The 2023 Banking Storm: Risk or Opportunity? With Huw Van Steenis, Vice Chair of Oliver Wyman

Simon Brewer

For much of life, the world of banking might seem both impenetrable and dull. There are times when it vaults to being center stage, at which point it typically ushers in fear, loathing and even panic. Despite leaps in technology and financial disintermediation, banks remain at the epicenter of financial flows. They're the lifeblood of modern economies. With the collapse of Silicon Valley Bank on one side of the Atlantic, a previously niche specialist and generally unknown bank, to Credit Suisse, a global behemoth, echoes of '08 have been heard. To help get our arms around the state of play and understand whether these are isolated events as opposed to indicative of wider frailties, we wanted to find one of the world's top thinkers on the subject and do a special edition, record it and turn it around quickly. When we asked some of our network who they'd like to hear, one name kept coming back, it was Huw van Steenis, Vice Chair at Oliver Wyman, previously, amongst his other roles in finance, Global Head of Banks and Diversified Financial Research for 14 years at Morgan Stanley, and prior to that, Head of Diversified Financials at JP Morgan. So Huw, welcome to the Money Maze Podcast.

Huw van Steenis

Simon, wonderful to be with you. Although it's a shame it takes a crisis to get on your wonderful show.

Simon Brewer

Well, you've seen a fair chunk of crises as have I, but I've been looking forward to this a lot. I've probably got too many questions which I'll have to pare back as we go along. But the spark that lit the touchpaper began in the US. And I guess, let's just start, are you shocked by the chain of events and by the responses?

Huw van Steenis

I wasn't shocked by the smaller of the two banks which went under because they had had for at least six months worries about crypto malpractice and crypto might bring them down. But no, look, the pace of this is extraordinary. I mean, this is 20 to 30 times faster than anything we saw 15 years ago or in the Eurozone banking crisis. And in the end, history doesn't repeat itself, but human behavior does. At the end of the day, this does remind you of some past banking crises where you had a prolonged period of stability, stability bred complacency, a huge shock in interest rates, and a couple of people who are reaching for the top shelf have

tippled back over. We should go into it a little bit more and I'm sure unpack it. But obviously, part of this is the sharpest increase in interest rates in our lifetime. But also, it's working through the excesses of the pandemic. So to just put some numbers on it, in the States between 2020 and 2022, there were 5.2 trillion deposits bunged into the US banking system, only 2 trillion which were insured. Now, loan growth as we remember was really tepid. It's about $700 billion of loan growth. So what do you do with the rest? Well, banks put about $1.9 trillion on deposit with the Fed, but bought two and a trillion quarter of securities. And obviously, the foolish ones bought long-dated securities. And if we come on to Silicon Bank, effectively, it was a really dumb rates trade which went sour.

Simon Brewer

And if we reference the history books and look back at the US savings and loans crisis, I believe between 1986 and 1995, a third of those 3000 institutions went bust. After that and following the great financial crisis of '08, regulators made changes to establish more resilience. But under Trump, there was pushback. Is this where the seeds of this crisis were sown?

Huw van Steenis

Well, look, I think it's great to go back to that early '80s period and probably even dial back a bit earlier. But there's a great book by Will Black called 'The Best Way to Rob a Bank Is to Own One'. It's a little bit turgid. It was written by a bank regulator, but some phenomenal insights in it. And he said, look, what made that debacle worse were the 3 D's: deregulation, desupervision, and then the decriminalization of white collar crime. And that's kind of what were beneath the S&L crisis. Deregulation, desupervision was on show here in 2018. The Trump reforms which were supported bipartisan rolled back what was a systemic bank from $50 billion to $250 billion. Let's put that in context. In the Eurozone, a systemic bank is cut off at €30 billion. SVB was the 16th largest bank, and yet wasn't subject to Basel stress tests nor to liquidity coverage ratios, and so sadly, not being in the eye of the supervisor, they had some poor practices.

Simon Brewer

Which of course allows us then to move over to Europe that has had, one might argue, better scrutiny and regulation. We have Credit Suisse, a poorly run institution for a long time. But suddenly, any remaining trust evaporates. Reminds me of Ernest Hemingway's quotation, 'How did you go bankrupt?' 'Two ways,' he answered. 'Gradually and then suddenly.' So tell me, Huw, what goes wrong?

