A DAY AT THE BIG BANK

Case-study

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United States of America, Near future

On the way to work, Jason looked back at the recent evolution of his financial world.

The financial markets have always been unpredictable, but the decade of financial crises and scandals that began with the Dot Com meltdown in 2001 deeply shook trust in the efficiency and fairness of the financial system. A large number of banks took severe hits, whether because of unreasonably risky investments, or because of activist boycotts fueled by practices perceived as unfair and discriminatory by impoverished customers.

The U.S. finance industry was eager to emphasize that a repetition of the Great Depression had been avoided because of excellent coordination among all actors. But a more realistic explanation was the massive influx of capital from government-owned investment vehicles: Sovereign Wealth Funds (SWFs).[1] The growing power of SWFs, driven by large current account surpluses and increased revenues in oil producing economies, generated mixed feelings. Some of these investment flows aroused security concerns, as they were suspected of being motivated by political objectives rather than the maximization of risk-adjusted returns.[2] The capitalist world was watching as some of its largest private companies were bought by foreign governments whose concept of capitalism was rather particular.

Protectionism was still rising, in the midst of hot debates about curbing international flows of capital and harnessing market volatility.[3] The U.S. government had officially proposed that the international community collaborate on a multilateral framework for “best practices” in the financial markets. The European-headed International Monetary Fund, with support from the World Bank and the OECD, had made proposals for the regulation of foreign investments and the reduction of systemic risk. Banks were said to depend too much on the ever-increasing volatility of financial markets

Meanwhile, the European Union pushed for the principle of taxing financial transactions at the global level. Most European countries had already enacted a tax that would enter into force as soon as all EU members had approved it. To the astonishment of some observers, the U.S. Administration was not against the tax. Experts spoke of a two-tier tax, with the regular rate around 0.01 %, potentially applied to all financial transactions. A U.S./E.U. agreement was in the works, and others were under discussion with China and India, powerfully supported by Singapore. In fact, India had already imposed such a tax on its domestic market. China was playing along because the regulatory fever provided more legitimacy to its mix of liberalism and government-controlled capitalism.

The principle of a tax on financial transactions was not new, but this was the first time it had enjoyed credible global political support.[4] The tax addressed two of the most pressing challenges of the century: stability of the financial markets and global development. The U.S. Administration saw it as an opportunity to reclaim leadership over global financial markets. The explicit political rationale was to allocate revenues from the tax to alleviate poverty and help the

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[1] For an introduction to these funds, see for instance “Sovereign Wealth Funds”, by Lee Hudson Teslik, *Council of Foreign Relations*, January 2008 (Available at http://www.cfr.org/publication/15251/).

[2] For instance “Funds that shake capitalist logic”, by Lawrence Summers. *Financial Times*, July 29th, 2007.

[3] See for instance “We must curb international flows of capital”, by Dani Rodrik and Arvind Subramanian. *Financial Times*, February 25th, 2008 and “Option demand spurs market volatility? --- Banks' hedge plays may be driver to recent spikes”, by Rob Curran , *The Wall Street Journal*, February 20th, 2008.

[4] See Appendix 2 for a chronology of the idea of taxing financial transactions.

global economy move towards environmental sustainability. A year before, the U.S. had officially shifted from a “Trade, Not Aid” policy to a “Trade with Aid” policy and had committed anew to the target of 0.7% of their GNP in international aid to meet the “Millennium Development Goals”[5]. A tax on financial transactions appeared as an effective means to meet the objective. Besides, it was gaining growing popular support among U.S. voters and would give the United States an advantageous bargaining position in other multilateral agreements.

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For Jason B. Spence, C.E.O. of The Big Bank, these new political developments raised strategic questions. It was early Wednesday morning and his executive committee was about to meet to decide about their position. In the afternoon there would be a special meeting with a handful of his board directors. The bank needed a clear strategy for the next day’s discussion with the U.S. President’s Working Group, where the U.S. Treasury, the Federal Reserve, the State Department and a few others would discuss the U.N. project to create a Committee on Global Financial Regulation to implement the tax.[6] The bank’s position should already have been decided, but the sudden departure of the head of Corporate Communications had delayed the process by a few days. Now Jason was in a hurry, a mood he hated.

When Jason stepped out of his chauffeured Lexus at the curb in front of the bank’s headquarters tower, he discovered a dozen tents, reminding him of his son’s outdoor excursions. There seemed to be nobody around, but since it was barely 7 am, people might still be sleeping. He saw stacks of signboards and hesitated to walk over and read them. One he could see read: “Why are you excluding us?” A second warned: “People are more important than profits”. Jason looked for his security people and saw none. He decided to enter the building. The guard at the reception desk told him the tents had already been there when he took his shift in the middle of the night. “Well,” thought Jason, “this will be handled by the security and communications teams.” The bank had experience with this sort of demonstrations; they were smoothly dealt with once the protesters were engaged in deeper conversation about the bank’s commitments to CSR, philanthropy and local communities development. The Big Bank was the biggest cash giver in the United States and had long since integrated responsibility issues into its business.

