Knowledge@Wharton: We are meeting today to discuss global banking and capital markets with: Wharton Professor Richard Herring, who is also a Co-director of The Financial Institutions Center at Wharton and also a Co-chair of The Shadow Financial Regulatory Committee; Bill Schlich, who is the Global & Americas Banking and Capital Markets leader at Ernst & Young; and, also from Ernst & Young, Donald Vangel who is a Senior Advisor on banking, supervisory and regulatory matters at the firm’s financial services office. Don is also a former supervisor with the New York Fed. Thanks very much for joining us gentlemen here at Knowledge@Wharton.

Responding to the New Wave of Re-regulation

Knowledge@Wharton: We would like to talk about how capital markets are being reshaped following the global financial crisis and also the new wave of re-regulation, which includes big legislation in the U.S. under Dodd-Frank, Basel III changes, and also more recently action by the G-20 in Korea -- which is a lot to swallow in a very short period. What should global banks be doing now to prepare to digest all of this regulation, which is still ill-formed to some degree? Dick, could you talk for a minute or so about that?

Richard Herring: Well, I think the important thing to remember is that although the broad outlines have been set out all of these initiatives have very long phase-in periods and in the case of Dodd-Frank there are literally hundreds of implementing regulations to be done, hundreds of studies. We don’t really know what it’s going to turn out to look like and so I think the most important thing institutions can do right now is to monitor very carefully what is happening in each of the firms. Not only that but, with regard to Dodd-Frank, some of the implementation is clearly going to be slowed down because Congress has yet to fund the necessary additional personnel for the SEC and the CFTC to actually start doing the work on the regulations and the studies.

Moreover, we have to keep in mind that we have lots of different countries doing this at the same time – that the Basel initiative is going on – and they aren’t necessarily coming out with the same conclusions. One of the more worrisome initial results is that the Europeans have taken a very different view of what to do with the ratings agencies than we have. I’m not sure either one of them is exactly correct but it will tend to in the short-run to balkanize capital markets in a way that I think none of us would wish.

Knowledge@Wharton: Bill, what’s your take on the overall effect of all of this legislation?

Bill Schlich: Well, from a business perspective I think right now what organizations are doing, and need to continue to do, is to really understand what are their core businesses? Where are they making money? Who are their customers? And to figure out where is most optimal to make that money? In other words, where can they be most profitable? Yes, the regulations are not finalized yet, but what we are seeing is organizations spending a lot of time trying to figure out what their core business is in the markets that make sense for them.

Knowledge@Wharton: Is that the core business that they had yesterday? Or the core business of tomorrow? And how are those different?

Bill Schlich: Well, that’s a great question and I think in some respects it is looking at the businesses you did before. How did you do it? Where did you do it? And why did you do it? And then trying to figure out what that business will be in the future. We do see a tremendous amount of focus on the customer. Who is the customer? And what does the customer want, which I think is a little bit of the future but also a little bit of the past.
**Governance Challenges**

**Knowledge@Wharton**: Don, as a former regulator, this is right up your alley in a way. This is a lot of regulation coming down the pike at one time.

**Donald Vangel**: There is a lot of uncertainty, which makes it very difficult to plan in a very concrete way around what the precise implications are going to be. [There are] a lot of straws in the wind domestically and internationally. Notwithstanding that, there is an imperative for firms to do the best they can from a governance standpoint to get their arms around all of those moving parts – if for no other reason than to identify the key issues in the implementation phase of many of these matters. [Banks will want] to influence the shape of the final rules in a way that is going to be most constructive – whether you do that as an individual institution or as part of an industry group – and also deal with some of the issues that are beginning to crystalize fairly early.

For instance, there is a theme that pervades Dodd-Frank about increased reporting requirements. Just about every aspect of the statute – whether it is to inform decisions around systemically important institutions, provide information to the Office of Financial Research, or increased [requirements] for regulatory reporting more broadly, [require firms to] look at issues of data and systems architecture so firms can understand about data availability and what may need to be done sooner rather than later to position their systems architecture to be responsive to those issues.

Those are the kinds of questions that we see firms beginning to ask early on and to look at it in a very multi-disciplinary way.

**Richard Herring**: I'd like to add a bit to that. I certainly agree with everything you have said. But I think yet another potential driver of this whole effort will be what is done with regard to rapid resolution. The whole essence of that is having timely information that will permit someone to take over an institution should it fail and knowing the systems – knowing who operates the systems, knowing who owns the systems, and all of that is going to require really massive expenditures in IT, which has typically been one of the motive forces for consolidation in the industry. But on the other hand, we have regulations that are pushing the other way, that are trying to discourage firms from being bigger.