Huw van Steenis

It's tricky, because I think at one level, you say there's not much in common between the banks in the States and Credit Suisse. But if you unpick it, there probably is. So first is, in all the cases of the four banks which have failed, and obviously, there's another one wobbling at the moment, they were the banks of the billionaires and the VCs. And what we've now found is these are hyper-connected people. They're all sitting on social media. They're all frenzied by what's going on social media and whip their money out. I think that billionaire movement is something which regulators will have to come back and look at. These uninsured deposits moved very fast. And throughout history, it's the uninsured depositors who had run. Even in 84, with the largest bank crisis of that stage, Continental Illinois, it was foreign depositors who ran.

Simon Brewer

Let's just stay with the concept of deposit and deposit protection, because there are siren calls that depositors shouldn't lose money under any circumstances. You'd written in the FT the other day about banks need to be more sensitive to the threat of deposit flight and to pay up for funding, and that that will lead to tightening financial conditions. I wonder whether you could explain that.

Huw van Steenis

There's a couple of legs to this. Let's go from the end backwards. I think we've just seen the sharpest tightening of financial conditions in history following the fastest bank run in human history and the fastest increase in interest rates in our lifetimes. I think that's partly a function of this digital bank run. In the States now, if you're a mid-cap bank, you're really thinking about how many loans you want to give, what's the right price you want to give them, because you're not quite sure 0f the stability of your funding base. I think in contrast, some of the bigger banks are actually benefiting. They're actually getting excess deposits, hundreds of billions of excess deposits, no doubt, but they are equally going to worry, are these easy come, easy go deposits? So they may not want to make loans either. So I think the financial conditions will sharpen tightly. I think we all would disagree about how much. I think Goldman is putting in it's as if financial conditions just tightened 25 to 50 bips. My good friend Torsten Slok now at Apollo thinks it's 150 bips. I think the bank nerds like me and say David Esser are probably more on it's like a point increase. But nonetheless, this is a huge hit. In Europe, what we don't know yet is how big a hit it is. I think though my conversations with the bank CFOs and treasurers and investors is that they are starting to worry about the cost and availability of funding. So I think financial conditions tighten our side of the pond as well. It comes down, Simon, to the point of how sticky are those deposits and then what you do with

it. You've run money for a very long while. If you've got daily liquidity money, you don't put it in 10-year illiquid securities. And I guess in a way, it's a classic ALM mistake which the management of SVB we're doing.

Simon Brewer

And extraordinary that Blackrock have been in there and run their slider all over, presumably using their Aladdin system, which we discussed on previous interviews, and there were all the flaws being sort of highlighted. Maybe it's tough, but is it fair to suggest that that tighter regulatory oversight in Europe means that there are fewer accidents to happen in your mind in Europe than the US?

Huw van Steenis

I think so. But I think there's two lenses on this. So first is every bank, about 30 billion in the Eurozone has stress tests of some sort and they've got liquidity. The liquidity rules are could you hold your breath for 30 days with no funding? It doesn't mean that they couldn't. If the waterline went very high, they would have some issues, but they've got a much bigger gap. In a way, what happened here is there was a bit of denial by the banks. Let's think if we did history again, if SVB had raised capital November last year, a very different story. So it gives the banks more time to react. That said, the second though, and I think it's a much more, again, historical sweep is if you think about, let's say, Japanese banks 15 years after their crisis, they hadn't made that many loans, there was bugger all speculation, there really wasn't much to go wrong on the asset side. So I think what you find here is, again, 15 years after the crisis, we haven't had the rampant speculation in the Eurozone or the UK that we've seen in the States around the tech sector. Maybe there's a couple of fringes around a bit of commercial real estate, but there isn't the same speculation. On the asset side, I don't think that they are bad debts lurking quite in the same way that we've seen through this big rate shock,

Simon Brewer

We might come back to the valuation situation and opportunity later on, but I just want to stay with this sense of the stronger getting even stronger. Is there almost now an oligopoly of the super banks? And from that might flow super profits because you're worried about where you go, therefore, your choice has diminished to a very small number.

