 US Billion respectively for the 2nd and 3rd Quarters of 2008 (equivalent Indian Rupees. 30,500 Crores). This marked significant erosion of margins in the areas such as Residential Mortgages, Commercial Real Estate and High Yielding Liquid Assets for the banker resulted in panic among the financial sectors in the United States.

There are other banks in the list of current financial crisis. Following is the brief list of troubled banking corporations along with their current outstanding dues.

Name of the Banking / Mortgage / Finance / Investment Company	Amount in US \$	Equivalent INR (in Crores)
Fannie Mae & Freddie Mac - US Govt Seized control of these two Mortgage giants)	Estimated Liabilities \$ 5 Trillion	2,25,00,000
American International Group - AIG (bailout by Federal Reserve bank of New York)	Bail out amount \$ 85 Billion	3,82,500
WaMu - Washington Mutual Bank (acquired by JP Morgan Chase)	Mortgage Loan losses \$ 19 Billion	85,500
Bear Stearns (acquired by JP Morgan Chase) (Share price was \$ 170 US during Jan 2007 now acquired at \$ 2 US !!!)	Purchase Consideration \$ 270 Million	1,215
Merrill Lynch (acquired by Bank of America)	\$ 8.63 Billion Losses 2007 \$7.027 Billion Losses during first 2 quarters of 2008	38,835 Loss during 2007 31,622 Loss during 2008
Wachovia (acquired by CITI Group)	\$ 42 Billion Losses \$ 53 Billion Debts \$ 312 Billion Loan Portfolio	1,89,000 Losses 238,500 Debts 14,04,000 Loan Portfolio

*Note: The numbers mentioned above are taken from the published results by the Corporates with respect to SEC filings

Some of the banks / corporations mentioned above are sold to / acquired by other banks and some are bailed out by the American Government. The list of such banks is increasing day by day and the experts are busy in estimating the total loss on account of the current crisis.

The current American financial crisis has its roots back to their freedom of trade and calls for stringent regulatory implementation.

Lessons that we need to learn from out of present crisis:

To Government and its agencies:

- ✓ Promote sound economic and regulatory policies
- ✓ Government should understand that financial bailouts' can lead to imprudent lending streams in future times hence, work on crisis prevention and detection mechanisms instead of bailout mechanisms.
- ✓ Step up surveillance of implementation of economic and credit policies.

- ✓ Keep a watch on global and regional spill-over effects on account of financial crisis.
- ✓ Effective monitoring of inter country economic, monetary and trade policies
- ✓ Work on improving transparency of the information sharing to general public and investors in particular
- ✓ Promote saving schemes among the commoners
- ✓ Constant Control of inflation and cost of capital in growing economies like ours.

To banks in India (Public & Private Sector):

- ✓ Do through Financial / Legal / Credit Due-Diligence: do not compromise on the process of due-diligence and document the outcome of each case.
- ✓ Know your customer in letter and spirit and not merely for completing the checklists required as per banking norms.
- ✓ Strict adherence to fundamental lending norms

- ✓ Implement strict compliance to regulatory requirements and never overlook or manage non-compliance or what may be termed as low-compliance to the prescribed norms in the name of relationship.
- ✓ Be conservative in approach in selection of clients.
- ✓ Avoid partnerships with participant agencies that are vulnerable to threats in the process of regular banking requirements.
- ✓ Double check on credit history of clients before sanction of the loans and during the tenure of the loan. Reduce external dependency of critical components of the loan processing stages. Where ever dependence on external agencies is unavoidable insist on strict monitoring and audit mechanisms. Ruthless implementation of penal provisions wherever identified.
- ✓ Enhance Inter bank, Intra bank sharing of critical information about defaulters.
- ✓ Be watchful of multiple loans on single property, in particular mortgage loans.
- ✓ Implementing provisioning norms in strict compliance with the guidelines.
- ✓ Run incentive schemes (may be as part of annual day celebrations) for people demonstrating higher moral and ethical practices.
- ✓ Structure pay package to suit to the risks being taken by the employees - high risk high pay module.
- ✓ Avoid reckless lending & have good corporate governance

To Regulatory agencies - such as SEBI / RBI / CLB / FEMA and the like..:

- ✓ Maintain healthy distance between the Regulators and the Regulated
- ✓ Adherence to prudential norms, rules, regulations and guidelines at all times
- ✓ Not yield to the influence of high profile entrepreneurs / politicians in the way of implementing Rules & Regulations in the larger interest of the Indian Economy

- ✓ Faster clearance of pending suits / cases
- ✓ Encourage individuals who take the responsibility of strict implementation of the guidelines.
- ✓ Insulate people from out of possible damage on account of strict implementation of the guidelines.
- ✓ Device appropriate pay package to the people at the helm of affairs
- ✓ The Apex body should insist on getting periodic policy decisions taken by the banking sector before they are actually implemented for vetting. A separate wing may operate for this purpose.

To Employees:

- ✓ Plan expenditure and investments to suit to annual earnings & avoid excessive borrowings
- ✓ Lead happy life by methodical savings: do not neglect to save some percentage of your monthly earnings on a regular basis.
- ✓ Don't be greedy when it comes to return on investments. Do not expect your investments to perform beyond industry standard and spoil your principle amounts.
- ✓ Don't go the American way in acquiring own houses: Employees started acquiring houses with budgets beyond their repayment capacities, resulting in non payment and collapse of entire market.

To professionals:

- ✓ Adhere to ethical practice
- ✓ Maintain professional independence at all times
- ✓ Be critical in compliance with regulatory norms
- ✓ Promote moral and ethical business practices among colleagues and clients
- ✓ Cultivate bold expression of professional opinions in the process of assurance practice.
- ✓ Do not circumvent to professional obligations or pressures and seek the support of co-professionals in tough times.
- ✓ Subject the professional work to peer review for better results.