Also with regard to who are your customers and your core business – it is really a huge challenge for a number of the very largest firms in the world because if you look in 2006 and 2007, they were making more than half their revenue off of securitization. That is gone. And so it really is a time to rethink what is our purpose and what should we be doing to help our customers fulfill the basic financial needs of making payments, protecting against certain uncertainties in the future, and providing the kinds of financial services they want rather than the ones that are necessarily enormously popular because they are so opaque.

**Capital Requirements and Basel III**

**Knowledge@Wharton**: There has been a lot of new rules, re-regulation, new regulatory regimes, and there is a lot of prep work from what you have said that needs to be done. But there still is a lot of uncertainty.

**Bill Schlich**: Well, I think right now the biggest area of uncertainty is the capital requirements. How much capital does an organization have to hold? We know those requirements are going up. But how far are they going to go, and in what jurisdiction? Will it be different country-to-country? I suspect it may be? And how does it impact my business model?

It is very difficult to be strategic today when you don’t know the capital requirements in each jurisdiction. You don’t know the liquidity requirements. All we do know is that jurisdictions want things ring fenced and they want to be able to understand the business in their jurisdiction, and they want to make sure there is enough capital and enough liquidity there. With that backdrop though, then you have to figure out – to Professor Herring’s point – who are your customers? How are you going to make money? And can you make it in a way that’s profitable given this increased cost to capital? ROAs [return on assets] are coming down, there’s no doubt. And how far they come down I don’t know. But it will be interesting to see how far the ROAs come down and then it will be interesting to see how investors react.

**Donald Vangel**: The Basel III process has certainly gone a long way towards calibrating at least the first stage of increased capital requirements. The Basel III framework articulates new definitions for what qualifies in effect as good capital and raises requirements for how much of that capital should be held.
But it leaves still undetermined how much if any additional capital should be held to deal with pro-cyclicality issues, that is, to put in place a counter cyclical buffer on top of the conservation buffer. How much additional capital, if any, should systemically important institutions have to hold on top of that? The G-20, while it endorsed the Basel III framework, pretty strongly also deferred to each jurisdiction to deal with systemically important institutions within its boundaries with respect to additional capital and liquidity requirements. So, it does run the risk of on top of having consolidated capital requirements that still have a ways to go in terms of: How much capital will you need to hold (and how much liquidity) in specific jurisdictions if you are viewed to be systemically important within them. So there's a question of trapped capital as well as the absolute level of capital that needs to be held.

Richard Herring: I think you've made an important point about the way the Basel committee works. We have explicit capital requirements as a minimum at 4.5% that are basically equity to risk weighted assets. We have another 2.5% that is supposed to be a capital offer of sorts, yet it is put together in such a way that it really becomes required capital, because although the regulators say they want banks to feel free to use it whenever they want, they will, in fact, if they do use it, withdraw their right to pay dividends and bonuses and things like that.

So it really does become capital that is explicit. And as you mentioned, re: other things that were controversial -- they stuck under Pillar 2 [under Basel II] where its' really a private matter between the regulator and the regulatee and [the public] won’t get to know about that. And it is going to make for a very unlevel playing field. There is some hope that they are going to migrate a leverage ratio after some calibration. But given the resistance in Europe – and they have a long way to go to meet a leverage ratio that is anything like the U.S. banks – there is some doubt that that will ever see the light of Pillar 1.

Global Banks Face Increasing Complexity

Knowledge@Wharton: So not only is there a lot of fuzzy math around capital requirements in Basel III alone, but then of course we have the whole new regulatory regime in the U.S. [under Dodd-Frank] and then what the G-20 is doing, and then there are other entities in Europe that are looking at new rules for the eurozone. What kind of coherence or incoherence are we going to see among those rules? We are talking about global banks – they have got to deal with Basel III, but they've also got to deal with Dodd-Frank and they've got to deal with whatever the G-20 comes up with.