Huw van Steenis

Yes, but I think we were already creating a super league of banks anyway after the last financial crisis. Take the top US banks. Pre-financial crisis, they used to represent about 20% of industry profits. They now represent over

60% of industry profits. So I think that partly is a function of the regulation giving them a moat, and therefore, they're viewed to be safe and secure. But I think there's something else which you've discussed on previous pods which is around the role of technology. The more that technology becomes an important source of competitive advantage for a bank, how you serve your clients, the more that 'winner takes most' characteristic you see in tech is starting to come to banks. So the profitability of the top three banks is way higher than even the next three or the three after that. So I think that 'winner takes most' is playing out in banking and I think that has really helped the super league in the States.

Simon Brewer

But if we play that forward, we all remember Glass-Steagall divided banks from their banking activities, from their investment activities. That was all sort of rescinded and now we have these super banks that are doing all of those activities. Where's the risk there and what happens should one see human behavior again?

Huw van Steenis

I think this is where it comes down to bank by bank. So look, the history of banking would also suggest you need diversification. So at least with some of these super banks, they are well diversified between banking businesses and fee income businesses, US, non-US and so forth. Obviously, the tragedy for CS was it wasn't diversified enough and it wasn't earning enough. I think the quid pro quo will be regulators will be on their case even harder. They'll be focusing even more on the amount of capital and liquidity they have. Some would argue that banks are a public-private partnership, I think it's a bit too far myself. But at the end of the day, they will need to be incredibly well supervised. So no, there will be a pound of flesh for the big banks no doubt too.

Simon Brewer

I am older than you. When I started, the banks were if not utilities, they were viewed through a lens of rather dull with a yield and cyclically sort of exposed but you bought them below value, etc. But now it seems that we moved into a different environment where super profits might be available, concentrations happened, and I don't want to go from the money maze to the moral maze, but we're in a situation where the profits are being privatized but the risks of being socialized.

Huw van Steenis

I'm not sure I'd go quite that far. So with the reforms of the last 15 years, a huge amount of the risk-taking activity has moved out to the banks and into the private equity world, hedge fund world, specialist players. And if

you think about the value creation in last five years, it's been in people on your show. It's the KKRs and Blackstones, it's the stock exchange groups, and so forth. So I think that a lot of activities have actually moved out. And again, diversity is strength. The fact we've got a pluralistic system, you can go to get money from a bank or BlackRock or a private equity firm is obviously very helpful. What that means then is that what's left in the banks is a lower margin business. And of course, that means you do need to scale. And I think that's the challenge that the more scale you need, that's why the super league, the top three, top five, disproportionately benefit, not just because of their diversification, because in a lower margin business, you need that scale. So in a way, the scale is also a function of public policy rather than just because of greedy bankers.

Simon Brewer

Okay, I understand that's right and we would never call that to you so that's absolutely fine, but you're right. We've had Bain Capital talk about their private credit business. We understand this disintermediation impact, probably since the great financial crisis, a reluctance for a lot of banks to lend as they would have lended. Now, if the central bankers can ring fence the commercial banking system, they can contain a certain amount of risk. But with so much having moved into the shadow banking system, and I sit on a couple of asset allocation committees and private credit is an asset class that exists that never existed, what's the chance that in fact, the problem next shows up there and that becomes very difficult for the regulators?

Huw van Steenis

First banks are different because they leveraged. As you say, whatever shock you have, even though post reforms, the amount of equity capital in the banking system has tripled. Nonetheless, they are still levered institutions. And so that's why the regulatory focus is nearly always on them. Because at the end of the day, you're protecting depositors, and that's the foundation of bank regulation. So as we've seen with the write down of 81s, having some institutional investors lose a bit of money, that wasn't the policymaker's worry. And I think we've seen this time and time again. So I think you and I can sketch out, could there be bouts of illiquidity and what would that mean for private credit or commercial real estate? Interestingly, 60% of commercial real estate lending in the States was actually coming from the mid-cap banks, not the large banks of what comes from banks. So I still think there's a banking channel that we should focus on. But no, look, if the market is now moving into a phase of forensically looking at balance sheet after balance sheet after balance sheet, there will be a real focus on the real estate and private equity firms to work out are they well-funded, are they well marked, and what's the knock? Some of my smart friends in this space are clearly looking, are there good shorts in that area?

