More financial inclusion is needed

The leader of the Association of Bankers Bangladesh talks about how to save people from fraudulent multilevel marketing

REJAUL KARIM BYRON

IT is difficult to stop the so-called multilevel marketing companies from cheating people without further financial inclusion, said the chairman of the Association of Bankers Bangladesh.

In an interview with The Daily Star, Nurul Amin said 50 percent of the population does not have access to health and education.

They are easily lured by the attractive advertisements and propaganda of these companies, he said.

"If people cannot be made bank-oriented, these MLM companies will continue to cheat people," Amin said.

In India, more than 60 percent of the population has bank accounts. It is only 30 percent in Bangladesh. The number of bank account holders may have increased after the central bank allowed people to open accounts with only Tk 10.

Private banks now open an equal number of branches in urban and rural areas. "As a result after about five years, more people will have access to banks, which may narrow scope for cheating by MLM companies," he said.

Amin, also the managing director of National Credit and Commerce Bank Ltd (NCC Bank), talked to The Daily Star on a series of issues and the much-talked-about Destiny Group.

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Before the Destiny scandal, many such incidents like Jubok and Unipay2u occurred in Bangladesh.

In case of Destiny, the government and regulatory agencies took cautionary steps in time. "I think the government is in the right direction," Amin said.

On an allegation that the ABB functions as an agent of the central bank instead of working independently, Amin said: "The ABB is no collective bargaining agent."

It is a voluntary organisation working for the development of the community and has to work within the boundaries of the law, he said.

"Bangladesh Bank is the regulator and we are operators. We must have some relations. However, we think if the central bank wants to take any policy decision it is better if they take it after consulting with the ABB," Amin said.

About the new banks recently approved by Bangladesh Bank, he said it would have been better if the banks had been of specialised types -- perhaps for the garment industry or small industries or regional.

Now, a number of banks have already been approved and the finance minister has said the permission was given on political consideration. So there is no scope to comment on it, he said.

"We hope competition and fair play will continue to be there after the new banks emerge."

Amin also focused on banks' involvement in the stockmarket.

The exposure of banks has now become bearable and within a limit, he said.

However, if the exposure is limited to 25 percent of their capital after an amendment to the banking law, it might be initially difficult for the banks to maintain it.

NCC Bank is going to step into its 20th year. It started its journey with Tk 19 crore in paid-up capital in 1992. Its paid-up capital was Tk 695 crore in 2011.

The bank's assets now stand at about Tk 11,000 crore and the bank has been expanding its client base every day. The bank's deposits have crossed Tk 8,000 crore this year.

NCC Bank's net profit rose 3 percent to Tk 421 crore in 2011, compared to the previous year, according to data from the bank. The bank has 87 branches across the country and will open six more branches this year.

The power crisis is the biggest problem in infrastructure development, Amin said. He said NCC has bankrolled three power projects.

About the overall situation in the banking sector, Amin said there seems no big crisis in the sector now due to monitoring by the central bank and the banks' self-regulation.

He, however, said 12 primary dealer banks face some problems in maintaining the credit-deposit ratio.

He said the central bank's cooperation is required in this case.

ANALYSIS

JPMorgan's core problems

REUTERS, *New York*

JPMORGAN Chase & Co lost at least $2 billion in its failed hedging strategy not only because it was sloppy, but because it grew too big in a rarified market of complex financial instruments that it had created.

The strategy involved credit default swaps, a kind of derivative that was at the centre of the 2008 financial crisis. The swaps were originally used to hedge the bank's exposure to other investments it owns and included contracts tied to North American investment grade and junk corporate bonds, as well as bonds in Europe and Asia.

JPMorgan helped invent the market for such swaps, known as "synthetic" positions because they trade risk without trading the actual bonds. But two things made these particular positions untenable and costly for JPMorgan, according to traders in the market and derivatives experts.

First, as bond markets shifted and forced JPMorgan to realign its hedges, the bank layered swap on top of swap, complicating the structure and increasing the risk that its hedges would fail to offset losses from one swap with gains from another.

Second, the sheer size of JPMorgan's swap position became more than the thinly traded market could easily manage. The lack of liquidity meant the exit door was too small for JPMorgan to fit through quickly once the trades started to deteriorate.

Making matters worse, because JPMorgan was so dominant in this market it became clear to hedge funds and other trading entities that it was isolated and at risk -- providing opportunities for those who could successfully trade against the bank's position. The complexity of the trades made it difficult for the bank to stay on top of the risks as its position worsened.

Jamie Dimon, JPMorgan's CEO, has acknowledged sloppy execution and oversight of the trades. And he said it could take the rest of this year or longer to unwind the positions. He has declined to give details about how illiquid the positions are, but has said the bank could lose another $1 billion or more before the company can trade them away. Competing traders could force JPMorgan to pay even more to exit the trades, now that many have figured out details of the bank's position.

The effects of JPMorgan's stumble are still being tallied.

Though the bank can easily absorb a loss of $2 billion or more, its credit rating was cut on Friday by Fitch Ratings and its reputation for avoiding problems was dented. Dimon's calls to ease pending regulations have lost credibility. After all, the regulations are supposed to prevent banks from taking big risks of this kind with their balance sheets. On Friday, the bank's shares plunged more than 9 percent, wiping about $15 billion off its market value.