Donald Vangel: I think the potential for a very balkanized world around some of these specific rules is legion. I think even within the U.S. what I find really interesting is regulatory reform actually created a more complex regulatory structure rather than a less complex regulatory structure. There are some 250 rules that need to be written – many of them jointly by numerous agencies. The statute in effect gives almost every regulatory agency backup authority over every other regulatory agency, and getting regulators to cooperate and work cohesively that way, in my personal view, has never been a strong suit of the U.S. regulatory environment. And then you look the way issues are evolving as they relate to things like incentive compensation -- where the approach in the U.S. so far has been a somewhat principles’-based approach looking at the way incentive structures are structured – the governance around them as it relates to risk-taking is trying to move the industry towards more discipline. The approach in Europe is much more prescriptive. Institutions that operate globally are going to need to comply with both sets of requirements. I think the fragmentation around the world is likely to be increasingly significant.

Richard Herring: I have a wonderful picture that illustrates your first point. It's by one of the major U.S. banks and it shows the sort of cross-cutting reporting to various regulators for each of their lines of business. And then it shows what Dodd-Frank added. And it virtually doubles the complexity of the system. It's just astonishing. And to think that we are going to deal with all of this through a committee of 10 and hangers on – most of whom have no expertise or interest in systemic risk -- is to me a design for disaster.

Donald Vangel: It is going to be interesting.

How Level Is the Playing Field?

Knowledge@Wharton: Bill, it doesn’t sound like we are looking a very level playing field here. Does this mean that regulatory arbitrage is going to be a major problem?
Bill Schlich: I think the question is how unlevel will the playing field be? I think it's too early to tell. I mean, you have the Volker rule in the U.S., which obviously some say gives the Europeans an advantage. You have the comp differential that Don talked about, which the Europeans would say puts them at a disadvantage. There are some out there that believe the centers of banking are going to move to Asia for a whole host of reasons.

Knowledge@Wharton: Including some threats by a British banker to do exactly that.

Bill Schlich: Exactly. So I think the real question is how long will they be unlevel for, and then how will they become more level? From my perspective when you look at Volker rule it is pretty prescriptive of what you can and cannot do. And it is going to become clearer over time what that means. But at the same time, I wouldn’t be surprised if the Europeans start to get to the same place through requiring additional capital against trading books. So the question is, yes, they will be unlevel, but for how long will they be unlevel and will people be able to take advantage of it?

Donald Vangel: I think it's difficult absent something like a global resolution regime, or some monolithic authority that is able to set a singular set of rules and apply them consistently across jurisdictions. I think we are moving towards an environment where there is going to be much more ring-fencing of operations within individual jurisdictions with respect to the rules that need to be applied – the capital and liquidity that need to be managed – and that is going to make managing a global financial conglomerate increasingly difficult.

Bill Schlich: Right. And the question will be how global can you be? And actually some of us believe that the global institution is very important. But more importantly, it is going to call into question what happens with innovation? Who does it? Where is it done? How do we move credit? If we don’t come up with a way to get credit to move again? Securitizations are for the most part dead. How are we doing to move credit? How are we going to incentivize people to originate credit and then move it? It becomes much more difficult if you are talking about organizations that can be very separate in different jurisdictions.

**Regulatory Impact on ROE/Dividends**

Knowledge@Wharton: How will all of these new regulations likely affect profit margins, ROE [Return on Equity] and dividends over the next year or two, or three? Bill, let's start with you.

Bill Schlich: Well, I think it's clear that ROEs are going down. Cost of capital is going up. Margins are shrinking. We had together in September [2010] the lead directors from 18 of the largest institutions in the world – financial institutions – and the consensus was ROEs are going to be cut in half from what they were a couple years ago. So if you were at 20 you are going to be at 10. And they put the range of a return equity for a global institution between 8% and 12%.

I think it's clear with capital requirements going up, margins are shrinking, ROEs coming down. The interesting point to all of that: Where is the investor on this? We haven’t really heard from the investor yet. What's their reaction to an ROE of 8% versus 12%? How will they respond? Will banking investments still be attractive or not attractive? What pressure will shareholders put on management? We need to increase profits. We need to take on more risk. So the constituency that hasn’t been heard from yet is the shareholders and what their thinking is around ROE.

Donald Vangel: When you talk to bankers there is a lot of interest about migrating to businesses that are less demanding for capital and liquidity, and [that are] more fee based. What that means for banking in terms of credit creation and sort of intermediation is a real question in my mind. If you look to maximize a return on equity in this market and to optimize in effect your use of capital, I think you are going to move to businesses that are less balance-sheet intensive and demanding of liquidity and capital.

Richard Herring: I think all of that is true. Theory would teach us that by raising equity you should be able to get a better return on the debt you raise. But since these trillion dollar institutions are already going to be benefiting from the implied guarantees from the safety net, they are not going to realize that. It's just sheer cost. And so it is, in a way, taking away the safety net – maybe not very convincingly but that's part of what's happening in this and it is not going to make for a happier firm.

