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Presentation for the Open Forum on Non-Bank Lending

4th March 2010

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Macroeconomic context for non-bank lending discussion paper

- 2009 saw a surge in bond issuance, concentrated on large, investment grade firms.
- This was driven in part by changes in relative prices.
- The increase in capital market issuance offset some of the drop in bank lending.

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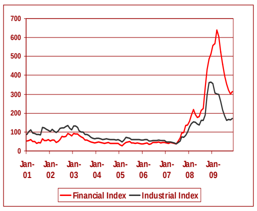
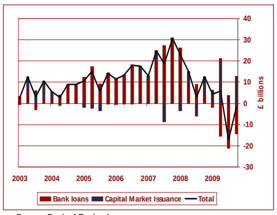
Relative Prices and Issuance

Corporate and financial sector borrowing costs (bps) above risk free rate (based on asset swaps)



Source: Merrill Lynch

UK corporate bond issuance and bank loans



Source: Bank of England

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UK businesses have historically relied on bank finance

- Use of debt capital market instruments somewhere between US and Continental Europe
- Banks will always play some role in providing debt to firms due to:
  - Fixed costs of issuing capital market instruments
  - Flexibility that bank loans offer, particularly in the form of overdrafts or revolving facilities
- Comparison to the US suggests there is scope for reducing the barriers to less large firms accessing capital markets

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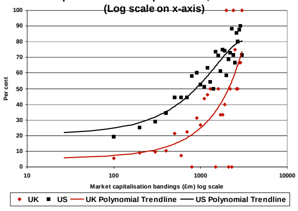
Company financing structure

Per cent of firms with bond market issuance compared to market capitalisation, UK and US. (Log scale on x-axis)



Comparison of corporate financing structures in the UK, US, France and Germany (per cent of total) 2007

Corporate Liabilities (2007)	UK	US	France	Germany
Equity	58	59	71	58
Corporate bonds (debt)	9	14	5	3
Loans (debt)	32	26	23	39
Money Market Instruments (debt)	1	1	1	0

Source: Office for National Statistics, Federal Reserve Board, Eurostat

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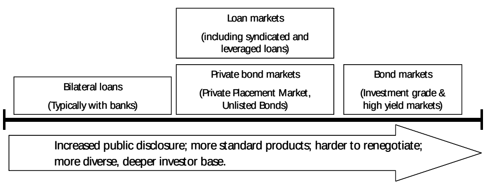
Bank channels to non-bank channels: Relationship between traditional bank loans and corporate bonds



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Discussion paper on the development of non-bank lending channels

Developing non-bank lending channels, could:

- Increase diversity of business funding sources
- Enhance competition in lending to firms
- Reduce the impact of financial shocks on the economy

Holistic approach needed – no short-term silver bullet

The discussion paper explored possible barriers to the development of non-bank lending channels, scope to reduce these barriers and ways for investors to invest in corporate debt more effectively.

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Key factors shaping non-bank lending channels

- Credit assessment and monitoring
- Corporate transparency
- Transparency in the pricing of loans
- Preferences of UK investors
- Non-bank loan markets and high yield bond markets

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Some questions for actuaries:

- How does illiquidity affect pension fund or insurers ability to hold an asset?
  - To what extent is this driven by regulation?
  - What other factors limit institutional investors from holding assets to maturity?
- What criteria must new asset classes meet before institutions are comfortable investing in them?
  - What role do actuaries play in determining guidelines for asset allocation?
  - What characteristics do new asset classes need before institutions will invest in understanding the asset class?