Jason went to his office, granting a hasty smile to his secretary. He could not deny that he felt a bit nervous about how the day would evolve... At 7.30, he opened the meeting with a brief update on the political context of the tax on financial transactions. Jason looked at Atos T. Anders, President for Global Markets. “Atos, we are looking forward to your opinion on the issue. Go ahead, please!”

> “Thank you, Jason. Well, ladies and gentlemen, I think we all agree that this tax is a threat to us, and it’s also political nonsense. It is obviously our interest and our responsibility to prevent the adoption of a mandatory policy that would constrain our activities and harm economic growth. We have no choice but to keep telling policy-makers and the public how irrational this solution is.[7]
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> “The financial system is extremely efficient and the success of this bank proves that rational actors are rewarded. This tax will harm us along with the efficiency of the entire system, and

[5] See Appendix 3 to learn more about the Millennium Development Goals.
[6] See Morin (2006) who discusses such an international regulation effort as part of his recommendations. According to him, this situation would not be without resemblance with the Bretton Woods discussions in 1944.
[7] See Appendix 1 for arguments and counter-arguments for such a taxation mechanism.

its alleged benefits are as vague and dubious as the true rationale of its political proponents. Frankly, I am overwhelmed by the speed with which anti-trade sentiments and socialism are gaining momentum in the current political process, and the way in which they are beginning to intrude on our lives. What comes next: More new taxes? Government-approved transactions? State-run banks? Personally, I am losing faith in the commitment of our government to protect our freedoms, and its commitment to preserve the economy that guarantees our happiness."

"Did you analyze the impact of the regulation on our business?" asked Jason. Atos replied:

"Financial transactions *are* our business. Financial transactions are how we serve our customers. How can more regulation not harm us? In the recent past we expanded our capital markets and investment banking activities, which are now generating hundreds of millions of additional net income a year. Such a tax would drastically reduce the volume of our transactions and all my colleagues agree that our profits would be materially affected. In particular, currency and derivatives trading would encounter severe difficulties. Outsourcing of staff to off-shore sites may be an option, but a large number of layoffs can be expected, none of which could prevent a 10 to 20% impact on revenues and profits.[8] Interbank transactions will be massively affected. Our estimate is that up to 80% of daily transactions may disappear, with proportionate financial consequences.

"Obviously these developments would make it virtually impossible to maintain our projected profit and growth figures. Beyond that, they would jeopardize our strategic goals in the global sector. All in all, this tax represents a heavy burden for all our stakeholders – our customers, our employees, and above all our shareholders. It is my conviction that whatever we do to oppose this tax, we must act fast. Too much is at stake. I have no doubt we will win this battle."

"What is your plan?" asked Jason. Atos continued:

"First of all, we have to continue the dissemination of sound economic reasoning that demonstrates the irrationality of the tax. We must finance and support the growth of overwhelming empirical evidence that competitive countries depend on open and democratic political systems, which adopt an approach to bank regulation that relies on private monitoring, imposes fewer regulatory restrictions on bank activities and gives less of a role to government actors. Prominent economists – including Nobel prize winners – and scientific evidence are firmly on our side. Just one example: A recent survey of more than 200 regulations and supervisory practices in more than 100 countries has found no benefits of direct official oversight of banks. In fact, the contrary is true. Regulatory restrictions increase cronyism, corruption, and collusion, with adverse ramifications on the efficiency and effectiveness of bank intermediation.[9] Why should we – and the citizens of democratic countries –make sacrifices on the basis of wishful, willful stupidity?"

"But there is massive popular support for such a tax. You can't expect everyone to become an economist!" interrupted Mary Paine, the newly appointed President for Consumer Business. Atos was ready with a counter-argument:

[8] Kapoor (2004) indicates similar estimations.
[9] For an introduction to this research and its literature, see e.g. "Bank Regulation and Supervision", by Ross Levine. *National Bureau of Economic Research*: Fall 2005.

> "There's no doubt that our view has strong support among the educated elites, way beyond economists. The precise problem is that the people in the street think this tax on financial transactions will be paid by the rich. In other words, they support it because they expect to benefit at the expense of others. We will prove them wrong. We've already done some preliminary work with a special task force at the American Bankers' Association. Focus groups show a positive response to the message that this tax would hit the ordinary person. As consumers, people will face higher prices from companies who have to deal with increased costs of capital. As bank clients, they are unlikely to accept higher fees. We will also convince people whose retirement depends on pension funds that they will lose a significant part of their future comfort. The ordinary person suffers from this tax – this has to be the clear message, and it will work. I propose that we give our full support to this task force. It is still rather informal but has precise plans for a large public-relations campaign."