On the other hand we should note that there have been profitable financial institutions that have in fact done very well with 20% equity. You just do different sorts of things.

Donald Vangel: Right.
Knowledge@Wharton: At least initially, since we are still a rather slow economy, banks will be measured against other industries right? And other choices that investors have. So if these other industries aren’t giving the returns that they did pre-crisis, then the banks may not look so out of line if their ROE is dropping by 50%. Is that correct?

Bill Schlich: Could be. The investor thinks about not just the totality of the return but the risk of the return. So it will depend on how the investor looks at the banking industry in totality.

Richard Herring: We shouldn’t leave out the point that the Fed, by keeping interest rates at virtually zero, is trying to provide an enormous subsidy to the banking industry that we should not let go unnoticed. Because they are able to gather funds at virtually no cost, and they can lend them out at very handsome margins, which is half the reason that they have delayed the phase-in of the capital rules for a very long time, they realize it is expensive to go out and raise new equity in the markets.

Transaction costs are very high and people are not enthusiastic I think it’s safe to say about banks today. But if they can retain it as earnings from these very fat spreads, it’s really – if you like – a transfer from those of us who are trying to save to the banks who need to rebuild their capital positions.

Knowledge@Wharton: How much longer do you think that will be necessary?

Richard Herring: Well, they are talking about five, six or seven years, I think.

Models for Future Growth

Knowledge@Wharton: There was some mention made of all of this shifting the models that banks will be looking at for growth in the future. Bill, can you talk about what some of those future growth models might be? How they will be different? How will you make a transition? I imagine consolidation might be part of that conversation.

Bill Schlich: It will be difficult to know what that is going to be without knowing what the rules of the road are going to be – how much capital and in what jurisdictions do you need that capital. But a couple things are clear. One, there is a tremendous focus – I said it before – on the customer. Who is your customer? What are you providing him? How do you best provide that customer?

Secondly, the emerging markets will be incredibly important. Every financial institution I speak to says they are investing a significant amount of money in the emerging markets – China, India, Brazil. So I think it will take time to figure out but over time with the focus on customers, which makes you focus on your core business – and then the focus on emerging markets – we will start to see what that new business model is going to look like.

Donald Vangel: I think the focus on customers is an important element and, frankly, something of a shift.

Knowledge@Wharton: Weren’t banks always focused on customers?

Donald Vangel: Well, nominally yes, but I think [it was] more introspective than extroverted, if you will. And I think now, as the environment gets more uncertain, as things like capital and liquidity requirements become more binding, looking to the customer as to what the demand is for financial services -- to let that drive strategy more than the environment for financial services -- I think is a constructive development.

Knowledge@Wharton: For example, I have read recently about a couple of banks that have announced, “Well, we are going to be moving more strongly into wealth management.” Because presumably, there is always going to be money in wealth management. So that’s a shift. What exactly they are turning away from I’m not quite sure.

Richard Herring: And it is being driven to a large extent by regulatory requirements, I think. But I think it’s easy to get too gloomy about the future of the financial services business because one thing we do know from economics is that it is a luxury good. It is something people want more of as they get wealthier.

Now if the economy stays in the doldrums that’s a major problem for more than just banks. But as they become wealthier people do still want transactions services. They want savings products that will protect them from downside risks. And that’s where a number of innovations will come from. They are going to want foreign exchange services. They are going to want all kinds of opportunities to borrow and to hedge risks and so in some sense I think the demand is there. It’s just going to be a challenge to figure out a more efficient way to deliver
The Potential in China and Other Emerging Markets

**Knowledge@Wharton:** You mentioned emerging markets and, specifically, China. Some banks have seen that as a difficult market to crack. Could you talk a little bit about your experience with that?

**Bill Schlich:** I think when you look at the Chinese market -- obviously the banks there are quite large. They are very strong. But they are very much deposit-based. They take in deposits and they run money. The ability to crack that marketplace, which is controlled by the government -- where it sets mortgage rate and deposit rates -- is going to be very difficult for banks. So you may see a number of joint ventures.

You may see a lot of the banking being done in that part of the world through a different country. We see Singapore as a country that, from a capital markets perspective, is going to continue to grow. You may see some of it being done through investments in other institutions. But that's a difficult market to crack, especially in the deposit-taking space. They own the marketplace and there are four or five very large ones, very much controlled by the government.