The bank is investigating how it got into the mess, and it is expected this week to accept the resignation of Ina Drew, the New York-based head of the Chief Investment Office where the trades were made, and ask for the resignations of two of her subordinates, London-based Achilles Macris and Javier Martin-Artajo, according to sources familiar with the matter.

AFP

Pedestrians walk past the JP Morgan Chase headquarters in New York.

A JPMorgan spokesman declined to comment for this story.

JPMorgan created the credit default swap market in the 1990s, when a team of its financial engineers designed the instruments so institutions could hedge, or speculate on, changes in the creditworthiness of bonds. In 2001, the bank launched an index of swaps that helped pave the way for the instruments to be actively traded.

At the root of the losses, traders at other firms say, were bets tied to debt through an index known as CDX.NA.IG.9, which tracks credit default swaps on about 127 investment grade companies in North America, including Target, Home Depot, Kraft Foods, Wal-Mart and Verizon Communications.

The position came to consist of layers of index positions that were both for and against corporate creditworthiness getting worse. Some of the positions were supposed to offset, or neutralise, one another. But traders say the risk that the layers would not work together as intended increased as more were added.

For two decades, "financial institutions have been gambling, and often losing, based on assumptions that historical correlations will remain constant or converge," said Frank Partnoy, a former derivatives trader who writes books on the instruments and teaches law at the University of San Diego.

Some traders believe JPMorgan's assumptions began to go awry early this year. One position in favour of a broad improvement in corporate creditworthiness lost money when credit weakened. Worse, a hedge on that position lost money, too, when credit ratings fell for fewer companies than the bank expected in that situation.

The growing problem in the layers of positions probably stayed below the surface because of the way the portfolio was constructed, said Janet Tavakoli, an expert in derivatives and structured financial instruments.

"The nature of JPMorgan's large CDS book is that even a fool will appear to be making money as revenues pour in" from selling protection against default, said Tavakoli, adding that in her view the kind of valuation models JPMorgan uses "cannot distinguish between dumb trades and smart trades." The overwhelming flaw is that assumptions can be manipulated - whether intentionally or otherwise - so that an income stream that isn't hedged appears to be hedged, she said.

But hedge funds and other institutions in the market smelled weakness and dozens took advantage of the bank, according to traders. Reports by the Wall Street Journal and Bloomberg in early April about the bank's giant positions only made awareness of JPMorgan's problem and its isolation greater.

While Dimon has declined to describe the specific positions, he said the bank made the portfolio "more complex" as it tried to "rehedge" its positions over time.

The losses from these trades are embarrassing for JPMorgan not only because the bank helped invent the market, but because the trades themselves are designed to protect the bank from losses. Like insurance policies, the contracts give a buyer the right to collect a payment from a seller if a bond goes into default. As market demand for these insurance instruments increased, banks created ways to trade cross-sections, or tranches, of the synthetic indices.

Now JPMorgan, which emerged from the financial crisis with relatively few wounds and enormous new power and influence, has, by Dimon's own admission, lost credibility because of its mishandling of derivatives.

JPMorgan executives to leave over trading loss

REUTERS, *London/New York*

JPMorgan will move to limit the fallout from a shock trading loss that could reach $3 billion or more by parting company with three top executives involved in its costly failed hedging strategy, sources close to the matter said.

The bank - the biggest in the United States by assets - is expected to accept the resignation this week of Ina Drew, its New York-based chief investment officer and one of its highest-paid executives, in the next few days, the sources said.

Two of Drew's subordinates who were involved with the trades, London-based Achilles Macris and Javier Martin-Artajo, are also expected to be asked to leave, they said. Neither was available for comment on Monday.

The departures come after the unit Drew runs, known as the Chief Investment Office (CIO), mismanaged a portfolio of derivatives tied to the creditworthiness of bonds, according to bank executives.

The portfolio included layers of instruments used in hedging that became too complicated to work and too big to quickly unwind in the esoteric, thinly traded market.

One hedge fund manager who previously ran a proprietary (or prop) trading book at JPMorgan said the bank's public commitments to trim balance sheet risk were at odds with its network of trading silos, who were making bets independently with only a handful of the bank's most senior executives notified of their vast, complex exposures.

"This (CIO) group was completely separate, completely distinct from the prop trading unit. We had no clue about their prop book and they would have no clue about ours for that matter," the manager said.

"They were all totally independent. All the activities were reported to New York and they ran the allocation of capital to each and every strategy ... those decisions were definitely not taken in London. These things were very, very opaque. Every bank is, whether you're Goldman, Morgan (Stanley) or JP."

Drew had repeatedly offered to resign in recent weeks after the magnitude of the debacle became clear, according to one of the sources, but the resignation was not immediately accepted because of her past performance at the bank.

Until the loss was disclosed late on Thursday, Drew was considered by some market participants as one of the best managers of balance sheet risks. She earned more than $15 million in each of the last two years.

"Ina is an amazing investor," said a money manager who knows Drew, but who declined to be quoted by name. "She's done a really good job over a lot of years. But they only remember your last trade."

Departures had been on the cards in the wake of the trading losses, though in disclosing the losses on Thursday, CEO Jamie Dimon said only that the bank was continuing to investigate and would take disciplinary action with those involved.