"Do you think you can convince everyone?" asked Jason, not without a hint of irony. Again, Atos was prepared:

> "There is no reason we cannot gain the support of our customers, and that's millions of people. The activists who are trying to monopolize media attention deserve special treatment. I know a public relation firms that has a lot of experience with these people. They divide activists into four categories: radicals, opportunists, idealists and realists. They implement a three-step strategy to divide and conquer their movements: Isolate the radicals, cultivate the idealists, and co-opt the realists. These strategies have been very successful for the oil industry, the tobacco industry and pharmaceuticals." [10]

"I suppose that when public opinion turns against this tax, it will be much easier for our political supporters to take the appropriate steps?" asked Gerry J. Matheson, President for Corporate Affairs. Atos could not conceal a trace of satisfaction as he replied:

> "Gerry, you know the answer. Of course you're right. So we should target legislative decision-makers and negotiators in the U.S., and maybe increase some of our donations here and there. However, we must also use our networks abroad. For instance, we're connected to a lobbying firm whose President heads the European Global Finance Forum, a network of European Parliament members and banking industry executives that promotes effective financial policies. He is ready to convince our European allies in the industry that, even though development and environment are wonderful concerns, we don't need medicine that kills the patient. Once the European Parliament is convinced, we'll look to the European Commission to persuade national governments."[11]

"Aren't you afraid of the consequences for our reputation?" asked Gerry again, with a smile of complicity at the corner of his mouth. Atos said:

> "Look, there is no reason we in particular would be exposed to criticism. Everything we do or will do is perfectly legal, and reflects our responsibility to maximize our profits for our shareholders. In the face of irrationalities, we have to speak for prudence. When necessary, we will act under an industry umbrella that preserves our brand name. What is crucial is to

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[10] The opportunists then naturally become allies. See for instance "Mongoven, Biscoe & Duchin: destroying tobacco control activism from the inside", by Stacy M Carter. *Tobacco Control,* 2002.

[11] For an insight on European financial lobbying, see "In Europe, finance lobby sways terror-funding law- legislators with close ties to industry water down money-laundering rules", by Glenn R. Simpson, *Wall Street Journal,* May 24 2005.

show cooperation throughout the industry, and dissuade those who want to play alone. We should *not* be afraid, because we are basing our actions on a rational and scientific approach. The only driver of this tax is ideology."

"Before discussing this approach in details, let's hear some more views" said Jason. "I think both Gerry and Mary have prepared something. Gerry, you have the floor."

"Jason, ladies and gentleman, I think we can be more subtle. We are not against regulation, but we want to show that good governance and self-regulation is a better solution. We should focus on our core business: banking with good governance."

"Can you be more specific about how to deal with the political pressure for international regulation, in particular for the tax?" asked Jason. Gerry replied:

"I don't think there is any urgency. So this is not the right time to act. Experience has taught us that these kinds of situations require patience and a level head. There are scientific debates, not just ideological ones, about whether taxation of financial transactions is an appropriate means to alleviate poverty and to support the transition towards an environmentally sustainable economy. Concerning poverty, it is not proven that more development money really helps, and concerning sustainability, we have many possibilities of interpreting the notion. Systems change and evolve. Throughout history, human beings have invented solutions to their problems, and I am an optimist. There are holes in the current coalition and many weaknesses on the political front. It is very unlikely that we will face practical consequences before long. International political agreements take a lot of time and few are ever enforced. I personally believe this taxation proposal is a political fad that will quickly vanish from the political landscape. As I told you, we should focus on our business, and show how well we do – not just for ourselves, but for everyone."

"Do you really believe that approach can convince anyone to drop their regulation efforts? The debate is not only about sustainability, it's about constraining us," said Atos. He seemed miffed to discover that Gerry wasn't merely his supporter. Gerry explained:

"We don't need politicians to drop this initiative, as long as it entails no consequences for us. For example, they may eventually opt for a tax on air travel instead. If they really do something that impacts our business, we can always adjust later. I agree, however, that there is a genuine perception that the current system is not stable, and that at least coordination is necessary, if not regulation. We should not appear to fight against regulation and supervision but, as we did for the Basel accords, we should propose to constitute expert committees to draft joint recommendations. We should in particular reinforce the idea that markets contain disciplinary mechanisms that, under appropriate conditions, reinforce supervisory efforts by rewarding those banks that manage risk effectively and penalizing those whose risk management is weak or ineffective. Transparency is a key element of an effectively supervised, safe and sound banking system. Public disclosure of reliable and timely information helps market actors to make an accurate assessment of a bank's financial condition and performance, business activities, risk profile and risk management practices."

"The United States has been a market leader in disclosure and transparency in its banking system and yet it has known crises," objected Jason. "That's why we're having this discussion." Gerry shot back:

"Banks aren't the only ones to be blamed here! The insurance industry is a major determinant of financial crises. Generous insurance schemes reduce the incentives of private investors to monitor banks, and this increases the ability of bank owners to take on excessive risks, increasing the probability that the country suffers a systemic crisis. Look at the monoline insurers."

"But I agree that we should go beyond the official guidelines to ensure that sufficient and meaningful information is provided to the markets. We should develop sound and comprehensive internal control and risk management systems, complemented by effective internal audit activities and a strong compliance culture. But we need to preserve some degree of confidentiality. Besides protecting the privacy of our clients, there is detailed information on our risk management techniques and strategies that we would not like to share with our competitors."

"Do you have a specific proposal?" asked Jason.

