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This submission gives a private sector perspective on how to unwind the government interventions made in response to the financial crisis, in particular with respect to private sector financial institutions. It does not consider the question as to when this should happen, to which the best answer is, broadly, "as soon as the chance of any unwinding having to be reversed is reduced to negligible."

This paper also addresses those aspects of the unwinding that might be best coordinated across governments and the role the IMF might choose to play in that regard.

The nature of the intervention

Governments have adopted a range of interventions with respect to financial institutions. In generic terms, they might be summarized as follows:

- Supporting the capital of the bank—in some senses the "cleanest" since it does not involve any disturbance of the institution above shareholder level. This has been adopted by the United States and a significant number of countries in Europe, the Middle East, and elsewhere.

- Supporting the asset base of the bank, either by sharing the risk on certain asset classes (e.g., TARP in the United States or APS in the United Kingdom) or by taking certain toxic assets out completely ("good bank/bad bank" solutions as in Switzerland).

- Supporting the liabilities of the bank by guaranteeing deposits beyond the level that is considered conventional to support the retail market (e.g., the United States and many European countries) and providing state guarantees for debt issued by financial institutions (e.g., the United States, the United Kingdom, Germany, Ireland, Denmark).

- Liquidity support by creating liquidity in the market, for example by governments setting up state-guaranteed SPVs, which provide funding to financial institutions (e.g., France) and allowing riskier assets as eligible collateral for financing purposes by the central bank (e.g., the United States, the United Kingdom, the euro area)

To some degree (particularly after the initial stages of the financial crisis), these policies were adopted as an integrated package; however their unwinding can (and should) happen in stages across these different interventions.

Beyond interventions

In addition to their interest in unwinding interventions, governments will also wish to consider policy issues in relation to financial institutions generally, including those in which it retains an interest. Such issues might include:

- The on-going, viable structure of a particular financial institution, for example the need to restructure it into a good bank and bad bank.

- The regulation of the sector, including pressure to enforce longer-term guidelines on governance, compensation, etc.

- The level of competition in the market place (particularly retail)—should state-supported bank X retain a Y percent share of its domestic market?

- Whether it wishes to recognize that there may well be systemically important banks that are "too big to fail" (and what does "failure" really mean?).

- The interaction between investment banking/trading and conventional banking; does any country wish to reinstate Glass-Steagall?

In addition, where the government retains a shareholding of significance, it may ask or require the financial institution to divest itself of certain noncore assets to resolve its own capital needs (in a not dissimilar way to the State Aid restructuring requirements that have been implemented by the European Union).

These are fundamental issues that need to be addressed not only on a country by country basis but also taking into account cross-border banking and capital market implications. For example, financial regulation should, ideally, be conformed across the global markets—where the IMF and the World Bank could play a role.

Unwinding

Reverting to the interventions themselves, Rothschild believes that there is a natural sequence for the unwinding:

- It is difficult to see how other unwinding steps can be taken until the financial institution is reasonably in control of, and has full understanding of, its own assets. So, the first element of an unwind might sensibly be the unwinding of asset support packages (and, in the case of good/bad bank, the formal separation of such assets).

- Ending quantitative easing is also desirable early in the program; this is possibly best coordinated by (the relatively few) governments involved in the practice and may not necessarily involve the IMF other than as a broker of ideas.

- Ideally, too, liability guarantee schemes would have moderated toward normalized policies (e.g., retail deposits only up to just a modest level), although the greater risk probably lies in a premature phasing-out and historically the complete unwinding of such liability guarantees has typically taken five or more years.

- After the above phases, the sale of stakes in the capital of the institutions may begin.

These are general guidelines; indeed the next two paragraphs expand on how these last two might be seen in parallel.

Implementation

Rothschild strongly supports a policy initiative whereby the taxpayers of a country who have supported their financial institutions should be given an early chance to reinvest in the unwinding. In addition, we observe very strong appetite from retail investors for assets that have traditionally been seen as secure dividend generators. For example, in France, the 2005 initial public offering of EDF generated €6.7 billion in orders from 4.9 million private individuals. Similarly, the final sell-down of Telstra shares by the Australian government in 2006 generated A$7.8 billion in orders from 2.5 million individuals. Modern distribution techniques and communication media have made accessing such demand a cost effective option.

A common concern amongst senior politicians is that the targeting of the general public as investors relatively early in the unwind exposes a financially less sophisticated audience to too much risk. At the same time, history teaches us that early sales in any unwinding generally bring significantly higher returns than the later ones. Rothschild therefore strongly supports the idea that retail investors might be invited to acquire government-backed securities exchangeable into the bank's capital. Effectively this might take the form of a, say, three-year government bond, yielding no interest (bank deposits yield little anyway) but convertible into the financial institution's shares at a premium to current market. No downside (if held to maturity), but potentially significant upside. Such investments could well be issued before certain other unwinding has been fully implemented, particularly the guarantees.

A program

Unlike the private sector, governments do not sell individual assets, they sell programs. It is arguable that a major offering of a well-known retail bank (or other financial institution) could create a swell of enthusiasm that could, of itself, do a lot to reinstate confidence. To address this and to make sure that each sale/unwind fortifies the next, governments should consider its assets as a package as well as looking at the individual characteristics of each financial institution.

If successful, it could be that the unwinding resuscitates a large element of the confidence that has been so seriously degraded by the crisis over the past few years. This, in turn, could help influence the question of timing referred to at the outset of this note.