



FRENCH KISS

Last month I concluded my opinion piece by saying that I would continue to invest in banks that stick to the “KISS” principle (Keep it Simple Stupid). This month I had the opportunity to meet Bertrand Badre, the Chief Financial Officer of leading French Bank, Credit Agricole. I had never looked at this company in the past because it never appeared at the top of the list of high yielding banks. I therefore had no idea as to the extent it might stick to the KISS principle. You can therefore imagine my delight when he started talking about the simplicity of their retail division and how this division contributed 27% of net income. I was beginning to get excited when he emphasised the conservative nature of the agricultural roots of the organisation and the bucket loads of deposits provided by these regional banks. I could barely control myself when he talked about asset management, insurance and private banking as not only were these relatively uncomplicated but there was also an element of strong growth attached. These divisions contributed 30% of net income. Here I was with almost 60% of income being generated in exactly the way that I hoped it would be generated. I was beginning to think that this was the kind of French KISS that could work for me without getting me into any trouble with my wife!

We then began to talk about Corporate and Investment banking. This division generated 33% of net income. I was impressed by the fact that they had no direct exposure to the sub-prime market but then the love affair began to turn sour. The discussion turned to the whole area of CDOs (Collateralised Debt Obligations). Credit Agricole had got involved in the party. They had packaged these CDOs together and sold them on for a fee. When the proverbial shit hit the fan they were left with \$1.9bn of these CDOs that they could no longer sell on to their clients. They had now decided to write off 100% of the riskiest parts, the equity part (also known by the term toxic waste) and 68% of the next riskiest part (known as mezzanine). This resulted in a €190m charge.

Using terms like mezzanine might make this sound incredibly complicated but as Bertrand went through his explanation I began to realise that this was not rocket science. Last month I gave the impression that these were incredibly complicated and anyone involved automatically broke the KISS principle but please take my word for it, if you had enough time you could get to understand that CDOs are not that complicated. In other words putting together these CDOs did not in fact break the principle of KISS. (There are plenty of other products that have been developed by investment bankers that are genuinely more complicated than CDOs).

I then realised that the vast majority of income generated at Credit Agricole does in fact come from areas that meet the principle of KISS and yet at the end of the meeting I did not feel the urge to buy shares in the company. I realised that I could not bring myself to invest in them because even though they stick to the KISS principle, the way they do it is not good enough. The thing that really made me realise this was the response to a question I asked about how they calculated the amount of money they had written off in relation to CDOs. I thought that they would answer this by saying

that they had gone back to the source of the potential problem and attempted to check the quality of the assets that backed up these CDOs. In other words we now know that sub-prime lending standards were awful so it would make sense to see if bad lending had also occurred in other areas like prime mortgages, commercial mortgages and corporate bonds. Instead he basically said that they had plucked the number out of the air. This sure was keeping it simple but it made me realise that the way you KISS is also important!.

In conclusion I should have remembered the old saying that “it ain’t what you do its the way that you do it” because anyone can KISS but not everyone can do it well and if I could turn the clock back I would change the title on last months opinion piece to “I want bankers that know how to KISS properly”.