"Yes, I would propose the creation of a 'Federation for Banking and Governance' aimed at gathering leading institutions for whom an efficient banking system is one where responsible business means doing good business with good governance. I would also propose some public relation action to show the general public our commitment to good governance."

"Second, we need to show that we care for the poor, so that the Bank's reputation and marketing strategy resonate with the widespread concerns over poverty and sustainability. There are win-win solutions ready at hand: we can better allocate our Corporate Social Responsibility and philanthropic resources so that they also serve our core business. Making our philanthropy more strategic is necessary and profitable. One idea is to raise money from our richest customers to fight against poverty in Africa. We could also set up a fund for America's revival, so that every American child who wants to realize his dreams has the chance to do so. And we should delocalize some of the operations of our foundation into poor neighborhoods in New Orleans or Oklahoma City. We can also show that investment is the best development aid. For example, the bond market in Africa provides great alternatives to other emerging markets, so let's put some more money there."

Marc Simon, Jason's Canadian-born assistant, had quietly entered the room. He chose this moment to tell Jason: "I just received a call from Corie Hennigan."

Corie Hennigan had been fired a few years ago. The official reason was inappropriate use of confidential information, but she'd claimed she was a whistleblower who was scapegoated on fake ethical charges. Her dismissal had been a nightmare.

"What does she want?" asked Jason, not bothering to conceal his annoyance. Marc replied, "She says she represents the protestors downstairs. They're targeting us because of our commitment to Corporate Social Responsibility. She says quote, 'It's time to walk the talk.' She insisted I write down their demands." Jason took the note from his assistant and read:

ONE AMERICAN, ONE BANK ACCOUNT

RICH OR POOR: SAME SERVICE, SAME PRODUCT, SAME PRICE

"What exactly is this about?" said Jason. Marc explained:

"She said it is time to enforce financial justice. She claims she has multiple revelations about how the bank profits from the poor, making them pay more money than the rich for identical products and services.[12] She said she is prepared to feed the news to thousands of people in the financial community, depending on our support for her cause. She said she will call back in an hour and she insisted to talk to you in person."

Jason said, "Mary, how much time would you need to make your presentation?"

"Not more than 10 minutes," answered Mary Paine.

"Go ahead" said Jason. She began:

> "My proposal is to face reality, to anticipate the trends and to design a set of proactive and dynamic strategies to become the leader of tomorrow's banks. I have analyzed the needs and motivations that feed this effort towards more international regulation and I propose to support it, for our best interest and for the world's. This is a unique opportunity to initiate an authentic and trustful relationship with our stakeholders and shape the landscape in which we are going to be the leader tomorrow."

"Sounds like an idealistic approach" commented Gerry. Atos let out a minute but audible snicker. Mary shot back:

> "Far from it! I have taken a 360° perspective, and it's a cold-eyed, realistic account of the problem we are facing. Look out the window: if people are in the streets, it is because, *in reality*, crises do matter to them. The poor are among those who bear the biggest burden of crises, as wages plummet and unemployment soars. If other countries criticize liberalization, it is because they don't benefit as much as we do from it.[13] So who is denying reality? Few people outside our industry will be convinced that more self-regulation and greater transparency can solve these problems. The reality for us is that only 44% of opinion leaders trust banks, the lowest score for all industries in the U.S.[14]. Intelligent people tell us that the current financial system is an obscure and alien world to them, and that it is based on the ruthless exploitation of uninformed borrowers and naïve investors. Let's face it. In spite of all the smiling clerks and happy children in our advertising campaigns, for most people we're the Darth Vaders of money."
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> "What happens without trust? People are avoiding our products and our services and they are spreading the word. Competition with non-bank providers is hitting us as they enter our market with a much more credible image.[15] We are becoming a necessary evil, and I am scared about that. We risk losing our 'social license to operate' if we don't regain the trust of our stakeholders. Sustaining our financial performance is not enough; this factor comes only third in the building of trust, after service to clients and reputation and just before local community involvement.[16] If we want our role in society to be credible for our stakeholders, we need to identify values beyond profit. We need to find that purpose to invent our future."

Jason was confused and intrigued at the same time. He asked: "What does this mean in practice?" Mary said:

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[12] See appendix 4 for examples of controversial practices.

[13] For a Nobel Prize winner in Economy who holds these views, refer to Stiglitz (2002). See also "Financial Hypocrisy" by the same author, www.bepress.com, December 2007.

[14] Edelman Trust Barometer 2008.

[15] See "No bank is an island: Get global before globalization gets you" by Wendy Feller, Cormac Petit and John White. IBM Institute for Business Value study. February 11th, 2008.

[16] Edelman ibid.

"We have to really know our customers and manage their expectations. This is different from engineering their consent and favoring their consuming behaviors. It implies deserving their trust. Such a relationship cannot be achieved if consumers believe that our only purpose as a corporation is to maximize our profits whenever we deal with them. They dream of another bank and we have to meet their expectations. We are potentially in a very powerful position because money is at the heart of our customers' lives and we are managing that heart. For most of us, our relationship with money is a deeply conflicted one and we don't want to be associated with its negative side."[17]

"In terms of political influence, we have a lot to gain in supporting this tax initiative. We're only talking about government-controlled investment and taxation of financial transactions, but there are proposals for much more drastic measures against our industry. I hear growing doubts about the role of the financial sector and its actual contribution to prosperity. We need to take a stance: are we at the service of society or do we see our private interest as more important than political and social aspirations? In the political process, we should cooperate, not manipulate! Personally, I feel that the energy and efforts of many of our employees would be doubled if the company they are working for takes an affirmative stance toward its respect of democracy and its societal role."