Simon Brewer

So if you were to look at your crystal ball and think about the next few years, we've got a tightening cycle that’s still ongoing. We probably are headed into recession, I would say we are headed into recession in the US , it's just a question of how severe and its duration. Would you think that there are going to be a lot more air pockets within the financial sector as a result of that trajectory?

Huw van Steenis

Like you, I think we are moving to a recession. We can debate how long depending on where monetary policy goes. But what we've seen in the past is these initial problems turn into asset quality problems as people can't roll their debt. You mentioned the S&L crisis early on. One of the phrases there was a rolling loan gathers no bad debts. And obviously, if you can't roll a loan, then that's the issue. I think around parts of private equity, parts of commercial real estate, and obviously, parts of the economy where low interest rates have just allowed anyone to roll their debts, it will be gobsmacking if we don't see some asset quality problems. But going to this point, I think much more of the speculation around zero interest rates came through in the US than it did in Europe or Japan. And therefore, I think a lot more of the focus needs to be on those areas.

Simon Brewer

Which of course leads to the valuation question and opportunity because it's easy to run away from when to go on a bank stock and yet we've got some very apparent value in the European banking space. Your former colleague, my former colleague, David Esser, has talked about UBS currently being a steal. I see Crispin Odey had taken his 2% state yesterday. And just before this, I was reading some Bernstein research as well and they had taken their targets up. Generally, if you were running your own fund right now, would you be pretty excited taking a three-plus year view about the value that's there?

Huw van Steenis

If we go across the stocks, I think there are a good number of opportunities. You mentioned David who talked about the UBS transaction being a deal of a lifetime. Autonomous put out a 72% increase in book value for pro forma, a base case from this transaction. Well, I can't think of an M&A banking deal in history which had a 70% book value accretion. So obviously, there are some interesting opportunities. I think we do need to pass the weak from the strong and play through the dynamics. As always, banks are ever a leverage play on the macro. So if we are heading into a soft recession, then that's a different scenario than a harder recession. But as I said, in

Europe, I do think we’ve probably got a slightly softer one coming through, although you never know. I think there are some interesting opportunities here on a three-year view. Some of the bank equities are cheap, but also, have we really discredited 81s? Was this a one-off event? It's very interesting, five sets of regulators have come out since the weekend saying they are going to respect the hierarchy of CoCos are senior to equity. If that's the case, then the 81 asset class could also be interesting. So I think for a smart investor, there's a lot of interesting opportunities to work through.

Simon Brewer

Let's switch tack and talk about crypto. I actually don't like talking about crypto much because I'm not in the camp that thinks that I want to have it in an asset allocation. But you've made the point that when signature was rescued, the FDIC left the digital businesses to run off. Now, let's talk about that and what's going on? What's the motivation?

Huw van Steenis

Recognize I spent 18 months serving Mark Carney and so I might be stuck in the group of central bankers who think that crypto is awful. I realized I've got a prior bias here. However, if you look at Silvergate’s and Signature's failure, it's very tough not to say that the allegations of money laundering and poor KYC weren't a material contributor to the loss of confidence and the outflow of deposits. As you know, a couple of our mutual hedge fund friends have been short these names because of the crypto allocations. So I think if you're sitting there as the Fed, as our supervisor, or FDIC, as a rescuer of banks, and you see that crypto probably tripped over two banks and also probably lit the tinder to trip over the third US Bank, you would be very negative on banking digital assets. So we'd already seen before this crisis a series of Wells notices, which normally mean enforcement action against firms. We saw another one last night against Coin. But I think it's very interesting that if FDIC say they don't want the digital asset business to be acquired by another bank, I think you're basically seeing policymakers trying to put a choker on this. I think one or two folks have talked about this as this choke point 2.0. It doesn't mean that this is the end of crypto by any means, but it means that the regulated banking system is going to be under a forensic gaze of regulators. And going back to the super league, the super league are going to be highly discouraged from banking any crypto. So I think it's going to make it more difficult to get your money in and out of the crypto system at least for some time.

