SETTING THE CREDIT CRISIS RECORD STRAIGHT

MARK LANE MEETS TETSUYA ISHIKAWA, AUTHOR OF THE CONTROVERSIAL NEW BOOK, HOW I CAUSED THE CREDIT CRUNCH, AND SEEKS HIS VIEWS ON WHERE IT ALL WENT WRONG

The public want some scapegoats. Who can they blame for the credit crunch? Who can they blame for the fact that they and people around them are losing their jobs? Bankers? Traders? Politicians? Anyone will do at the moment. Sir Fred Goodwin, and his connections with the Royal Bank of Scotland, fitted the bill perfectly for a short time but I think we've all got a bit bored of him now. So now it's time to find somebody new, a job which I am sure the British media will be happy to help out with.

Tetsuya Ishikawa

These are bizarre, irrational times we live in for as a I write this, the headline in one particular national newspaper is that house prices are showing signs of recovery. Later in the article there is an interview with an estate agent (that most partial of observers on the housing market) saying the past few weeks have been frantic.

The whole story is upbeat as if, somehow, rising house prices are good news and recovery in the housing market somehow implies we are heading out of recession.

It seems, then, that on the one hand we are obsessed, as a nation, with house prices, many viewing them not as homes but as investments. On the other, when these investments don't do as we want them to do we want to blame the very people who turned our homes into investments in the first place by ramping up the whole market for a decade.

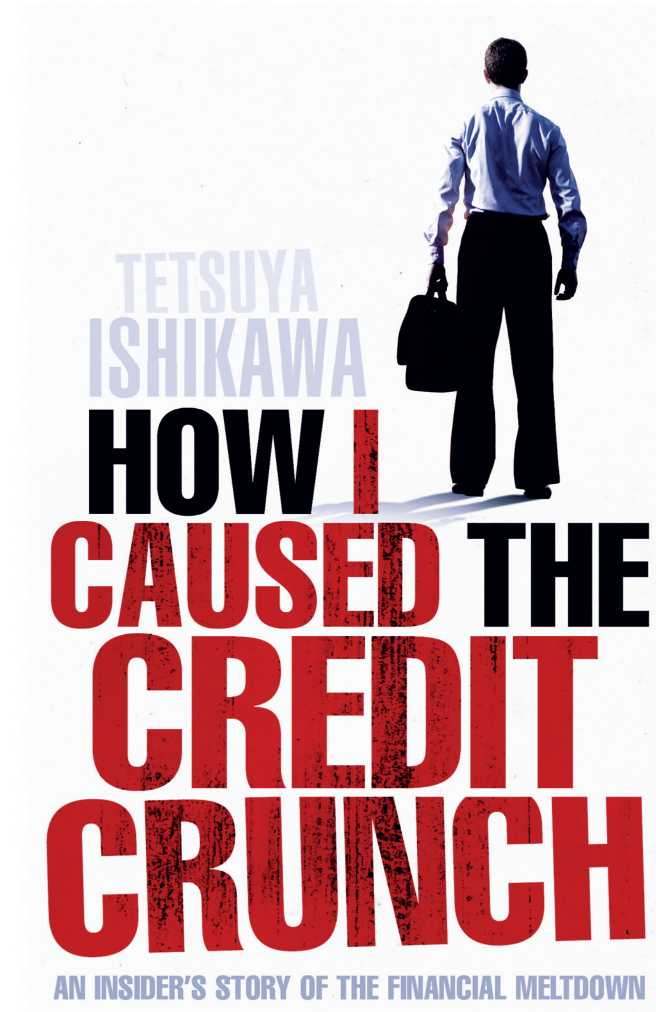
It is against this backdrop that I caught up with a one man who, if he isn't careful, might just end up following in the footsteps of Sir Fred Goodwin. Tetsuya Ishikawa is the author of a new, provocatively titled book entitled How I Caused the Credit Crunch.

The book is a factional - fiction based on fact - account of Tetsuya's seven years at the epicentre of the credit markets. In it, Tetsuya explains in layman's terms the complex financial instruments which enabled debt to be parcelled and re-parcelled, a process known as securitisation. That debt was given ratings by agencies based on how risky it was and, logically, the returns for investors were higher the riskier the debt.

The idea of securitisation generally was to disperse risk while enabling cash-rich investors to share in the risks associated with bank lending. But, as we all know now, things went horribly wrong. Banks became highly leveraged, buying each other's securities to boost short-term profits and generally - and I choose this term carefully - behaving in an idiotic manner. The banking system became fraught with risk, market sentiment shifted, people got jittery and financial Armageddon followed.

