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Culture change could be the saviour of UK banks

By Pat McFadden

The relationship between risk, responsibility and reward needs realigning, writes Pat McFadden

The banking crisis of 2008 left the UK with not only a big financial bill to pay but also a profound question for the future: how to have a global financial centre without it holding the rest of the economy to ransom.

The upside of being a global leader in financial services has included, traditionally: a lot of highly paid jobs, valuable tax revenues for governments and a critical mass of associated services. But the crisis exposed the downside: a potentially huge risk for taxpayers and the wider economy when things go wrong.

As the UK grappled with the financial consequences of the crisis, further cultural problems in banking emerged including the dragging out of the eye-wateringly expensive and long-running scandal of the mis-selling of payment protection insurance, as well as money laundering and Libor traders rigging the market with no regard for honesty or straight dealing. It looked as though the customer was there to be fleeced, reputational damage could be ignored and deals were a combination of a war to outwit the person on the other end and a cartel to fix the price.

These cultural and standards problems are a betrayal of the public who bailed out the banks and of the many good honest people who work in banking and share the wider public's horror at what has been exposed.

This week marks an important point in setting out how the UK will try to deal with both the financial hangover of the crisis and the cultural problem.

On the first point, the future of the two banks in which the government holds large stakes – RBS and Lloyds – is crucial. On Wednesday George Osborne, the chancellor of the exchequer, is expected to set out his thinking. The backdrop he has fashioned for himself is not a good one. The unseemly bundling out of Stephen Hester – the RBS chief executive who most regard as having done a good, though incomplete job – risks turning RBS into little more than the banking arm of the Treasury.

Such heavy-handed political interference may turn out to hamper the very objective the government seeks, which is an orderly return of the bank to the private sector. Instead, at least in the short term, investor confidence has been damaged, staff morale hurt and more questions than ever raised about the government's strategy.

Any plan for the future of these banks must have, at its heart, the interests of the taxpayers who bailed out the banks, not any pre-election fire sale or a timetable governed by electoral rather than economic interests.

Before the chancellor's Mansion House speech comes the report of the Parliamentary Commission on Banking Standards, on which I have served for the past year.

This body has taken extensive evidence from the industry, regulators and consumer organisations. It has exposed perverse and sometimes dangerous incentives in banking and a serious misalignment between risk, responsibility and reward.

Risks have been misunderstood by those running them – with other people's money. Responsibility has been shirked. Some of our most startling evidence showed not only ignorance among some senior bankers about the organisations they were leading – but also an incentive to remain in such ignorance in case the regulators came calling.

When regulators act, too often it is at the level of the corporate fine, which can be easily dismissed as a cost of doing business. Individual responsibility is too rare and too seldom enforced.

On pay, the issue is not only the level but the incentives built into the system. Rewards are paid out before the consequences of actions are known or understood, and people are able to walk away with huge packages intact when banks run into trouble, while taxpayers foot the bill.

This system and the culture it gives rise to needs to change. Realigning the relationship between risk, responsibility and reward is at the heart of the Banking Commission's report. That means reforms instilling greater personal responsibility into the system from top to bottom, changing remuneration structures so that risks are known – many years hence – before pay awards can be made, and a tougher sanctions regime to instil proper accountability when things go wrong.

All of this has to go together with wider reforms on capital and leverage designed to make banks more resilient – the argument that a safer banking sector is necessarily less competitive or will lead to relocation cannot be allowed to block essential change.

Culture change is not a witch hunt against banking. It may turn out to be its saviour. After everything that has been exposed, it is very much in the interests of the financial sector to address these issues of culture, standards and personal accountability.

Reform is about keeping the benefits of having a global, and hopefully successful, financial services industry in the UK – but with incentives recast and the interests of taxpayers and the wider economy protected too.

The writer is a Labour MP and member of the Parliamentary Commission on Banking Standards

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