

International Capital Market Association

Speeches

Dangers and Benefits of Leverage

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I. Preamble

I think I will start with an apology that you will have to endure another speech. It will not be long, because everything that could have been said has probably already been said. I will not comment on my former boss Stanley Ross's remarks but I will comment on Eugene Rotberg's remarks, which were as thoughtful as ever. It is his thoughtfulness and his intellectual strength which has often moved this market forward.

II. Dangers of Leverage

Gene, our old mentor, Mr Woljinower, who was called 'Mr Death' in Wall Street, during his time, used to work for the Federal Reserve and then became the Economist at First Boston. He put what you said about leverage – which took you about four minutes - more simply. He said it in two words. He said, 'You see, leverage in derivatives is nothing more than putting a jet engine on a bicycle. As long as the fuel keeps coming it will go up and up, but when the fuel stops, it will come down very rapidly.' This is exactly what you said, in your thoughtful and technical way, and this is exactly the way it happened. That is what he told us in the early 90s and, together with Kaufman from Salomon Brothers, who most people have probably forgotten, these were the two economists who often mentioned the dangers of the leverage.

III. Market Benefits

I do not want to talk about that; I want to tell you how privileged I feel that I have been able to be part of the extraordinary development of this market. It is a market I always believed in and it is a market where I do believe that there cannot be better mechanisms to allocate capital around the world. Over 10 or 20 years we have wrestled control of that capital allocation from the Government's. We have bridged the extraordinary restrictions which existed in the 70s and 80s and still in the 90s across Europe in currency controls, in restrictions in statutory requirements, in savings being imprisoned before being able to be allocated around the world. We have created – as Gene explained – a complex and complicated machine, but which was and is able today to raise trillions of dollars and allocate those across the world. We clearly have helped, after the defeat of the Soviet Union, to bring a new economic and political model to many countries in this world. We have taken the risks – sometimes frivolously, as has been said today, sometimes though with great courage to spread what we believed in: market economies and market allocation of scarce resources.

IV. Mistakes

Gene, you have actually made two thirds of my speech already – indeed, we did lift billions of people out of total poverty and, yes, we helped to build an economic and partially political system around the world which resembled something we all believe in.

The other side of it – and I have never made any secret of it – is that we lost ourselves on that road and there is no doubt that the industry committed severe mistakes. We got sloppy. Due diligence was not due diligence any more. The best banks in the world did not hesitate to put their good names on prospectuses that had not been prepared properly, on securities which were sold as public issues but were in fact private placements, on other instruments which should have never been in either retail or institutional hands, but there is nothing new about financial systems or the financial industry losing its way from time to time and we have seen it quite often in history.

V. Responsibility

Nevertheless all the people here should take great pride in what has been achieved over the last 40 or 50 years. That is why I feel very privileged tonight. We should take great satisfaction that we were able to help, to build, to add something to that system and the only thing I can say to all those who have the responsibility today is that those with that control over that machine have to take it very seriously. We all know the market needs serious reforms. What is happening when it comes to liquidity? Some of the procedures used for new issues are not what I would call a modern market. They are no longer up to date for the great tasks which are ahead of this market: namely to provide capital to the entire world.

VI. Closing Remarks

With that, ladies and gentlemen, I particularly want to thank all of those with whom I have worked over the years, those with whom I have crossed paths competitively or generally, in the end collectively bringing very difficult transactions to good ends. Once again, I feel very privileged to have been part of that development and I hope I have a few years left in which I can witness the future of this market.

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