**Donald Vangel:** It's interesting. I talk to Chinese bankers a lot who are very interested in expanding, for instance, into the United States with much more of a retail footprint than right now -- they are pretty much limited to a wholesale business through branches. Yet the U.S. regulators have been reluctant to allow that kind of expansion to date. I wonder if the desire to expand in the U.S. could ultimately lead to some liberalization of policies in the home country over time.

**Knowledge@Wharton:** And how about other major emerging markets – India and Brazil – being the obvious ones?

**Bill Schlich:** I think you are seeing a tremendous amount of money being invested there. So we look at Brazil and India as two places you are going to continue see significant growth -- in both core banking and the capital market space.

**Richard Herring:** I think Brazil is far in the lead among the BRIC countries in the sophistication of its banking system and the sophistication of its markets. Part of it is the heritage of living with hyperinflation. But part of it is also that they have integrated with the world economy much more rapidly. They have not tried to run a closed economy quite the same way that China and India have -- and Russia, of course.

What Level of IT Investment Will Be Needed?

**Knowledge@Wharton:** It appears that substantial investments and information technology will be needed to comply with all this re-regulation. What level of investment is needed? How would you characterize it? And how do you balance investment in the right IT -- to get the right data -- with the investment needed to drive the business in the future?

**Bill Schlich:** Don said that lots of the investment in the past was more front office than what we call back office. And I think that's true. The crisis made it obvious -- especially to the regulators -- how difficult it was for some organizations to pull information together. So this is not really a request. It's almost being forced to do it to be able to comply with the new rules and the amount of information they are going to have to provide to the regulators.

So you are seeing investments across all stools of the information flow, whether it be financial reporting, regulatory reporting, risk reporting, or management reporting. And, quite frankly, they are trying to come to where they can pull a single source of data at the transactional level, which they've never really been able to do before. And if they are able to do that then they are able to cut that information four or five ways and to provide the regulators what they need. It is going to be a significant undertaking. The investment dollars that are being spent is hundreds of millions of dollars by organizations both short term and long term.

**Knowledge@Wharton:** Could you characterize that as a percentage of income or revenue for a given global bank -- what they are going to need to invest in a given year or over the next five years?

**Bill Schlich:** I'm not sure I'd be able to do that. Do you have any idea?
Donald Vangel: No. The way I look at it, it is probably the biggest investment that banks have had to make -- that has been driven by regulators -- has been the investment in Basel II. I see this investment and that’s been in the hundreds of millions of dollars over several years. I see this need to upgrade systems and data as being equivalent to that in terms of scale and duration.

I do think that to the extent that it improves substantially the timeliness, accuracy and consistency across different dimensions of data with -- respect to risk information in particular -- it has the potential to make companies materially more agile and to really create a return. I don’t think it should be viewed as a response to a regulatory mandate. I think then it's just pure burden and just a cost to the industry. It should be viewed much more as investment in management information that will contribute to flexibility.

Richard Herring: I would very much agree. Many of the costs that regulators have imposed in the past have been dead-weight costs that have no value in running the business. But this, if it’s done right, should help managers run their business much more effectively and help regulators regulate much more effectively. But it does require a lot of agreement on what information you need and what way you need to cut and indeed the accounting standards you use in putting it together. And that’s where a lot of hard work has to be done.

What Role Might CoCos Play?

Knowledge@Wharton: What role might CoCos, which are Contingent Convertible Bonds, play in the regulatory effort? It seems like they could serve as an effective shock absorber. How investors may view them is one thing and how regulators view them another. Professor Herring, could you give your view?

Richard Herring: In my view there are at least 14 or 15 different proposals for CoCos and almost all of them suffer from fundamental defects of one sort or another. There is first of all the amount you want issued? What triggers them? How many of them will be converted into equity at the trigger point and on what terms are going to be triggered?

Knowledge@Wharton: It might be good to just start with a quick definition of a CoCo.

Richard Herring: A CoCo is a bond essentially that, under certain circumstances, has a triggering event that will convert it into equity. This benefits the bank in the sense that its equity increases and its liquidity requirements actually decline because they no longer have to pay interest and amortization on the bond (that was converted). Now the trick is to make it attractive enough for bond holders to want to buy it, and yet to make it useful in giving banks a better equity buffer.

And my view on this has been that the existent CoCos -- I think two in the market at present -- are really not the way one would want to do it. They are intervening at much too low a point where there is no chance of correction. I would prefer to see them used as an incentive, which means that you really want to maximize the amount of dilution so that both management and shareholders have a strong incentive to avoid the conversion -- and hopefully they don’t get converted very often -- by either restructuring or raising new equity while they can.