"Have you been able to identify business implications?" asked Jason. Mary continued:

"Well, I do have some preliminary ideas. To me, the first principle is anticipating regulations driven by the need to stabilize the banking industry. For example, we may like to focus on the traditional banking businesses and prepare to sell off our brokerage activities. I know there are political discussions about legally imposing such separations across the sector."[18]

"Second, we could invest more on a long term, deep root basis. This is not philosophy, it is asset management, in line with the growth of socially responsible investment (SRI). In our investments, we can anticipate the long-run social and environmental trends, and make choices about a reduced number of companies. Instead of being stuck with comparative Price Earnings Ratio or any other ratio or broker story, our investment can be based more on a comprehensive analysis of a company. By making this extended SRI market mainstream, we can push it from the 15% it now covers to a third of total assets, which will make us a true leader in the transition to a sustainable economy. Let's use finance as a tool, not just as a money pump. For example, there are needs to finance infrastructure, such as roads or bridges or water networks. Instead of financing individual houses, let's invest in water and electricity networks or energy efficiency projects. These projects will become profitable within five years, or in some cases, like water, even within a year."

"My third idea is about becoming the bank for the world. The principle is to be a genuine catalyst of the global wealth accumulation process. We can start at home by giving full support to the National League of Cities programs that propose to connect the poor to the financial mainstream. The California experience has been a tremendous success and we

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[17] See "The Soul of Money: Reclaiming the wealth of our inner resources", by Lynne Twist, New York: Norton 2003.

[18] See "How to End the Subprime Crisis", by Paul Craig Roberts, *Global Research*, March 10, 2008. For this former Assistant Secretary of the Treasury "the heart of the problem is a 1999 'reform' that repealed an earlier reform known as the Glass-Steagall Act." In 1933 the Glass-Steagall Act separated commercial banking from the securities business. PBS Frontline gives an estimate of $300 million for the cost of the 20-year lobbying effort that would have led to the 1999 decision (see "The Long Demise of Glass-Steagall", *PBS Frontline*, 2008).

should roll out similar programs nationwide and then worldwide.[19] However, this is credible *if and only if* we simultaneously proactively pull out from all practices that directly or indirectly penalize the underprivileged.[20] No one should feel excluded or penalized because he is poor. It is a shame to be such a big bank in such a big country, and still have millions taking expensive payday loans.[21] We should also develop in emerging countries, trying to keep our reserves locally and use these flows as guarantees for micro-credit organizations."

"And now, you are going to ask us to lend money to a risky customer at the same rate as we lend to a safe client!" said Atos. "This is absurd!" Mary looked at him coolly and said:

"Our stakeholders expect that in some situations we adjust our return expectations in order to promote values such as poverty alleviation. For the poor, we cannot merely calculate and price the risk of default. We need to work out less-risky environments within which the people we are lending to feel protected and morally committed to reimburse their loans. Are *we* going to wait for a Nobel Peace Prize from Bangladesh to teach us about banking for Americans?" [22]

Mary turned to Jason and said, "Mr. Chairman, people in this country are longing for sincere and honest change. You should seize this historic opportunity to reinvent our bank. Let's get the world on our side and become the bank people dream of!"

"Thank you very much, Mary, for those provocative thoughts," said Jason. "I'll admit that I am impressed by your presentation and have spotted some opportunities. Ladies and Gentlemen, thank you all for your proposals. We have to choose the best one. But we also have to deal with the mess downstairs. Do we have more information, Marc?"

Marc looked up from his mobile phone and said, "Mr. Chairman, I've been getting a flood of SMS, e-mails and phone calls. It looks like we're the target of a global grass-root campaign. Similar protests are reported in front of our offices in Los Angeles, San Francisco, New York, Washington, London and Paris. The activists are telling poor people to march towards our offices all over the world and ask for bank accounts and financial justice. We're getting calls from Bloomberg, the Wall Street Journal, and the Financial Times. They say they have received e-mails announcing important news about the company's stand on justice and human rights within the next hour. CNN is downstairs. They are filming the protestors and have asked for an interview."

Jason looked around the room. He felt a moment of tiredness, but did not show it. He smiled, but his eyes were serious. "Well, that's interesting," he said. "What shall we say, assuming we want to say something?"

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[19] See the Special Report "New NLC Action Kit Offers Advice on Helping Families Achieve Financial Stability, by Heidi Goldberg. *Nation's Cities Weekly*, February 4, 2008.

[20] For a behavioral analysis of marketing practices affecting the poor, see Bertrand et Al. (2006).