Simon Brewer

As the other side of that, as a longtime gold bull without boring on the subject, I'm reminded of Ray Dalio's comment which is that gold's attractiveness is the reciprocal of confidence in the general central banking. And so I would not be surprised to see that become more centerstage as opposed to the 12,000 cryptos or the number that might be out there that are purporting to be digital gold.

Huw van Steenis

But it's interesting on that. So one of the major stable coins, I'm not trying to pick on any particular name, when you look at where did they leave the money overnight, because of the regulations, the largest banks in the States were leveraged constrained, they didn't want flighty deposits. So actually, they turned away the stable coin deposits. You may argue it's anti-competitive too, but it's mostly because they just didn't need those deposits. They went to the tier two banks. So if you look at where the stable coin cash balances were, bizarrely enough, it was Silvergate, Signature, SVB, FR. So I think there's also going to be a reappraisal also of stable coins, which is one of the routes to get money in and out of the crypto house.

Simon Brewer

We've seen in the UK, but elsewhere as well, the development of the neobanks, the Monzos and the Starlings and the rest of them. Where do they sit in the reordering of the banking playing field?

Huw van Steenis

I think it's a great question. I'm not sure I've got high conviction on the answer because I think it depends by bank, because I think what we're also learning here is banking culture really matters. Have you done your ALM and risk management and KYC really matters. So I think it's unfair to pick on any one institution. On one level, the rising interest rate environment means that you can get more profitability from a bank over time. You just need to get through the speed bump of the adjustment of the interest rates. I think that you've got a couple of things though. What you're seeing, and Simon you've discussed it before, across the whole of the tech and the fintech world is that profitability has to be much sharper. So everyone is now trying to- their moonshots are now looking to do shots down the M4. There are much shorter runways that they need to turn profit. So the aspiration for extraordinary growth is no longer there. But nonetheless, if they've got insured deposits, they're well managed, they can be good franchises. But I think there'll be a real reassessment. And you've seen the valuation of a lot of these fintechs for 70, 80, even sometimes 90%.

Simon Brewer

Now you, I think with Mark Carney, we're the author, co-author of a report on the future of finance. What would you think might be the two or three important changes over the next few years that will alter the landscape?

Huw van Steenis

One would be as money becomes ever more digital, how do we think through what a digital bank run looks like in the future? What does that mean for the way a bank thinks about liquidity and the kind of maturity and the kind of loans that it can make on those deposits? So I think there'll be a reevaluation on the kind of digital world. I think, second, you have to view that there's going to be a big call to be made around what is the future of tokenisation in banking, and I don't just mean crypto, that could also mean stable coins, CBDCs, or even just simply tokenisation of security asset classes. Personally, I think that the whole enthusiasm and the race towards the CBDC is going to slow. We need to really stop, reflect, think about what we've just learned. And do we really want to be giving out digital tokens backed by the central kank which would maybe exacerbate a bank run? But I think it's a deep and difficult question. I had to do a TED Talk on this last year. I talked about that central bankers were trying to come up almost with a Goldilocks CBDC, not too much to destabilise the system and not too little to be irrelevant to not get their boondoggles because to be fair, researching a CBDC has been an extraordinary opportunity because guess where you go? You get to go to Vietnam, Bahamas, Eastern Caribbean. I mean, it's been a boondoggle for CBDC researchers. But I think that whole securitisation, I think it's close. But I think around the institutional space, even when we use our Visa or MasterCard, they tokenise our transaction between you and me because they want to encrypt it. I think we will continue to need to think about enhancing that encryption even if it may not be a digital and decentralised one. So that's the second one. And the third one, I think it does come back to the climate stuff. I think that the work that Mark kicked off, and I obviously was in the room with him around getting finance to think about climate not only as a financial risk but also as an opportunity is going to continue to be a major theme. I think it's probably a more micro theme. Just to give an example, Simon, and I hope it's not too micro, when the banks looked at climate risk, they never thought that there would let's say in Europe be climate shocks in the coming decade. Well, last summer, given the droughts, I can think of at least four banks I know who are worried about farms going bust this year in Germany or Holland because of the droughts as a result of climate change. So I think there's an appreciation, but much more importantly, I'm sorry, it's a long answer, is finance is now thinking about the opportunities of marshaling money. And I think with the green subsidies, the IRA in the States and the EU plan here, if you toss it all up, something like 3 trillion of subsidies or discounted loans. For a banker and financier, and let alone central banks, that's something one has to get behind.