That means having a pretty high level for the trigger. And in my mind the trigger should be fairly advantageous to the bondholders so they are attractive to hold. If the trigger actually does happen you will have a mass of disgruntled shareholders to which you can add new shareholders -- the unwilling shareholders who held the CoCos before. And you have a very good chance of management change and real structural change, and enough time to accomplish it. Finally, the key advantage is that there should be no excuse for having over-the-weekend sleepless nights in which you bail out a bank or put it through bankruptcy because it will be very evident that a bank is in decline over a long period of time.

Knowledge@Wharton: So these CoCos would be an instrument that would help in cases when a financial crisis might seem to be approaching either for an individual institution or systemically?

Richard Herring: Well, I would like to see it happen before [it comes to that].

Knowledge@Wharton: They are meant to be a shock absorber that helps to avoid that situation.

Richard Herring: Yes. It is supposed to be an extra incentive for management to undertake change while they still have the flexibility -- the financial flexibility -- to do it. And the problem is we saw time and time again managers sticking to the same old strategy that was not working:
Knowledge@Wharton: In your opinion, Bill, – let's say CoCos had been in widespread use in 2006. Would this have had a significant shock absorbing effect on what happened in 2007 and 2008?

Bill Schlich: Well, it may have. You know, additional capital is always a good thing. The concern I have with the triggers is where do you set them? How do you set them? But more importantly, if you are the institution that it gets triggered on, okay, now we'll convert to capital and that's a positive.

Richard Herring: And that depends on the level at which you do it and the amount at which you do it. If you double – literally double – your capital then you've got time to actually change your strategy in many ways. And you've got reduced liquidity. You've got time to sell off a big part of your firm if you need to. But I perfectly agree that if you wait until 4% or 5% to do that it's just not going to work.

Knowledge@Wharton: As a [former] regulator? What would you say?

Don Vangel: I think the idea -- one of the policy objectives -- is to increase the capacity of the system to absorb shocks and to internalize the costs of that as much as possible on the industry itself. I agree with professor Herring. I think how you structure these [is key] – it's hard to argue that more loss absorption capacity is not a good idea. The question is what are the calibrations and what are the structures? And I do think structuring the instruments in a way that encourages behavioral change in advance of the need to use them to absorb shock – other things being equal – it itself a shock absorber because it forces. Shock absorption is not just on a liquidation basis it's on a management basis as well.

Lessons Learned from the Financial Crisis

Knowledge@Wharton: Do you think that the main lessons of the financial crisis have been learned? And is a new round of increasingly risky behavior on the part of banks now more likely or less likely? Professor Herring?

Richard Herring: I think the jury is still out quite frankly. The Fed is actually through its policy trying to push not only banks, but investors into taking riskier bets in the interest of regenerating the economy. But the spreads you used to see between junk bonds and treasuries have come way, way down to before crisis levels. You are beginning to see bonuses that look like pre-crisis levels. You are beginning to see dividends next year. It's not at all clear to me that we have seen fundamental changes in the way these institutions are run. That may happen as the regulations click in. But so far I'm not persuaded that we have learned much of anything.

Donald Vangel: I would agree with that only because, if you look at the way financial institutions are performing, profits are really being driven, for credit-granting institutions, by improved credit quality rather than by really top-line growth. Where the business is going to go when it really begins to grow again and risk-taking as opposed to risk-aversion becomes the driving force? I think it remains to be seen. I think the potential is there for us to reach for a yield in ways that are consistent with circumstances that gave rise to the problem in the first place.

Bill Schlich: I do think banks are less complex today. They are not doing the same transactions they did in the past. You don’t see the securitizations being done. And you don't see the very complex transactions being done. Having said that, like we said before, the one thing that really hasn't come out yet is the investor’s push for higher yield.

To Don's point, as that push for higher yield comes it will have organizations building new complex products, but [it will] also be forcing new organizations to take more risk. Risk-taking is not a bad thing. Risk-taking is how you make more money. It's whether or not you have learned the lessons about risk management and how you do it. I get more concerned about what's the next risk we need to worry about. We spend a lot of time on the risks around securitizations and subprime mortgages and all that.

Knowledge@Wharton: Fighting the last war as it were.

Bill Schlich: Yes. What is the next risk? And how do we prepare ourselves for that? And are organizations setting themselves up in a way where they have time and the ability to sit back.