[21] See "Beyond Payday Loans", by William J. Clinton and Arnold Schwarzenegger. *The Wall Street Journal*, January 24, 2008.

[22] See "Subprime Lender", Interview with Muhammad Yunus by Emily Parker. *The Wall Street Journal*, March 8, 2008.

Preparation:

Once you have decided about a consistent strategy to address this political effort towards the taxation and regulation of financial transactions, you will present your strategy to the board of directors.

Note that you will also have to answer the phone call from Corie Hennigan and to decide about the journalists' requests.

Hints:

Recall that a strategy includes a clearly identified goal with a series of means towards the attainment of that goal. You may like to structure your work by main stakeholders. For instance:

- Political institutions
- Shareholders
- Customers
- Civil Society Organizations
- Competitors
- Banking Associations
- Employees
- General Public
- Media
- …

Note that the board directors may expect precise answers to some of the tactical decisions featured in the case.

Appendix 1: The rationale for a global tax on financial transactions

Proponents of a tax on financial transactions rely on the following key arguments, with varying emphasis:

- **Raising revenue for global development**

  Even a very small tax (e.g., 0.005%) has significant revenue raising capacity (Nissanke, 2003). The generated tax revenue could be used to meet the UN Millennium Development Goals of alleviating poverty and to finance global public goods, e.g. measures against environmental destruction.

- **Social justice**

  The tax contributes to more equity on a global level by redistributing wealth from the rich to the poor. Moreover, the tax serves to enhance fiscal fairness across factors of production: it would counteract the progressively shrinking taxes on "globalized" capital compared to the stable or increasing tax burden on labour.

- **Stability of financial markets**

  The tax would reduce short-term speculative trading and decrease volatility in the market. In addition, a two-tiered tax on currency transactions (Spahn, 1996) would decrease the likelihood of currency crises. The second tier would involve higher tax rates at times of severe currency volatility, thus making it unprofitable to continue to trade currencies.

Counter-arguments and responses

- **The tax harms the efficient functioning of financial markets.**

  The first and most heated debate among economists revolves around the effects of the tax on the efficient functioning of financial markets. According to the efficient market hypothesis, prices in a free market reflect all available information about economic fundamentals so that resources are allocated to their best use (Friedman, 1953). Proponents of this view claim that a tax on financial transactions would harm the efficient functioning of the financial market. More specifically, the tax is a transaction cost which would prevent traders from realizing arbitrage opportunities. The consequence would be less liquid markets, which would be more volatile and less efficient (Dodd, 2003, Habermeier and Kirilenko, 2003). Even if there existed purely speculative activity, the tax would do more harm than good since it could not discriminate between such speculation and beneficial trading activity, i.e, fundamental investment or arbitrage trading.

  In response to this, it is argued that financial markets do not function efficiently in the first place. For example, market participants who trade purely speculative can dominate the market in the short run (De Long et al.1990). Also, speculators can trigger unwarranted movements when individually rational market participants collectively act as a herd (Banerjee, 1992; Frankel, 1996). With respect to a loss in liquidity it is argued that excessive "super liquidity" from speculative trading does not bring any extra benefit for financial markets (Jetin, 2003). Moreover, the tax should be so small in magnitude that it would not discourage any fundamental investment or trading activity (Palley, 2003; Nissanke, 2003, Landau, 2004).

- **The tax could not prevent currency crises.**

  It is doubted whether a small tax on currency transactions would be able to prevent speculative attacks leading to financial crises. The Spahn proposal of a two-tiered tax (Spahn, 1996) is a reaction to these concerns: A low tax rate for times of normal fluctuation would be complemented by a second tier which involves hiking the tax rate up at times of severe currency volatility. In such cases, the high tax would render it unprofitable to continue trading currencies, thereby acting like a circuit breaker and preventing further destabilization.

- **The tax is politically unfeasible.**

  It is argued that global agreement on a tax on financial transactions is unrealistic. First, there are strong incentives for single governments to deviate unilaterally in order to enhance the attractiveness of their domestic markets. Second, the influential financial industry has vested interests at stake and would lobby against the tax. Also, coordinated implementation and actual enforcement across nations and markets is costly and complicated. Last, the distribution of potential tax revenue may be a source of political conflict among a potential coalition.

  Doubtlessly, political agreement on a tax on financial transactions is the key factor for successful implementation. Appendix 2 offers a list of historical events related to taxation of financial transactions which demonstrates the spread and popularity of the idea also among political actors.

- **The tax would be ineffective due to widespread avoidance and evasion.**

  Another argument which is frequently made against the imposition of the tax is that it would be ineffective. The experience with the Swedish tax on stock and derivative transactions (1984-1991) is seen as evidence that market participants would find ways to avoid the tax (Umlauf, 1993). Obviously, the size of the political coalition for the tax is a main determinant of the likelihood and ease of tax avoidance. Critics of the tax argue that even in the case of a large political coalition among the major market places, investors could operate off-shore or construct innovative derivatives (Dodd, 2003; Habermeier and Kirilenko, 2003).