Simon Brewer

So I'm struck that our conversation is focused on the US and Europe and it's left out that huge chunk, which is Asia. What are the observations we'll make about the Asian financial system, big domestic institutions, population growth, etc.? Are they learning anything from this and trying to do it differently or should we be thinking about the opportunity set there as investors?

Huw van Steenis

Going back to 2008, I always find it fascinating that for the West, a bank run was a surprise. So for the Bank of India, it was the first since 1865. However, if you take the IMF database since 1972, I think there's been 170-ish systemic banking crises around the world. We don't learn from the emerging markets. But in our lifetime, of course, we have had in Korea and Indonesia and beyond major banking panics. As a result, that kind of FX mismatch is way lower. Liquidity management is better. So I don't think they're seeing the same stresses that we are at the moment, although I still think this nature of a digital bank run is something we worry about. So I think the nature of the excesses and mismatches is always when we should focus. Obviously, China is in a different camp. There are some state-run banks there which obviously have got a series of bad debts which they're tromping through. But if I think about the private sector banks, whether it be the Singaporeans or the Australians, they look in somewhat better shape for the moment, but look, like everything in life, one needs to think about the individual bank, not just the system.

Simon Brewer

You are Vice Chair at Oliver Wyman. Tell me a little bit about how you as a firm and you, because you're called upon to do lots of things, operate with clients.

Huw van Steenis

It's a fantastic firm. Its heritage is very much of technical and risk for financial services. That's the background. And you may remember at Morgan Stanley, Oliver Wyman at Morgan Stanley used to write a joint report, which David and I were on the one side of. So I think they've got an extraordinary knowledge and technical know-how around financial services, but over the last 20 years, they’ve also grown into many other sectors. So I think they get very heavily called upon by large institutions to help them think through difficult complex problems to solve and try to have the technical know how to do it. So I think it's a very exciting place. Part of my role is to work with clients, but also, I'm doing quite a lot of research as well, bringing on my kind of investment analyst heritage as well.

Simon Brewer

Going back to that climate question, we had Nicolai Tangen as a guest a year before, absolutely fantastic guest, and my gosh, as you know him well, just inspiring individual, and you're working with Norges Bank on the climate advisory board. Tell us a little bit about what you and he are hoping to achieve.

Huw van Steenis

Nicola and Norges Bank itself wants to be a world leader in thinking about investing in the energy transition around the world. I think there's sort of three blocks to that. First is obviously understanding investment risks where there is energy transition or climate change. What does that mean for a portfolio? Particularly for fund which is the largest investor in the world, they own 3% of most European companies and about 1.4 of every US company, they're thinking about very long-dated risks. So they really want to understand what do 21st century risks mean to companies they are a custodian of. Second is to seek out the opportunities. Who can be the biggest investor in climate tech? Who can be the biggest investor in the solutions and opportunities around this? And third, to be honest, I think this is where Nicolai and Carine are very inspirational is, can there be a standard setup? And this is the really tricky one. As a sovereign wealth fund, most SWFs, sovereign wealth funds, as you know, want to keep a little bit below the radar because of their political influence. But because their arm's length body, they also want to be involved in standard setting bodies to really enhance the disclosure so that the investment community can make better informed risks. So I think it's a very inspiring mandate and he's very kindly invited myself and three others to try and join a climate advisory board to think through not just the plan they've got, but how each and every year can they get that little bit shrewder and savvy around the investment risks and opportunities or how can they actually improve the standards in the market. All credit to Nicolai and team.