Tetsuya's book, while brilliantly explaining the complex stuff, also alludes to the personalities involved in the financial industry generally. High on testosterone, low on morals, they made millions by day while living to excess by night. They did drugs, used prostitutes, spent thousands on the best Champagne money could buy, they drove ridiculously expensive cars, splurged tens of thousands on tailor-made suits and so on.

A number of things stand out about the book. First, there is the sheer audacity of the products being created. At one stage Tetsuya likens a particular deal to a shop-keeper buying his own stock just so he can put the transaction down as a revenue on his balance sheet. There doesn't appear to be any intrinsic value being created by the deals. The investment bankers, in their own, cosseted little world, truly do seem to have lost touch with reality.



And herein lies the problem. During one particularly illuminating passage, the protagonist drives out to some prime US real estate to try get a feel for the burgeoning property market that is making all these deals possible. Here, he bumps into a Ferrari-driving mortgage broker. The broker tells him about some of the products he is selling and Tetsuya immediately sees that, long-term, they simply don't stack up. People with terrible credit ratings are being allowed to borrow huge sums yet the broker doesn't seem that concerned about whether they will be able to pay it back.

I put it to Tetsuya that surely people in the industry must have realised what was going on. Surely somebody must have known that you can't just keep creating money out of fresh air. Arguing that the principles behind securitisation were fine. The problem, he suggests, "is that people took it to another level and it got out of hand. You have to remember that people in the industry are under huge pressure to deliver profits for their employer. Individuals became driven solely by profit and remuneration and nothing else got a look in."

He continues: "The entire credit crisis was based on the assumption that credit was endless. We were operating in a period where there was this massive growth in investment capital. The Asian banks, collectively, had trillions to invest. Suddenly this investment pool around the world looked enormous and people got carried away. What they didn't count for is that if things did start to go wrong, how quickly they would falter."

The first signs of things going wrong in the book is when news emerges of people starting to default on their mortgages in the US. Securities start getting down-rated by ratings agencies and investors start panicking. The interesting thing is that, even at this stage with the blindingly obvious staring them in the face, many investors simply refuse to accept what is happening. They think it's just a short-term market correction. "The problem was that many have such a strong intellectual belief in the workings of the free market," Tetsuya says.

In the book, the key protagonist ultimately ends up being made redundant. Nobody wants his products. In real life, Tetsuya, whose banking career took in stints at Morgan Stanley, Goldman Sachs and ABN Amro, says he is now happy writing. He has a column with the Guardian and, indeed, has become a media spokesperson on the credit crunch.

His argument for writing the book, he says, was to set the record straight on the credit crisis generally and encourage people to ask what really went wrong so that we can learn some lessons for the future (as opposed to simply looking for scapegoats).

"The whole debate around the credit crunch has missed some key points in my opinion," he says. "One of the most important issues for me was the culture of short-termism in the industry and this, I would argue, is a reflection of the society we live in. Shareholders demand a profit and there is pressure on people in the industry to deliver.

"Thirty years ago, investment banks were partnerships rather than publicly listed companies. The firms were owned by the partners who had a stake in the business and, as such, it was in their interests to make long term decisions that were in the best interests of the business. Their mentality was completely different - they were not simply driven by a desire for short-term profits."

To me, this begs the question as to why older heads in the industry did not see the speculative bubble that was being created and perhaps think to do something about it. The answer, Tetsuya suggests, is because even the older generation got caught up in the growth frenzy. As he rightly points out, "initially, some lessons were learnt from the Great Depression but they were forgotten over time."

The strength of this book, I would suggest, is that it remains objective throughout. Tetsuya has written an honest, open account of what may well come to be seen as a very dark period for high finance. It's significance is that this period is now having a huge impact on us all - not least the many owner managers who will be reading this now and wondering why their bank is suddenly reluctant to extend their overdraft.

If looking for a scapegoat, such readers may well wish to blame Tetsuya and his ilk, however, I would ask them to think again. He and his colleagues created, fine-tuned and made money from these complex products ultimately to plug a gap in the market. They acted in self interest just as your amateur buy-to-letter (another product of these perverse times) acted in self interest despite the fact that his or her actions ultimately helped ramp up prices for first -time buyers.

The difference was that Tetsuya and his contemporaries made millions in the process. Given the chance, I dare say most of us would do the same. NE

How I Caused the Credit Crunch by Tetsuya Ishikawa is published by Icon Books Ltd.