  Others argue, however, that the extent of potential tax avoidance by going off-shore is overrated. Outsourcing involves extra costs and risk which may not be lucrative in the presence of a small tax. In addition, location decisions depend also on the network of support services, sound infrastructure and quality of living (Jetin, 2003). While tax avoidance by product innovation cannot be ruled out, this may not be a valid argument for determining whether the tax is warranted. As with any fiscal instrument, compliance would have to be monitored and readjustments would follow in accordance with innovative avoidance strategies (Palley, 2003).

- **The tax is technically unfeasible.**

  While it is frequently argued that it would be technically unfeasible to collect the tax and to monitor its compliance, several reports claim the opposite, in particular for currency transactions (Landau, 2004; Kapoor, 2004). For example, Kapoor (2004) emphasizes that the evolution of the Continuous Linked Settlement Bank (CLS Bank) for the purpose of the settlement of large FX transactions provides a very convenient mechanism for the tax to be collected centrally at a very low cost. Typically, the tax would be collected electronically at the point of settlement, either at the CLS bank or under the gross currency settlement systems of each country, and would be directly payable to the central bank of the country.

- **Development aid is largely ineffective.**

  Finally, some people question the very idea of raising money for development aid and argue that it is ineffective and no solution to poverty (e.g. Sala-i-Martín, 2001). Typically, they favor improved access to free trade as a more sensible approach.

  In contrast, proponents of development aid programmes argue that, by and large, projects to provide such basics as clean water, hospitals, medicines and education are of great benefit to many of the most needy people in developing countries (See Appendix 3).

Appendix 2: The history of a global tax on financial transactions

1936	John Maynard Keynes proposes in his “General Theory of Employment, Interest and Money” the imposition of a small transaction tax on all stock exchange dealings to diminish instability in domestic stock markets.
1978	Nobel laureate James Tobin proposes a 0.1% tax on spot market currency transactions to reduce destabilizing short-term speculation in foreign exchange markets. Henceforth, such a tax is often referred to as “Tobin tax”.
1983	Sweden levies taxes on domestic stock and derivative transactions. The result was widespread avoidance by use of foreign brokers. The tax was abolished in 1991.
1989	Following the U.S. stock market crash of 1987, the tax receives prominent support from Nobel laureate Joseph Stiglitz and from former U.S Treasury Secretary Lawrence Summers.
1995	Paul Spahn proposes a modification of the Tobin Tax which gains widespread attention. The “Spahn tax” should have two tiers: A very low rate for normal currency exchange, and a higher rate for periods of high currency volatility.
	During the U.N.’s Copenhagen Summit James Tobin officially lobbies for the imposition of a tax on currency transactions.
1997	Ignacio Ramonet, editor of Le Monde Diplomatique, renews the debate around the Tobin tax with an editorial titled "Disarming the markets". Ramonet proposes to create an NGO for the introduction of this tax, which is named ATTAC (Association for the Taxation of financial Transactions for the Aid of Citizens).
1999	The Canadian House of Commons passes a resolution directing the government to "enact a tax on financial transactions in concert with the international community."
2000	The Canadian delegation to the UN Social Summit proposes an amendment to the Summit Declaration mandating a study on the Tobin tax. Intense pressure from the US results in a declaration that does not refer to the Tobin tax specifically but more generally to the study of innovative sources of funding.
2001	15 Argentinean Deputies of different political parties submit a bill requiring the institution of a Tobin Tax.
	The French National Assembly adopts an amendment to the 2002 Finance Law that institutes a tax on transactions on the currency markets at a rate of between 0.01% and .1% that will be enforced when similar laws are adopted by other countries in the European Union.
2002	The Commission of Finance and Budget in the Belgian Federal Parliament approves a bill to introduce a tax between 0.01% and .1% once all countries of the Euro zone introduce a similar law.

A German Bundestag commission on globalization releases a final report which among 200 proposals favors a currency transaction tax.

2004 Indian Finance Minister, P. Chidambaram, proposes the introduction of a Securities Transaction Tax (STT) of 0.15% in the Indian financial markets.

A French working group on new international financial contributions, established by President Chirac, proposes among other measures a tax on financial transactions.

2005 Former Austrian chancellor Wolfgang Schüssel calls for a European Union Tobin tax to base the communities financial structure on more stable and independent grounds. However, the proposal is not taken into account by the European Commission.

2006 Economic advisors encourage the Bank of Thailand (BOT) and the Finance Ministry of Thailand to impose, among other measures, a low-rate Tobin tax on currency trading to curb the growing strength of the Baht.

“Stamp out poverty”, a network of more than 50 UK organisations, trade unions and faith groups demands a 0.005% stamp duty on sterling currency transactions to raise funds for international development.

2007 French President Nicolas Sarkozy is considering to control hedge funds with a tax on speculative investments**.**

The London based specialist currency company INTL experiments during one week with a 0.005% tax levied on all its transactions, raising more than £ 5000 for development charity.

2008 The Indian government is considering a Tobin tax-like system to reduce exchange rate volatility and to stem short-term capital inflows.