Simon Brewer

Staying with interesting folks, Sandra Robertson, who is the CIO at Oxford University Endowment Management, who you know well, so we did have a sneaky little moment to say what will be the question that she wanted to ask you to make sure that you weren't entirely comfortable today. And she said, if you had 100 billion to invest in the climate transition, how would you allocate it and what percentage return would you require?

Huw van Steenis

I think this is both a really important but actually quite a difficult question. Where are the opportunities? So look, first, climate tech climate solutions are incredibly exciting opportunity areas and they're very broad. This is from AI to optimise how a grid is run through two data standards, the MSCIs and the other data carriers of the world through to, quite frankly, carbon capture. This is an area full of opportunity. It remains still relatively capital light so you can get things like returns. There's a lot of money trying to chase this but I think that's the area which the climate solutions really has to be the standout and category you want to put your money. Second is what I think of as the industry leaders. How is McDonald's changing the agriculture value chain? How is Microsoft changing the tech value chain? These leaders can have disproportionate influence on emissions of not only themselves, but the entire industry. Again, getting behind these leaders and helping empower them to do that is very exciting, probably more in a public market equity portfolio. Now, here's the tricky bit. Ideally, we don't want to put a ton of money behind renewables, but capital-intensive renewables have got a shockingly bad return on investments. If you want to go and invest around, I don't know, an offshore wind farm at the moment in Europe, you probably get 3% to 4% returns on capital. That's not what an endowment, a family office, a pension fund typically wants to have. It's probably more for an insurer. It's more than legal and general type returns. And that's the tragedy because that's where the money is needed. Because the challenge to national security from the Ukrainian war and beyond is we now need more energy independence. So there are plenty of subsidies going into renewables and I think we therefore need to think about pre-subsidy, that 3% to 4% just isn't enough. But can you it be supercharged or can you get behind the benefit of those subsidies would be a question I want to do the investment work on. But I think it's tough to put a lot of your 100 billion into that only to get 3% given inflation is still rampant. And then last, the improvers. If you go back to the modeling of how emissions fall, half of the emissions falling is companies going from grey to green. It's getting Solvay to reduce its emissions and become a cleaner come. It is getting Volkswagen to go from dirty to green. I think the improvers have got a bit of a bad rap because at the moment, that's where the emissions are. And I think what a lot of the NGO community have got wrong is it's not just about reducing financed emissions, it's about financing emissions reduction. We need to help those improvers get better and I think that gray to green opportunity is a huge one. I think that's one of the more exciting ones, both for private market opportunities as well as the public. So as ever, an investment question like this, if Sandra doesn't know the answer, it must be bloody complicated.

Simon Brewer

Well, I didn't realise the question, but also, we've had a lot of conversation on the show but also on our second channel, the curated channel, we did one with TechMet technology metals run by Brian Menell, where, of course, the irony is to be able to facilitate all of this, a lot of stuffs going to be pulled out of the ground even

before Ukraine has to be rebuilt. That might offer some really quite attractive returns however distasteful at one level it might seem to people who don't want to pursue that.

Huw van Steenis

I think BlackRock has got 42 ESG ETFs, and obviously, the ESG backlash means some of the early ones have struggled because they are too broad an index. But the latest one they've just filed is a rare earths ETF for exactly that reason, because that's where a lot of the opportunity may lie.

Simon Brewer

I'm smiling because we had scheduled the head of BlackRock's ETF business to come out on Thursday, but he's now been pushed back because we have you. So Salim Ramji, who runs the passive business is on and has a great conversation about passive. He puts me in my place on a number of things where I was wrong, but really, really interesting about the ETFs, particularly in the fixed income space. Let's just talk about some general things. I'm struck by the fact that you've been over the years that I've known you a great thinker and writer and speaker, and you're being called upon to do a lot particularly right now. How do you make time to think?

