

# [The world’s financial system](https://assignbuster.com/the-worlds-financial-system/)

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IntroductionThe world’s financial system has a complex structure that includes different institutions such as banks, insurance companies, stock and bond markets, as well as mutual funds. These institutions are regulated by the government. Financial system channels billions of money from savers to those who have productive investment opportunities.

There are eight basic concepts, knowledge of which would help to understand how financial system is working. These are stocks, bonds, indirect finance, financial intermediaries such as banks, government regulation, accessibility to securities, collaterals and debt contracts. These components determine performance of any financial institution. The 2008 financial CrisisIn general, the world’s financial system is being affected by different factors that either improve its performance or destroy it entirely. Such factors originate from political, socio-economic, environmental as well as cultural systems. Altogether these factors produce strong economic impact that can even result in the financial crisis.

Financial crises disrupt financial markets by causing sharp declines in asset prices and subsequent failure of firms. Financial crisis took place in 2008. It began in August of 2007, when mortgage market in the United States of America started experiencing its first defaults. This has caused a shake in all financial markets. As a result, the worst global financial crisis took place ever since the time of the Great Depression. In the U.

S., Wall Street firms as well as commercial banks suffered unbearable losses. Acquiring credit became much more difficult since households and businesses had to pay higher rates for their borrowing. This financial crisis resulted in crashing of the stock markets all over the world. Investment banks, commercial banks and insurance companies suffered from severe losses, further deteriorating their financial status. Several questions arose concerning the crisis, but the most significant thing is to find out why financial crises are becoming more prevalent throughout the history.

In order to analyse the effect of the 2008-2009 financial crisis, this paper discusses three institutions, how they operated during the crisis and how they have progressed after the crisis. These institutions are the Royal Bank of Canada, the American International Group and the Manulife. American International GroupThe American International Group (AIG) is an American multinational insurance corporation having its headquarters in 180 Maiden Lane, in New York City. In Britain, its headquarters is in Fenchurch street, in London. In 2011, according to the Forbes 2000 listings, it was the 29th largest public company worldwide. It started back in 1919 as an insurance agency in Shanghai, China.

The company moved to the U. S. and then became a public company in 1969. AIG is the largest underwriter in the USA among commercial and industrial insurers. It sells travellers’ insurance throughout the world through Travel Guard. The company was involved in a series of fraud investigations from 2005.

This led to a $1. 6 billion fee for AIG and crime charges for some of its executives. In September 2008, AIG was stripped off its AA rating when it suffered from a liquidity crisis after its credit rating downgraded. The company was supposed to post additional collateral with its trading counterparts, but since its credit rating went down, it could not increase. This led to its liquidation in this year of financial crisis.

The Federal Reserve Bank created a secured credit facility, to prevent AIG from collapsing so that it could meet its requirement of delivering additional collateral to its counterparts. This facility offered a structure to lend up to US$85 billion that was secured by the stock in AIG subsidiaries. This was then exchanged for warrants and suspension of dividends to the common and preferred stock that had been issued previously. This crisis led to AIG’s share prices to fall by over 95 per cent. In the first half of that year the company announced a loss of $13.

2 billion. AIG announced that it was considering selling its aircraft leasing division in order to raise cash. AIG aircraft leasing division is the International Lease Finance Corporation. AIG was allowed to borrow $20 million from its subsidiaries in New York. AIG’s stock dropped, by 60 per cent, at the stock market opening on 16th September that year. The company then delivered collateral of over $10 billion to creditors and CDS parties since its credit rating had gone down.

Federal Reserve Bank created a 24 month credit liquidity facility that enabled AIG to draw up to $85 billion. The collateral forthis money was AIG’s assets as well as its non-regulated subsidiaries. In November 2010, AIG announced that it had raised $36. 7 billion to pay a significant portion of government’s assistance by selling its American Life Insurance Company (ALICO) as well as the initial public offer of AIA Group Limited. The net cash proceeds from these transactions were held by the New York’s Fed. The recapitalization plan that was declared in 2010 was closed in January 2011.

This enabled the remuneration of the New York Fed’s revolving credit facility. The exit of the New York Fed’s was a part of recapitalization plan that had been declared in 2010. The New York Fed worked with AIG to make it stable so that it could come out of the systemic risk and, therefore, could repay taxpayer assistance. Recapitalization was created for the remuneration of the obligation of AIG to the American public acceleration. On February 2012, Maiden Lane II LLC (ML II) sold its last securities that it had bought as Federal help to AIG.

On August 2012, Maiden Lane III LLC (ML III) sold its last security. The New York Fed’s management of Maiden Lane II and III portfolio ensured that there was full remuneration of New York Fed’s lends to two LLCs. This had influence on a net gain of $9. 4 bln. If AIG was allowed to fail, policyholders could face uncertainty about their rights and claims. Global commercial banks would also have suffered losses on loans and credit to AIG.

Moreover, confidence in other insurance providers could have been interfered with, leading to a run on the industry. Royal Bank of CanadaThe Royal Bank of Canada is currently the biggest financial institution located in Canada, measured by its market capitalization, deposits as well as revenues. The bank has over 80, 100 employees and more than 18 million clients worldwide. The bank was started in 1864, and its headquarters is in Toronto, Ontario. The bank was ranked position 53 on the 2008 Forbes Global 2000 listing. Currently it is ranked at position 68.

Due to the 2008 financial crisis the bank wrote down C$2. 79 billion for the financial year 2008. There was immense liquidity, decline in financial investments as well as rising defaults. However, the bank managed better than American and European banks. The Federal Reserve of Canada reported in that year that implementation of more conservative lending practices provided better protection for the industry than competitors in other countries.