Appendix 3: The Millennium Development Goals[23]

"At the Millennium Summit in September 2000 the largest gathering of world leaders in history adopted the UN Millennium Declaration, committing their nations to a new global partnership to reduce extreme poverty and setting out a series of time-bound targets, with a deadline of 2015, that have become known as the Millennium Development Goals."

"The Millennium Development Goals are the world's time-bound and quantified targets for addressing extreme poverty in its many dimensions-income poverty, hunger, disease, lack of adequate shelter, and exclusion-while promoting gender equality, education, and environmental sustainability. They are also basic human rights-the rights of each person on the planet to health, education, shelter, and security."

Goal 1:	Eradicate Extreme Hunger and Poverty
Goal 2:	Achieve Universal Primary Education
Goal 3:	Promote Gender Equality and Empower Women
Goal 4:	Reduce Child Mortality
Goal 5:	Improve Maternal Health
Goal 6:	Combat HIV/AIDS, Malaria and other diseases
Goal 7:	Ensure Environmental Sustainability
Goal 8:	Develop a Global Partnership for Development.

[23] Source : UN Millennium Project. Visit http://www.unmillenniumproject.org.

Appendix 4 – Examples of controversial practices in financial services, with potential benefits

Services to the poorest and immigrant population

Cash checking

Very poor people, including many immigrants, often have no bank accounts. While many of them fail to meet the requirements for opening an account, other reasons for being "unbanked" include habit, unease with banking services, and general distrust for banks. Without a bank to cash their checks - a service generally free to account holders – these estimated 40 million adults rely on cash checking services.[24] The nationwide 13,000 check cashers charge between 1% and 10% for a handwritten check. A full-time worker who cashes weekly pay checks of $300 at a rate of 5% would save $30,000 over his 40-year career with a cashing account. 25 states have legally imposed rate caps on cash checking services.

- Banks can indirectly benefit by supplying money to the check cashers.

Services to poor working families

Payday loans

Payday loans are small cash advances of usually $500 or less, taken in order to meet an unforeseen expense. Payday loans are typically due after two weeks or a month. Fees often correspond to a yearly interest rate of over 400%. 15 million U.S. families a year rely on the service of 22.000 payday loan shops, which are primarily located close to military bases and African-American neighborhoods.[25] 99% of payday loans go to repeat borrowers, the average loan is rolled over 8 times. Thus, the average payday borrower pays $800 to borrow $325. Payday lending is illegal in fourteen states, in other states an interest cap has been introduced.

Car-title loans

Car-title loans are short-term loans (e.g., 30 days) of typically between $601 and $2,500 in which the car title is used to secure the loan.[26] The annual interest rate is up to 300 % and the loan is typically "rolled over" several times.

- Banks can indirectly benefit from the payday loan-business and from the car-title loan business by providing capital to the loan shops.
- In states where payday lending is illegal, out-of-state banks can benefit from partnerships with loan shop chains. These partnerships may enable loan shops to circumvent state law ("rent-a-bank" model).
- Banks can also benefit from arrangements which circumvent state law by enabling loan shops to collect fees in excess of legally imposed interest rate limits.

[24] http://www.time.com/time/magazine/article/0,9171,1653666,00.html
[25] http://www.responsiblelending.org/pdfs/2b002-payday2005.pdf
[26] http://www.scjustice.org/pdfs/TitleLoans.pdf

Services to standard bank costumers

Credit cards

Credit card issuers raise interest rates of up to 34% when the cardholder's payment is late. In addition, issuers charge late fees, typically between $29 and $39. Late fees have more than doubled between 1995 and 2005, from an average of $13 to $34.[27] Between 1989 and 2001, credit card debt in the US almost tripled from $238 billion to $692 billion.[28] Total revenue generated by all credit card fees tripled from $8.3 billion in 1995 to $24 billion in 2004.[29]

- Banks can increase profits by sending out mailing statements closer to due date which gives cardholders less turn around time. This raises the likelihood that some consumers end up paying higher interest rate and the late fee.
- Banks can determine default payment due dates on a fixed number of days irrespectively of whether this day is a weekday or a weekend day. Consumers with due dates on a weekend day may realize it too late and end up paying the late fee even though they were willing and able to repay.
- Banks can increase interests rate over time such that consumers who have never missed a payment still pay higher rates. They may do this when the consumer score worsens, e.g., due to late payments at a different bank, additional loans etc. Conversely, banks may not account for increasing consumer scores. They may also increase interest rates for no reason and inform customers only via opting out letters which some do not receive, do not read, or do not understand in time.
- Banks can increase profits by substituting fixed annual fees for alternative fees (balance transfer fee, cash advance fee, foreign exchange fee, etc.). While fixed annual fee may be prominent in the consumer's cost perceptions and complicate marketing activity, alternative fees are more difficult to detect and understand.
- Banks can increase profits by lowering the minimum payment requirements (e.g., from 5% to 2%). This ensures more interest income over a longer period of time from those consumers who tend to pay only the minimum.

[27] http://www.consumersunion.org/pub/core_financial_services/004292.html
[28] http://www.responsiblelending.org/issues/credit/
[29] http://www.demos-usa.org/pubs/IndustryPractices_WEB.pdf

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