Huw van Steenis

So first is you have to be really hypothesis-led. Second, I do try and make sure I got time to mug up on the past. So I'm afraid even with the fall of the banks for the last two weekends, I'm afraid I downloaded again 'The Best Way to Rob a Bank Is To Own One'. I also downloaded another book. I think history is so important because of the rhyme. One thing I'm afraid I do is I have a phony meeting in my diary for an hour and a half a day. Now, I probably shouldn't have said that. My colleagues now know. But I put in a phony meeting to try and make sure I've got a block of 90 minutes or two hours where I can actually think or read or research. It's tricky because it is relentless. And sometimes, like our good hedge fund friends and investing friends, sometimes some of that thinking time is going for a walk on the weekend as well.

Simon Brewer

Of those strands you said, I'm hypothesis led. Can you just explain or illustrate what that means?

Huw van Steenis

The easiest example would be if this really has become a bank run of the billionaires, who else looks like has got billionaire clients? Now, that's a very obvious one. But it's looking for those fact patterns and repetitions to see

who may look similar, who may look dissimilar. So as a research analyst, I would always encourage my team to actually write the first page of the research before they've done any homework. And then they go off and then try and work out well, was I right, was I wrong and actually test that argument. But I think you've got to be led by a thesis.

Simon Brewer

More generally, what's on the Huw van Steenis list of yet to be accomplished.

Huw van Steenis

I remain passionate about markets and the investing world. So for me, the key thing is to keep joining up the dots between my small amount of know-how and where the opportunities are. I've been blessed to have opportunities to serve with Mark Carney but obviously more recently with Norwegian Sovereign Wealth Fund, Oxford and Oliver Wyman. I'm just keen to keep joining up the dots between markets and ideas and capital.

Simon Brewer

If we could set up a dinner for you to sit with two of the great finance people or investors, folks from the present or the past, who would they be?

Huw van Steenis

That's a very good question. I haven't thought about that at all. So I am passionate about Keynes and what I've learned from reading him. I know it's hideously obvious, but he nailed it on so many ways. In fact, I'm going to misquote him now but he said something like the sound banker is someone who would rather fail conventionally, and I think that's right. If I look at Silicon Valley Bank, they didn't want to look atypical. When they failed, they fell to misery. So I think Keynes is just rich and thoughtful and interesting. Through Morgan Stanley, I was blessed to meet some of the most extraordinary minds. So I met Stan Druckenmiller and so forth. I used to very kindly go and have lunch with George Soros at his townhouse in London. But if I have to say, I'd love to carry on talking to George because I think his understanding of the macro and translating that through into trade and micro was extraordinary. And also, to think about risk appetite. When you've got hot hands, when do you really go for it and when do you not? Effectively, as a bank analyst, I'm looking at macro through a macro lens, and I think George in some ways personifies what makes a good bank investor.

Simon Brewer

And what would you tell a 20-year-old Huw.

Huw van Steenis

I definitely would encourage him to read financial history. My good friend Neil Ferguson has a line that he wishes that more central bankers had read history rather than doing a PhD in economics, and I'm sure that's right. So having a really good list of financial history from I know what happened to Weimar Republic, Adam Ferguson's brilliant book 'When Money Dies', through to what happened more recently. So one is financial history. Second, of course, get the technical skills. But I'm sure that many of them programme and code. And third is just be voracious in listening to the signals. It can be just subscribing to The Economist. These days, you can get a retail access to Bloomberg quite cheaply. That's phenomenal too. And obviously, of course, listen to your podcast.

Simon Brewer

Good, I didn't even prompt you. That's fantastic. Thank you. Huw, this been terrific and I really appreciate. We all appreciate you coming in a very busy schedule to talk to us and to lay some stuff out on the table that is not obvious to many people however much they might be professional investors. So thank you very much. We always take away a couple of things or I try to summarise. My goodness, I wrote down a lot today. But I liked your last comment perhaps because all those years ago, I studied economic history, but read financial history, and Neil Ferguson was one of our top guests as you might remember. We're hopefully going to have him back later in the year. And in this whole energy transition, the opportunities are not altogether clear. But financing emission reduction and that focus on the companies that are deemed maybe to be the polluters or the non-greens that are in that transition is perhaps where a lot of the investment opportunity lies. And I think that's still being explored. So Huw, we're going to let you go. Thank you so much.

Huw van Steenis

Thanks, Simon. It was a real pleasure. Thank you.

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