However; most of the Canadian banks were not unfavorably influenced by the financial crisis as other banks in the world. This is explained by the fact that most of its operations were performed through foreign affiliates in local currency. Canadian banks in the 12 country set rank second after Australia in terms of local claims in the local currency as a proportion of foreign claims. The division of RBC foreign claims gives a portrait of the significance of its exposure to different countries. Given the magnitude of Canadian banks in the U.

S., 56 per cent of Canadian bank operations are in the USA. Considering local claims in local currency operations as a percentage of overall foreign claims, it is evident that the most significant local currency claims are in the USA, Latin America and the Caribbean. Therefore, essential factors that have resulted in RBC being least affected by the crisis include its position abroad as well as its least exposition abroad. During the support period of the 4th quarter of 2008 up to the second quarter of 2010, the corporate profits of RBC were $7. 8 billion.

This was a positive earning in six of the seven quarters. RBC’s CEO Gordon Nixon was the 18th highest paid CEO in the country in 2008, earning $9. 6 million per year. He became the 9th highly paid CEO earning a total of $12. 1 million.

RBC started drawing support from other banks in September 2008. In this year, RBC’s second quarter profit by assets was $1. 56 billion, down by 7 per cent last year.[3] It also announced a $202 million tax loss due to its recent acquisition of 50 per cent stake in custody bank it did not own, RBC Dexia. International banking reported a net loss of $196 million.

Wealth management had reported a profit of $212 million. The insurance division earned a profit of $151 million; this was a 23 per cent increase compared with the profit earned the previous year. During the early months of the financial crisis, it relied heavily on loans from the Feral Reserve of the USA. In February 2009, CMHC came up and picked up a steam. It undertook its first peak borrowing in March 2009.

It borrowed approximately $25 billion. Its second peak of borrowing was in July 2009 with an amount close to $23 billion. It also received the third higheest level of support after TD Bank and Scotiabank. CMCH support slowly increased from February to October. This occurred almost a year after the financial crisis occurred.

As a result, CMCH decreased support for RBC from other government sources. However, compared to its market capitalization, RBC borrowed less than other Canadian banks. $25 billion were borrowed at its peak. However, this amount was immense considering the notion that Canadian banks did not require bailout at that time. RBC is aware of the perception that it could be too dependent on the market revenue, which is too volatile. In the aftermath of the crisis, investment bankers from Lehman and other leading banks came to RBD seeking jobs.

Therefore, for RBC, financial crisis became a catalyst to grow. It poached talents easily. In the USA, RBC increased its capital markets staff by 24 per cent since 2008. ManulifeManulife is a Canadian insurance company and an international financial services provider. It provides financial protection, wealth and asset management solutions. It is officially recognized as Manulife Financial Corporation.

Operating in 22 countries and territories throughout the world, its global head office is in Toronto, Canada. It operates in the USA through the brand name John Hancock division. Measured by market capitalization, Manulife is one of the largest insurance companies in the world, having approximately 26, 000 employees. It was founded in 1887. Its first president was the Canada’s Prime Minister, Sir John A Macdonald.

The shares of this company started trading in the Toronto Stock Exchange, New York Stock Exchange, Philippine Stock Exchange and the Stock Exchange of Hong Kong in 1999. It opened its branch in Guangzhou and Beijing in 2003 and 2003 respectively. Unlike the banking sector in Canada, Insurance sector was hardly hit by this financial crisis in 2008. In fact, this was the hardest hit for this Canadian company in that year. The crisis led to the decrease of shareholders’ net income for the company from $4, 302 million to $517 million. This was a sharp drop that has ever happened to this company.

The earnings were profoundly impacted by $3, 748 million due the decline in the worldwide equity market conditions. This was the year when the company reported its first loss in its history. This forced the company to raise a substantial amount of money in emergency manoeuvres in order to overcome the crisis. As it was trying to hedge out its stock exposure, new pain was inflicted by the low interest rates in the market. Investors moved away from Manulife shares driving the stock down by 25 per cent in a period of one month. In the fourth quarter of the year 2008, shareholders’ loss amounted to $1, 870 million.

This was approximately $1. 24 loss per share. This high reported loss was attributed to the sharp drop in swap interest rates. Further drop in global equity markets reduced the fourth quarter earning by $2, 920 million. This resulted in charges for credits as well as impairments and downgrades. However, the company took initiatives to improve its operations so that it could no longer be threatened by the crisis.

It struggled to maintain its capital strength. It implemented a comprehensive plan that allowed it to achieve reduced level of exposure to the volatility of equity market. The company reviewed its annual annuity guarantee offerings, as well as modifying its product designs to balance the features that attracted its customers to the products. It also expanded its variable annual annuity to encompass new business that are written in the United States, as well as the majority of Canadian new business. The company monitored market conditions and managed its product features, fee levels and the hedging program throughout 2009. This ensured a balance between risk and long-term profitability for its product line.

In 2009, the company’s net income from shareholders increased from $517 to $1, 402. It also increased in 2010 to $2871. This was a significant improvement for this company since the global financial crisis. So far, the company has reduced earnings sensitivity to equity markets. It has continued to diversify its businesses and strengthened its capital position.

ConclusionIt is evident that the financial crisis of 2008 had adverse effects on several large financial services provider. This caused a lapse in the world economy since several institutions collapsed, leaving depressed shareholders who have lost confidence in this business. However, it has also been observed that several financial services providers have undertaken significant steps to ensure that they get back to their operation conditions prior to the economic crisis.